

1st August 2024: Soft ISM Mfg. sparks flight-to-quality ahead of jobs report

- **SNAPSHOT:** Equities down, Treasuries up, Crude down, Dollar up.
- **REAR VIEW:** Weak ISM Mfg data, although Prices unexpectedly lifts; Initial Jobless Claims rises more than expected; BoE cuts, as expected, but no timeline ahead given; Chinese PMI's disappoint; Continued heightened geopolitical tensions; Strong META report; MBLV cut FY guidance.
- **COMING UP: Data:** Australian PPI, Swiss CPI, Italian Industrial Output, Italian Retail Sales, US NFP, Durable Goods (R). **Events:** BoC Market Participants Survey. **Speakers:** BoE's Pill & Fed's Barkin. **Supply:** Australia. **Earnings:** AXA, Engie, IAG, IMCD, Volvo Car AB, Chevron, Exxon.

MARKET WRAP

US indices were a sea of red on Thursday (SPX -1.4%, NDX -2.4%, RUT -3%) in what was a distinct flight-to-quality session in the wake of the very soft US ISM Manufacturing PMI. On the data set, the headline surprisingly declined, and outside the bottom end of the forecast range, while prices paid rose. As such, in the US session, the Dollar Index saw a notable bid to highs of 104.44, with high beta FX weighed on, but safe-haven FX (JPY and CHF) saw strength with the Swissy outperforming. Continuing to illustrate the flight to quality trade, Treasuries saw notable strength with the short-end seeing the greatest gains with the 2yr yield hitting a low of 4.1520% or losses of 17bps. The 10yr breached 4% to the downside. The crude complex also saw sharp losses of circa USD 1/bbl, despite strength in the European morning on heightened geopolitical tensions given the recent Israeli attacks. Sectors closed mixed, as Technology saw large downside and was the clear underperformer with the semiconductor ETF SOXX lower by over 7%. Earnings-wise, Mobileye (-22%) disappointed, while Meta (+4.8%) still eked out gains after a solid report, despite the broad sell-off. Elsewhere in the day, Initial Jobless Claims rose much more than expected, as did Q2 productivity, which saw unit labour costs decline. On the central bank footing, BoE opted to cut rates to 5.0% from 5.25%, as expected, but with a 5-4 vote split with Governor Bailey not giving a view on the path of rates or comment on the market curve. Lastly, continued to digest the dovish Fed Chair Powell press conference on Wednesday, and accompanied with the aforementioned data, there are now 85bps of cuts priced in by year-end vs. 74bps pre-ISM. Looking ahead, the US jobs report is the highlight on Friday.

US DATA

ISM MANUFACTURING: ISM Manufacturing PMI for July was very soft as the headline unexpectedly fell to its lowest since November of 46.8 (exp. 48.8) from 48.5, and beneath the bottom end of the forecast range, 48.0. Prices paid rose more than forecasted to 52.9 (exp. 51.8, prev. 52.1), while employment and new orders fell to 43.4 (exp. 49.0, prev. 49.3) and 47.4 (prev. 49.3), respectively. Production and inventories dipped deeper into contractionary territory, while backlog was unchanged, and new export orders and imports ticked marginally higher, albeit remaining sub-50. Overall, the report notes the past relationship between the Manufacturing PMI and the overall economy indicates it corresponds to a change of +1.2% in real GDP on an annualized basis. On the data set, Oxford Economics notes it confirms the sector is still struggling from high interest rates and slowing demand, but ultimately expects boosts from the IRA and CHIPS Act should support production, but it will take time for the upcoming rate cuts by the Fed to feed through and expect only gradual progress later this year. The panellists responses painted a downbeat picture for the months ahead as new orders remain subdued.

JOBLESS CLAIMS: Initial jobless claims (w/e 27th Jul) rose to 249k from 235k, well above the expected 236k and the upper bound of the forecast range, 248k, which saw the 4-wk average lift to 238k (prev. 235.5k). Continued claims (w/e 20th Jul) jumped to 1.877m (exp. 1.856m) from the prior, revised lower, 1.844m. Note, that seasonal factors expected a decrease of 21,901 (or -9.7%) from the prior week. Pantheon Macroeconomics notes the pick-up is largely due to late filing in the wake of Hurricane Beryl, which made landfall in early July, as most states, including Texas (+11k), allow people to make retrospective claims in the event of a natural disaster. Ahead, Pantheon adds, it is unclear if fewer auto plants are shutting for scheduled maintenance this year, or if shutdowns are occurring later this year, in which case overall claims likely will rise over the coming weeks

UNIT LABOUR COSTS: Q2 productivity surpassed expectations lifting 2.3% (exp. 1.7%, prev. 0.4%), which meant unit labour costs cooled significantly to just 0.9% (exp. 1.8%, prev. 3.8%). As such, combine this data with the softer employment cost index from Wednesday, which Chair Powell in the press conference said was welcome, ING notes it should really boost the Fed's confidence that inflation pressures emanating from the jobs market are cooling fast and that we are on a path to achieving 2% inflation.

GLOBAL

US NFP PREVIEW: The rate of payroll additions is expected to ease in July, below the previous and also below recent averages. Fed Chair Powell has suggested that this is merely normalisation of the labour market, which was coming back into better balance while the unemployment remains low. The jobless rate is expected to be unchanged in July, still above where the Fed forecast it would be this year. Labour market proxies also allude to a slowing in payroll gains, with the weekly initial jobless claims data that coincide with the BLS survey window ticking up a touch, and continuing claims increasing, while the ADP's gauge of employment also disappointed expectations in the month. While the wage data are expected to continue easing, Fed officials' focus is now pivoting back onto both sides of its mandate (rather than its recent heavy focus on just inflation); accordingly, analysts have suggested that any downside surprised in the headline nonfarm payrolls data, or any tick-up in the jobless rate, could embolden calls for the Fed to begin cutting rates. Currently, money markets are certain that the Fed will cut rates by 25bps in September, and have also fully priced a second cut this year, while retaining a very high probability that we could even see a third cut before the year is out. [To download the full report, please click here.](#)

BOE REVIEW: In-fitting with the broad consensus of analyst expectations, the MPC opted to cut rates for the first time since March 2020, taking the Bank Rate to 5.0% from 5.25%. The decision to loosen policy was made via a 5-4 vote with dissent from Pill, Greene, Mann and Haskel. Note, for some of those who opted to cut rates viewed the decision as "finely balanced" whilst also observing that "inflationary persistence had not yet conclusively dissipated, and there remained some upside risks to the outlook". For the dissenters, they wished to keep policy steady on account of waiting to see stronger evidence that upside pressures to inflation would not materialise. In terms of guidance from the Bank, the MPC is to ensure Bank Rate is restrictive for sufficiently long until the risks to inflation returning to target had dissipated further (NOTE: In June, it said "restrictive for sufficiently long to return inflation to the 2% target sustainably). Alongside the

statement, Governor Bailey stated that policymakers need to be careful not to cut rates too quickly, or by too much. For the accompanying MPR, 1, 2 and 3yr ahead inflation forecasts were revised lower with the 3yr ahead projection at just 1.5%; implying that there is further scope for the MPC to lower rates. At the follow-up press conference, Bailey gave little away by stating that he would not give a view on the path of rates or comment on the market curve. In terms of what he did say, the main takeaway was his desire to stress the upside risks to inflation and the cautious approach taken by the MPC. Overall, despite an initial dovish repricing in the wake of the announcement, the lack of signals for further reductions saw BoE pricing move in a hawkish direction with an unchanged rate in September priced at 76% and the next full 25bps cut not fully priced until December.

FIXED INCOME

TREASURY WRAP: T-NOTE (U4) FUTURES SETTLED 29+ TICKS HIGHER AT 112-23+

T-Notes saw notable strength on Thursday amid clear flight-to-quality assets sparked by a soft US ISM Manufacturing PMI. At settlement, 2s -17.1bps at 4.167%, 3s -16.9bps at 3.974%, 5s -15.1bps at 3.847%, 7s -13.7bps at 3.888%, 10s -12.5bps at 3.980%, 20s -10.9bps at 4.346%, 30s -9.8bps at 4.270%

INFLATION BREAKEVENS: 5yr BEI -5.7bps at 2.216%, 10yr BEI -4.3bps at 2.188%, 30yr BEI -4.2bps at 2.194%

THE DAY:

Through the European morning T-Notes were largely sideways, and in pretty contained ranges, in the run-up to US ISM Manufacturing PMI. Although, prior to the data, as US participants entered for the day T-Notes began the bid, after of course the dovish Powell press conference on Wednesday. Ahead of the aforementioned ISM, initial jobless claims rose much more than expected, and even outside the upper bound of the forecast range, which sparked a bid in Treasuries to intra-day highs of around 112-14.

Thereafter, the ISM Manufacturing PMI was very soft and came in below the forecast range in addition to the prices paid metric beating. In wake of the ISM's, it catalysed massive risk-off sentiment and a clear flight-to-quality, with the T-Note reaching a peak of 112-26. T-Note came settled slightly off the peak, but hovered around the figure through the duration of the afternoon. Across the curve, yields saw significant losses with the short-end noticing the greatest weakness, highlighted by the 2yr hitting a low of 4.1520%, and on track for its largest daily fall since December. Elsewhere, 10yr slipped beneath 4.00%, and the 30yr saw the 'shallowest' losses but still in excess of 10bps.

In addition to the soft data, it is worth remembering Chair Powell's dovish press conference on Wednesday whereby he noted the base case for the Central Bank is to cut interest rates at the September meeting. On Thursday we saw money market pricing move notably more dovish with 83bps of cuts priced in by year-end, vs. 72bps before ISM Manufacturing. Looking ahead, all attention is on US NFP on Friday, with mega-cap Apple and Amazon earnings after-hours.

STIRS:

- **Market Implied Fed Rate Cut Pricing: September 31bps (prev. 29bps D/D), November 56bps (prev. 46bps), December 83bps (prev. 72bps).**
- NY Fed RRP on demand at USD 349bln (prev. 413bln) across 66 counterparties (prev. 66).
- US sold USD 90bln in 4-wk bills at 5.285%, covered 2.87x; sold USD 85bln in 8-wk bills at 5.230%, covered 2.74x.
- US to sell USD 76bln in 13-week bills and 70bln in 26-week bills on August 5th; to sell USD 46bln in 52-week bills on August 6th and all to settle on August 8th.
- SOFR at 5.38% (prev. 5.33%), volumes at USD 2.185tln (prev. 1.978tln).
- EFRF at 5.33% (prev. 5.33%), volumes at USD 78bln (prev. 87bln).

CRUDE

WTI (U4) SETTLED USD 1.60 LOWER AT 76.31/BBL; BRENT (V4) SETTLED USD 1.32 LOWER AT 79.52/BBL

The crude complex was lower on Thursday and weighed on by the broad risk-averse sentiment and flight-to-quality trade. Before this, WTI and Brent saw notable strength through the European session and printed highs of USD 78.88/bbl and 81.80/bbl, respectively, amid geopolitical risk premium, as tensions remain heightened following Israel's recent strikes in the Lebanese and Iranian capitals. As such, participants are on the lookout for a response from the regions, where some have warned that a joint response against Israel could be on the cards. The latest from the Hezbollah leader was that the battle with Israel has entered a new phase. However, after the soft US ISM Manufacturing PMI which sparked the initial risk-off sentiment, it has been one-way traffic through the US afternoon, with US indices dumping, Dollar bid, and clear flight to quality trade leaving WTI and Brent to tumble into settlement, therefore settling at lows. For the record, no action was seen on a non-event OPEC+ JMMC meeting, which made no policy change recommendations, as widely telegraphed. Looking ahead, there is US NFP on Friday, weekly Baker Hughes rig count, in addition to Chevron and Exxon earnings.

STOCKS: On the earnings footing, **Shell (SHEL)** profits fell on weaker trading and refining but still beat forecasts in Q2, and it launched a USD 3.5bln share buyback. **ConocoPhillips (COP)** topped Q2 profit alongside reaffirming shareholder return for 2024. Separately, **Hess (HES)** slid on news that Chevron's USD 53bln takeover of Hess faces further delays, with an arbitration hearing on ExxonMobil's ownership dispute set for next year.

EQUITIES

CLOSES: SPX -1.4% at 5,447, NDX -2.4% at 18,890, DJIA -1.2% at 40,348, RUT -3% at 2,186

SECTORS: Technology -3.36%, Energy -2.56%, Consumer Discretionary -2.25%, Industrials -1.83%, Financials -1.38%, Materials -0.35%, Communication Services +0.89%, Health +1.06%, Consumer Staples +1.09%, Real Estate +1.58%, Utilities +1.85%.

EUROPEAN CLOSES: DAX: -2.30% at 18,083, FTSE 100: -1.01% at 8,283, CAC 40: -2.14% at 7,370, Euro Stoxx 50: -2.30% at 4,761, AEX: -1.46% at 907, IBEX 35: -1.90% at 10,854, FTSE MIB: -2.68% at 32,857, SMI: +0.29% at 12,317, PSI: -0.70% at 6,662.

EARNINGS

- **Meta Platforms (META)** - Top and bottom line beat, gave better-than-expected guidance and said Meta AI is on track to be the most used AI assistant in the world by the end of the year.
- **Qualcomm (QCOM)** - Reversed initial post-earnings gains, where EPS and revenue beat, after CEO flagged the impact of the US revoking an export license for China firm Huawei.
- **ARM Holdings (ARM)** - Next quarter and FY guidance fell slightly short.

- **Moderna (MRNA)** - EPS fell short and cut FY revenue guidance as it expects lower sales in Europe.
- **Cigna Corp (CI)** - FY EPS view was less than bullish than forecasts.
- **Hershey (HSY)** - Q2 results missed analysts expectations citing consumers are pulling back on discretionary spending
- **Mobileye (MBLY)** - Cut FY revenue guidance as it said a more significant than anticipated softening of business conditions in China is expected to lead to challenges in the second half.
- **Carvana (CVNA)** - Q2 revenue exceeded expectations, with FY adj. EBITDA guide above forecasts.
- **Applied Materials (AMAT)** - Denied US CHIPS Act grant for USD 4bln R&D project.
- **ConocoPhillips (COP)** - Bottom line beat.

STOCK SPECIFICS

- **Air Products and Chemicals (APD)** - Beat on EPS and confirmed its outlook.
- **Eli Lilly (LLY)** - CEO sees its weight-loss drug shortage ending 'very soon'.

US FX WRAP

The Dollar Index was firmer, with strength stemming from gains over Cyclical Currencies, as havens saw strength in flight-to-quality after the exceedingly soft ISM Manufacturing PMI. Initially, the Index dropped on the ISM unexpectedly declining even further into the contractionary space. That said, the DXY swiftly pared losses, and made fresh session highs of 104.44 later on. ISM drop can largely be attributed to the declines seen in Employment, Production, and New Orders. Elsewhere in the data space, Initial Jobless Claims rose 14k to 249k, markedly above the expected, and also the consensus range. Going forward, Apple/Amazon earnings after-hours and the NFP on Friday will be the next possible catalyst for the Buck, with the US economy forecasted to add 175k jobs in July, while the Unemployment Rate is projected to hold steady at 4.1%

EUR/USD dipped below 1.08, with weakness ramping up in response to the release of European PMI Mfg data for July, which France and Spain disappoint, while EZ and Germany beat. That said, EZ the EZ Unemployment Rate surprisingly ticked higher to 6.5%, although, movement in the cross was sustained, with losses resuming after the poor US ISM data, which saw the cross test the earlier mentioned trough.

Activity currencies mainly saw losses against the Greenback, except for the **Kiwi** which traded flat. The **Pound** took the spotlight in the space, as participants awaited the 50/50 BoE announcement. Although, heading into the decision, Sterling saw weakness in the UK morning to see Cable hit an initial intra-day low of 1.2760. The Central Bank cut rates by 25bps to 5%, as expected, with 5 voting to cut, and 4 dissenting. Looking ahead, the BoE cut its 2024 inflation forecast by 25bps to 2.5%, though raised 2024 growth to 1.25% (prev. 0.5%). In terms of remarks, BoE Governor Bailey said the decision was finely balanced, and said he would not give any view on the future path of rates and the market curve; Cable was little changed, but made fresh session lows of 1.2728 later in the session amid the aforementioned Dollar strength and risk-averse sentiment. BoE pricing sees 1 more full 25bps cut by year-end. Meanwhile, UK'S S&P Global Mfg PMI (July) was above expectations.

CAD saw sizeable losses, weighed on by the aforementioned sentiment and tumbling crude prices, although S&P Global Canada Mfg PMI falling in June (sharpest drop since December), would not have helped. Lastly, Antipodeans diverged amid weak Chinese PMI data, with the Aussie dropping below 0.67 ahead of the Australian PPI (Q2) on Friday.

The **Yuan** faced losses on Thursday, with weakness ensuing after China's Caixin Mfg PMI Final (Jul) fell more than expected, shifting into the contractionary territory for the first time since October 2023, driven by a fall in factory activity, new orders, and buying levels. USD/CNH experienced session highs of 7.2583, though retreated slightly.

Haven FX performance was to the upside amid a continuation of the flight to quality trade, with the **Swissy** extending into a third straight day of gains. USD/CHF finished near session lows, as the cross approaches March's lows of 0.8729, ahead of Swiss CPI (Jul) and Retail Sales (Jun) on Friday. USD/JPY saw session lows of 148.52 failing to break the major support of 148.50, and in turn, climbed above the 149 mark.

EMFX was almost exclusively weaker across the board against the Greenback, and without sounding like a broken record, amid the broad risk-averse sentiment. Elsewhere, **EUR/CZK** fell on Thursday, wiping out all gains incurred earlier in the week. The CNB cut their Repo Rate by 25bps to 4.5%, as expected, with the decision unanimously made. On central bank decisions, the Chilean Central Bank unexpectedly held rates at 5.75%. while the BCB held their Selic Interest Rate at 10.5%, as expected; **USD/BRL** set a fresh 12-month high, touching levels not seen since January 2022, before Friday's Industrial Output report for June. **TRY** was the clear EM outperformer and saw gains vs. the Dollar amid lower oil prices.

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