US Market Wrap

28th November 2022: Cyclicals knocked on China protests while Fed twists the hawkish knife

- **SNAPSHOT**: Equities down, Treasuries flat, Crude down, Dollar up
- **REAR VIEW**: China riots hit iPhone production; Bullard says markets are underpricing risk of aggressive Fed; Williams sees a higher terminal rate than in September SEPs, but could be cuts in 2024; Lagarde says wages are picking up and more hikes are needed; BlockFI files for bankruptcy.
- **COMING UP**: **Data**: EZ Consumer Confidence (Final), German CPI (Prelim.), US Consumer Confidence **Event**: Fed Discount Rate Minutes **Speakers**: ECB's de Guindos, Schnabel; BoE's Bailey, Mann **Supply**: Italy
- **WEEK AHEAD**: Highlights include: Eurozone CPI, US ISM, NFP, PCE. To download the report, please click here.
- **CENTRAL BANK WEEKLY**: Reviewing RBNZ, FOMC & ECB Minutes, Riksbank, CBRT, SARB. To download the report, please click here.

MARKET WRAP

Stocks were sold globally on Monday with cyclicals leading the losses as civil unrest and higher COVID cases in China mark a big step back in reopening hopes. Bloomberg reports that Apple (AAPL) is set to lose 6mln iPhone Pros from the unrest at its Chinese plant were an example of the issues faced. Treasuries were ultimately little changed on the day, with earlier risk-off demand hampered by hawkish Bullard, who said markets were underpricing the risk of a more aggressive Fed. Williams and Mester gave more two-way remarks, with the former even touting potential cuts in 2024, albeit both stressed the need for more to be done on tightening. Little US data of note aside from a slight improvement in the Dallas Fed manufacturing survey, attention falls on PCE and NFP later this week. 5yr5yr US inflation breakevens fell by 5bps to 2.20%, the lowest in over a month, as many commodities were sold. However, Oil prices were ultimately well off the lows with speculation over an OPEC+ production cut at the December 4th meeting to offset the China woes. Meanwhile, in crypto, lender BlockFi is filing for bankruptcy, with reports suggesting its assets and liabilities range anywhere between USD 1-10bln.

FED

WILLIAMS (voter) spoke at the Economic Club of New York, reiterating the need for more hikes and to keep rates high, whilst also providing some updated forecasts: unemployment rate rising from 3.7% to 4.5%-5.0% by late 2023; inflation declining to 5.0-5.5% by the end of 2022 and 3.0-3.5% by late 2023; modest economic growth this year and in 2023. In his subsequent remarks, the NY Fed president said the terminal rate will be data-dependent, whilst also noting it's possible there could be rate cuts in 2024. WSJ reported later that Williams sees a "somewhat higher" rate path in 2023 vs the September SEPs (median dot was 4.6%).

MESTER (2022 voter) spoke to the FT, stressing the costs of stopping tightening too early are too high but did say she sees inflation coming down in 2023 and her risk balance will change then but she doesn't see inflation at the 2% target until 2024. To consider a pause, the Cleveland Fed president needs to see "several" more good CPI reports with more moderation and even a reduction in core services prices, as well as better balance in the labour market.

BULLARD (2022 voter, hawk) reiterated in a MarketWatch interview the need for rates to get to the bottom end of the Taylor Rule consistent 5-7% range to be restrictive, whilst adding that markets are underpricing the risk that the Fed may be more aggressive. The St. Louis Fed president said rates will need to be kept at a sufficiently high level all through 2023 and into 2024. Said if rates get to sufficient restrictive territory by the end of Q1 2023, could have the conditions for inflation to subside in a reasonable time frame. On the balance sheet, Bullard said the Fed can evaluate its reduction path next year sometime, but so far so good.

FIXED INCOME

T-NOTE (H3) FUTURES SETTLED 2 TICKS LOWER AT 113-08

Treasuries were ultimately little changed Monday, with risk-off demand hampered by hawkish Bullard. 2s -0.8bps at 4.471%, 3s +0.0bps at 4.233%, 5s +0.0bps at 3.891%, 7s +0.0bps at 3.808%, 10s -0.2bps at 3.700%, 20s -0.5bps at 3.973%, 30s -0.8bps at 3.744%.

Inflation breakevens: 5yr BEI -5.1bps at 2.350%, 10yr BEI -4.3bps at 2.283%, 30yr BEI -4.9bps at 2.339%.

THE DAY: Treasuries bounced in risk-off trade as futures reopened for the week amid civil turbulence in China, seeing T-Notes (H3) peak at 113-27 in early London trade. Citi's rates desk said, "during London's AM hours, the flow reversed to HF's selling Treasuries as they outperformed EGB's", paring most of the strength in T-Notes. The earlier bull-flattening turned into a mild steepener with the front end catching a bid in the NY morning, despite hawkish ECB's Lagarde comments and some two-way remarks from Fed's Mester in the FT. However, T-Notes went on to edge out session lows of 113-06 in the NY afternoon, with Fed's Bullard doubling down on his hawkishness, saying markets are underpricing risks of a more aggressive Fed.

STIRS:

- EDZ2 +2.5bps at 95.07, H3 +1.5bps at 94.79, M3 +1.5bps at 94.755, U3 +1bps at 94.895, Z3 +0.5bps at 95.185, H4 +0.5bps at 95.59, M4 +0.5bps at 95.97, U4 flat at 96.245, Z4 -1bps at 96.415, Z5 flat at 96.66, Z6 +1bps at 96.655.
- NY Fed RRP op demand at USD 2.055tln across 90 bidders (prev. USD 2.031tln across 90 bidders).
- US sold USD 61bln of 3-month bills at 4.285%, covered 2.56x; sold USD 51bln of 6-month bills at 4.550%, covered 2.90x.
- Wrightson on Treasury debt limit, "Our guess is that the Treasury will announce a new CMB on Thursday to replace the 16-day bill that is running off on December 8. The size and tenor of any new CMB may give us some sense of how the Treasury views the debt-limit constraints it faces between now and January."
- Fed's Williams does not see signs of a bank reserves shortage forming, saying banks are ok with holding reduced levels of reserves.

CRUDE

WTI (F3) SETTLES USD 0.96 HIGHER AT 77.24/BBL; BRENT (F3) SETTLES USD 0.44 LOWER AT 83.19/BBL

Oil prices were initially lower on Monday with China COVID/protests and a surge in pre-embargo Russian supply weighing, albeit prices recovered in US trade with OPEC cut speculation. Troughs were made in WTI and Brent front-months at USD 73.60/bbl and 80.61/bbl in the European morning, levels not seen since last December and January, respectively. China uncertainty remains a key factor in price action with the latest protests only further muddying the waters as COVID cases surge. Meanwhile, Russian seaborne oil exports are reportedly rising despite the approaching December 5th deadline for the embargo. Citi's energy desk, to wit, "Some of these shipments may be intended to beat the deadline, but it also appears Russia has been successful in finding other markets." Citi says, "The combination of slowing Chinese demand and robust Russian supply adds to the pressure on OPEC+ to make deeper cuts in production limits at their December 4 summit." The recovery in the NY session was likely influenced by that anticipation of OPEC, with Eurasia Group out saying OPEC+ will seriously consider a new cut at the meeting.

PRICE CAP: EU has failed to agree on a Russian oil price cap as of Monday, according to the latest Bloomberg reports citing diplomats, but they reportedly discussed a cap as low as USD 62/bbl (prev. reports on talks suggested a USD 65-70/bbl range). One diplomat said, "There is no deal. The legal texts have now been agreed, but Poland still can't agree to the price". Warsaw has been outspoken in its demands for a lower cap.

EQUITIES

CLOSES: SPX -1.54% at 3,963, NDX -1.43% at 11,588, DJIA -1.45% at 33,849, RUT -2.05% at 1,831.

SECTORS: Real Estate -2.8%, Energy -2.74%, Materials -2.2%, Technology -2.13%, Industrials -1.81%, Financials -1.78%, Communication Svs -1.55%, Utilities -1.07%, Health Care -0.75%, Consumer Discretionary -0.60%, Consumer Staples -0.31%.

EUROPEAN CLOSES: EURO STOXX 50 -0.68% at 3,936, FTSE 100 -0.17% at 7,474, DAX 40 -1.09% at 14,383, CAC 40 -0.70% at 6,665, FTSE MIB -1.12% at 24,441, IBEX 35 -1.11% at 8,323, SMI -0.05% at 11,162.

STOCK SPECIFICS: **Apple (AAPL)** was hit on reports it will face a production hit of 6mln iPhone Pros due to the turmoil at the Zhengzhou plant, according to Bloomberg citing sources. Meanwhile, WSJ reports that Foxconn is working to resolve the complaints by giving USD 1,400 payments to employees. **Biogen (BIIB)** took a dive on reports of a second death linked to the potential antibody treatment for Alzheimer's from **Eisai (ESALY)**, who is partnered with Biogen on the drug, according to Science.org. Energy stocks were hit on the lower crude prices overall but **Exxon (XOM)** is also experiencing issues in New Mexico, the co. reportedly is being held back in the Permian Basin due to potash, according to WSJ, noting the land is shared with miners making drilling oil less accessible to XOM. **Kroger (KR) and Albertsons (ACI)** CEOs are to face congressional questions this week over their planned US merger. **Credit Suisse (CS)** was hit after the head of its Swiss unit said some customers have withdrawn some money but very few have closed accounts. **Pinduoduo (PDD)** soared after strong beats on EPS and Revenue. **Univar Solutions (UNVR)** is in talks to be acquired by **Brenntag (BNTGY)** but talks are ongoing and there are no concrete agreements yet. **Tesla (TSLA)** is reportedly developing a revamped Model 3 set for production in Q3 2023; focused on redesigned interior and reducing costs, according to Reuters sources. **iCAD (ICAD) and Google (GOOGL)** Health reached a strategic development and commercialization agreement. **Cleveland-Cliffs (CLF)** is increasing prices for hot rolled, cooled rolled and coated steel products. **Microsoft (MSFT)** will reportedly offer EU remedies in coming weeks to avoid formal objections over the USD 69bln **Activision (ATVI)** bid, Reuters reported, adding the remedy will consist of a 10yr licensing deal for **Sony (SONY)**, supporting ATVI shares. Elsewhere for Sony, the Co. will reportedly supply Apple with its image sensors and is expected to feature in the next series of iPhones that go on sale next year, according to Nikkei. **Disney (DIS)** CEO Iger announced the hiring freeze will stay in place but workers in Florida are reportedly seeking a pay increase and other benefit changes, where Unions will stage a rally on Wednesday amid the talks. Casino’s (LVS, WYNN, MLCO) were bid after receiving 10yr gaming concession renewals from the Macau government.

FX WRAP

The Dollar was marginally bid on Monday amid the risk-off tone although the moves in FX overall were quite choppy. The buck started out weaker amid pronounced Euro strength despite a downbeat risk tone on China's COVID and protest woes. The DXY saw a low of 105.31 matching the mid-November low before advancing above the 200dma at 105.370 to highs of 106.52 as the later stock and bond pressure supported the buck. Fed's Williams repeated Powell largely, saying he expects a somewhat higher terminal rate vs the September SEPs showed. Bullard also repeated rates need to get to the bottom end of the 5-7% range and suggested rates will need to be kept at a sufficiently high level through 2023 and into 2024, whilst warning the market is underpricing risks of the Fed being more aggressive.

The Euro saw a high of 1.0496 in the morning failing to rise above 1.05 before a slow grind lower throughout the afternoon to fall sub 1.04 to lows of 1.0336. There were several central bank speakers from the ECB and Fed, remarks from ECB President Lagarde saw her repeat that the ECB expects to raise rates further but noting how much further, and on how fast they need to go, will be data-dependent, adding the ECB may need to move into restrictive territory. Knot said the risk of ECB not doing enough is more pronounced, and that risks to the inflation forecast are entirely tilted to the upside. ECB's de Cos noted the hikes so far are not enough to return inflation back to target. Attention now turns to the EZ inflation figures this week.

The Yen was marginally bid against the buck but off its best levels with USD/JPY only marginally lower at pixel time despite the pair hitting lows of 137.51 in the morning as the aforementioned COVID woes supported the haven demand with a downbeat Asia and European session. The vast majority of the move was pared however as the Dollar started making a comeback as US stocks sold off.

The Franc was weaker vs the Dollar but flat against the Euro with EUR/CHF trading between 0.9793-0.9890 with the unwind of initial Euro strength taking it to more or less flat in a volatile session.

Cyclical currencies were lower vs the buck on the downbeat risk tone with underperformance in the Aussie on its high exposure to China and weaker than expected October retail sales data. NZD and GBP still both saw notable weakness. CAD was also weaker albeit to a lesser extent, with oil prices choppy on the session. Cable fell from highs of 1.2118 to lows of 1.1941 after breaching through the 1.2000 psychological level. EUR/GBP was firmer, rising above key levels such as 0.8600 and 0.8650, a level it currently resides around with speculation around EUR/GBP buying for month-end.

The Yuan was weaker for both onshore and offshore with USD/CNH hitting a high of 7.2571 from lows of 7.1956 with the highs being hit on the reopen of trade as markets digested the protests in China over the zero COVID policy. There has been some argument the protests could be a net positive (eventually) if it means the government cave in and abandon the strict rule. However, the damage is being felt with reports that Apple's (AAPL) iPhone factory in Zhengzhou is to see a production hit of 6mln iPhone Pros due to the unrest shows the damage being done. There's an expectation that things will likely get worse before they get better.

Scandis saw the NOK and SEK weaker vs the Euro and the Dollar. Both were weaker due to the risk-off tone but NOK saw more pronounced weakness against the Euro than SEK due to the choppy crude prices and retail sales in Norway falling 0.3% after a prior 0.1% gain.

EMFX were mixed with BRL and MXN finding strength against the firmer greenback while TRY, ZAR, and RUB were weaker. MXN trade data was a narrower deficit than expected while the BRL brushed off a slowdown in Brazilian bank lending pending a new economic team in the coming days per the Workers' Party leader in the Chamber of Deputies.