US Market Wrap

5th September 2023: Dollar and yields rise while oil surges on production cut extensions

- **SNAPSHOT**: Equities mixed, Treasuries down, Crude up, Dollar up
- **REAR VIEW**: Saudi and Russia extend voluntary production cuts; Waller aligns with Powell; Mester remains hawkish; Employment trends ease; Soft China and EZ PMIs
- **COMING UP**: **Data**: Australian GDP, German Industrial Orders, EZ, German, French, Italian, UK Construction PMI, US MBA, US ISM Services **Events**: NBP & BoC Policy Announcement. **Speakers**: Fed's Collins & Logan; BoE's Bailey, Cunliffe & Dhingra; RBA's Hawkesby; Riksbank's Thedeen; BoJ's Takata **Supply**: UK & Germany Earnings: Barratt Developments & Melrose.

MARKET WRAP

Stocks were mixed in the face of higher Treasury yields, which supported the buck against major peers. Overnight, the tone was downbeat after PMI data out of Asia and Europe. US stocks ultimately traversed sideways, however, amid a thin economic releases docket – the services ISM and the S&P Global PMI data are due to be released on Wednesday. Meanwhile, Employment Trends data for August saw another easing, continuing the run seen since March 2022. Remarks from Fed voter Waller were judged to be more dovish than his usual hawkish stance; he suggested that the Fed should move with caution on further rate hikes, but caveated that one more hike was unlikely to tip the economy into a recession. Mester meanwhile, was her usual hawkish self. Crude oil prices jumped with Brent settling above USD 90 /bbl for the first time this year on news that both Saudi Arabia and Russia have extended some of their voluntary supply restrictions for a period of three months (analysts were expecting a one month extension). The crude upside triggered a macro response, seeing yields move higher on the potential inflationary impact; Treasury yields were also supported by a deluge of corporate supply, which is expected to see between USD 40-50bln issued this week and around USD 120bln in the month as a whole, some desks said.

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FED GOVERNOR WALLER told CNBC that the Fed will move carefully, which traders found notable given Waller's typically more hawkish stance. He also said that further rate hikes will depend on incoming data, but he needed to see more to judge whether the Fed is done raising rates. Additionally, Waller highlighted that one more hike would be unlikely to send the US economy into a recession. Many on the Fed have been turning to the argument of how long rates will need to stay at the terminal level for, rather than the actual interest rate level with markets now pricing in rate cuts from June, but almost fully priced for a rate cut in May. Waller said that the Fed will have to keep rates up until inflation comes down, noting that the recent data gives the Fed space before arriving at its decision. On policy lags, he said it is hard to determine the impact, but it was clear that they were shorter than historically. Elsewhere, he noted the job market is strong, and it is not surprising to see the unemployment rate tick up, and he sees the labour market starting to soften. He said the data looks good for a soft landing, while slower growth in Europe and China will have some impact on the US at the margins. Waller is keeping a close eye on Commercial Real Estate but is not seeing anything that threatens the economy. Waller also noted that Treasury yields are probably at where they should be.

FED'S MESTER (non-voter, hawk), in an interview with German press, said the cost of undershooting monetary policy at the moment is still higher, and that she can well imagine the Fed might have to raise the policy rate bit more, but noted there is still a lot of time before the next decision in September, and we will get a lot of data and information by then. Mester stressed that given the strength of the labour market and the strength of underlying demand, she believes the costs of insufficient tightening is greater at this time, than the cost of overdoing it. She also noted the Fed will need to keep a sufficiently restrictive stance for quite some time to feel assured inflation will come back down to 2%. She believes inflation is still way too high, especially in services, where it is sticky, exclaiming there is still a lot of work to do. Mester expects growth to slow to below trend growth, but so far we have not seen that in the data, even though a number of forward-looking indicators suggest that the slowdown will continue. What we need now is a slowdown in demand. The latest indicators suggest that demand is somewhat stronger than expected, that the momentum in the economy is greater than thought. But if the underlying demand is stronger than expected, it needs a more restrictive policy. Mester assumes we will see some increase in unemployment. On the balance sheet, Mester believes balance sheet reduction can and should continue in the background even if the Fed stops raising the interest rate or even lower it.

EMPLOYMENT TRENDS: The Conference Board's Employment Trends report saw the headline slip to 113.02 in August from the revised down 114.71 seen in July. The CB noted that the ETI has been on a declining trend since March 2022, and the index remains elevated, and accordingly, "job gains may continue over the coming months, but the rate of growth may lessen and eventually will switch to job losses," it said. "The ETI suggests that weakness in the job market will eventually broaden to the rest of the labour market," it added.

FIXED INCOME

T-NOTE (Z3) FUTURES SETTLED 20 TICKS LOWER AT 109-30+

The Treasury curve was sold across the curve in wake of a slew of corporate issuance, with some suggesting the complex was also playing catchup with Bund trade from Monday, while oil prices surged on oil production cut extensions from Saudi and Russia. At settlement, 2s +9.4bps at 4.962%, 3s +9.2bps at 4.667%, 5s +8.6bps at 4.377%, 7s +8.5bps at 4.346%, 10s +9.1bps at 4.264%, 20s +8.6bps at 4.564%, 30s +9.0bps at 4.375%.

INFLATION BREAK EVENS: 5yr BEI +5.2bps at 2.362%, 10yr BEI +3.5bps at 2.299%, 30yr BEI +3.4bps at 2.293%.

THE DAY: Treasuries sold off throughout the US session on a slew of investment grade supply where 24 deals were announced while inflationary concerns were also rife given the surge in crude oil prices following the voluntary production cuts from Saudi Arabia and Russia through to year-end. There had been a small rise in T-notes during the US morning as Fed's Waller spoke to CNBC, where the usual hawk towed the same patient line as Fed Chair Powell, however, the move had swiftly reversed for the aforementioned reasons. Meanwhile, Mester gave an interview to German press, where she was her usual hawkish self, noting the cost of undershooting monetary policy is still higher than over shooting. With supply in focus this week, overall there is expected to be USD 125bln worth this month as participants return from the Summer with USD 40-50bln worth expected this week, while IFR point out the move lower was led by rate locking and deal tied hedging plays with real money making room for the supply early on.

STIRS:

- SR3U3 +2.8bps at 94.568, Z3 +6.5bps at 94.570, H4 +11.5bps at 94.755, M4 +14.5bps at 95.060, U4 +16.0bps at 95.440, Z4 +15.5bps at 95.800, H5 +14.5bps at 96.080, M5 +13.5bps at 96.250, U5 +13.5bps at 96.340, U6 +11.5bps at 96.410, U7 +9.5bps at 96.395.
- NY Fed RRP Op demand at 1.568tln (prev. 1.574tln) across 97 bidders (prev. 94)
- US sells USD 60bln in 42 day cash management bills at a high rate of 5.285%, B/C 3.04x; US sells USD 43bln in 1yr bills at a high rate of 5.12%, B/C 3.14x
- US sells USD 71bln in 3mth bills at a high rate of 5.315%, B/C 2.94x; US sells 64bln in 6mth bills at high rate of 5.300%, B/C 3.02x
- US to sell USD 50bln 17-week bills, USD 80bln of 4-week, and USD 70bln of 8-week on September 6th, settling September 12th (all sizes unchanged)

CRUDE

WTI (V3) SETTLED USD 1.14 HIGHER AT 86.69/BBL; BRENT (X3) SETTLED USD 1.04 HIGHER AT 90.04/BBL

Crude surged on news that Saudi Arabia and Russia are to extend voluntary production cuts. Saudi Arabia will extend its 1mln BPD cut for 3-months to include October until the end of December (analysts were expecting a one-month extension), SPA reported, and the decision will be reviewed monthly to consider either deepening the cut or increasing production. The report added that the extension of cuts was designed to reinforce the precautionary efforts made by OPEC+ countries, with the aim of supporting the stability of the oil market. Moments after the Saudi announcement, Russia also said it would extend the reduction of oil exports until the end of the year, and will extend its additional voluntary reduction in oil supplies to world markets by 300k BPD until end of December 2023. Similar to the Saudi announcement, Russia said the decision would be reviewed monthly to consider the possibility of deepening reduction or increasing production depending on situation on the world market, adding that the move was aimed at strengthening precautionary measures taken by OPEC+ countries in order to maintain stability and balance of oil markets. Goldman Sachs explained to its clients that oil market tightness and cyclical oil price moves helps to explain OPEC's recent policy decisions, and is consistent with its objective of achieving stability in oil markets. "We find that OPEC production increases are more likely when OECD commercial stocks and Saudi's market share are low; when time spreads, recent price increases, and positioning are elevated; and when production was increased at the prior meeting." Goldman says that the elevated pricing power of OPEC+ suggest that risks around OPEC+ path, and its assumption that OPEC+ countries reverse half of the May 2023 cut in January 2024, are skewed towards lower supply for longer. "We see a potentially more aggressive OPEC+ price target as the key moderately bullish risk to our 12-month ahead Brent forecast of USD 93/bbl."

EQUITIES

CLOSES: SPX -0.42% at 4,497, NDX +0.11% at 15,508, DJI -0.56% at 34,642, RUT -2.10% at 1,880.

SECTORS: Materials -1.81%, Industrials -1.69%, Utilities -1.54%, Financials -0.96%, Real Estate -0.95%, Health -0.94%, Consumer Staples -0.83%, Consumer Discretionary -0.09%, Communication Services +0.04%, Technology +0.39%, Energy +0.49%.

EUROPEAN CLOSES: DAX -0.33% at 15,773, FTSE 100 -0.17% at 7,440, CAC 40 -0.34% at 7,255, Euro Stoxx 50 -0.23% at 4,269, IBEX 35 -0.27% at 9,391, FTSE MIB +0.00% at 28,648, SMI -0.85% at 10,959.

STOCK SPECIFICS: **Blackstone (BX)** is to replace **Lincoln National (LNC)** in the S&P 500, and **Airbnb (ABNB)** is to replace **Newell Brands (NWL)** in the S&P 500 at the open on 18th September 2023. **SoftBank's Arm** is seeking a valuation of over USD 52bln in its IPO, SoftBank is offering 95.5mln ADS for USD 47-51, aiming to raise up to USD 4.87 bln, according to the SEC filing. **AMD (AMD), Cadence (CDNS), Google (GOOGL) and Intel (INTC)** have indicated interest in purchasing ADSs. China is reportedly to launch a new state-backed fund that aims to raise USD 40bln to boost the chip industry, via Reuters citing sources. **Intel Corp. (INTC)** Foundry Services and **Tower Semiconductor (TSEM)** announced a new US foundry agreement; INTC's advanced 300mm manufacturing facility in New Mexico is to provide a new capacity corridor for TSEM. **QUALCOMM Inc. (QCOM)** said it will supply chips to power in-car infotainment systems to Mercedes and BMW. **Ford Motor (F)** will push back series production of its long-awaited SUV Explorer model at its Cologne site by six months to wait for the next-gen Volkswagen battery technology to be available. **Warner Bros Discovery (WBD)** is expecting lower adj. EBITDA for the FY in a range of USD 10.5-11bln, noting adj. EBITDA is to be hit by c. USD 300-500mln, predominantly due to impacts of strikes. **Alibaba's (BABA)** Cloud Division is reportedly considering raising funds through a private round from Chinese state-owned enterprises ahead of the business' market debut in Hong Kong, according to Bloomberg. **NextGen Healthcare (NXGN)** is reportedly in talks to be acquired by Thomas Bravo, according to Bloomberg. **Oracle (ORCL)** was upgraded to Overweight from Equal Weight at Barclays. **General Mills (GIS)** was downgraded to Neutral from Outperform at Exane BNP Paribas. **AMD (AMD)** spoke at a tech conference, talking up AI noting that customers are actively evaluating their MI250 and MI300 across training and inference, and some are doing deployments with MI250, many with MI300. AMD also sees continued acceleration around the engagements since last earnings call and there has been an increase in commitments. **Seagate (STX)** also spoke, but was less optimistic and revised down guidance due to weakness in China. TF International Securities Analyst tweeted that following Samsung's price increase in August, **Micron (MU)** has also started to increase NAND flash wafer contract prices by approximately 10% since September, which will help improve Micron's (MU) earnings in 2H23. **Boeing (BA)** and Aviation Capital finalised an order for 13 737 Max jets. Airlines (JETS) were hit on the surge in oil prices but United Airlines (UAL) added to the woes after it issued a nationwide ground stop due to computer issues, albeit this was later cancelled. On auto strikes, **General Motors (GM)** said the UAW demands have significant costs attached that would threaten manufacturing momentum. **Zoom (ZM)** was supported after it announced a new AI functionality.

US FX WRAP

The Dollar surged on Tuesday with US participants returning from the Labor Day weekend; the DXY rose from lows of 104.10 to highs of 104.90, supported by higher Treasury yields. The move in yields came on the back of a deluge of corporate issuance, as 24 investment grade deals were announced, while the EZ PMIs overnight were warning of a surprising increase in input prices. The DXY hit a high of 104.80 as US players were arriving, but swiftly pared following commentary from Fed's Waller, who echoed Powell in saying the Fed can be patient, a more dovish take from the hawk on the Board of Governors. However, the move did not last long with DXY then gradually returning to test 105.00, but finding a cap just shy at 104.90 perhaps as a hawkish Mester offset Waller. Mester was noting how the cost of undershooting monetary policy is higher than overshooting.

The Euro saw weakness after disappointing final EZ PMI's which showed slower growth and rising input prices. The release suggested that there are signs employers are “moving towards job cuts sooner, not later". The release also highlighted that Germany and France led the declines, “where activity in the service sector weakened at the fastest rate this year”. The yield differentials also weighed on the single currency. On levels, EUR/USD slipped from a 1.0798 peak, under the psychological 1.0750, and thereafter below the 12th June low at 1.0733, to an intraday trough at 1.0708 ahead of the 1.0700 psychological mark.

The Yen was notably softer vs the Dollar. USD/JPY topped 147.00 from a 146.41 base and continued grinding higher to eventually to a 147.80 peak, rising above the November 2022 peak of 147.57. The move was primarily driven by the US yield curve, as mentioned above, with yields firmer across the curve on a slew of corporate supply.

The antipodeans were underperformers on Tuesday as the Dollar surged with the risk environment also weak with equities lower but the weakness stemmed overnight after disappointing China PMI data. Both the Kiwi and Aussie saw notable downside but the AUD was the underperformer after the RBA overnight. However, there was little fireworks from the meeting which left rates unchanged as expected and reiterated guidance that some further tightening may be required, which saw some volatility around the event but ultimately was little changed. AUD/USD hit a fresh YTD low at 0.358 while NZD/USD hit a YTD low of 0.5860, AUD/NZD fell from 1.0879 to 1.0840. Although there was little reaction around the RBA, only 12more bps of tightening are priced in by Feb of 2024 and analysts at Westpac note that the RBA's policy stance overall remains a weight on the Aussie, especially vs the Dollar with the Fed Funds rate highly likely to remain 125bps above the RBA cash rate deep into 2024.

CAD only saw mild weakness vs the rampant dollar as some weakness was offset by the rally in crude prices after Saudi and Russia extended voluntary production cuts through to the end of the year which saw USD/CAD pare overnight gains to a low of 1.36 in an initial reaction. The cross tested 1.36 to the downside again where it only briefly dipped below the round level, before paring into APAC trace to c. 1.3620.

GBP was weaker vs the dollar but it was stronger vs the Euro. Some upside in the Pound was seen in the morning following the upward revision to UK PMIs, which also saw UK yields rise. GBP/USD fell to a 1.2529 daily low from a 1.2631 intraday peak as it eyes the lows from the 13th and 12th of June at 1.2499 and 1.2487, as well as the psychological 1.25.

CNH was weaker vs the Dollar after disappointing China Caixin PMI data where the services missed expectations and the composite fell from the prior which ultimately saw USD/CNH hit a peak of 7.3117 with the Dollar strength and weak data keeping USD/CNH bid throughout the day, briefly rising above the late August highs.

EMFX was weaker across the board due to the dollar strength with notable weakness in the MXN despite the jump in crude prices with many LatAm currencies hit on the weaker China data. Note, in Mexico, Sheinbaum is the favourite to win presidential nomination in 2024 as Mexican law prohibits ALMO from seeking a second six-year term, but Sheinbaum is a close ally of AMLO. COP also saw weakness despite the gains in oil, given the strong dollar and soft China PMI's but also as the government called on the central bank to lower rates. BRL was also weaker on aforementioned factors, but the latest industrial production data was worse than expected. Despite the weakness in MXN, CLP was clear under performer as copper prices slipped and as attention turns to the Chile Central Bank rate decision this evening, where analysts look for a 100bps cut to 9.25%, but some see a 75bps reduction. Elsewhere, ZAR was weaker as gold prices slipped and on more power concerns following stage six load shedding on Monday. The TRY was relatively flat vs the dollar despite broad EM weakness and dollar strength, with CBRT in ultra hawk mode to help rampant inflation while Erdogan is also set to announce a medium-term plan on Wednesday.