Rates Spark: No turning back

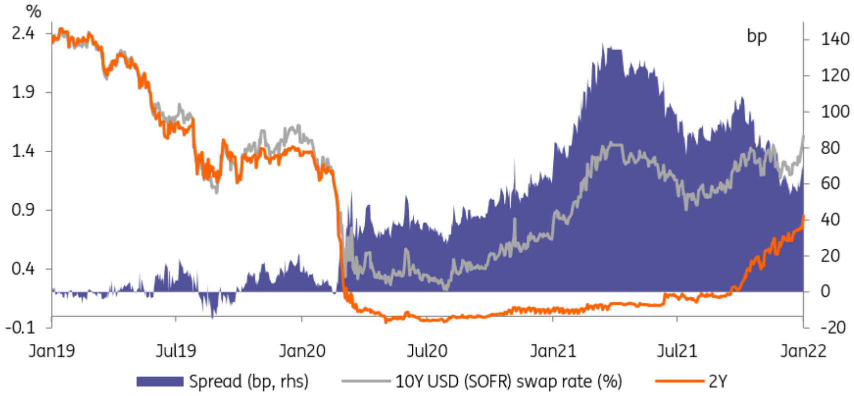
The last session of the week is likely to be dominated by two forces: reaction to the latest batch of US job numbers, and markets bracing for a busy week of bond supply. Despite their recent jump, a retracement lower in rates is unlikely. Curve dynamics on the other hand should be complicated by next week's supply

Source: Shutterstock

The hawkish asymmetry will be most visible in higher yields today

Starting with US numbers. Our hunch is that even a disappointing headline non-farm payroll figure could be seen by rates markets as consistent with a tighter labour market, as they did in November. This is all the more true that Covid-19-related restrictions have revived fears of labour shortages and could prolong the circumstances prevailing since the start of the pandemic. On the other hand, a bumper job creation figure would more convincingly indicate that the Fed is fast approaching its full employment mandate.

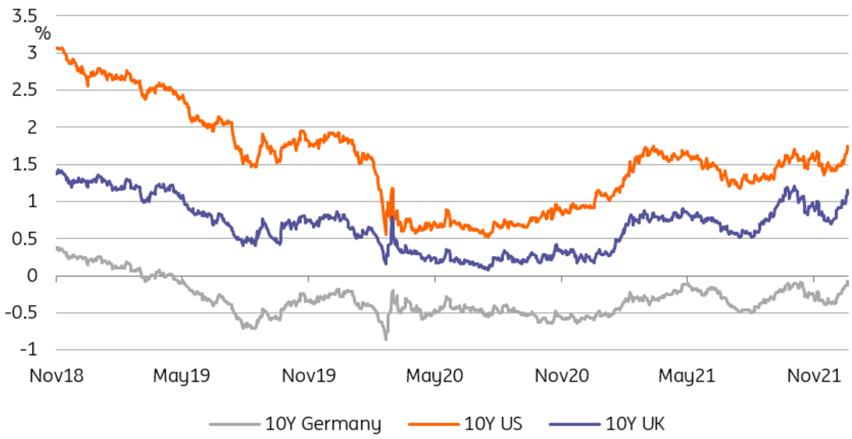
USD rates should continue to rise but re-steepening is likely due to supply



Source: Refinitiv, ING

This asymmetry is nothing new. US rates have been trading with a distinctly hawkish bias since last summer. We still think rates are skewed higher today, and indeed in the medium term, but this raises the bar for further flattening of the USD curve around today's release. Note also that US Treasuries face 3Y, 10Y, and 30Y supply next week and we would not be surprised to see any rally sold into in anticipation. This means curve dynamics will be harder to read for a few days.

10Y German yields are closing in on 0%



Source: Refinitiv, ING

We're surprised at the pace of the move but the direction of travel was never in doubt

EUR rates should similarly be on high alert for further supply next week. The read-across from the hawkish FOMC minutes had 10Y German Bund yields test their highest levels in over two and half years and only a handful of basis point short of 0%. Truth be told, we're surprised at the pace of the move but the direction of travel was never in doubt. It looks like less severe Covid-19 restrictions are allowing EUR markets to focus on more long-term issues such as the impending ECB normalisation cycle. Supply pressure, in particular portfolio rebalancing among potential buyers, means a retracement lower in yields is unlikely in our view.

Today's events and market view

In the European session, the highlight will be the Eurozone CPI release and, more importantly, the core inflation print. Even as headline declines are pushed down by base effects, a stubbornly core reading would keep ECB tightening fears intact.

December US job numbers will no doubt be the release with the most market-moving potential today. In November, disappointing job growth but a drop in the unemployment rate was enough for markets to, rightly, infer a hawkish turn at the Fed. Similarly, we think the bar for a dovish reaction to today's numbers is high.

From the Fed, Mary Daly and Raphael Bostic will both have the opportunity to give their interpretation of the latest numbers. Markets will be most sensitive to any comment on Fed balance sheet reduction once the hiking cycle starts.

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