Rates Spark: No validation yet for rates to fall – means only one thing!

We continue to expect market rates to get lower in 2024, but let's take this one step at a time. Evidence is mounting for a step higher in market rates first. The eurozone economy remains a 3% inflation one and the angst level on the US labour market remains low. It's not all about that, but let's not jump the gun. Or if we have, just re-set a bit

US labour market data and eurozone inflation data not just in tune with rate cut optimism

Market rates continue to drift higher, and we feel that this process can continue in the weeks ahead. Markets are just not yet seeing enough from the macro data to validate the dramatic fall in market rates seen at the tail end of 2023. The key areas to watch are inflation data in the eurozone and labour market data in the US.

We had a smattering of German lander inflation data on Thursday that showed spikes in headline rates. We actually should not worry too much about this as it was mostly base-effect induced, and the monthly readings were in fact fine. If they get repeated in the months ahead, eurozone inflation does head for 2%. But the market was still spooked by the headline readings that are practically double 2% in many cases. The market has built an aggressive rate cut discount independent of any confirmatory bias by the European Central Bank, and we are still not at a point where it can conclusively be stated that the current ECB rate cut discount will be delivered, and certainly not at the pace inferred. At least not yet.

And then there is the US labour market. We'll know a bit more post the US payrolls report on Friday, but the claims data out on Thursday continue to point to a labour market that is far from collapsing into a materially weak stance. While it's true that the inflation reduction story is solid in the US, it still needs to be fully delivered, and that can still take some time. Moreover, it does not look like the labour market will act to accelerate the rate cut narrative. In fact, if anything, the rate reduction narrative has taken a step back through the first few days of 2024. The Fed minutes helped, but not a whole lot. Uncertain geo-politics have been more influential in keeping rates in check.

So a big question remains as we face into payrolls – can the outcome be soft enough to validate the markets interpretation of Chair Powell's 13 December press conference. The risk is high for a 'no' (more detail in the data section below).

The re-evolution of a negative 10yr term premium adds another twist, as long tenor rates have on that measure overshot to the downside in the past month or so. We still expect to see 3.5% on the 10yr as a call in 2024, but we fear a pull-back theme first. The 4% level is key. If the 10yr gets comfortable above that post payrolls, it could do some testing higher for a bit. At least until something really breaks.

Data on Friday and market views

From the eurozone on Friday, we get harmonised CPI data that is likely to show a re-acceleration in inflation to around 3% headline (up from 2.4%). But this is coming from a pure base effect, as the month-on-month increase is expected to be around 0.2%, which is far more tolerable. Core inflation is expected to ease down to around 3.4% (from 3.6%). Based off this we can conclude that the eurozone is a 3% inflation economy currently. So still some work to do. The big US focus is on payrolls Friday. The non-farm payrolls change is expected at 175k, the unemployment rate at 3.8% and average earnings at 3.9%. Even if this shows some creaking in the detail, in absolute terms, this is not a labour market in trouble. That will set the scene, but watch for durable orders data and ISM services too. No scare stories expected here, although the ex-transportation orders reading (an important lead indicator) is likely to run weak.

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