

The Signal in the Noise

Structural Tightness Beneath the “Soft Landing Narrative”

- The collapse of the French government and a shock -32k ADP payroll contraction confront the “soft landing” narrative, revealing a breakdown in global collateral quality and the end of labor hoarding.
- The depletion of the ON RRP facility means Treasury cash rebuilds now directly drain bank reserves, forcing dealers to rely on Fed backstops to manage daily liquidity needs.
- While markets are aggressively pricing immediate rate cuts to salvage the economic cycle, the yield curve is steepening as long-term inflation and fiscal risks prevent the long end from rallying along with the front end.

This week revealed a clear gap between optimistic stock markets and signs of structural stress in the global economy. While investors continue to price in a “soft landing” scenario supported by hopes of a Federal Reserve interest rate cut, the collapse of the French government and weak U.S. labor data suggest growing risks. The collapse of the French government caused the spread between French and German 10-year bond yields to widen to 90 bps before settling at 77 bps, driving a flight-to-safety bid into U.S. Treasuries. The spread between 10-year Treasuries and French OATs is not just a yield play; it is a barometer of global collateral quality. Next, the ADP employment report released on December 3 showed a contraction of 32,000 private sector jobs, defying expectations for a gain. This decline was driven entirely by small businesses, which shed 120,000 positions, indicating that the sector most reliant on floating-rate credit is capitulating despite the headline stability in larger firms.

Underlying these macro signals, the U.S. financial system is facing a structural liquidity shortage following the Federal Reserve’s cessation of Quantitative Tightening on December 1. The ON RRP facility, which previously held over \$2.5 trillion in excess cash, has effectively emptied, falling to just \$1.485 billion as of December 5. With this buffer gone, the Treasury’s effort to maintain its TGA balance, which stood at \$878.67 billion on December 4, is now draining reserves directly from the banking sector. This scarcity forced banks to borrow \$26 billion from the Standing Repo Facility (SRF) on December 1, the second-highest volume since 2020, while general collateral repo rates spiked to 4.25%, trading 33 bps above the Fed’s target range. Routine usage of this backstop facility suggests that private balance sheet capacity is constrained and that the system has hit the “lowest comfortable level of reserves.”

This combination of delayed macro data and liquidity stress catalyzed a sharp repricing in U.S. rates markets this week. Treasury yields fell across the curve, with the 2-year dropping to 3.56% and the 10-year settling at 4.14%. Traders aggressively lifted the implied probability of a December rate cut from 40% to over 70% following Governor Waller’s pivot on December 2, where he explicitly supported a cut as “additional insurance” against labor market stalling. As the FOMC prepares for its final meeting of the year, the divergence in global central bank policy is widening; while the Swiss National Bank is expected to hold rates at zero despite weak growth, the U.S. outlook for 2026 remains disputed. Forecasts from T. Rowe Price suggest U.S. rates could fall below 3% by 2026 on recessionary pressure, sharply contrasting with Deutsche Bank’s view that rates may need to hold steady near 375-400 bps to counter persistent inflation risk.

Chart 1. Bond Spread Franch OAT-BUND 10Y



Source: Teleborsa

Table 1. ON RRP Balance (in Billions)



Source: FRED

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