US Market Wrap

31st May 2022: Stocks & bonds hit into month-end while oil whipsaws on EU's Russian oil ban

- **SNAPSHOT**: Equities down, Treasuries down, Crude down, Dollar up.
- **REAR VIEW**: EU agree on Russia oil embargo; Waller is prepared to take rates past neutral; Strong Chicago PMI; Consumer Confidence fell, but better than expected; OPEC considers exempting Russia from oil-production; EZ inflation well-above forecast; more ECB speakers lean hawkish.
- **COMING UP**: **Data**: German Retail Sales; EZ, UK & US Final PMIs, US ISM Manufacturing PMI, Construction Spending, ADP. **Event**: BoC Policy Announcement. **Speakers**: Fed's Williams, Bullard; ECB's Lagarde, Lane, Panetta, Knot.

MARKET WRAP

Stocks were subdued Tuesday (SPX -0.5%, NDX -0.3%, RUT -1.3%, DJIA -0.7%) as US players returned from the long weekend to a slew of macro pressures that dictated sector performance. The session had looked to start with a pro-energy, anti-fuel dependent (airlines, cruises, etc...) bias in wake of the EU agreeing in principle to a watered-down sixth sanctions package on Russian oil, although the upside in oil benchmarks faded through the session, and then legged lower on WSJ reports that OPEC is considering removing Russia from the production quotas in order for other member states to ramp production. That unwind coincided with energy closing as an underperforming sector. Regardless, stock futures were choppy to end the month and rangebound for the US session, seeing a chunky, month-end-distorted buyside Market on Close order imbalance into the close. Treasuries were sold across the curve, with the belly weakest, as US played catch up to the hot European inflation and hawkish Waller after the long weekend. Dollar rose in month-end chop, while Euro dipped on growth woes post-oil embargo and high-single-digit EZ inflation data.

US

FED: Governor Waller Monday said he supported 50bps rate hikes for “several meetings” (currently, Powell and co. have guided to 50bps rate rises in June and July, and analysts assume they will revert to lower increments after that, or perhaps even pause); Waller said the FOMC should not take 50bps off the table until inflation comes down significantly, warning that core inflation was not coming back to target any time soon. Waller argued that policy rates should be above neutral by year-end to reduce demand (previously in May, he argued that the Fed did not need to tank the economy to bring down inflation). Elsewhere, Waller suggested that balance sheet reduction would be the equivalent to a couple of 25bps rate hikes, whereas others have suggested it could be about 25bps worth over the course of a year. The Fed governor seems confident in the strength of the US economy, noting that it continued to power along at a healthy pace, and he does not expect the Q1 GDP contraction to be repeated.

CHICAGO PMI saw an upside surprise after rising to 60.3 from 56.4, against expectations for a decline to 55.0. The print is a welcome sign after regional survey prints from New York, Philadelphia, and Richmond all disappointed, while the KC Fed survey also slowed somewhat. Furthermore, the Dallas manufacturing index, released later Tuesday, entered contraction territory at -7.30 from the prior 1.10. Nonetheless, the Chicago figure could help soften the blow for the national ISM manufacturing survey on Wednesday. But, Pantheon Macroeconomics notes the Chicago PMI does not always move in line with the national ISM print and more broadly highlights the hit to manufacturers from surging energy prices and China disruption, "but firms in the shale ecosystem are doing much better".

US CONSUMER CONFIDENCE declined to 106.4 from a revised higher 108.6, although it fell less than the expected 103.9. The Present Situation Index fell to 149.6 from 152.9 while the forward-looking expectations fell to 77.5 from 79.0. Overall a weak report but perhaps not as poor as expected. The present situation index was hit by a perceived softening in labour market conditions, but the views of current business conditions, which tend to move ahead of trends in jobs, improved. "[The] Present Situation Index remains at strong levels, suggesting growth did not contract further in Q2". However, with expectations seeing more declines, consumers also do not expect to see the economy pick up steam in the months ahead. Still, they do expect labour market conditions to remain "relatively strong, which should continue to support confidence in the short run." The jobs differential between those plentiful and hard to get fell to 42.3 from 48.3. In contrast, the 1yr ahead consumer inflation expectations declined to 7.4% from 7.5% (Note, the UoM 1yr ahead inflation expectations also declined by 0.1%). But, analysts warn of a potential near-term move higher as energy prices increase again.

FIXED INCOME

T-NOTE (U2) FUTURES SETTLE 22 TICKS LOWER AT 119-14+ (SINCE FRIDAY)

Treasuries were sold across the curve, with the belly weakest, as US played catch up to the hot European inflation and hawkish Waller after the long weekend. 2s +4.0bps at 2.538%, 3s +5.0bps at 2.708%, 5s +7.6bps at 2.812%, 7s +9.8bps at 2.873%, 10s +10.4bps at 2.853%, 20s +10.6bps at 3.275%, 30s +9.0bps at 3.066%.

INFLATION BREAKEVENS: 5yr BEI +0.1bps at 2.994% 10yr BEI +1.5bps at 2.636% 30yr BEI +2.3bps at 2.413%.

THE DAY: T-Notes bounced from lows, alongside other govvies, at the London open as stocks dipped, making highs of 120-08 before paring through the European morning, with the selling aided by the hot Eurozone HICP Flash data for May (follows the hot country-level data on Monday). The selling gained some momentum at the NY handover, with heavy selling noted by traders in lack of an obvious catalyst, potentially some spillover from hawkish-leaning ECB's Kazimir, but otherwise, just US flow catching up to weekend newsflow (Waller's 50bps until inflation comes down statement and uncomfortable inflation in Europe). T-Notes made lows of 119-06+ before recovering ahead of the NYSE cash open, with desks noting lows were bought by month-end index-linked buyers, although the contracts failed to reclaw 119-20 before better than expected Chicago PMI and Consumer Confidence data saw selling return, though ranges were respected. T-Notes hovered for the rest of the session into settlement.

AHEAD: NFP on Friday is the data highlight this week, although ISM mfg. comes ahead on Wednesday with expectations very low after all the abysmal survey data for May, although the Chicago PMI was the outlier. On Fed speak, the schedule sees Waller, Williams, Bullard, Logan, Mester, and Brainard, not to mention any unscheduled remarks ahead of the June FOMC blackout Saturday.

STIRS

- Eurodollars bear-flattened as the whites (1st year of quarterlies) were hardest hit in wake of Fed's Waller Monday reasserting hawkish comms, while transatlantic pressures brew in wake of hawkish ECB commentary in the face of high, single-digit EZ inflation.
- (levels since Friday settle) EDM2 flat at 98.238, U2 -8.0bps at 97.415, Z2 -9.5bps at 96.90, H3 -9.5bps at 96.755, M3 -8.5bps at 96.74, U3 -6.5bps at 96.84, Z3 -6.0bps at 96.935, H4 -5.5bps at 97.00, Z4 -5.0bps at 97.115, Z5 -8.0bps at 97.145.
- No major option blocks in STIRs.
- NY Fed RRP op demand at USD 1.979tln across 101 bidders (prev. USD 2.007tln across 99 bidders).
- US sold USD 53bln of 3-month bills at 1.120% (prev. 1.060%), covered 2.98x; sold USD 49bln of 6-month bills at 1.580% (prev. 1.530%), covered 2.81x.

CRUDE

WTI (N2) SETTLED USD 0.40 LOWER AT 114.67/BBL; BRENT (Q2) SETTLED USD 2.00 LOWER AT 115.60/BBL

Oil prices settled subdued Tuesday after WSJ OPEC reports about potential Russian exclusion from OPEC added to the fade from highs seen in wake of the EU's Russian sanction agreements. WTI (N2) and Brent (M2) hit session highs of USD 119.98/bbl and 120.80/bbl, respectively, as US trade got going, before gradually fading through the session as stocks struggled and traders reassessed how much of EU's sanctions package was already priced and how effective it will be. The downside extended more acutely on the late WSJ reports of Russia potentially being suspended from OPEC, which could potentially pave the way for Saudi, the UAE, and other producers to pump "significantly" more oil. Note this week's private and official EIA inventory data will both be delayed respectively by one day due to the US holiday on Monday.

EMBARGO: EU leaders agreed in principle on a watered-down sixth sanction package compared to the original proposal unveiled in early May. The agreement would see a ban on seaborne oil over the next six months, whilst pipeline oil will temporarily be exempted. Germany and Poland, which are both fed by the North Druzhba pipeline, agreed to a voluntary phase-out by the end of the year, which would bring the embargo's coverage to 90% of all EU oil purchases from two-thirds. Hungary, the remaining 10%, would effectively be exempt after the EU gave PM Orban an undefined time limit for continued pipeline use, with the EU saying they would address the problem "as soon as possible". Hungary, Slovakia, and the Czech Republic were given assurances that should the South Druzhba pipeline shut for any reason, the EU would provide emergency supplies. Analysts have questioned the effectiveness of the deal as it would be phased in throughout the year, thus giving Russia time to react to the announcement.

RUSSIAN OIL: Reuters reported Rosneft intends to increase oil production within central Russia from June 1st, and other producers are reportedly to restore production due to seasonal demand and requests emanating from foreign buyers. The report cited Deputy PM Novak's forecasts of 2022 Russian oil production at 9.64mln BPD or 480mln/T, which compares to the late 2021 (pre-Ukraine invasion) forecast of 540-550mln tonnes in 2022. That comes amid exports recovering as barrels find their way to other buyers, mainly Asia, exhibited by reports today that Rosneft sold 900k T of June ESPO blend oil from the Kozmino port to China's Unipec.

GAZPROM: From June 1st, Russia's Gazprom is to cut off supplies to several buyers including Shell Energy Europe (SHEL LN) and Denmark's Orsted (ORSTED DC) over their refusal to establish Rouble accounts for payment.

OPEC: OPEC May oil output stood at 28.76mln BPD, +170k BPD, according to a Reuters survey; with OPEC+ members output +280k BPD, taking compliance up further to 178% from 164%. Meanwhile, Bloomberg reported Libya's Agoco has lost 220k BPD of oil output due to Tobruk disruption.

EQUITIES

CLOSES: SPX -0.63% at 4,132, NDX -0.31% at 12,642, DJIA -0.67% at 32,990, RUT -1.26% at 1,864.

SECTORS: Consumer Discretionary +0.76%, Communication +0.41%, Financials -0.34%, Technology -0.7%, Consumer Staples -0.73%, Industrials -0.85%, Real Estate -1.34%, Health Care -1.37%, Utilities -1.38%, Materials -1.6%, Energy -1.65%.

EUROPEAN CLOSES: Euro Stoxx 50 -1.40% at 3,788; FTSE 100 +0.07% at 7,605; DAX -1.30% at 14,386; CAC 40 -1.43% at 6,469; IBEX 35 -0.85% at 8,855; FTSE MIB -1.21% at 26,761; SMI -0.93% at 11,627.

STOCK SPECIFICS: Fuel-levered sectors such as **airlines (UAL, DAL, AAL, LUV) and cruise liners (CCL, RCL, NCLH)** all opened lower on the EU oil sanctions package, before fading alongside the oil benchmarks. Major **Apple (AAPL)** supplier Foxconn said H2 2022 was developing in a better direction and is confident on supply chain stability. **AMC (AMC)** opened firmer, albeit faded, after 'TopGun: Maverick' saw a record-breaking Memorial Day weekend according to Comscore data. **Tesla's (TSLA)** Shanghai factory had restored manufacturing capacity to levels seen before lockdown, according to SCMP. **Gold Fields Limited (GFI)** tumbled after it agreed to acquire **Yamana Gold Inc. (AUY)** for USD 6.7bln in an all-share merger. **KE Holdings Inc. (BEKE)** surged after it posted a strong report consisting of a surprise Q1 profit, a beat on revenue, and a share buyback programme, although it did provide a soft Q2 revenue guide. Note, China ADRs posted their first monthly gain since October. **PotlatchDeltic Corporation (PCH)** fell after the Real Estate name announced an all-stock merger with **CatchMark Timber Trust (CTT)** for a combined market cap of over USD 4bln and total enterprise value of more than USD 5bln. China's **BYD (BYD)** is in talks to buy six African lithium mines that could meet its battery demand in the next ten years, according to ThePaper citing sources. **Gun names (RGR, OLN, SWBI)** are in focus with Punchbowl reporting the House Judiciary Committee will be holding an emergency hearing on Thursday to mark up a package of gun-control bills, while President Biden said Tuesday he would meet with Congress regarding guns.

FX WRAP

The Dollar was bid as many US players returned after the memorial day market holiday. The risk tone on Tuesday was choppy, although commentary Monday from Fed's Waller (hawk) was supportive after he said he would back 50bps moves until neutral and he would support moving rates 50bps until inflation is coming down towards the 2% target. Waller believes the Fed can hike rates and lower demand without causing a severe economic downturn. Although Waller is a hawk, it has provided an impulse in wake of other hawkish members shifting language lately, with suggestions of a more "measured" 25bps increment hikes from September, albeit all data-dependent. On which, the US data slate Tuesday was encouraging, the Chicago PMI was better than expected, a welcome sign after some dismal regional manufacturing surveys for May, while the CB Consumer Confidence data declined, but not as much as feared.

The Euro was hit with a downbeat risk session throughout European hours in wake of the Russian oil ban sparking growth concerns; ECB's Visco said the halting of Russian gas flows could shrink domestic output on average in 2022-23 and the Bank of Spain calculated the potential interruption of imports of Russian energy could have a 2.5-4.2% negative impact on the EU economy. It could impact Germany by between 1.9-3.4%, Italy 2.3-3.9%, France 1.2-2% and Spain 0.8-1.4%. Meanwhile, the May EU HICP inflation data was hotter than expected on all accounts and above the top-end of the forecast range which supported EZ yields, although there was no sustained move in EUR/USD given the state-level prints on Monday left the writing on the wall. Nonetheless, the hot data on the same day as an EU oil embargo emphasises the high inflation and cautious growth story for the ECB ahead of their meeting next Thursday. On that, ECB's Kazmir said he expects a 25bps rate hike in July but is open to discussing a 50bp move, possibly in September due to record inflation. He also sees the neutral rate closer to 2.0% than 1%, adding it will take roughly 200bs of hikes to get to neutral.

The Yuan was weaker on both offshore and onshore Yuan, albeit more so as a function of a stronger Dollar and weaker Euro while the PMI data was better than expected, alongside encouraging COVID developments in Shanghai. China official PMI data for May was better than expected, but still in contraction territory. Manufacturing PMI rose to 49.6 in May (exp. 48.9, prev. 47.4), while the Non-Manufacturing PMI rose to 47.8 (exp. 45.0, prev. 41.9), lifting the Composite measure to 48.4 from 42.7 in April. Capital Economics said that the data “adds to broader evidence that activity has started to rebound as containment measures were rolled back,” but added that “the recovery is likely to remain tepid amid weak external demand and labour market strains.” Meanwhile, a city official in Shanghai said the city is moving into a normalised epidemic control phase and looks to resume a normal life.

Yen was weaker against the Dollar and the Euro as US yields rose across the curve although lows in USD/JPY were seen in the European morning (127.60) due to the risk off tone, albeit prices reversed throughout the late mornings and afternoon to highs of 128.88. Note, APAC session Tuesday saw the Japanese unemployment rate for April dip to 2.5% from the prior and expected 2.6% while retail sales rose above expectations. However, IP forecasts for May were worse than expected and April's Industrial output also tumbled by more than expected.

The Swissy was weaker against the buck but it firmed against the Euro and Yen after SNB rhetoric and Swiss GDP, retail sales, and trade data. SNB's Zurbrugg saw little reaction but he noted inflation is low relative to other nations but it is not irrelevant and a high nominal value of the CHF has dampened inflation within Switzerland. He also believes energy prices won't increase as quickly as they recently have, and supply chain problems will not persist. His comments perhaps dilute some of the commentary around the SNB taking policy action in the near-term. Although, it is worth bearing in mind that Zurbrugg leaves after the June meeting and will be replaced by Schlegel. As such, there was no movement in the CHF in wake of this commentary. On data, GDP was in line with expectations on an annualised basis but Q/Q it beat consensus. Meanwhile, trade data saw an improvement in the trade surplus while retail sales were not as bad as feared.

Cyclical currencies were mixed, CAD managed to eek a gain over the buck ahead of the BoC rate decision on Wednesday, a full preview is available here. Meanwhile, the initial rally in crude prices in wake of the EU Russian oil embargo supported the Looney, albeit it was off highs as oil prices reversed as the effectiveness of the ban was questioned while a WSJ piece suggested some OPEC members are mulling suspending Russia's participation in the oil production deal which would pave the way for Saudi and UAE and others to increase production. AUD, NZD and GBP were lower against the buck, while the NZD underperformed after a bleak NBNZ survey and a stark warning from RBNZ’s Hawkesby that recession represents a real threat. Meanwhile, Aussie building approvals declined by more than expected while the Australian Current Account Balance in Q1 was a narrower surplus than forecasted and the prior. GBP was weaker against both the buck and the Euro in a holiday-shortened week ahead of the Platinum Jubilee (Thursday and Friday bank holidays). Cable traded either side of 1.2600, a level it resides upon at pixel time, while EUR/GBP was flat but traded either side of 0.8500.

Scandis were firmer against the Euro, but NOK outperformed SEK thanks to the initial rally in Brent prices, while the Norges Bank announced a reduction of foreign currency buying for next month compared to May. Riksbank's Ingves spoke but didn't say much other than inflation-targeting policy requires updates to meet future challenges.

EMFX was mixed, BRL saw marginal gains in wake of a strong decline in the unemployment rate, although BCB Chief Neto spoke, noting that the market expects rate hikes in Brazil are coming to an end. COP extended gains after the election results on Sunday saw leftist Gustavo Petro win the highest votes in the first round of elections while business-friendly Rodolfo Hernandez was the runner up. CLP saw gains despite a larger than expected decline in copper output while Copper prices were lower in fitting with other metal prices. ZAR saw weakness in fitting with weaker gold prices and commentary from Eskom warning of more load shedding as its power system is under severe pressure. HUF was weaker after the NBH hiked by less than analysts expected; the NBH hiked by 50bps, beneath the 60bps estimate but the Bank did state it will continue with gradual tightening

RUB saw gains against the Dollar, despite the Russian oil embargo, while CBR's Yudayeva spoke on the Rouble, saying recent strength was driven by a drop in imports and an absence of fiscal rule, adding the RUB is mostly driven by Russia's current account while the CBR will use special measures to reduce the role of foreign currency in Russia.

Yudayeva also noted there is no talk about imposing negative interest rates on the Dollar and Euro deposits for Banks' retail clients. The CBR also released a statement saying EUR and USD statuses as reserve currencies are to decline after the West froze part of Russian Reserves.