US Market Wrap

13th October 2022: Stocks and Dollar whipsaw after hot CPI

- **SNAPSHOT**: Equities up, Treasuries down, Crude up, Dollar down
- **REAR VIEW**: Hot CPI; ECB staff model implies dovish ECB terminal rate; Another potential fiscal U-Turn in the UK; JPY intervention speculation; Large crude stocks build.
- **COMING UP**: **Data**: Chinese inflation and Trade Balance, US Retail Sales, US University of Michigan Prelim Survey **Speakers**: BoE's Bailey, Fed's George, Cook, Waller Supply: Japan

MARKET WRAP

Stocks ultimately settled in the green, a remarkable comeback after the hot CPI sent risk assets lower. Several theories were cited for the bounce back in stocks: Reuters reported that an ECB staff model sees a target-consistent terminal rate of 2.25%, beneath the 3.0% level that markets are currently pricing in, however, policymakers are sceptical. There had also been support in the pre-market on reports of a UK PM Truss potential fiscal U-Turn, where a corporate tax hike is now in play despite initial plans to scrap the hike. Some desks also attributed the stock rebound to a short squeeze in positions that were wagered betting that the CPI data would catalyse a Fed pivot, particularly given the magnitude of the turnaround wasn't reflected in Treasuries, albeit bonds did come off lows. The 30yr Treasury auction was weak but resulted in little reaction. When looking into the CPI report, bulls were focussing on the flat core commodity prices (goods), the first flat reading for five months, while some also looked at that ex-food and shelter, prices only saw a 0.1% gain. However, on the flip side, the bears were looking at the services prices, which saw the highest monthly gain since 1990. The Dollar saw a wide trading range; DXY rose to highs of 113.92 after CPI, before paring to lows of 112.14; GBP outperformed on the potential U-Turn, seeing cable hit a high of 1.1379 from lows of 1.1058. There was also fresh speculation of more Japanese intervention after some sudden price movements in the Yen after USD/JPY hit a high of 147.47 before knee-jerking lower to 146.52, albeit if it was intervention it wasn't successful with USD/JPY back above 147.00. Oil prices were largely influenced by the USD, albeit there are ongoing risks regarding US/Saudi relations, while the latest inventory reports saw a larger build than expected. There were surprisingly no Fed speakers on Thursday, but after the CPI data markets are now fully pricing in a 75bp hike with a small chance of a 100bp move with the terminal FFR now seen between 4.75-5.00%. Attention now turns to Chinese CPI and PPI data overnight and Fed speakers from George, Cook and particularly Waller on Friday, as well as bank earnings, US retail sales and UoM data.

US

CPI: The September inflation data was hot. Headline CPI eased to 8.2% Y/Y from a prior 8.3%, above the 8.1% expected. The monthly gauge saw a rise of 0.4% M/M, hotter than the expected 0.2%, and accelerating from the prior 0.1%. The core component rose too: the annual measure rose to a 40yr high of 6.60%, above the street's expectation for 6.5%, and accelerating from the prior 6.3%. The monthly measure rose by 0.6% M/M, above the 0.5% forecast and matching the prior pace. The hot inflation data saw markets react hawkishly, and now fully price in a 75bps rate hike at the November 2nd FOMC, while expectations of the eventual terminal rate accelerated to around 4.85% in March 2023 (the implied FFR target range nudges up to 4.75-5.00%), above the Fed's median projection of 4.6% for 2023. The WSJ's Fed whisperer Nick Timiraos noted that the report seals the case for a 75bps hike in November, and also questions whether the Fed will be able to stop raising rates after a 50bps hike in December and a 25bps hike in February. Looking into the report, Oxford Economics points out services prices jumped by 0.8%, the highest gain since August 1990 and price gains were broad-based, which will be a concern for the Fed. Meanwhile, the consultancy adds that there was some good news: core commodity (goods) prices were flat in September, the first time in five months that core goods prices did not increase, while some pointed out that ex-food and shelter prices only saw a 0.1% gain.

JOBLESS CLAIMS: Initial jobless claims rose to 228k from the prior 219k, and above the expected 219k, while continued claims also rose to 1.68mln, again above the expected and the prior, revised lower, 1.365mln. Looking into the release, Oxford Economics note the jump in claims in Florida following Hurricane Ian which drove the overall increase. Moreover, OxEco adds, based on changes in claims after prior hurricanes, claims in Florida are likely to remain elevated for at least a few more weeks. Overall, Oxford notes, “while there have been some signs of a slight loosening in labor market conditions, the job market overall remains tight. Even as the economy slows, employers appear to be reluctant to lay off workers that they have struggled to hire and retain.” Looking ahead, the consultancy adds, “we expect only a modest rise in unemployment and jobless claims as we head toward a mild recession in 2023.”

FIXED INCOME

T-NOTE (Z2) FUTURES SETTLED 15 TICKS LOWER AT 111-00+

Treasuries bear flattened after hot CPI, but debt was off the lows on reports of a potential UK U-turn, while ECB staff reportedly model a lower terminal ECB rate than the market is pricing. At settlement, 2s +16.8bps at 4.455%, 3s +14.4bps at 4.450%, 5s +9.5bps at 4.209%, 7s +7.0bps at 4.101%, 10s +5.0bps at 3.952%, 20s +5.3bps at 4.244%, 30s +4.3bps at 3.931%. Inflation Breakevens: 5yr BEI +6.6bps at 2.441%, 10yr BEI +5.3bps at 2.359%, 30yr BEI +4.0bps at 2.257%.

THE DAY: The Treasury curve bear flattened with yields higher across the curve after hotter-than-expected CPI data for September, though the debt space was off lows as markets digested the report - bulls took note of the ex-food and shelter print being up just 0.1%, while the bears looked at the services pricing rising 0.8%, the most since 1990. The hot report saw an acceleration of aggressive market pricing, with a 75bps Fed rate rise in November fully priced, with a small chance of an even larger 100bps move. The WSJ's Fed whisperer Timiraos said the data implied that a 75bps hike is coming, but warned it could bring about a more aggressive Fed; futures are now pricing the peak Federal Funds Rate at 4.85%, or an FFR of 4.75-5.00%. Across the pond, Gilts surged on reports of another potential UK fiscal U-Turn, with talk that the government is mulling hiking corporation tax despite initial plans to scrap the CT tax hike – the UK was setting the tone for the broader macro landscape in early trading, as well as throughout parts of the day. In afternoon trade, Reuters reported that an ECB staff model puts the terminal rate in Europe at 2.25%, beneath the 3% that markets are currently pricing in; however, the response from ECB policymakers was mixed, with some fearing the model contains errors. Meanwhile, the 30yr Treasury bond auction was met with little reaction but overall it was weak and tailed by 1bp (more below).

AUCTION: After the previous auction stopped through by 1.5bps, today's auction saw a disappointing 1bps tail; the auctions had seen an average stop-through of 0.6bps over the last six sales. Despite the tail, bid-to-cover was slightly better than the recent average at 2.39x (avg. 2.37x), but not as strong as the prior 2.42x. The takedown saw dealers take 12.2%, beneath the average but rising from the prior 10.9%. Similar to what was seen in the 10yr auction yesterday, indirect bidders declined, but it was met with a higher take-up from direct bidders. The directs took 18.65% of the auction, above the 17.4% average and 17.1% prior, while indirects took 69.13%, down from 72.1% last month and the average 70%. The hot CPI earlier in the session may have been a reason behind the weaker auction with increased volatility going into the supply after more potential U-Turns from the UK government in the morning.

STIRS

- EDZ2 -16.0bps at 94.950, H3 -22.5bps at 94.860, M3 -23.0bps at 94.910, U3 -22.0bps at 95.055, Z3 -19.5bps at 95.225, H4 -16.5bps at 95.460, M4 -12.5bps at 95.670, U4 -9.0bps at 95.825, Z4 -6.5bps at 95.950, Z5 +0.0bps at 96.190.
- NY Fed RRP op. demand USD 2.244tln (prev. 2.247tln), across 102 bidders (prev. 103)
- US sold USD 63bln in 4wk bills at 3.250%, B/C 2.50x. US sold USD 52bln in 8wk bills at 3.480%, B/C 2.48x.

CRUDE

WTI (X2) SETTLED USD 1.84 HIGHER AT 89.11/BBL; WTI (Z2) SETTLED USD 1.89 HIGHER AT 87.95/BBL; BRENT (Z2) SETTLES USD 2.12 HIGHER AT USD 94.57/BBL

Oil markets saw a mixed session, falling in wake of hot CPI Data -- which gives the Fed scope to continue hawkish rate hikes and raising further risks of an economic recession that would be negative for oil demand -- but then rebounded as the USD weakened, and risk-assets rebounded. The IEA's monthly oil market report saw its Q4 demand view lowered by 300k BPD, while its 2023 demand outlook was cut by 470k BPD (both are still expected to show growth). The weekly energy inventory data saw crude stocks build way above expectations (9.88mln vs an expected 1.75mln), while stocks at Cushing drew down by 309k; gasoline posted a surprise build (2.023mln vs an expected -1.825mln), while distillate stocks saw a larger than expected drawdown (-4.853mln vs an expected -2.05mln); the data's release had only a marginal influence on energy assets, with much of the focus instead on the macro narrative. Meanwhile, the geopolitical risk premium is another factor traders are monitoring, with the White House again ramping up rhetoric against Saudi Arabia; officials said that US analysis showed to Saudi Arabia that there was no basis to cut oil production, and the US reportedly told the Saudis that OPEC could wait until its next meeting to see how the situation has developed, adding that other OPEC nations were feeling coerced by the Saudis to support production cuts. Elsewhere, North Korea launched a short-range ballistic missile, fired from near Pyongyang, and said it took the action as a strong military countermeasure after South Korean artillery fire, KCNA reported.

EQUITIES

CLOSES: SPX +2.6% at 3,670, NDX +2.30% at 11,034, DJIA +2.83% at 30,039, RUT +2.41% at 1,728.

SECTORS: Financials +4.14%, Energy +4.08%, Technology +3.12%, Materials +2.91%, Utilities +2.55%, Health Care +2.26%, Communication Svs. +2.23%, Industrials +2.2%, Real Estate +1.84%, Consumer Staples +1.61%, Consumer Discretionary +0.98%.

EUROPEAN CLOSES: EURO STOXX 50 +0.93 at 3,362, FTSE 100 +0.37% at 6,852, DAX 40 +1.51% at 12,356, CAC 40 +1.04% at 5,879, FTSE MIB +1.56% at 20,786, IBEX 35 +1.21% at 7,349, SMI +0.37% at 10,237

STOCK SPECIFICS: **Apple's (AAPL)** initial sales of the iPhone 14 and iPhone 14 Plus were lower than expected, even though the first wave of market responses to the higher-priced iPhone 14 Pro and 14 Pro Max has been "enthusiastic," according to DigiTimes. **Applied Materials (AMAT)** cut its Q4 revenue view beneath expectations to reflect the impact of the new export regulations although it has been partially offset by supply chain performance improvements. **Walgreens Boots (WBA)** beat on EPS and revenue and guidance was relatively in line with expectations. **Blackrock (BLK)** beat on EPS and revenue, but AUM declined to beneath USD 8tln from the prior 9.46tln. **TSM (TSMC)** profit was above expectations, as was its gross margin while Q4 guidance also beat expectations however it did cut its CapEx guidance for the year. **Delta Airlines (DAL)** missed on EPS but beat on revenue; guidance for revenue missed expectations but EPS guidance beat the consensus. CEO also noted Q4 is looking really good and holiday bookings look very strong; adds business travel is returning. **Kohl's (KSS)** had activist investor Macellum urge Kohl's to make changes to the board, according to WSJ. **Squarespace (SQSP)** named **Amazon's (AMZN)** Nathan Gooden as CFO, according to WSJ. **Albertsons (ACI)** confirmed it is in talks with **Kroger (KR)** and have been on and off for months, according to CNBC. EU antitrust regulators are preparing charges against **Google's (GOOG)** AdTech unit, according to sources.

FX WRAP

Dollar whipsaws on hot CPI, GBP rallies on potential UK U-Turn while sudden JPY movements raises intervention alarm

The Dollar traded within a mighty range on Thursday with DXY, rallying in wake of a hotter-than-expected CPI report, although there was a strong turn around, taking DXY to lows of the day of around 112.15 from highs of 113.92. The hot CPI saw the market price in a more aggressive Fed rate hike trajectory, with a 75bp hike now fully priced in for November along with a small chance of an even larger 100bp move. The terminal rate is now seen at 4.85% (which would imply FFR target range of 4.75-5.00%), above the Fed's current projections of 4.6%. Nonetheless, the Dollar tumbled which coincided with a bout of risk on in stocks - there had been some supporting factors, such as another UK U-turn and some ECB sources suggesting a lower terminal rate than markets were implying albeit the move in stocks is still surprising given the magnitude of it.

The Yen was hit on the initial CPI data with USD/JPY posting a high of 147.67 although shortly after a large move lower was observed with no reasoning behind it leading to more speculation of intervention from Japan's MoF, albeit this is yet to be confirmed. USD/JPY then hovered around unchanged levels after hitting a low of 146.52 before paring to 147.00.

The Euro was bid thanks to the weaker dollar, although EUR/USD failed to make a sustained break above 0.9800 with a high of 0.9805 before paring beneath the level. There was ongoing hawkish ECB speak with both Simkus and Kazaks looking for 75bps at the next meeting; Simkus expects a 50bps move in December, while Kazaks said he is looking for "another big hike". Meanwhile, there were also reports suggesting that an ECB staff model put the target-consistent terminal rate at 2.25%, lower than the 3% markets are pricing in, but ECB policymakers were mixed about the model and feared it could include errors.

Cyclical currencies saw gains thanks to the turnaround in stocks but GBP was the clear outperformer, rallying from lows of 1.1058 to highs of 1.1379 on reports of another major U-Turn from the UK government with reports suggesting there are discussions, which include an increase in corporation tax. AUD and NZD saw decent gains with NZD outperforming in what has been a familiar theme after the RBA's 25bp hike last week (beneath expectations) and the RBNZ's 50bp hike (in line with expectations). CAD saw decent gains too but USD/CAD found support at 1.37 while the Looney was also supported by higher crude prices in the risk turn around.

Scandi FX was mixed: the SEK was flat vs the EUR, but NOK saw gains owing to moves in Brent crude prices, while the hotter-than-expected CPI data from Sweden did little to support the SEK vs the EUR and NOK. Riksbank's Bremen spoke after the data; she expects inflation to continue rising in coming months but the outlook is uncertain, and she added that policy was in a restrictive place but the Riksbank should continue with rate hikes.

EMFX was supported by the weaker Dollar. RUB and BRL posted solid gains. BRL was supported polling showed President Bolsonaro was still lagging behind his rival Lula ahead of the runoff vote at the end of October (Bolsonaro at 41%, Lula at 49%). MXN was flat after the Banxico minutes, albeit little new information was revealed; all members mentioned different labour market indicators have continued to improve. ZAR saw mild gains as the weakness in gold prices offset a lot of the support from the weaker buck.