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

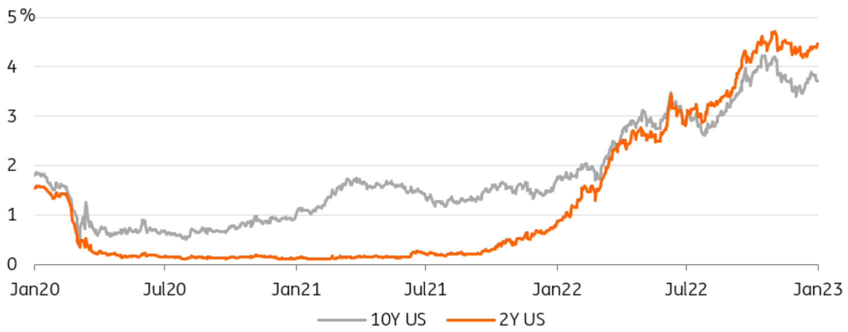
(10yr from 3.9% to 3.7% and lower), and also a fall in the Ted spread. The latter reflects falls in Libor, and low 3mth commercial prints from banks (in fact almost flat to 3mth term SOFR!).

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 likley 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.

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