Fixed Income Market Insights

May 11, 2023

Key takeaways

Bond yields were higher this week, with GT2s up 11 basis points and GT10s higher by 1 basis point respectively and 2s/10s more inverted by 10 basis points (-51), driven by still-robust payroll gains and sticky core inflation. On the data front, headline Non-Farm Payrolls again came in stronger than expected with 253,000 new jobs added in April, driven by persistent gains in services employment, including durable strength in leisure and hospitality, healthcare, professional/business services and government. The NFIB Small Business Optimism index, which surveys hundreds of small businesses across a range of issues, again edged lower to 89 during April, breaching the pandemic-era nadir (89.5 June 2022) to the lowest level since 2013, as elevated inflation, high interest rates labor and softening business expectations continue to weaken sentiment. Headline CPI rose +.4% during April and up 4.9% over the past year, the first sub-5% annual gain since April 2021, as a rebound in core goods and energy was dampened by another month of tepid advances in services and food/beverage prices. Headline PPI again came in weaker than expected during April with prices up +.2%, driven by an uptick in services and more muted gains in goods prices given recent the recent trends of lower commodities costs and improving supply chains and logistics.

We suggest

We continue to prefer playing rate defense given elevated inflationary expectations and ongoing FOMC rate hikes. We favor barbell strategies in securitized products, anchored by short, higher current cash flow assets and longer, high quality bonds.

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SLOOS in the News

As market participants continue to assess the potential fallout from this year's bank failures, the Federal Reserve's Senior Loan Officer Opinion Survey (SLOOS) released earlier this week revealed additional tightening of credit conditions and, more importantly, a sharp contraction in the demand for loans as businesses scale back growth plans in the face of slowing demand and worsening economic outlook. According the latest SLOOS, which measured bank lending practices and business sentiment at the end of the first quarter, 46% of banks tightened credit for commercial and industrial (C&I) loans in the first quarter for large and small businesses, the highest share since the third quarter of 2020. While this was only a modest increase from the fourth quarter given already-tighter credit standards driven by 500 basis points of FOMC rate hikes, early data for the second quarter suggests even further tightening, as the National Association of Credit Management April index revealed that "approvals of new credit plummeted and is now well into contraction territory."

Market Snapshot

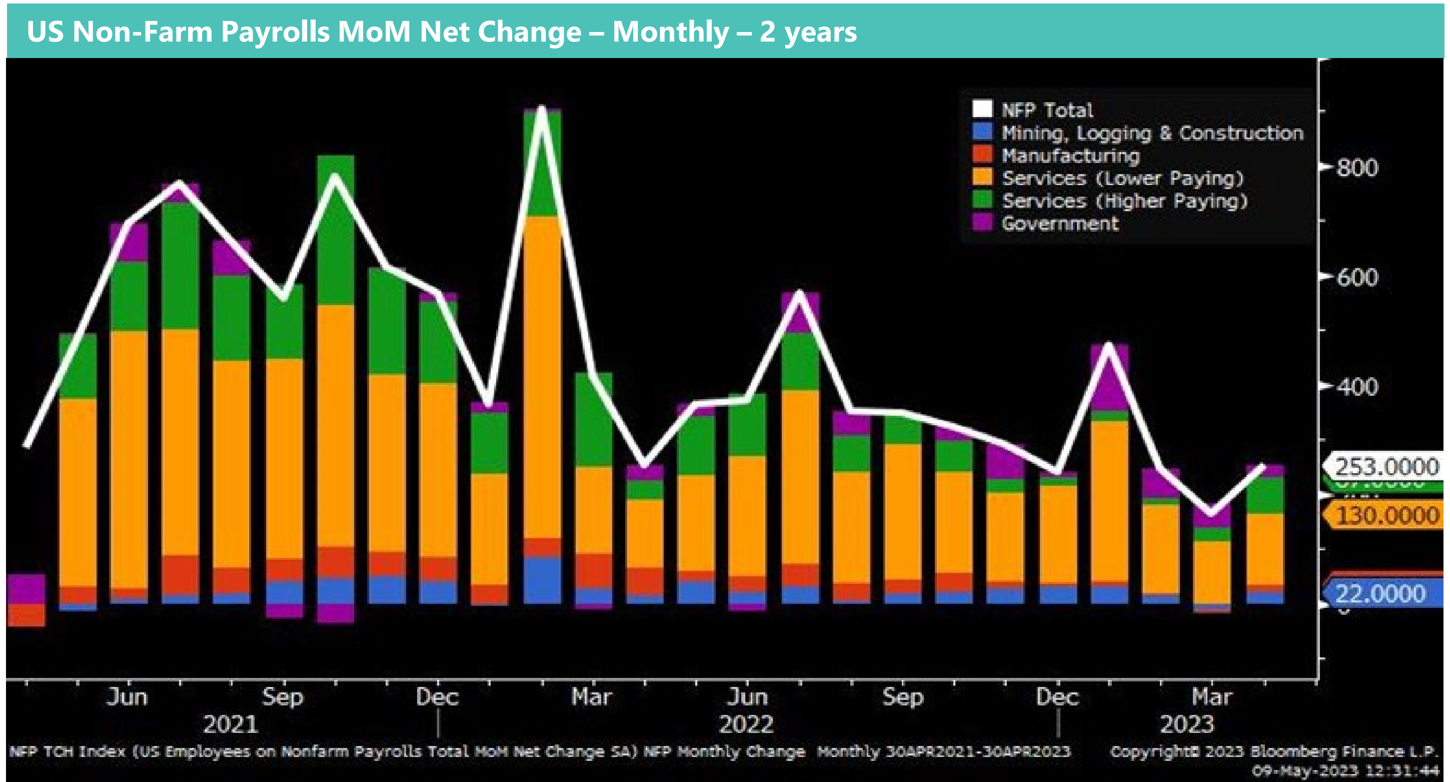
	This week 5/11/23	Last week 5/04/23	Basis Points Change	Weekly % Change	YTD % Change
3-month USD Libor	5.34%	5.33%	1	0.19%	11.95%
SOFR	5.05%	5.06%	-1	-0.20%	17.44%
2-year US Treasury	3.90%	3.79%	11	2.90%	-11.96%
5-year US Treasury	3.36%	3.33%	3	0.90%	-16.21%
10-yr US Treasury	3.39%	3.38%	1	0.30%	-12.63%
2s-10s UST Spread	-51.00	-41.00	-10.00	24.39%	-7.27%
DJIA	33,310	33,128	182.00	0.55%	0.49%
S&P 500	4,131	4,061	70.00	1.72%	7.58%
Spot Gold	2,021	2,056	-35.00	-1.70%	10.68%
WTI (Oil) Current Contract	70.87	68.56	2.31	3.37%	-11.70%
1-year Brokered CD	5.10%	5.10%	0	0.00%	10.87%
5-year Brokered CD	4.50%	4.50%	0	0.00%	12.50%
5-year Bullet US Agency	3.50%	3.50%	0	0.00%	-14.22%
5-year/NC1yr Callable US Agcy.	4.95%	4.91%	4	0.81%	-8.33%
CDX IG Spread Index	80.92	80.83	0.09	0.11%	-1.34%
CDX High Yield Index Spread	100.12	99.69	0.43	0.43%	-0.50%
15-yr UMBS	4.48%	4.47%	1	0.22%	-3.86%
30-yr UMBS	5.00%	4.95%	5	1.01%	-6.19%

Source: Bloomberg data as of 5:00pm ET 5/11/2023 and 5:00pm ET 5/4/2023

This is consistent with the SLOOS survey, which stated that "Banks most frequently cited an expected deterioration in the credit quality of their loan portfolios and in customers' collateral values, a reduction in risk tolerance, and concerns about bank funding costs, bank liquidity position, and deposit outflows as reasons for expecting to tighten lending standards over the rest of 2023," and that "Mid-sized banks reported concerns about their liquidity positions, deposit outflows, and funding costs more frequently than the largest banks." While lending standards have tightened across all loan types, lenders are particularly concerned about deteriorating credit quality across commercial real estate (CRE) loan exposures given historically low office occupancy, excess supply and the mountain of loan maturities over the next three years, with refinance rates significantly higher versus pre-FOMC rate hike originations. Given these higher rates and weaker business sentiment, banks reported record low demand for a myriad of CRE loans, from land development to completed Multifamily projects, further fueling concerns for a more protracted economic downturn during the balance of 2023. While the extent of further deterioration of loan demand and additional credit tightening can vary by business and region, suffice it to say that the aggregate data point to tighter loan terms and less demand across all loan categories for the balance of this year and likely into 2024, adding stress to an already-taxed economic landscape battered by higher interest rates and still-elevated inflation. Stay tuned!

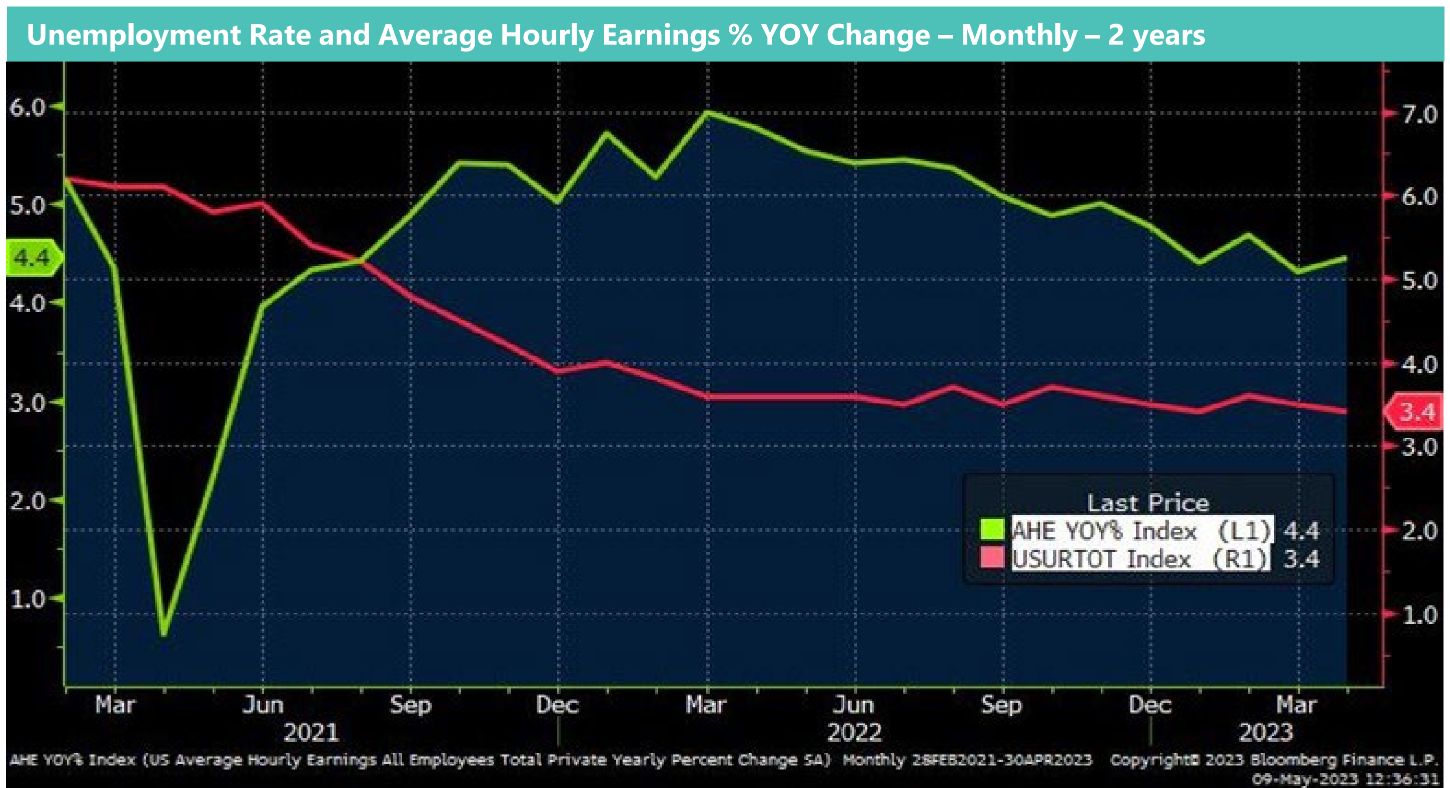
The debt ceiling public relations battle has begun with the passage of a House bill last week and little official progress post a May 9th meeting with the President and congressional leadership. To recap, the House of Representatives narrowly passed (217-215) a bill last week that increased the debt ceiling by $1.5 trillion in exchange for a package of spending reductions. While the bill in current form continues to be publicly panned by Senate democrats and the President, its passage by the Republican-led House appears to have forced behind the scenes negotiation and portends more politically charged debate in the weeks to come. Also, look for more debate regarding additional bank regulation in the wake of the SVB/SBNY/FRBK failures, with public hearings coming to a theater near you.

US Non-Farm Payrolls MoM Net Change – Monthly – 2 years



Source: Bloomberg as of 5/11/2023

Unemployment Rate and Average Hourly Earnings % YOY Change – Monthly – 2 years



Source: Bloomberg as of 5/11/2023

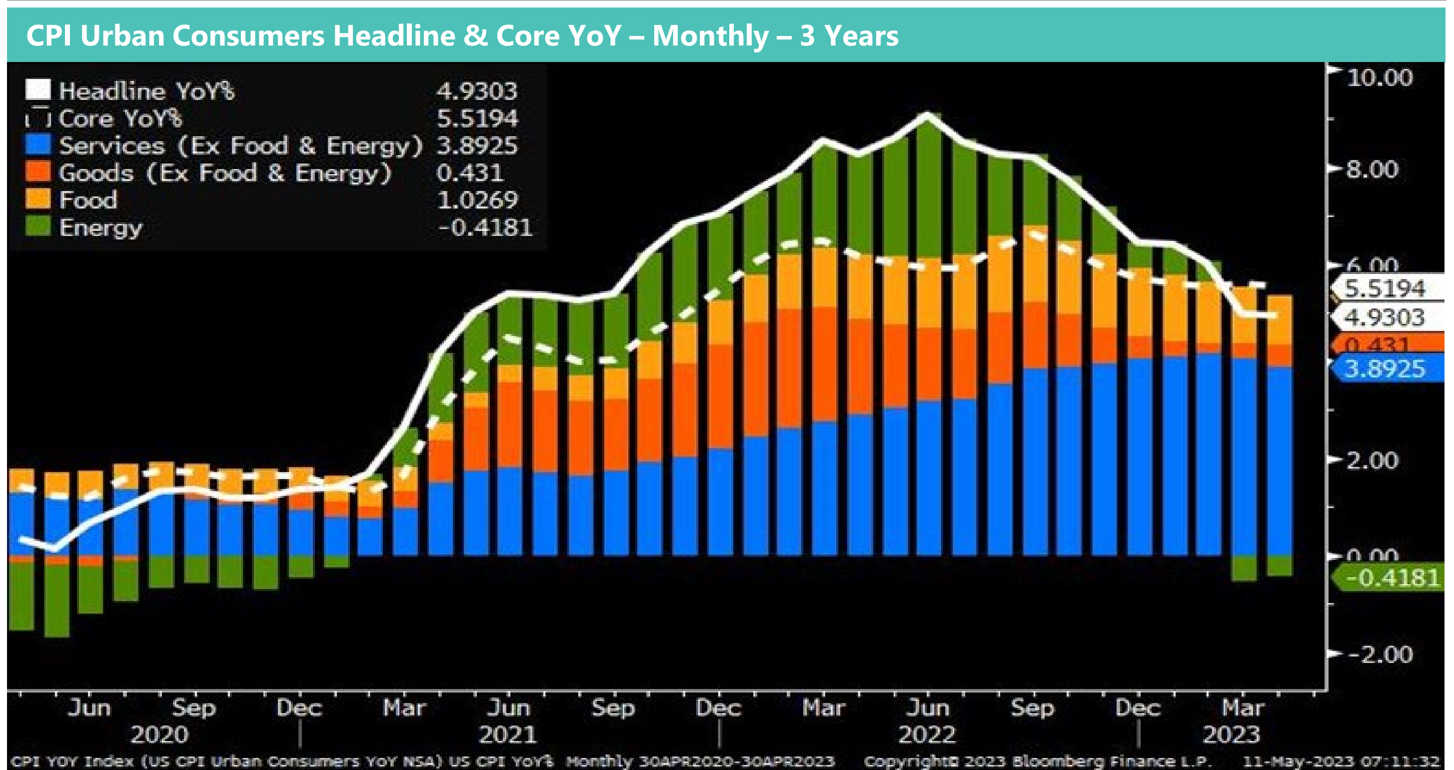
Headline Non-Farm Payrolls again came in stronger than expected with 253,000 new jobs added in April (185,000 est.), driven by persistent gains in services employment, including durable strength in leisure and hospitality, healthcare, professional/business services and government. Taken together with revisions that subtracted 149,000 jobs in the prior two months, job creation remains healthy with average monthly gains of 222,000 during the last ninety days, a deceleration from the fourth quarter's 291,000 pace (vs. 423,000 Q3 2022). Looking by industry revealed broad based strength, led by gains in education/health (+77k), professional/business services (+43k), leisure and hospitality (+31k) and government (+23k), which were partially offset by reductions in temporary help (-23k) and wholesale trade (-2k). Beyond the headline number, the big takeaways were the large, downward revisions to job gains reported during February and March (-149,000) and the reacceleration of average hourly earnings (+.5% vs. +.3% Mar./+4.4% YOY vs. 4.2% YOY Mar.), mixed news for the FOMC given the persistent tightness of labor markets and durability of elevated, nominal wage gains post pandemic. Regarding the labor market, last week's JOLTS job openings (9.6 million), the number of available positions per unemployed worker (1.6) and quits rate (2.5% or 3.9 million jobs) remain historically high, suggesting that wage inflation will remain elevated in the months to come. Additionally, labor participation remains nearly a percentage point lower than the 2019, pre-pandemic high as elevated retirement rates, skill mismatches and increased entrepreneurship have dampened employer efforts to fill millions of job openings. This lower participation has driven down the unemployment rate to 3.4%, matching January's cycle low of 3.4% (lowest since 1969) and supported elevated average hourly earnings (4.4% YOY), both conditions expected to persist in the near term. All in all, another solid employment report that revealed little fallout from recent banking sector duress and the durability of nominal wage gains, with some silver linings regarding downward revisions to previous months' payroll gains and slower pace of job creation versus the fourth quarter of last year.

NFIB Small Business Optimism – Monthly – 2 Years

Source: Bloomberg as of 5/11/2023

The NFIB Small Business Optimism index, which surveys hundreds of small businesses across a range of issues, again edged lower to 89 during April (89.7 est.; 90.1 Mar.), breaching the pandemic-era nadir (89.5 June 2022) to the lowest level since 2013, as elevated inflation, high interest rates labor and softening business expectations continue to weaken sentiment. On the inflation front, 23% of respondents reported that inflation was their most significant business problem, down from 24% last month and shy of last July's cycle high 37% print (highest since 1979), but still historically elevated and indicative of the chronic nature of inflationary pressures afflicting small businesses. For the first time during the post pandemic era, labor quality was cited as the top business problem at 24%, edging out inflation and reflective of elevated labor market friction as employers struggle to find qualified applicants for a myriad of open positions. Additionally, a full 45% of small businesses said they had unfilled job openings (51% record high; May 2022) and 40% stated they have increased compensation over the last three months to recruit new workers as chronically tight labor markets continue to add to wage pressures. As with other elevated input costs, higher labor expenses are being passed along to customers with 33% of the small businesses surveyed stating that they anticipate higher selling prices, a reduction from last March's all-time high of 66% (1974 inception) and the lowest share since March 2021, but still historically high. The combination of still steamy inflation and durable labor shortages have dampened optimism, with businesses expecting better economic conditions over the next six months fell to a year-to-date low of -49% last month (versus -38% pandemic low), an improvement versus last June's -61% cycle low, but still historically anemic. Indeed, the NFIB chief economist stated that "Optimism is not improving on Main Street as more owners struggle with finding qualified workers for their open positions," and "Inflation remains a top concern for small businesses but is showing signs of easing." All in all, chronic weakness in small business optimism squares with consumer sentiment data and underscores weakening economic expectations, mounting concerns regarding a meaningful credit contraction on the heels of SVB/SBNY/FRBK bank failures and durably elevated inflation expectations.

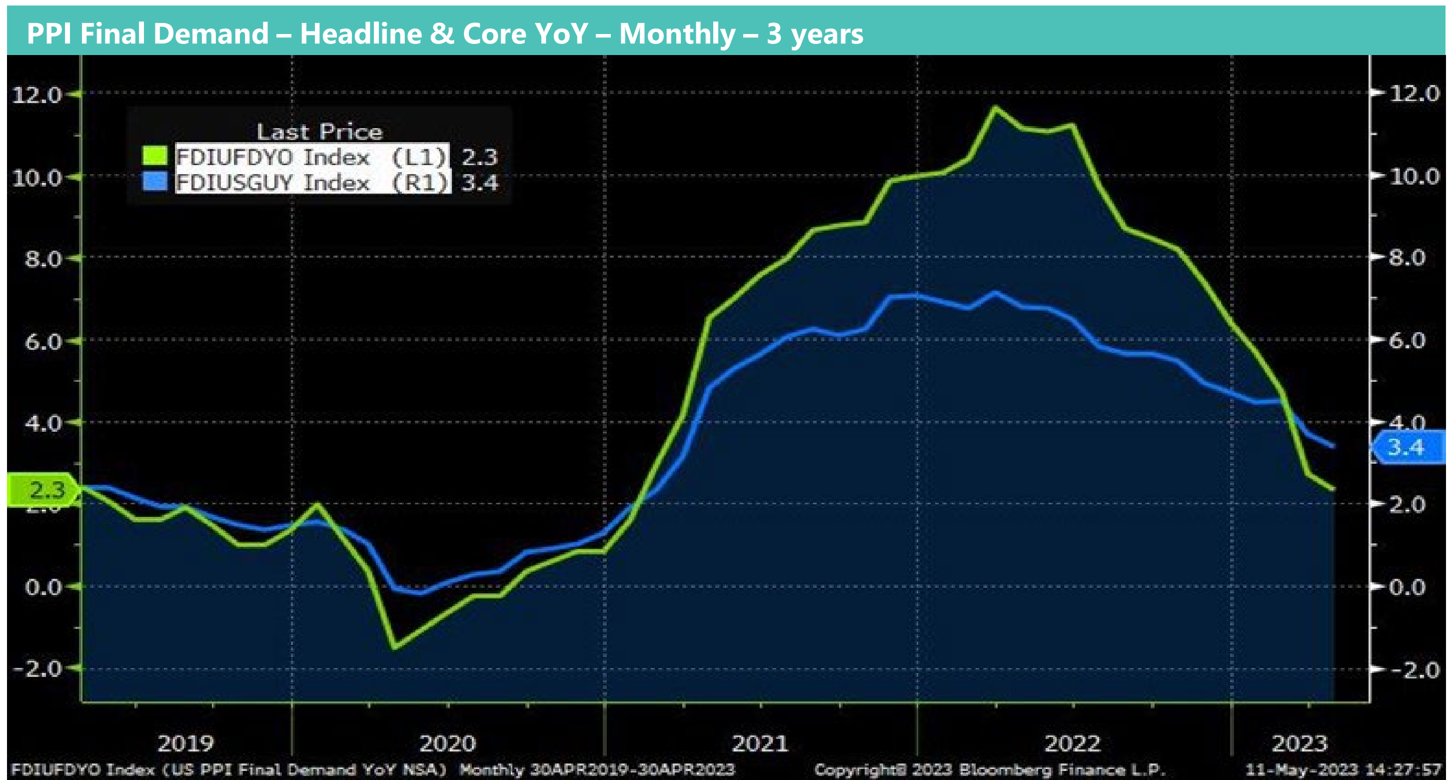
CPI Urban Consumers Headline & Core YoY – Monthly – 3 Years



Source: Bloomberg as of 5/11/2023

Headline CPI rose +.4% (+.4% est.) during April and up 4.9% over the past year (+5.0% est.), the first sub-5% annual gain since April 2021, as a rebound in core goods and energy was dampened by another month of tepid advances in services and food/beverage prices. Core CPI (less food and energy) was up +.4% (+.4% est.) in April and 5.5% (+5.5% est./+5.6% Mar.) over the past 12 months, a moderation from September's year-over-year cycle high (6.6%; highest since 1982), but historically high and indicative of the durable nature of inflationary pressures across both services and selected goods. Indeed, the breadth of price gains remains problematic, with 59.9% of index components up by more than 4% on an annualized basis, down from 66.1% in March (64.2% Feb.) and nearly double the pre-pandemic run rate. From a contribution standpoint, core goods were up +.6% in April, the largest monthly gain since June 2022, driven by a 4.4% jump in used car prices (worth +.14% Headline), services were up +.2% in April and 6.8% from a year ago, just shy of January's cycle high (7.6%/30yr High), driven by a +.5% gain in shelter (worth +14% Headline), which were partially offset by lower prices for utilities, new cars and airline fares. Drilling down into headline CPI components, prices were mixed, with the largest gains seen in used cars (+4.4%), gasoline (+3.0%), motor vehicle insurance (+1.4%), rents (+.6%), which were partially offset by flat food prices and declines in airfares (-2.6%), energy services (-1.7%), and new cars (-.2%). Additionally, real estate prices remain high, with values at or close to record levels in many parts of the country, driving another increase in owner's equivalent rent during April (+.5%; +8.1% year over year), fractionally higher than February's record high, 8% annual advance. Given that inflation expectations are closely tied to food, energy and shelter costs, the durable nature of elevated prices across these aggregates has unmoored near-term, consumer expectations away from the FOMC's 2% target, a key consideration for policymakers and supportive of the FOMC's stance of 'higher for longer' regarding short term interest rates. All in all, the breadth of inflationary pressures remains broad-based, particularly in shelter and other services, with a potential silver lining observed in owners' equivalent rent, a lagging indicator given the slow process of lower spot rents bleeding into price data, which rose at the slowest pace since April 2022 last month (+.5%).

PPI Final Demand – Headline & Core YoY – Monthly – 3 years



Source: Bloomberg as of 5/11/2023

Headline PPI again came in weaker than expected during April with prices up +.2% (+.3% est.; +2.3% last 12 months), driven by an uptick in services and more muted gains in goods prices given recent the recent trends of lower commodities costs and improving supply chains and logistics. In the aggregate, both goods and services prices were higher last month, with goods up +.2% (+.8% year over year/-1.0% Mar.), and services higher by +.3% (+3.0% year over year/-.1% Mar.), continuing the trend of headline PPI disinflation that started last December and driving expectations for a durable easing of wholesale prices. From a contribution standpoint, nearly 80% of the increase in Headline prices was driven by the +.3% jump in services, the largest monthly gain since November 2022, with the remainder due to higher goods prices, due largely to an 8.4% increase in gasoline prices, which more than offset another decline in food costs. Core PPI (less food, energy and trade) also came in weaker than expected with prices up +.2% last month (+.3 est.; +3.4% last 12 months), well off March's 9.7% cycle high and reflective of base effects, but still indicative of elevated inflationary pressures away from food and energy. As with much of the past two years, the persistence of these cost increases has enabled businesses to raise prices, which have been passed along to consumers and served to keep inflation expectations elevated above the FOMC's stated target of 2%. As reported in the NFIB Small Business Optimism index this week, more than 33% (all-time high of 66 in March 2022) of small businesses surveyed stated that they raised selling prices last month and 40% of respondents said they raised compensation to attract and retain employees, both likely to add to pricing pressures in the months to come. That said, easing supply chain bottlenecks and cooler goods demand have dampened the cost of processed goods for intermediate demand, reflecting prices earlier in the production pipeline, which fell -.4% in April (-3.2% last twelve months; -.9% Mar.), the ninth contraction in ten months and driven by a -4.1% drop in diesel fuel and broad-based declines across other energy and food components. All in all, a weaker report than expected as lower food prices and declining transportation costs weighed down strength in other services and last month's rebound in gasoline prices.

The Week Ahead

The data calendar slows over the next week, headlined by University of Michigan Consumer Sentiment, Retail Sales and Existing Home Sales. Looking ahead, markets remain focused on inflation, employment data and more signs of weaker economic activity. On the new issue front, ABS volumes ramped up during the second week of May, with 10 deals totaling $7.9 billion priced through the 11th and $97.6 billion year to date ($117.8 billion over same period last year; $276.7 billion for 2022) and IG corporate issuance was again robust with $33.4 billion priced as of the 11th and $524 billion year to date ($619.8 billion over same period last year; $1.26 trillion for 2022). While new issue supply slowed last year given FOMC rate hikes and elevated volatility, market conditions have generally improved for much of 2023 and the new deal landscape remains favorable for a wider spectrum of ABS and corporate issuers as investor demand remains strong.

Friday 5/12
UM Consumer Sentiment

Monday 5/15
Empire Manufacturing

Tuesday 5/16
Retail Sales; Industrial Production

Wednesday 5/17
Housing Starts

Thursday 5/18
Weekly Jobless Claims; Existing Home Sales; Leading Economic Indicators

About the author

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As a fixed income trader with more than 25 years of experience, David Petrosinelli brings deep knowledge and unique perspectives to InspereX's clients. His background includes sales and trading of mortgage-backed securities, commercial mortgage-backed securities, asset-backed securities, collateralized loan obligations, and collateralized mortgage obligations. Before joining InspereX (formerly known as Incapital) in 2020, he served as a Managing Director at Brean Capital and previously held various positions with Piper Sandler Companies and Shay Asset Management. David closely monitors underlying trends within the bond markets and how those markets are shaped by both American policymakers and the global macro economy. He earned a bachelor's degree in accounting and finance from Northeastern University and an MBA in economics and finance from Loyola University Chicago. He is a CFA Charterholder and holds FINRA Series 7 and 63 licenses. He is based in New York City.

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