US Market Wrap

10th February 2022: Hot CPI and Hawkish Bullard sends yields soaring, stocks tumbling

- **SNAPSHOT**: Equities down, Treasuries down, Crude mixed, Dollar flat
- **REAR VIEW**: Hot CPI; Bullard favours 100bps of hikes by July 1st, says Fed should be open to inter meeting moves; ECB's Lane took a dovish view of bottlenecks and price pressures; Average 30yr auction; Jobless Claims ease; Banxico hike 50bps, as expected; Ukraine preparing for war in Donbass region; Strong DIS & UBER earnings
- **COMING UP**: **Data**: UK GDP, German CPI (Final), US Uni. of Michigan Prelim. **Events**: IEA OMR **Speakers**: ECB's Elderson **Supply**: US **Earnings**: Under Armour; British American Tobacco **Holiday**: Japanese Foundation Day

MARKET WRAP

Stocks tumbled after Thursday's hawkish developments. A hot CPI report saw the 10yr yield eventually rise above 2% and markets start to price in a more hawkish expectation from the Fed. Moves were exacerbated in the afternoon after Fed's Bullard, a 2022 voter, voiced his support for a 50bps move and 100bps of tightening by July 1st, which would also imply a 50bps move in May, unless the Fed were to move inter-meeting, something Bullard said the Fed should keep an open mind on. The commentary saw yields extend on gains, particularly in the short end with the 2yr rising 26bps by the closing bell to 1.61% with the curve seeing heavy bear-flattening in wake of the CPI and Bullard. Crude prices started on the front foot on geopolitical concerns to see Brent briefly top USD 93/bbl but gains were short lived as risk assets tumbled. The dollar was unchanged on the session, but within wide parameters which saw the buck hit a post CPI high above 96.00 before completely reversing to lows of 95.17. Growth and tech led the declines given their sensitivity to the spike higher in Treasury yields, although equity losses were broad based with major indices down between 1.4 and 2.2%. No sector closed green, although Materials, Energy and Financials were the least hit while Real Estate, Tech and Utilities felt the brunt of the sell off with the former two heavily influenced by yields. The moves also saw the VIX rally to 24. On a micro note, Disney (DIS) held onto gains after a very strong quarter and encouraging commentary, although Uber (UBER) lost its gains after comments on guidance from the investor day disappointed investors.

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CPI: January CPI was hot. The core M/M rose 0.6%, in line with the prior but above the expected 0.5%. Core Y/Y rose 6.0%, above the prior 5.5% and above the 5.9% expected. The headline M/M saw a 0.6% rise, in line with the prior revised 0.6% while Y/Y rose 7.5% from 7.0%, topping the 7.3% expectation. There was an immediate hawkish reaction which saw Fed Funds futures start to price in just over a 50% chance the Fed will hike by 50bps in the March meeting. It is worth noting the hawks, ahead of the report, had suggested 50bps is possible, but the base case from Bullard, Bostic, Harker and Mester was for a 25bps move, although providing the usual data-dependent caveat. Therefore, any remarks from them will be key ahead of the blackout before the March 16th meeting to help gauge expectations. The breakdown saw some prior drivers lose momentum such as Shelter prices, which rose 0.3%, slowing from the prior and the slowest since August 2021 while used car prices also slowed, rising 1.5% from 3.3% in December, marking the slowest pace since September 2021, meanwhile new vehicle prices were flat. Analysts have suggested headline inflation will likely ease somewhat going forward as base effects come into account and as supply chain woes ease as we look to exit the pandemic. Analysts at Pantheon Macroeconomics highlight the flat new vehicle prices as a positive and described it as a significant development. PM “expect new vehicle prices to fall outright over the next few months” and notes used vehicle prices will also fall and CPI will follow. However, the consultancy notes, “Used vehicle inflation is 40.5% y/y, compared to the zero pre-Covid trend, so they have a long way to fall.” Pantheon adds that vehicles account for 10% of the core CPI, so declines in these metrics will help lower the overall core inflation rate also - Pantheon suggests the "peak likely will be in March, close to 6.5%, but it will then fall rapidly”. Elsewhere, "The biggest contribution to the m/m core was rents, up 0.45%, but that’s in line with the recent trend and is no surprise." PM says they expect rents to rise at a similar pace for most of this year, "propelled by rocketing home prices, rapid wage gains, and the very low vacancy rate for rental property." The consultancy notes the broader core inflation pressure in Jan was spread across apparel prices (+1.1%), household furnishings (+1.6%), and prescription drugs (+1.3%). Airlines fares also saw a surprising rise, but higher fuel costs were likely a driver there. But another upward pressure ahead to consider is that hotel room rates dropped by 3.9% in Jan, but can be expected to rise again as omicron fades in the months ahead.

FED: **Bullard (2022 voter, hawk)** delivered a very hawkish tone as he noted he favours 100bps interest-rate increases by July 1st, which would imply two 50bp hikes at the March and May meetings unless they go inter-meeting, which is something Bullard said the Fed should be open too. He favours a half-point rate hike in March but he deferred that decision to Fed Chair Powell. On the balance sheet, he favours a reduction start in Q2 and the reduction may require asset sales. It is clear the January inflation report sparked concerns for Bullard who on February 1st said he does not see a compelling case to start with a 50bps rate hike. On a potential interbank meeting, SGH Macro's Tim Duy writes "Everything is on the table. We must have an intermeeting action on our radar at this point. The news flow is not going to get any better for the Fed and sitting on its hands amid inflation not seen in decades is doing nothing but eroding its credibility". Blackrock also called on the Fed to end asset purchases now, which are currently scheduled to end in March. Note, we are set to get the updated purchase schedule from the NY Fed tomorrow at 20:00GMT/15:00EST, therefore if there was any changes to their asset purchase schedule, it would likely be announced then, if not before.

JOBLESS CLAIMS: Weekly initial jobless claims eased to 223k in the week of February 5th (exp. 230k, prev. 239k). Oxford Economics notes that initial claims continue to unwind the recent spike as the Omicron variant fades, and have now reversed around 80% of their Omicron-rise in three weeks' reports, which OxEco says reflects the improving pandemic situation, as well as the strength in the labour market. Continuing claims for the week of January 29th, meanwhile, rose to 1.621mln (exp. 1.615mln, prev. 1.621mln). OxEco notes that for the last five weeks' worth of data, continuing claims has remained beneath the pandemic average of 1.71mln, and the consultancy expects continuing claims to stay at these levels, or decline further, as health conditions improve and the labour market continues to tighten.

GLOBAL

ECB: ECB's Lane noted since bottlenecks will eventually be resolved, price pressures should abate and inflation return to its trend without a need for a significant adjustment in monetary policy. He added, such a gradual tightening of the labour market constitutes a key mechanism for inflation to stabilise at the 2% target over the medium term, whereas there are no indications of aggregate overheating in the euro area labour market. In addition, Lane said it is always necessary to monitor second-round effects, since increases in the consumer price level may propagate through second-round effects on other sectors and on wages. However, even such second-round effects should eventually fade, given the temporary characteristic of the initial price surge, unless long-term inflation expectations are permanently altered by the temporary phase of higher inflation. Lane continued we are not in a situation where there is lots of probability that inflation remains above the target over the projection horizon, and inflation is surprisingly high. Lastly, he added, bottlenecks alone will not keep inflation above target. Analysis of Lane's comments can be found here. **Finland's Rehn** also spoke, he said it is more preferable to progress one step at a time in normalising monetary policy in an uncertain environment, and the ECB will use all tools to stabilise inflation around 2%. Rehn said lifting rates too fast may hurt the economy and employment. **ECB's VP de Guindos (Spain)** said there are upside risks to the inflation outlook and he expects growth to rebound strongly over 2022, with inflation to start declining this spring and the Commission's forecast of 3.5% inflation looks realistic. He also declared the need to maintain flexibility/optionality on monetary policy. **France's Villeroy**, who has spoken heavily in recent days, declared there is a lot of uncertainty on inflation and we think inflation will fall down in the coming Q due to easing energy prices and supply chain pressures. Moreover, the pace of policy normalisation is completely open, and optionality on policy is necessary, whilst direction of rates is clear but pace is uncertain. **ECB's Banking Supervision Chair Enria** noted the Bank could consider quantitative requirements in 2023 if banks do not comply with expectations on leveraged loans.

GEOPOLITICS: Ukraine said they are actively preparing for war in Donbass region, according to the Director of Russian Foreign Intelligence cited by Al Jazeera. This followed updates throughout the day out of Ukraine that Russia is continuing to militarise in the Black Sea region, and Russian manoeuvres in the Azov and Black Seas make navigation virtually impossible, and in response Ukraine will work together with partners to ensure that actions from Russia receive a proper assessment and response. Ukraine's Foreign Minister said they will come up with a defensive position in response to Russian exercises in the Black Sea. All of these updates following morning reports, via Interfax, that Russia is to hold military drills within the Black Sea. Meanwhile, Russian Foreign Minister Lavrov noted the EU is planning a collective response to Russian security proposals, adding that if this is the case, talks "will fail". Lavrov further stated Russia is in full favour of diplomacy and felt like UK Foreign Secretary Truss ignored "many facts" provided by Russia. UK's Foreign Minister Truss declared Russia needs to move its troops if they are serious about diplomacy and there remains time for Russia to halt aggression towards Ukraine, while PM Johnson suggested intel on Russia remains grim but believes the package to support Ukraine is the right one but will not rule out providing additional support. Finally, Lavrov declared if UK wants to normalise relations with Russia, Moscow will be ready for that on the basis of mutual respect. Note, German Chancellor Scholz said they are ready for dialogue with Russia.

RIKSBANK: As expected, the Repo Rate was maintained at 0.00%. Additionally, and against the calls of some desks, the Riksbank elected to keep its QE purchases at SEK 37bln for Q2-2022; however, we saw hawkish dissent from Breman, Floden and Ohlsson on the matter who, to surmise, called for a SEK 10bln reduction and a commitment to a gradual tapering during H2. Unsurprisingly, the repo path was brought forward slightly though the first hike is still not expected until 2024. Finally, and the driver of the SEK depreciation, in-spite of the upgrades to CPIF forecasts and the acknowledgement of some inflation upside (albeit upside they still expect to pull back over the year) the Riksbank elected to double-down on their 'transitory' inflation view by adding the line that "... even if the risk of too low inflation is assessed to have declined, it still remains." An addition that will be a key focus for the minutes, upcoming speeches and future policy announcements.

FIXED INCOME

T-NOTE (H2) FUTURES SETTLE 30+ TICKS LOWER AT 125-25+

Treasuries saw heavy bear-flattening after the strong CPI print was backed up with a uber-hawkish Bullard comments. At settlement, 2s +23.7bps at 1.585%, 3s +21.2bps at 1.823%, 5s +15.6bps at 1.956%, 7s +13.4bps at 2.039%, 10s +11.3bps at 2.040%, 20s +9.1bps at 2.382%, 30s +8.7bps at 2.319%. 5yr TIPS +12.0bps at -0.795% 10yr TIPS +9.1bps at -0.420% 30yr TIPS +9.2bps at 0.119%. 5yr BEI +3.9bps at 2.765% 10yr BEI +2.0bps at 2.467% 30yr BEI -0.5bps at 2.219%. 2s10s -12.3bps at 57.4bps 2s30s -14.7bps at 87.7bps 5s10s -4.1bps at 12.2bps.

OPS & SALES: Fed bought USD 3.201bln in 7-10yr Treasuries; offer-to-cover 2.52x (prev. 2.96x on Jan 10th); the majority of buyback in old 10s issue. US sold USD 53bln of 1-month bills at 2bps, covered 3.18x; sold USD 43bln of 2-month bills 25bps, covered 2.97x; sold USD 23bln of 30yr bonds at 2.340%, covered 2.30x, tailed by 1.1bps. NY Fed RRP op demand at USD 1.634tln across 76 bidders (prev. USD 1.653tln across 77 bidders).

THE DAY: Trade out of APAC/Europe was light with all attention focused on the approaching US CPI. The January print did not disappoint for action after the firmer than expected M/M readings saw bids across the curve evaporate. The uncomfortably high reading was led by broader spending patterns rather than the usual suspects like used and new cars, seeing curve flattening bets ramp up as a more aggressive Fed tightening path was hiked. Just to show how much was on the line, note that more T-Note futures were traded in the 30 minutes after the release than after last Friday's NFP, with over 400k traded in the Mar'22 contracts. The selling saw the 10yr yield rise above 2.00% for the first time since 2019, and amid the Fed's 7-10yr buyback, the 7s10s briefly inverted. Losses were held going into the NY afternoon, although note the curve-flattening bets had the 30yr the relative outperformer, albeit still strongly offered, going into the new issue auction. But, vol spiked again not long before the offering after Fed's Bullard came out swinging, calling for 100bps of hikes by July 1st and a 50bps hike in March, even saying the Fed should be open to considering inter-meeting hikes; Bullard also said he favours balance sheet reduction start in Q2. That saw a spike higher in yields led by the front-end, taking 2s10s to lows of c. 44bps, a big tumble from 56bps pre-CPI. The 30yr auction was an after-thought by that point, but it saw an average demand reception (details below). Going into settlement, yields pared slightly from their highs, with new peaks of 2.05% for 10s and 1.59% for 2s set. Friday sees Uni of Michigan prelim survey and the last month-ahead schedule release for Fed purchases before QE comes to completion. However, it wouldn't be surprising to see some unscheduled Fed speakers opine ahead of the weekend.

30YR AUCTION: An average 30yr auction overall with the 1.1bps tail and 2.30x B/C ratio in line with the six-auction averages, and given the CPI reading and recent Fed speak, that has probably taken off some of the shine of the significantly cheapened (M/M) new issue as volatility rises again. Nonetheless, the 2.340% stop rate marks the highest since May 2021. The breakdown was more positive, with Dealers taking 14.3%, below average 17.9%, while Indirects yet again stood in to take an above-average share (67.95% vs avg. 64.3%).

NEXT WEEK'S AUCTIONS: US to sell USD 19bln of 20yr bonds on Feb 16th; to sell USD 9bln of 30yr TIPS on Feb 17th; all to settle on Feb 28th.

STIRS: Heavy bearish activity across the STIRS complex, with the very front-end pricing risks of an inter-meeting hike, particularly after Bullard's remarks. EDH2 -14.5bps at 99.270, M2 -25.5bps at 98.700, U2 -32.0bps at 98.315, Z2 -32.0 bps at 98.010, H3 -31.5bps at 97.830, M3 -29.0bps at 97.680, U3 -24.5bps at 97.625, Z3 -20.5bps at 97.63, Z4 -9.5bps at 97.725, Z5 -8.5bps at 97.745, Z6 -7.5bps at 97.755, Z7 -6.5bps at 97.750.

CRUDE

WTI (H2) SETTLES USD 0.22 HIGHER AT 89.88/BBL; BRENT (J2) SETTLES USD 0.14 LOWER AT 91.41/BBL

Oil prices were choppy on Thursday and ultimately settled mixed as the commodity complex battled the volatility out of stocks, bonds, and the Dollar post-CPI, meanwhile, energy traders await updates on geopolitics. The OPEC Feb MOMR was released, which saw 2022 world oil demand growth forecast unchanged at 4.2mln BPD; noted OPEC producers (excluding exempt countries) fell around 750k BPD short of Jan targets. On Russia, Russian Foreign Intelligence cited by Al Jazeera noted that Ukraine is actively preparing for war in the Donbass region, while the Ukraine military separately said Russia is continuing to militarise in the Black Sea region. On Iran, there have been few material updates amid the resumption of Vienna talks, but note the Russian Foreign Ministry said there is a long way to go until there is a resumption of the nuclear deal.

EQUITIES

CLOSES: SPX -1.81% at 4504, NDX -2.33% at 14705, DJIA -1.47% at 35241, RUT -1.55% at 2051

SECTORS: Real Estate -2.86%, Technology -2.75%, Utilities -2.61%, Consumer Discretionary -1.78%, Industrials -1.65%, Health Care -1.57%, Communication Svs -1.41%, Consumer Staples -1.03%, Financials -0.85%, Energy -0.68%, Materials -0.57%.

EUROPEAN CLOSES: EURO STOXX 50 -0.2% at 4,197, FTSE 100 +0.4% at 7,672, DAX 40 +0.1% at 15,490, CAC 40 -0.4% at 7,101, FTSE MIB +0.2% at 27,190, IBEX 35 +0.5% at 8,886, SMI -0.5% at 12,300.

STOCK SPECIFICS: **Ford's (F)** Oakville and Windsor plants running at reduce schedules due to interruption on Detroit /Windsor bridge amid a blockade by protestors; the route is a key trade link between US and Canada. **Western Digital (WDC)** reported the contamination of material used for manufacturing processes is impacting operations at its Yakkaichi and Kitakami JV flash fabrication facilities. **Ford (F)** hired Alan Clarke a former **Tesla (TSLA)** employee to work in their advanced EV development department, via Auto News. Moreover, F plans to introduce at least five new battery electric SUVs under Lincoln brand through 2026, according to Reuters sources. **Kellogg (K)** expects double-digit inflation in 2022, majority of this is market driven. **Tesla (TSLA)** is to locate its China design centre in Beijing, according to WSJ. **Carnival (CCL)** announced Princess Cruises will do its first-ever summer season sailing to Mexico, Hawaii and the California coast roundtrip from LA. **Apple (AAPL)** stated it is working with law enforcement on Airtag tracking, and will use them to apprehend and charge alleged criminals. **Google (GOOGL)** reportedly lost a patent trial in Texas regarding Nest thermostats. **Netflix (NFLX)** reportedly names Karen Toliver as vice president of animated film, according to Variety. The US backed the USD 14bln sale of **Boeing (BA)** F-15 jets to Indonesia.

EARNINGS: **Coca-Cola (KO)** beat on EPS and revenue; projects commodity price inflation will be in the mid-single-digit percentage range for 2022. **Disney (DIS)** was firmer after topping Wall St. consensus on top and bottom line, whilst Disney+ paid subscribers also beat expectations. Note, DIS said international parks will continue to be impacted by COVID-related volatility through Q2. **PepsiCo (PEP)** had a mixed report where EPS was inline but revenue beat; also announced an annual dividend boost and a USD 10bln share buyback programme. **Uber (UBER)** had a stellar report; posted a surprise profit per share alongside beating on revenue and MAUs. CEO expects trips and gross bookings to recover rapidly in Q1, and expects to see a significant EBITDA increase even with new investments. **Canada Goose (GOOS)** shares tumbled after the Co. cut its FY22 view as Omicron related restrictions impacted demand for its parkas and footwear. **Mattel (MAT)** was firmer following beats on EPS and revenue, whilst FY22 outlook was strong. **Twilio (TWLO)** surged after EPS posted a shallower loss per share than expected and beat on revenue; Q1 revenue view topped expectations. **Twitter (TWTR)** had a poor report, where it missed on all major metrics, but analysts are pointing towards engagement not as poor as **Meta (FB)**. TWTR also announced a new 4bln share buyback programme. Affirm (AFRM) accidentally leaked their earnings on Twitter before deleting the tweet, although they officially released them during hours after the mishap what saw a larger loss per share than expected, to send the stock tumbling despite the leak sending the stock higher as the snapshot focused on the positives.

FX WRAP

The Dollar was flat on Thursday between 95.172-96.013 parameters in a choppy day after the hot CPI data saw the buck rise above 96.00 before paring in the afternoon. The 10yr yield rose above 2% while the 2yr rose over 25bps to highs of 1.60%. Then, Fed's Bullard announced he would favour 50bps in March and 100bps by July 1st, implying two 50bps hikes in the next two meetings, but he suggested the Fed should be open to inter-meeting rate decisions. Market pricing now looks for a roughly 60% chance of a 50bps move in March, while analysts are not ruling out an inter-meeting decision after Bullard's remarks. Markets also look for over 150bps of tightening by year end. **The Euro** tracked the buck with EUR/USD trading between 1.1376 at the lows and 1.1495 while the latest bout of ECB commentary saw remarks from Lane sounding optimistic on bottlenecks, while Rehn said they should take policy one step at a time.

JPY was weaker which saw USD/JPY rise to c. 115.87 after the BoJ announced it will purchase unlimited 10yr JGBS to rein in the yield, however, JPY saw further weakness with the cross soaring above 116.00 after the hot US CPI data which sent US yields significantly higher, although the cross then pared from highs back beneath 116 in the afternoon. Note, there had been speculation whether the BoJ would intervene recently after the 10yr JGB yield inched closer towards the BoJ's 25bp cap. **CHF** was weaker against the buck given the SNB's negative rate stance and its carry or funding status, with USD/CHF within a strike of 0.9300 at one stage, but retreated alongside the Dollar.

SEK saw weakness in wake of the latest Riksbank rate decision. The bank maintained its Repo Rate at 0.00% as expected and maintained its QE programme for Q2 at SEK 37bln, however, there were three hawkish dissenters and some desks had expected a hawkish adjustment to the purchases. The weakness followed after the statement suggested that even if the risk of too low inflation has declined, it still remains. EUR/SEK rose above through 10.50 resistance in the cross, with technicians eyeing 10.56 as the next level of resistance.

Cyclical currencies were mixed, the high-beta AUD and NZD were lower as risk appetite soured after hot CPI and hawkish remarks from Fed's Bullard. GBP managed to hold onto its gains however was off the highs after nearing 1.3650 at one stage, before paring a lot of the moves ahead of UK data including monthly GDP for December, the first look at Q4, IP, and the production breakdown. CAD was weaker as oil prices tumbled with the risk appetite, while there are more reports of factory's halting production due to the blockades, including from Ford (F) and Toyota (TM), alongside reports of railway strikes which will likely only exacerbate the current worrisome supply chains, something BoC Governor Macklem has said could impact economic activity if it persists.

EMFX was mixed, TRY and ZAR held their bid with ZAR supported by constructive remarks from South African President Ramaphosa who said fundamental change and reforms are needed to revive growth, and they are working together to revitalise the economy, he also spoke of improving the importance to improve their electricity system. South Africa also saw better than expected manufacturing production data for December, although mining production was weak. RUB was weaker amid ongoing geopolitics although it comes ahead of the CBR on Friday. MXN was weaker in fitting with risk appetite while the latest Banxico decision did little to sway the Peso as it traded of more macro themes.

BANXICO: Banxico hiked rates as expected by 50bps, although known dove Esquivel opted for a 25bp hike. The new governor decided to opt with a 50bp move despite the opposition despite some risk that she may side with the doves. Some analysts also looked for a smaller 25bp move to give Banxico more optionality if they have to react to a more aggressive Fed. The statement saw that inflationary pressures have been greater and lasted longer than expected and these inflation pressures will be watched closely n upcoming meetings. The Banxico highlighted that inflation expectations for 2022 and 2023 have increased again while medium term expectations decreased slightly but longer terms remain on target. The Central Bank also noted that the balance of risks for the trajectory of inflation within the forecast horizon remains biased to the upside.