US Market Wrap

4th August 2022: Cyclical assets stumble as BoE heralds a deep recession

- **SNAPSHOT**: Equities mixed, Treasuries up, Crude down, Dollar down
- **REAR VIEW**: BoE hikes 50bps and provides dire growth/inflation forecasts; Jobless claims rise to 2022 high; China military tests expand, sending missiles over Taiwan into Japan's EEZ; Mester sees rates rising above 4%; Saudi cuts NW Europe OSPs, raises US and Asia; Meta to sell USD 10bln in corporate bonds; BKNG issue somewhat cautious commentary; LLY miss and cut guidance; EBAY post mixed report but beat on EPS and revenue.
- **COMING UP**: **Data**: German Industrial Output, US & Canadian Labour Market Reports **Events**: RBA SOMP & RBI Policy Announcement **Earnings**: Allianz, Deutsche Post; LSE, WPP, Western Digital

MARKET WRAP

US stock indices were little changed on Thursday with external growth concerns brewing after the BoE's sustained recession forecast. The 50bps hike from the BoE was an afterthought for bond traders against its five-quarter recession call, lifting global government bonds in reaction. The Pound managed to claw back its losses as Dollar selling extended through the US session, with another rise in initial claims data sustaining concerns over the outlook for the labour market - ongoing PLA drills around Taiwan don't help the Dollar either. Mester was out calling for rates above 4% in 2023, which did cap the recovery in the front-end of the rates curve to some extent, although yields were still lower mainly across the curve. In commodities, oil prices tumbled lower amid Aramco price cuts to Europe signalling a plateau in demand from the continent, while the demand outlook was also hampered by the BoE forecasts. Reports suggested emergency OPEC capacity could be tapped in the event of a winter crisis, adding supply-induced pressure on the oil benchmarks. Traders now look to Friday's jobs report, full preview available below.

CENTRAL BANKS

BOE: As forecast by consensus and priced by markets, the BoE delivered a 50bps hike, taking the Base Rate to 1.75%. The decision to raise rates for a 6th consecutive time was unanimous, however, there was dovish dissent from external member Tenreyro who is of the view that the Bank Rate might already have reached the level consistent with returning inflation to the 2% target in the medium term. For the other eight MPC members, the decision to raise rates by the largest magnitude in 27 years was justified by the view that “there had been indications that inflationary pressures were becoming more persistent and broadening to more domestically driven sectors”. On inflation, Q4 inflation is expected to rise to just over 13% (vs. the June forecast of slightly above 11%) on account of higher expected household energy prices. In 2023, inflation is now expected to pull back to 5.5% (vs. the May forecast of 3.5%) whilst the three-year projection is seen at just 0.76%. Given that the projections are based on the market-implied rate curve, this suggests that the MPC views the current rate path as too aggressive for it to be able to attain its 2% inflation mandate. From a growth perspective, the accompanying projections were sobering reading against the current inflationary backdrop with the UK now expected to enter a recession in Q4 and last for five quarters with consumption growth expected to turn negative. Despite the growth outlook, the MPC’s statement reaffirmed the committee to act “forecefully” in the face of more persistent inflationary pressures. Accordingly, Governor Bailey noted that returning inflation to 2% remains the Bank’s priority and the costs of the Ukraine war will not deflect the BoE from pursuing its mandate. Furthermore, Bailey stated that tighter policy now reduces the risk of more extended and costly tightening later. For the September meeting, Bailey noted that all options are on the table for September and beyond but the 50bps increase this week does not mean the BoE is moving to a pre-determined path of hiking rates by 50bps at each meeting. As it stands, post-meeting pricing pencils in 35bps of tightening for September and a total of roughly 100bps by year-end. Analysts at ING are of the view that there is a strong possibility of a 50bps move in September but such a move could be the last from the BoE as the window to hike rates closes. Asides from the decision itself, the MPC announced that subject to a vote, the “Committee is provisionally minded to commence gilt sales shortly after its September meeting”. In terms of the size, a total reduction of GBP 80bln in the first year of the scheme was “likely to be appropriate” of which GBP 40bln would be active sales.

FED: **Mester (2022 voter)** spoke again Thursday where she largely reiterated familiar themes but she did specify she had pencilled in going a bit above 4% on rates next year, something she said she put in at the June SEPs. She noted rates will need to be held there for a while until inflation comes back closer to its 2% goal. Mester also added it is not unreasonable to see a 75bps hike in September, but it could well be 50bps and the decision will be guided by the data. She expects rates to rise through year-end and through H1 23, before pausing and then to start bringing rates back down. Interestingly, Mester also said given the size of the balance sheet, the Fed should discuss selling some MBS - something we knew was likely to happen at some point "down the line", but these remarks suggest these could be conducted relatively soon. On a recession, she reiterated there is still a path to a soft landing but recession risks have risen.

GLOBAL

NFP PREVIEW: The US economy is expected to add 250k nonfarm payrolls in July, with the pace of payroll additions cooling again amid tight labour market conditions. The unemployment rate is expected to be unchanged at 3.6%. Traders will use the data to shape expectations of how the Fed will set policy at its September meeting; the central bank is in a data-dependent, meeting-by-meeting mode, as it focuses on bringing inflation back to target. Accordingly, any upside surprise for the headline and wages will give the central bank scope to move rates higher by a larger increment in September, whereas any downside surprise to the headline may indicate that the slowing growth momentum has crept into Q3, and any downside surprise in the wages component may allow the central bank to revert to a smaller increment of rate hikes. For full preview, please click here.

US JOBLESS CLAIMS: Jobless claims rose more than expected to a fresh 2022 high of 260k (exp. 259k, prev 254k), while continued claims rose to 1.416mln from 1.368mln, also above the 1.37mln expectation. Jobless claims data have been on a gradual rise in recent weeks and are showing signs of a cooling labour market. Analysts have also noted that continued claims have not been rising as fast as initial claims, which could imply those who take the initial jobless claims benefit are not on them for too long, thus finding new jobs quickly. Analysts at Oxford Economics (OxEco) think "the risk is that claims continue to drift higher as labor market conditions slowly cool", however, the consultancy does not expect a steep rise from the current levels any time soon as the demand for workers continues to outstrip supply. However, OxEco does believe claims are more prone to an increase rather than a decline, but stress it does not foresee a surge in new claims. Attention now turns to NFP on Friday (preview above), where job growth is expected to slow to +250k in July from a prior 372k; note this week's claims data is not relevant for the July jobs report.

TAIWAN: The PLA added an additional zone around Taiwan for its exercises and precision strikes were conducted within the eastern part of the Taiwan Strait. Meanwhile, the Chinese foreign affairs representative said whether the PLA's drills become the new normal depends on the US and forces in Taiwan. The drills saw hundreds of Chinese fighter jets around Taiwan's airspaces and 22 planes entered the ADIZ and all 22 jets crossed the median line. Meanwhile, a new missile test saw missiles being fired over Taiwan which landed in Japan's Exclusive Economic Zone - after China cancelled its bilateral meeting with Japan over the G7 Taiwan statement. The current round of PLA drills are expected to run until Monday. Meanwhile, the WSJ reported that the US military has postponed its Minuteman III (ICBM) missile test to avoid further angering China and avoid misunderstandings over Taiwan. White House's Kirby noted the US condemns China launching missiles near Taiwan and he expects China to continue their drills over the coming days but noted the US is prepared and USS Ronald Reagan will remain stationed in the area to monitor the situation. He also clarified the Minuteman III ICBM will be rescheduled in the near future and it does not affect he readiness of the US nuclear deterrent.

FIXED INCOME

T-NOTE (U2) FUTURES SETTLE 20+ TICKS HIGHER AT 120-23+

Treasuries rallied and were led by the belly as the BoE's sustained recession forecast spooked global markets. At settlement, 2s -6.3bps at 3.045%, 3s -7.3bps at 2.98%, 5s -8.8bps at 2.784%, 7s -8.4bps at 2.744%, 10s -6.3bps at 2.685%, 20s -3.1bps at 3.159%, 30s -0.4bps at 2.973%. Inflation breakevens: 5yr BEI -4.6bps at 2.746%, 10yr BEI -2.2 bps at 2.463%, 30yr BEI -0.1bps at 2.232%.

THE DAY: After hitting resistance at 120-14 in the NY afternoon on Wednesday, T-Notes hovered a few ticks beneath into the APAC Thursday session before dipping further at the London handover. Treasury activity was light ahead of the BoE decision and the contracts printed session lows of 120-03 beforehand. While the Old Lady confirmed a 50bps hike, against a significant minority of expectations for 25bps, it was the sustained recession and inflation forecasts that caught the global market's attention, lifting govvies. T-Notes peaked at 120-26+ in wake of the rise in US initial claims and mild improvement in the trade deficit (and ergo GDP). Another busy slate of corporate IG supply capped the bid, particularly ahead of Meta's (META) USD 10bln four-part debut debt offering. Traders also have an eye to next week's refunding, and of course, Friday's NFP (preview here).

STIRS:

- Eurodollars bull-flattened but are off best levels, aided by Fed's Mester ('22 & '24 voter) calling for hikes above 4% by next year and then pausing.
- EDU2 +1bps at 96.635, Z2 +2bps at 96.215, H3 +5bps at 96.325, M3 +7bps at 96.505, U3 +9bps at 96.735, Z3 +11bps at 96.905, H4 +11.5bps at 97.065, M4 +12.5bps at 97.21, Z4 +12bps at 97.38, Z5 +10bps at 97.51.
- Block activity saw a massive 57k SOFR Z2/Z3 calendar sold for -54; traders suggest the block was a likely exit from a 67k buy on July 26th for -63.
- In bills, US sold USD 59bln of 1-month bills at 2.110%, covered 2.80x; sold USD 53bln of 2-month bills at 2.280%, covered 2.54x.

CRUDE

WTI (U2) SETTLES USD 2.12 LOWER AT 88.54/BBL; BRENT (V2) SETTLES USD 2.66 LOWER AT 94.12/BBL

Oil prices were lower Thursday amid Aramco price cuts to Europe, grim BoE forecasts, and a pessimistic ECB survey, while reports suggest emergency OPEC capacity could be tapped. Reuters sources noted that Saudi Arabia and UAE could pump significantly more oil in the case of a winter crisis, but would only do so if supply worsened; said OPEC members possess around 2.0-2.7mln BPD of spare capacity, saving it for a winter crisis. On the demand side, the BoE's grim UK growth forecasts add to the broad pessimism in Europe, accentuated by the latest ECB survey that showed Eurozone consumers are bracing for a recession and higher inflation.

SAUDI PRICES: Saudi Aramco raised its September OSPs to the US and Asia, with the Asia premium rising to a fresh record at plus USD 9.80/bbl vs Oman/Dubai average from the prior 9.30/bbl, although Bloomberg noted that its survey of estimates had expected a larger USD 1.50/bbl hike. Meanwhile, its OSPs to NW Europe were cut to plus USD 4.70/bbl vs ICE Brent compared to the August premium of USD 5.30/bbl.

EQUITIES

CLOSES: SPX -0.08% at 4,152, NDX +0.44% at 13,311, DJIA -0.26% at 32,727, RUT -0.13% at 1,906.

SECTORS: Energy -3.59%, Consumer Staples -0.79%, Health Care -0.49%, Financials -0.34%, Materials +0.05%, Utilities +0.12%, Real Estate +0.13%, Communication Svs. +0.18%, Industrials +0.31%, Technology +0.42%, Consumer Discretionary +0.54%.

EUROPEAN CLOSES: Euro Stoxx 50 +0.61% at 3,755; FTSE 100 +0.04% at 7,448; DAX +0.54% at 14,661; CAC 40 +0.64% at 6,513; IBEX 35 +0.19% at 8,158; FTSE MIB +0.36% at 22,656; SMI +0.20% at 11,201

STOCK SPECIFICS: **Amgen (AMGN)** is to acquire **ChemoCentryx (CCXI)** for USD 4bln or USD 52/shr. The FAA acting chief will meet FAA safety inspectors in South Carolina Thursday before determining whether **Boeing (BA)** can resume deliveries of its 787 Dreamliner, Reuters reported. **Intel (INTC)** and Italy are close to a USD 5bln deal for an advanced packaging factory, according to Reuters sources. **Walmart Inc. (WMT)** is cutting hundreds of corporate roles in a restructuring effort, WSJ reported citing sources, following the recent profit warning. **3M (MMM)** commenced its split-off exchange offer for its food safety business; stockholders have the option to exchange some, all, or none of their shares of 3M common stock. **Costco (COST)** July sales rose 10% Y/Y to USD 16.85bln, above the expected rise of 9.4%. **Coinbase (COIN)** and Blackrock (BLK) are to create new access points for institutional crypto adoption, according to a blog, connecting Coinbase Prime and Aladdin.

EARNINGS: **Booking Holdings Inc (BKNG)** beat on EPS and revenue with solid gross booking while Q2 room nights surpassed 2019 levels for the first time and it announced it expects record Q3 revenue. On early Q3 trends, exec said that the pace of growth moderated, but through Q3 it expects higher gross bookings. **eBay Inc (EBAY)** beat on EPS and revenue although GMV fell 18% to USD 18.55bln. Active buyers missed expectations while guidance was more or less in line. **Eli Lilly and Co (LLY)** missed on EPS and revenue while it cut FY EPS view but affirmed its revenue view. **Kellogg Co (K)** beat on EPS and Revenue whilst also raising its revenue growth forecasts. **Alibaba Group Holding Ltd (BABA)** beat on EPS but missed on revenue. In the year ending June, more than 123mln annual active customers each spent over RMB 10,000 on Taobao and Tmall. Co said that starting in July, it has seen gradual business recovery compared to June, especially in fashion and electronics.

FX WRAP

The Dollar sold off quite heavily Thursday to see the index lose hold of the 106.00 handle amid a move lower in US yields while the risk tone was relatively mixed across asset classes with stocks mixed, oil tumbling, and precious metals firmer. The move in yields drove the downside in the Dollar while US data was also mixed as jobless claims rose once again, Challenger layoffs declined, and international trade data printed a slightly smaller deficit than expected, which prompted a slight upgrade to the Atlanta Fed GDPNow tracker to 1.4% from 1.3%. Attention now on Friday's NFP. Fed speak saw Mester express her hawkish roots noting rates should go a bit above 4% next year before holding them there for a while until inflation returns closer to its target while she also called for a discussion on MBS sales.

The Euro was supported by the weaker Dollar, seeing the single currency rise above 1.02 while a weaker GBP in wake of the BoE was also supportive. There was also hawkish commentary from ECB's Kazaks (a known hawk) saying the bank should keep hiking rates to fight inflation. However, there was a cautious ECB survey (conducted in June) that showed EZ consumers are bracing for a recession and high inflation. On data, German Industrial orders in June were not as bad as feared although the EU construction PMIs slowed.

The Yen was bid against the buck seeing USD/JPY fall sub 133 but did not manage to secure a gain against the Euro. The haven currency was supported by the aforementioned move lower in US yields. The geopolitical tensions surrounding Taiwan are worth keeping an eye on in Japan with the latest set of drills saw missiles land in Japan's Exclusive Economic Zone (EEZ) after China cancelled its meeting with Japan over the G7 statement, showing tensions between Japan and China are also rising.

The Pound saw a choppy reaction over the BoE: a knee-jerk move higher in the currency on the 50bps hike was unwound after some abysmal growth forecasts from the BoE. Cable saw a high of 1.2215 before paring to lows of 1.2064 in the aftermath of the BoE, albeit GBP managed to reverse some of its losses as the Dollar selling sustained. Sterling remained weaker against the Euro, seeing EUR/GBP rise to highs of 0.8437 from lows of 0.8358. A full Newsquawk review of the BoE rate decision can be found here.

Cyclical currencies were generally firmer against the buck but CAD was flat, whereas antipodeans had firmed throughout the session. AUD/USD hit a high of 0.6989 from a 0.6936 base and at pixel time remained above the 50 DMA around 0.6958 with the RBA SoMP due Friday. The Kiwi managed to rise above 0.6300 after breaching the 50dma at 0.6293 while the AUD/NZD cross managed to hold its head above 1.1050. CAD was flat and the cyclical underperformer with WTI prices tumbling on global demand concerns, dipping beneath USD 90/bbl for the first time since the Russian invasion of Ukraine. USD/CAD traded within a 1.2819-1.2876 range and hovers around 1.2850 heading into the US close.

EMFX was mixed. RUB was weaker as oil prices plummeted. TRY was flat and couldn't benefit from the lower oil prices. ZAR was buoyed by higher gold prices while LatAm FX performed well, with BRL, MXN, CLP and COP all rising against the Dollar. The BCB voted unanimously to lift its Selic rate by 50bps to 13.75%, in line with the consensus view, supporting the BRL. The BCB did however adjust its guidance to signal a smaller than 50bp hike at the next meeting which implies the tightening cycle is not over yet, but it may be approaching an end. On the fiscal side, a poll found the Real is expected to strengthen 2.6% to 5.13 in 12 months' time (prev. saw 5.20). In Mexico, the latest Reuters poll sees another 75bp hike to 8.5% next week, according to all 13 analysts surveyed, while a separate poll sees MXN strengthening against the buck to 20.62 in 12 months' time (prev. saw 20.55 in the July poll).

BCB REVIEW: The BCB voted unanimously to lift its Selic rate by 50bps to 13.75%, in line with the consensus view, as it continues to advance the process of monetary tightening significantly into even more restrictive territory. The central bank's updated economic projections now see inflation at 6.8% this year (prev. 8.8%), or around 180bps above the upper bound of its inflation target, before falling to 4.6% next year. "They are now incorporating the effects of a recently Congress approved cut to energy taxes that resulted in lower inflation expectations in 2022 but higher ones in 2023," Rabobank says, adding that "the Copom unusually decided to shed light on their Q1 2024 inflation projection at 3.5% Y/Y, being free from calendar effects and temporary tax cut effects." Rabo says that this is the most dovish aspect of the statement. Looking ahead, the Committee will be looking at the need for a "residual adjustment, of a lower magnitude," which Rabobank says leaves room for either an additional 25bps rate hike at that meeting, or even stopping the tightening cycle. "We still believe the Copom is most likely sitting on their hands until year end, bringing this long hiking cycle to a halt at 13.75%, they would then start the easing cycle only by the end of Q2 2023, until reaching 11.00% by end-2023 and 7.50% by end-2024." Rabo will be keeping an eye on the meeting minutes next week (Tuesday) for more details on the Committee's views on inflation and the state of the economy.

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