Monthly FX & Rates Strategy

What if …?

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- At the latest May FOMC, the statement conceded that "In recent months, there has been a lack of further progress towards the Committee's 2 percent inflation objective". But, Fed Chair Jerome Powell managed to sooth frayed nerves as he highlighted that policy is on balance restrictive and the Fed is not looking at hiking rates. Overall, our macroeconomic team maintains expectations of 2x25 bps cuts across 2024, in Sep and Dec, although the risk is still tilted towards the Fed delaying cuts even further.

- It is worth conceding with humility that our forecast since the start of the year of a backdrop of lower Treasuries yield and a weaker USD has proven to be premature. Rightfully, investors are starting to ask pertinent questions relating to tail risk. What if Fed does not cut at all this year? What if 10Y US Treasuries yield head back up to 5%? What if CNY depreciates past 7.35? What if USD stays strong against ASEAN FX?

- Specific to FX, the impact of a later start to the Fed's easing cycle on the USD is clear. It is all but certain that the USD is likely to stay strong, at least in 2Q24. But, consistent with our view of lower US rates going forward, we reiterate that USD would weaken anew, but starting later in 3Q24. The key risk to our bearish USD view is that the Fed keeps its rates unchanged.

- We highlight risk of near-term USD strength in 2Q24 while noting delayed recovery in the Majors against the USD. E.g. our updated EUR/USD forecasts are 1.06 for 2Q24, 1.08 for 3Q24, 1.09 for 4Q24 and 1.10 for 1Q25 (from the previous forecast of 1.09, 1.11, 1.10 and 1.12 respectively)

- We expect Asia FX to stay weak for the remainder of 2Q24. Our expectation of an eventual Asia FX recovery is still intact, albeit starting from 3Q24 instead. The key risk to our cautiously positive view on Asia FX is a sudden CNY devaluation.

- Pressure is mounting for the CNY to catch up with the depreciation of the JPY which has slumped more significantly. Should the CNY devalue sharply beyond last Sep's low of 7.35 /USD, there will be clear negative spillovers into the rest of Asia FX. Overall, our updated USD/CNY forecasts are 7.28 for 2Q24, 7.15 for 3Q24, 7.05 for 4Q24 and 6.95 for 1Q25 (from the previous forecast of 7.15, 7.05, 6.95 and 6.85 respectively). The entire suite of our USD/Asia forecasts are adjusted similarly for more near term USD strength.

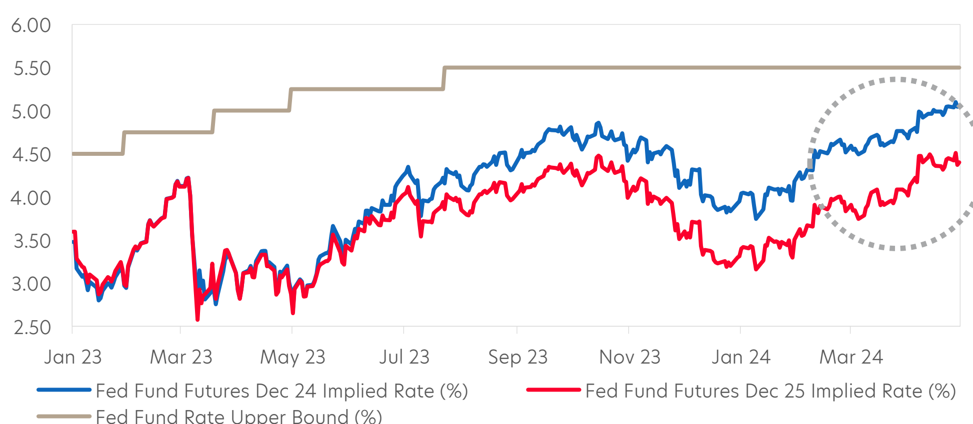
- In the rates space, our base case for US rate cuts continues to be pushed back and the consensus narrative is moving in the direction of rate cuts in 2024 being optional. A more hawkish Fed guidance or a more aggressive term premium repricing could catalyze the next leg higher in rates. Since we retain an easing policy framework, our directional outlook for the rest of the curve is pointed lower, albeit at a shallower incline compared to before. Overall, we have adjusted our 10Y US Treasuries yield forecast modestly higher to 4.40 for 2Q24, 4.20 for 3Q24, 4.10 for 4Q24 and 4.00 for 1Q25 (from the previous forecast of 4.20, 4.10, 4.00 and 3.90 respectively).

As the year progressed, the market backdrop has gotten increasingly more difficult as US rates climbed anew, and the USD strengthened further. The main culprit for this development is simply persistent stickiness in US inflation which has repeatedly forced the US Federal Reserve to signal its reluctance for near term rate cuts and consequently resulted in the market pushing back and reducing the upcoming rate cut trajectory.

Global investors started the year expecting rate cuts as early as Q2 with as much as 6 x 25 bps cuts priced in for 2024 alone. Over the past four months, this expectation has been significantly delayed and cut down in size. In terms of magnitude, the latest Fed Fund Futures now imply barely 2 x 25 bps cuts by end of 2024 and about 4 x 25 bps cuts by end of 2025. In terms of timing, market consensus for the start of the rate cuts has now been pushed back to Sep. The runway for rate cuts this year is now uncomfortably short with just 5 more FOMCs to go across Jun, Jul, Sep, Nov and Dec.

Chart 1: What if the Fed does not cut at all this year?

Source: Bloomberg, UOB Global Economics & Markets Research



The opening paragraph of the latest FOMC statement did warn very succinctly that "In recent months, there has been a lack of further progress towards the Committee's 2 percent inflation objective". To Fed Chair Jerome Powell's credit, he did handle the rather difficult follow up FOMC press conference relatively well.

There were fast and furious questions prodding the Fed Chair about rate trajectory and inflation expectations. Ultimately, Chair Powell managed to sooth frayed nerves and ameliorate market worries when he noted that current monetary policy setting appears "suitably restrictive" and that he still sees more likely rate cuts ahead, rather than rate hikes. Objectively, Chair Powell also reiterated that there are many paths to inflation and that the Fed remained at its core data dependent and independent above all.

Overall, our macroeconomic team's view remain that we can still expect 50 bps of rate cuts for 2024 (i.e. two 25-bps cuts, one each in Sep 24 and Dec 24). It is noted that at the latest FOMC, Chair Powell's commentary continued to espouse the message of patience that rates may stay elevated for longer until it has gained greater confidence that inflation is moving sustainably towards the 2% objective. And that on balance, the risk is still tilted towards the Fed delaying cuts even further, nudged by a slow inflation descent. For more details, kindly refer to Macro Note: "US May 2024 FOMC: Expectations for rate cuts still alive, timing uncertain but resuming hikes are highly unlikely" dated 02 May 24.

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At this juncture, it is worth conceding with humility that our forecast since the start of the year of a backdrop of lower Treasuries yield and a weaker USD has proven to be premature and has been progressively pushed out later into the year as well. Overall, our core view does remain that once the rate cuts materialize, we still forecast a topping out of yield and a weaker USD. However, the magnitude of this delayed pull back in yield and anticipated weakening of the USD is now decidedly lower for this year. More importantly, it is still not too late to ask pertinent questions of tail risk. There are several questions that spring to mind.

What if the Fed does not cut at all this year? What are the implications for rates and the USD should the Fed signal otherwise that it is not going to cut this year? What if 10Y US Treasuries yield push higher towards 5%? In addition, how will this further rise in US Treasuries yield affect yield differential against other Majors? Does this imply that the EUR will weaken further at the onset given that the European Central Bank (ECB) has flagged clearly that it will start rate cuts first in Jun?

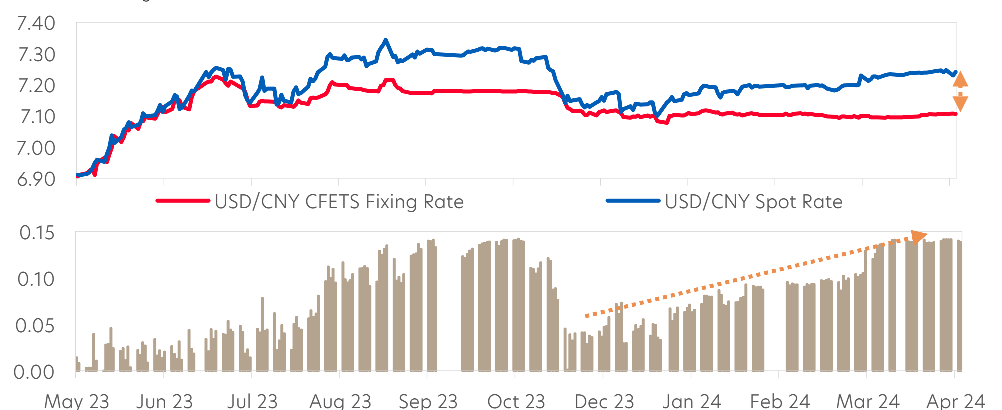
Chart 2: What if 10Y US Treasuries yield push back up further towards 5%?

Source: Bloomberg, UOB Global Economics & Markets Research

What if CNY depreciates past 7.35 to the USD? It is noted that to the People's Bank of China (PBOC)'s credit, the central bank has been keeping CNY depreciation pressure at bay by holding the USD/CNY CFETS Fixing Rate steady around 7.10 since the start of the year. But the depreciation pressure is clearly growing as the differential between USD/CNY spot vs the Fixing Rate has now widened to about 15 big figures and while 1Q24 GDP growth turned out to be better than expected, China's economic recovery remains patchy and uncertain.

Chart 3: What if CNY depreciates past 7.35 to the USD?

Source: Bloomberg, UOB Global Economics & Markets Research



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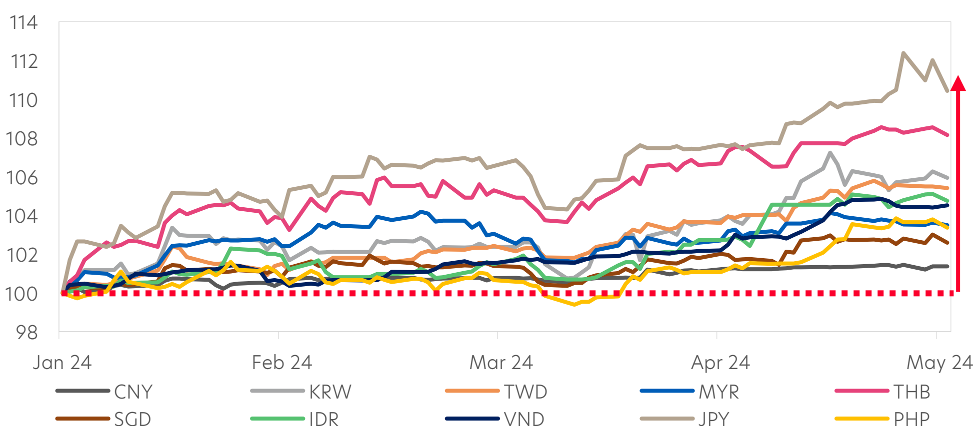
What if the USD stays strong for the rest of the year? How much more can Asian and ASEAN FX weaken? It is noted that both the SGD and CNY have been anchors of stability this year. While at the other end, the trio of JPY, THB and KRW have depreciated the most year-to-date against the USD. The rest of Asia and ASEAN FX are torn in-between both extremes. Bank Indonesia has been forced to hike its interest rate to stabilize the IDR. As a base case, given the risk of further local currency depreciation, it is very difficult for any Asian or ASEAN central bank to cut rates ahead of the Fed this year.

Chart 4: What if USD stays strong against Asia and ASEAN FX?
(Year-to-date normalized return for USD against various Asian and ASEAN FX)

Source: Bloomberg, UOB Global Economics & Markets Research



We take the opportunity in this latest FX & Rates Strategy Monthly to discuss and update our FX and Rates views amidst these increasing near term risk of higher rates and stronger USD.

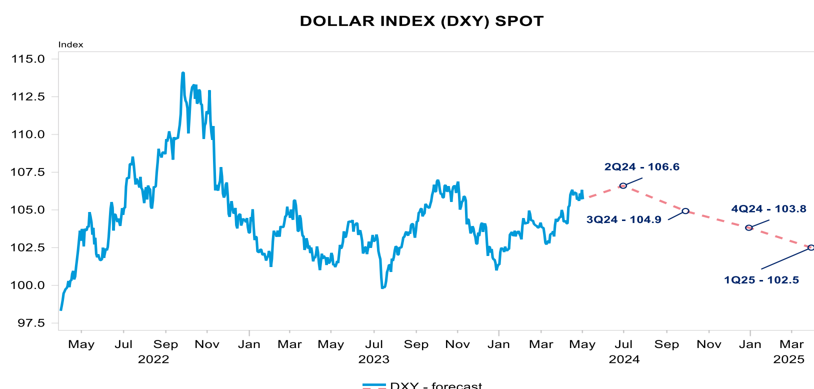
FX Strategy

Near term USD strength in 2Q24 due to a later start to Fed rate cuts

As recently as the FX & Rates monthly report in early Apr, we opined that USD is likely to weaken anew starting in 2Q24 as markets teed up for a Fed rate cut in Jun. Yet, a hotter than expected Mar CPI and sustained patience from Fed officials spurred a further scale back of Fed rate cut expectations. Our macro team has also updated their timing and quantity of Fed rate cuts expected in 2024 to two 25 bps cuts in Sep and Dec, compared to three moves in Jun, 3Q24 and 4Q24 previously. For more details, pls refer to Macro Note published 11 Apr here.

Chart 5: We now expect USD to stay strong in 2Q24 before weakening anew in 3Q24

Source: Macrobond, UOB Global Economics & Markets Research



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The impact of a later start to the Fed's easing cycle on the USD is clear. As US Treasury yields gained over 40 bps across the curve in Apr, the US Dollar Index (DXY) also rose in tandem from 105.6 to 106.2 across the month. In the immediate few months, we may see further discounting of expected Fed rate cuts although the scope is diminishing given the Fed is still considering rate cuts this year. As such, it is all but certain that the USD is likely to stay strong, at least in 2Q24. Consistent with our view of lower US rates going forward, we reiterate that USD would weaken anew, now starting 3Q24 as the widely anticipated Fed rate cut in Sep comes into view.

Most Asia FX continued to bear the brunt of the "higher-for-longer" Fed rate rhetoric with some currencies weakening over 2% against the USD in Apr. Dropping for a fourth straight month, the Asia Dollar Index is set to revisit the lows last seen in Nov. Similar to its developed peers, Asia FX is likely vulnerable to further losses against the USD at least in 2Q24 as the start to Fed's rate cut cycle is pushed out to Sep from Jun previously. A potential CNY devaluation and further geopolitical risk escalation in the Middle East are tail risks that may derail our expectations of an eventual recovery in Asia FX in 2H24. On the positive side, signs of the Chinese economy stabilising together with proactive steps taken by some Asian central banks have helped mitigate the headwinds on Asia FX.

Major FX Strategy

Expected USD weakness delayed to 2H24 though risks to the view emerging

The recent May FOMC meeting was a non-event, as what we have expected as the Fed kept rates unchanged at a range of 5.25% - 5.50% for a sixth straight meeting. While the Fed highlighted the "lack of further progress" toward its 2% inflation target, the door remains open for Fed rate cuts later in the year. Fed chair Powell also made it clear that a pivot towards rate hikes remains unlikely. As the Fed waits patiently for data to substantiate its easing case, US rates and the USD would probably stay elevated in the near term, at least in the remainder of 2Q24.

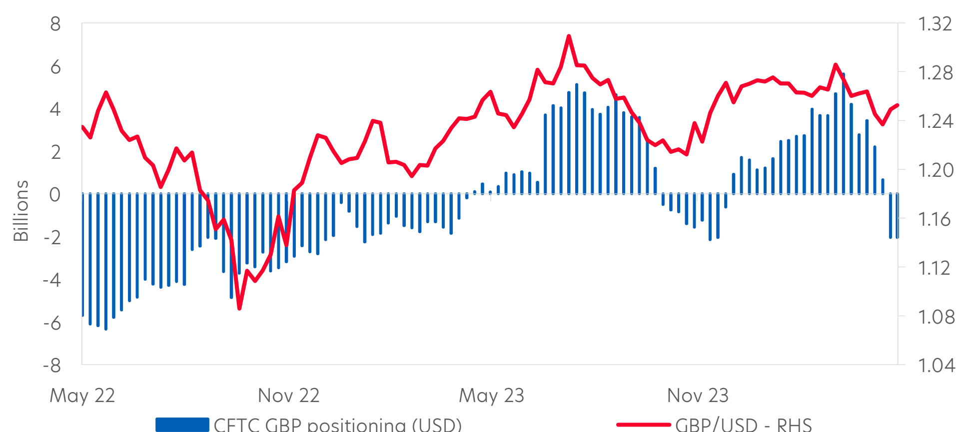
That said, we still expect USD to weaken anew starting 3Q24 as our expected Fed rate cut in Sep comes into view. Our macro team expects US headline inflation to average 2.5% this year (compared with 3.2% in 1Q24) which implies a resumption of the disinflation process in 2H24, giving the Fed the much-needed confidence to commence its easing cycle. However, the extent of the expected USD weakness is likely more gradual than previously forecast owing to lesser Fed rate cuts this year – two 25 bps moves vs three 25 bps moves previously.

The key risk to our bearish USD view is that the Fed keeps its rates unchanged across 2024, a theme that is gaining traction recently as US inflation proved to be stickier than thought. In such a backdrop where other Major central banks such as the European Central Bank (ECB), Bank of England (BOE), Reserve Bank of Australia (RBA) and Reserve Bank of New Zealand (RBNZ) that may have started easing by 3Q24, the USD would likely stay strong into end-2024 – though not our base case yet - supported by favourable rates differentials.

EUR/USD has retreated from 1.08 to 1.07 over the past month. The move is modest considering the significant scale-back of Fed rate cut expectation in the month together with the ECB asserting its policy independence from the Fed, setting the stage for a Jun rate cut. In the near term, EUR/USD is likely to stay on the defensive as the EUR – USD rate differential stays wide until the Fed joins ECB in cutting rates. Compared to our last update, we now expect EUR/USD to turn around starting 3Q24 when the driver for the currency pair switches back from the ECB to the Fed. Our updated EUR/USD forecasts are at 1.06 in 2Q24, 1.08 in 3Q24, 1.09 in 4Q24 and 1.10 in 1Q25.

GBP was surprisingly resilient in Apr given the headwinds. While the steady build up in net GBP/USD long positioning since last Dec was wiped out in the past one and half month, GBP/USD only fell 1% to 1.25 in Apr, staying well within 1.20 – 1.29 range established since late 2023. For now, we keep to our longer-term bullish view on GBP/USD albeit with a later start date (3Q24). Our updated GBP/USD forecasts are at 1.24 in 2Q24, 1.26 in 3Q24, 1.28 in 4Q24 and 1.30 in 1Q25.

Chart 6: GBP/USD stayed supported within recent ranges despite positioning turning net short



The JPY touched a 34-year intraday low of 160.17 on 29 Apr before reversing sharply to 153 in the following two sessions on suspected intervention. Based on the precedent in 2022, it may take a couple of interventions before the JPY could stabilise. This is especially so when USD/JPY is at the mercy of US rates which is biased to stay elevated awhile longer as the Fed pushes back the timetable of its rate cuts. We think a more reasonable timeframe for USD/JPY to come down in a more sustained basis is probably in 3Q24 amidst a renewed slide in US rates as the Sep Fed rate cuts come into focus. In the near term (2Q24), USD/JPY is likely to stay volatile as markets weigh the "higher for longer" rhetoric with the specter of intervention from authorities. Overall, our updated USD/JPY forecasts are 158 in 2Q24, 155 in 3Q24, 152 in 4Q24 and 148 in 1Q25.

AUD outperformed in the G-10 space in Apr, fending off even a resurgence of the USD to stay little changed at 0.65 in the past month. Interest rate futures have erased rate cut expectations in 2024 after a hotter than expected CPI print in 1Q24. That said, we think further gains of AUD/USD from here may be limited as the CNY – a currency which the AUD tracks - remains weak. A sustained recovery in AUD/USD is probably reserved for 2H24 when clearer signs of a CNY recovery take hold. Overall, our updated AUD/USD forecasts are at 0.65 in 2Q24, 0.66 in 3Q24, 0.67 in 4Q24 and 0.68 in 1Q25.

Asia FX Strategy

Expected Asia FX recovery likely delayed but not derailed

Asia FX fell for a fourth straight month in Apr, weighed by sustained USD strength as markets repriced for fewer and later Fed rate cuts. Returning back to last Nov's lows, the Asia Dollar Index has effectively wiped out the initial gains across Nov-Dec 2023 spurred by hopes of the Fed starting its rate cut cycle in 2024. US rates staying "higher for longer" meant most Asia economies are likely to nurse bond outflows, weighing on their respective currencies.

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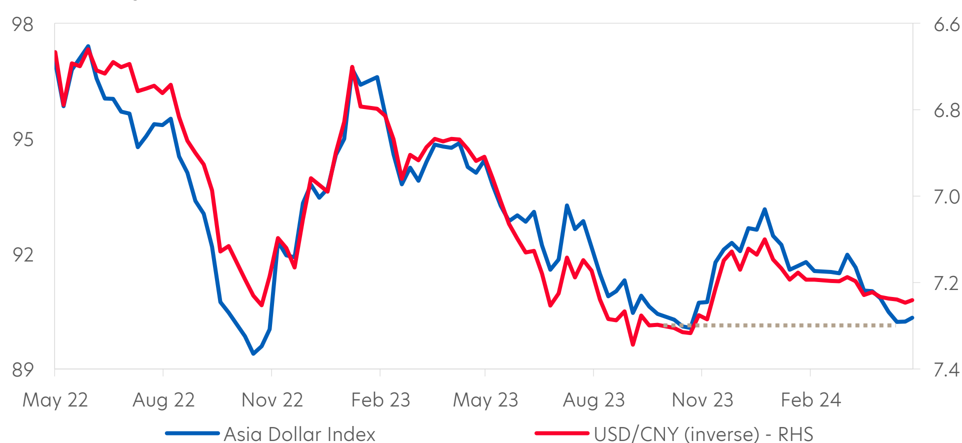
Going forth, we expect Asia FX to stay weak for the remainder of 2Q24 as we deferred our first Fed rate cut call to Sep from Jun previously. Our expectation of an eventual Asia FX recovery is still intact, albeit starting later from 3Q24 instead. Factors underlining our sanguine outlook are still the renewed USD weakness ahead of the first Fed cut and a turnaround in CNY as the Chinese economy shows clearer signs of recovery in 2H24.

Chart 7: Asia FX are largely back to lows seen last Nov while CNY's declines are more modest due to a stable fixing

Source: Bloomberg, UOB Global Economics & Markets Research



The key risk to our cautiously positive view on Asia FX is a sudden CNY devaluation. Despite a significant repricing in Fed rate cut expectations since the start of the year, the CNY has depreciated a modest 2% against the USD, amongst the least amongst Asia and Major FX peers. The relative calm in the CNY is only made possible by a stable fixing by the PBOC at around 7.10 /USD since Dec. Pressure is mounting for the CNY to catch up with the depreciation of the JPY – a key trade partner – given that the latter has slumped about 10% year-to-date against the USD. Should the CNY devalue suddenly and sharply beyond last Sep's low of 7.35 /USD, there will be clear negative spillovers into the rest of Asia FX that will likely derail our expected recovery in 2H24.

The CNY is likely still burdened by the ongoing Fed repricing although we have recently upgraded our 2024 China's GDP outlook to 4.8% from 4.5%. For more details, pls refer to Macro Note published 16 Apr here. While the pessimism on China may have dialed down compared to the start of the year, the key driver underpinning a CNY turnaround is still absent at this point in time. The US-China rate differentials will stay wide in the interim (even as China's yields are starting to turn up) and only start to meaningfully narrow in 3Q24 in favour of CNY as the Fed rate cut narrative regains momentum. Overall, our latest USD/CNY forecasts are 7.28 in 2Q24, 7.15 in 3Q24, 7.05 in 4Q24 and 6.95 in 1Q25.

As expected, the Monetary Authority of Singapore (MAS) has kept its monetary policy unchanged at its latest Apr meeting. The positive slope of the S$NEER policy band, facilitating a gradual pace of appreciation of the S$NEER, is likely to keep SGD crosses elevated in the near term, even as Fed rate cut trajectory remains uncertain and the Middle East situation remains fluid. As for the USD/SGD, the pair is likely to stay elevated in the interim pacing other USD/Asia pairs while we wait out for US rates to eventually weaken anew in 3Q24. Overall, our updated USD/SGD forecasts are 1.37 in 2Q24, 1.35 in 3Q24, 1.34 in 4Q24 and 1.33 in 1Q25.

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While USD/MYR has eased off from the key 4.80 level in mid-Apr for a third time in the past six months, broad USD strength indicates a probable retest of the level in the near term. However, continued engagements by the Bank Negara Malaysia (BNM) with corporates and investors to further encourage conversions and boost sentiment toward the MYR may prevent the USD/MYR from gaining a foothold above 4.80. We reiterate the view that the MYR's close correlation to the CNY means that it will benefit and trace an eventual CNY recovery later this year. Our updated USD/MYR forecasts are at 4.80 in 2Q24, 4.70 in 3Q24, 4.65 in 4Q24 and 4.60 in 1Q25.

The THB fell close to 8% year-to-date to 37/ USD, one of the worst performing Asia FX as Bank of Thailand's (BOT) rate cut expectations build. We have updated our BOT rate view in Apr (For more details, pls refer to Macro Note published 12 Apr here), now looking at the BOT to cut the policy rate twice this year, 25 bps each, at its Jun and Aug meetings. This is based on our view that inflationary pressures will remain muted and growth will be more subdued. It is likely more pain for the THB in the near term before a brighter Asia FX outlook in 2H24 starts to pare THB's losses on the year. In all, our updated USD/THB forecasts are at 37.5 in 2Q24, 36.8 in 3Q24, 36.3 in 4Q24 and 36.0 in 1Q25.

While the IDR has weakened to a 4-year low of 16,290 /USD in Apr, suspected intervention and an unexpected rate hike by Bank Indonesia (BI) have helped to limit losses. We can reasonably expect further steps by authorities to smooth out IDR volatility in the near term to wait out an eventual turn in the broad USD. That said, it is likely that IDR would be vulnerable to further but limited losses for the remainder of 2Q24. After which, we maintain the view that IDR would join the regional FX recovery when the Fed cuts rates in Sep. Our updated USD/IDR forecasts are 16,400 in 2Q24, 16,000 in 3Q24, 15,800 in 4Q24 and 15,600 in 1Q25.

USD/VND traded up to a new high above 25,463 in Apr alongside broad USD strength against Asian peers. With receding Fed rate cut expectations, USD/VND is likely to stay elevated for awhile longer. The State Bank of Vietnam (SBV) said it had intervened in the FX markets in Apr and this may help to keep volatility in check. Beyond near-term external headwinds, we expect the VND to draw support from resilient fundamentals and a subsequent recovery in the CNY. Our updated USD/VND forecasts are 25,600 in 2Q24, 25,100 in 3Q24, 24,800 in 4Q24 and 24,600 in 1Q25.

Rates Strategy

Back to higher for longer

Rates price action for the month of Apr 24

The lull in Mar was broken as yields pushed higher in Apr aided by re-pricing of US monetary policy expectations. The Fed funds futures market took out another 25bps clip of rate cuts this month, leaving behind a maximum of two possible rate cuts priced for 2024 at the end of Apr.

Chart 8: Monthly change (29 Mar to 29 Apr)

Source: Bloomberg, UOB Global Economics & Markets Research

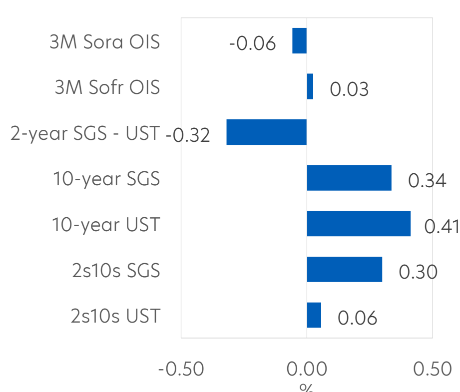
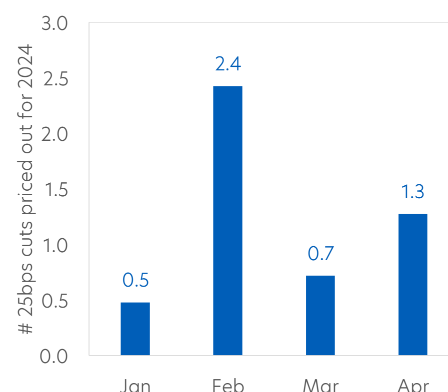


Chart 9: Monthly change in 2024 Fed rate cuts pricing

Source: Bloomberg, UOB Global Economics & Markets Research



The UST curve mostly experienced a parallel shift higher as the 2s10s bear steepened by around 6bps. In contrast, our 2s10s SGS curve steepened by 30bps in Apr thanks to the front end remaining sticky and significantly outperforming the UST re-pricing. The belly of the SGS curve (10-year region) bore the brunt of this month's UST led yield spike, resulting in the 2s10s30s spread flipping back positive for the first time since Oct 23.

This flip from hot to cold on Fed rate cuts has already come a long way. A meaningful reversal will require next month's data to come in well under expectations, particularly those on the inflation front. In the absence, the storyboard will mostly be variations of 5Ws +1H (who, what, when, why, where, and how) of potentially higher yields given their proximity to this rate hike cycle's high.

This time is different with Fed guidance still neutral to dovish

We note that the push higher in yields took place whilst the backdrop of Fed guidance has remained neutral to dovish. Based on Bloomberg's natural language processing Fedspeak index, the probability of Fed hiking is currently low, and this is opposite to how the Fed was guiding for most of last year. An extended reset higher in yields would be more sustainable when complemented by Fed guidance. This is one area where we see a possible catalyst for the next bearish leg in UST. A surprise turn in Fed guidance towards rate hikes will be disruptive. We do not think that investors will settle for a one and done precision pricing if policy makers were to open the door for hikes. It is more likely that we get overshooting in this scenario, like how markets overshot on the downside after Powell's pivot in Dec.

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Chart 10: Policy makers' guidance is not hawkish

Source: Bloomberg, UOB Global Economics & Markets Research

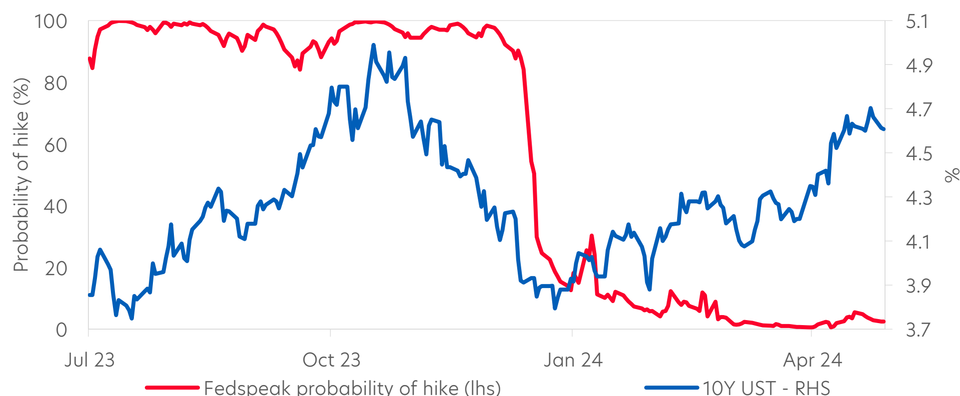
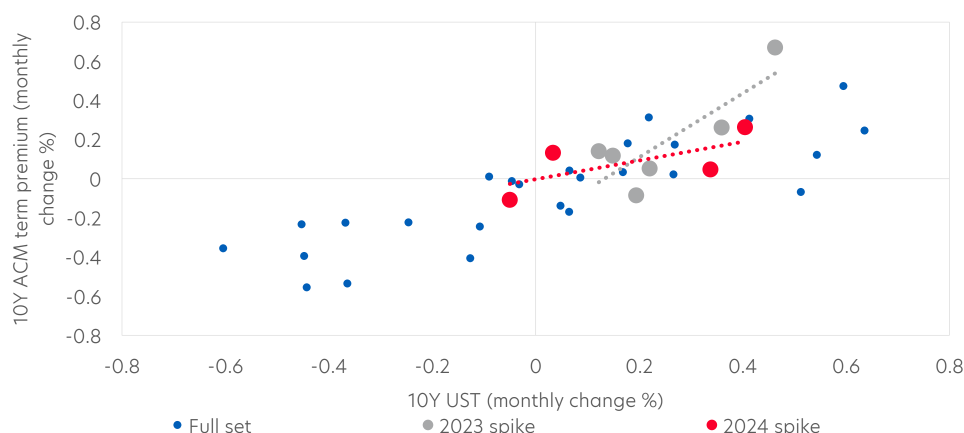


Chart 11: 10Y UST vs term premium 2021 to 2024

Source: Bloomberg, UOB Global Economics & Markets Research



Another possible bear catalyst for UST presents when we compare this year's run up in 10Y UST yield to Oct 23's term premium scare. Thus far the process has been associated with a milder uplift in the term premium. However, most US fiscal deficit projections sees large shortfalls persisting and they are unlikely to be materially changed regardless of Nov's US election outcome. This means that stress points are present during long bond auctions, and it may take just one particularly poor auction to trigger a more aggressive round of term premium repricing seeing as how market sentiment is already weighed down by a challenging supply outlook.

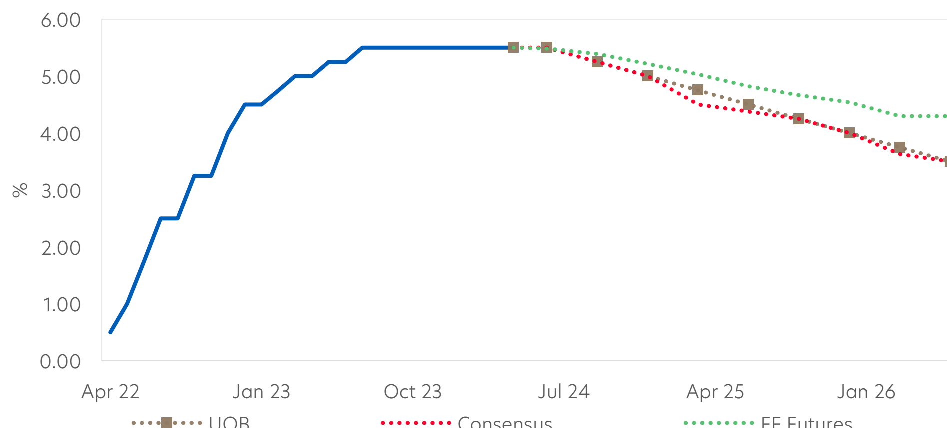
Reiterate our FOMC view for 50 bps of cuts across 2024

In their base case, our US macro team expects the Fed Funds rate to stay at 5.50% until a US easing cycle kicks off in 3Q 24 and rate cuts are forecasted to extend into 2026. This anticipation of a turn lower in the US monetary policy cycle, is based on:

- inflation declining into policy makers' comfort zone, and
- that the prevailing policy real rate level is perceived as sufficiently restrictive.

Chart 12: Fed Funds forecasts

Source: Bloomberg, UOB Global Economics & Markets Research



We have not assumed a serious retrenchment in economic growth when deriving this Fed baseline. Therefore, in the event of a substantial (unforeseen) negative growth shock, the policy rate will likely undershoot deep into more accommodative territory.

Although our US macro team's base case is for US monetary policy easing to kick off this year, recent data does shift the needle towards the possibility that there may be less cuts delivered rather than more cuts.

At a high level, the US economy has continued to perform in a resilient manner and in the absence of a significant growth shock, disinflation momentum has diminished. Considering that possible fiscal scenarios coming out of this year's election are more likely to be a continuation of the government's largesse rather than austerity. This could add more fuel to proponents of the second inflation wave narrative. Simply put, the arguments for Fed rate cuts do increasingly seem like falling into the "wants" category rather than "needs".

As it stands, we have factored in 50bps of rate cuts across 2024 as our base case and Fed funds futures market pricing as of end Apr is roughly in line with our view. Divergence sets in over the full cycle as we have a more dovish profile for Fed Funds compared to what the market has priced in. Specifically, our easing cycle bottom for Fed Funds sits at 3.25% which is 95bps lower than the futures market price of around 4.20% as of end Apr.

For end 2Q24, we see the 3M compounded in arrears Sofr and Sora at 5.35% and 3.66% respectively. Thereafter, short term rates are then expected to drift lower across 2024 in tune with our expectations of 75 bps rate cuts from the US Federal Reserve. Eventually the 3M compounded in arrears Sofr and Sora could drop to 4.98% and 3.42% respectively by 4Q24.

Gradual QT tapering the way to go

Investor consensus is coalesced around a Fed balance sheet size that is in the mid to high USD 6tn region. Based on the current QT run rate, we should get to this region by 4Q24. This schedule could change further depending on which way the Fed leans for sunsetting QT; a gradual/tapered stop or a more abrupt end.

Chart 13: Fed balance sheet

Source: Bloomberg, UOB Global Economics & Markets Research

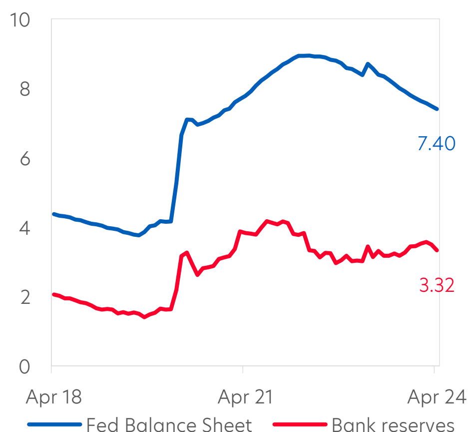
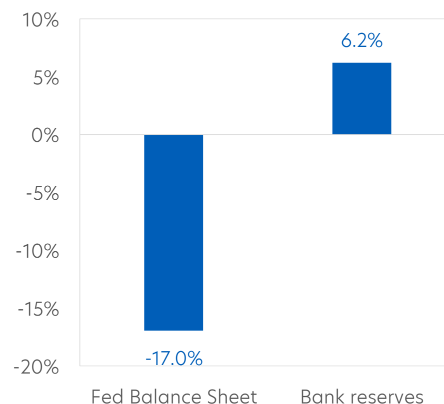


Chart 14: Change since start of QT (Jun 22)

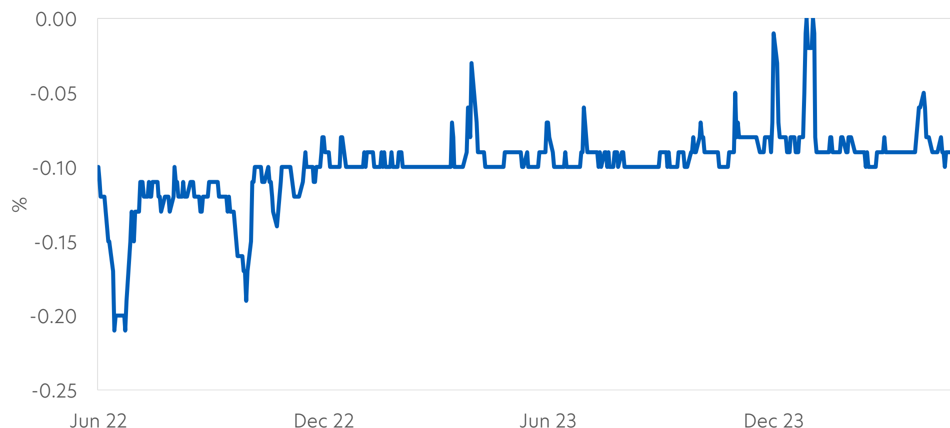
Source: Bloomberg, UOB Global Economics & Markets Research



At the end of the day, there is no hard science behind deriving the optimal Fed balance sheet size. It all boils down to ensuring enough liquidity for market functioning as the overarching objective, as such we favour a tapered approach towards sunsetting QT which may result in a longer runway.

Chart 15: Sofr – IORB spread

Source: Bloomberg, UOB Global Economics & Markets Research



Market functioning, as measured through the spread between Sofr and Interest on Reserve Balances (IORB) rates, has been relatively well behaved since QT kicked off back in Jun 22. We have yet to witness liquidity stress to the extent seen in the previous 2017 to 2019 QT phase which drove the Sofr-IORB spread sharply higher into positive territory and stayed higher for an extended period of time.

10Y UST and SGS yield forecast adjusted modestly higher

For the longer end of the curve, we have the 10Y UST and SGS yields at 4.40% and 3.35% respectively by end 2Q24. Our forecasts have been tweaked higher compared to the previous month given that our Fed baseline has been reduced from 75bps of cuts to 50bps as well as factoring scenario probabilities which have shifted towards those that entail lesser Fed rate cuts. The overall forecast curve points lower across time due to our monetary policy easing cycle base case.

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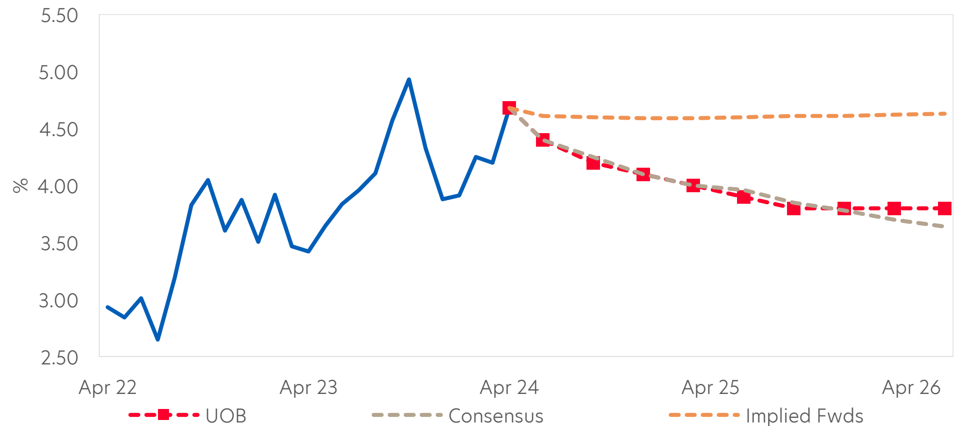
Chart 16: 10Y UST

Source: Bloomberg, UOB Global Economics & Markets Research

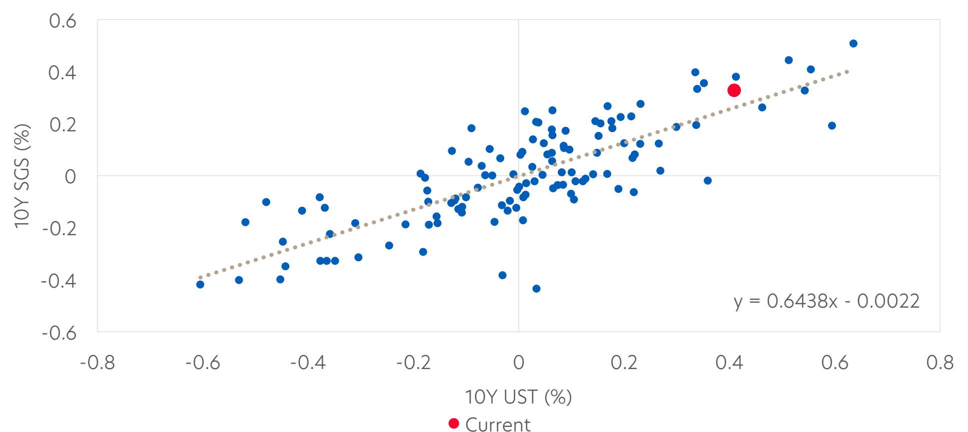


Considering that, market pricing has only one 25bps cut locked in for 2024 (with another 25bps a coin toss), the room for more hawkish re-pricing is modest unless policy makers open the door to the possibility of rate hikes. That outlier scenario aside, owing to our more dovish Fed easing cycle call and our expectation that rate cuts will begin in 3Q 2024, we think that there is value in the 10Y segment of the curve.

However, we note that adjustments in the 10Y UST term premium has been modest and has not demonstrated the same repricing intensity as previously seen in Oct 23's "term premium scare". This is an uneasy equilibrium and one that currently seems more likely to resolve higher. Therefore, our bias in the short term for 10Y UST price action is that the risks lie in the direction of sticky to higher yields.

Chart 17: Monthly yield change (2014 to 2024)

Source: Bloomberg, UOB Global Economics & Markets Research



For SG rates, our forecast assumes that the long-term relationship which governs the process of SG rates adjusting by a lesser degree to US rate changes will continue to hold into the rest of 2024 as well as persist across the whole US rate cut cycle. Fundamentally, we think that the potential for significant SGS outperformance is limited because the SGD NEER is starting from a position of strength, and we do not expect the MAS to tighten monetary policy further.

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Across 2024, the 10Y UST and SGD yields are projected to progressively decline and may touch 4.10% and 3.15% respectively by end 4Q24.

2s10s UST yield curve may get more volatile as we shift to eventual policy easing

Based on our Fed easing expectations, the second half of 2024 will be a transition period from policy plateau to policy easing. Aside from impacting outright yield levels, the policy shift is also set to herald in a period where yield curves become more volatile as well as raising the possibility of a range break.

Chart 18: 2s10s UST curve

Source: Bloomberg, UOB Global Economics & Markets Research

Since Oct 23, 2s10s UST curve has ranged between -16bps and -54bps. It currently sits just above the middle of this range. A move out of this seven-month sideways price action is a probable outcome as we get closer to the inaugural rate cut, our bias in this instance is for the curve to steepen. Historically, monthly 2s10s UST curve changes have recorded a wider dispersion of outcomes during policy rate cuts compared to policy rate plateaus. In addition, episodes of large positive monthly change in the curve occurs more frequently than negative ones.

On the other hand, if our rate cut view gets pushed back, that would extend the status quo's run, but we think that the probability of 2s10s UST curve breaching the range top should still outweigh a downside break scenario. Term premium repricing, given the challenging US fiscal deficit outlook, is one candidate which could support the curve. Investors' concern over this narrative has receded but the arguments remain valid and could resurface under the right conditions.

Wider monetary policy views

Our monetary policy views on major developed markets (DM) sees central bankers there positioned to cut their own policy rates ahead of, or largely in step with the US. The exception being Japan where the BOJ continues to dance to a different tune and policy normalization/exit from negative interest rate policy (NIRP) remains the objective. We have penciled in another BOJ rate hike in 4Q 24 to take the policy rate up to 0.25% which will be its highest since 2008.

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UOB forecasted change in policy rates (%) - Developed Markets	2024	2025
United Kingdom	-0.75	-1.00
Eurozone	-0.75	-0.25
Australia	-0.60	-1.00
United States	-0.50	-1.00
New Zealand	-0.50	-1.00
Japan	0.15	-

Source: UOB Global Economics & Markets Research

UOB forecasted change in policy rates (%) - Asia	2024	2025
Philippines	-0.75	-1.00
Hong Kong	-0.50	-1.00
South Korea	-0.50	-0.50
Thailand	-0.50	-
India	-0.25	-1.00
China	-0.25	-
Singapore*	-0.13	-0.71
Indonesia	-	-1.00
Taiwan	-	-
Malaysia	-	-
Vietnam	-	-

* Represented by the change in 3M OIS rate
Source: UOB Global Economics & Markets Research

In the Asian region, it is our view that central banks may be more inclined to adopt a wait and see approach to their own rate cuts. Our argument for this is two-fold:

- First, external demand will probably receive some support from expected monetary policy easing by DM central banks. Consequently, Asian policy makers may be inclined to assess the magnitude of uplift in external demand before deciding on pulling their own policy levers.

- Second, interest rate differentials are historically tight at the moment. Prospects for widening of the differentials could lend support to domestic currencies and this in turn may translate to improved investor confidence/risk appetites. Such an outcome will also be received favourably by policy makers.

Rate hikes, such as the one delivered by Bank Indonesia in Apr are exceptions rather than the norm in our view. Justification for higher rates across Asia at this stage essentially boils down to the defense of domestic currencies and policy makers are aware of the limitations of unilaterally leaning against the USD tide.

Summary table of rates forecasts

Rates	30 Apr 24		2Q24F	3Q24F	4Q24F	1Q25F
US Fed Funds Target	5.50	Current	5.50	5.25	5.00	4.75
		Previous	5.50	5.25	5.00	4.75
3M compounded SOFR	5.35	Current	5.35	5.23	4.98	4.73
		Previous	5.34	5.21	4.96	4.71
10Y UST	4.64	Current	4.40	4.20	4.10	4.00
		Previous	4.20	4.10	4.00	3.90
3M compounded SORA	3.65	Current	3.66	3.56	3.44	3.32
		Previous	3.69	3.67	3.57	3.40
10Y SGS	3.40	Current	3.35	3.20	3.15	3.10
		Previous	3.15	3.10	3.00	2.95

Source: UOB Global Economics & Markets Research

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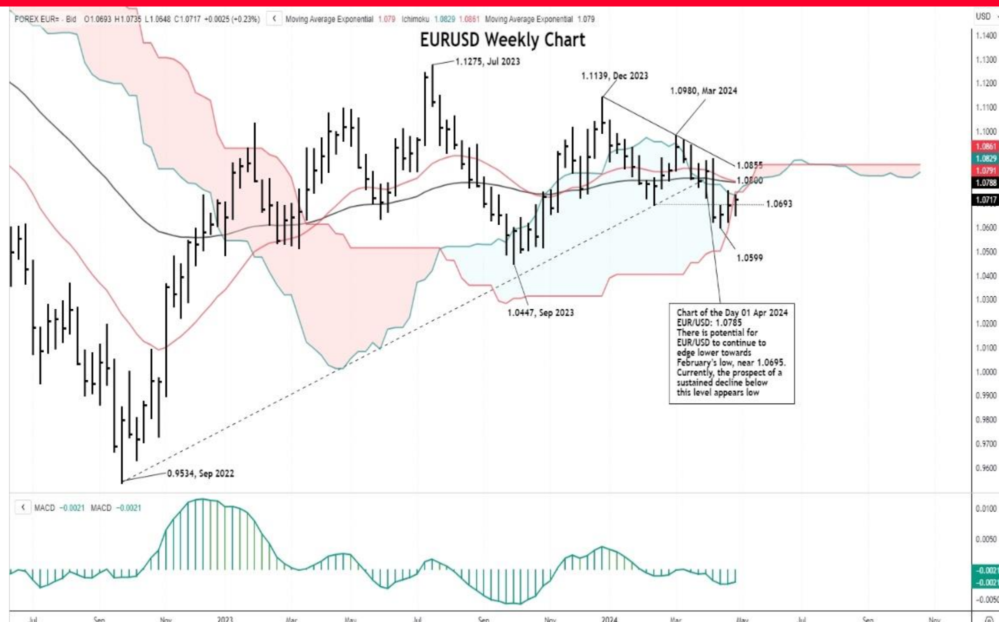
FX Technicals

EUR/USD: 1.0720

EUR/USD is likely to trade within a range of 1.0600/1.0855 for the next month or so; either of these levels must be clearly breached before a clearer picture emerges.



Source: LSEG Workspace, UOB Global Economics & Markets Research

Our most recent Chart of the Day was from about a month ago, on 01 April 2024. At that time, when EUR/USD was trading at 1.0785, we highlighted that "there is potential for EUR/USD to continue to edge lower towards February's low, near 1.0695." We added, "Currently, the prospect of a sustained decline below this level appears low."

EUR/USD subsequently broke below 1.0695, reaching a low of 1.0599 in mid-April. Despite the decline, there has been no significant increase in downward momentum. Although EUR/USD is currently trading below the weekly Ichimoku cloud, the price action does not seem to constitute a clear break through the cloud support, especially as the bottom of the cloud has risen over the past few weeks. Additionally, both the 21-day and 55-day EMA seems to have turned sideways. For the next month or so, EUR/USD is likely to trade within a range, roughly between 1.0600 and 1.0855. Either of these levels must be clearly breached before a clearer picture emerges.

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FX, INTEREST RATES & COMMODITIES

Forecasts

FX	02 May	2Q24F	3Q24F	4Q24F	1Q25F
USD/JPY*	153	158	155	152	148
EUR/USD*	1.07	1.06	1.08	1.09	1.10
GBP/USD*	1.25	1.24	1.26	1.28	1.30
AUD/USD*	0.66	0.65	0.66	0.67	0.68
NZD/USD*	0.60	0.59	0.60	0.61	0.62
DXY*	105.28	106.6	104.9	103.8	102.5
USD/CNY*	7.24	7.28	7.15	7.05	6.95
USD/HKD*	7.81	7.83	7.80	7.80	7.80
USD/TWD*	32.40	32.8	32.3	31.8	31.3
USD/KRW*	1,368	1,400	1,360	1,330	1,300
USD/PHP*	57.41	58.0	57.5	56.5	55.5
USD/MYR*	4.74	4.80	4.70	4.65	4.60
USD/IDR*	16,185	16,400	16,000	15,800	15,600
USD/THB*	36.82	37.5	36.8	36.3	36.0
USD/VND*	25,383	25,600	25,100	24,800	24,600
USD/INR*	83.47	84.0	83.0	82.0	81.0
USD/SGD*	1.35	1.37	1.35	1.34	1.33
EUR/SGD*	1.45	1.45	1.46	1.46	1.46
GBP/SGD*	1.70	1.70	1.70	1.72	1.73
AUD/SGD*	0.89	0.89	0.89	0.90	0.90
SGD/MYR*	3.50	3.50	3.48	3.47	3.46
SGD/CNY*	5.35	5.31	5.30	5.26	5.23
JPY/SGDx100*	0.88	0.87	0.87	0.88	0.90

POLICY RATES	02 May	2Q24F	3Q24F	4Q24F	1Q25F
US Fed Funds Rate	5.50	5.50	5.25	5.00	4.75
JPY Policy Rate	0.10	0.10	0.10	0.25	0.25
EUR Refinancing Rate	4.50	4.25	4.00	3.75	3.50
GBP Repo Rate*	5.25	5.25	4.75	4.50	4.25
AUD Official Cash Rate	4.35	4.35	4.00	3.75	3.50
NZD Official Cash Rate	5.50	5.50	5.25	5.00	4.75
CNY 1Y Loan Prime Rate	3.45	3.20	3.20	3.20	3.20
HKD Base Rate	5.75	5.75	5.50	5.25	5.00
TWD Official Discount Rate	2.00	2.00	2.00	2.00	2.00
KRW Base Rate	3.50	3.50	3.25	3.00	2.75
PHP O/N Reverse Repo	6.50	6.25	6.00	5.75	5.50
MYR O/N Policy Rate	3.00	3.00	3.00	3.00	3.00
IDR 7D Reverse Repo*	6.25	6.25	6.25	6.25	5.75
THB 1D Repo*	2.50	2.25	2.00	2.00	2.00
VND Refinancing Rate	4.50	4.50	4.50	4.50	4.50
INR Repo Rate	6.50	6.50	6.50	6.25	6.00

INTEREST RATES	02 May	2Q24F	3Q24F	4Q24F	1Q25F
USD 3M SOFR (compounded)*	5.35	5.35	5.23	4.98	4.73
SGD 3M SORA (compounded)*	3.65	3.66	3.56	3.44	3.32
10Y US Treasuries Yield*	4.58	4.40	4.20	4.10	4.00
SGD 10Y SGS*	3.40	3.35	3.20	3.15	3.10

COMMODITIES	02 May	2Q24F	3Q24F	4Q24F	1Q25F
Gold (USD/oz)	2,306	2,300	2,350	2,400	2,450
Brent Crude Oil (USD/bbl)	84	85	85	90	90
Copper (USD/mt)	9,766	8,000	8,000	7,000	7,000

* Changes made to forecasts as compared to previous report dated 12 April 2024
Source for spot rates: Bloomberg

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