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fxPoetry

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Andrew Fately
Executive Director, Senior FX Marketer
Global Markets Marketing Department
andrew_fately@smbcgroup.com
Direct: +1 212-224-4532
Representative: SMBC Capital Markets, Inc.

Much More Cha-Ching

They're certainly talking the talk
As every last dove's now a hawk
But can they maintain
Rate hikes as they drain
The balance sheet? Or will they balk?

While not scheduled to give a speech, yesterday Fed Vice-Chair Lael Brainerd granted an interview to CNBC and sounded quite hawkish throughout. The noteworthy comments were, it is "hard to see the case for a pause," when discussing what may occur come September, as she has already bought into the June and July hikes. This was clearly a rebuttal to the Bostic comments last week that have been interpreted by some as the resurrection of the Fed put. In addition, she indicated that QT, if carried out as currently planned, may be equivalent to another 2-3 rate hikes. Now, she didn't say if those were 25bp or 50bp hikes, but nonetheless, it is the first time I have heard any FOMC member put a number on the impact. And remember, Ms Brainerd has been one of the most reliable doves on the FOMC.

From the other end of the spectrum, Cleveland's Loretta Mester was also on the tape yesterday and there was no confusion how Ms Mester, one of the most hawkish members of the Fed, would explain her views. According to her it is, "too soon to conclude that inflation has peaked" and "Fed rates probably need to go above the neutral level." At this point, it seems the need for a two-day meeting has passed. It strikes me, given the unanimity of views that they need to hike 50bps at the next two meetings, they could easily have a 10-minute Zoom call and be done with it. Of course, that will not be the case, they will meet, and Powell will sit down with the press afterwards, but it would take a remarkable change of situation to alter this outcome.

This morning, though, jobs are the thing
About which the market will swing
Investors expect
Job growth has been checked
But still hope for much more cha-ching

This takes us to the key data release this morning, the Unemployment report. The first concern is that yesterday's ADP Employment report was a much weaker than expected 128K with a 45K revision lower to the April data. But, with that in mind, here's what is on the cards, at least according to Bloomberg surveys:

Nonfarm Payrolls	320K
Private Payrolls	302K
Manufacturing Payrolls	39K
Unemployment Rate	3.5%
Average Hourly Earnings	0.4% (5.2% Y/Y)
Average Weekly Hours	34.6
Participation Rate	62.3%
ISM Services	56.5

The first thing to remember is this is a seasonally adjusted number, so the reported number will not reflect the actual number, but a number that includes a series of assumptions which, since the pandemic impacted the economy, may not be that accurate. But beyond that issue, the current median estimate is substantially lower than any number we've seen since the December 2020 print during the early stages of the Delta variant and its impact on the economy. Certainly, it makes sense that job growth is slowing given how rapidly it has rebounded from the induced lows in the wake of the pandemic, but the key question will be is this representative of an actual slowing in the growth impulse, or is it a reversion to the mean? Recall, Q1 GDP was negative, and while there are many who believe that was a technical glitch essentially, in the way GDP is measured and the impact of inventories, there are also many who foresee a far less robust economy weighed down by excessive debt and much higher energy prices.

From the Fed's perspective, today's number will have not impact as they have already made their proverbial bed. However, if it happens to be weak and is followed by another weak number next month (and I'm talking negative) the discussion at the Eccles Building is likely to become far more heated at the July meeting. In this vein, just yesterday Elon Musk explained he had a "super bad feeling" about the economy and that Tesla needed to cut 10% of its workforce. While anecdotal, it is not a positive sign, especially given the worldwide following the man has achieved in everything he says.

Beyond those things, though, there is not much else to tell. With China and Hong Kong both closed for Dragon Boat Day and the UK closed for the Platinum Jubilee, there was less activity than usual. Yesterday's US equity rally was followed by strength in Japan (Nikkei +1.3%) as well as Australia (+0.9%) and Korea (+.45%), but the European situation has been less impressive with the DAX (+0.2%) the leader and the CAC (+0.1%) barely above water. Of course, compared to most of the rest of the continent, those are the solid performers with plenty of red numbers around. US futures are also softer with the NASDAQ (-1.1%) leading the way although the others are all lower by about -0.55%.

Bond markets are continuing to sell off with yields creeping ever higher. Treasuries (+1.0bps) seem intent on testing the 3.0% level again and in Europe, bunds (+2.1bps) and OATs (+2.6bps) are also on the move. In fact, the entire continent is seeing higher yields. At this point the bond market is torn between the idea that inflation will continue to rise and drag yields higher with it or the central banks will win this battle by causing recessions which will force yields lower ultimately. That is what is keeping the 30-year yields in relative check while keeping 10-year yields in a range.

Now, German 10-year yields have just broken their range on the high side which may portend a similar move in the US. That is not the consensus view, but it cannot be completely ignored in my mind.

Turning to commodities, oil (-0.75%) has backed off a bit but remains above that old range high of $115/bbl. The OPEC announcement of increased production was really a nothing burger as all they did was compress 3 months' worth of production increases into 2 months. And remember, given only Saudi Arabia and the UAE are even producing at their quotas, it is unclear whether or not this production will come to pass. Alas, oil has much further to climb I fear. NatGas (-0.4%) continues to bounce around but is firmly above $8 / mmBtu and looks like it only has one way to head as well, higher. Gold is unchanged today but rallied sharply yesterday and is just consolidating those gains. However, base metals (Cu -0.8%, Al -2.2%) are under pressure today, not a positive economic sign.

Finally, the dollar is definitely rebounding a bit from yesterday's slide, and I would contend the broad trend remains higher overall. In the G10, NOK (-0.5%) is the laggard today on weaker oil prices while NZD (-0.35% and SEK (-0.3%) are next in line, both suffering from the combination of weaker commodity prices and a risk off sentiment developing. In the emerging markets, the outliers are KRW (+0.8%) which responded to a much higher than expected CPI print (5.4%, 4.1% core) and the view that the central bank would implement even tighter monetary policy, and IDR (+0.3%) which benefitted from an uptick in equity investment inflows. However, virtually the rest of this bloc is softer this morning on the broad dollar strength story, albeit none are collapsing.

Ms Brainerd speaks again at 10:30 this morning but it seems like we already got her views on tape yesterday, so she is unlikely to say anything new unless today's NFP is a HUGE miss. But as I have been indicating, the underlying trend remains for a stronger dollar and is likely to continue in that direction until the Fed blinks. If they stick to their guns and really do take Fed funds to 3.5%, the dollar will be at parity or below vs. the euro and 145 or so vs. the yen. But if they don't…

Good luck, good weekend and stay safe
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The author is a salesperson in SMBC Capital Markets, Inc.
The views expressed are his own and may differ from Research.