newsquawk

US Market Wrap

6th January 2023: Soft wage growth sees markets rejoice amid dovish Fed repricing

- **SNAPSHOT**: Equities up, Treasuries up, Crude flat, Dollar down.
- **REAR VIEW**: Headline NFP tops expected, unemployment rate falls, but wage growth slows; ISM Services tumbles; TSLA cuts Model Y & 3 prices in China; EU headline inflation falls but core rises; LUV expects net loss in Q4; Plethora of Fed rhetoric, but little new.
- **WEEK IN FOCUS**: Highlights include US & Chinese CPI, Chinese Trade, UK GDP and US Earnings Season. To download the report, please click here.

MARKET WRAP

Stocks and bonds surged Friday after the December US jobs report saw notable declines in wage growth, cooling inflationary fears and taking some of the hawkish onus off the Fed. The tumble in ISM Services not long after further supported the dovish reaction. There weren't any other major catalysts of note in the NY session, barring some Fed speaker rhetoric (nothing market moving), although inflationary concerns in Europe were piqued earlier on after the Core Eurozone inflation numbers came in hotter than expected. The jobs report wasn't all dovish, with above-expected headline job growth and the unemployment rate falling. But, participants latched onto the fall in hourly earnings growth and the notable downward revisions to the November figures, particularly after the angst created in wake of the prior report, so the market's bounce today is in part a reflection of that relief. Elsewhere, the Dollar saw a tumble off of multi-week highs, keeping commodities generally supported, although oil prices failed to hold on to the strength, ending the week near lows.

FED

Cook (voter) said inflation is "far too high" and "of great concern" despite recent encouraging signs; recent data suggest growth in worker compensation has "started to decelerate". Moreover, market rent data suggests housing inflation is to slow down; also cites improving supply chains and anchored expectations.

Barkin (non-voter) noted the Fed's more gradual interest rate path should limit harm to the economy, and it makes sense for the Fed to steer more deliberately on rates now to account for policy lags. On inflation, said the last two US reports are a step in the right direction, however, the median remained high. Concludes that the Fed is still resolute on inflation, and needs to stay on the case until inflation is "sustainably" back to the 2% goal.

Bostic (non-voter) said it needs a target rate above 5%, though "not a lot above" (FOMC Dec. median 5.1%), and he expects Fed to hold at a peak policy rate for an extended period, "well into 2024". On the jobs data, noted it does not change his outlook on the economy, affirming the need to stay the course as inflation is too high. Regarding the economy, the Atlanta Fed President noted recession is not his baseline and any recession would be short and shallow.

Evans (retiring, non-voter), via Timiraos’ Twitter, noted stepping the pace of hikes down to 25bps allows a little more time to let the data evolve, and you can still string them out. Suggesting that down-stepping to 25bps doesn’t mean that a pause is imminent.

George (retiring) noted renewed inflation pressures from energy and crop prices are a very real risk; how much additional policy tightening will be needed remains an essential aspect of Fed deliberations.

WSJ's Timiraos (non-voter) noted revisions to average hourly earnings data paint a marginally less worrisome picture for the Fed on wages than the Nov report. Timiraos later added Friday’s employment report does little to clarify how much the Fed will raise interest rates at its next policy meeting.

Goldman Sachs continues to expect 25bps Fed Funds Rate hikes each in February, March, and May; continues to expect no rate cuts in 2023.

US

NFP: The US non-farm payrolls report for December was mixed. Headline jobs added printed 223k, topping the expected 200k and the prior 256k, while the unemployment rate fell to 3.5% (exp. 3.7%, prev. 3.6%). As such, the solid employment growth with a fall in the unemployment rate will do little to appease the Fed in its progress towards reducing the tightness in the labour market. However, the softening in average earnings to 4.6% (exp. 5.0%, prev. 4.8%), and the chunky downward revisions to the prior, provide a near-term cushion for the inflation outlook. Meanwhile, the rise in labour force participation to 62.3% from 62.2% bodes well with the fall in the unemployment rate, particularly given some concerns over rising COVID/flu cases which some expected to take participants out of the labour force. Overall, Capital Economics notes the report for the Fed will probably keep it hiking at the next couple of meetings. But, the consultancy continues to expect weaker labour market conditions to push wage growth even lower soon, helping to reinforce the downward trend in core inflation already underway. On market pricing, before the jobs report a 25bps rate hike at the February meeting was 55% priced in, but has since risen to 73% priced, while the probability of a 50bps hike fell to 27%.

ISM SERVICES: ISM Services disappointed, highlighted by the headline falling into contractionary territory at 49.6, well beneath the expected decline to 55.0 and from November's 56.5. Business activity also slumped to 54.7 (exp. 59.5, prev. 64.7), while new orders and employment both dipped into contractionary at 45.2 (prev. 56.0) and 49.8 (prev. 51.5), respectively. On the inflationary front, prices paid encouragingly fell to 67.6 (prev. 70.0), but it still remains highly elevated. The report notes, “respondents indicated that supplier deliveries were faster in December, based on increased capacity and improved logistics. Employment contracted due to a combination of decreased hiring due to economic uncertainty and an inability to backfill open positions. The holiday season contributed to the continued growth in business activity, albeit at a slower rate.” Oxford Economics adds, "we remain quite a ways from a significant slowdown, while the price index showed a continued easing of inflation pressures, and supplier deliveries suggested improving supply chain conditions." Looking ahead, Oxford "looks for restrictive monetary policy and tighter financial conditions to constrain services sector activity, and as such don't think a soft landing is likely, but the latest economic data suggest there is a risk this scenario may play out."

FIXED INCOME

T-NOTE (H3) FUTURES SETTLED 1 POINT & 6+ TICKS HIGHER AT 114-07

Treasuries saw a massive bull steepener after the December jobs included meaningful cooling in wage growth metrics. 2s -20.1bps at 4.252%, 3s -22.6bps at 3.976%, 5s -21.0bps at 3.701%, 7s -19.4bps at 3.637%, 10s -16.6bps at 3.556%, 20s -12.5bps at 3.847%, 30s -12.1bps at 3.677%.

Inflation breakevens: 5yr BEI -2.6bps at 2.229%, 10yr BEI -1.5bps at 2.211%, 30yr BEI -0.5bps at 2.275%.

THE DAY: T-Notes traded in a fairly tight range ahead of NFP in light activity, peaking at 113-02+ at the Tokyo/London handover before selling in sympathy with EGBs after the hot core/super-core EZ inflation print, finding interim support of 112-25 later in the European morning. As the NFP data was released, the contracts briefly made session lows of 112-20+ before breaking out to the upside as the dust settled, with traders latching on to the meaningful declines in the average hourly earnings figures as a dovish development. The strength was being led by the front end as hawkish Fed pricing was dialled back, steepening the curve. T-Notes found interim highs of 114-06+ in the NY morning before stretching to fresh peaks in pre-settlement trade. Participants are now preparing for next week's 3y, 10yrdailled, and 30yr auctions, and more broadly, US CPI on Thursday.

STIRS:

- EDH3 +4bps at 94.91, M3 +9bps at 94.85, U3 +13.5bps at 94.98, Z3 +20.5bps at 95.34, H4 +27bps at 95.815, M4 +31bps at 96.26, U4 +32bps at 96.57, Z4 +31bps at 96.75, H5 +27.5bps at 96.83, H6 +21bps at 96.89, H7 +18.5bps at 96.795.
- Fed pricing for 25bps Feb hike ramps up to 75% implied probability, with implied terminal rate falling beneath 5%.
- NY Fed RRP op demand at USD 2.208tln (prev. 2.242tln) across 100 bidders (prev. 106).

CRUDE

WTI (G3) SETTLED USD 0.10 HIGHER AT 73.77/BBL; BRENT (H3) SETTLED USD 0.12 LOWER AT 78.57/BBL

Oil prices were choppy to end the week, with the Dollar selling post-US jobs report supporting commodities before unwinding later on. WTI and Brent front-month contracts made interim lows in the NY morning ahead of the NFP report, but late in the session hit further lows of USD 73.24/bbl and 78.05/bbl, respectively. Initially, the crude complex rallied to session highs of USD 75.47/bbl and 80.59/bbl after the dovish reaction post-jobs data, finding sympathy with stocks and tailwinds from the falling Dollar. Prices then meandered within ranges, and holding in the black, into the NY afternoon with energy catalysts on the light side, only to flirt back in the red in pre-settlement trade. On the week, prices are firmly in the red, with WTI down over USD 5/bbl and Brent seeing even greater losses of nearly USD 7/bbl.

US PRODUCTION: Motiva's Port Arthur, Texas refinery, the US' largest at 636k BPD capacity, was reported to be back in operation after the winter storm. Meanwhile, Lyondell's (LYB) Houston refinery (265k BPD) is operating at half capacity due to a coker outage, according to Reuters. Finally, the latest Baker Hughes rig count saw oil rigs -3 at 618, nat gas -4 at 152, leaving total rigs -7 at 772.

EQUITIES

CLOSES: SPX +2.28% at 3,895, NDX +2.79% at 11,040, DJIA +2.12% at 33,629, RUT +2.26% at 1,792.

SECTORS: Materials +3.44%, Technology +2.99%, Real Estate +2.87%, Consumer Staples +2.71%, Industrials +2.69%, Consumer Discretionary +2.4%, Financials +2.27%, Utilities +2.03%, Communication Services +1.72%, Energy +1.67%, Health +0.88%.

EUROPEAN CLOSES: EURO STOXX 50 +1.47% at 4,017, FTSE 100 +0.87% at 7,699, DAX 40 +1.20% at 14,610, CAC 40 +1.47% at 6,860, FTSE MIB +1.40% at 25,180, IBEX 35 +1.09% at 8,701, SMI +0.79% at 11,144.

STOCK SPECIFICS: **Tesla (TSLA)** cut prices on its Model 3 and Y by 13.5% and 10%, respectively, in China; also plans to cut prices of the same vehicles in Japan by as much as 9.9%. Additionally, Tesla was lowering prices in some markets outside of China too, with the view of supporting plant output. **Southwest Airlines (LUV)** cut its outlook due to weather and cancellations; now expects to report a net loss in Q4. Sees Q4 pre-tax negative impact in a range of USD 725-825mln and it cancelled more than 16,700 flights between December 21st to 31st. **Costco (COST)** reported solid December comparable sales; +7.3% Y/Y (exp. +5.0%). **World Wrestling Entertainment (WWE)** controlling shareholder Vince McMahon elected himself executive chairman, in a bold return after a sexual misconduct scandal. **Fate Therapeutics (FATE)** declined a proposal from **Johnson & Johnson (JNJ)** unit Janssen Biotech for a continuation of the collaboration and option agreement; as a result, the agreement has been terminated and all collaboration activities will be wound down in Q1 '23. Following this, there has been a plethora of broker downgrades for the Co. Solar names such as **First Solar (FSLR)**, **Sunnova Energy (NOVA)**, **SunPower (SPWR)**, and **Sunrun (RUN)** were upgraded at Wells Fargo. The bank cited an improved regulatory backdrop in 2023 and long-term tailwinds, including ESG mandates and government and corporate de-carbonization goals. **Silvergate Capital (SI)** was downgraded at JPMorgan; cited the Co.'s worse-than-expected deposit outflows and questions the company's long-term profitability. **Qualcomm (QCOM)** is the biggest winner of Apple's cancellation of 2024 iPhone SE 4, according to TF International Securities analyst Ming Chi Kuo. Republican McCarthy's emerging speaker deal is seeking a USD 75bln defence spending cut. Of note for defece names such as **Lockheed Martin (LMT)**, **Northrop Grumman (NOC)**, **General Dynamics (GD)**, and **Raytheon (RTX)**. Eisai and **Biogen (BIIB)** received FDA approval of Leqembi for the treatment Alzheimer's disease. **McDonald's (MCD)** is planning to make "difficult" decisions about changes to its corporate staffing levels by April, as part of a broader strategic plan for the burger chain, according to WSJ.

WEEKLY FX WRAP

Buck rattled by mixed BLS metrics and roiled by weak services ISM

USD - A holiday-shortened start to 2023, but no lack of volatility given several key data points, FOMC minutes and further progression towards a full removal of zero-Covid restrictions in China. The Dollar remained depressed as financial centres returned from extended New Year breaks in staggered fashion before bouncing firmly on bullish macro fundamentals rather than accounts of the Fed's December policy meeting even though they were deemed to be hawkish. Using the DXY for reference, the index was down at 103.440 on Monday and held fractionally above the next day to give the Greenback a platform to build recovery momentum with impetus from an unexpected rise in US construction spending. However, FOMC minutes failed to add fuel even though no participants anticipated that rate cuts would be appropriate in 2023, in contrast to market pricing, and drops in October and November inflation were welcome, but it will take 'substantially more evidence' of progress for the Fed to be confident of a sustained downward path in prices, and there is caution about an 'unwarranted' easing in financial conditions. Instead, hot NFP proxies in the form of Challenger Layoffs and ADP gave the Buck another boost, not to mention weekly jobless claims as a more timely snapshot of the labour market, and the DXY peaked at 105.630 just ahead of payrolls in anticipation of another upbeat report only to be deflated by the overall outcome. Specifically, the headline beat was offset by a negative net two month revision and an unexpected decline in the unemployment rate was overshadowed by softer average earnings. The Dollar retreated broadly and the DXY lost 105.000+ status, but any real attempt to regroup was thwarted by a pretty bleak services ISM survey, in headline and sub-component terms. Indeed, the Greenback did not respond positively to hawkish comments from Fed's Bostic or Cook, as the cooling in wages and prices paid underpinned the peak inflation narrative and supported the theory that the Fed will pivot further towards flagging growth to try and engineer a soft landing, when it sees more slack in the labour market.

NZD/AUD/GBP - As is often the case, high betas and cyclicals suffer most when risk sentiment reels to the benefit of the Buck and other safe-havens, so have more to gain when the boot is on the other foot, and Friday was no exception to the rule as the Kiwi rebounded from sub-0.6200 levels, the Aussie from under 0.6750 and Pound from new lows since last November circa 1.1842. Nevertheless, Aud/Nzd remained elevated on the 1.0800 handle amidst Aud/Usd outperformance approaching 0.6900 at best in correlation with the Yuan appreciating markedly on the Chinese reopening wave with extra vigour via strong PBoC midpoint fixes and measures aimed at propping up the ailing real estate sector. Conversely, Sterling lagged as the UK's winter of strike action continued and the cost of living crisis merely compounded the gloom.

EUR/CAD/JPY/CHF - All taking advantage of their US rival's downturn (not helped by weaker than anticipated factory orders by the way), with the Euro back on the 1.0600 handle having ducked beneath 1.0500 following some cooler and well below consensus Eurozone inflation data that embellished the sharp retracement in EGB yields and tempered ECB rate hike expectations, irrespective of 'guidance' from most GC members retaining a hawkish slant. Elsewhere, the Loonie got a late boost to carve out new weekly peaks around 1.3450 compared to 1.3685 at the other end of the spectrum from a blow-out Canadian LFS as the employment change topped 100k against a paltry 8k forecast and the jobless rate slipped to 5%, while the Yen stopped the rot following a slump from peak to trough between 129.51 and 134.77 extremes as Treasuries snapped back up to converge with JGBs and unwind some renewed BoJ/Fed divergence. On that note, Governor Kuroda stuck to dovish intentions and sourced reports suggested that there is no urgency to make more marked YCT adjustments. Meanwhile, the Franc largely followed external moves after narrowly mixed Swiss CPI readings, with Usd/Chf veering from 0.9231 to 0.9409.

SCANDI/EM - China and the Yuan aside, Rand fortunes were in tandem with Gold that topped near Usd 1865/oz and panned close to Usd 1824, but the biggest independent and negative factor arrived earlier in the final session of the week via reports that SA's ruling ANC party is looking to alter the SARB's mandate having previously proposed a Fed-like dual remit targeting inflation and employment. Conversely, the Real pared losses amidst promises by various new Government officials appointed by President Lula to adopt fiscal restraint, the Peso, Forint and Koruna were underpinned by hawkish Banxico. NBH and CNB minutes, with Huf also crossing 400.00 and key chart resistance against the Eur, while the Pln gleaned traction from the NBP's accompanying statement following no change in rates.