US Market Wrap

28th July 2022: Recession fears mount after US shrinks for second straight quarter

- **SNAPSHOT**: Equities up, Treasuries up, Crude mixed, Dollar flat.
- **REAR VIEW**: US GDP sinks for second consecutive quarter; Biden-Xi direct teams to work on face-to-face talks; Jobless claims misses expectations; US House lawmakers on course to pass CHIPs act; SNB may take monetary policy measures at any time, if so required; OPEC sources suggest August meeting set to keep output steady; Poor META report; QCOM guidance light; SAVE to acquire JBLU; Decent 7yr auction; Range of poor EZ data.
- **COMING UP**: **Data**: Japanese CPI, German GDP Flash, Unemployment, EZ CPI (Flash), US PCE Price Index **Earnings**: Renault, ams-OSRAM, BNP Paribas, Caixabank, Intesa Sanpaolo, Nexi, Signify; AstraZeneca, NatWest, IAG; Exxon Mobil, Chevron, Phillips 66, AbbVie.

MARKET WRAP

US equities ultimate rallied on Thursday, after an indecisive blip in wake of the US Q2 GDP data, which showed the economy shrank for a second consecutive quarter. Some define two straight quarters of negative growth as a recession, however, key officials like President Biden and his Treasury Secretary, along with notable commentators like the former Treasury Secretary Summers, have been emphasising that jobs creation continues, household finances are strong, and consumer spending is growing – all of this is inconsistent with the traditional view of what constitutes a recession. Officials also noted the resilience of the economy in the face of headwinds. The indecisive equity action in wake of the data could have been an attempt to reconcile the ‘good data is bad data and vice versa’ playbook, or perhaps even month-end factors (equities are a sell for this month-end, according to many sell-side pension models); additionally, many note that there are very encouraging pockets within some segments of US corporate reporting (MSFT this week is the key example). But with the Fed in a meeting-by-meeting, data-dependent approach, this narrative will always be subject to volatility. Indeed, some of this might be seen on Friday, when the PCE and ECI data – two key data points Fed officials like to monitor – are scheduled to be released. Inflation metrics have been cooling on an annualised basis, and Treasury Secretary Yellen on Thursday said that this could continue to be seen in the ‘days ahead’, potentially guiding the PCE data due Friday.

GLOBAL

US GDP: An advanced look at US GDP in Q2 revealed economic growth contracted by 0.9% in the quarter (exp. +0.5%), and follows the -1.6% reading for Q1, marking two consecutive quarters of negative growth. While that satisfies one rule of thumb definition of what constitutes a recession, officials have recently been at pains to explain how the current economic dynamics means that the US is not in fact in a ‘recession’; these economists cite the tightness in the labour market, where the economy has continued to add jobs. That said, analysts argue that the data still represents a downshift in the economy amid high prices and as the Fed tightens policy to manage inflation; rates are currently at neutral, although the central bank has this week signalled that it intends to continue hikes taking rates into restrictive territory. Meanwhile, within the GDP data itself, Oxford Economics says that the poor performance can be partly explained by slower inventory accumulation, though much of this was offset by contributions from net trade. But there are still signs of domestic weakness: residential and business investment fell, as did government spending for the third consecutive quarter. Consumer spending components were also soft. The inflation metrics within the data picked up to the highest rates since 1981, although the core measure ticked lower for the first time since Q4 2020; timelier PCE data for June will be released on Friday, and are expected to continue to give the Fed ammo to tighten policy. “The economy is battling headwinds of high inflation, aggressive Fed tightening, financial market volatility and weakening global demand,” Oxford Economics says, “these challenges are eroding business and consumer confidence and will suppress hiring and economic activity into 2023.” The consultancy echoes Fed Chair Powell in stating that “while we continue to see a pathway to a softish landing, it’s admittedly narrowing,” and adds that it anticipates “only a modest rebound in H2 and now see real GDP growing closer to 1.7% this year and around 1% next year.”

US JOBLESS CLAIMS: Initial jobless claims fell from the 2022 high, easing to 256k from a revised up 261k, while continuing claims (which this week coincides with the survey period for the BLS jobs report) pared back to 1.359mln from 1.384mln. Pantheon Macroeconomics said that “jobless claims are still chaotic as a result of the annual automakers’ retooling shutdowns, which play havoc with the seasonals," adding that "when the distortions fade, next month, we expect to see a gently rising trend, close to 230K."

US/CHINA: US President Biden and China President Xi held a call on Thursday, and while the readout has been fairly limited, Xi told Biden that the US should abide by the 'One China' policy, and act in line with its words. Regarding the Taiwan issue, Xi told Biden that 'those who play with fire will get burned', and noted China fiercely opposed Taiwanese independence as well as the interference of external forces. Biden is said to have told Xi that the US stance on 'One China' remained unchanged, and the US strongly opposes any unilateral changes of the status quo in the Taiwan Straits. Meanwhile, House Speaker Nancy Pelosi is set to leave for a trip to the APAC region on Friday, but it's still unclear whether her stops will include Taiwan. Furthermore, a Senior US admin official noted the two discussed a face-to-face meeting and directed teams to follow up, but they did not discuss any potential lifting of US tariffs on Chinese products.

FIXED INCOME

T-NOTE (US) FUTURES SETTLED 18 TICKS HIGHER AT 120-31+

The Treasury curve bull-steepened on Thursday, as shorter dated yields plunged in wake of US Q2 GDP data, which showed a second consecutive quarter of economic shrinkage. At settlement, 2s -10.0bps at 2.872%, 3s -9.1 bps at 2.817%, 5s -9.7bps at 2.698%, 7s -8.2bps at 2.707%, 10s -5.8bps at 2.674%, 20s -0.6bps at 3.233%, 30s +2.0bps at 3.022%. Inflation breakevens: 5yr BEI +2.3bps at 2.763%, 10yr BEI +1.8bps at 2.480%, 30yr BEI +0.5bps at 2.270%.

While US administration officials have been at pains to note the strength of the labour market does not suggest the economy is in a recession, desks are still noting that there is a markdown in the pace of growth, something officials themselves have acknowledged, and this data serves to underscore arguments that the Fed will not be able to take rates to the 3.75-4.00% terminal rate level implied by the June SEP. In wake of Wednesday's Fed and Thursday's grim GDP data for Q2, money markets now envisage rates will rise to 3.00-3.25% by the end of the year (earlier in the week there was an expectation that they could be lifted to 3.50% by December); additionally, rates are seen peaking out around 3.25% before the Fed starts lowering rates next year. The Fed, of course, is now data-dependent, and accordingly, Friday's PCE and ECI data are the next catalyst that could adjust the narrative, and market pricing.

STIRS:

- EDU2 +5.0bps at 96.715, Z2 +6.0bps at 96.395, H3 +8.5bps at 96.595, M3 +11.5bps at 96.785, U3 +12.0bps at 96.980, Z3 +11.5bps at 97.115, H4 +11.0bps at 97.240, M4 +10.0bps at 97.355, U4 +9.0bps at 97.435, Z4 +8.0bps at 97.495, Z5 +8.5bps at 97.550.
- NY Fed RRP op. demand at USD 2.240tln (prev. 2.189tln) across 111 bidders (prev. 102).

CRUDE

WTI (U2) SETTLED USD 0.84 LOWER AT 96.42/BBL; BRENT (U2) SETTLED USD 0.52 HIGHER AT 107.14/BBL

The crude complex was choppy through Thursday, and eventually settled mixed, albeit well-off extremes. Highlighting this, WTI and Brent saw highs of USD 99.84/bbl and 109.06/bbl, respectively, and lows of 96.21/bbl and 106.00/bbl. Back to the day, there was little new fundamental newsflow for the crude complex as nothing materially changed with the Nord Stream 1 situation, however, WTI and Brent did edge to sessions following the US cash open where it was seemingly tracking the sentiment in stocks. Looking ahead, there is a wealth of US energy companies reporting on Friday, such as Chevron, Exxon, and Phillips 66, as well as US data in the form of PCE and ECI.

OPEC+: A senior US official said the administration was optimistic that there could be some positive announcements coming out of the next OPEC meeting, adding that additional supply would help stabilise the market and potentially bring down prices. Moreover, the US official believed that a price cap on Russian oil was worth pursuing, but still needed to determine what that price is and how to get other countries on board. Following this, a report from Reuters, citing eight sources, noted that the OPEC+ meeting on August 3rd was likely to see oil output kept steady or raised slightly in September. Within the report, two said that a modest increase for September would be discussed, while five said output would likely hold steady.

GAS: Austrian Chancellor Nehamer stated that the European Union could not ban Russian gas imports without damaging itself. On NS1, a Kremlin spokesperson hopes the Nord Stream 1 turbine will arrive soon at the Portovaya station and be installed.

GLOBAL OIL: North Sea Oseberg stream to load 2 cargoes in September (vs 4 in August); Troll to load 5 cargoes in September (vs 7 in August); North Sea Brent crude oil stream to load 1 cargo in September (vs. 2 in August). Elsewhere, ADNOC stated it shut down operation at Fujairah terminal due to exceptional rainfall, according to a spokesperson. Furthermore, it diverted Fujairah terminal oil lifting to Jebel Dhanna terminal which can handle Murban shipments.

EQUITIES

CLOSES: SPX +1.21% at 4,072, NDX +0.92% at 12,717, DJIA +1.03% at 32,529, RUT +0.88% at 1,868.

SECTORS: Real Estate +3.7%, Utilities +3.53%, Industrials +2.07%, Materials +1.69%, Consumer Discretionary +1.67%, Consumer Staples +1.59%, Technology +1.43%, Financials +0.7%, Health +0.55%, Energy +0.45%, Communication Services -0.73%.

EUROPEAN CLOSES: Euro Stoxx 50 +1.23% at 3,652; FTSE 100 -0.04% at 7,345; DAX +0.88% at 13,282; CAC 40 +1.30% at 6,339; IBEX 35 -0.49% at 8,084; FTSE MIB +2.10% at 21,932; SMI +0.66% at 11,129.

EARNINGS: **Meta (META)** was lower after it missed on EPS, revenue, and MAUs alongside Q3 revenue view coming in short. Moreover, META said economic downturn will have a broad impact on digital advertising business, and the situation seems worse than it did a quarter ago. **Qualcomm (QCOM)** saw losses after it beat on EPS and revenue, but Q4 guidance was light for both profit and revenue. **Ford (F**) gained following a stellar report, where it beat on EPS and revenue alongside raising its dividend. In commentary, Ford's CFO said it had begun cost-cutting efforts and sees inflation-related costs increasing in H2. **Mastercard (MA)** firmed after topping analyst expectations on the top- and bottom-lines, and lifted its FY22 adj. EPS view. **Royal Caribbean (RCL)** posted a shallower loss per share than expected, and also beat on revenue; the cruise company said that it continues to see a robust and accelerating demand environment for cruises and on-board spend. **Stanley Black & Decker (SWK)** sank after an awful report, missing on EPS and revenue alongside cutting its FY EPS view; SWK said the softening of demand accelerated during the last part of the quarter, although it does expect demand to normalise. **Honeywell (HON)** beat on EPS and revenue, but Q3 guidance was short of expectations. **Merck (MRK)** surpassed the street's consensus on key drug sales as well as the top- and bottom-lines. Looking ahead, FY revenue view was raised. **Comcast (CMCSA)** beat on profit and revenue, but the telecoms giant said it saw no growth in broadband subscribers, which it attributed to strong pandemic signups pulling new business from future quarters. **Teladoc (TDOC)** plummeted after it posted a much deeper loss per share than consensus with EPS guidance also weak. The loss was attributed to a USD 3bln impairment charge.

STOCK SPECIFICS: **JetBlue (JBLU)** is to buy **Spirit Airlines (SAVE)** for USD 33.50/shr in cash, after SAVE and **Frontier (ULCC)** agreed to terminate their merger agreement. **Best Buy (BBY)** Q2 comp sales declining about 13%, noting it has seen weaker demand for consumer electronics amid inflation. **Charles Schwab (SCHW)** authorised a USD 15bln stock repurchase programme and declared 10% increase in its dividend. Jack Ma intends to relinquish control of **Ant Group (BABA)**, WSJ sources said, and will transfer some voting power to executives, which could push-back IPO timing by over a year. Solar names, such as **Sunrun (RUN), Sunnova Energy (NOVA), First Solar (FSLR), and SunPower (SPWR)** saw strong gains after Democratic Senator Machin agreed to support a bill which would grant a range of clean energy incentives.

FX WRAP

The dollar was choppy, but currently flat, trading a range between 106.980 and 106.050. Following Wednesday's softness, which came after the FOMC switched to a data dependant approach, a second consecutive contractionary US GDP print sounded the recessionary fears and hindered the buck's recovery as bear-steepening flipped to bull-steepening along the Treasury curve. Nonetheless, there is a slew of data on Friday (PCE and ECI), where the latter is of paramount importance given Fed Chair Powell said on Wednesday that "ECI data on Friday will be an important indicator", after noting job creation has been modestly slower. Additionally, after-hours on Thursday is earnings from behemoths Apple and Amazon.

JPY was the clear outperformer against the Buck, and printed a low of 134.25, a level not seen since June 23rd, a beneficiary of perceptions that Fed policy may not get too far from neutral; the USD itself was on track for the largest daily percentage fall against the Yen since March 2020. Overnight there is a range of Japanese data, such Tokyo CPI, Unemployment, IP, Retail Sales and the BoJ's latest Summary Of Opinions.

CHF saw slight gains against the Buck, and the Swissy got a lift after the SNB noted that it may take monetary policy measures at any time between regular assessment dates, if required. The comments came via the SNB's "National Bank in Brief" release which is part of a set of publications that are, according to the central bank, designed for "schools and the general public" and are not listed as an "economic publication". Following this commentary, it has heightened the focus on Swiss inflation prints and the potential for intra-meeting action by the SNB, an approach they have ample precedent for.

EUR was mildly weaker and saw lows of 1.0115 in the European morning, following a range of poor Eurozone data, highlighted by a miss on EU economic sentiment, which was later followed by German HICP, and CPI above consensus. On top of this, EUR/USD cross underpinned by another sharp retreat in EGB yields. Additionally, the ever-present energy crisis is of concern for the single-currency. Onto Friday, there is EU flash Q2 GDP alongside flash July HICP, alongside a range of EZ data.

Activity currencies were mixed, with NZD seeing slight gains, hence the outperformer, while CAD and GDP were flat, and AUD slightly weaker against the Buck. For the latter, AUD/USD slid to lows of 0.6956, with the drop in the cross is being highly influenced by AUD/JPY price action. Nonetheless, technicians note that AUD/USD daily techs lean bearish but monthly techs are very bullish. Additionally, this week's Australian Q2 CPI printed slightly beneath expectations, which comes ahead of retail sales on Friday. The Pound has held onto most of its post-Fed gains, as Cable saw a high of 1.2191 but ran out of momentum into the pivotal 1.2200 level, which all comes ahead of the key BoE meeting next week. The Loonie meandered between 1.2869 and 1.2795, which came against the backdrop of choppy crude prices as there the CAD was bereft of any specific newsflow. Onto Friday, there is May Canadian GDP.

EMFX was mixed as TRY and RUB saw losses, whilst BRL, MXN, and ZAR all gained vs the Buck. The latter was boosted due to the rising gold prices which reclaimed USD 1,750/oz to the upside, as well as South Africa reportedly finalising a plan to take on part of Eskom's USD 24bln debt. Elsewhere, Brazilian inflation index was not as hot as feared and CNH/CNY were flat as there appears to be no major breakthroughs from the call between Xi and Biden. The readout, so far, was China President Xi told US President Biden that the US should abide by the One China principle, and act in line with its words, according to State Media.