US Market Wrap

15th December 2022: Global risk-off after data slips, Dollar rips, and ECB's hawkish whip

- **SNAPSHOT**: Equities down, Treasuries up, Crude down, Dollar up.
- **REAR VIEW**: ECB hikes 50bps as expected, Lagarde attempts to guide above market expectations; BoE sees dovish dissent; SNB hikes 50bps; Norges hikes 25bps; US Retail Sales, IP and regional Fed surveys disappoint; IJC fall; China targeting >5% 2023 GDP target.
- **COMING UP**: **Data**: UK Retail Sales, EZ, UK & US Flash PMIs, EZ HICP (Final), **Expiries**: Quad Witching

MARKET WRAP

Stocks bled lower globally through the session Thursday with weak data coming in the face of an abrasively hawkish-in-tone ECB. The index futures saw two bouts of pronounced selling: 1) in the European morning in catch-up to Wednesday's FOMC, and 2) in the NY morning after the ECB taunted markets for being too dovish in pricing. It was a volatile session for global sovereign bonds with US and UK yields lower, the former aided by notable falls in US retail sales and industrial production, not to mention misses in Empire and Philly Fed mfg. surveys, while the UK curve caught a bid as the BoE confirmed a downshift in its hiking pace to 50bps, taking the Bank Rate to 3.50%, while two even dissented for no change. On the other hand, EGB yields rocketed with the German 2yr rising 30bps, the largest one-day rise since 2008 after the 50bps hike to 2%, while Lagarde's commentary indicates a preference to get to a terminal rate closer to 4% than the 3% currently priced by markets (2.8% pre-ECB), expanding the dispersion between markets and central banks, a growing theme. Despite this, the Euro failed to hold on to gains against the Dollar, with the latter seeing broad strength amid the cyclical risk aversion, seen particularly in high-beta currencies - the Aussie posted its worst down day since March 2020.

US DATA

RETAIL SALES: Headline retail sales declined 0.6% in November, deeper than the 0.1% expectation and paring from October's gain of 1.3%. The ex-autos metric declined 0.2% despite expectations for a 0.2% gain, while the prior was revised lower to 0.5% from 0.7%. The ex-gas and autos print saw a 0.2% fall. The control showed a 0.2% decline, despite expectations for a 0.2% rise, showing further evidence of slowing consumer spending, even heading into the holiday period. Looking into the report, ING highlights, "Furniture fell 2.5%, department stores saw sales fall 2.9%, while electronics were down 1.5%", but on a positive note, "food and beverage sales rose 0.8% while health/personal care increased 0.7% and miscellaneous sales rose 0.5%." ING concludes that in an environment where the Fed is focused on inflation and signalling a peak rate of 5.00-5.25%, this disappointing report is only going to increase concerns about the prospect of a recession.

JOBLESS CLAIMS: US initial jobless claims fell to 211k in the latest week, well beneath the expected 230k, while the prior was nudged up slightly to 231k. The week-delayed continued claims remained little changed at 1.671mln. Pantheon Macroeconomics notes the initial claims figure was "depressed by a seasonal adjustment quirk, which will keep claims at a similar level next week, before a rebound to a new cycle high the following week." The consultancy affirms that the trend is now rising, albeit from a very low base. Concluding, "The Challenger layoff announcement data point clearly to a hefty increase in layoffs, though the latest data likely overstate the pace of the deterioration."

EMPIRE STATE/PHILLY FED: The December **NY Fed** Manufacturing survey fell into contractionary territory at -11.2, deeper than the expected -1.0 from the prior +4.5. The report saw "New orders moved slightly lower, while shipments edged higher. Delivery times and inventories were little changed. Labor market indicators pointed to a moderate increase in employment, but a slightly shorter average workweek. Input prices and selling prices increased at about the same pace as last month. Looking ahead, firms expect some improvement in business conditions over the next six months, but optimism was very subdued." The **Philly Fed** headline remained in contractionary territory but it saw an improvement from the prior month, printing -13.8 from -19.4, albeit it still missed expectations for -10. "The survey's indicators for general activity, new orders, and shipments were all negative, and the firms reported a decline in employment, on balance. The survey's broad indicators for future activity improved and indicate firms expect growth overall over the next six months." On inflation, both prices paid and prices received declined, but firms continue to report an overall increase in prices. Analysts at Oxford Economics write, "Manufacturing conditions in the US are deteriorating as central banks continue to raise rates and the global economy weakens. The result has been a dwindling pipeline and downbeat sentiment, while lingering supply chain challenges also weigh on regional, and national, factory activity".

IP & MFG. OUTPUT: US manufacturing output fell -0.6% in November, well beneath the expected 0.1% decline and against October's rise of 0.3%, which was upwardly revised from +0.1%. While industrial production fell 0.2%, against the expected 0.1% rise and the prior 0.1% decline. The smaller fall in IP was largely a result of the 3.6% M/M jump in utilities output amid cold weather conditions, taking some of the "shine" in the reading. Meanwhile, mining output dropped 0.7% M/M, accompanying lower crude production, and a 2.8% M/M drop in motor vehicle output, not to mention output falls across primary metals, computers & electronics, furniture, and textiles. Capital Economics writes, "With exports now suffering from the strong dollar, and a global recession looming, we expect that further weakness in manufacturing lies in store." The consultancy highlights the accompanying weak Empire State and Philly Fed manufacturing reports Thursday that give further weight to a downturn in the sector.

CENTRAL BANKS

ECB: As expected, the ECB stepped back from its 75bps cadence of rate hikes and opted to raise its key three rates by 50bps a piece, taking the Deposit rate to 2.0%. Furthermore, the Governing Council judges that "interest rates will still have to rise significantly at a steady pace to reach levels that are sufficiently restrictive". The statement reiterated that future policy rate decisions will continue to be data-dependent and follow a meeting-by-meeting approach. On the balance sheet, from the beginning of March 2023 onwards, the APP portfolio will decline at an average pace of EUR 15bln per month until the end of Q2 with its subsequent pace to be determined over time. Lagarde later noted that the EUR 15bln figure represents roughly half of redemptions over that period of time. The accompanying macro projections saw 2022 HICP upgraded to 8.4% from 8.1%, 2023 raised to 6.3% from 5.5% with 2024 and 2025 seen at 3.4% and 2.3% respectively and therefore indicative that further tightening will be required to bring inflation back to target over the medium term. On the growth front, 2022 GDP was upgraded to 3.4% from 3.1% and 2023 now seen at just 0.5% (prev. 0.9%) with the upcoming recession likely to be shallow and short-lived. Thereafter, 2024 and 2025 GDP is seen at 1.9% and 1.8% respectively. At the follow-up press conference, Lagarde was defiant in her hawkish stance and even went as far as pre-judging the February meeting by stating that markets should expect a 50bps pace of hikes for a period of time. Lagarde later noted that info predicates 50bps at the next meeting, "possibly the next one as well and possibly thereafter". In terms of the unanimity of the Board, Lagarde stated that there was a very broad majority view that the ECB should show perseverance. However, some wanted to do a bit more and some a bit less. Later, sources showed that over a third of ECB policymakers wanted to opt for a larger 75bps hike. Overall, despite the ECB's negative experience earlier in the year by prejudging the magnitude of rate hikes ahead of time, Lagarde appeared to be willing to play the same card again in an attempt to highlight her hawkish stance and put the inflation genie back in the bottle. Time and a likely tough winter for the Eurozone will tell if this was a brave or misjudged move from the President. As it stands, market pricing puts the terminal rate at around 3%.

BOE: As expected, the MPC opted to step down the pace of its rate hiking cycle to 50bps from 75bps, taking the Base Rate to 3.5%. The decision to move on rates was not a unanimous one with dovish dissent from Dhingra and Tenreyro who voted for no change. They framed their decisions on the viewpoint that the current setting of the Bank Rate was more than sufficient to bring inflation back to target, before falling below target in the medium term. At the hawkish end of the spectrum, external member Mann backed a 75bps hike on the basis that it would reinforce the tightening cycle and lean against an inflation psychology that was embedding in wage settlements and inflation expectations. Elsewhere, the statement noted that further increases in the Bank Rate may be required; according to a "majority" of the Committee. Additionally, the statement did not repeat the November line that rates are unlikely to reach the peak implied by the market. ING notes that this adjustment was not too surprising given that market rates have fallen markedly since the political drama and LDI (Liability Driven Investing) pensions issues in October. The MPC is of the view that CPI inflation has reached a peak, but is expected to remain high in the coming months. Overall, ING concludes that their best guess is the MPC will deliver another 50bps hike in February before pausing its rate hike cycle at a peak rate of 4%. Capital Economics holds a more hawkish view and looks for 50bps increases in both February and March.

SNB: Overall, very much as expected from the SNB. A 50bp hike was delivered to 1.00% with the only 'major' tweak being the replacing of "further" with "additional" in the forward guidance line; though, it remains to be seen what, if any, bearing this alteration has. For reference, Chairman Jordan did not elaborate on this much in the presser. Rates aside, FX language was reiterated and the Exemption Threshold altered to account for the 50bp move. As such, the reaction was limited but the Franc did experience some modest pressure, perhaps spurred on a 'buy the rumour, sell the fact' narrative given the as-expected move and the inflation forecasts now showing Switzerland at a peak, limiting the need for further tightening. Within the subsequent press conference, the main but perhaps unsurprising point was Chairman Jordan explicitly confirming that the SNB has sold foreign FX in recent months; additionally, he reiterated a willingness to undertake two-way intervention.

NORGES BANK: Overall, very much as expected from the Norges Bank. Which delivered the flagged (by Governor Bache in the last press conference) 25bp hike, alongside acknowledging that inflation remains elevated, the labour market is slightly tighter and the economic slowdown might be longer lasting than forecast in September - in-fitting with what data has shown since. In terms of policy ahead, the Repo Path was subject to very minor downside alterations and implies around 35bp of tightening before a peak around March 2023; i.e. a 25bp move in Q1 2023 and then some optionality for another move, if inflation remains stubbornly elevated as the forecasts for CPI-ATE imply. Following the announcement, EUR/NOK saw fleeting downside though this was limited in both duration and magnitude.

BANXICO: The Central Bank of Mexico hiked rates by 50bps as expected to 10.50%, matching the move from the Fed on Wednesday. The decision was not unanimous however, with Esquivel opting for a 25bp hike - Esquivel has previously spoken of deviating from the Fed. The bank continued to signal that further rate hikes will be needed, although specifically saying at its next "meeting" rather than "meetings" previously, where it will then assess if the reference rate needs to be further adjusted. Its inflation forecasts were revised marginally higher but left unchanged for 2023, but core CPI saw revisions higher from Q422 to Q1 2024, but it still expects inflation to return to its 3% target at the end of 2024. Analysts at Pantheon Macroeconomics expect Banxico to deliver a 25bp hike in February, albeit they say it is unnecessary, and they cannot rule out another 25bp hike in March.

FIXED INCOME

T-NOTE (H3) FUTURES SETTLED 6+ TICKS FIRMER AT 114-29+

Treasuries rallied on Thursday amid weak US data, shaking off pronounced EGB selling after the hawkish ECB. 2s -0.2bps at 4.247%, 3s -0.9bps at 3.955%, 5s -2.4bps at 3.628%, 7s -3.4bps at 3.566%, 10s -5.1bps at 3.452%, 20s -6.2bps at 3.687%, 30s -4.4bps at 3.496%.

Inflation breakevens: 5yr BEI -3.4bps at 2.259%, 10yr BEI -1.2bps at 2.184%, 30yr BEI -0.6bps at 2.204%.

THE DAY: After hitting peaks of 115-01 during Powell's press conference on Wednesday, T-Notes edged lower into the Tokyo morning on Friday, finding lows of 114-19+. Contracts were then rangebound before breaking out to the upside into the BoE meeting in sympathy with Gilts, only to reverse back down to session lows of 114-18 in wake of the hawkish ECB. The 08:30ET data slate was a net negative on the growth outlook with a big miss on retail sales accentuated by misses in both the Empire State and Philly Fed surveys, seeing T-Notes print session highs of 115-02+, with the fall in jobless claims an afterthought. However, sustained weakness in EGBs (German 2yr +30bps, largest one-day rise since 2008) through the European close capped the UST rally, not to mention a massive 18.1k 5yr vs 8.1k Ultra 10yr futures steepener. Amid the chop, the curve saw a period of steady pronounced flattening from around 09:00ET through until 11:00ET. As Europe closed shop, the sustained, cross-asset risk-off trade (stocks sold, Dollar bought) coincided with haven demand in USTs, seeing T-Notes drift to the top-end of their 114-18/115-02+ trading range into the settlement.

REFUNDING: US to sell USD 12bln in 20yr bonds on Dec 21st to settle on Jan 3rd; to sell USD 19bln in 5yr TIPS on December 22nd, to settle on December 30th. In bills, to sell USD 54bln 13-week bills and USD 45bln 26-week bills on Dec. 19th (both sizes unchanged), both to settle on Dec. 22nd.

STIRS:

- EDZ2 +0.5bps at 95.26, H3 -4bps at 94.925, M3 -4bps at 94.89, U3 -4bps at 95.06, Z3 -2.5bps at 95.425, H4 -1 bps at 95.885, M4 -0.5bps at 96.295, U4 +1bps at 96.585, Z4 +2.5bps at 96.745, Z5 +4bps at 96.93, Z6 +5.5bps at 96.895.
- US sold USD 46bln of 1-month bills at 3.780%, stops through 7bps, covered 3.16x; sold USD 46bln of 2-month bills at 4.060%, covered 2.72x.
- NY Fed RRP op demand at USD 2.124tln (prev. 2.193tln) across 98 bidders (prev. 97 bidders)

CRUDE

WTI (F3) SETTLED USD 1.17 LOWER AT 76.11/BBL, BRENT (G3) SETTLED USD 1.49 LOWER AT 81.21/BBL

Oil prices were subdued Thursday amid hawkish central banks and weak output data dimming the demand outlook, accentuated by a strong Dollar. WTI and Brent front-month futures attempted a rally in the London morning to highs of USD 77.77/bbl and 83.18/bbl, respectively, although a hawkish ECB and poor US data saw prices unwind. There was an attempt at a recovery into the London close but the Dollar strength was just too strong to give way to anything more meaningful. Keeping some pressure on the supply upside were updates from TC Energy which has announced it is restarting segments of its 620k BPD Keystone pipeline that are not affected by the oil spill, whilst caveating that the affected segment will not be restarted until safe and the PHMSA gives approval, without providing a further timeline. While in Europe, Equinor (EQNR NO) announced its Johan Sverdrup oilfield phase 2 has started production with peak production seen at 720k BPD with an aim to raise it to 755k BPD, which could meet 6-7% of daily oil demand across the continent.

EQUITIES

CLOSES: SPX -2.49% at 3,896, NDX -3.37% at 11,345, DJIA -2.25% at 33,202, RUT -2.52% at 1,775.

SECTORS: Communication Svs. -3.84%, Technology -3.78%, Materials -3.02%, Industrials -2.45%, Financials -2.01%, Health Care -1.86%, Consumer Discretionary -1.78%, Consumer Staples -1.66%, Real Estate -1.28%, Utilities -1.27%, Energy -0.53%.

EUROPEAN CLOSES: EURO STOXX 50 -3.51% at 3,836, FTSE 100 -0.93% at 7,426, DAX 40 -3.28% at 13,986, CAC 40 -3.09% at 6,523, FTSE MIB -3.45% at 23,726, IBEX 35 -1.7% at 8,219, SMI -2.51% at 10,880.

STOCK SPECIFICS: **Amazon (AMZN)** has reportedly agreed to change some business practices as part of an EU settlement, according to NY Times citing sources; avoiding a legal fight and billions of dollars worth of potential fines. **Tesla (TSLA)** CEO Musk sold 22mln more shares, raising USD 3.6bln. Meanwhile, Electrek reported Tesla (TSLA) is on the verge of announcing a factory in Mexico and has recently acquired land in Nuevo Leon. **Warner Brothers Discovery (WBD)** raised write-off costs by USD 1bln. **Netflix (NFLX)** is reportedly letting advertisers take their money back after missing viewership targets on its ad-supported tier, according to Digiday, although NFLX said they are happy with the launch so far. **Lennar (LEN)** posted a strong report but GM guidance disappointed. **Novavax (NVAX)** proposed a public offering to sell up to USD 125mln of its common stock. **Southwest Gas (SWX)** is to sell MountainWest Natural Gas for an EV of USD 1.5bln to **Williams (WMB)**. An insider purchased 10k shares of **VF Corp (VFC)** at USD 28.50/shr. **Disney (DIS)** announced its 'Avatar 2' sales so far have exceeded 'Top Gun: Maverick'. The Bear Cave made negative comments on **Six Flags (SIX)**. TF International Securities survey indicated **Seagate (STX)** and **Western Digital's (WDC)** HDD and SSD shipments for server storage may decline by 10-15% YoY in H123 due to inventory corrections and weak demand.

CHINA: The US Public Company Accounting Oversight Board (PCOAB) secured "complete access" to inspect and investigate Chinese firms for the first time in history, reducing risk of China ADR's being delisted in the US. SEC Chair Gensler said if authorities do not allow complete access for 3 years, SEC would prohibit trading in securities of issuers engaging in those audit firms. The US watchdog selected KPMG Huazehen LLP in Mainland China, who audits Yum China (YUMC), and PriceWaterhouseCoopers in Hong Kong, who audits Alibaba (BABA) for inspection.

FX WRAP

The Dollar pared its post-FOMC losses and saw notable strength as stocks tumbled, with DXY rising above 104.00 to highs of 104.88 in wake of a plethora of central bank activity and several US data points. Retail sales came in beneath analyst expectations on all metrics while the Philly and NY Fed surveys also disappointed. Industrial production & manufacturing output also fell short of expectations. A fall in initial claims data was the only "positive", albeit not desired on the Fed in its efforts to loosen the labour market. Money market pricing for the Fed still has not budged with weak economic data adding to the case the Fed does not need to be as hawkish as they are implying. The upside in the Dollar came despite a move lower in Treasury yields while the ECB leaned notably hawkish.

The Euro was lower against the buck despite the hawkish ECB. The central bank hiked by 50bps as expected and judged interest rates will still have to rise significantly at a steady pace to reach levels that are "sufficiently restrictive", while taking a data-dependent approach. It also implemented QT at EUR 15bln/mth until the end of Q2 23, but left open optionality for adjustments. Lagarde in the presser also noted we should expect 50bps rate hikes for a period of time and warned inflation may be higher in January and February, adding that anyone who thinks the ECB is pivoting is wrong, the ECB has to go longer than the Fed. It is clear today's decision had a lot of debate, with Lagarde noting members on the GC had a range of opinions, some wanted to move higher, some wanted to move lower - later Bloomberg sources saw over a third of ECB Policy Makers wanted another 75bp hike, but Lagarde offered two consecutive 50bp moves instead, which could end up being three more 50bp hikes if inflation does not improve. Nonetheless, the Euro saw weakness falling from highs of 1.0735 during the press conference, before paring to c. 1.06.

The Yen was notably weaker amid the rising Dollar and came despite a move lower in Treasury yields while any haven demand on Thursday went straight to the Dollar, with the Yen, Franc, and Gold all weaker vs the buck. Note, in the APAC session the latest Japanese trade balance saw the deficit narrow to JPY 2.027tln from 2.166tln, but it was still deeper than forecast.

The Swissy was weaker vs the buck and flat against the Euro in wake of the SNB and ECB rate decisions. The SNB delivered a 50bp hike as expected to 1.00% with the only 'major' tweak being the replacing of "further" with "additional" in the forward guidance line; though, it remains to be seen what, if any, bearing this alteration has. Chairman Jordan did not elaborate much in the press conference, so in upcoming commentary we will look for how much further tightening they actually expect, given forecasts implying Switzerland is now at the inflation peak of 3.00%. Rates aside, FX language was reiterated and the Exemption Threshold was altered to account for the 50bp move. On FX, we are attentive to see whether SNB officials reiterate the willingness for two-way intervention, as necessary. But interestingly the SNB confirmed it sold foreign currency, "and thus the utilisation of a strong CHF as part of the overall monetary policy mix to tackle inflation", IFR commented.

The Yuan was weaker vs the buck, both onshore and offshore, while the China activity data was weaker than expected overnight adding to the Yuan woes. Retail sales declined 5.9% while industrial output rose 2.2%, beneath the 3.6% expected. Meanwhile, WSJ sources reported that China is to set a GDP target in excess of 5% for 2023. By way of comparison, Morgan Stanley expects Chinese 2023 GDP growth of 5.4% and JPM expects 4.3%.

Cyclical currencies were weaker as the Dollar soared and equities tumbled amid downbeat manufacturing data, seeing huge downside in AUD/USD, despite the stronger-than-expected Aussie jobs report, showing its largest downward move since March 2020, falling from highs of 0.6869 to lows of 0.6677, but meandering around 0.6700 in latter trade. NZD and GBP were also notably weaker, albeit not as much as the Aussie. Sterling sold off after the BoE rate decision, trading off the vote split: hiked by 50bps as expected although Mann opted for a larger 75bp hike, while Tenreyro and Dhingra opted to leave rates unchanged. The BoE also removed the line that rates are not likely to reach the peak as viewed by markets. Looking ahead, BoE added further increases may be required, according to a majority of the Committee. CAD was the cyclical outperformer although still saw notable losses against the buck with downside in crude prices adding no favours.

Scandis were weaker in general, vs both the Dollar and the Euro on Thursday. NOK outperformed SEK however after the latest Norges Bank rate decision, which hiked rates by 25bp as expected, alongside acknowledging that inflation remains elevated, the labour market is slightly tighter and the economic slowdown might be longer lasting than forecast in September - in-fitting with what data has shown since. In terms of policy ahead, the Repo Path was subject to very minor downside alterations and implies around 35bp of tightening before a peak around March 2023; i.e. a 25bp move in Q1 2023 and then some optionality for another move, if inflation remains stubbornly elevated as the forecasts for CPI-ATE imply.

EMFX was predominantly weaker although RUB managed to eek a gain vs the buck. ZAR saw particular underperformance as gold prices took a hit, while MXN and BRL saw similar losses. MXN saw little reaction to the Banxico rate decision (more above). Attention in Brazil lies on the fiscal bill, where a lawmaker said it needs a vote today or it is finished. Meanwhile, reports in Estadao noted members of Brazilian President-elect Lula's party are reportedly starting to discard the Transition PEC, a proposal to permanently exclude Brazil’s main cash-transfer program from the rule that limits growth in public spending.