

Rates Spark: Labouring higher

The US labour market has emerged as an area of persistent strength and this is in turn preventing Treasury yields from dipping too low. Combined with a hawkish Fed and supply next week, we see a skew higher in yields



Bonds will maintain a keen focus on the US labour market, which is still hot

The US 10yr got back up at 3.75% post the low jobless claims number released yesterday, but failed to hold up, instead slipping back towards 3.7%. This refusal for market rates to head higher is preventing financial conditions tightening by as much as the Fed would prefer.

The Fed's FOMC minutes from the day before noted concern that financial conditions were not tight enough. Indeed if you look at the Bloomberg measure of this, conditions have re-loosened in the past week, to a mere 0.24 of a standard of deviation tight currently. That's not tight enough. It ideally needs to be a full standard of deviation tight (or thereabouts).

This refusal for market rates to head higher is preventing financial conditions tightening

The main reasons for the re-loosening in conditions has been the recent fall back in market rates

(10yr from 3.9% to 3.7% and lower), and also a fall in the Ted spread. The latter reflects falls in Libor, and low 3mth commercial prints from banks (in fact almost flat to 3mth term SOFR!).

Yesterday's jobless claims number and firm ADP reports keep pressure on the Fed, and any easing in financial conditions adds to that pressure; as it is counter-productive from the Fed's point of view, potentially requiring them to be even more aggressive.

Next stop is the payrolls report today. No reason to expect it to be weak based on what we see. The market expects a slowing in employment growth to the 200k area, but the whisper is likely higher than that. Hourly earnings are helped by a positive base effect, and is predicted to slow to 5.0% year-on-year.

Delivery of a 4 (point anything) handle would really set the bond bulls going. The counter that a higher 0.5% month-on-month outcome would not only hold the YoY rate at 5.1%, but also annualises to wage inflation of a still troubling 6% (for the Fed). There's lots at stake as we face into this report.

The fall in long-dated Treasury yields makes the Fed's job more difficult



Source: Refinitiv, ING

A day heavy in data but we keep our higher rates bias

The Fed won't validate cuts priced by the curve until much later in the cycle

The highlights of this week are the resilience of employment numbers, and the hawkishness of Fed speakers. Esther George advocated keeping rates above 5% well into 2024 in a pushback against market rate cut expectations. Raphael Bostic also argued against celebrating prematurely the slowdown in inflation. Bullard, known for his usually hawkish outtings struck a more upbeat note saying the Fed Fund rate is approaching sufficiently high level after soften inflation readings. Although neither are voters this year, they are a reminder that the Fed won't validate cuts priced by the curve until much later in the cycle.

Even though the US labour market is strong we still expect USD rates to be skewed higher in the

coming days, courtesy of long-end Treasury supply that should give investors a bias towards selling Treasuries on rallies.

Today's events and market view

There is a heavy economic release slate in Europe today before market participants can turn their attention to the US employment report. Eurozone inflation is top of the list although member state surveys helped shape expectations earlier this week. Note that more recent contributions to the Bloomberg median estimate of 9.5% were below that level. Reflecting that new information. An inflation print below that level might not really qualify as a 'surprise', and shouldn't be a strong reason for bonds to perform.

This is particularly true if we're right in suspecting that core inflation could actually come in higher than consensus. In light of the vagaries of energy prices and government interventions, European Central Bank officials have rightly signalled that their attention is on core inflation. Eurozone retail sales and economic sentiment indicators complete the list.

In the afternoon, much of the action will be determined by the US jobs report. Strong labour data this week would have contributed to skew expectations higher but we still expected investors to have a bias towards selling on strength given long-end supply next week.

The ISM services index and factory order will prevent markets from starting their weekend early.

There is also a long list of speakers both from the ECB and the Fed to liven up the rare gaps between economic releases.

Authors

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose

possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.