

## Rates Spark: More jobs, more hikes...

It's always tough to interpret market reaction to payroll data. This time around a reasonable report should be enough to tempt market rates up, continuing the post BoE induced "V". But then again, the market is going into payrolls expecting it to be strong, which leaves room for disappointment. Either way, it will set the scene from now till the 2 November FOMC



### A reasonable payrolls outcome to maintain upward pressure on market rates

The 5% handle on the wages number is arguably the most relevant part of the payrolls report for markets, as wage inflation is where second-round effects come from, risking the manufacture of permanently elevated inflation. And wage inflation is liable to remain elevated if jobs growth continues, which is why the second focus for attention is on the 250k growth in jobs expected; still quite a chunky number.

For the market rate doves, positives pitted against that include a 10yr breakeven inflation rate running at a very tolerable 2.2%, and a 10yr real yield that's in the 1.5% area. The former is good as it points to a market discount for inflation to fall significantly, and the latter is good as it's reflective of already tight financial conditions (the 10yr real yield was negative not that long

ago; in the early summer).

Tight financial conditions take pressure off the Fed to be overly aggressive in the months ahead. Currently, the Bloomberg measure has financial conditions at 1% tight versus normal. This is where it needs to be, at least for another few months, to help rein in the economy. And this is why it would not be helpful for the Fed should market rates collapse lower and credit spreads tighten from here.

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*Price action so far this week suggests the market has moved away from the "early pivot from the Fed" narrative*

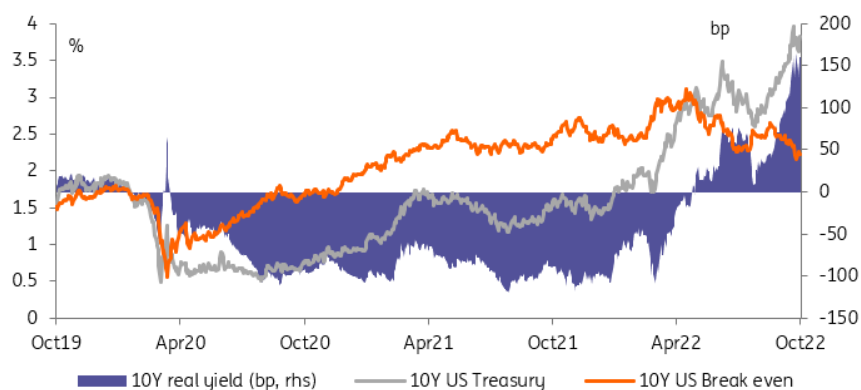
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At least not just yet, as we're on the cusp of a turn lower in inflation metrics. The Fed will need to see some real confirmation of this before getting comfortable, and the firm payrolls report the market anticipates does not help in that respect. Our job here is not to determine whether that's a good thing or a bad thing, but rather to interpret how the Fed and the market are likely to view it.

Price action so far this week suggests the market has moved away from the "early pivot from the Fed" narrative. That really was kicked off by the Bank of England (BoE) gilt buying solution to the sell-off in long-end gilts. But it should not matter hugely for the US. Nothing has broken in the US. The system is holding up reasonably well. Re-financing costs have clearly risen, and heightens angst, but that's to be expected in a rate hiking environment.

We still think market rates are more liable to rise from here. We may well have seen the structural top at 4% for the 10yr, or thereabouts, but we also feel we're liable to see it at least one more time. There is a large fall in market rates to come, but we're not at that point just yet. See more [here](#).

## Positive real rates are helpful for the Fed but 10Y should test 4% again



Source: Refinitiv, ING

## ECB chatter has been conspicuously absent recently

There was much fanfare – we are guilty as well – ahead of this week's European Central Bank (ECB)

non policy-setting meeting in Cyprus as it was said the Council would start discussing quantitative tightening (QT). It is thus surprising how little was actually heard on the topic. The only implicit reference to QT over the past day was actually contained in the minutes of the September ECB meeting, where it was noted that the large balance sheet was continuing to provide “significant” accommodation. And in that context it was reiterated that the ECB was ready to adjust all of its instruments to reach its inflation goals.

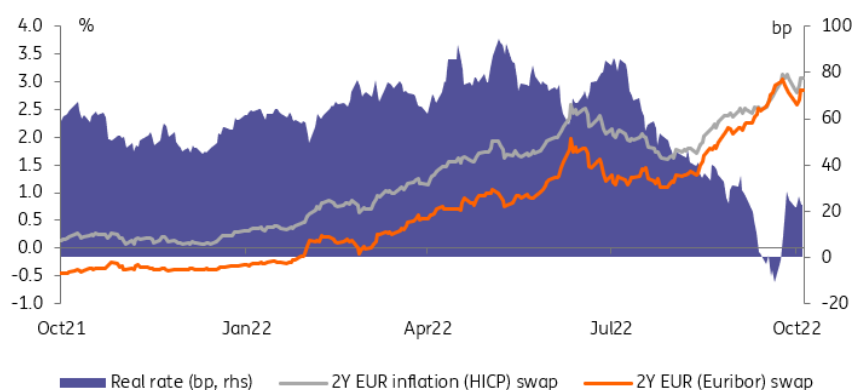
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*One could be tempted to see the absence of QT chatter as a dovish relief*

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One could be tempted to see the absence of QT chatter as a dovish relief. But the ECB minutes also left no doubt that the central bank remains committed to its goals and is ready to take further sizeable (interest rate) steps. While there was certainly some read across from other markets as well yesterday, EUR front end rates still rose notably – 2Y ESTR OIS by more than 15bp for instance.

## Not much QT news from the ECB but the EUR curve remains steep



Source: Refinitiv, ING

## Government fiscal plans in the market's cross hair

There is much at stake in the eurozone when it comes to QT. The main focus are certainly Italian sovereign bond spreads, even if the ECB may believe it has tackled that issue with the Transmission Protection Mechanism. But beyond spreads there is also a fear of stoking further market volatility, especially when government funding plans in the eurozone are under growing upside risk. The ECB minutes at one point noted it was “essential to communicate prudently on the way forward and to counter the risk of increased volatility in the bond market”.

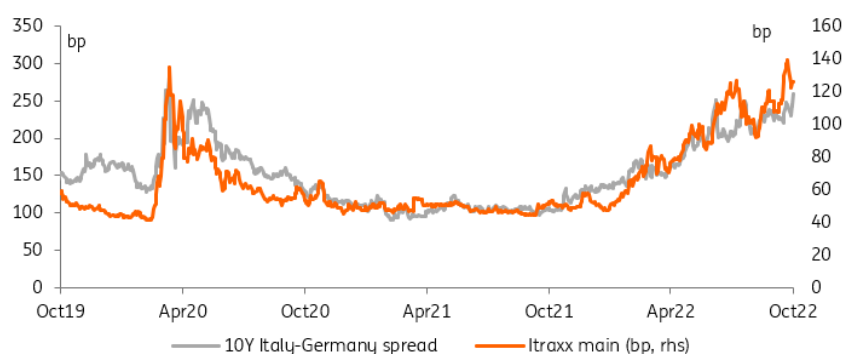
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*Government funding plans in the eurozone are under growing upside risk*

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The UK experience has highlighted the fragility of financial markets amid the central banks push for higher rates. Variables not under the control of central banks – in this case fiscal policy – can derail any envisaged tightening plan no matter how well thought out. The BoE is back to buying long end gilts, even if only reluctantly. Though after another push higher of 30Y yields – at one time by 20bp to touch 4.4% – it did buy again in small size after two days of not accepting any offers in the daily operations.

## Credit and sovereign spreads await nervously ECB QT



Source: Refinitiv, ING

## Today's events and market view

Today's main event is the release of the official US job market data. The consensus sees unemployment staying at just 3.7%, payrolls increasing by 250k and wage growth staying elevated. That should be enough to leave the Fed on track for another 75bp hike at the November meeting. There are more opportunities to confirm that message with the Fed's Williams, Kashkari and Bostic scheduled to speak today later in the afternoon after the jobs data release.

Few other events are worth of note. The UK will see the BoE's Ramsden speak. Current intervention in long-end gilts is set to end 14 October and BoE officials have so far not budged from their overriding inflation objective, keeping up the pressure gilts. They can thus remain a major source of overall rates market volatility near term.

## Authors

### Padhraic Garvey, CFA

Regional Head of Research, Americas

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

### Benjamin Schroeder

Senior Rates Strategist

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

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