

## Rates Spark: Pressure at the extremities

The fair value number for the US 10yr yield is 4%, but we really need to see Friday's payrolls number first. The bond market is screaming at us that it'll be weak. But unless validated, the rally seen of late is vulnerable. Also be aware of front end pressure, although this was calmer yesterday



### Resumed inversion points to overshoot risk in the 10yr yield

An interesting aspect of the price action in the past couple of days has been the resumed inversion of the US curve. The front end is participating in the falling yields trend, but the 10yr benchmark is leading it. That can reflect an overshoot tendency in the 10yr. It is true that the JOLTS data showed a surprise drop in job openings, but that should have been just as capable of sparking a larger front end move, helping to dis-invert the curve. At the same time, such price action is consistent with a 2yr yield that does not yet see a rate cut as a front and centre event. Typically, the 2yr really gaps lower about three months before an actual cut. But in the meantime, it should be capable of keeping better pace with the falls in yield being seen in the 10yr.

While we are of the opinion that 4% is the structural fair value number for the 10yr (on the assumption that the funds rate targets 3% as the next low), we also feel that this market needs a weak payrolls number on Friday to validate the move seen in the 10yr yield from 5% all the way down to sub-4.2% in a matter of weeks. The fact remains that we have not seen either a labour market recession or a sub-trend jobs growth experience. At least not yet. The market is trading as if the 190k consensus expectation is wrong for Friday and that we're going to get something

considerably weaker. The JOLTS data supports this – as does the latest Fed Beige book. But we do need to see that report before we could even consider hitting 4% on the 10yr.

## Repo pressures ease, but still some cross-winds to monitor on money markets

At the other extreme of the curve, the elevation in repo rates seen at the end of November that had extended into Monday of this week had begun to ease back through Tuesday. The issue here is ultra front end market rates had come under upward pressure. Extra bills issuance has been a factor, as this has both taken liquidity from the system and placed upward pressure on bills rates generally. Repo is a function of the relatives between available collateral and available liquidity and at month-end, liquidity was tied up, and that pressured repo higher. The resumed build in volumes going back to the Fed on the reverse repo facility on Tuesday proves a reversion towards more normal conditions.

That said, SOFR remains elevated, and that will contribute to balances falling in the Fed's reverse repo facility as we progress through the coming weeks. If the market is showing a better rate than the 5.3% overnight at the Fed, that should take cash from the reverse repo facility. Interestingly there was a surprise jump in usage of the standing repo facility. Not large, but it shows that in some quarters there is at least some demand for liquidity. A bit early for this to become the dominant issue, but worth monitoring all the same.

### Today's events and market view

The JOLTS data highlighted the markets' sensitivity to any indications of a cooling US labour market. Ahead of Friday's payrolls report, markets will eye the ADP estimate. Given its poor track record of forecasting the official data, it is likely to take a larger surprise to move valuations – the consensus is looking for a 130k reading today after 113k last month. Other data and events to watch are the US trade data and, up north, the rate decision by the Bank of Canada.

On this side of the Atlantic, we will get eurozone retail sales and, in the UK, the Bank of England financial stability report.

In government bond primary markets, Italy is conducting an exchange auction. The UK sells £3bn in 10Y green gilts. The main focus over the coming days and weeks will be on governments' announcements regarding their issuance plans for next year.

## Author

### **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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