Rates Spark: Rolling the payrolls dice

It's payrolls Friday, again. Arguably the most influential number for markets. It sets the tone not just for Friday, but for the month ahead. Market rates continue to traverse 200k-plus payrolls outcomes and c.0.3% MoM inflation, a combo that keeps the rate-cut window shut. We remain tactically bearish until that window is forced open by the data

Payrolls on Friday to set the tone ahead of CPI next week

The market is primed for a headline payrolls outcome in the 200k area, north of that in fact. That's where it's been for the past three months. And it's averaged 250k through 2023 as a whole, so no material let-up in the jobs creation game. The key reference level is 150k. That's the replacement level. Anything above that is consistent with a tendency toward above trend growth. With a minimum 2% handle on growth and the same for inflation, we quickly hit 4% plus. That's where the 10yr Treasury yield is, at 4% plus – now in the 4.3% area. That's not more than 50bp above the terminal rate the market anticipates for the fund rate.

And 10yr SOFR is lower of course, in fact now back below 4%. There is not a whole lot of term premium priced in that. In fact, the Treasury term premium is running at -10bp, which means that the 10yr yield is nothing more than a manifestation of future interest rate expectations with zero compensation for being out the curve. The benefit in the 10yr is the price appreciation attainable on a rate-cut-driven bond market rally, effectively a 3-6 month window. Then it's best to get out.

The thing is, there is no imminent rate cut window where inflation continues to pop and the labour market refuses to lie down. And next week's CPI report is not likely to help a whole lot. That's why we remain tactically bearish on Treasuries, at least until that window properly opens.

Solid ECB expectations provide a front-end anchor for EUR rates

The short end of the euro swap curve traded sideways with market expectations of a June cut well anchored. Markets were unfazed by strong March PMIs from Spain and Italy, and also the final eurozone composite PMI coming in above 50 did little. Euro rates seem to be in a holding pattern for tenors up to 2 years, awaiting data from the US that could give some clarity about the Fed's next move. In our view the ECB does not have to wait for the Fed to cut rates in June and even beyond June the ECB can continue independently if inflation data maintains a downward trend. Having said that, there should be a reassessment of the pace of rate cuts with a move to a shallower path if the notion of the Fed delaying cuts gains traction.

The back end of the Bund curve is showing more movement with 10-year yields coming down 4bp on the day. This has come on the back of UST yields falling with slightly higher jobless claims. A spread of 200bp between 10y USTs and Bunds seems to be a level to watch and has already been broken on Wednesday intraday. With the 10y UST playing with the idea of 4.5%, it's hard to imagine euro rates will be untouched, but the UST-Bund widening theme may therefore have some more to go in the near term.

Friday's events and market view

The key release on Friday is the official US jobs report. The consensus is looking for a 214k number for private payrolls increase. The distribution of survey responses ranges from 145k to 290k. The unemployment rate is expected to inch down to 3.8%. There are also a number of Fed speakers to watch again, including the Fed's Collins, Barkin, Logan and Bowman. The eurozone we will see retail sales numbers being releases.

Some focus has shifted to rising geopolitical tensions in the Middle East. This has led to moderate flight to quality bid, but predominantly we are seeing the effect in oil prices where Brent has now risen above US$90/bbl. It can complicate the calculations for central banks, particularly the ECB which is assuming falling oil prices.

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