U.S. TREASURIES: WAITING IN VAIN?

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02/08/2017

The U.S. Treasury (UST) market had a somewhat unusual confluence of potential risk events last week as it had to digest both an FOMC meeting and a monthly Employment Situation report all within a 48-hour trading window. As we now know, things turned out rather harmlessly, as both the outcome of the Federal Reserve (Fed) gathering and the jobs data did little to change investor sentiment. Although another rate hike, at a minimum, for 2017 certainly seems to be in the offing at some point later this year, last week's results have seemingly left the UST arena waiting in vain for some type of signal for when the next Fed move could occur.

Let's take a look at things in chronological order. First up: the FOMC meeting. As expected, the voting members left the Fed Funds target range unchanged following December's quarter-point increase. The language in the policy statement also did not offer any meaningful changes. In other words, there were no hints of preparing the money and bond markets for a potential rate hike at its next convocation, scheduled for the "ides of March," or March 15. Interestingly, if the Fed does wish to provide any insights on the timing of the next potential tightening move, chair Janet Yellen will have that opportunity February 14 and 15, when she is slated to give the Fed's semiannual monetary policy report before the Senate Banking Committee and then the House Financial Services Committee.

This brings us to the January jobs report. The underlying data gave a little something for everybody: better-than-expected job growth, without any hints of demand-induced wage pressures. To provide some perspective, total nonfarm payrolls rose by 227,000—not only the best performance since September, but also a visible improvement over the 148,000 average tally from the prior three months. Another positive aspect was that the civilian labor force rose by a hefty 584,000, pushing the participation rate up 0.2 percentage points (pp) accordingly. However, not every participant was able to find employment, and as a result, the jobless rate rose 0.1 pp to 4.8%. On the wage front, average hourly earnings rose by only a modest 3 cents, which dropped the annual rate of increase down to 2.5% from a downwardly revised gain of 2.8%.

Conclusion

As we noted in our January 11, 2017, blog post, "U.S. Treasuries: The Fed 'Wage'rs a Bet", the UST market's focus now seems to put wages first, job creation second, especially in the context of what the Fed is looking at. With respect to the inflation aspect of their dual mandate, the jobs report offered Treasuries a nice elixir: an increase in the jobless rate combined with reduced wage pressures, despite a solid gain in payrolls. In addition, other inflation-related data that has been recently released—a slowing in both the core PCE and Employment Cost Indexes—gives the Fed more leeway to wait and see how fiscal policy develops this year without having to act pre-emptively. In fact, last week, Speaker of the House Paul Ryan stated that any tax reform or tax cut legislation may have to wait until spring before being taken up by the lower chamber, potentially pushing the timing out further for the Fed's next move. Against this type of backdrop, the UST 10-Year yield appears more than likely to trade in its newfound, post-December rate hike range of 2.30% to 2.60%,[1] barring any unforeseen developments.

Unless otherwise noted, all data is from Bureau of Labor Statistics as of February 3, 2017.

[1]Source: Bloomberg, as of 2/3/17.

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DEFINITIONS

Treasury : Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

Federal Open Market Committee (FOMC) : The branch of the Federal Reserve Board that determines the direction of monetary policy.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Rate Hike : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Federal Funds Rate : The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the “policy rate” of the U.S. Federal Reserve.

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Personal Consumption Expenditure (PCE) Price Index : measure of price changes in consumer goods and services in the U.S. economy.