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Sunday Tea with BNPP: Bracing for impact

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KEY MESSAGES

- We are cognisant of the risks of temporary higher yields and flatter curves if US data is stronger this week (as we expect it to be). Nonetheless, we retain a bullish rates bias via steepeners and US-Europe compression trades with a bias to add bullish duration exposure on pullbacks.
- We have explored CTA ‘pressure points’ and found that USD shorts versus EUR, GBP and CEEMEA are most vulnerable to being unwound. By contrast, global rates and commodity model positioning appears less stretched.
- US equities could make new all-time highs on better US data this week, in our view.

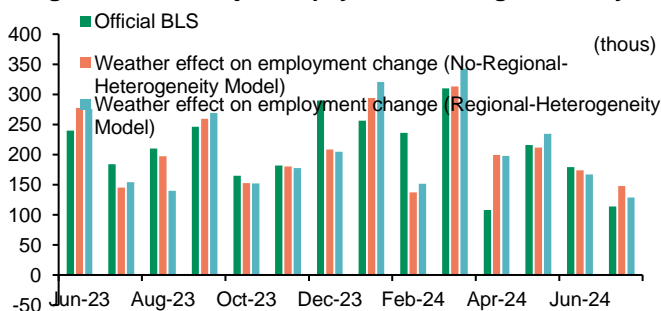
US data in focus: The week ahead will be all about US data with the much-anticipated US payrolls release out on Friday, preceded by ISM services, ADP employment and JOLTS data. We estimate payrolls growth will rebound to 175k in August from 114k in July as the unemployment rate falls to 4.2%. This would be consistent with a 25bp Fed cut in September, in our view. However, any sign that July’s apparent labor market weakness had become more pronounced in August could warrant a 50bp move, particularly given Fed Chair Jerome Powell’s statement that policymakers “do not seek or welcome further cooling in labor market conditions.”

That said, we think weather effects exaggerated weakness in the July report and that the August report will clarify the signal versus the noise. We estimate severe weather was responsible for the roughly 30-35k gap between the reported 114k gain and the underlying pace of around 140-150k. Adding these jobs back to the August data would push the reported reading above that level, resulting in a monthly pace of around 175k, we think. For more details see [US August jobs preview: Sizing September’s rate cut](#), dated 29 August.

Markets remain undecided between a 25bp and 50bp cut in September (pricing at the time of writing is 32bp). While a clearly weak payrolls report likely leads to a 50bp cut, Powell’s dovish stance toward the labor market in his Jackson Hole speech may have lowered the bar for a more aggressive Fed should NFPs be only modestly weak.

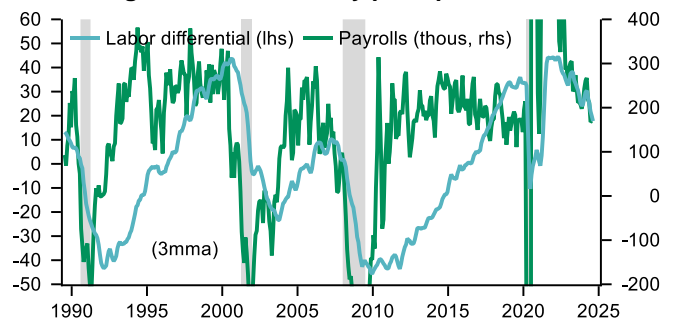
At a high level, the market’s reaction function to NFPs looks relatively symmetric given we are still priced for about 100bp in 2024 cuts and a 3-3.25% fed funds rate by end-2025. However, larger yield moves appear asymmetrically skewed lower. An extreme downside surprise in August NFPs (especially if followed by increasingly weak economic data) would give the market more room to price a much more aggressive Fed over the coming quarters. An upside surprise would shift market expectations toward a 25bp-per-meeting cadence for this year, but still subject to the evolution of data going forward. Based on risk–reward, our bias remains for lower rates and a steeper curve and we retain our 5s30s UST steepener even though we are cognisant of the risk of higher yields and flatter curves temporarily if our central case for better-than-expected data across the course of next week is realised. Signs of a more aggressive Fed would increase the likelihood of short-end forwards being out-delivered, making 2s5s and 2s10s steepener more attractive, in our view.

Fig. 1: Weather-adjusted payrolls were higher in July



Sources: BLS, FRB San Francisco, Macrobond, BNP Paribas

Fig. 2: Jobs availability perceptions worsen



Sources: BLS, The Conference Board, Macrobond, BNP Paribas

The risks are similar in the eurozone, especially with 10y back to fair value in contrast to still-rich front-end rates. We also note that the August Dutch CPI came out above consensus, at 3.6% on Friday. This reading is particularly relevant for Dutch pension fund indexation decisions and therefore for EUR 10s30s. The largest Dutch pension fund, ABP, uses the August CPI as its reference for indexation decisions. By how much it decides to index pensions remains an open question, especially as we move closer to the transition. We do note, however, that in the last two years, it fully matched the August CPI prints. At 3.6% it would be more than last year's 3.02%. The Dutch indexation picture looks more benign with other funds, as we discussed in [EUR Rates: Preliminary thoughts on Dutch PF indexation](#), dated 12 August.

Exploring CTA pressure points: As we head into an event-risk heavy September we think it is worth exploring where vulnerabilities lie when it comes to model positioning. As CTA assets under management have continued to grow in recent years, so too has their importance in markets and our newly launched CTA tracker (see [here](#) for the latest chart pack and [here](#) for the methodology) aims to provide a cross-asset overview of how these models are currently positioned in the market.

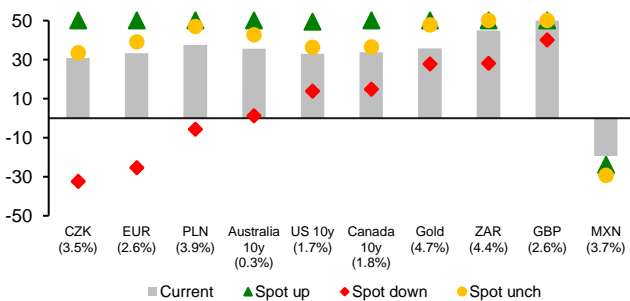
On an asset class level, the current output suggests FX positioning is most stretched. In other words, CTAs have built large USD shorts, in particular versus G10 FX with EUR and GBP longs extending. We find these are particularly vulnerable. In the case of EUR, for example, we estimate that a 2.6% move lower in EURUSD would elicit an unwind of 58 scores on our metrics (compared to approximately 1/3 of an increase proportionately on a move higher in spot). In EM FX, ZAR, PLN and CZK exhibit a similar profile when it comes to model asymmetries. In the case of MXN, we estimate that USDMXN would have to fall more than 4% within the next month for CTAs not to continue selling MXN, highlighting the asymmetry to the topside in the pair from a model perspective.

In Asia FX, on the other hand, our CTA model still suggests more room for USD shorts to build. This technical flow can be exacerbated by USD supply from underhedged exporters in the region and by the asymmetric risks for US rates into this week's data. We think the RMB can benefit from supportive measures announced last week for the Chinese property sector.

In rates, models have turned bullish across the board. We find longer-dated duration in the US, Australia, Canada is relatively stretched. For instance, a 1.7% sell-off in 10y US treasury futures would be sufficient to see CTAs halve their UST longs. That said, positioning in rates is less extreme than in FX currently, according to our estimate, meaning the asset class is generally less vulnerable to unwinds from these models and 'pressure points' are generally more symmetrical.

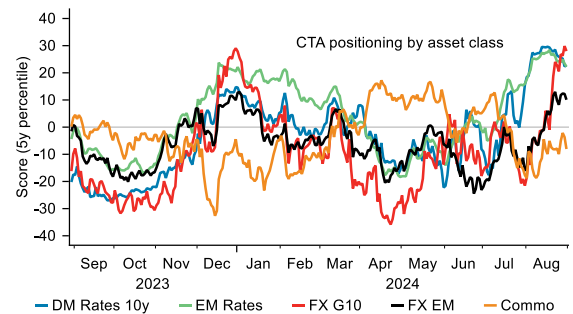
Across other asset classes, gold stands out as a place where CTAs have built large longs. However, the asymmetry in gold remains to the topside, meaning that even if spot is unchanged models will, according to our estimates, continue to accumulate gold.

Fig. 3: 21-day forward CTA score implied in different spot scenarios



Sources: ECB, Eurostat, Macrobond, BNP Paribas

Fig. 4: Asset class aggregated scores across time



Sources: Eurostat, Macrobond, BNP Paribas

Equity markets: We think US equities could make new all-time highs next week if our economic forecasts prove correct for manufacturing ISM, services ISM and NFPs to all beat consensus. In the case of significant misses, the 9.7% RTY decline in the first five days of August raises a red flag, in our view.

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