US Market Wrap

14th July 2022: Volatile session after Fed hawks push back on 100bps, defibrillating risk

- **SNAPSHOT**: Equities mixed, Treasuries down, Crude down, Dollar up
- **REAR VIEW**: Waller and Bullard still for 75bps, for now; hot PPI; Jobless claims rise; Draghi's resignation rejected by Mattarella; CHIPS Act could see Senate floor next week, but GOP's aren't keen; Strong TSM earnings, weak JPM and MS earnings.
- **COMING UP**: **Data**: Chinese GDP (Q2), Retail Sales, US NY Fed Manufacturing, Retail Sales, IP & Uni. of Michigan (Prelim.) **Speakers**: Fed's Bostic, ECB's Rehn **Earnings**: UNH, Blackrock, Citi, Wells Fargo.

MARKET WRAP

The risk tone had started off quite sour out of Europe and in wake of disappointing bank earnings which saw both JPMorgan (JPM) and Morgan Stanley (MS) miss street expectations while US data saw a hot PPI print and a rise in initial jobless claims. However, the tone had turned throughout the afternoon after Fed hawks Waller and Bullard both announced they were still backing 75bps in July (for now) despite the hot June CPI report which reversed implied market pricing of 100bps to 30% from 70% earlier Thursday. The commentary saw stocks move off lows led by the Nasdaq which was the only index to close in the black while the Treasury curve was off lows and steepened between the front and belly. Similar price action was seen in the Dollar with DX hitting a fresh YTD high of 109.29 before paring to just above 108.50 at pixel time. The Euro hit new lows beneath parity at 0.9953 with messy Italian politics playing their part: PM Draghi is now set to address parliament on Monday after President Mattarella rejected his resignation. Elsewhere, oil prices tumbled as risk soured in the morning to see WTI and Brent seeing lows of USD 90.56/bbl and 94.50/bbl, levels not seen since February, prior to the Ukraine invasion; precious - Gold printed beneath USD 1,700/oz - and the majority of base metals were also all lower. Looking ahead retail sales print Friday will be the pivotal data point, particularly after Waller said he would need to see the print before deciding whether to raise his July hike base to 100bps from 75bps. Meanwhile, major US earnings in the morning include STT, C, BK, WFC, BLK, USB, PNC, PGR, and UNH.

GLOBAL

FED: **Waller (voter)** was cautious on calling for a 100bps hike, suggesting his base case is for 75bps still but he would be open to a larger hike if Retail Sales (due Friday) and housing activity data comes in strongly; he later added that inflation expectations data before the next meeting will also help shape his view on the hike increment. The Governor warned of the risks of overdoing it on rate hikes, whilst also saying he sees the neutral rate at 2.00-2.25%, below the Fed median of 2.5%. Another 75bp move from the Fed would take rates to 2.25-2.5%, so above the top end of his neutral view and perhaps a reason why he is hesitant to call for a 100bps hike despite the June CPI. Waller said markets may be getting ahead of themselves by pricing in 100bps and that the June CPI was not a big surprise, albeit that was somewhat at odds with his prepared remarks that the report was a "major league disappointment"; said the Fed should not knee-jerk react to the inflation report. Given Waller is normally one of the more hawkish members on the Fed it was somewhat telling he is not yet prepared to back a 100bps hike, which infers a potential lack of appetite across the broader FOMC if the hawkish spearhead himself has doubts, although as mentioned, perhaps his lower view of neutral is a factor. **Bullard (2022 voter)** also pushed back on 100bps saying he still supports a 75bp hike after the June CPI report and is not backing 100bps for now. He still wants rates at 3.5% by year-end but when asked about rates at possibly 4% or more he said it is a possibility but only if data were to get worse in the Fed's eyes. **Mester (2022 voter)** said after the closing bell Wednesday the Fed does not need to make a decision on rates now, but added inflation was too high and the CPI report was uniformly negative. Mester has not seen convincing evidence that inflation has peaked, and expects the Fed will need to go beyond neutral. The risk of recession has increased, but the Fed must lower inflation. **Daly (2024 voter)** said her most likely posture was for a 75bps rate hike in July but added that 100bps is within the range of possibilities.

US PPI: US headline PPI printed above expectations, with M/M rising 1.1% (exp. 0.8%, prev. 0.9%) and Y/Y jumping 11.3% (exp. 10.7%, prev. 10.9%). Meanwhile, core Y/Y also exceeded consensus at 8.2% (exp. 8.1%, prev. 8.5%), but M/M rose 0.4%, a bit beneath the expected 0.5% and prior 0.6%. Delving into the print, Oxford Economics notes, three-fourths of the headline gain in producer prices was driven by a 2.4% rise in the index for final demand goods. Moreover, the strong goods print was helped by a 10% jump in prices for final demand energy, which came from an 18.5% increase in gasoline prices, though indexes for diesel fuel, electric power, and residential natural gas also contributed to the advance. Additionally, OxEco added, June's energy-driven price increases lifted final demand goods prices 1.3ppts to a record 17.9% Y/Y, more than doubling the pace of services inflation. Looking ahead, the consultancy states, “despite a modest improvement in supply conditions, price pressures will remain uncomfortable in the near term and bolster the Fed's resolve to prevent inflation from becoming entrenched in the economy.” Lastly, OxEco concludes, “with producer price inflation persisting at elevated levels over the coming months, and companies retaining pricing power, higher production costs will sustain upside risks to consumer prices as businesses tease out how much additional pass-through consumers will tolerate.”

US JOBLESS CLAIMS: Initial jobless claims rose to 244k, above the expected, and prior, 235k. Meanwhile, continued jobless claims fell to 1.331mln, beneath the consensus 1.383mln and the previous 1.372mln. Looking into the data release, Pantheon Macroeconomics note, “the spike in jobless claims likely is due to seasonal adjustment problems caused by the annual automakers’ retooling shutdowns.” Ahead, number will be choppy over the coming weeks, but when the dust settles, the consultancy believes claims will be slightly higher than the recent 230k trend. Nonetheless, PM adds, “they will remain low by historical standards; it’s risky for firms to let people go unless they have no choice, because re-hiring is difficult.”

ITALY: The Italian government has sparked huge political uncertainty in Italy after the 5-Star Movement (M5S) boycotted a confidence vote over what it believes to be an insufficient cost of living support package. The confidence vote saw the MS5 abstain the vote but nonetheless the government still secured confidence from parliament, even without the M5S. This implied Salvini's League voted in favour of the government's cost of living package. Even after the win PM Draghi felt he had lost support with the M5S boycott and tendered his resignation to President Mattarella, however, Mattarella rejected this and asked Draghi to address parliament in order to gauge the political situation, which will take place on Monday. Draghi could attempt to form a new government without the M5S, which is possible, assuming the government ex-M5S remains intact, then they will control 175/321 Senate seats and thus retain a majority. However, Salvini's League said on Wednesday they are not willing to remain in the government in the scenario that M5S quits, and this would erase the new majority if so. Another option would be fresh elections, which only adds to the current uncertainty.

FIXED INCOME

T-NOTE (U2) FUTURES SETTLED 13+ TICKS LOWER AT 118-16

Treasuries were sold overnight and after the hot US PPI before recovering with other assets into the close, with the belly weakest. 2s +1.3bps at 3.157%, 3s +3.0bps at 3.171%, 5s +6.1bps at 3.080%, 7s +6.6bps at 3.064%, 10s +6.1bps at 2.967%, 20s +2.7bps at 3.368%, 30s +4.0bps at 3.108%. Inflation breakevens: 5yr BEI +2.6bps at 2.580%, 10yr BEI +0.9bps at 2.305%, 30yr BEI +0.5bps at 2.215%.

THE DAY: T-Notes were already drifting lower through the APAC before the European session saw heavy offers extend with growing chatter around a 100bps Fed hike accentuated by the BTP sell-off amid the political instability in Italy. There was an initial rally to local peaks of 118-27+ at the NY handover before the above forecast headline PPI number for June kicked off a move to session lows of 117-28+, aided by the acute commodity selling seen at the time, particularly oil as the benchmarks hit pre-Ukraine invasion levels for the first time amid the Dollar's climb. However, the moves soon pared as Europe began closing shop, and additional front-end buying pressure after Fed's Waller, the current spearhead for hawks, proclaimed 75bps was still his base case despite the CPI print but said he would be open to a larger hike if retail sales (due Friday), housing market data, and inflation expectations warrant it. Still, the cautiousness of the Governor saw a pullback in July 100bps pricing. A Bullard interview in Nikkei saw the other hawk spearhead refrain from calling for 100bps also.

STIRS:

- The very front-end of the curve outperformed amid Bullard and Waller refraining from calling for a 100bps July hike.
- EDU2 +8bps at 96.465, Z2 +4bps at 96.06, H3 -5bps at 96.22, M3 -7bps at 96.425, U3 -6bps at 96.635, Z3 -6bps at 96.80, H4 -6bps at 96.94, M4 -6.5bps at 97.055, Z4 -6bps at 97.17, Z5 -6.5bps at 97.145.
- Notable option flow included 21.3k EDH3/U3 96.125/96.75 put calendar spreads, while in SOFR, 48.8k SR3Z2 97.2500/97.5000/97.7500 call flys and 18.9k SR3Z3 put flys.
- NY Fed RRP op. demand saw a chunky rise to USD 2.207tln from 2.155tln, raising some eyebrows.
- US sold USD 48bln of 1-month bills at 1.980%, covered 2.75x; sold USD 43bln of 2-month bills at 2.270%, covered 2.47x.

CRUDE

WTI (Q2) SETTLED USD 0.52 LOWER AT 95.78/BBL; BRENT (U2) SETTLED USD 0.47 LOWER AT 99.10/BBL

Oil prices settled off lows after acute NY morning commodity selling in the face of the Dollar's ascent unwound into the later session. WTI and Brent front-months hit session lows of USD 90.56/bbl and 94.50/bbl, levels not seen since February, prior to the Ukraine invasion. Citi's energy S&T desk to whit, "There is something of a bearish feedback loop becoming established in the market, where prices already fell on recession fears and reports of increased OPEC and Russian supplies for June but have continued to fall even as backward looking measures only confirm that consensus." The desk goes on, "The fundamental balance certainly looks weaker than a month ago, but we're not sure it rates as even weaker than already anticipated, at least by those tracking developments most closely."

EUROPEAN ENERGY: Germany's energy regulator announced a fall in its overall gas storage level fell to 64.5% vs 64.6% Wednesday, at a time it is expected to be building storage, saying gas is being partially withdrawn from storage as a result of market conditions. Meanwhile, French President Macron said France will need consumers and businesses to restrain their energy consumption, followed by later FT reports that the UK had become a net power exporter to France for the first time since 2017 amid the nuclear power outages across France.

RUSSIA: Russia's Foreign Ministry said attempts by G7 to cap Russian oil prices may result in price increases. Also said Nord Stream 1's future work will depend on gas demand and "one-sided sanctions". Bloomberg reported later that Russia, incentivised by the G7's price cap efforts, is aiming to get control of pricing by creating its own benchmark, with trading on the national platform to start in October. Separately, Reuters reported Saudi has imported at least 647k T of Russian fuel oil from April to June, more than double the imports a year earlier, according to data and traders.

LIBYA: Libya has appointed a new chief of the NOC, Farhat Bengdara, who has promised to lift blockades and increase output, FT reported.

EQUITIES

CLOSES: SPX -0.30% at 3,790, NDX +0.34% at 11,768, DJIA -0.46% at 30,630, RUT -1.07% at 1,708.

SECTORS: Financials -1.92%, Energy -1.9%, Materials -1.89%, Communication Svs. -1.05%, Real Estate -1%, Industrials -0.58%, Health Care -0.37%, Consumer Discretionary -0.06%, Utilities +0.01%, Consumer Staples +0.16%, Technology +0.93%.

EUROPEAN CLOSES: Euro Stoxx 50 -1.66% at 3,396; FTSE 100 -1.63% at 7,039; DAX -1.86% at 12,519; CAC 40 -1.41% at 5,915; IBEX 35 -1.77% at 7,804; FTSE MIB -3.44% at 20,554; SMI -1.08% at 10,787.

EARNINGS: **JPMorgan (JPM)** saw losses after it missed on EPS and revenue alongside FICC and investment banking revenue falling short, however, equities did beat. Moreover, JPM suspended share buybacks. **Morgan Stanley (MS)** was softer following misses on top and bottom line, while revenue segments were mixed. Equities and FICC beat but investment banking fell short. **Conagra Brands (CAG)** saw weakness after it marginally beat on EPS but missed on revenue and also saw an impact from higher costs, with operating margins falling by 310bps. CAG has communicated additional pricing increases that will take effect in the Q2 of FY23. **TSMC (TSM)** firmed after it beat on net profit while revenue and operating income jumped Y/Y. Moreover, Q3 revenue view topped St. consensus. On commentary, TSM noted it will face challenges from rising global inflation costs and excess inventory in chip supply chain will take a few quarters to rebalance, and sees capacity remaining tight this year. **First Republic Bank (FRC)** firmed after beating on top and bottom line.

STOCK SPECIFICS: **Intel (INTC)** told customers it will raise prices on a majority of its microprocessors and peripheral chip products later this year, citing rising costs, according to Nikkei. Increases have not been finalised, likely to range from a minimal single-digit increase to over 10% or 20% in some cases. **Alibaba (BABA)** is reportedly cutting over a third of its investment team after regulatory lockdown, according to Reuters sources. Separately, BABA saw pressure following a WSJ piece, which noted executives called in by China authorities as it investigates historic data heist. **Twitter (TWTR)** said it is not planning company-wide layoffs but could implement restructuring and organisational changes, according to a filing. **Cisco (CSCO)** was softer following a downgrade at JPMorgan, who see downside risks to enterprise spending levels. The second day of **Amazon (AMZN)** prime day saw total US online spend surpass USD 5.9 bln, representing 9.2% growth, both days saw total spend touch USD 11.9bln, +8.5% according to Adobe. California regulator responsible for issuing driverless-car permits said it is looking into concerns raised in an anonymous letter that **General Motors' (GM)** Cruise unit was preparing to launch its robotaxi service prematurely, according to WSJ. Upside in marijuana names (**MJ, TLRY, CGC**) was attributed to reports a marijuana decriminalisation bill has been teed up for

Senate introduction. **Coscto (COST)** saw upside after Deutsche Bank upgraded the stock; said it is "is one of the most consistent operators in our group, and its steady traffic gains and high membership renewal rates serve as key differentiators in an increasingly uncertain backdrop."

CHIPS ACT: Reports indicate that Senate Majority Leader Schumer is telling Senators to prepare for a floor vote as early as Tuesday to start moving the CHIPS Act. This would include the USD 52bln for semiconductors plus investment tax credit from the FABS act while other pieces from the broader USICA package, may still be added. However, Republican Senator Cornyn told Punchbowl he and other Republicans will not vote to process the CHIPS bill next week and he wants to wait until later in August when reconciliation plans are clear. Furthermore, GOP Senator Thune warned the ten GOP votes might not be there next week. Meanwhile, the US Commerce Department said the agency is reviewing policies for the export of some semiconductor chips to China.

FX WRAP

The Dollar was bid Thursday to see the index hit a fresh YTD high of 109.29, a level not seen since 2002. The buck had been propped up in the European morning on Euro weakness amid the political uncertainty in Italy while the risk-off trade was also supportive. The greenback moved off highs in wake of Fed's Waller who toned down market pricing for a 100bp Fed hike in July saying his base case is for 75bps although would be open to a larger hike if retail sales and housing activity data comes in strong, but he did suggest markets are getting ahead of themselves. Other Fed hawk Bullard was also quoted in Nikkei reaffirming his call for a 75bps hike and suggested they are currently at a good pace while he reiterated he wants rates at 3.5% by year-end.

The Euro was weaker and dipped beneath parity again as political uncertainty in Italy weighed. The Italian government survived the no-confidence vote but PM Draghi announced his resignation anyway as he felt he had a lack of support without the 5-Star Movement backing him, nonetheless, President Mattarella rejected the resignation and instructed him to address parliament to gauge the political situation, which will take place on Monday. Note, as the Dollar eased amid the Fed speak, the Euro cross rose back to parity while some support was seen after Mattarella rejected market-friendly Draghi's resignation.

The Yen weakness continued as it suffered from the rising Dollar and higher US yields although USD/JPY was off highs after the later Dollar pullback. **CHF** was weaker against the buck and only marginally weaker against the Euro. **Gold** prices (and metals in general) were weaker on the stronger buck and the move higher in US Treasury Yields, seeing gold briefly dip beneath USD 1,700/oz. Note several banks have been revising their gold price forecasts with UBS the latest to cut its gold forecast to USD 1,600/oz for both September- and year-end from 1,800/oz and 1,700/oz, respectively, although the desk sees a H223 end price of USD 1,650/oz.

Cyclical currencies were weaker on the stronger buck and soured risk tone, but also closed off worst levels. CAD was the clear underperformer however as oil prices plummeted to see WTI as low as USD 91/bbl at one point before settling around USD 95.50/bbl - the Looney gave up its post-BoC strength to see USD/CAD trade as high as 1.3223 at one point. After the initial weakness, AUD and NZD returned to relatively flat levels vs the buck while the Aussie earlier saw a strong jobs report with a record low unemployment rate but nonetheless traded off the broader risk aversion into the NY session. The Aussie and Kiwi moved in tandem against the Dollar with AUDNZD flat. GBP remained weaker in the midst of the conservative leadership round with the latest seeing Sunak, Mordaunt and Truss as top three favourites.

EMFX was predominantly weaker although the RUB saw some strength. ZAR was the laggard on the fall of gold prices while BRL was softer on reports Brazil's economic team is discussing proposals to change the 'Spending Cap' rule, according to Bloomberg sources. The report added this would open up the possibility that the government that takes over in 2023 is to increase public spending. Although an alternative proposal is being studied where it could use public debt as a reference to decide how much spending can grow each year, the sources said. MXN was weaker while CLP was the underperforming LatAm currency on weaker copper prices; COP managed to eek a small gain against the buck.