Rates Spark: Enough to hold rates down

The US 10yr yield remains below 4%. However that's not been validated by the data as of yet. Friday's payrolls report can be pivotal here, but based off consensus expectations the market will remain without validation from the labour market. Also, the Fed's FOMC minutes due on Wednesday are unlikely to be as racy as Chair Powell was at the press conference

Sub 4% on the US 10yr to hold at least till we see Friday's payrolls outcome

The 13 December FOMC meeting outcome remains a dominating impulse for the rates market. The US 10yr yield shot to below 4% on that day, and has broadly remained below 4% since. It was briefly below 3.8% over the holiday period, but now at closer to 4% it is looking for next big levels. The thing is, validation of the move of the 10yr Treasury yield from 5% down to 4% came from the Fed, but not so much from the macro data. We can reverse engineer this and suspect that the Fed has either seen something, or fears that it will see something that will require lower official rates.

In consequence, data watching ahead remains key. In that respect, we are days away from a key reading on the labour market as December's payrolls report is due on Friday. A consensus outcome showing a 170k increase in jobs, unemployment at 3.8% and wage growth at 3.9% would leave us still lacking validation for lower market rates from the labour market data. We have it from survey evidence, and from scare stories on credit card debt and commercial real estate woes.

But it's the labour market that is really pivotal.

Risk assets struggled a tad yesterday, and that makes a degree of sense given the complicated back story, and the remarkable rally seen into year end. While a one-day move cannot be simply extrapolated, there are reasons to be a tad concerned on the risk front at this early phase of 2024. Geo-political concerns have not abated, and in fact if anything are elevating. Europe is closest to many of these risks, and the economy has been faltering for at least a half year now. Yes the market is expecting rescue rate cuts, but the European Central Bank is yet to endorse those expectations.

An elevation of stress without the prospect of near term delivery of rate cuts can be an issue for risk assets. For market rates, this combination maintains downward pressure. The only issue is how far we've come so fast. We remain of the view that the US 10yr fair value level is around 4%, but that we will likely overshoot to the downside to 3.5% in the coming months. Our fair value comes of a forward 3% floor for the funds rate plus a 100bp curve. See more on that here.

Today's events and market views

It's quiet in Europe for data through Wednesday. The bigger focus for Europe will be on regional inflation readings for December due on Thursday, along with a series of December PMI readings. The likelihood is for some stalling on inflation reduction alongside confirmation of ongoing manufacturing and business weakness. In the US on Wednesday we get ISM readings that will also show a degree of pessimism in US manufacturing. The job openings data will also be gleaned, but the bigger market impulse can come from the FOMC minutes, ones that will refer back to the pivotal 13 December meeting. The odds are they won't be nearly as dovish as Chair Powell was at the press conference.

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