CIMB preferred

13 September 2024 **Fixed Income**

US Fixed Income Strategy: Market Implications of August NFP and CPI Data

Summary

- The August Nonfarm Payrolls (NFP) and Consumer Price Index (CPI) reports did not provide the definitive evidence of a worsening US economic slowdown.
- Consequently, the market's reaction was mixed, leading to a revision of its aggressive rate cut expectations to 25 basis points at the upcoming September FOMC meeting.
- Despite short-term uncertainties, our target exit levels are maintained at 3.50% for the 10-year US Treasury and 3.80% for the 30-year US Treasury by the end of 2025, as the medium-term trajectory remains intact.
- The optimal strategy is to adopt a long-term perspective and hold fixed income investments throughout the anticipated Fed easing cycle to maximize returns.

Key Message

Conflicting signals from the latest US CPI data

Wednesday night's US CPI report for August largely met expectations, with headline inflation easing to 2.5% YoY from 2.9%, while core inflation remained steady at 3.2% YoY. The market's reaction was mixed; although consumer prices declined across various products, core services inflation, particularly in the rental sector, remained elevated and even saw a slight uptick.

Latest economic data do not justify aggressive policy measures

When combined with last week's NFP report, the CPI data suggests that the Federal Reserve might adopt a more gradual approach rather than the aggressive rate cuts anticipated by the market. The NFP report highlighted a deceleration in employment growth and significant downward revisions to prior months' figures, alongside a slight decrease in the unemployment rate and a marginal increase in average hourly earnings. Both the NFP and CPI readings do not support a 50bps cut at the September meeting or the extensive cuts the market had hoped for.

The bet for 50bps cut in September is now off

This sentiment is reflected in the Fed Funds Futures market, which has now scaled back its September rate cut expectation to 25bps from 50bps. While the actual trajectory of rate cuts remains uncertain, it's noteworthy that the expected 1-year rate at the end of 2025 is around 2.75%, two years ahead of the Fed's projected timeline of 2027 – suggesting that between the market and Fed, something has got to give.

Maintaining our target exit levels

A further reduction in rate cut expectations could potentially raise UST yields in the near term. However, our target exit levels remain unchanged at 3.50% for the 10-year UST and 3.80% for the 30-year UST by the end of 2025, as the medium term trajectory remains intact.

Volatility in the UST market is expected to remain elevated in the short term as the market seeks corroborative evidence of a worsening US economic slowdown. The optimal strategy is to adopt a long-term perspective and hold your fixed income investments throughout the anticipated Fed easing cycle to maximize returns.

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