US Market Wrap

17th August 2022: UK inflation spike ignites risk aversion but dovish FOMC Minutes soften the blow

- **SNAPSHOT**: Equities down, Treasuries down, Crude up, Dollar flat.
- **REAR VIEW**: FOMC Minutes lack hawkish punch; Mixed US retail sales; Disappointing 20yr auction; Atlanta Fed GDPnow Q3 tracker cut to 1.6%; Bullish EIA data; UK CPI highest in 40 years; China's military is to partake in a military exercise in Russia; Poor TGT earnings; LOW beat on profit.
- **COMING UP**: **Data**: Australian Employment, EZ CPI (Final), US IJC, Philadelphia Fed, Existing Home Sales, New Zealand Trade Balance **Events**: Norges Bank & CBRT Policy Announcements **Speakers**: Fed's George, Kashkari; ECB's Schnabel **Supply**: France.

MARKET WRAP

Stocks were lower on Wednesday as global markets ramped their hawkish central bank pricing in wake of double-digit UK CPI data. The July FOMC minutes released later in the session softened the blow after noting that participants expressed a risk the Fed could tighten more than necessary. While the bounce off the lows in the front-end of the Treasury curve held, the bounce in stocks could not, and the major indices reapproached lows into the close. The US retail sales data had little market reaction, with the internals mixed, although the disappointing Target (TGT) earnings offset some of the more positive stock reports from Tuesday. Oil prices were firmer amid bullish US inventory data, although the upside was capped by broader risk aversion. In FX, the Dollar was ultimately flat after the post-minutes pullback in hawkish Fed pricing favoured other low yielders such as the Euro and also pared losses for the Yen, unwinding earlier Buck strength, although the antipodeans were underperformers, despite the hawkish RBNX hike, with attention on selling pressure in the metals space.

US

FOMC MINUTES: The July FOMC minutes didn't pack any hawkish surprises for participants, and if anything, left participants with a more balanced consensus on the Fed, exhibited by the pull-back in hawkish Fed pricing by the market. To cherry-pick, there was much attention on the comment that due to the fluid economic backdrop and lags in policy transmission, there was a risk "the Committee could tighten the stance of policy by more than necessary to restore price stability". Although, there were also comments that echoed the slew of hawkish Fed speak seen since the meeting, where some said rates would have to reach a sufficiently restrictive level to control inflation and remain there for some time. And as expected, participants concurred future rate hikes would depend on incoming information, judging that at some point it would be appropriate to slow the pace of hikes. One to watch, also, is that some said asset valuations have eased from elevated levels in recent months, potentially foreshadowing a firmer acknowledgement from the Fed that in its view, "market froth" has been dealt with, reducing the barriers to announcing the cessation of further tightening. Of course, inflation remains the main determinant of a 'pivot' where there remain concerns: participants agreed there was little evidence inflation pressures were subsiding and that it would take considerable time for the situation to be resolved. WSJ's Timiraos, synonymous with the horse's mouth for some, summarises, "Fed officials saw the risks as more two-sided last month: On one side, there's a risk they'll not do enough to bring inflation down before higher prices grow entrenched. But officials for the first time acknowledged the risks that they'd overdo it."

RETAIL SALES: US retail sales were a mixed bag, but ultimately a non-event. Headline M/M in July printed 0.0% (exp. 0.1%, prev. 0.8%) and ex-autos came in at 0.4% (exp. -0.1%, exp. 0.9%), while ex gas/autos was 0.7% (prev. 0.7%). The retail control rose to 0.8%, above the expected 0.6% and the prior 0.7%. In the wake of the report there was little change in Fed pricing and limited reaction seen across US asset classes. Nonetheless, Oxford Economics note the data “confirms that while consumers are feeling the burden of still elevated prices, they remain resilient. Consumers continued spending in July at a solid pace.” Furthermore, weighing on the headline was a steep drop in gasoline station sales, largely due to the fall in prices at the pump and a fall in motor vehicle and part sales - despite a reported rise in unit auto sales. Looking ahead, OxEco adds, “spending will receive a further boost in the coming months as consumer goods and energy price gains continue to ease.” Lastly, the consultancy concludes, “today’s solid report keeps the Fed in an aggressive policy tightening mode, debate at the Sept. FOMC meeting will be between a 50 or 75bps rate hike. With inflation, commodity prices and inflation expectations easing, the Fed might decide to scale back the rate hike to 50bps. Either way, we still expect another 125bps increase in the fed funds rate by year-end.”

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FIXED INCOME

T-NOTE (U2) FUTURES SETTLED 20 TICKS LOWER AT 118-24+

Treasuries were all sold Wednesday as hot UK inflation ignited a bear-flattener, but pared after dovish FOMC minutes. 2s +3.4bps at 3.285%, 3s +8.0bps at 3.271%, 5s +8.8bps at 3.048%, 7s +8.1bps at 2.986%, 10s +7.1bps at 2.895%, 20s +6.3bps at 3.383%, 30s +3.4bps at 3.149%. inflation breakevens: 5yr BEI +3.7bps at 2.754%, 10yr BEI +1.9bps at 2.476%, 30yr BEI +1.1bps at 2.252%.

THE DAY: T-Notes were sideways from their Tuesday settle through the APAC Wednesday session with little catalysts aside from the RBNZ, which hiked 50bps as expected although the outlook leant on the hawkish side. The commotion spewed out of London after the UK CPI surprisingly rose into double-digit territory, hammering Gilts and beyond lower. The selling sustained into the NY morning, with desks citing skittered nerves ahead of the FOMC minutes and 20yr bond auction. The US retail sales print was mixed with little surprises and saw a brief spell of short-covering before selling resumed into the afternoon. The largest 20yr tail on record kept T-Notes near session lows at 118-18 before a front-end led bounce in wake of the FOMC minutes that lent to the dovish side of expectations.

20YR AUCTION: A disappointing 20yr new issue where despite another disproportionate cut in size to USD 15bln and relative cheapness on the curve, the 3.380% stop marked a 2.5bps tail, the largest on record and considerably worse than last month's 2.7bps stop-through and the six-auction average of a 0.4bps tail. The 2.30x bid/cover ratio was both beneath the prior 2.65x and average 2.35x. The takedown saw a chunky 14.7% takedown from Dealers, with a significant fall in indirect participation to 67% from 78% last month.

STIRS:

- EDU2 +1.3bps at 96.663, Z2 -1.5bps at 96.08, H3 -5bps at 96.045, M3 -7bps at 96.125, U3 -8.0bps at 96.325, Z3 -9.5bps at 96.50, H4 -11bps at 96.68, M4 -12.5bps at 96.83, Z4 -12.5bps at 97.055, Z5 -10.5bps at 97.315.
- More block puts across ED whites seen Wednesday, follows the large position closing seen in puts through the week so far.
- US sold USD 30bln of 119-day CMBs at 2.890%, covered 3.06x.
- NY Fed RRP op. demand rose to USD 2.199tln from 2.165tln.

CRUDE

WTI (U2) SETTLED USD 1.58 HIGHER AT 88.11/BBL; BRENT (V2) SETTLED USD 1.31 HIGHER AT 93.65/BBL

Oil prices were modestly firmer in what was a choppy session amid bullish inventories and broader risk aversion. Oil prices drifted slightly higher into the Wednesday APAC session after the private inventory data indicated a small crude stocks draw and a chunky gasoline draw. Selling of the benchmarks was capped somewhat in the London morning amid comments from OPEC Sec-Gen Al Ghais that he sees a likely oil squeeze and remains bullish on oil, highlighting the "thin ice" conditions of spare capacity. WTI and Brent front-month advanced to session highs of USD 89.16/bbl and 94.48/bbl, respectively, after the more bullish than expected EIA inventory data. However, the buying couldn't sustain and prices receded back into earlier ranges soon after with participants still awaiting clarity/responses around the Iran deal.

EIA DATA: The US saw a massive 7.1mln bbl crude stock draw in the latest week, the highest since April which was despite a 3.4mln bbl SPR release, while gasoline stocks drew 4.6mln bbls and distillates built 0.8mln, both similar to the private data. The net draws were seemingly a function of export strength, with refinery utilisation declining on the week, exhibited by crude exports setting a new record at 5mln BPD amid Europe's scramble for alternative energy supplies to Russia. Meanwhile, US crude production declined 100k BPD to 12.1mln BPD, the first decline since July.

EQUITIES

CLOSES: SPX -0.72% at 4,274, NDX -1.21% at 13,470, DJIA -0.50% at 33,980, RUT -1.80% at 1,983.

SECTORS: Communication Services -1.85%, Materials -1.4%, Consumer Discretionary -1.12%, Industrials -0.77%, Technology -0.7%, Health -0.63%, Financials -0.52%, Real Estate -0.29%, Consumer Staples -0.23%, Utilities -0.15%, Energy +0.8%.

EUROPEAN CLOSES: Euro Stoxx 50 -1.29% at 3,756; FTSE 100 -0.27% at 7,515; DAX -2.04% at 13,626; CAC 40 -0.97% at 6,528; IBEX 35 -0.91% at 8,434; FTSE MIB -1.04% at 22,757; SMI -0.10% at 11,119.

EARNINGS: **Lowe's (LOW)** beat on profit and forecasts operating income and EPS to come in at the top end of its guidance range. Although, it missed on revenue and comparable sales. **Target (TGT)** was lower in wake of missing on the top and bottom line, and added inventory actions, such as significantly cutting prices, place notable pressure on near-term profitability. Moreover, TGT said it is planning cautiously for remainder of the year and current trends support prior guidance for FY rev growth in low- to mid-single digit. **Agilent (A)** was firmer following a strong report, as it beat on EPS and revenue alongside raising FY and next quarter guidance. **TJX (TJX)** missed on revenue with FY23 EPS view also coming in short. Additionally, sees FY23 US comp store sales falling 2-3%, against the prior rise of +1-2% as it said inflation impacted the spending habits of its customers. **Jack Henry & Associates (JKHY)** posted a strong report for the quarter but looking ahead FY23 EPS and revenue view were both short of the St. consensus which is the reason for the weakness seen. **Krispy Kreme (DNUT)** saw losses after it missed on EPS and revenue while the FY22 revenue view was also short of expected. Co. said it is seeing a significant deceleration in commodity costs in recent weeks.

STOCK SPECIFICS: **Apple (AAPL)** is in talks to make Apple Watches and MacBooks in Vietnam for the first time, as the tech giant looks to diversify production away from China, according to Nikkei. Separately, AAPL targets September 7th for its event to unveil the iPhone 14 line-up. **Southwest Gas (SWX)** had Carl Icahn raise his stake in the company to 8.7% (prev. 7.6%). Elon Musk said he was joking when he said he was going to buy **Manchester United (MANU)**. Since, according to Bloomberg, the Glazers are reportedly open to the sale of a minority stake of MANU, but considerations are at an early stage. Later reports in The Times say UK's Jim Ratcliffe is an interested suitor. **TPG (TPG)** is reportedly exploring the sale of Immucor for over USD 2bln, according to Bloomberg. **Amazon (AMZN)** is reportedly testing TikTok like app feature amongst its employees, according to WSJ. **Tesla (TSLA)** legal chief who led purchasing probe has left the co. which marks at least the fourth legal chief departure since 2019. **Sanofi (SNY)** discontinued the development of its breast cancer treatment, amcenestrant, after the trial showed no signs that the drug was effective. **Denbury (DEN)** reportedly exploring options including a sale, according to Bloomberg.

FX WRAP

The Dollar was choppy on Wednesday but is flat at pixel time after it pared its gains in wake of the FOMC Minutes where officials expressed a risk the Fed could tighten more than necessary. Elsewhere on Wednesday, the highly anticipated US retail sales, which printed 0.0% M/M, was a non-event highlighted by the fact it garnered little market reaction and had mixed internals. For the session, the Buck printed a low of 106.300 in contrast to a high of 106.890, and with the key risk events for the week to one side, market participants will be awaiting the next stimulus for market direction in summer trading conditions. Nonetheless, on Thursday there is Philly Fed, which comes after the woeful NY Fed on Monday, as well as Fed's George (2022 voter) and Kashkari (2023 voter) scheduled.

Antipodeans, NZD and AUD, saw losses in excess of a per cent vs the Greenback, and as such were the G10 underperformers. This came on a range of factors, as the Aussie was already pressured coming into the US session following the softer-than-expected Wage Price Index data. Meanwhile, the Kiwi fared relatively better due to the hawkish 50bps rate hike from the RBNZ, as the bank agreed that further rate increases were needed, and it also hiked its projections for the OCR and inflation with the OCR now expected to peak at 4.1% (prev. ~4.0%). Furthermore, the central bank reiterated it remains resolute in its commitment to return inflation to the target and to further bring forward the timing of OCR increases. Additionally, the weakness seen in the commodity markets, especially iron ore and copper, weighed on the Antipodes. Regarding levels, AUD/USD and NZD/USD hit lows of 0.6912 and 0.6259, respectively, as they managed to claw back some losses in wake of the aforementioned FOMC minutes. Attention now turns to July Australian employment on Thursday.

EUR saw gains against the Greenback, and hence was the G10 outperformed, after it managed to resist the Dollar's advances relatively well with a deeper reversal in EGBs to thank. EUR/USD even managed to surpass 1.02 to the upside, albeit briefly, to highs of 1.0202 following the FOMC minutes. Elsewhere, Eurozone data releases did not help the single currency, as flash GDP and employment for Q2 both fell slightly short of consensus. In addition, the recession fears and energy supply/price concerns continue to persist for the Euro.

CAD and **GBP** both saw losses, with the latter's not as pronounced as the formers. Despite saying that, Cable traded between 1.2141-1.2029. UK CPI hit a 40-year peak at 10.1% Y/Y, stoking further recession fears and dimming the Pound's outlook as the BoE is now priced in for another 50bps rate hike. The Loonie saw losses, although is well off its worst levels as the rebound in oil prices, following the bullish EIA inventory data, helped the CAD pare some of its losses.

Safe havens, CHF and JPY, were both weaker against the Buck, with USD/JPY hitting a high of 135.49 and falling just short of the 50DMA and August high 135.58/59. Moreover, the cross rallied on surging Tsy/JGB yield spreads, but in the aftermath of the less hawkish than expected FOMC minutes, the gains were trimmed on account of Treasury yields slipping. Meanwhile, USD/CHF hit a high of 0.9544, but the Buck ran out of momentum before it could mount a serious test of the round 0.9550. Looking ahead, Japanese CPI on Friday looms.

EMFX was lower across the board with the ZAR was the notable underperformer while the TRY stoutly defended 18.0000, once again. The ZAR was weighed on by a surprise negative retail sales print and the downside in gold, as well as Eskom, again, noting Stage 2 load shedding to be implemented between 16:00-24:00 on Wednesday and Thursday. Elsewhere, most EM currencies were rattled by the broader gloomy market mood. Looking forward, EM watchers look to the Mexican retail sales on Friday.

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