US Market Wrap

10th August 2022: Aggressive Fed rate path bets ease after soft CPI, stocks rally

- **SNAPSHOT**: Equities up, Treasuries mixed, Crude up, Dollar down.
- **REAR VIEW**: CPI cooler than expected, core Y/Y matches prior pace; Evans sees FFR toping out at 4%; Kashkari maintains rate path; Solid 10yr auction; Transneft resumed flows via Druzhba's southern leg; 36 Chinese crafts & 10 ships were in/around Taiwanese straight on Wednesday; Musk sells USD 6.9bln worth of TSLA stock
- **COMING UP**: **Data**: US IJC, PPI **Events**: IEA OMR, OPEC MOMR; Banxico Policy Announcement **Speakers**: Fed's Daly **Supply**: US **Earnings**: Daimler Truck, Siemens, Deutsche Telekom; Entain; Zurich **Holiday**: Japanese Mountain Day.

MARKET WRAP

The cooler than expected CPI saw a dovish reaction across assets, with stocks rallying to see the SPX reclaim 4200 for the first time since May, while the Nasdaq and Russell outperformed. Both the Core and Y/Y metrics were softer than expected, while the Core Y/Y, despite expectations for an acceleration, maintained last month's 5.9% pace, which helps with the peak inflation narrative. Market pricing for the Fed saw a dovish reaction with markets now leaning towards a 50bps hike in September, rather than 75bps as was priced in before the release. T-Notes rallied in wake of CPI although pared heavily from the highs ahead of 10yr supply and 30yr supply on Thursday while the Dollar tumbled after the data, seeing DXY briefly dip beneath 105.00 for the first time since 4th July. Crude prices were choppy, benefitting from the weaker Dollar before being hit on the resumption of oil flows from the Druzhba pipeline as planned, before ultimately settling firmer in fitting with the risk appetite despite a larger crude stock build from the EIA data. Fed speak saw Kashkari and Evans, where the former noted the Fed is "far, far, far away" from declaring victory on inflation and the latest CPI does not alter his rate path of 3.9% by year-end and 4.4% by the end of 2023, while Evans sees rates at 3.25-3.50% by year-end and 3.75-4% by end 2023. It is clear the Fed still want to see more evidence on cooling inflation and are reluctant to acknowledge peaking inflation just yet. Ahead of the September FOMC, we will see the release of the July PCE, the August CPI and the August NFP which will be used collectively to help determine the Fed's reaction function for the meeting, alongside Wednesday’s CPI report.

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CPI: CPI was cooler than expected with headline M/M seeing a 0.00% change (exp. 0.2%, prev. 1.3%), primarily led by the 4.6% decline in energy prices, while the Y/Y metric rose 8.5%, beneath expectations of 8.7% and cooling from the prior months 9.1%. Core M/M rose 0.3% beneath the expected 0.5% and cooling from the prior 0.7%. The Core Y/Y matched prior month's pace of 5.9%, despite expectations of an acceleration to 6.1% which is a welcome sign and will help support the peak inflation narrative. With the September FOMC not until September 21st, there is still several data points to digest alongside the July CPI and NFP reports, as we will see Core PCE at the end of this month, followed by the August CPI and NFP reports before the Federal Reserve meeting. The Fed will likely be welcomed by this latest report but will be cautious to declare victory just yet with Fed's Evans speaking after the report clarifying they are not done with hikes and he sees the FFR topping out at 4% with rates between 3.75-4.00% at the end of 2023 (in line with the Fed's median view in June of 3.8%). Looking into the report, analysts at Oxford Economics note "the surprise was the relatively tame increase in core prices. Within the core, a reversal in travel-rated categories including hotel, airfare and car rental prices helped lower reading". The consultancy also notes that although it is an encouraging report, "inflation pressures remain strong especially in the core services sector with by still buoyant increases in residential rent prices." Meanwhile, on the Fed OxEco look for 125bps of hikes this year and "still see 75bps as likely given still elevated inflation readings and ongoing tight labor market that is leading to large wage gains." However, they do acknowledge the July report could see the Fed downshift the size of its hikes to 50bps in September, something which the market is now leaning towards with an implied probability of just 35% for a 75bp move as opposed to 65% before the release.

FED: **Kashkari (2023 voter)** stated he is happier to see inflation surprised to the downside, but the Fed is “far far far” away from declaring victory on inflation, and Kashkari added the latest data does not change his rate hike path and expects rates at 3.9% by year-end and 4.4% by end of next year. On inflation, he reiterated the Fed is united about its commitment to get inflation down to 2%, and noted the idea of cutting rates early next year is not realistic. However, the

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Minneapolis President said it is much more realistic the Fed will raise rates and leave them there until inflation is well on its way to 2%. Lastly, Kashkari declared the US may be in a recession in the near future, but the risk of recession would not deter him from doing what is needed. **Evans (non-voter, departing)** said do not expect we are finished with rate hikes, and he expects FFR to be at 3.25-3.50% by year-end and at 3.75-4% by end of 2023 and to peak at 4%. On inflation, Evans added it will be challenging to bring inflation down and it is quite possible we will be able to tighten policy enough to bring inflation down and unemployment will only rise towards 4.25%. Additionally, regarding the economy, it is almost surely a little more fragile, but it would take something adverse to trigger a recession. Lastly, on the labour market, he added it is vibrant and employment is so strong and a sign of a still-strong economy.

FIXED INCOME

T-NOTE (U2) FUTURES SETTLED 8+ TICKS AT 119-24

Treasuries saw pronounced bull-steepening as soft CPI saw hawkish Fed bets unwind while approaching bond supply capped strength out the curve. At settlement, 2s -7.0bps at 3.216%, 3s -6.9bps at 3.147%, 5s -5.5bps at 2.925%, 7s -3.5bps at 2.864%, 10s -0.7bps at 2.790%, 20s +3.7bps at 3.281%, 30s +3.7bps at 3.042%.

THE DAY: Treasuries saw light activity in APAC and Europe Wednesday. After hitting lows of 119-13 at the London handover, T-Notes then bounced through the London morning to highs of 119-24+, only to pare back towards lows ahead of US CPI. The softer than expected CPI, on both headline and core metrics, saw Treasuries spike higher with hawkish Fed pricing receding. T-Notes hit session highs of 120-22 in wake of the data, compared to 119-12 where they sat pre-data. The move partially faded ahead of the 10yr auction, with 119-28 serving as support. The strong auction (more below) briefly restrained any further selling before resuming into settlement. Heading into settlement, Fed's Kashkari struck a hawkish tone noting the CPI data does not change his view on the rate path (3.9% by year end, 4.4% by end-2023). Attention now moves to Thursday's 30yr Bond auction, while we will also see PPI and jobless claims data.

10YR AUCTION: A solid USD 35bln new issue auction after the soft CPI in what marked the first stop-through (0.6bps) since February, with the 2.755% yield down from last month's 2.960% and the lowest since April. The 2.53x bid/cover ratio was better than the prior 2.34x and the avg. 2.50x. The breakdown was also solid with Dealers taking a meagre 9.9% (prev. 20.7% and avg. 14%) after a strong step up in Indirects participation to 74.5% from 61.3%. Note the 3yr on Tuesday also saw a strong Indirects bid, something to watch out for in Thursday's 30yr offering. 5yr BEI -4.4bps at 2.703%, 10yr BEI -2.0bps at 2.441%, 30yr BEI +0.2bps at 2.231%.

STIRS:

- EDU2 +8.0bps at 96.635, Z2 +8.0bps at 96.100, H3 +7.5bps at 96.140, M3 +5.5bps at 96.270, U3 +4.5bps at 96.505, Z3 +5.0bps at 96.705, H4 +6.0bps at 96.890, M4 +7.0bps at 97.050, U4 +7.0bps at 97.160, Z4 +7.0bps at 97.245, Z5 +5.5bps at 97.430.
- US sold USD 30bln of 119-day CMBs at 2.780%, covered 2.82x.
- NY Fed RRP op. demand fell to USD 2.178tln from 2.187tln.

CRUDE

WTI (U2) SETTLED USD 1.43 HIGHER AT 91.93/BBL; BRENT (V2) SETTLED USD 1.09 HIGHER AT 97.40/BBL

Crude prices were firmer Wednesday in line with broader risk sentiment after the soft US CPI report, although the upside was capped on the resumption of Druzhba pipeline flows and mixed US inventory data. The oil benchmarks initially rallied in the wake of the CPI report, but then sold off to see WTI and Brent front-months hit lows of USD 87.66/bbl and 93.63/bbl, respectively, on the resumption of Druzbha pipeline. However, the sustained pick-up in broader risk sentiment was contagious to the energy space and better buying developed into the NY afternoon - chunky draws in US gasoline stocks also helped.

US INVENTORIES: Crude stocks saw a 5.5mln bbl build, well above the expected +0.1mln and the private data which indicated +2.2mln, that was accompanied by US oil output rising to 12.2mln BPD, the highest since April 2020. The products were mixed, but net bullish, with gasoline stocks drawing 5mln against distillates building 2.2mln; refinery utilisation surged 3.3%. Headlines noted US gasoline exports rose to 1.13mln BPD, the highest since December 2018.

DRUZHBA: Transneft resumed flows via Druzhba's southern leg Wednesday after Ukraine confirmed it's ready to resume transit. That follows reports Tuesday that Russia suspended oil exports via the southern leg amid transit payment issues.

FREEPORT: US nat gas prices were buoyed by Reuters reports that Freeport LNG had retracted a force majeure - a notice to describe events outside a company's control which releases it from contractual obligations - that it initially declared in the wake of the explosion in June. The removal of the declaration leaves Freeport LNG and its LNG buyers - which include BP (BP/ LN), Total (TTE FP), Jera, Osaka Gas (9532 JT), SK Gas Trading (018670 KS), and Trafigura - "facing a collective loss of up to USD 8bln as they source alternative supplies at elevated spot market prices".

EQUITIES

CLOSES: SPX +2.10% at 4,209, NDX +2.85% at 13,378, DJIA +1.63% at 33,309, RUT +2.91% at 1,964.

SECTORS: Materials +2.87%, Consumer Discretionary +2.87%, Communication Services +2.77%, Technology +2.77%, Financials +2.31%, Industrials +2.21%, Real Estate +1.44%, Health +1.11%, Consumer Staples +0.74%, Energy +0.71%, Utilities +0.44%.

EUROPEAN CLOSES: Euro Stoxx 50 +0.91% at 3,749; FTSE 100 +0.25% at 7,507; DAX +1.23% at 13,700; CAC 40 +0.52% at 6,523; IBEX 35 +0.49% at 8,352; FTSE MIB +0.95% at 22,702; SMI +0.24% at 11,159

STOCK SPECIFICS: Elon Musk sold almost USD 7bln worth of **Tesla (TSLA)** shares over the past few days and he said he is done selling stock, but it was in the hopefully unlikely event that **Twitter (TWTR)** forces the deal to close and some equity partners don't come through. **American Airlines (AAL)** said it has taken delivery of a **Boeing (BA)** 787 - the first Dreamliner delivered since 2021 by the Co. **Oracle (ORCL)** extended AT&T (T) cloud agreement with a new five-year deal. **Tesla (TSLA)** is reportedly in talks with the Ontario government for a Canadian Gigafactory, according to InsideEVs. **Martin Marietta Materials (MLM)** raised its quarterly cash dividend to USD 0.66/shr (prev. USD 0.61/shr).

EARNINGS: **Coinbase (COIN)** were down as much as 5% pre-market since results Tuesday night, but since the aforementioned cooler-than-expected CPI report Bitcoin gained and as such COIN saw pronounced gains. Nonetheless, COIN posted a poor report, highlighted by a deeper loss per share than expected and missed on revenue. Moreover, volumes fell as the number of active traders declined during the quarter. Lastly, FY22 revenue guidance was also light. **Akamai (AKAM)** was bid after it beat on profit and revenue, but Q3 EPS and revenue guidance was light. **Wynn Resorts (WYNN)** reported a shallower loss per share than the St. consensus but missed on revenue as results in Macau continued to be pressured by COVID-related shutdowns. **Trade Desk (TTD)** surged after a revenue beat and Q3 revenue view topped expectations. Additionally, Co. said its performance gives it confidence that it can gain market share in any economic environment. **H&R Block (HRB)** firmed after it beat on EPS and revenue alongside raising FY guidance. Moreover, HRB raised its quarterly dividend by 7% to USD 0.29/shr and announced a new USD 1.25bln share buyback programme. **Roblox (RBLX)** saw losses in the wake of a deeper loss per share than expected and also missed on revenue. Additionally, bookings, a key sales metrics, also disappointed as they were down 4% Y/Y and with Average Bookings per DAU were down 21% Y/Y.

FX WRAP

The Dollar took a beating on Tuesday after the cooler-than-expected CPI report reigned in Fed expectations, with markets now leaning more towards a 50bps move in September rather than 75bps before the data, particularly as the core Y/Y matched last month's pace, supporting the peak inflation narrative. The Dollar collapsed after CPI to see DXY fall sub 105 to lows of 104.63 before returning to the round level. Fed's Evans spoke in wake of the data and he still sees rates peaking at 4.00% with the FFR between 3.75-4.00% by the end of 2023 (albeit he is departing early 2023 and a non-voter this year), while Kashkari (2023 voter) said the fed is "far, far, far away" from declaring victory on inflation while noting he is happier to see a downside surprise to inflation but it does not change his rate hike path and sees rates at 3.9% by year-end and 4.4% by end of 2023. When digesting the inflation report it is worth highlighting we will see the August CPI report before the September FOMC, as well as the July PCE and August NFP report, so all reports should be digested in order to help determine the Fed's reaction function.

The Euro was buoyed by the weaker dollar to see EUR/USD rise from 1.0203 at the lows to highs of 1.0368 before paring, but it did manage to stay comfortably above 1.03. The paring of Fed market pricing helped narrow the policy differentials between the US and EZ with markets nearly completely pricing in another 50bps move from the ECB in September, albeit their rates remain much lower than those in the US. Meanwhile, the final reading of HICP and CPI in Germany came in all as expected and unrevised, as did Italian CPI.

The Yen also found plenty of support from the cooler-than-expected US CPI print which sent both the Dollar and US yields tumbling, thus supporting the Yen in a similar vein to the Euro as the cooler CPI helped cool expectations of a more aggressive Fed to help narrow policy and yield differentials with the BoJ/Japan. **CHF** saw strong gains against the buck but also appreciated against the Euro while gold prices also surged but were well off highs heading into the close and ultimately failed to hold onto gains north of USD 1,800/oz.

Cyclical currencies also rallied finding tailwinds from the buck but also as the dovish CPI sent stocks flying. AUD reclaimed 0.7100 to a high of 0.7109 while NZD/USD was the outperformer rising from lows of 0.6276 to highs of 0.6434, seeing AUD/NZD fall sub 1.1050 from 1.1081 at the highs. GBP saw gains taking cable above 1.2250 from lows of 1.2066. BoE's Pill spoke on Wednesday where he said wage growth is running too fast while noting rising rates will only have an effect around the end of 2023, noting the threat of inflation psychology is much more acute in the UK and Europe than the US. On policy, he does not see the return of QE for at least the next few years. CAD also saw gains, albeit not as much as other cyclical crosses amid a choppy crude complex.

EMFX was stronger across the board due to the weaker Dollar with outperformance in ZAR which found tailwinds from gold prices. BRL saw decent gains primarily as a function of the Dollar while the latest Retail sales disappointed expectations. MXN was also bid ahead of the Banxico rate decision on Thursday, analysts expect a 75bps hike while Banxico's Heath on Wednesday stated they need to continue hiking rates in order to not have a neutral posture. CLP saw solid gains thanks to the gains in copper prices while COP was also buoyed as LatAm FX in general performed well. In CEE, NBH's Deputy Governor Virag said there is a very serious risk of a global recession in the Autumn and determined tightening must continue, warning inflation could rise until Autumn or the end of the year, adding double-digit interest rates are needed and all tools must be deployed against inflation. Meanwhile, the CNB said July CPI was smaller than expected in its summer forecast.