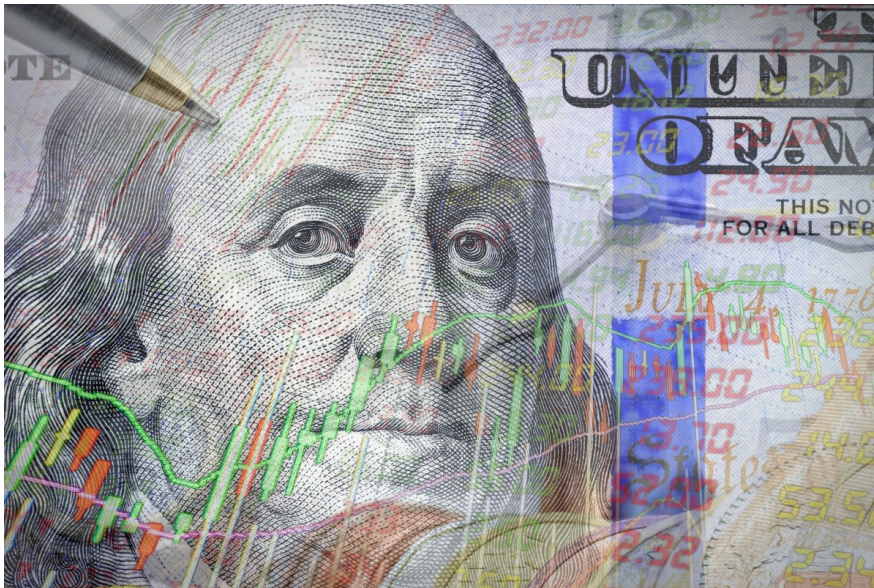


## Rates Spark: Payrolls day, and it's potentially a big one for rates

Post the FOMC, the information value from US payrolls is amplified in our opinion. It's a report that can always generate volatility. We think this one has the capacity to create a lot of discussion. Also, the back end of UST and Bund curves are tightly correlated, suggesting inflation risk from the US has been spilling over to materially impact Bund yields



### Friday's payrolls report is super interesting post the FOMC tone setting

We provocatively asked the question yesterday whether Chair Powell had seen the payrolls number ahead of time. We'll get some clue on Friday. The interesting thing about this report is, if it's strong, it would absolutely negate a chunk of the air of confidence that Chair Powell exuded at the FOMC press conference. We'd continue our march towards 5% on the 10yr yield, with Powell's words of comfort fading fast.

On the other hand, if it's particularly weak, for example the unemployment rate hitting 4% (vs 3.8% now), it would act to amplify Powell's relative confidence on a rate-cutting trajectory ahead.

Remember, Chair Powell explicitly noted that a material weakening in the labour market could precipitate rate cuts even if inflation were to remain relatively sticky and moderately elevated (those weren't his words, but that's the translation). Here, the 10yr would have seen its highs already, at least on a multi-week perspective.

Something along the lines of the consensus estimates would be middle of the road. If we got that (payrolls at 240k, unemployment at 3.8% and average earnings at 4% year-on-year) we'd be left with the momentum economy narrative, one that keeps rates elevated for longer. It would leave the 10yr in the area of 4.6%, most probably with an ongoing bias to test higher next week, and to continue to do so until we get a ratchet down in inflation readings from the 0.3% / 0.4% month-on-month area to 0.2% (CPI is up on the week after next).

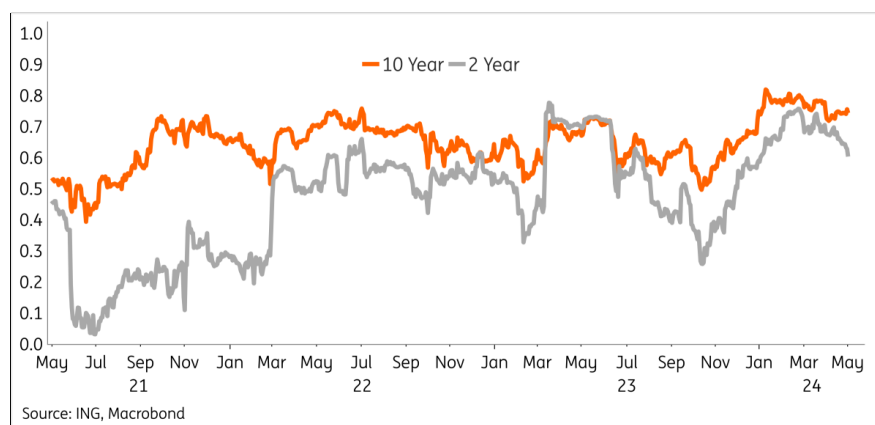
## Correlations between 10y UST and Bunds are high

The growth and inflation numbers from the eurozone earlier in the week reflected a cautious economic recovery but also contained some reminders of sticky inflation. The situation is nowhere comparable to the US data, but we think that euro markets will remain more sensitive to upside inflation surprises, even minor ones. The turn in US inflation momentum has simply increased the wariness of markets about inflation risk over a longer horizon.

The focus on inflation risk has kept the correlation between 10y UST and Bund yields high (see figure below). Risk premia are known to move closely together at a global level and Bund yields in this case were lifted by USTs. The 5y5y inflation swaps for euro and dollar have drifted up in recent months, for which the culprit is clearly US data. The short end of the curve has actually seen a reduction in correlation, and it seems markets are starting to accept the notion that the ECB may move independently from the Fed.

Fed Chair Powell seemingly discounting inflation risk was therefore a reason for euro rates to continue a tick lower after Wednesday's holiday. Next thing to watch will be Friday's US nonfarm payroll figures, which may finally come out weaker after a four-month streak of positive surprises. If true, then there may be some easing in inflation risk, which should help Bund yields to go down.

## Rolling correlations of UST-Bund yields, 3-month rolling



### Friday's events and market view

US nonfarm payrolls will take centre stage in terms of data releases. The estimate is 241k,

well below the big 303k in the prior release and lower than any other reading this year. The ISM Services index will also be watched, and is expected to come in slightly stronger at 52.0. From the eurozone we have the March unemployment rate, which consensus sees staying at 6.5%. Chief Economist Lane from the ECB will give a lecture at Stanford University.

No notable issuance is scheduled.

## Author

### Michiel Tukker

Senior European Rates Strategist

[michiel.tukker@ing.com](mailto:michiel.tukker@ing.com)

### Benjamin Schroeder

Senior Rates Strategist

[benjamin.schroeder@ing.com](mailto:benjamin.schroeder@ing.com)

### Padhraic Garvey, CFA

Regional Head of Research, Americas

[padhraic.garvey@ing.com](mailto:padhraic.garvey@ing.com)

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