Fixed Income Market Insights

April 13, 2023

Key takeaways

Bond yields were higher this week, with GT2s up 15 basis points and GT10s higher by 15 basis points respectively and 2s/10s unchanged (-52), driven by still-robust payroll gains and sticky core inflation. On the data front, headline Non-Farm Payrolls again came in fractionally stronger than expected with 236,000 new jobs added in March, driven by persistent gains in services employment, including continued 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, edged lower to 90.1 in March, still hovering near pandemic-era lows (89.5 June 2022), as high inflation, labor shortages and softening business expectations continue to dampen sentiment. Headline CPI came in lower than expected in March, rising +.1%, the smallest gain since last July, and up 5.0% during the last year, as chronic strength in shelter and other core services was largely offset by flat food costs, lower energy and muted core goods prices. Headline PPI again came in much weaker than expected during March with prices down -.5%, the largest contraction since April 2020, driven by a large decline in energy prices and another, unexpected drop-in services.

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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Commercial Lending Blues

A Federal Reserve report released last week revealed some early signs of credit contraction in the wake of the Silicon Valley and Signature Bank failures last month, with commercial bank lending plummeting by nearly $105 billion in the final two weeks of March, the largest, two-week decline in this data series since 1973. The data revealed that this dramatic slide was broad-based across commercial and industrial (C&I) and real estate loans, and largely driven by smaller banks, which accounted for nearly $75 billion of the record slide. This data is particularly striking given that the top 25 banks account for a majority of all lending in the United States, fueling concerns of a deeper credit contraction in the months to come as lenders of all sizes appear poised to reign in balance sheet risk further given the large drop in bank deposits and worsening economic outlook.

Market Snapshot

	This week 4/13/23	Last week 4/6/23	Basis Points Change	Weekly % Change	YTD % Change
3-month USD Libor	5.25%	5.21%	4	0.77%	10.06%
SOFR	4.80%	4.81%	-1	-0.21%	11.63%
2-year US Treasury	3.98%	3.83%	15	3.92%	-10.16%
5-year US Treasury	3.51%	3.37%	14	4.15%	-12.47%
10-yr US Treasury	3.46%	3.31%	15	4.53%	-10.82%
2s-10s UST Spread	-52.00	-52.00	0.00	0.00%	-5.45%
DJIA	34,021	33,485	536.00	1.60%	2.64%
S&P 500	4,143	4,103	40.00	0.97%	7.89%
Spot Gold	2,053	2,026	27.00	1.33%	12.43%
WTI (Oil) Current Contract	82.20	80.58	1.62	2.01%	2.42%
1-year Brokered CD	4.80%	4.80%	0	0.00%	4.35%
5-year Brokered CD	4.25%	4.40%	-15	-3.41%	6.25%
5-year Bullet US Agency	3.69%	3.54%	15	4.24%	-9.56%
5-year/NC1yr Callable US Agcy	4.87%	4.85%	2	0.41%	-9.81%
CDX IG Spread Index	74.72	78.86	-4.14	-5.25%	-8.90%
CDX High Yield Index Spread	101.55	100.57	0.98	0.97%	0.92%
15-yr UMBS	4.48%	4.29%	19	4.43%	-3.86%
30-yr UMBS	4.99%	4.84%	15	3.10%	-6.38%

Source: Bloomberg data as of 2:45pm ET 4/13/2023 and 2:30pm ET 4/06/2023

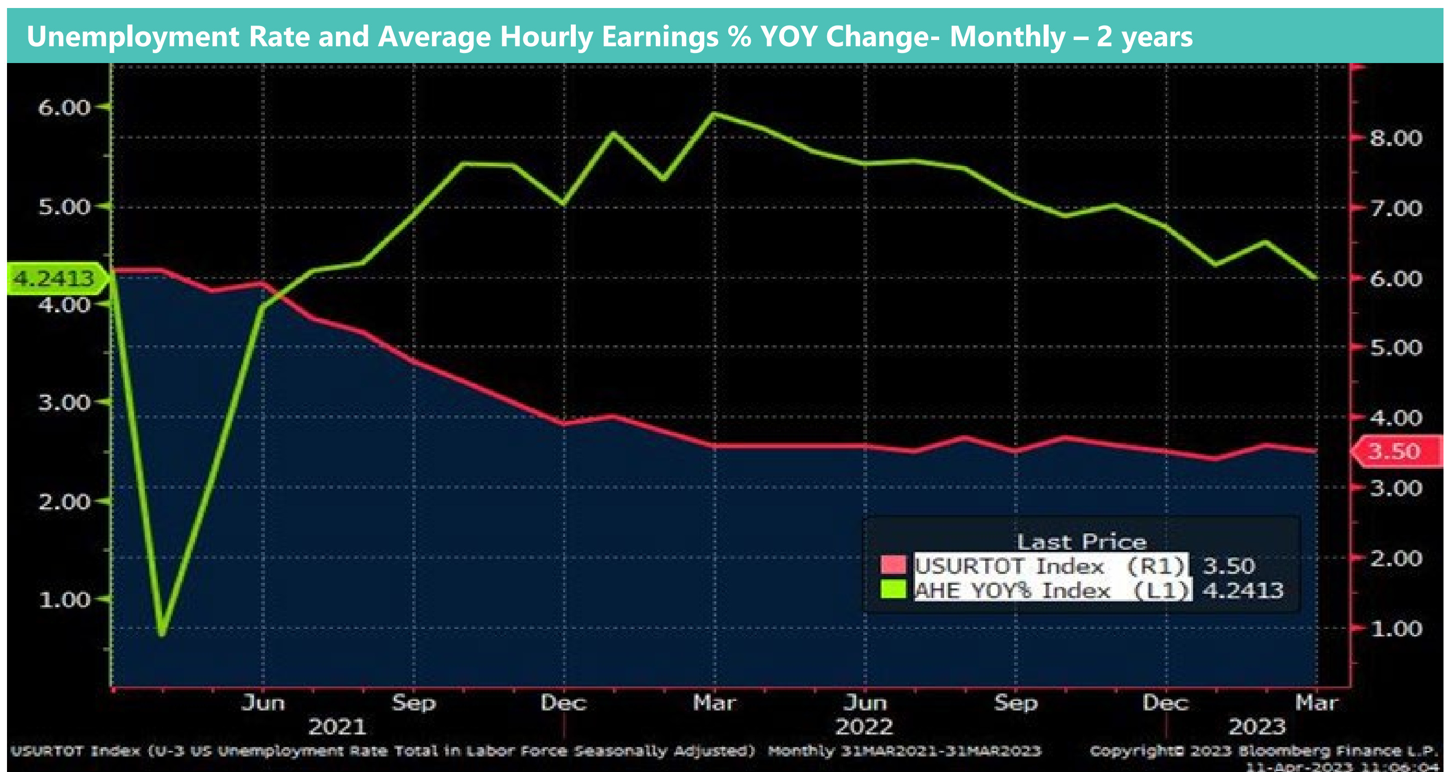
Perhaps more daunting is the relative importance of regional/community banks regarding certain types of loans, where recent data have revealed that smaller banks (up to $250 billion in assets) are responsible for nearly 50% of all C&I lending, with even larger market share when it comes to residential and commercial real estate lending, with estimates of upwards of 60% and more than 70% respectively. Regarding commercial real estate lending, the magnitude of smaller bank concentration is particularly troubling given the amount of debt to refinance over the next few years, with estimates topping $1.5 trillion of commercial real estate debt maturing through 2025. Taken together with the new trend of hybrid work models and unfavorable market conditions for securitization of larger commercial real estate loans via the CMBS market, where new issue volumes are down more that 80% over the past year, a veritable perfect storm of dwindling liquidity for new loans and refinancings and elevated delinquencies and defaults is brewing, with the potential for the deepest downturn in commercial real estate since the Great Financial Crisis in 2008. While lower market interest rates would likely offset some of these negative headwinds, suffice it to say that the risk/reward profile of this important economic sector has changed, with the risks of a self-fulfilling loop of higher defaults and withering credit extension higher than at any time over the last 15 years. Stay tuned!

Still quiet on the fiscal front as another congressional recess and House hearings continue to populate the congressional calendar. Among several legislative imperatives, negotiations regarding the debt ceiling are likely to ramp up given the rapidly approaching date when the government could technically run out of money, with estimates ranging from July through September. Additionally, look for growing calls for tighter bank regulation in the wake of the SVB/SBNY failures last week, with public hearings all but certain.

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

Source: Bloomberg as of 4/13/2023

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



Source: Bloomberg as of 4/13/2023

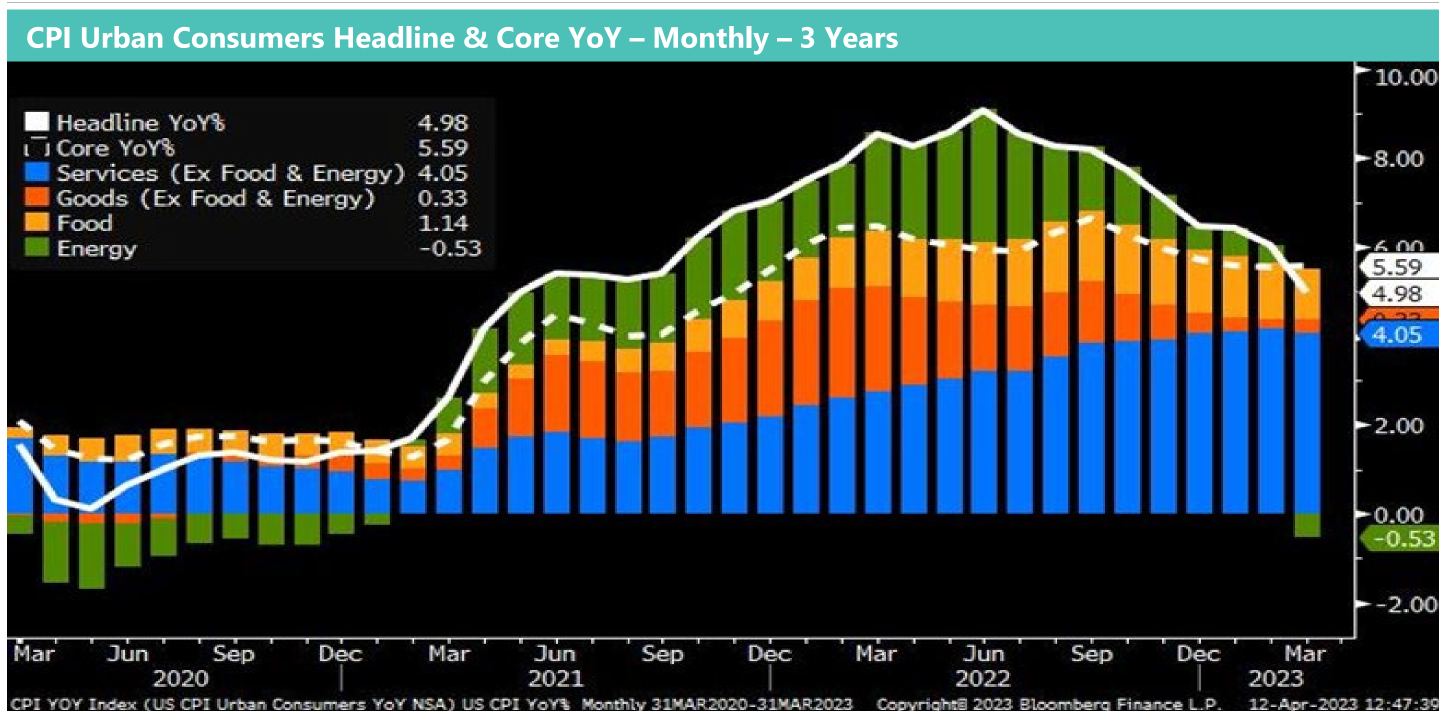
Headline Non-Farm Payrolls again came in fractionally stronger than expected with 236,000 new jobs added in March (230,000 est.), driven by persistent gains in services employment, including continued strength in leisure and hospitality, healthcare, professional/business services and government. Taken together with revisions that subtracted 17,000 jobs in the prior two months, job creation remains healthy with average monthly gains of 345,000 during the last ninety days, an acceleration from the fourth quarter's 291,000 pace (vs. 423,000 Q3 2022). Looking by industry revealed broad based strength, led by leisure and hospitality (+72k), education/health (+65k), government (+47k), and professional/business services (+39k), which was partially offset by retail (-15k), temporary help (-11k) and construction (-9k). Beyond the headline number, the big takeaways were the fourth consecutive uptick in labor participation (62.6% vs. 62.5% est.) and continued moderation in average hourly earnings (+.3% vs. +.2% Feb./+4.2% YOY vs. 4.6% Feb.), good news for the FOMC given the chronic tightness of labor markets and durability of elevated, nominal wage gains post pandemic. Regarding the labor market, last week's JOLTS job openings (9.9 million), the number of available positions per unemployed worker (1.92) and quits rate (2.5% or 3.9 million jobs) remain historically high, suggesting that wage inflation will remain elevated in the near term. 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 hindered employer efforts to fill millions of unfilled job openings. This lower participation has driven down the unemployment rate to 3.5%, just shy of January's cycle low of 3.4% (lowest since 1969) and supported elevated average hourly earnings (4.2% YOY), both conditions expected to persist in the months to come. All in all, another solid employment report with some silver linings regarding wage growth moderation and the recent up trend in labor participation.

NFIB Small Business Optimism – Monthly – 2 Years

Source: Bloomberg as of 4/13/2023

The NFIB Small Business Optimism index, which surveys hundreds of small businesses across a range of issues, edged lower to 90.1 in March (89.8 est.; 90.9 Feb.), still hovering near pandemic-era lows (89.5 June 2022), as high inflation, labor shortages and softening business expectations continue to dampen sentiment. Additionally, the first index read post SVB/SBNY bank failures revealed more businesses reported tighter credit conditions, with 9% of respondents that borrow regularly stating that financing was harder to obtain compared to three months earlier, the most since December 2012. Perhaps more daunting is the same share (9%) expect tougher credit conditions in the next three months, matching the highest level in nearly a decade, which may portend a deeper economic downturn should this trend continue. On the inflation front, 24% of respondents reported that inflation was their most significant business problem, down from 28% last month and shy of last July's cycle high 37% print (highest since 1979), but still historically elevated and indicative of the durability of inflationary pressures afflicting small businesses. Additionally, a steamy 43% of small businesses said they had unfilled job openings (51% record high; May 2022) and 42% stated they have increased compensation over the last three months to attract new workers as 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 37% 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 April 2021, but still historically high. The combination of high inflation and chronic labor shortages have dampened optimism, with businesses expecting better economic conditions over the next six months maintained -47% last month (versus -38% pandemic low), an improvement versus last June's -61% cycle low, but still historically weak. Indeed, the NFIB chief economist stated that "Small-business owners are cynical about future economic conditions," and "There are major uncertainties ahead, most immediate is concern that a banking crisis could develop." All in all, persistent weakness in small business optimism aligns with consumer sentiment data and underscores lackluster economic expectations, newly-minted concerns regarding a meaningful credit contraction on the heels of SVB/SBNY bank failures and chronically elevated inflation expectations.

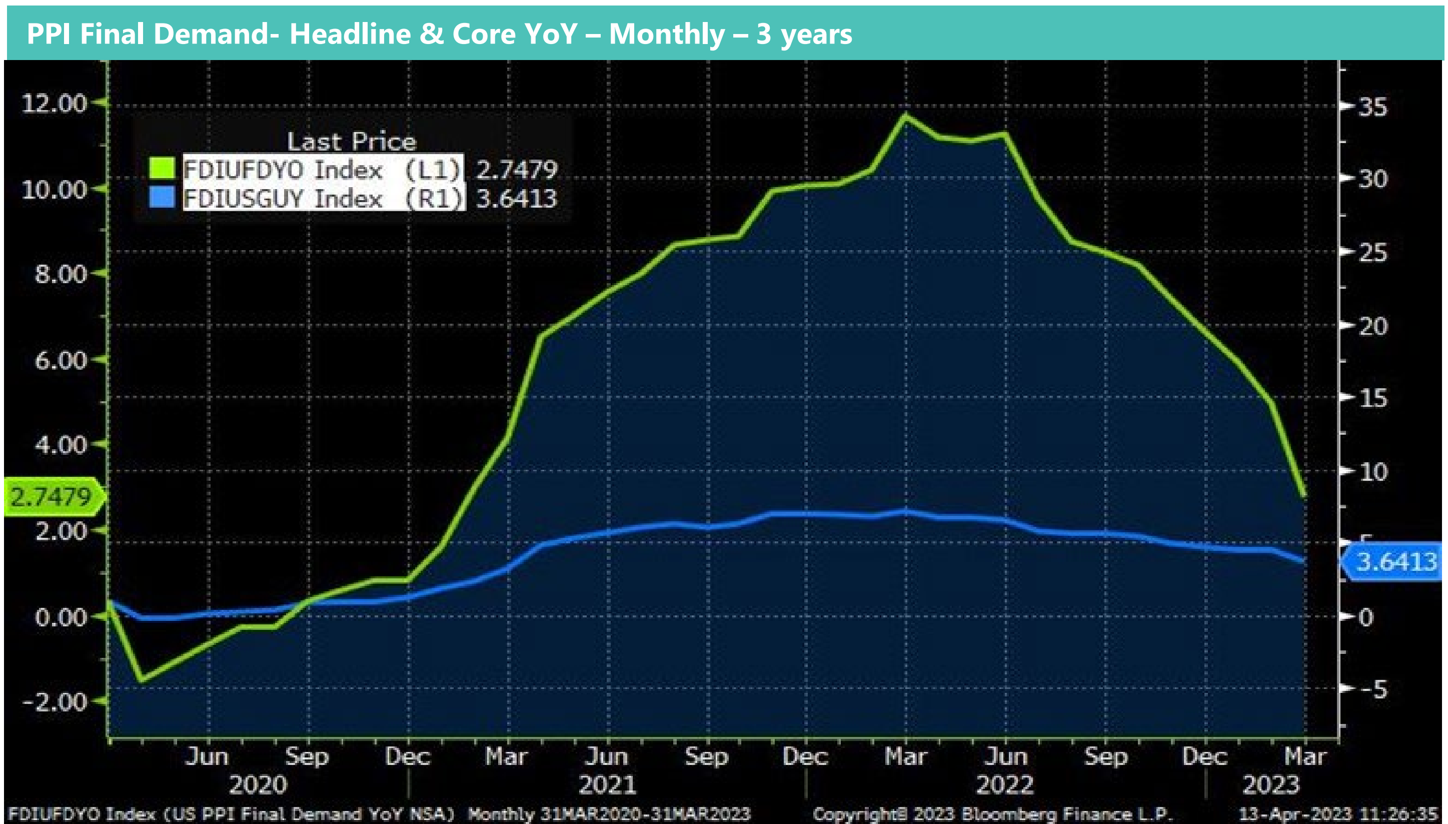
CPI Urban Consumers Headline & Core YoY – Monthly – 3 Years



Source: Bloomberg as of 4/13/2023

Headline CPI came in lower than expected in March, rising +.1% (+.2% est.), the smallest gain since last July, and up 5.0% during the last year (+5.1% est.), as chronic strength in shelter and other core services was largely offset by flat food costs, lower energy and muted core goods prices. Core CPI (less food and energy) was up +.4% (+.4% est.) in March and 5.6% (+5.6% est.) over the past 12 months, the first year-over-year acceleration in six months, a moderation from September's year-over-year cycle high (6.6%; highest since 1982), but historically steamy and indicative of the durable and broad-based nature of inflationary pressures across both services and selected goods. Indeed, the breadth of price gains remains problematic, with 65.9% of index components up by more than 4% on an annualized basis, up from 64.2% in February (60.9% Jan.) and more than double the pre-pandemic run rate. From a contribution standpoint, services continue to run and again drove the advance in prices, up .3% (worth +.18% Headline) in March and 7.3% from a year ago, just shy of January's cycle high (7.6%) and the largest annual advance in nearly 30 years (shelter component of services +.6%), which were largely offset by lower energy and medical care prices, which fell -3.5% and -.5% respectively (worth nearly -.28% Headline). Drilling down into headline CPI components, prices were mixed, with the largest gains seen in airline fares (+4.0%), motor vehicle insurance (+1.2%), shelter (+.6%), new vehicles (+.4%), apparel (+.3%), which were mostly offset by flat food prices and declines in all components of energy (-3.5%), used cars (-.9%), and medical care (-.5%) as goods spending continues to moderate and tilts towards services. 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 March (+.5%; +8.0% year over year), matching February's record high, 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 one likely to extend the FOMC's tightening cycle into the May 3rd meeting. 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 during March (+.5%).

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



Source: Bloomberg as of 4/13/2023

Headline PPI again came in much weaker than expected during March with prices down -.5% (0% est.; +2.7% last 12 months), the largest contraction since April 2020, driven by a large decline in energy prices and another, unexpected drop in services (trade/warehousing). In the aggregate, both goods and services prices were lower last month, with goods down -1.0% (+2.0% year over year/-.3% Feb.), and services lower by -.3% (+2.8% year over year/+.1% Feb.), continuing the trend of headline PPI disinflation that started last December and elevating expectations for a sustained easing of wholesale prices. From a contribution standpoint, over two-thirds of the decline in Headline prices was driven by goods disinflation (-6.8% energy, led by 11.7% drop in gasoline), with the remainder due to lower services costs (-.9% trade; -1.3% transportation/warehousing). Core PPI (less food, energy and trade) also came in weaker than expected with prices up +.1% last month (+.3 est.; +3.6% 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 durability 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 37% (all-time high of 66 in March 2022) of small businesses surveyed stated that they raised selling prices last month and a near record 42% of respondents said they raised compensation to attract and retain employees, both likely to add to pricing pressures in the near term. That said, loosening supply chain bottlenecks and slower goods demand have dampened the cost of processed goods for intermediate demand, reflecting prices earlier in the production pipeline, which fell -1.0% in March (-1.0% year over year), the eighth contraction in nine months and driven by a -6.5% drop in diesel fuel and broad-based declines across other energy components. All in all, a much weaker report than expected, albeit driven largely by outsized declines in energy prices (oil/gasoline) resulting from economic concerns regarding the SVB/SBNY failures, which will likely rebound next this month given the jump in oil prices.

The Week Ahead

The data calendar remains full over the next week, headlined by UM Consumer Sentiment, Retail Sales, Existing Home Sales and Weekly Jobless Claims. Looking ahead, markets remain focused on inflation, employment data and more signs of slowing economic activity. On the new issue front, ABS volumes slowed this week, with 3 deals totaling $2.4 billion priced through the 12th and $74.8 billion year to date ($89.3 billion over same period last year; $276.7 billion for 2022) and IG corporate issuance was again muted with $9.5 billion priced as of the 12th and $413.4 billion year to date ($518.6 billion over same period last year; $1.26 trillion for 2022). While new issue supply slowed last year given FOMC rate hikes and higher volatility, market conditions have generally improved for much of 2023 and the new deal landscape remains favorable for a wider breadth of ABS and corporate issuers as investor demand remains strong, with the caveat that additional fallout from the SVB/SBNY failures will trigger issuance furloughs like those observed over the past month.

Friday 4/14

UM Consumer Sentiment; Retail Sales; Industrial Production

Monday 4/17

Empire Manufacturing

Tuesday 4/18

Housing Starts

Wednesday 4/19

Federal Reserve Beige Book

Thursday 4/20

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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