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United States: Data-dependent discomfort

■ **Recent indicators point towards ongoing strong US growth** ■ **The non-manufacturing ISM index has caused a jump in treasury yields: data-dependent forward guidance implies that investors expect the Fed will not remain passive when data are particularly strong** ■ **Growth outside the US is slowing yet higher US yields have been mimicked across the globe** ■ **The dollar has also strengthened which is unwelcome news for corporates in developing economies which carry a lot of debt in USD**

Research on what determines the reaction of bond markets to economic news, i.e. to data releases which differ from the consensus forecasts, shows that three aspects matter: relevance (the relationship to the economic drivers of bond yields), timeliness (data gathering is quickly followed by the publication of the results) and robustness (limited or no subsequent revisions). This makes the first week of the month so important with the publication in the US of the ISM manufacturing and non-manufacturing indices as well as the labour market data. All three score very high on the three characteristics although the non-farm payrolls sometimes see large revisions.

This week's data point towards ongoing strong growth in September. Despite a decrease of 1.5 percentage points to 59.8 percent, the ISM manufacturing index remains at a high level. Job creation came in well below expectations (134.000 versus 185.000) but there was a big upward revision of the previous data (+87.000) so all in all the labour market remains strong. The big event this week however was the ISM non-manufacturing index which jumped 3.1 percentage points to a record level of 61.6 (the index was launched in 2008). Treasury yields saw a big intraday rise (chart 1), the yield curve steepened and the dollar rallied (chart 2). Bond investors may have been surprised by the big increase in the non-manufacturing index, all the more so considering that the manufacturing index had declined. However, chart 3 shows there is no clear relationship between the relative change of both indices and the change in the 10 year yield on the release date of the non-manufacturing index. Positive comments of Fed chairman Powell may also have contributed to the movement which continued on Thursday.

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INTRADAY EVOLUTION OF US TREASURY BOND YIELDS AND EUR/USD

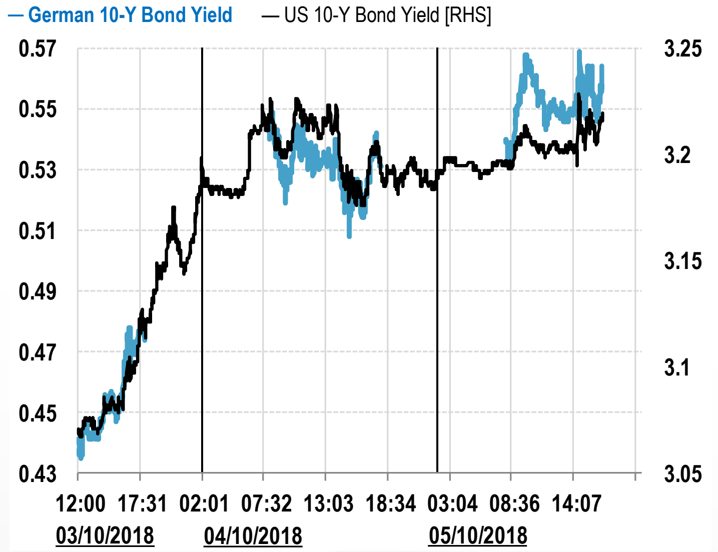

Chart 1 Source: Bloomberg, BNP Paribas.

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The jump in bond yields shows the inherently unstable equilibrium of the current market environment, a situation which can be traced back to the data-dependent forward guidance of the Fed in combination with the inertia of inflation despite an ever tighter labour market.

At some point doubts creep in whether inflation can remain as low (yields have been on a rising trend for months now) and one very strong economic release is sufficient to trigger expectations that the tightening cycle may last longer than expected (hence the steepening of the yield curve this week): when policy is data-dependent, strong data should end up forcing a change in policy. The ensuing market discomfort stretches well beyond the US, all the more so because the global economy is slowing. This makes the rise in treasury yields which was mimicked by bond markets across the globe most unwelcome. The stronger dollar makes things even more painful for many corporates in developing economies carrying a lot of USD debt.

William De Vijlder

INTRADAY EVOLUTION OF EUR/USD

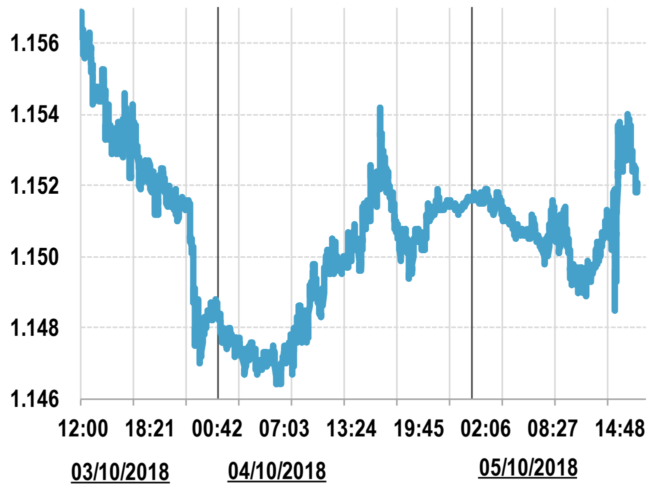
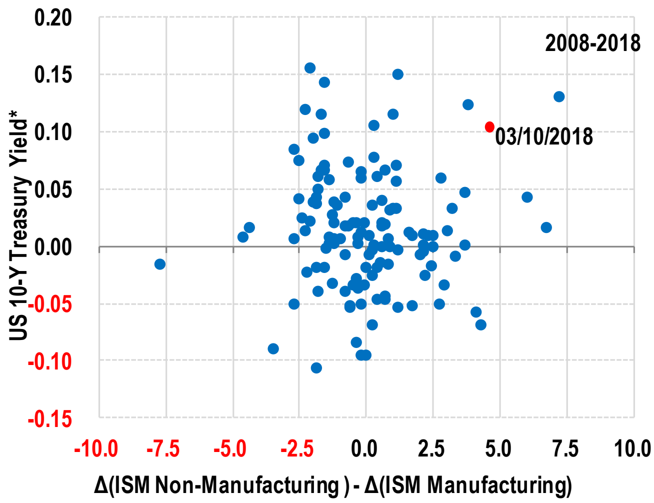


Chart 2 Source: Bloomberg, BNP Paribas.

CHANGE IN ISM NON-MANUFACTURING VERSUS MANUFACTURING AND CHANGE IN BOND YIELD



* daily change at release date for the ISM non-manufacturing

Chart 3 Source: ISM, Thomson Reuters, BNP Paribas