

Daily Closing Comment | Treasury Takes Issue with Issuance

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US Treasury Comments

- The Q4 refunding announcement today revealed Treasury would look to reduce issuance due to an improving fiscal outlook, but was reluctant to reduce Bill auctions since they only represented 11% of marketable debt outstanding. Instead, Treasury would cut next week's 3yr auction by \$1 bn to \$26 bn, and may look to cut the 2yr auction by \$1 bn as well. The size and pace of reductions will depend on the extent of the fiscal improvement, but these new auctions sizes would be kept steady through Q1 2015 if the TBAC's recommendations are accepted. Regarding the potential for higher cash balances, Treasury already announced on Monday that it would target a \$200 bn cash balance for the end of the year, but will continue to analyze the TBAC's recommendation to hold a \$500 bn cash balance. The higher cash balance will be achieved mostly with higher Bill issuance, but "Treasury's ability to run higher cash balances in FY 2015... may be somewhat constrained by debt limit considerations."
- Lower short term coupon issuance could provide some steepening bias into the curve and supports our preference for swap spread wideners into year end. UST 2s10s and UST 10s30s steepened marginally today to stay right on top of supports at 182 bp and 71 bp, respectively. With domestic data still upbeat, we expect the flattening trend to return over the medium term, with today's employment numbers indicating continued labor market improvement.
- In 10 of the past 12 months, the ADP report correctly predicted the direction of surprise in the NFP report (*see our chart*). The magnitude of the surprise has not been very consistent, but the 10k surprise in today's ADP report suggests the possibility of a positive surprise to the consensus 235k NFP forecast. Similarly, since November 2001, the Employment component in the ISM Non-Manufacturing survey has an 85.8% the correlation with NFP. Today's 59.6 reading is a 9yr high and corresponds to a 390k NFP print (*see our chart*). Our official economics call is for a more tempered 240k, though market expectations are certainly biased upwards.
- We don't expect any major policy changes at tomorrow's ECB meeting (policy release at 7:45 am EST and Draghi press conference at 8:30 am EST), but we could be due for some additional information on the ECB's bond buying plans with ABS purchases set to begin this month.

US Treasury Technicals

	Last	Change	Support	Resistance	Comments
2y	0.526	0.014	0.53	0.44	Weekly trend channel resistance at 38 bp managed to hold despite a daily break below. Yields are now firmly back in the middle of the bearish channel in place since the start of the year, with daily and weekly momentum neutral.
5y	1.634	0.010	1.68	1.61	Weekly momentum readings remain neutral, and 5yr yields are moving back into the 1.54-1.82% range that held through September. Yields retraced their mid-October rally and broke through some stiffer support at 1.61%, with 1.68% the next support level.
10y	2.350	0.016	2.42	2.30	10yr yields have drifted back into the middle of the weekly bullish channel in place since the start of the year, with support at 2.30% becoming resistance. Daily and weekly momentum readings are more neutral over the past week. We see 2.42% as a strong support level that marks the top of our expected medium-term rate range.
30y	3.065	0.017	3.08	3.00	The late August low yields failed to provide resistance as the curve bull flattened into supply. Weekly trend resistance at 2.91% held up as yields bounced off recent lows after the 30yr TIPS auction.
2s10s	182.090	0.295	182	192	Post September ECB and FOMC, the UST 2s10s steepened to resistance at 206 bp before moving back into the flattening trend channel from February 2014. The late August flats of 182 bp are support, with 175 bp below.
10s30s	71.314	0.057	71	77	The H2 2009 flats of 71 bp were broken over the past few weeks and is now back in line as support as the October FOMC statement brought bear flattening back into fashion.

Source: BMO CM, Bloomberg

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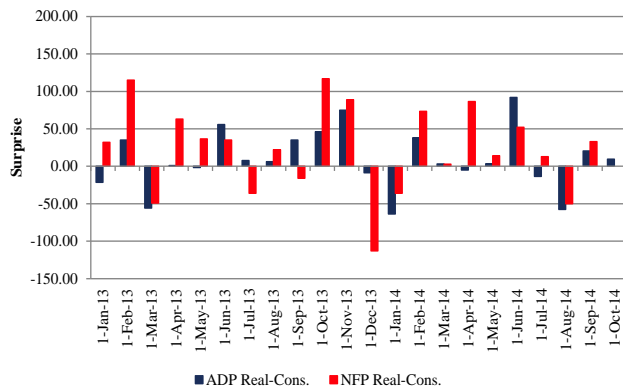
Treasury Auctions

- No Treasury auctions.

Economics

- ADP Employment Change was 230k in October, beating estimates of 220k and up from September's 225k (originally 213k).
- Markit Services PMI was in line with expectations of 57.1 for the final October print, down from earlier 57.3. The Markit Composite PMI level ticked down to 57.2 from 57.4.
- ISM Non-Manufacturing Composite declined to 57.1 in October, lower than estimates of 58.0. Components of the index remained strong, though mostly down slightly from September levels. Employment, however, rose to a 9yr high of 59.6 from 58.5.

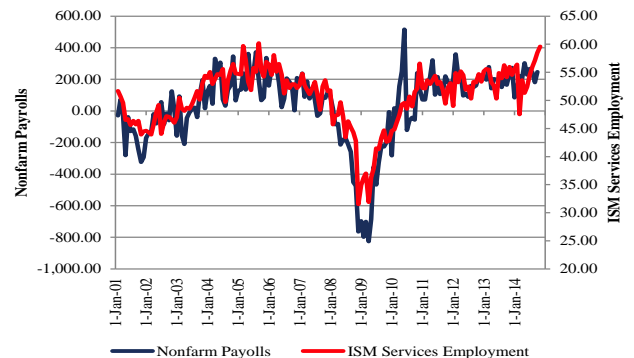
Figure 1: Surprise in ADP vs Surprise in NFP



Source: BMO CM, Bloomberg

- In 10 of the past 12 months, the ADP report correctly predicted the direction of surprise in the NFP report.
- The magnitude of the surprise has not been very consistent, but the 10k surprise in today's ADP report suggests the possibility of a positive surprise to the consensus 235k NFP forecast.

Figure 2: ISM Non-Manufacturing Employment vs Nonfarm Payrolls



Source: BMO CM, Bloomberg

- Since November 2001, the Employment component in the ISM Non-Manufacturing survey has an 85.8% the correlation with NFP. Today's 59.6 reading is a 9yr high and corresponds to a 390k NFP print on a linear regression.
- Our official economics call is for a more tempered 240k, though market expectations are certainly biased upwards.

Fixed Income Strategy Market Update

Global Fixed Income Strategy



A daily focus on fixed income markets, trends, and trades

November 5, 2014

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