

Risk-off trade on regional banking woes

- **SNAPSHOT:** Equities down, Treasuries up, Crude down, Dollar down, Gold up
- **REAR VIEW:** US regional bank concerns gain momentum, led by WAL and ZION; JPM's Dimon is not so sure on market's view that everything will be fine; Trump and Putin view phone call as positive, to meet in Hungary; US Philly Fed unexpectedly signals contraction; China says all rare earth licenses applications for civilian use will be approved; Fed's Waller makes the case for a 25bps cut in October, but data dependent thereafter; French PM survives both rounds of no confidence motion as expected; UK GDP matches expectations, Services & Mfg output beat; Australian unemployment rate moves higher; EIA crude stocks show bigger-than-expected build; TSMC top Q3 expectations
- **COMING UP: Data:** EZ HICP Final (Sep), Atlanta Fed GDP. **Suspended Release:** US Building Permits/Housing Starts (Sep), Industrial Production (Sep). **Speakers:** RBA's Hauser; BoE's Pill, Greene, Breeden; Fed's Musalem; ECB's Nagel. **Supply:** Australia. **Earnings:** Ally Financial, SLB, American Express, State Street, Volvo AB.

MARKET WRAP

Risk-off trade was seen on a reignition of regional banking woes after Western Alliance (WAL) and Zion Bancorp (ZION) announced exposure to bad loans tied to fraud, adding to the concerns following the collapse of Tri-Color and First Brands. The regional banking woes saw KRE close lower by over 6%, while the financial sector saw a near 3% hit. The downside in US banks hit sentiment with equities sliding throughout the US session, while havens were supported. Gold rose above USD 4,300/oz while T-notes rallied across the curve, led by the front-end, with money markets starting to price in more rate cuts from the Fed. In FX, the Dollar was sold in response, while CHF and JPY outperformed. Crude prices also tumbled throughout the session in the risk-off environment, hitting lows following a positive read on both sides following the phone call between Russian President Putin and US President Trump, who will hold high-level staff meetings next week before a Presidential meeting in Hungary. Attention turns to the Zelensky meeting with Trump on Friday. Elsewhere, Fed speak saw Governor Waller call for a 25bps cut in October, but suggested decisions thereafter will depend on data, which led to some initial T-note selling before the banking woes ignited an FTQ bid. Governor Miran continued to leave a dovish message. Data saw the Philly Fed business activity headline tumble, but internals were better. Back to equities, Tech managed to squeeze out marginal gains despite all other sectors in the red, supported by positive Oracle (ORCL, +3.1%) commentary. Elsewhere, French PM Lecornu survived the no-confidence motions. On China, China's Commerce Ministry said it took a constructive stance during recent talks, noting the critical minerals export controls will not impact civilian use. The Foreign Minister also said that decoupling from the US is not a rational choice, and called for effective communication to resolve differences. However, after the close on Wednesday, Trump said that the US is in a trade war with China.

US

PHILLY FED: Philly Fed's summary of Manufacturing activity in the region was mixed. Headline Business Index of general activity plummeted to -12.8 from +23.2, well below the +8.5 forecast, more than offsetting last month's increase. However, internals offset some of the drop in activity. New Orders rose to 18.2 from 12.4, shipments index declined but remained positive, and the Capex index rose to 25.2 from 12.5. Employment saw a slight drop to 4.6 from 5.6, but continued to reflect overall increases in employment. Prices Paid picked up to 49.2 from 46.8. Prices received also moved higher, with both indices remaining elevated. The six-month outlook index rose to 36.2 from 31.5, suggesting widespread expectations for growth over the next six months.

FED'S WALLER (voter): Waller maintained the view that cutting rates is the right thing to do, with not much changing in the last six weeks. That said, Waller notes he doesn't want to make a policy mistake, suggesting moving carefully in 25bps increments. He stated that based on the current data, a 25bps cut is justified in the upcoming October meeting - labour market sending clear warnings that the Fed should be ready to act - with easing beyond dependent on data. The Fed Governor sees neutral at around 100-125bps lower than the current FFR, but sees a slower path of rate cuts if GDP holds up or the job market speeds up. Waller argues that you should see downward pressure on mortgages if the Fed continues to cut the policy rate. Waller referenced the latest Fed Beige Book, saying it did not show that things are rosy and booming. Waller said GDP may weaken at the end of the year, inflation estimates are now around 2.5%, with nothing that seems set to jump. On tariffs, tariffs are having a modest inflation impact, and inflation is on track for 2%, Waller contended. Tariffs don't appear to be depressing growth.

FED'S MIRAN (VOTER): The Fed Governor doesn't see a recession as a result of renewed US-China tensions. Miran continues to believe the Fed should cut 50bps, but expects they will cut by 25bps. He expects growth of around 2% for 2025, while for 2026, growth could hinge on how China-US tensions are resolved. On rates, Miran said risks emerging in this past week have increased the urgency for rate cuts. For neutral, he argues that rate cuts are needed because of passive monetary policy tightening and improved inflation outlook.

FED'S BARKIN (2027 voter): Barkin said demand remains solid, particularly among those with higher incomes; Clear that businesses are planning to pass along what tariffs they can. He noted that productivity seems to be increasing, which could offset some cost pressures. On labour, Barkin said there has been a noticeable shift in the job market; executives note there are lots of applicants for every position.

FIXED INCOME

T-NOTE FUTURES (Z5) SETTLED 16+ TICKS HIGHER AT 113-24

T-Notes catch FTQ bid as regional banks are slammed. At settlement, 2-year -8.0bps at 3.426%, 3-year -8.2bps at 3.429%, 5-year -8.2bps at 3.548%, 7-year -7.8bps at 3.740%, 10-year -7.2bps at 3.973%, 20-year -6.0bps at 4.549%, 30-year -5.8bps at 4.581%.

INFLATION BREAKEVENS: 1-year BEI +0.4bps at 3.218%, 3-year BEI -3.6bps at 2.579%, 5-year BEI -3.4bps at 2.322%, 10-year BEI -2.5bps at 2.260%, 30-year BEI -1.5bps at 2.210%

THE DAY: T-notes bull steepened on Tuesday in risk-off trade as regional bank woes hit the broader market and bolstered rate cut bets. T-notes traded sideways in the morning until a speech from Fed Governor Waller was met with several chunky block sales. The Governor alluded to further easing of 25bps in October, but said cuts beyond October will depend on the data. Nonetheless, T-notes then reversed in a flight to quality bid as regional banks were slammed. Western Alliance (WAL) and Zion Bancorp (ZION) disclosed bad loans tied to alleged fraud, adding to recent credit concerns following the bankruptcies of Tri-Color and First Brands. JPMorgan CEO Dimon earlier in the week warned that "When you see one cockroach, there are probably more". The regional banking ETF (KRE) tumbled on Thursday amid the WAL and ZION news, while financials were the clear sector laggard. The downside in banking stocks hit risk sentiment as these credit concerns mount, somewhat reminiscent of the SVB collapse and its impact on regional banks and risk sentiment at the time. T-notes pushed higher to settle at peaks supported by the banking woes.

Elsewhere, in funding markets, it is worth noting that SOFR has risen above the top end of the Federal Funds target range of 4.00-4.25%, sparking liquidity concerns. Usage of the Reverse Repo facility at the NY Fed (where participants park excess cash) has diminished drastically recently, back to c. USD 5bln from the roughly USD 200bln figures seen in July. With excess cash seemingly scarce, usage of the standard repo facility (where participants borrow extra cash from the Fed) has accelerated in recent sessions, rising to USD 8.35bln today, from USD 6.75bln on October 15th - both above the Q3 quarter-end spike of USD 6bln, and rising to the highest levels since 2020.

SUPPLY

Notes

- US Treasury to sell USD 13bln of 20-year bonds on October 22nd and USD 26bln of 5-year TIPS on October 23rd; all to settle October 31st

Bills

- US sells USD 8-wk bills at a high rate of 3.960%, B/C 2.91x; sells USD 4-wk bills at a high rate of 4.030%, B/C 2.79x
- US Treasury to sell USD 86bln of 13-week bills and USD 77bln of 26-week bills on October 20th, to sell USD 95bln of 6-week bills on October 21st; all to settle October 23rd.

STIRS/OPERATIONS

- **Market Implied Fed Rate Cut Pricing: Oct 26bps (prev. 24bps), Dec 53bps (prev. 48bps), January 69bps (prev. 62bps).**
- NY Fed RRP op demand at USD 7bln (prev. 5.5bln) across 11 counterparties (prev. 20)
- EFFR at 4.10% (prev. 4.10%), volumes at USD 81bln (prev. 80bln) on October 15th.
- SOFR at 4.29% (prev. 4.19%), volumes at USD 3.059tln (prev. 2.932tln) on October 15th.
- Treasury Buyback (Liquidity Support, 7-10yr coupons, Max. USD 4bln.): Accepts USD 192mln of USD 10.44bln offered, offer to cover 54.36x.

CRUDE

WTI (X5) SETTLED USD 0.81 LOWER AT USD 57.46/BBL; BRENT (Z5) SETTLED USD 0.85 LOWER AT USD 61.06/BBL

The crude complex settled lower after a notable sell-off amid global risk-off sentiment on potential regional banking woes. Through the European morning, benchmarks edged higher to hit highs of USD 59.11/bbl and 62.75, respectively, before heading lower amid no clear catalyst but as US/China rhetoric once again intensified. USTR's Greer said China is taking actions as if it wants to decouple, with China's Commerce Ministry overnight noting it took a constructive stance during recent trade talks. Thereafter, WTI and Brent sold off and saw another leg lower to intra-day troughs as Trump said he is speaking to Putin, the conversation is ongoing, a lengthy one, and he will report the contents. As markets awaited the outcome, continued global risk off was seen, albeit with no clear headline driver, but US regional banking woes were seemingly at the forefront, which intensified WTI and Brent moves to session lows of USD 57.26/bbl and 60.84, respectively. Thereafter, further pressure arrived from Trump, who spoke positively on the phone call with Putin, believing great progress was made, and that there would be a meeting between US/Russia officials next week, and then he would meet with Putin in Hungary; Krelmin's take on the call matched that of Trump's. Some support, albeit fleeting, arrived for crude prices, whereby Trump said, "If Hamas continues to kill people in Gaza, which was not the Deal, we will have no choice but to go in and kill them". For the record, in the weekly EIA data, crude saw a larger build than expected, in fitting with the private metrics, while distillates and gasoline both drew more than anticipated. Overall, crude production rose 7k to 13.636mln.

EQUITIES

CLOSES: SPX -0.63% at 6,629, NDX -0.36% at 24,657, DJI -0.65% at 45,952, RUT -2.09% at 2,467

SECTORS: Financials -2.75%, Energy -1.12%, Utilities -1.03%, Consumer Discretionary -0.88%, Consumer Staples -0.78%, Industrials -0.59%, Materials -0.56%, Communication Services -0.45%, Real Estate -0.30%, Health -0.11%, Technology +0.13%.

EUROPEAN CLOSES: Euro Stoxx 50 +0.89% at 5,655, Dax 40 +0.38% at 24,273, FTSE 100 +0.12% at 9,436, CAC 40 +1.38% at 8,189, FTSE MIB +1.12% at 42,374, IBEX 35 +0.48% at 15,646, PSI +1.08% at 8,341, SMI +1.25% at 12,686, AEX +0.40% at 959.

STOCK SPECIFICS:

- **Regional Banks (KRE)** tumbled led by losses in Western Alliance (WAL) and Zion Bancorp's (ZION). ZION announced it faces charges due to bad loans to a couple of borrowers, while WAL alleged a borrower had committed fraud. The developments follow the collapse of First Brands and Tri-Color, thus increase credit fears.
- **Apple (AAPL)** head of AI-driven web search, Ke Yang, is leaving for Meta (META).
- **TSMC (TSM)**: Profit & operating margin beat; lifted FY revenue growth & better than expected next quarter outlook.
- **Salesforce (CRM)**: Announced financial targets for the next 5 years.
- **Hewlett Packard Enterprise (HPE)**: Weaker than exp. FY26 profit view at its analyst day.
- **United Airlines Holdings (UAL)**: Revenue missed.
- **J.B. Hunt Transport (JBHT)**: Q3 results exceeded expectations.
- **Becton Dickinson (BDX)**: Prelim Q4 revenue missed & announced CFO transition plan.
- **Nio (NIO)**: Government of Singapore Investment Corporation filed a lawsuit against the Co.
- **US Bancorp (USB)**: Top & bottom-line surpassed Wall St. expectations.
- **Travelers (TRV)**: Net premiums written & book value per shr. missed; note, EPS & rev. topped.
- **BrightHouse (BHF)** reportedly in talks for a sale to Sixth Street at roughly USD 55/shr, according to Reuters, citing sources, deal would value the insurer at roughly USD 3.1bln.
- xAI is reportedly working on a USD 20bln lease-to-own deal for **NVIDIA (NVDA)** chips, according to The Information.
- **Oracle (ORCL)** co-CEO said the distributed cloud segment has non-GAAP gross margins of 40-60% and this part of their business is growing rapidly. Distributed cloud offering is growing 77% Y/Y with an average deal size of USD 67mln. AI infrastructure saw 117% growth Y/Y in Q1 FY26. Cloud infrastructure revenue expected to be USD 166bln by FY 2030.
- **Datadog (DDOG)** to explore fresh takeover bid for GitLab (GTLB), StreetInsider reports.

FX

The Dollar Index was sold on Thursday as jitters over US regional banks sparked a global risk-off trade, resulting in JPY, CHF, and EUR strength. Concerns surrounding US regional banks grew (on top of First Brands & Tricolor bankruptcies), after it emerged that Western Alliance has a lawsuit against the same defendants named in Zions Bancorp's recently disclosed case of misrepresentations and contractual defaults by the borrowers and obligors, as well as other irregularities. The underperformance in financials had its toll on the FX market, sparking a general risk-off tone, bolstering gold's already strong intraday rally. The development clouded out other, yet important global developments. China's commerce ministry said it took a constructive stance during the US-China trade talks and all rare earth license applications for civilian use will be approved. At the Fed, Miran (voter) continues to argue for easing in 50bps increments, Waller (voter) laid out the case for a 25bps cut in October, while Barkin (2027 voter) says there has been a noticeable shift in the job market, and executives note there are lots of applicants for every position. Meanwhile, Trump and Putin had a phone call, with both parties speaking positively about the outcome and indicating an upcoming meeting between Trump and Putin in Hungary. The latest US data saw the Philly Fed Business Index unexpectedly tumble into contraction, weighed down by poor business conditions. DXY now trades ~98.30 from earlier highs of 98.706.

G10FX price action was split; CHF, JPY, and EUR outperformed as preferred USD alternatives in the US risk-averse environment. At the BoJ, Assistant Governor Shimizu made the case for a cautious approach when proceeding with policy normalisation, given the uncertain environment around domestic and global trade policies. Meanwhile, Tamura also advocated for caution and said they will closely monitor FX market developments. BoJ Governor Ueda spoke in late trade, noting his view on the global economy has not changed much, but will adjust the degree of monetary support in accordance with the likelihood of growth and inflation forecasts materialising. USD/JPY saw lows of 150.23 from earlier peaks of 151.39.

GBP saw strength against the dollar with GDP in August, matching expectations of a +0.1% reading, while Services Y/Y and Manufacturing Output M/M topped forecasts. Cable now sits around 1.3430 from earlier 1.3394 lows.

AUD was the notable G10 laggard after a poor September jobs report, which unveiled lower job growth than expected (14.9k vs exp. 20k) as well as a downward revision to the prior month's reading (from -5.4k to -11.9k), leaving job growth basically flat over the last two months. The unemployment rate jumped more than expected to 4.5% (exp. 4.3%, prev. 4.2%, rev. 4.3%), albeit some of the move would have been a function of the increase in the participation rate. AUD/USD sits near the lows of 0.6472. Elsewhere, NZD/USD and USD/CAD were little changed.

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newsquawk.com · +44 20 3582 2778 · info@newsquawk.com