

Rates Spark: Unless the print is sub-150k, no change in tone

To abort the rise in Treasury yields, we'd need to see a print below 150k. Else onwards and upwards. In the UK, gilt yields stopped their steep ascent, but fiscal concerns remain a focal point of investors



To abort the rise in Treasury yields, we'd need to see a print below 150k. Else onwards and upwards

Given the move already in Treasuries, there is some talk that Friday's numbers will need to be strong to continue this momentum, and in that sense there is some vulnerability for a lower yield reaction to a consensus outcome. The counter is that the dominant driver of the rise in the US 10yr Treasury yield has been a downsizing in capacity for the Fed to cut rates. When the Fed first cut in September 2024, the December 2025 funds rate was discounted at 2.8%. Since then, that's risen to 3.9%, broadly equivalent to the 100bp move higher in the 10yr rate. Given that, we'd need an outright weak number to shake things up.

On the payrolls, it's averaged 180k per month through 2024 – and averaged 150k per month through the last four months of 2024. The number expected this month is within these parameters, and in consequence we doubt that delivery of say 165k (the consensus) will be

dramatically impactful for Treasuries. Part of the rationale for that indeed centres on next week's CPI data. Look at that data with your eyes squinted and you see the US as a 3% inflation economy. Inflation is clearly in better shape now, but has not gone away as an issue.

Since the Fed cut, the economy too has shown a degree of resilience. And the Trump election win has added a degree of oomph to the perception of the macro environment. His stated policies too are, if anything, likely to place upward pressure on prices. The latest FOMC dots reflect this, with some members openly accepting that potential Trump policies impacted their dot decision making.

Payrolls, as always, are a pivotal report. But we need to deviate materially from consensus to have an effect this time around.

Upward potential for gilt yields capped

The rise in GBP rates has come to a halt, but at 4.8% the 10Y gilt yield has settled at a significantly higher level compared to the 3.8% low from last year. Having said that, in November the 10Y stood at 4.6%, so not that much lower than today. The sharp rise in yields can partly be attributed to fiscal concerns but should be framed against significantly higher rates in both the US and eurozone. The 10Y UST yield is also some 100bp higher than September 2024.

The rise in gilt yields has a self-reinforcing feedback loop through the UK's debt sustainability, by increasing borrowing costs used for budgeting purposes. An earlier sensitivity analysis from the Office of Budget Responsibility suggests that the recent rise in rates, if sustained, would be enough to wipe out the government's estimated fiscal headroom of £9.9bn. After the recent developments in France and the US, markets seem to put more emphasis on such debt dynamics.

What markets may be underestimating is how higher rates also pass through to growth and inflation by tightening financial conditions. The Bank of England is now priced to cut rates by just 50bp this year, resulting in constraining Bank Rate of 4.25%. And the increase further out on the curve will hurt investment activity through lending rates. Lower growth and inflation should help bring rates down eventually, thereby capping the upward potential for gilt yields from here in our view.

Friday's events and market view

We'll first have industrial production figures from Spain and France, and then retail sales from Italy. But US payroll numbers will be the main attraction, together with the unemployment rate. Later we'll also see the Michigan sentiment indices, which are broadly expected to remain stable.

Author

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.