US Market Wrap

May 12th: Hot CPI sparks hawkish market reaction

- **SNAPSHOT**: Equities down, Treasuries down, Crude up, Dollar up
- **REAR VIEW**: High CPI print; Positive infrastructure developments; Decent 10-year auction; Fed reiterate inflation is transitory, but have tools to deal with it if needed; Crude stocks draw less than expected
- **COMING UP**: **Data**: US Initial/Continued Jobless Claims **Event**: Banxico Rate Decision **Speakers**: Fed's Waller, Barkin, Bullard; BoE's Bailey and Cunliffe **Supply**: Italy & US **Earnings**: Disney, Alibaba; EDP, Telefonica; Burberry **Holidays**: Ramzan-id & Ascension Day

MARKET WRAP

The selling pressures continued today lead lower by the Nasdaq 100 and Russell 2000, as the inflationary fears came to fruition today after CPI rose higher than all analyst expectations across both headline and core metrics. The hot print sparked a hawkish reaction across markets on fears the Fed may act sooner rather than later, sending bonds tumbling with the 10-year yield back around 1.69% which only further pressured the latest stock rout. SPX fell sub 4,100 and is now closer to 4,150, led lower by heavy selling in large-cap tech stocks, although all sectors, ex energy, were lower today - energy was flat. Fed officials were vocal after the data print, but the message appears to be the same and the Fed will look through the data given its transitory nature from low base effects. However, there were a couple of interesting comments; Clarida noted that as "we go through the year", the Fed will assess data and will communicate well in advance about any taper decision. The "through the year" comment was interesting given he has only previously said "now is not the time" for tapering discussion, but today's comment implies the potential for H2 tapering being a possibility for the Vice-Chair. Meanwhile Bostic suggested we will be able to see the inflation picture more clearly in 5-6 months once the inflationary noise has settled, indicating perhaps we will have more of an idea on any policy changes towards the end of the year. Aside from CPI, the tone on infrastructure seems to have improved on both sides of Congress after a bipartisan meeting today, which was followed with a proposal from the Bipartisan Policy Center for a USD 1 trillion bill, paid for with user fees and a corporate tax hike to 25%; although GOP's will be against the tax hike, but it will please some of the moderate Senators, while the reduced size may help cool some inflation fears, but it is still above the GOP proposal of USD 568bln, but nonetheless, acts as a starting point for negotiations. Elsewhere, the 10-year auction today was very strong stopping through by 1.3bps which provided a bid to the T-note off lows while indirect bidders returned to the auction; UST's remained lower across the board post CPI.

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CPI: Headline CPI rose +0.8% M/M, a lot firmer than the expected +0.2%, Y/Y rose 4.2% (exp. 3.6%). The Core rate followed suit, M/M topped expectations at +0.9% (exp. +0.3%) whilst Y/Y printed +3.0% (exp. +2.3%). Overall, the report was substantially firmer than forecasted and above all analyst forecasts, but analysts have highlighted the index for used cars and trucks surged by the highest increase since data began and will be attributing the large gain in April and could be seen as a one-off. On this, analysts note car prices contributed roughly 0.35pp to the core reading. ING analysts state how there is evidence of broadening price pressures and increasingly doubt the Fed’s position that this is transitory, as such, ING thinks the Fed will end up hiking rates far sooner than 2024. Looking ahead, ING analysts highlight it is worth keeping an eye on housing costs, primary rents, and owners’ equivalent rent, as they account for a third of the CPI basket. Moreover, adjustments tend to lag 12-18 months below house price developments, as rents normally change once a year. As such, housing components may well be the ones to watch through H2 '21. Following the report, Clarida (voter) was surprised by the higher-than-expected inflation data and noted as they get **through the year** (see more below in the Fed section), they will assess data and communicate well in advance any taper decision. Additionally, as expected, he reiterated if inflation is pushed to levels inconsistent with the mandate, the Fed will use tools to bring it down. Whilst Bostic (2021, 2024 voter) offered a timeframe, suggesting 'noise' around inflation could last four to five months before the trend becomes clearer.

FED: Vice-Chair **Clarida** (voter) spoke in wake of today's CPI print where he said he was surprised by the April reading, although he also said there is a lot of noise right now in data. The influential policymaker largely otherwise stuck to the script, saying that if inflation were pushed to levels inconsistent with the mandate, the Fed will use its tools to bring it down. Interestingly, Clarida said as we got through the year, the Fed will assess data and will communicate well in advance about any taper decision. The "through the year" comment was interesting given he has only previously said "now is not the time" for tapering discussion, but today's comment implies the potential for H2 tapering being a possibility for the Vice-Chair; we have only heard that timeframe given by regional Fed members so far, and not from the core

Board of Governors. Clarida also said the Fed does not have unlimited tolerance for inflation; well-anchored inflation expectations are essential. Note that Brainard said on Monday that she would be carefully monitoring measures of longer-term inflation expectations to ensure they are well anchored at 2%. Clarida is echoing his colleague here, a stance that will give the Fed wiggle room to look through these "transitory" inflation prints, so long as long-term expectations remain anchored at 2% (note the subjectivity on how one measures this i.e. inflation breakevens/consumer surveys). While today's inflation has upped expectations for potential Fed action, Clarida today stressed that the employment picture was still far from substantial progress. Fed's **Bostic** (2021, 2024 voter) spoke later, further pushing back on the inflation report, saying the US is in a turbulent time and would expect volatility in inflation; said Fed would notice if inflation developed in troubling ways. Bostic said most businesses do not expect price pressures to persist; the economy is still in a "transitional" phase. He said it is too soon to judge whether inflation is on a worrying trend. Bostic also said he was not seeing "excessive froth" in financial markets. On the timing for "noise" inflation, Bostic said it could last four to five months before the trend becomes clearer, again suggesting if there were to be a policy change this year it wouldn't be until the latter part of the year. On housing, Bostic added fundamentals point to higher prices for new and existing homes and he does not see much evidence of high-risk lending in housing.

INFRASTRUCTURE: The bipartisan meeting in Washington went well, with both sides leaving the meeting sounding quite optimistic. House Minority Leader McCarthy said the meeting with US President Biden was positive, and he thinks bipartisan cooperation on infrastructure is possible. At the same time, Senate Minority Leader McConnell stated there is a bipartisan desire for an outcome, but he reiterated a need to decide what "infrastructure" is. Both GOP leaders expressed to Biden that no Republican will vote to increase taxes and that they are not interested in reopening the 2017 tax bill, with the GOP "red line" in talks is revisiting the tax cuts. House Majority Leader Hoyer stated Democrats would continue to work towards Bipartisanship on infrastructure; and agreed there is a basis for infrastructure, and he hopes they can get there. House Speaker Pelosi stated she is more optimistic about being able to pass a bipartisan bill following today's meeting. Following the meeting, the Bipartisan Policy Center issued a compromise bill which is for a USD 1 trillion infrastructure bill, paid for with user fees and a corporate tax hike to 25%. The 25% corporate tax rate will be welcomed by the moderate Democrats like Manchin but given there are still tax hikes; it may prove to be a sticking point for the GOP's. While the USD 1trln size (down from Biden's proposed USD 2trln proposal) may help cool some inflationary fears, it is still above the GOP's USD 568bln proposal, but nonetheless, it acts as a basis for negotiations. Biden did, however, state he is not going to give up on a whole range of things that point to the question of raising productivity and increasing jobs, while he wants to get a bipartisan deal on infrastructure to kick start it and then fight over what is left. Note, McCarthy later stated the house GOP's will be unveiling their less than USD 800bln proposal next week, which will not include tax hikes.

FIXED INCOME

T-NOTE (M1) FUTURES SETTLED 17 TICKS LOWER AT 131-29+

The belly led a vicious Treasury sell-off on Wednesday after a decent 10-year auction failed to heal the damage from a record-breaking hot CPI print. 2s +0.4bps at 0.165%, 5s +5.4bps at 0.855%, 10s +6.6bps at 1.690%, 20s +6.3bps at 2.289%, 30s +5.6bps at 2.408%; TYM1 volumes were well above average. 5yr TIPS +2.6bps at -1.888%, 10yr TIPS +4.4bps at -0.871%, 30yr TIPS +7.4bps at 0.039%. SOFR and EFFR unchanged at 1bp and 6bps.

OPS & SALES: Fed bought USD 1.735bln 20-30yr Treasuries, O/C 3.1x (prev. 3.2x). US sold USD 41bln of 10-year notes, stop-thru 1.3bps; sold USD 35bln 119-day CMBs at 2bps, covered 3.24x. NY Fed RRP demand rises to a new YTD peak at USD 209.3bln across 39 bidders (prev. USD 181.8bln across 28 bidders).

THE DAY: Treasuries were modestly bid overnight, clawing back some losses from Tuesday amid COVID concerns in Asia, particularly out of chip supply fulcrum Taiwan, while the geopolitical risk flare in Israel didn't exactly embolden the risk tone. It wasn't till the Europe/US handover that offers resurfaced, building into approaching refunding auctions. The selling was at first slow, then all of a sudden, as April CPI printed the highest core Y/Y figure since the mid-90s, while even the core M/M rose at an eye-gouging 0.9% pace. The well above forecast print saw 700k TYM1 traded in the hour after it (around half the volume of a whole average day) as the belly of the curve led the sell-off, seeing Eurodollars and USTs mark a complete reversal of the post-NFP bid, re-embedding term premia as participants begin to question the nerve of the Fed's "look through all inflation as transitory". While employment may not be where the Fed wants it, as Clarida reiterated today, there is now a relatively higher chance of inflation running too hot to force a Fed cave before the labour market's healing is complete. As the dust settled from the report, USTs saw further downside, with bulls cautions to reengage ahead of the approaching 10-year auction - the spillover pressures saw German Bund yields continue to print new cycle peaks. Bulls will have made a sigh of relief after the decent 10-year auction, which stopped though by 1.3bps, covered more than average, and saw decent participation from the non-dealer community for the USD 41bln new issue, particularly from Indirects, which are often seen as a proxy for foreign demand. While a solid auction, it was not enough to see a meaningful pare back in yields, with TYM1 contracts rising by just a few ticks, before chopping around lower into the futures settlement. Participants now look to Thursday's 30-year auction to see if that 10-year demand from today sustains.

CRUDE

WTI (N1) SETTLED USD 0.80 HIGHER AT 66.10/BBL; BRENT (N1) SETTLES USD 0.77 HIGHER AT 69.32/BBL

Crude futures crescendoed into the US session after a choppy start in Europe, with hot CPI and commodity momentum keeping prices buoyed despite the big rally in the Buck. Inventory data had little sway this week, particularly since the Colonial Pipeline incident in wake of the recording period. Nonetheless, today's EIA report (bbls) saw Crude stocks -0.4 mln (exp. -2.8mln; vs API -2.5mln), Cushing -0.4mln (exp. -2.8mln; vs API -2.5mln), Gasoline +0.4mln (exp. -0.6mln; vs API +5.6mln), Distillate -1.7mln (exp. -1.1mln; vs API -0.8mln). The figures will likely see some large deviations from next week's report amid the US' largest refined products pipeline being offline. The energy complex could be pricing in some geopolitical risk premium amid the intensifying shelling in Israel-Gaza, although the conflict remains contained to the region for now, some infrastructure in the region has been shut down, including Chevron's (CVX) Tamar Nat Gas platform. Moving on, Tuesday saw the release of both the OPEC MOMR and EIA STEO followed today by the IEA OMR. The IEA and EIA both cut their 2021 forecasts whilst OPEC maintained their metric - with the former two citing India's COVID situation as a factor. IEA also maintained their forecast of a strong ramp-up in refining activity in the next four months, with refinery runs expected to peak in August. "While the market looks oversupplied in May, stock draws are set to resume from June, even with global oil supply on the rise...Under the current OPEC+ production scenario, supplies won’t rise fast enough to keep pace with the expected demand recovery.", the agency said. On the OPEC front, Russian Deputy PM Novak said today that compliance with the OPEC+ deal in April was below 100%, but Russia will strive to stick to it - via IFX. In the US, Exxon (XOM) Baytown, Texas refinery's (584k BPD) large gasoline unit remains operational following an unplanned boiler shutdown. Meanwhile, it's worth keeping the latest reports of a traffic blockage along the Mississippi river amid a structural crack on a bridge.

EQUITIES

CLOSES: SPX -2.12% AT 4,063, NDX -2.62% AT 13,001, DJIA -1.99% AT 33,587, R2K -3.46% AT 2,130

SECTORS: CONSUMER DISCRETIONARY -3.28%, TECHNOLOGY -2.86%, MATERIALS -2.54%, INDUSTRIALS -2.44%, REAL ESTATE -2.37%, UTILITIES -2.35%, COMMUNICATION SVS. -2.03%, CONSUMER STAPLES -1.32%, FINANCIALS -1.29%, HEALTH -1%, ENERGY +0.06%

EUROPEAN CLOSES: EURO STOXX 50 +0.14% AT 3,951; FTSE 100 +0.84% AT 7,006; DAX +0.21% AT 15,152; CAC 40 +0.28% AT 6,285; IBEX 35 +0.32% AT 9,016; FTSE MIB +0.47% AT 24,512; SMI +0.39% AT 11,033

STOCK SPECIFICS: Tesla (TSLA) is looking for entry into the US renewable fuel credit market, according to sources, hoping to profit from the Biden administration's move towards new zero-emission goals. Electronic Arts (EA) beat on EPS and revenue with solid guidance, raising FY EPS and revenue. Amazon.com Inc. (AMZN) won its fight against the EU order to pay roughly EUR 250mln in back taxes to Luxembourg after Europe's second-highest court sided with AMZN. Intuit Inc. (INTU) expects to exceed the high end of its FY company revenue and profit guidance; sees Q3 lower than expected due to the extension of the IRS tax filing deadline. Pfizer Inc. (PFE) and BioNTech (BNTX) - US CDC advisers will discuss today whether to recommend the vaccine to children aged 12-15. Lumentum Holdings (LITE) was in line with EPS and revenue guidance but downgraded its FY EPS and revenue view. Also, LITE approved a share buyback of USD 700mln over two years. Unity Software (U) had a slight beat on EPS and revenue, raised its Q2 and FY revenue view. Upstart (UPST) beat on EPS and revenue whilst increasing expectations for Q2 and FY revenue view. FAA Administrator said the Boeing (BA) electrical issue that grounded some 737 Max craft is a pretty straightforward fix. General Electric (GE) CFO at a GS conference expects operational improvements in H2 21 and to be at the high end of free cash flow range tied to timing of the recovery. Idex Corp (IEX) raised its quarterly dividend 8% to USD 0.54/shr. Energy Transfer (ET) CEO Warren says he wants Co. to move into the chemicals business through acquisitions. American Airlines (AAL) Executive states bookings are comparable to 2019 and some corporate clients may begin travel in Q3; expects to fly at 85-90% of 2019 capacity by July.

FX WRAP

The dollar surged today after a much firmer than expected CPI report caused a risk-off move in equities and helped spark the bid for the greenback, as did the leg higher in US yields which saw the 10-year yield top 1.69% for the first time since April 13, although a strong 10-year auction saw yields slightly off highs. The inflation print sparks concerns that inflation will run too hot and the Fed will have to step in, although the FOMC have told us that inflation will be transitory and the spike higher is due to base effects. Clarida previously suggested if the inflation stays high for longer than a year than perhaps it is not as transitory as once thought, while Bullard and Brainard noted yesterday that some effects may spill over into Q2. The upside in the dollar weighed on EUR as did the UST/Bund spread with 10-year bund only firmer by ~1bp while the 10-year surged ~6bps. JPY was softer taking its hit from the dollar and on rate differentials, while gold took its cues from the same dynamics. The rise in the dollar took its toll on CNH as well, while relations continue to sour between China and the US after US Senators agreed on a bipartisan pact to amend the China competition bill and have proposed sanctions for Chinese cyber hacks and IP theft.

Cyclical currencies tracked the dollar and the downside in the equity space, seeing AUD, NZD and GBP tumble, particularly the antipodeans given their high beta's, while NZD was the laggard as Aussie perhaps found some support from another revival in base metals, seeing AUDNZD higher and around 1.08. Losses were perhaps stemmed in GBP given strong data out of the UK this morning with beats on GDP, industrial output and manufacturing output, while trade data was also encouraging although there was little reaction at the time of release. CAD, however, continues to hold onto recent gains thanks to the hawkish BoC last month, while it was also supported by upside in the crude space today.

EMFX was softer across the board amid the fall in equities and bid into the buck sparked by the firmer than expected US CPI print, which raises concerns the Fed will have to act to prevent inflation rising although it is one report and the Fed have expressed many times the rise in inflation is transitory, but, if it were to get out of control they have told us they will act. BRL continued its post-BCB minute decline while the latest Service Sector Growth did little to support the Real. MXN was also softer on the aforementioned reasons, while the rise in crude and decent Industrial Output data failed to fight off headwinds. Note, USTR Tai has vowed to use the USMCA deal to address Mexican labour issues and the two sides will partner to prevent a race to the bottom for US and Mexican workers. TRY was softer in fitting with general EM's although the rise in oil prices only added as another headwind for the Lira, while the fall in gold added another headwind for ZAR.