US Market Wrap

29th September 2022: Stocks & Dollar tumble into month-end while German CPI ignites EZ inflation fears

- **SNAPSHOT**: Equities down, Treasuries down, Crude down, Dollar down
- **REAR VIEW**: Hot German CPI; Truss backs her tax plan; BoE's Pill expects a significant and necessary response to UK plan; Jobless Claims see big decline; Q2 US GDP contraction confirmed; Mester and Bullard stick to hawkish themes; META announces hiring freeze; AAPL downgraded at BAC
- **COMING UP**: **Data**: Chinese NBS PMIs, German Retail Sales, EZ CPI (Flash), Unemployment, US PCE Price Index **Events**: Russian President Putin, Moody's on Italy **Speakers**: Fed's Williams, Brainard; ECB's Elderson, Schnabel.

MARKET WRAP

Stocks sold off hard on Thursday heading into the final trading day of the month, reversing the recently-rare glimpse of optimism on Wednesday. Losses were led by the tech-heavy Nasdaq with a downgrade on Apple (AAPL) from Bank of America adding to the tech woes with heavyweights among underperformers, but also the defensive with Utilities and Real Estate sectors also suffering. Despite the strong downside in stocks, the Dollar saw pronounced weakness with the DXY testing 112.00 from an earlier high of 113.79, while GBP roared. Cable briefly rose back above 1.11 from Thursday lows of 1.0763 despite the UK PM's commitment to her tax plan but BoE's pill confirmed the PM's plan will prompt a significant and necessary response from the MPC. The Euro also saw gains after hotter than expected German CPI data, sending yields higher while there was accompanying hawkish ECB speak. Note, the commitment from Truss and hot German CPI also resulted in initial Treasury selling across the curve before rebounding gradually throughout the session while Fed speak was also hawkish, but from the known hawks Mester and Bullard. US data saw jobless claims saw smaller print than expected printing a fresh low since late-April while Final Q2 US GDP confirmed a contraction of 0.6% while the PCE metrics were revised slightly higher, albeit the more timely September PCE data is due on Friday for a further gauge of inflation. Note, LME aluminium prices spiked higher after reports suggested the LME is to discuss a potential ban of Russian metals.

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FED: **Mester (2022 voter)** said the Fed is not at a point of stopping rate hikes, adding they are not in the restrictive territory yet. She noted, so far, the economy has handled Fed tightening but she stressed the need to get inflation down. She also added her views are probably a bit above the median path reflected in the September projections. On inflation, Mester sees it coming down but the FFR has to be higher for that to happen. On the labour market, she is not expecting a big bump up in participation, adding the US is basically back to trend on labour force participation. On the dollar, Mester acknowledged it is one of the conditions that has tightened, and that it is helpful on inflation. **Bullard (2022 voter)** spoke three times on Thursday, but to summarise, he noted markets have understood their message from the latest dot plot, which shows more tightening is expected this year. He said it would be a bad idea to mess around with the inflation target. He has a hard time seeing the unemployment rate rise that much given so many job openings, but he is anxious to see to what extent global QT will affect financial conditions. He pays a lot of attention to market-based measures of inflation expectations, such as TIPS and swaps - which have come down, which is encouraging, as is real rates into positive territory. The Fed will probably need higher for longer rates than markets expected previously and a recession is a risk, but not his base case.

JOBLESS CLAIMS: Initial jobless claims were strong, falling to 193k, the lowest level since late April despite the expected rise to 215k from the prior 209k (revised down from 213k). Continued claims cooled to 1.347mln from 1.376 mln despite the expected rise to 1.388mln. The data shows how tight the labour market is in the US and Fed's Bullard labelled today's claims metric as "super low". The differences between labour supply and demand are key for the Fed and will contribute to their aggressing hiking cycle with the current dot plot pencilling a terminal rate of 4.6% in 2023 - markets are implying a terminal rate of 4.5% currently. Looking ahead, analysts at Oxford Economics do not expect claims to fall much from current levels, but they also do not expect a spike anytime soon either, noting it is more likely to trend higher next year where they are predicting a mild recession to see unemployment rise to 4.7%. Note, several Fed speakers noted an unemployment rate of 4.5% would be seen as a successful tightening process.

US Q2 GDP: US final GDP was confirmed to decline 0.6% in Q2, in line with the prior estimate, which was the second consecutive quarterly contraction. Looking deeper into the report, the final deflator was revised higher to 9.1% (exp. 8.9%, prev. 9.0%), and consumer spending also inched up to 2.0% (prev. 1.5%), while sales was maintained at 2.0%. Delving into the release, Oxford Economics note, "the Q2 economic contraction was led by weakness in goods-producing industries while stronger services mitigated the decline." Meanwhile, construction and nondurables manufacturing - namely chemicals manufacturing - contributed most to the headline decline. However, on a positive note the leisure and hospitality industry recouped its GDP losses suffered during the COVID recession. Nonetheless, OxEco adds, activity across industries will weaken as the economy slips into a recession in H1 2023. Further on this, Oxford expects "a modest rebound in economic growth in H2, but the combination of persistently high inflation, more aggressive Fed monetary policy tightening, negative spill over effects from slower global activity and weaker corporate earnings will push the US economy into a mild recession in H1 2023."

GEOPOLITICS

PUTIN SPEECH PREVIEW: Russia is expected to officially annex Donetsk, Luhansk, Zaporizhzhia and Kherson on Friday. Deputies of the State Duma have been sent an invitation to the Kremlin on September 30th. The event will reportedly commence at 15:00 Moscow Times (13:00BST/08:00EDT) and will see a speech by Russian President Putin (exact timing unknown). A source via TASS suggested that the president is to address both houses of parliament on Friday - the meeting will focus on the results of the referendums. "There will be a speech that will determine the key tasks that we will have to solve in the near future", TASS sources said. For the full analysis piece, please click here. Note, there was a rather daunting opinion/sources piece in the Moscow Times warning how the partial mobilisation of Russian troops is a distraction, before a mass mobilisation, and after that, tactical nuclear weapons, more info available here.

FIXED INCOME

T-NOTE (Z2) FUTURES SETTLED 13 TICKS LOWER AT 112-14+

The Treasury curve bear flattened with early morning selling inspired by hot German CPI state metrics and a gilt sell-off follow through, before paring from lows. 2s +7.6bps at 4.170%, 3s +6.9bps at 4.191%, 5s +6.4bps at 3.986%, 7s +6.5bps at 3.890%, 10s +4.6bps at 3.753%, 20s +1.9bps at 4.004%, 30s +1.8bps at 3.699%. Inflation Breakevens: 5yr BEI -18.1bps at 2.232%, 10yr BEI -13.7bps at 2.206%, 30yr BEI -10.3bps at 2.101%.

THE DAY: Treasuries were sold in the European morning after German state CPI reports came in hotter than expected, across the board, which was later confirmed with the headline CPI rising 10% Y/Y while HICP rose 10.9% Y/Y, all above expectations. Also adding to the downside was the weakness in Gilts continuing, weighing on fixed income overall as the UK PM reaffirmed her commitment to the looser fiscal policy. The 10yr T-note hit a low in the London morning of 111-20+ before gradually rebounding throughout the rest of the session. The US data bought in much lower initial jobless claims print than expected, which saw a brief dip in T-notes, although the move was ultimately short-lived and the dip in Treasuries was bought. Fed speakers saw little new added with Mester and Bullard reiterating familiar hawkish themes; Mester once again noted she does not believe the Fed is at neutral yet while Bullard said the market has understood the Fed's message from the dot plot. IFR noted new algo programmes were triggered on the break of several resistance levels in yields with block buys adding to the dip.

STIRS:

- EDZ2 -2.0bps at 95.310, H3 -5.5bps at 95.295, M3 -6.0bps at 95.330, U3 -6.5bps at 95.440, Z3 -6.5bps at 95.535, H4 -8.0bps at 95.710, M4 -8.5bps at 95.885, U4 -8.5bps at 96.010, Z4 -7.0bps at 96.120, Z5 -5.5bps at 96.265.
- US sold USD 53bln of 1-month bills at 2.660%, B/C 2.54x; Sold USD 47bln in 2-month bills at 3.065%, B/C 2.57x.
- NY Fed RRP op. demand USD 2.372tln (prev. 2.367tln), a new record, across 103 bidders (prev. 101).

CRUDE

WTI (X2) SETTLED USD 0.92 LOWER AT 81.23/BBL; BRENT (X2) SETTLED USD 0.83 LOWER AT 88.49/BBL

The crude complex was choppy on Thursday, but eventually settled lower, towards the bottom end of the day's ranges but off the USD 80.34/bbl and USD 87.33 lows for WTI and Brent, respectively. There were several updates regarding price caps too of note. The German coalition agreed to gas & electricity price brakes, and a cut in gas sales tax. Meanwhle, an EU Senior Diplomat noted EU countries are nowhere near a consensus on a gas price cap (more details below).

OPEC: Ahead of the OPEC+ meeting next week, OPEC+ commenced discussions around an output cut with one saying it a cut is “likely”, according to Reuters sources. Note, on Tuesday other Reuters sources noted Russia will likely propose OPEC+ reduces output by around 1mln BPD.

GAS PRICE CAP: A senior EU official said ministers will discuss different options for a gas price cap on Friday, and that most nations are calling for a gas price cap. However, later an EU Senior Diplomat added EU countries are nowhere near a consensus on this and it is difficult to say whether a price cap on Russian gas could be agreed. This was in fitting with earlier remarks from the EU Commission who said they will not put a proposal to cap gas prices on the table for Friday’s emergency meeting of energy ministers, according to a working document cited by journalist Keating. Reminder, expectations going into this was for the gas cap to be discussed, but no formal proposal was expected to be put forward, given resistance to this from some key member nations including Germany.

BANK COMMENTARY: Goldman Sachs’ Currie stated the oil market is in a deficit and is set to tighten further and the oil price should be in the USD 85-95/bbl range.

LOADINGS: North Sea Ekofisk crude oil stream to load 13 cargoes in Nov (prev. 14 in Oct) and Forties to load 11 cargoes (vs 11), according to trade sources cited by Reuters. Separately, the Russian Urals oil loading plan from Primorsk is set to fall to 1.2mln/T for October 1st-10th (vs 1.3mln/T for September 1st-10th).

IAN: NHC said Tropical Storm Ian is expected to weaken Friday night and Saturday after it moves inland. In terms of co. specifics, BP (BP/ LN) redeployed offshore personnel and resumed production at Na Kika (130k BPD) and Thunder Horse (250k BPD) platforms, while Chevron (CVX) said there has been no damage to platforms and has begun started to redeploy personnel and resume normal operations at our two platforms that were shut in. Elsewhere, South Carolina seaports will close all marine terminals on Friday due to Hurricane Ian.

EQUITIES

CLOSES: SPX -2.11% at 3,640, NDX -2.86% at 11,164, DJIA -1.54% at 29,225, RUT -2.54% at 1,671.

SECTORS: Utilities -4.07%, Consumer Discretionary -3.38%, Real Estate -2.87%, Technology -2.74%, Communication Services -2.46%, Industrials -1.83%, Consumer Staples --1.64%, Materials -1.53%, Financials -1.24%, Health -0.92%, Energy -0.13%.

EUROPEAN CLOSES: EURO STOXX 50 -1.69% at 3,279, FTSE 100 -1.77% at 6,882, DAX 40 -1.71% at 11,976, CAC 40 -1.53% at 5,677, FTSE MIB -2.40% at 20,353, IBEX 35 -1.91% at 7,300, SMI -0.92% at 10,127

STOCK SPECIFICS: **Amazon (AMZN)** expanded pay and benefits for front-line employees with a new investment of nearly USD 1bln; pay increases will begin in October. **Apple (AAPL)** was downgraded at Bank of America; said AAPL has held up relatively well in a down market, but it expects a negative impact on the company from weakening consumer demand. **Berkshire Hathaway (BRK.A)** bought a further 6mln shares in **Occidental Petroleum (OXY)**, according to an SEC filing. **Warner Bros. Discovery (WBD)** was sued for allegedly inflating HBO Max numbers, according to LA Times. **Google (GOOGL)** is to begin winding down its Stadia streaming service, according to a blog post. **Nike (NKE)** is expected to step up discounts to move excess inventory, according to WSJ. Biden-Harris administration announces lower premiums for medicare advantage and prescription drug plans in 2023. **Lululemon (LULU)** won a dismissal of **Peloton's (PTON)** patent lawsuit. **Meta (META)** CEO announced a hiring freeze and warned employees of restructuring.

EARNINGS: **Carmax (KMX)** posted a poor report, highlighted by a wide miss on EPS alongside falling short on revenue as “affordability challenges” led to a sharp drop in sales. **Bed Bath & Beyond (BBBY)** posted a much deeper loss per share than expected and missed on revenue; maintains FY outlook and sees breakeven operating cash flow by end of fiscal 2022. **MillerKnoll (MLKN)** marginally missed on revenue alongside poor guidance as both EPS and revenue were light of consensus; seeing some degree of uncertainty in end markets. **Rite Aid (RAD)** reported a deeper loss per share and cut FY23 adj. EPS view. Note, it beat on revenue and backed FY23 revenue view. **Vail Resorts (MTN)** posted a shallower loss per share than expected and beat on revenue; seeing strong demand for ski season passes and full-year sales that have rebounded past pre-pandemic levels.

FX WRAP

The Dollar was weaker on Thursday printing a low of 112.06 and trimmed some of its weekly gains, as it was largely affected by the surge higher in Sterling as well as month/quarter-end position squaring where month-end models signal Dollar selling. As such, desks note profit-taking appeared in order. Elsewhere, the Buck saw very fleeting upside in the wake of the strong initial jobless claims report, which was greatly beneath expectations, but as mentioned this only briefly halted the downward slide. Fed's Mester (2022 voter) and Bullard (2022 voter) were on the wires, a lot, but did not add much new and stuck to the hawkish tone. However, Mester did acknowledge she is probably a bit above the median path reflected in the September projections. Looking ahead, core PCE for August and Fed's Brainard and Williams are the key scheduled risk events for Friday, but market participants will remain very cognizant of the ongoing macro fundamentals.

GBP was the clear outperforming currency against the Buck, as the Pound managed to recoup some of its losses since the "mini-budget" last Friday, and as such Cable printed a high of 1.1107, but still a way from Friday's open of 1.1255. Cable did initially probe 1.0900 with some apprehension on psychological grounds and the fact that two recent peaks above the round number had capped its recovery efforts previously, but extended well beyond once those levels were breached. Before this, Sterling seemed more susceptible to another slide and especially when UK PM Truss stuck to the plans laid out in the mini-budget, arguing that it is right to take decisive action given the difficult economic environment and the Government is ready to make tough decisions. In terms of BoE speak, BoE's Pill stated the fiscal easing announced last week will prompt a significant and necessary monetary policy response in November.

The EUR firmed against the Greenback and printed a fresh WTD peak of 0.9797, amidst a sharp backup in EGB and UST yields along with hawkish ECB and Fed rhetoric. Moreover, the Pound's bounce back also supported the push higher in the single currency. Meanwhile, German inflation data was hot across the board and reached another peak, and as such ING added "it provides more ammunition for the ECB to hike by 75bp at the October meeting". Additionally, all eyes remain on the energy crisis ahead of the EU Energy Ministers Meeting, where an EU Senior Diplomat said EU countries are nowhere near a consensus on a gas price cap.

Activity currencies, NZD, AUD, and CAD, were lower and saw similar weakness vs the Greenback but were well off worst levels, at pixel time. The currencies tracked risk sentiment and traded widely off the macro fundamentals and risk-off conditions, highlighted by the hard selling in stocks. For the Loonie, Canadian monthly GDP for July was slightly better than expected, but there was little market reaction while Statscan also expect GDP to be little changed in August.

Safe-havens, CHF and JPY, saw slight losses as USD/JPY traded in 144.79-06 parameters with the Yen managing to pull away from potential Japanese intervention territory, yet again.

EMFX was mixed, as CNY/CNH, RUB and TRY all firmed, while ZAR, BRL, and MXN weakened vs the Greenback. For the Yuan, the USD/CNH fell following news that Chinese banks were told to prepare for FX intervention, and the PBoC suggested mortgage rate floors could be relaxed as the key real estate sector remains in distress. Regarding the Rand, gold prices were flat alongside Eskom's update where Stage 4 load-shedding will continue to be implemented until 05:00 on Saturday morning and reduce to Stage 3 throughout the weekend. Elsewhere, BCB contained declines with the help of above consensus Brazilian jobs data and BCB chief Neto stating that it is too soon to talk about easing. Lastly, Mexican President Obrador claimed inflation has peaked which came prior to the rate decision where there was little market reaction.

BANXICO REVIEW: Banxico hiked rates by 75bps, as expected, to 9.25% (prev. 8.5%), in a unanimous decision in the face of accelerating inflation and deteriorating external conditions, such as persistent supply and demand issues and rising commodity prices. In the accompanying commentary, Banxico said the balance of risks for the trajectory of inflation within the forecast horizon remains biased to the upside, and the Board will thoroughly monitor inflationary pressures as well as all factors that have an incidence on the unforeseen path for inflation and its expectations. As such, Banxico's updated inflation projections were lifted across the board, and it now anticipates year-end inflation at a peak of 8.6% (prev. 8.1%), while "cooling" to 4.0% (prev. 3.2%) by the end of 2023 before returning to target in 2024 with inflation seen at 3.1% by Q3 2024. Looking ahead, Pantheon Macroeconomics expect the Board to increase rates by a final 75bp at the next meeting - assuming the Fed does the same, and then to remain on hold over H1 2023. Pantheon state that "weakening domestic demand, deteriorating global conditions, and a less hawkish Fed, thanks to rapidly falling inflation, should give Banxico room to pause. But the risks to rates remain massively tilted to the upside."