Economics

DBS Flash

SGD rates: The liquidity conundrum

Strategy/Singapore/Rates

Group Research

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- *SGD liquidity has begun to ease at last*
- *Sibor, SOR and MAS bills are not equivalent*
- *We are neutral on SGD rates after the recent rally*
- *SGD papers are still attractive to USD-based investors*

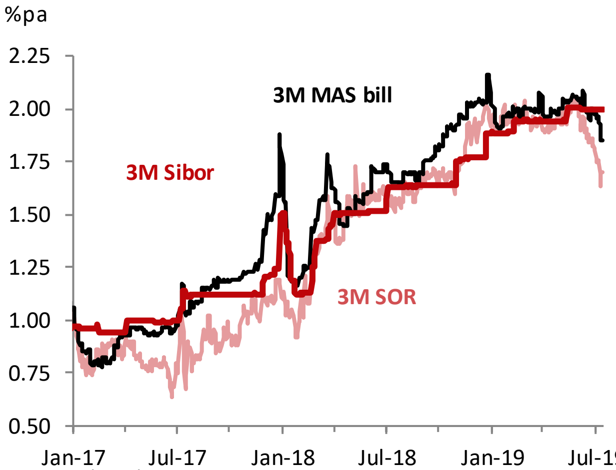
Rates: Making sense of SGD rates

There have been conflicting views on the level of SGD liquidity and how that impacts different SGD interest rates. Throw upcoming Fed cuts and potential Monetary Authority of Singapore (MAS) easing into the mix and the trajectory for SGD rates becomes murky. Below, we lay out how best to view SGD rates at this point.

SGD liquidity is tight, but not as tight as it was in June. Our two favorite ways to gauge this would be via the 3M MAS bill / 3M Libor spread and SGS-swap spreads. The spread between the 3M MAS bill and the 3M Libor peaked at -30bps in June and has since ground down to -47bps.

By comparing SGD to USD rates, we strip out the Fed expectations component and this gives a much clearer view on how SGD liquidity is. Note that, we use the MAS bill to proxy clean SGD liquidity in the financial system as opposed to Sibor (which affects a narrower segment of the industry) or the SOR (which has FX dynamics

Divergences in Sibor, SOR and MAS Bill



Source: Bloomberg

that need to be considered). Similar conclusions can be drawn from looking at SGS-swap (SGS yields less swap rates) spreads. Swap spreads across the 2Y, 5Y and 10Y tenors have generally narrowed over the past few weeks.

Sibor, SOR and MAS bills are not equivalent. While these rates should trade close together, divergences can occur. The divergence between the Sibor (stubbornly high) and the SOR (drifting lower) has caught the attention of market participants (the MAS bill is riding in between the two rates). Sibor, by definition, is an interbank rate. It is a measure of unsecured borrowing costs by banks without additional FX dynamics. As mentioned previously (see here), funding for banks have become more expensive as they turn increasing towards fixed deposits (versus savings deposits). It is not surprising that the Sibor is higher than the MAS bill rate (which can be accessed by a broader range of institutions). Meanwhile, the SOR is sensitive to changes in the US dollar. The pullback of the USD has allowed the SOR to drift lower. Alternatively, it can be interpreted that participants in the SOR space prefer deploying funds in USD rather than SGD. **Tightness in SGD is not uniform across the system.**

MAS easing tends to drive SGD rates higher, all else equal. However, this misses the point that Fed policy and the outlook for the USD will be the overriding forces driving short-term SGD rates. If the MAS flattens the slope, there would theoretically be less room for the SGD to appreciate and this would put upward pressure on SGD rates relative to USD rates. That said, we should keep in mind that the SGD should be viewed as a basket of currencies versus the USD and there is reasonable room for the SGD to fluctuate within the NEER band. The trajectory of the USD is therefore a lot more important for SGD rates. **Unless sentiment towards Asia sours materially, short-term SGD rates are biased lower in a Fed easing environment.**

We have been bullish on SGD rates for a while and are now broadly neutral after the sizable rally over the past few weeks. We think that there is still room for inverted SGS-swap spreads to normalize and for liquidity conditions to improve but outsized returns from current levels are likely to be more muted. **SGD papers are still attractive for USD-based investors given depressed swap rates (relative to yields), favorable cross currency basis swaps and relatively high yields.**

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