Burst bond Dam?

Is the latest bond yield surge the prelude to something more damaging?

Source: Niall Williams

Next stop....3.70%?

News headlines this morning led with the cancellation of the two-Korea talks due to start today following a US-Korean air-drill, which the N Koreans, perhaps reasonably, took offense at. This is a sensitive nation quick to take offense. Did no-one see this coming, seriously?

Stocks are off. The S&P 500 overnight gapped 0.7% lower, and Asian stocks and FX will likely follow suit this morning. But if this is a generalized risk-off situation developing, the combination of a stronger dollar (yes, that works) and weaker bonds (10Y US Treasury yields are now 3.07%) looks odd.

Yesterday we commented on the breaking of the 3.0% 10Y Treasury yield hurdle. Our consideration then was that this was best described as a 2bp move - nothing significant. But as today's moves have shown, they merely marked the start of a new trading range, where there is frankly no big psychological hurdle in sight. Looking back in history, the last significant peak in yields was in February 2011, when yields held up at about 3.70%-3.80%. Before then the yield

trend was predominantly downward, from much higher levels.

Why this is significant, is that if bonds are embarked on a journey to higher yields, then the recent outflows from troubled EM countries (Argentina, Turkey, Indonesia) could become even greater. This does not inevitably mean that it will turn into a full-blown EM rout, but it makes it easier for one to develop should conditions worsen and spook investors.

If there is one silver lining in this otherwise unhelpful development, it is that at least the yield curve has steepened a bit. That's one source of doom that looks a little less threatening this morning.

3.07%

US 10Y Treasury yield

It was 3.0% yesterday

US dataflow nothing wrong with that - Japan's disappointing...Europe?

Some headlines are reporting disappointment in US retail sales yesterday as a factor in the market's ructions, but this simply isn't fair. All the headline and core and control figures for retail sales were in line with expectations. Admittedly, I think they should have been higher in places as they should have been getting a tailwind from the rise in retail gasoline prices. But these on-target figures were also matched with upwards revisions to most areas last month. The market moves were simply not a US data-driven event.

Today though, we could see the data improve further. US Industrial production for April has to deal with the 13th coldest month on record since 1895. That's cold. That means more people leaving their thermostat's in their houses turned up. That means more electricity generated to provide that warmth. Other data may suffer. Housing starts and building permits will be negatively affected. Precipitation levels were about normal for April, but what fell, was more likely to have fallen as snow. Not good house building / buying weather.

Europe's data revolves around CPI for April, though final readings. We won't see if Europe's inflation backdrop has improved for a few more weeks yet. Otherwise, attention is focussed on the Italian political talks, with a Northern League / Five-Star (North-Star?) talks are said to be entering their final lap. Should we be worried about that? On the one hand - yes, this sounds like a potentially anti-EU, anti-establishment political development. On the other hand, was what went before it so good?

If you are looking for an economic scapegoat for market jitters, you need look no further than some frankly not very impressive Chinese figures yesterday, when we saw the release of all the major activity indicators for April, and there were downside misses for two out of the three main ones. Retail sales and fixed asset investment undershot both expectations and the previous month's growth rate. Some solace can be gleaned from better than expected industrial production, But not much. We'll be giving this some more thought over the next few days to see if we need to be more concerned about China's growth trends.

Data out of the APAC region's more troubled economies, Indonesia, Philippines and India, was

mostly bad yesterday with the Indonesian trade deficit in March blowing out to $1.6bn from $1.1bn in February. A rate hike form BI tomorrow is looking very likely, but we are concerned that this may not cap the decline in sentiment. Philippine remittance data was also much weaker than expected, down 9.8%YoY, against expectations for a 3.7% gain. India stands out with some better trade data.

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