Economics

DBS Flash

SGD rates: Tight liquidity

Group Research

May 22, 2019

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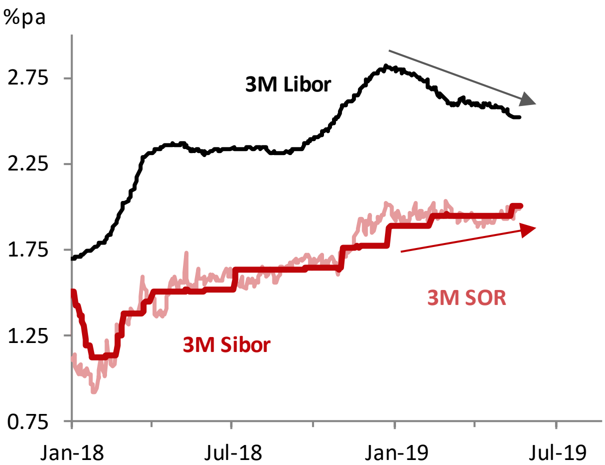
- *With the China-US trade tensions persisting, SGD rates underperformance is lasting longer than anticipated*
- *Some respite could come in June when a sizable SGS issue hits maturity*
- *Normalisation in UST-SGS spreads may take place in June/July but a revisit of the spread seen in late 2018 is unlikely*

The falling Libor did not lead to lower SOR or Sibor



Source: Bloomberg

Rates: Tight SGD liquidity

SGD rates underperformance (relative to USD rates) has been the key theme over the past few months. Spread compression (between USD and SGD rates) is prevalent across all tenors and is perhaps most visible in the front of the SGD curve. Since the start of the year, while the 3M Libor has fallen by almost 30bps, the 3M Sibor has risen by 11bps. The factors driving tight USD-SGD rates spreads have been flagged by us in previous pieces (see here and here), however, the period of underperformance has proven to be longer-than-anticipated as China-US trade tensions worsen. **Below, we revisit some of the key points and flag some events that may offer respite to SGD rates.**

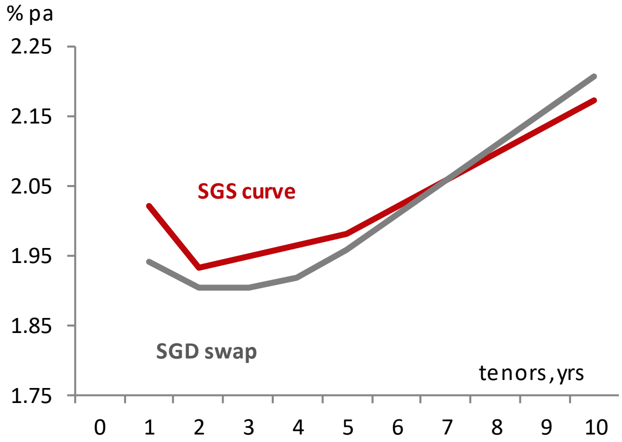
Multiple market indicators point to tight liquidity

SGD liquidity is still tightening, and this can be seen from two of our favoured gauges – SGS-swap spreads and the Libor-SOR spread. Intuitively, if there is a shortage of SGD relative to the USD, we would expect the cost of SGD funding to rise relative to that of USD funding. Notably, the 3M Libor-SOR spread has narrowed to 54bps, levels last seen in early 2018. Meanwhile, SGS-swap spreads measure the difference between cash and non-cash products. If market participants are short of SGD dollars, SGS (a cash product) yields would tend to be high relative to swap rates (non-cash). SGS-swap spreads are hovering close to zero through to the 20Y tenor with several tenors trading inverted (yields higher than swap rates). Under more normal liquidity conditions, we would expect the SGS curve to trade below the swap curve.

A lot of liquidity absorption is taking place

We think that the impact of increased Singapore Savings Bonds (SSBs) and liquidity absorption from the Monetary Authority of Singapore (MAS) may be driving SGD funding costs up. The amount of SSBs outstanding stands at close to SGD 5bn, or about twice the size of a typical SGS auction. Moreover, the MAS has ramped up the amount offered to SGD 350mn per month, up from

Tight liquidity exhibited with SGS yields higher than swap rates in the shorter tenors



Source: Bloomberg, DBS

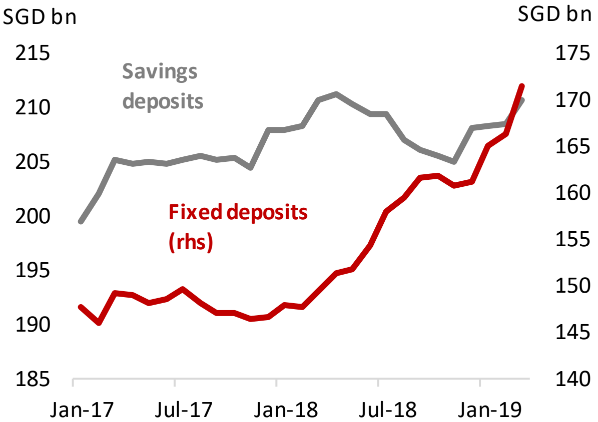
SGD 150mn at the start of 2018. At the current pace, the SSB programme is equivalent to two extra SGS issuances a year. With SSBs a direct competitor to bank deposits, it is not surprising to see banks turning to fixed deposits (which offer high rates than savings deposits) to retain customers.

The amount of sterilisation done by the MAS appears to be elevated. While this should be viewed in the context of how foreign reserves have been behaving, we note that the total amount of liquidity withdrawn has increased substantially (USD 9.3bn rise in forwards and SGD 8.2bn rise in bills outstanding since end-2018).

Respite around the corner?

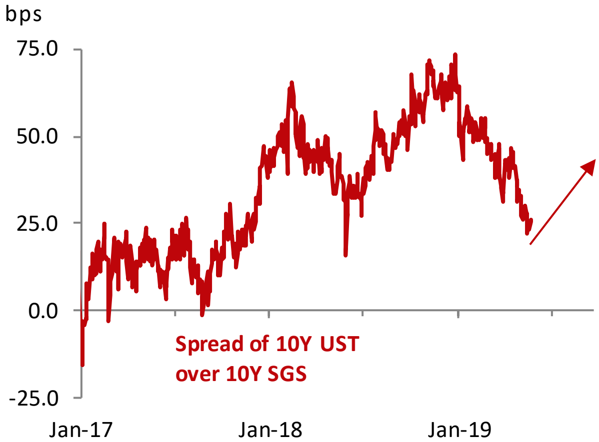
With the China-US trade row still escalating, a turnaround in SGD rates may not be apparent just yet. However, conditions could improve in June/July. Firstly, around SGD 8.7bn of SGS is due to mature in June and could provide some much-needed relief for SGD rates. With just the 2Y reopen (auction date: 29th May) and the new 20Y (auction date: 26th June) to contend with around the period and assuming an average auction size of SGD 2bn, there should be an additional SGD 4.7bn in liquidity injection. Tenor wise, the auction calendar for longer-dated SGSs becomes bare in 2H19 with just the 10Y auction (auction date: 2nd September) and an optional mini-auction (scheduled for 26th September, tenor not announced) to contend with.

Fixed deposits for other residents in Singapore rising faster than savings deposits



Source: MAS, DBS

UST-SGS spreads look tight and may normalise in the coming few months



Source: Bloomberg, DBS

We think that longer-tenor SGSs (>5Y) offer the best scope for outperformance given that spreads versus US Treasuries are already tight. Some normalisation is likely to take place. However, a revisit of the wide UST-SGS yield spreads seen in late-2018 appears unlikely unless FX dynamics turn favourable (Asia FX strength) and US yields head sharply higher, both of which are unlikely if the trade war persist.

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).