# US Market Wrap

## 14th October 2022: Stocks and Bonds hit as inflation expectations rise

- **SNAPSHOT**: Equities down, Treasuries down, Crude down, Dollar up
- **REAR VIEW**: Retail sales disappoint; UoM inflation expectations rise; Strong JPM, C, WFC earnings, MS disappoints; Fed's George cautious on front-loading; Bullard favours front-loading; Daly says Fed not talking pause; UK PM fires Chancellor; Japan concerned about FX
- **WEEK AHEAD PREVIEW**: Highlights include China CCP Congress; Inflation data from UK, NZ, EZ, Japan, Canada. To download the full report, please click here.
- **CENTRAL BANKS WEEKLY**: Previewing RBA minutes, PBoC, CBRT; Reviewing FOMC. To download the report, please click here.

## MARKET WRAP

Stocks sold off on Friday with losses broad based despite some glimpses of optimism in pre-market trade. Bank earnings kicked-off with FY NII guidance hikes from JPM and WFC, while Citigroup saw decent metrics, although MS disappointed. The UK was also in focus after the sacking of Chancellor Kwarteng, albeit PM Truss' speech was not enough to support the market, and she only partially U-Turned her contentious fiscal policies. Russian President Putin also gave some limited grounds for optimism after he noted that there were no plans for further mobilisations while sources suggested that he was open to negotiations. US data saw retail sales headline miss expectations, but the core and control group showed signs of strength, which resulted in two way Treasury flows, but the later UoM survey sounded the alarm on inflation again, as both short- and longer-term inflation expectations rose. Fed speak saw George (2022 voter) sound dovish, warning of over doing it with front loaded hikes, but Bullard (2022 voter) was not impressed with September's inflation report, and now sees rates rising to 4.50-4.75% by the end of the year (he was shooting for 4.5% at the end of September), but signalled rates above that would be data dependent. Meanwhile, Daly (2024 voter) said the Fed is not talking about a pause when it comes to rate hikes. Treasuries were sold across the curve after the data while the Dollar was supported and stocks pared some of the surprise Thursday gains. In late trade, Japan's Finance Minister Suzuki said Japan is deeply concerned about high volatility in the FX markets and they have seen unprecedented one-sided moves in the Yen.

## US

**FED**: Fed's George (2022), who dissented against the Fed's first 75bps rate hike in June, sounded cautious on Friday, noting her concern was that the Fed has been operating with some very aggressive rate moves, which need time to work through the economy; she agrees that the terminal Fed Funds Rate may have to be higher and stay there for longer, but she is more cautious than most about how quickly that is achieved. George also noted that she was in the camp of a steadier, and slower pace of rate rises to allow time to see any lagged effects from Fed policy, warning that supersized moves may cause an oversteer in the future, at a time of volatility. George sympathises with the strategy of front-loading rate increases, but she said she is mindful that the economy is readjusting and it was hard to know where the true restrictive level is. Fed's Daly (2024) said the Fed was not talking about stopping or pausing rate hikes, adding that an FFR target between 4.5-5.0% was where rates would likely end up, and the Fed will then hold there for a while, but the central bank would stop raising rates when it was appropriate. Daly is not hearing signs of recession when talking with contacts in the district, noting people expect any slowdown to be short-lived and not deep. Daly said this week's CPI report was not that surprising, and the labour market and housing demand was cooling, while retail sales data today was another sign. Daly still believes the SEP in September is reasonable, noting the Fed is tightening into a strong economy. Fed Governor Cook (2022) said the labour market was very strong; inflation remains stubbornly and unexpectedly high; she does not want a stop-and-go policy and repeats the Fed needs to see inflation actually falling in the data. Bullard (2022 voter) is at odds with George, and is still calling for more front loaded hikes while he wants rates at 4.50-4.75% by year-end - he had previously suggested rates of around 4.5% by year-end, while he was seemingly concerned about the latest inflation report. Looking beyond 2022, he said rate hikes above that level will depend on the data.

**RETAIL SALES**: Retail sales were flat in September, missing expectations for a 0.2% gain, while the core rate rose 0.1%, above the -0.1% consensus and the super core (ex gas/autos) rose 0.3% while the prior was revised higher to 0.6% from 0.3%. The control unit, a good gauge of consumer spending, rose 0.4% and picked up from the prior rate of 0.2% and expected 0.3%. With the core and control better than expected, Oxford Economics suggest the data points to a modest consumer spending acceleration at the end of Q3. The headline missed as spending on big ticket items and interest rate sensitive purchases weakened, OxEco notes, adding that “weaker gasoline, motor vehicle and part sales, furniture and recreational goods sales were offset by gains in other parts of the consumer basket.” The consultancy warns that “consumer spending is softening and we believe it’s only a matter of time before recessionary conditions lead consumers to tighten their purse strings even more.”

**UOM**: The Preliminary University of Michigan sentiment survey for October was encouraging on the headline levels; sentiment and current conditions both topped expectations, rising to 59.8 from 58.6 and to 65.3 from 59.7 respectively. Current conditions were supported by a strong labour market and lower gas prices, which helped offset lower stock prices, Capital Economics said. However, the forward looking expectations component was disappointing, falling to 56.2 from 58 and beneath expectations of a rise to 58.5. The downbeat expectations were also met with a concerning rise in the inflation expectations. The 1yr inflation expectations accelerated to 5.1% from 4.7%, while the 5-10yr expectations rose to 2.9% from 2.7%. The rise in expectations follows the latest hot CPI report with core Y/Y hitting a 40 year high, suggesting price pressures are broadening. However, Capital Economics points out the increase only partially reversed the declines over the latest months and point out expectations number in the preliminary are often revised lower in the final report for each month.

## GLOBAL

**GEOPOLITICS**: Russian President Putin said there were no plans for further mobilisation in Russia, and the mobilisation is finishing. Meanwhile, reports in Meduza (which claims to report “Real Russian news” and are banned in Russia) said Putin was still thinking about the resumption of negotiations, but still wants to control Donbas, while there could also be a temporary ceasefire issued. Meanwhile, the report added that authorities are ready to withdraw troops from at least part of the occupied territory of the Kherson region for the sake of this agreement.

**UK**: Chancellor Kwarteng was sacked, replaced by Jeremy Hunt, as the Truss administration partially U-Turned on some of the elements of its now notorious “mini-budget” which caused a sharp bond sell-off. Corporation tax will now be hiked next year, as originally planned, reversing a policy in her budget to scrap it. UK political watchers noted this would raise around GBP 18bln of funds vs a reported black hole of almost GBP 60bln, according to some. Meanwhile, Sky News later reported that a substantial amount of letters have gone to Sir Graham Brady, the committee that oversees the election of party leaders, or any Conservative party-led vote of confidence in a current leader. Such a vote can be triggered by 15% of Conservative MPs (currently 54 MPs out of the 360 sitting MPs as of January 2022) writing a letter to the chairman of the committee asking for such a vote. Elsewhere, the BoE’s buyback operation concluded today as planned.

## FIXED INCOME

### T-NOTE (Z2) FUTURES SETTLED 13+ TICKS LOWER AT 110-19

**Treasuries were sold across the curve after rising inflation expectations from UoM and mixed retail sales**. 2s +5.8bps at 4.507%, 3s +6.0bps at 4.504%, 5s +5.5bps at 4.266%, 7s +5.9bps at 4.162%, 10s +5.4bps at 4.008%, 20s +3.4bps at 4.279%, 30s +4.2bps at 3.975%. Inflation Breakevens: 5yr BEI +4.5bps at 2.497%, 10yr BEI +5.3bps at 2.412%, 30yr BEI +7.0bps at 2.329%.

**THE DAY**: Treasury yields were higher by 4-6bps across the curve with selling pressures observed after several US data points. The September retail sales headline disappointed expectations, but the core measure was more encouraging alongside a rise in the control group, which sparked two way flows. Later, the preliminary October UoM survey saw an encouraging rise in sentiment, led by gains in current conditions, however the forward looking expectations metric was poor and perhaps more pertinently, both the short- and long-term inflation expectations moved higher, adding to inflationary fears. There was also a move lower in Gilts after UK PM Truss's confirmed that the corporation tax will, though analysts note that the administration has not fully U-turned on many of its unfunded pledges yet, indicating that many of the issues remain at a time of deteriorating confidence in her new government; meanwhile, the longer dated gilt BoE buyback operation ended as planned today. There were several Fed speakers on Friday: George (2022 voter), who dissented to the first 75bp hike back in June, sounded dovish, stressing she is concerned about over reacting with the speed they are tightening. Bullard (2022), however, is still in favour of front-loading rate hikes. Note, the US Treasury released the discussion topics of their primary dealer meeting which revealed the Treasury asked dealers their views if the Treasury should buy bonds to support liquidity, suggesting it is something they may be considering, likely in the less liquid part of the curve given it is to support liquidity.

**STIRS**:

- EDZ2 -5.5bps at 94.900, H3 -10.5bps at 94.765, M3 -10.5bps at 94.815, U3 -8.5bps at 94.975, Z3 -8.0bps at 95.150, H4 -7.5bps at 95.390, M4 -7.0bps at 95.605, U4 -6.5bps at 95.760, Z4 -6.0bps at 95.890, Z5 -4.5bps at 96.145.
- NY Fed RRP op. demand USD 2.222tln (prev. 2.244tln), across 95 bidders (prev. 102)

# CRUDE

**WTI (X2) SETTLED USD 3.50 LOWER AT 85.61/BBL, (Z2) SETTLED 3.30 LOWER AT 84.65/BBL; BRENT (Z2) SETTLED USD 2.94 LOWER AT USD 91.63/BBL**

Crude futures fell on Friday, with desks attributing the weaker tone to a higher dollar, as well book squaring ahead of the weekend and the options expiry of November WTI on Monday, ahead of the underlying contract expiring on October 20th. Citi's analysts said that, in the background, there is "an uneasy balance in the market between worries a recession will undermine demand versus the support from the OPEC+ decision to reduce supply," adding that the 2mln BPD reduction in output limits from OPEC in November could translate into a 1mln fall in actual production levels, "but that may be enough to result in a tighter balance that supports a renewed push to the upside in the weeks ahead." Elsewhere, in France, union CFDT and CFE-CGC signed a majority wage accord for 2023; ExxonMobil (XOM) said the strike movement at the Fos-Sur-Mer and Gravenchon production sites will return to normality in 2-3 weeks. Meanwhile, sticking with European energy, UK government officials are said to be in talks with major US suppliers of LNG regarding a deal to bolster UK energy imports ahead of a winter spike in demand, Sky News reported. Finally, the weekly Baker Hughes Rig Count data showed oil rigs +8 in the week to 610, natgas rigs declined -1 at 157, leaving the total rig count +7 at 769.

# EQUITIES

**CLOSES**: S&P 500 -2.3% at 3,584, Nasdaq-100 -3.1% at 10,692, Dow Jones Industrial Average -1.3% at 29,644.

**SECTORS**: Cons Disc -3.86%, Cons Stpl -1.81%, Energy -3.63%, Financials -1.74%, Health -0.79%, Industrials -2.21%, Materials -3.38%, Real Estate -2.56%, Technology -2.86%, Communication -1.92%, Utilities -1.5%.

**EUROPEAN CLOSES**: EURO STOXX 50 +0.57 at 3,382, FTSE 100 +0.12% at 6,859, DAX 40 +0.67% at 12,438, CAC 40 +0.90% at 5,932, FTSE MIB 0.70% at 20,931, IBEX 35 +0.46% at 7,383, SMI +0.99% at 10,329

**STOCK SPECIFICS**: JPMorgan (JPM) reported strong investment banking and FICC sales revenue, which helped to offset disappointing equity sales and trading figures, while it also raised its FY NII view alongside beats on the headline EPS and revenue figures. JPM is hoping to resume share buybacks next year. Morgan Stanley (MS) beat on EPS but revenue missed expectations; in fitting with JPM, its FICC and Investment Banking revenues topped expectations, but equity sales and trading disappointed. Net interest income was above the street's view, but wealth management profits and margins missed, while non-interest expenses were also higher than expected. Wells Fargo (WFC) missed on EPS but revenue was a beat with stronger than expected net interest income. Non-interest expenses were above expectations, however, but upside was seen after it raised its FY22 NII view to +24% Y/Y to USD 43bln from the prior USD 35.8bln. Citigroup (C) beat on EPS and revenue but sales and trading revenue missed, as well as investment banking revenue although the equity revenue beat expectations. Citi also maintained revenue and expenses guidance for 2022. United Health (UNH) beat on EPS and revenue with guidance above expectations. McDonald's (MCD) raised its quarterly cash dividend by 10% to USD 1.52/shr. Twitter (TWTR) announced Elon Musk is being investigated by federal authorities related to the Twitter deal. Nutanix (NTNX) is said to be mulling a sale after receiving takeover interest, according to the WSJ; " buyer would likely have to pay a significant premium to Nutanix's market value", the Journal said. Kroger (KR) and Albertsons (ACI) confirmed their merger agreement; ACI will be acquired by KR for USD 34.10/shr in cash with an enterprise value of USD 24.6bln. ACI also announced a special dividend related to the deal. Tesla (TSLA) reportedly put plans for battery cell production on hold at its German location amid technical reasons, according to Handelsblatt; launch delayed until at least 2024.

# WEEKLY FX WRAP

**Pound downed, Buck a bit deflated and Yen decimated**

**USD/GBP/JPY**: The Dollar and index witnessed their most volatile session on Thursday when US headline CPI slowed a bit less than expected and core inflation actually accelerated against consensus for a slowdown to dampen hopes of a peak in consumer prices, but the DXY stalled just shy of 114.000, at 113.920, before a rapid retracement to 112.147. However, Fed rate pricing ramped up and remained elevated amidst official commentary underscoring the latest set of FOMC minutes that reiterated a determination to bring inflation back down via a move into more restrictive policy levels and maintaining that stance. Moreover, prelim UoM survey findings revealed rises in inflation expectations over both 1 year and 5 year horizons, and the Greenback was underpinned by weakness elsewhere, as Sterling suffered more UK political and fiscal blows (albeit interspersed with ostensibly positive impulses), the Yen continued to depreciate and the Yuan unwound recovery gains from recent record lows. Turning to the Pound first and foremost, Cable was extremely choppy between 1.0924-1.1380 parameters during another dramatic week that started with the BoE stressing that it intends to terminate emergency Gilt purchases on October 14 before Governor Bailey rammed home this message to pension funds on Tuesday via an ultimatum to get LDI positions and exposure hedged over the ensuing three days. Subsequently, the Bank unveiled an expanded collateral repo facility to provide banks with liquidity for clients facing higher margin calls, but also added linkers to its temporary bond buyback remit for a limited period only (ending on Friday as well). Meanwhile, the rumour mill began grinding in Westminster about a group of MPs meeting to discuss other mini budget U turns, with the Chancellor out of the country and to be presented with a list of proposed tax cuts that could be 'ditched, deferred', or 'junked' as one media outlet put it on his return. Other Cabinet officials issued denials and even the PM stuck to the line that the expansionary fiscal plan will be delivered to promote growth, but Truss eventually threw Kwarteng under the bus and asked him to leave number 11 Downing Street, with Hunt moving in just 38 days after his appointment. Markets were far from appeased, and Monday may be even more challenging for Sterling, Government debt and the PM who has only reinstated ex-Chancellor Sunak's corporate rate tax rise to supplement the postponement of the top band threshold reduction, thus far. Elsewhere, and far more straightforward, the Yen slumped from circa 145.24 to 148.73, with already wide BoJ/Fed policy divergence and JGB/UST differentials reinforced by Governor Kuroda maintaining an unflinching ultra-accommodative mantra in stark contrast to the aforementioned collective guidance from Fed members for further tightening. Additionally, intervention aside from jawboning was almost conspicuous by its absence and signals the emphasis on speed rather than size or velocity over value when it comes to taking decisive action.

**AUD/NZD/CAD**: Risk aversion and the threat of recession undermined the Aussie, Kiwi and Loonie for much of the week, while declines in underlying commodities, like metals and crude oil also weighed on the cyclical and activity currencies. Aud/Usd tumbled from the high 0.6300 area to sub-0.6200 at one stage, Nzd/Usd towards 0.5500 before bouncing quite firmly earlier today to around 0.5681 and fading again, irrespective of some independent factors that appeared supportive, on paper at least. Namely, RBNZ Governor Orr said in conjunction with the release of the Annual Report that there is more work to do and increasing the OCR is the most effective way to reduce inflation and support maximum sustainable employment over the coming years, consistent with the Bank's monetary policy mandate. On the flip-side, NZ's manufacturing PMI slowed to counter a pick-up in electronic card consumption, and it was a similar story in Canada where a comfortable wholesale trade beat came alongside weaker than forecast manufacturing sales, but Usd /Cad may garner further direction from just below 1.3900 within 1.3704-1.3977 extremes from BoC Governor Macklem who is due to speak later.

**CHF/EUR**: The Franc and Euro largely ignored Swiss and Eurozone data as they tracked their US counterpart with eyes on broad sentiment, yield spreads and several large option expiries in the case of the latter that kept Eur/Usd anchored around 0.9700 for some time. Ultimately, Usd/Chf maintained momentum above parity after overcoming resistance and bottoming in the low 0.9900 zone, with Eur/Chf nearer 0.9800 then 0.9650 following a raft of mainly hawkish ECB commentary, bar a Staff Model flagging a lower peak rate than markets are factoring in.

**SCANDI/EM**: Stronger than anticipated Swedish and Norwegian inflation data failed to provide the Sek or Nok much in the way of lasting support/traction, while the Cny and Cnh weakened regardless of well below spot PBoC midpoint fixings and pledges to keep the onshore Yuan basically stable via prudent policy, as China's Caixin PMIs (services and composite) fell beneath 50, new Covid outbreaks prompted tighter restrictions and strains with the US heightened over Taiwan and trade when Washington clamped controls on semiconductor chip exports (prior to exemptions for several companies). Conversely, the Sgd was cushioned by further MAS tightening, the Inr and Hkd via ongoing RBI and HKMA intervention and the Huf received much needed relief to clamber off deeper record lows vs the Eur when the NBH jacked up its overnight collateral loan rate by a huge 950bp to 25% and rolled out a new 1-day deposit tender at 18%.