US Market Wrap

27th July 2023: Stocks and Bonds fall after hot data, bank regs, and hawkish BoJ sources

- **SNAPSHOT**: Equities down, Treasuries down, Crude up, Dollar up.
- **REAR VIEW**: Dovish ECB; BoJ to discuss YCC tweak; Hot US data; US proposes bank capital regulation; Stellar META earnings; Weak 7yr auction.
- **COMING UP**: **Data**: Japanese CPI, Swiss KOF Indicator, Eurozone Economic Sentiment, German HICP (Prelim.), US Personal Income, Consumption, PCE & Employment Costs **Events**: BoJ Policy Announcement **Earnings**: Air France, BBVA, Capgemini, CNH Industrial, Intesa Sanpaolo, OMV, Sanofi & Vinci.

MARKET WRAP

The Dollar was bid and stocks and bonds were sold through the session after the super hot Q2 US GDP report and tumbling jobless claims catalysed a reversal lower. The downside in stocks and bonds was only worsened on the back of the new US bank capital proposals that look set to impact the US' largest lenders. Further selling pressure were seen after the Nikkei sources piece that the BoJ would be discussing when to widen its yield curve cap band ahead of its meeting on Friday. Even Bunds were lower on the session after initially bouncing as the ECB made dovish tweaks to its statement to suggest the top could be in for rate hikes, at least in some people's views. The Euro saw big losses through the 1.10 figure, while the Yen strengthened below the 139 level vs the Dollar at its best. The sell-off in Treasuries was strongest in the belly of the curve, with the cash 10yr yield reclaiming the 4% level. On an index level, the NDX was the relative outperformer (vs SPX and RUT) given the solid META earnings on Wednesday evening, albeit still closed in the red - European indices held up much better. In commodities, oil was firmer despite the strong Dollar, while metals fared much worse.

US DATA

GDP: Headline Advance GDP for Q2 came in at 2.4%, above the street consensus 1.8% (estimates ranged between 0.3%-3.0%) and accelerating from Q1's 2.0%, matching the Atlanta Fed GDPNow tracker's estimate of 2.4%. The deflator, which measures changes in the price of goods and services produced in the US, including those exported to other countries (price of imports are excluded), rose 2.2%, cooling from the prior 4.1% in Q1 and beneath expectations of 3.0%. In fitting with a cooler deflator, the Core PCE for Q2 cooled to 3.8% from 4.9%, beneath the 4.0% expected with headline cooling to 2.6% from 4.1%. The increase in real GDP reflected increases in consumer spending, nonresidential fixed investment, state and local government spending, private inventory investment, and federal government spending that were partly offset by decreases in exports and residential fixed investment. Imports decreased, but imports are a subtraction in the GDP calculation. Looking ahead, some desks are cautious of softer consumption into year-end amid student loan repayments restarting and as monetary lags work their way through the economy. Alternatively, with the services sector ebullient, there are now some tentative signs of the manufacturing sector showing some recovery, which could provide some tailwinds provided services don't enter a downturn.

JOBLESS CLAIMS: Weekly initial jobless claims fell to 221k from 228k vs the expected rise to 235, hitting the lowest level since February. Unadjusted initial claims totalled 213.7k, a fall of 44.5k from the previous week, where the seasonal factors expected a fall of 37.4k. On a state-by-state level, and unadjusted, there were only two states, Colorado (+131) and Utah (+234), that saw an increase in initial claims filed over the recent week. Meanwhile, amongst the declines, the largest state contributors were New York (-9.4k), California (-4.4k), and Gerogia (-3.1k). Wrightson warns, "the seasonal factors for next week are likely to have a similar effect. We think new claims could slip to the 215K to 220K range for the week of July 29." More broadly, the fall in initial jobless claims, combined with the tumble in continued claims, highlights the continued tightness of the US labour market. And given the downward momentum of the data, raises questions on whether we are seeing a deterioration in the labour market's balance. That would be a hawkish reassessment for the Fed. Note Fed Chair Powell at the July 26th FOMC presser, "Reducing inflation is likely to require a period of below-trend growth and some softening of labor market conditions." Powell also said, "stronger growth could lead over time to higher inflation and that would require an appropriate response for monetary policy." On which, SGH Macro's Tim Duy says, "If... growth accelerates above 2%, and with that progress toward looser conditions in the labor market slows or reverses, the Fed will hike again at the Oct/Nov meeting." The labour market imbalance will be further gauged in the Q2 Employment Cost Index on Friday, which is expected to rise 1.1%, which would only mark a minor improvement from the Q1 rise of 1.2%.

DURABLE GOODS: Headline durable goods orders were super hot, rising 4.7% in June, up from 1.8% and above expectations of 1.0%. The jump was driven by the volatile transportation equipment that saw new orders rise 12.1% M/M, while capital goods rose 11.2% and nondefense capital goods rose 16.9%. The core capital goods, nondefense capital goods ex aircraft, rose a more muted 0.2%, but still beating the -0.1% forecast, and analysts at Pantheon Macroeconomics highlight the upside surprise in core capital goods partly due to a jump in ship and boat orders. On the headline, civilian aircraft orders surged 88% in wake of the Paris Air Show, Pantheon notes, and caveats that aircraft orders are very noisy month to month, but have broadly followed the rebound in airline passengers since COVID. The desk notes "That said, passenger volumes returned to their pre-Covid level at the start of this year and have since flatlined, so we doubt the June jump in aircraft orders marks the start of a fresh upward trend".

ADVANCED GOODS TRADE BALANCE: The June Advanced Goods Trade Deficit narrowed roughly USD 4bln to USD 87.84bln from USD 91.86bln. Exports printed 162.5bln, 0.4bln more than May, while Imports fell 3.6bln to 250.3bln. Oxford Economics notes, "the outlook for both exports and imports remains downbeat, and the report doesn't warrant changes to the baseline". On exports, while they may benefit from a weaker dollar in the months ahead, any upside will be offset by a slowing economic backdrop abroad. Oxford further adds, "imports have been supported by the resilience of consumer spending, but expect further declines as spending continues to rotate away from goods towards services as businesses work through existing inventories as the economy heads towards a possible recession." On the figures, industrial supplies and capital goods led the decline in imports, offset by a rise in autos. The very modest rise in exports was driven by slight gains in capital and "other" goods. OxEco concludes, "while the deficit improved in June, net trade was still a small drag on Q2 GDP growth and we expect it to be broadly neutral over the balance of the year."

CENTRAL BANKS

ECB REVIEW: As expected, the ECB pulled the trigger on another 25bps hike, taking the deposit rate to 3.75%. The decision to move on rates again was based on the view that although "inflation will drop further over the remainder of the year", it "will stay above target for an extended period". Aside from the decision itself, focus for the statement was on the modest adjustment to the Bank's language on future decisions whereby the key ECB interest rates will be "set at" sufficiently restrictive levels for as long as necessary vs. the previous wording of "brought to". Elsewhere, the GC also opted to set the remuneration of minimum reserves at 0% (vs. prev. matching the deposit rate) in order to "preserve the effectiveness of monetary policy". In the follow-up press conference, Lagarde offered a more downbeat assessment of the Eurozone economy, noting that the near term outlook is deteriorating and momentum in the services sector is slowing. With regards to today's decision, Lagarde stated that policymakers were unanimous in their stance. When initially questioned over whether she thinks the Bank has more ground to cover, she said the decision will be based on the data and the GC is "open-minded". When pressed on the matter later during the press conference, Lagarde stated that at this moment in time she "would not say so" with regards to there being more ground to cover. On the balance sheet, Lagarde remarked that a reduction has not been discussed and there will be no trade-offs between rates and QT. Overall, the main takeaway ahead of the September meeting is that the ECB is happy to either pause on rate hikes or carry out further tightening, however, any decision to do so will be based on how the data plays out between now and then (note, there are two more inflation reports due before the September decision). As it stands, markets price a 25bps hike in September at around 40%. Analysts at Nordea are of the view that "today's move was the last hike in the cycle, though risks are tilted towards a further hike in the autumn". The following ECB source reports via Reuters saw that some ECB policymakers do currently favour a September rate hike, but others are eyeing a pause expecting a recession. Meanwhile on reserves, the sources noted the ECB debated raising banks mandatory reserves to 2% from 1%.

BoJ PREVIEW: The Bank of Japan will conclude its 2-day policy meeting on Friday and likely keep policy settings unchanged with rates to be kept at -0.1% and yield curve control maintained to flexibly target 10yr yields at 0% within a +/- 50bps target band as a recent poll showed that 77% of economists surveyed by Reuters anticipate no unwinding of ultra-easy policy this month and economists are evenly split on whether the BoJ will begin phasing out stimulus this year. The central bank will also release its latest Outlook Report which contains Board members' median forecasts for Real GDP and Core CPI, while press reports have noted expectations that the BoJ could raise the inflation forecast above the 2% target level and even to as high as 2.5% for FY23, which if confirmed, could be seen to pave the way for future policy normalisation. For the full Newsquawk preview, please click here.

FIXED INCOME

T-NOTE (U3) FUTURES SETTLED 1 POINT & 4 TICKS LOWER AT 111-00+

Treasuries saw heavy selling, led by the belly, after hot economic data, bank regulation proposals, a weak 7yr auction, and hawkish BoJ sources. 2s +9.9bps at 4.926%, 3s +13.4bps at 4.588%, 5s +15.5bps at 4.242%, 7s +15.7bps at 4.140%, 10s +15.3bps at 4.004%, 20s +13.7bps at 4.258%, 30s +12.2bps at 4.050%.

INFLATION BREAKEVENS: 5yr BEI +1.6bps at 2.410%, 10yr BEI +1.1bps at 2.377%, 30yr BEI +0.9bps at 2.306%.

THE DAY: Treasuries initially held onto their FOMC bid going through the APAC Thursday session, chopping sideways. T-Notes peaked at 112-07 in the European morning with the front-end leading but were reluctant to extend the bid much further from Thursday's peak at 112-05+. Contracts pared a few ticks into the NY handover. The dovish tweak to the ECB statement saw limited spillover strength from EGBs ahead of the US data.

The above forecast US GDP and Durable Goods orders, combined with the fall in jobless claims to the lowest levels since February saw Treasuries knee-jerk lower. And as the dust settled, the downside extended through the rest of the session, with a few corporate debt deals adding to the pressure ahead of the 7yr Treasury auction. The selling gained momentum on the back of the proposed bank capital adjustments, moves that on paper could see banks pullback from holding/buying Treasuries in order to meet more stringent capital requirements - albeit these are changes that aren't expected to take place for years.

Treasuries had found some respite as Europe closed up, but that was short-lived after a poor 7yr auction coincided with hawkish BoJ sources in Nikkei that suggested the bank will indeed be discussing when to tweak its yield curve cap at Friday's meeting, hitting in global govvies in response. T-Notes ultimately troughed at 110-30+ just before settlement, with the cash 10yr yield reclaiming 4.00%. Contracts are now reapproaching their early July lows at 110-05. In addition to any month-end flows, there are plenty of catalysts on Friday...

FRIDAY: BoJ Announcement & Outlook Report, German Flash CPI (Jun), French Flash CPI (Jun), Spanish Flash CPI (Jun), EZ Business Confidence Survey (Jul), US PCE (Jun), ECI (Q2), UoM survey final (Jul).

7YR AUCTION: A poor USD 35bln 7yr auction from the US Treasury where despite the large sell-off into the offering after hot economic data earlier, the auction still tailed by a chunky 1.3bps for a stop of 4.097%, worse than the six-auction avg. on the screws and the prior stop-through of 1.1bps. The bid/cover ratio of 2.48x was also beneath average. Dealers (forced surplus buyers) were left with a large 14.3% (avg. 11.4%), whilst Indirects saw a step-down in participation to 69.8% from last month's strong 75.3%, with muted participation from Directs.

STIRS:

- SR3U3 +0.5bps at 94.58, Z3 -2.5bps at 94.595, H4 -9.5bps at 94.785, M4 -15bps at 95.09, U4 -17.5bps at 95.46, Z4 -18.5bps at 95.795, H5 -18bps at 96.05, M5 -18.5bps at 96.205, U5 -18.5bps at 96.30, U6 -18.5bps at 96.505, U7 -17bps at 96.505.
- SOFR flat at 5.06% as of July 26th, volumes fall to USD 1.452tln from 1.470tln.
- NY Fed RRP op demand at USD 1.736tln (prev. 1.750tln) across 103 counterparties (prev. 96), fall coincides with a USD 23bln net T-bill settlement.
- EFFR flat at 5.08% as of July 26th, volumes rise to USD 98bln from 89bln.
- US sold USD 71bln of 1-month bills at 5.275%, covered 3.18x; sold USD 61bln of 2-month bills at 5.285%, covered 2.86x.
- US leaves 6-week, 13-week, and 26-week bill sizes unchanged.

CRUDE

WTI (U3) SETTLED USD 1.31 HIGHER AT 80.09/BBL; BRENT (V3) SETTLED USD 1.23 HIGHER AT 83.79/BBL

Oil prices were firmer on Thursday with hot US economic data providing tailwinds despite the reversal higher in the Dollar. Prices initially found a firmer footing in the Asia session as the Dollar sold off further post-FOMC. Prices were choppy through Europe until the triple growth impulse across US GDP, jobless claims, and durable goods orders saw new highs made. There was some turbulence as the Dollar reversed higher but ultimately the demand outlook outweighed the FX headwind to see WTI (U3) and Brent (Q3) futures go on to print session highs of USD 80.60/bbl and 84.09/bbl, respectively just after midday in NY, before some paring into the settlement as the Nikkei hawkish BoJ reports weighed on risk assets more broadly.

RUSSIA: Russian Energy Minister Shulginov told TASS that Russian 2023 oil and gas condensate production is forecast at 515mln T (prev. 535mln T in 2022) with the final figure dependent on further OPEC+ quota decisions - that is slightly less than the 520mln T figures that Russian sources told Reuters in April that it could reach, however, is still more than the official estimates of 490-500mln T given in December 2022. Meanwhile, Shulginov announced that Gazprom plans to start hydrocarbon output at the El Assel project in Algeria in 2026. Shulginov also said that Russia is to supply 18-20mln T of oil products to Africa this year.

NAT GAS futures tumbled to their lowest levels since early last week, and peculiarly, knee-jerked lower as the EIA data saw a smaller storage build than expected (+16BCF vs exp. +19BCF and prior +41BCF). Meanwhile, the US Supreme Court removed an obstacle to the long-delayed Mountain Valley nat gas pipeline, which would unlock supply from the Appalachia basin, granting its request to lift stays imposed by a lower court that had halted construction of the controversial final short section.

EQUITIES

CLOSES: SPX -0.64% at 4,537, NDX -0.22% at 15,465, DJIA -0.67% at 35,283, RUT -1.29% at 1,955.

SECTORS: Real Estate -2.12%, Utilities -1.73%, Financials -1.29%, Cons Disc -0.87%, Industrials -0.82%, Cons Stpl -0.81%, Health -0.77%, Materials -0.67%, Energy -0.54%, Technology -0.34%, Communication Svs +0.85%.

EUROPEAN CLOSES: DAX +1.70% at 16,406.03, FTSE 100: +0.21% at 7,692.76, CAC 40 +2.05% at 7,465.24, Euro Stoxx 50 +2.34% at 4,448.05, IBEX 35 +0.98% at 9,694.70, FTSE MIB +2.13% at 29,597.81, SMI +1.70% at 11,373.21.

EARNINGS: **Meta (META)** had a stellar report; EPS, revenue, DAUs, MAUs and advertising revenue all beat in addition to raising Q3 revenue guidance. META became the latest mega-cap tech name to benefit from ad. revenue growth, which analysts have said is positive for **Amazon (AMZN)** ahead of earnings next week. **McDonald's (MCD)** beat on EPS and revenue, while global comp. sales and US comp. sales also topped expectations. A MCD exec said there has not been a dramatic change in the US consumer and sentiment is actually improving a little bit. **Southwest Airlines (LUV)** marginally missed and beat on EPS and revenue, respectively, noting business revenues are continuing to recover, but not yet back to back to pre-pandemic levels amid higher costs. **Comcast (CMCSA)** beat on the top and bottom line, with most of the key underlying metrics also surpassing expectations. **Abbvie (ABBV)** earnings beat with key drug sales also strong. It also lifted its FY profit forecast. **Honeywell (HON)** posted a mixed report; missed on revenue but beat on profit. Q3 EPS view was short, but raised FY sales, margin and adj. EPS view. **Align Technology (ALGN)** topped the street consensus on EPS and revenue with FY23 revenue guidance strong. CEO highlighted strong growth in teen and younger patient volumes, with a notable increase in the teen segment. **eBay (EBAY)** beat on the top and bottom line, but GMV, US GMV and active buyers disappointed. Q3 profit view also fell short. **Keurig Dr Pepper (KDP)** missed on EPS but beat on revenue and international net sales; raised FY net sales outlook and reaffirmed EPS guidance. **Lam Research (LRCX)** earnings beat with strong guidance. **Bristol-Myers Squibb (BMY)** missed on EPS and revenue in addition to cutting the FY profit guide; it also announced a USD 4bln accelerated buyback. **Chipotle Mexican Grill (CMG)** sales and SSS missed while profit beat; guidance more-or-less re-affirmed. **Mastercard (MA)** profit beat with the strength driven by healthy revenue and margin. **Royal Caribbean Cruises (RCL)** posted a strong report; EPS and revenue beat alongside raising FY profit guide. Commentary was encouraging, as demand for 2023 sailings significantly exceeded expectations. Added booking volumes in Q2 remained significantly higher and exceeded expectations. 2024 sailings are up significantly vs all prior years at record prices. **HCA Healthcare (HCA)** surpassed Wall St. expectations on the top and bottom line alongside raising FY23 EPS, revenue, and EBITDA guidance.

STOCK SPECIFICS: For banks, US bank regulators, Fed, FDIC, OCC, announced a proposal to raise bank capital requirements, seeking comments until November 30th, and is to be fully phased in by July 1st 2028. Within this, regulators estimate proposed rule change would result in aggregate 16% increase in CET1 capital requirements for affected cos and it would establish new standards for how banks measure capital, market and operational risk. Although, most banks currently have enough capital to meet proposed requirements but it would require all banks with over USD 100bln assets to account for unrealised gains/losses on available-for-sale securities. Additionally, the Bloomberg report said that it would result in midsize firms such as **Regions Financial (RF), KeyCorp (KEY), and Huntington Bancshares (HBAN)** facing the level of stringent requirements that have until now been reserved for the largest lenders. **Tesla (TSLA)** is under investigation by California AG over Autopilot safety and marketing, according to CNBC. EU antitrust regulator opened an investigation into **Microsoft's (MSFT)** tying of its chat and video app Teams with its office product; co. is concerned that these practices may constitute anti-competitive tying or bundling.

US FX WRAP

The Dollar reversed its post-FOMC weakness on Wednesday with the buck supported by rising UST yields in wake of a slew of hot US data points with 10yr yields now back above 4% in wake of a hawkish BoJ sources piece, as well on the bank capital proposals from US officials. GDP came in above expectations, durable goods surged, while jobless claims saw a notable decline. The hot data, accompanied with Powell's remark yesterday that stronger growth over time could add to inflation and may require a policy response, could help with arguments from the hawks for more rate hikes, albeit money markets in the near-term saw little reaction and are still pricing in no more rate hikes this year. However, as Powell constantly reminded us on Wednesday, the Fed is purely data dependent now, and there are many data points due before the next Fed meetings. The gains in the buck took DXY back above 101 to peaks of 101.84 with the rally also supported by a dovish ECB weighing on the Euro.

The Euro hit a low of 1.0967 and remains sub 1.10 heading into APAC trade with weakness ensuing after the ECB statement which saw a dovish tweak to guidance, noting decisions will ensure that the key ECB rates will be set at (prev. brought to) sufficiently restrictive levels for as long as necessary to return inflation to target, implying they view rates at a sufficiently restrictive level at the current time based on the data. Lagarde later noted that at this moment, she does not believe that more work needs to be done, given the data, but stressed it all depends on the data. Implying future meetings could be a hike or a hold.

The Yen saw decent gains vs the buck, paring from highs of 141.31 with reports in Nikkei that the BoJ are to discuss a YCC tweak at tonight's meeting which saw USD/JPY fall sub 140 to lows of 138.75, and counting at time of writing, heading into APAC trade. It is worth noting similar source reports were seen last week via Reuters and Bloomberg, a full Newsquawk BoJ preview can be found here.

Cyclical currencies sold off. GBP was the underperformer falling victim to the rising greenback to see cable hit a low of 1.2783 from highs just shy of 1.30 with weakness in the cross extending as risk assets took a hit in wake of the aforementioned BoJ sources piece. AUD also saw notable downside, finding support at 0.67, falling from highs of 0.6821 while NZD hit a low of 0.6175 all as the Dollar resurged in wake of hot data and dovish ECB. NZD still outperformed its Aussie counterpart however with AUD/NZD testing 1.0850 support. Attention turns to Aussie PPI and retail sales data Friday, while the BoJ risk reaction will also be key for the AUD.

EMFX was generally weaker with LatAm FX hit on the risk environment and the rising Dollar albeit MXN was a relative outperformer thanks to strong US data given the close ties the Mexican economy has to the US economy while BRL only saw marginal weakness. Losses in COP and CLP were a bit more pronounced with CLP hit on lower copper prices. Specifically, Brazilian PPI data fell 2.72% in June, following a 2.88% decline in May. The Mexican jobless rate fell to 2.7% from 2.9% and beneath expectations of 3.0%. Attention for CLP traders looks to the Chile Central Bank rate decision on Friday, where it is expected to be the first major LatAm central bank to cut rates (Uruguay started cutting in April) with markets looking for a 50bp cut following two dissenters at the prior meeting with a c. 40% probability of a larger 75bp cut. Note, Brazil is expected to cut by 50bps next week, with a 34% probability of a 25bp move. The Columbian rate decision is also due next week but markets expect an unchanged print with a 18% probability of a 25bp cut.