US Market Wrap

12th October 2022: Stocks and yields lower after mixed Fed minutes ahead of US CPI

- **SNAPSHOT**: Equities down, Treasuries up, Crude down, Dollar flat.
- **REAR VIEW**: FOMC minutes leaves a bit for everyone; Hot PPI; Weak 10yr auction; US EIA STEO cuts 2023 world oil demand forecast, but raises 2022; Kashkari says Fed can lift rates to 4.5% and stay there for a while; Hawkish ECB rhetoric; Further conflicting reports on BoE gilt purchases beyond Friday; Druzhba pipeline damaged; White House mull Russia aluminium ban; Strong PEP earnings; INTC plans major headcount reduction;
- **COMING UP**: **Data**: German Final CPI, US CPI, US DoE **Events**: IEA OMR, Astana Summit **Speakers**: ECB's de Guindos, BoE's Mann **Supply**: Italy, US.

MARKET WRAP

Stocks ultimately closed with mild losses despite some key risk events, including a hotter than expected PPI report and mixed FOMC minutes. The PPI came in hotter than expected on the headline, with the M/M accelerating while the Y/Y slowed, but not as much as was hoped as attention now turns to US CPI on Thursday. Treasuries were firmer across the curve with outperformance in the belly, while the longer end was capped after a weak 10yr auction but the dip was bought in the 10yr after the FOMC minutes. The minutes revealed little new information in comparison to recent Fed commentary although there was an initial, short-lived dovish reaction despite the minutes being mixed and offering something for both the hawks and the doves. The 10yr note rose to session highs on some of the dovish aspects with it clear that some on the FOMC are cognizant of the risks of doing too much. However, on the hawkish side many still see the risk of doing too little a greater risk than doing too much given their fight against inflation which is "showing little sign so far of abating". Fed pricing was little changed after the data and FOMC minutes with markets still implying a c. 90% probability of a 75bp hike in November while the terminal rate is seen just under 4.7% from March. Elsewhere, the BoE remains in focus after reports in the FT suggested it signalled to lenders it is prepared to prolong bond purchases and take a flexible approach if volatility increases although the BoE later affirmed its end of week termination date. In commodities markets, crude settled lower with world oil demand forecasts being revised down by OPEC for 2022 and 2023, while the EIA cut their 2023 outlook but raised their 2022 forecast. Meanwhile, relations with Saudi and the US are souring after the latest OPEC production cut and the Deputy Energy secretary spoke on the close about their ability to tap the SPR if needed to stabilise markets, while also not ruling out a fuel export ban. Aluminium surged after reports the White House is considering a ban on Russian aluminium in a retaliatory move. In FX, the USD/JPY hit 24 year highs after fresh dovish commentary from BoJ's Kuroda while GBP was the outperforming currency after rumours of an additional government u-turn on tax cuts, aswell with talk of more extended support from the BoE in the Gilt market, although both of these rumours were later denied.

US

FOMC MINUTES: The minutes were in fitting with recent commentary and had a bit for both the hawks and the doves. The dovish commentary noted that "several" said as policy moved into restrictive territory, the risks would become more two-sided. Meanwhile, several said with the highly uncertain global economic and financial environment, it would be important to calibrate the pace of further tightening with the aim of mitigating risk of significant adverse effects on the outlook - a nod to the impacts US tightening has on global economies. Meanwhile, participants observed it would become appropriate at some point to slow the pace of rate hikes while assessing the overall effect of policy. On the hawkish side, many indicated once policy reaches a sufficiently restrictive level, it would be appropriate to maintain that level for some time while several underlined the need to maintain a restrictive stance for as long as necessary. Many participants also emphasised that the cost of taking too little action outweighs the cost of taking too much action. A lot of the commentary has been suggested at by individual Fed speakers since the September FOMC and is not too surprising, but it is clear some on the FOMC are cognizant of the risks of doing too much, although many still see the risk of doing too little a greater risk than doing too much given their fight against inflation which is "showing little sign so far of abating".

US PPI: The September PPI data was hot, with the M/M headline rising 0.4%, above the estimate of 0.2% and above the prior 0.2% decline. The Y/Y cooled somewhat to 8.5% from 8.7%, albeit not as much as to the expected 8.4%. The core metrics saw M/M rise in line with expectations at 0.3% with the prior being revised to 0.3% from 0.4% while the Y/Y rose 7.2%, beneath the 7.3% expectation and prior which helped offset some of the heat on the headline PPI, albeit it is still notable and suggests inflationary pressures are not easing as fast as hoped. Oxford Economics note the start of Q3 saw steady progress but the September report is a reminder price pressures remain elevated and volatile, particularly for food and gas and today's report will only add to the Fed's resolve to hike rates by 125bps by year-end.

FED SPEAK: **Kashkari (2023 voter)** said the Fed can lift rates to 4.5% and then stay there for a while as it assesses the economy. Kashkari noted there may be a housing downturn, but not necessarily a hard crash. There is tremendous uncertainty about the fundamentals of the US economy. By moving rates up aggressively, but not at an overwhelming pace, allows the Fed room to assess the economy. It is a judgement call on whether Fed moves in 50bps or 75bps increments on rates. Kashkari said he is not seeing much evidence that underlying inflation is softening, but did acknowledge the strong USD is creating challenges for other countries, but stated the Fed's job is focussed on bringing down inflation.

FIXED INCOME

T-NOTE FUTURES (Z2) SETTLED 11 TICKS HIGHER AT 111-15+

Treasuries were firmer across the curve, particularly the belly in wake of more BoE support talk, hot PPI, a weak 10yr auction and mixed FOMC minutes ahead of Thursday's CPI. At settlement, 2s -2.3bps at 4.293%, 3s -3.7bps at 4.309%, 5s -4.6bps at 4.121%, 7s -4.0bps at 4.038%, 10s -3.1bps at 3.908%, 20s -1.1bps at 4.195%, 30s -1.3bps at 3.889%. Inflation Breakevens: 5yr BEI -5.4bps at 2.381%, 10yr BEI -2.7bps at 2.303%, 30yr BEI -0.1bps at 2.211%.

THE DAY: The Treasury curve was bid across the curve, with the moves starting in the morning on reports the BoE are prepared to prolong bond purchase and take a more flexible approach if volatility continues. However, some of the moves pared when the BoE affirmed it would end on Friday. With the curve bid, the moves were predominantly in the belly although some selling pressure was seen in wake of the hotter-than-expected PPI data; but the core metrics showed some signs of cooling with all eyes now on Thursday's CPI data. The weak 10yr auction saw Treasuries sold with the auction tailing and a flop in indirect demand adding to the downside (more details below). The post auction dip was bought in wake of the FOMC minutes, however. The minutes saw little new information in relation to recent Fed commentary but there was something there for both the hawks and the doves. In wake of the minutes, 10yr yields edged lower to session lows of around 3.88% with participants seemingly fixated on the dovish aspects. The dovish commentary noted "several" said as policy moved into restrictive territory, the risks would become more two-sided and several participants noted with the highly uncertain global economic and financial environment, it would be important to calibrate the pace of further tightening with the aim of mitigating risk of significant adverse effects on the outlook. Meanwhile, participants observed it would become appropriate at some point to slow the pace of rate hikes while assessing the overall effect of policy. However, there were several hawkish aspects too, in particular many noting the risks of doing too little outweighs the risks of doing too much and inflation has shown little sign of abating, thus requiring restrictive policy for some time. Both of these arguments have been made in recent Fed speak but with Treasuries finding some support to the minutes shows how sensitive markets are to a hint of changing policy, as was seen early last week, although the weak auction did also provide a buying opportunity.

AUCTION: Overall a weak auction with the 1.6bps tail, albeit this is in line with the six auction average and also being a smaller tail than what was seen in the prior auction. The B/C was weaker than the average and prior auction. Dealers, the forced buyers, were left with 19.7% of the auction, relatively similar to the last 10yr auction but above the six auction average. There was a marked slowdown in indirect bidders, who only took 56.8%, much lower than the average 66.1% and the prior 62.3%. However, direct bidders took 23.5%, more than the prior 17.9% and average 17.7% - a solid improvement and helped offset some of the lack of indirect demand, although dealers were still left with a chunky size of the auction ahead of CPI on Thursday.

STIRS

- EDZ2 -3.5bps at 95.110, H3 +0.0bps at 95.085, M3 +1.0bps at 95.140, U3 +4.0bps at 95.280, Z3 +6.0bps at 95.425, H4 +8.0bps at 95.630, M4 +8.5bps at 95.800, U4 +8.5bps at 95.920, Z4 +7.5bps at 96.015, Z5 +5.5bps at 96.185.
- NY Fed RRP op. demand USD 2.247tln (prev. 2.222tln), across 103 bidders (prev. 100)
- US sold USD 33bln in 119day CMB's at a high rate of 3.890%, B/C 3.23x.

CRUDE

WTI (X2) SETTLED USD 2.08 LOWER AT 87.27/BBL; WTI (Z2) SETTLED USD 1.91 LOWER AT 86.06/BBL; BRENT (Z2) SETTLED USD 1.84 LOWER AT 92.45/BBL

Oil prices were lower on Wednesday and trundled lower throughout the session as WTI and Brent hit lows of USD 86.28 and 91.56/bbl, respectively, in the NY afternoon. Regarding the day, there were several oil specific updates, namely the OPEC MOMR (Oct), further details below, and the US EIA STEO, which cut its forecast for 2023 world oil demand by 490k BPD and now sees 1.48mln BPD Y/Y increase and raised its 2022 forecast by 20k BPD to 2.12mln BPD Y/Y (full details here). Elsewhere, on the Russia energy cap, Netherlands and Germany are to reportedly work with others on a gas price-cap plan, but Russia Deputy PM Novak noted it is easy to get around EU's plans for an oil price cap. In other news, there was a leak in the Druzhba pipeline. Lastly, private inventory data is after hours and expectations are (bbls): Crude +2.1mln, Gasoline -1.9mln, Distillates -2.2mln.

DRUZHBA PIPELINE: Polish pipeline operator said on Tuesday evening it detected a leak in the Druzhba pipeline, with the cause unknown, but a leak was detected in one of two lines, with the second line working as normal. Following this, a Polish top official for energy infrastructure noted it was probably accidental damage but the Polish PM did not want to make a final conclusion yet, but did note many signs do point to the Kremlin. Germany's State of Brandenburg Economy Minister noted there was a pressure drop in Druzhba's main pipeline No.2, according to DPA, and the leak was probably caused by accidental damage. On deliveries, Germany Schwedt Refinery is receiving oil deliveries with reduced capacity.

OPEC MOMR: World oil demand growth forecasts were revised down for 2022 and 2023 by 500k BPD and 400k BPD, respectively, with the former revised down to reflect the recent macroeconomic trends and oil demand developments in various regions. These developments include the extension of China's zero-COVID-19 restrictions, economic challenges in OECD Europe, and inflationary pressures in other key economies, which have weighed on oil demand, especially in H2 22. Note, MOMR release is stale as it follows the OPEC+ decision last week to cut output targets by 2mln BPD, which occurred as a result of "uncertainty that surrounds the global economic and oil market outlooks." That being said, the commentary surrounding gas-to-oil switching is interesting heading into the winter season in which the MOMR suggests there is an expectation for higher oil demand as the EU is set to lead global gas-to-oil switching due to soaring prices of natural gas and supply uncertainties during the winter. (Full details here)

EIA STEO: The EIA raised its 2022 world oil demand forecast by 20k BPD to 2.12mln BPD Y/Y while cutting 2023 forecasts by 490k BPD to 1.48mln BPD Y/Y (more info available here).

EQUITIES

CLOSES: SPX -0.33% at 3,577, NDX -0.05% at 10,785, DJIA -0.10% at 29,210, RUT -0.28% at 1,685.

SECTORS: Utilities -3.42%, Real Estate -1.39%, Industrials -0.81%, Materials -0.8%, Health -0.53%, Technology -0.34%, Financials -0.27%, Communication Services unch., Consumer Discretionary +0.23%, Consumer Staples +0.48%, Energy +0.75%.

EUROPEAN CLOSES: EURO STOXX 50 -0.26% at 3,331, FTSE 100 -0.86% at 6,826, DAX 40 -0.39% at 12,172, CAC 40 -0.25% at 5,818, FTSE MIB -1.27% at 20,466, IBEX 35 -1.29% at 7,261, SMI -0.08% at 10,199.

STOCK SPECIFICS: **PepsiCo (PEP)** beat on EPS and revenue alongside raising its FY22 core EPS view. In commentary, PEP now expects around 2.5ppt FX translation headwind to impact FY reported net revenue & core EPS growth. **Intel (INTC)** plans a major reduction in headcount, likely in the thousands, as the chipmaker looks to cut costs and cope with a declining PC market. **Moderna (MRNA)** and **Merck (MRK)** announced that Merck has exercised its option to jointly develop and commercialize personalized cancer vaccine. **Cameco (CCJ)** and **Brookfield Renewable Partners (BEP)** will buy nuclear power equipment maker Westinghouse Electric in a deal worth USD 7.9bln, including debt. Vista Equity reportedly near a deal to acquire **KnowBe4 (KNBE)** for roughly USD 4.5bln or USD 25/shr, according to WSJ. **Philips (PHG)** sees profit falling ahead, and reported a USD 1.3bln hit to its sleep business. Said its Q3 core profit would be down about 60% Y/Y and sees prolonged supply chain disruptions and a worsening macro-environment. **Owens & Minor (OMI)** lowered Q3 and FY22 adj. EPS view. **Twitter (TWTR)** is reviewing its policies around permanently banning users, potentially bringing its content moderation more in line with Elon Musk’s vision for the social media platform regardless of whether he becomes owner, FT reports. **Apple's (AAPL)** unionized stores will need to negotiate for new perks but it is offering additional education and health-care benefits to non-unionized stores; including **Coursera (COUR)** courses and new health benefits.

FX WRAP

The Dollar was choppy on Wednesday, although in narrow ranges, highlighted by a low of 113.020 and a high of 113.590. Regarding the day, the Greenback saw a surge higher in wake of the US PPI report where headline Y/Y and M/M came in above expectations, and saw risk off trade with the acceleration in M/M prices sparking more inflationary concerns ahead of Thursday's CPI. However, later in the session the Fed minutes spared some Dollar selling, albeit slightly delayed, as the doves took solace from the fact “several participants said as policy moved into restrictive territory, risks would become more two-sided". and it is "important to calibrate pace of further tightening with aim of mitigating risk of adverse affects”, as well “it would become appropriate to slow pace of hikes to assess effects of policy”. However, it is worth noting the minutes an echo of recent Fed rhetoric and there were also plenty of hawkish arguments too. Looking ahead, all attention turns to US CPI on Thursday, with earnings season getting underway on Friday.

GBP was the clear G10 outperformer against the Buck and Cable saw session highs of 1.1133 in wake of the aforementioned FOMC minutes. Elsewhere, BoE Governor Bailey stood firm on the expiry date for emergency purchases of long-dated and index-linked Gilts, an FT piece argued that buybacks could still be extended and then a spokesperson for the Bank ‘confirmed’ that the backstop will be withdrawn on October 14. However, that was far from the end of the UK pension fund or broader fiscal story, as another media outlet reported growing speculation about additional U-turns or postponements of tax cuts put forward by the Chancellor, only to be countered by a Downing Street source saying that the income tax reduction remains on course for next April and the decision to reverse former Chancellor Sunak’s corporate tax hike stands.

CAD and **AUD** were flat, while the NZD saw slight gains vs the Greenback, but all pairs were within contained ranges. NZD/USD hit a high of 0.5632 in contrast to a low of 0.5561 while AUD/USD traded between 0.6298-36, and USD/CAD between 1.3830-3761. The currencies traded more of macro sentiment indicated by all the Antipodes hitting their best levels after the FOMC minutes. Nonetheless, the Kiwi was underpinned on favourable AUD/NZD flows as the Aussie flagged following further signs that the RBA is getting closer to a natural point where it can pause and ponder how much tighter policy needs to be.

CHF and **EUR** were flat. For the single-currency there was a slew of ECB speak, tailing the usual hawkish line, as Knot said we are way below the neutral rate and the ECB needs at least two more significant hikes. Meanwhile, Holzmann noted a 100bp hike would be more than what is needed but a 75bp hike in October and a 50bp move in December would take the ECB to neutral. Meanwhile, on the data front EU industrial production printed above expectations for M/M and Y/Y. Additionally, the European energy woes still remain firmly in focus given the Ukrainian war and the added French strikes. Looking to Thursday, technicians note if US CPI, particularly core, remains high and retail sales don't slump, EUR/USD's 0.9528 September lows could be revisited.

JPY was the clear underperformer, as USD/JPY slumped to 24-year highs of 146.98, albeit just shy of the pivotal 147 level. BoJ Governor Kuroda was on the wires and fuelled the USD/JPY gains, as he reaffirmed the BoJ's negative interest rate policy. Lastly, Japanese machine orders for August fell more than the expected.

EMFX was predominantly firmer against the Buck, aside from the ZAR, with the RUB the outperformer, despite the ongoing geopolitical woes. Elsewhere, CNH/CNY saw marginal weakness and waned after a spirited comeback alongside Chinese equities prior to the close, and the HUF was hardly impressed by the latest liquidity tightening repo from the NBH. Lastly, the TRY was flat and was not convinced with the CBRT Deputy Governor’s argument that its current policy stance is not inflating price pressures.