US Market Wrap

12th January 2023: Doves rejoice as softer CPI cements expectations for smaller Fed hikes.

- **SNAPSHOT**: Equities up, Treasuries up, Crude up, Dollar down.
- **REAR VIEW**: US CPI falls largely as expected, but shelter holds firm; Harker favours 25bps in Feb, but warns the path to 2% will not be easy, as does Bullard and Barkin; Strong 30yr auction; Very strong AAL update; Mixed China inflation report
- **COMING UP**: **Data**: Chinese Trade Balance, UK GDP, US Export/Import Prices **Event**: ECB TLTRO Repayment Amount Publication **Speakers**: Fed's Williams, Harker & Kashkari **Earnings**: United Health, Blackrock, Bank of New York Mellon, Bank of America, JPMorgan, Wells Fargo & Citi.

MARKET WRAP

Stocks and bonds were firmer on Thursday after the third consecutive decline in CPI took 25bps at the February FOMC to a near certainty and took hawkish pressure off of the Fed. The decline in Y/Y CPI to 6.5% from 7.1%, with the M/M CPI even printing a surprise 0.1% decline, was mainly a result of falling energy and goods prices, with Core Services remaining higher as shelter inflation rose +0.8% M/M, but, many are willing to look past that given the CPI inflation data is seen lagging to signs that shelter price inflation is starting to moderate. Gains in stocks were most evident in the small-cap Russell 2k index, with easier Fed policy, the softer Dollar, and reduced hard landing chances supporting stocks levered to the real economy, while the SPX and NDX could only muster modest gains in comparison. Treasuries rallied through the session, with a solid 30yr auction helping duration close at highs and re-flattening the curve after initial bull-steepening post-CPI. The DXY fell through 103 to lows just north of 102, while USD/JPY tumbled to lows of 128.88, where it hasn't traded in over six months. Commodities/energy were supported via the softer Dollar.

US

CPI: December CPI fell 0.1% M/M, against expectations for no change after November's 0.1% increase.; the Y/Y figure fell to 6.5% from 7.1%, as expected. The Core M/M rose 0.3% vs November's 0.2% rise, as expected, and the Y/Y Core fell to 5.7% from 6%, as expected, confirming the third consecutive drop to the lowest level since December 2021. The internals were mixed with a notable pick up in services inflation, something the Fed has touted as being more 'sticky' than the declining goods inflation. However, the main driver in the services inflation was the 0.8% M/M increase in shelter inflation (which includes rent), which many, including Fed's Harker (voter), are eager to look past as backwards looking given "lower shelter costs take time to show in inflation data", with leading indicators pointing to a softening. Analysts at Capital Economics conclude, "this latest report adds more weight to our view that CPI inflation will fall more rapidly than the Fed expects this year. But the Fed isn’t going to stop raising interest rates until it sees accompanying evidence of an easing in labour market conditions and wage growth. It will be a couple more months before that evidence is also irrefutable."

FED

Harker (voter) said it is time for future hikes to shift down to 25bps but the Fed is likely to hike rates a few more times in 2023, expecting the Fed to get rates just over 5% and then hold. Once hikes end, said the Fed will need to hold steady for a bit but the worst of the inflation surge is now likely over and the labour market remains in excellent shape. Harker also said he remains concerned about commercial real estate. On inflation, Harker said he sees signs of moderating shelter price inflation, noting lower shelter costs will take time to show in the inflation data. That remark was particularly dovish in wake of the Dec. CPI shelter component being the biggest upward pressure on core CPI, with Harker telling us to look past that here. In terms of his forecasts, Harker said Core inflation will likely moderate to 3.5% in 2023 and hit the 2% target in 2025 (Dec. SEP median 3.5% in 2023 and 2.1% in 2025). He sees GDP slowing to 1% this year (Dec. SEP median at +0.5%), but not a recession. Meanwhile, Unemployment is likely to tick up to 4.5% this year from the current 3.5% rate before falling back to 4% over the next two years (Dec. SEP median 4.6% in both 2023 and 2024, and 4.5% in 2025).

Bullard (non-voter) maintained his view that he likes front-loading policy and doesn't see a purpose in dragging things out, perhaps signalling he would prefer 50bp in Feb (but he is a non-voter). Bullard also reaffirmed his view that

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something north of 5% is the lowest level the Fed could use to credibly restrict inflation, and his own preference is for getting north of 5%. On inflation, he said it remains extremely high, even after the December data, noting it is still well above target but it is moderating. The report was also encouraging and a sign we are heading in the right direction. However, Bullard did acknowledge core CPI has not moderated as much as the headline, while there is possibly too much optimism that inflation will come easily back down to 2%. The St Louis Fed President also said the most likely scenario is that the inflation number will remain above 2% and so the policy rate will need to be higher for longer. Although he does expect inflation to move down going forward, adding Fed policy has been the right one. Bullard also noted the prospects of a soft landing have improved and it looks like we had an above-trend rate of economic growth in Q4, as well as H2 22. Households still remain flush which should support household spending this year.

Barkin (non-voter) said the last three months of inflation prints have been a step in the right direction but is cautious that while the average has dropped, the median remains high. Barkin added the recession fears have been reduced, but inflation is still too high and the Fed has work to do, reiterating it makes sense to steer more deliberately as the Fed works to bring inflation down. With forward-looking real rates now positive across the curve, he favours moving more deliberately. The Richmond Fed President added "in concept" he is supportive of a rate path that is slower but longer and potentially higher. He said clearly sectors like used cars are past the inflation peak, but others are still under pressure. Believes we are going to continue to see wage pressures through the first quarter, though have the impression the labour market is easing. Barkin also warned that inflation is likely to prove more persistent than a "simple" drop to 2%, echoing Bullard's cautiousness.

FIXED INCOME

T-NOTE (H3) FUTURES SETTLE 25+ TICKS FIRMER AT 115-07+

Treasuries rallied across the curve with the fall in Dec. CPI increasing bond allure whilst simultaneously taking pressure off the Fed. At settlement, 2s -8.8bps at 4.141%, 3s -10.9bps at 3.816%, 5s -12.1bps at 3.549%, 7s -11.4bps at 3.503%, 10s -10.3bps at 3.453%, 20s -10.0bps at 3.748%, 30s -10.0bps at 3.581%.

Inflation breakevens: 5yr BEI +1.3bps at 2.252%, 10yr BEI -1bps at 2.211%, 30yr BEI -2.2bps at 2.264%.

THE DAY: T-Notes saw mild gains during APAC and the London morning, marking a double top at 114-22. The contracts managed to eclipse the Monday/WTD peak of 114-23+ in the run-up to the US CPI figures. As the numbers crossed, T-Notes knee-jerked lower from 114-24 to session lows of 114-00 before swiftly reversing to the upside, finding resistance at 115-07+ around 30 minutes later, although the front-end was leading the strength as Fed pricing eased, particularly after Harker (voter) came out to cement his call for a 25bps hike in February. The 2s10s spread topped out at -62bps in the NY morning, the highest since Jan. 3rd. However, the curve unwound its steepening into the afternoon as the long-end advanced into the 30yr auction, which saw a large demand reception despite the lack of concession, seeing T-Notes find session peaks of 115-11+ right after, with 2s10s back at -69bps. It's also worth highlighting that Fed's Bullard (non-voter) and Barkin (non-voter) after Harker in a more hawkish tone, eager to remind markets that it won't be a linear path back to 2%, supporting the re-flattening of the curve in the afternoon.

30YR AUCTION: The USD 18bln 30yr reopening was sold at 3.585%, marking a big 2.4bps stop-through, a marked improvement from the prior 3.1bps tail and the six-auction avg. 0.2bps stop-through. The 2.45x bid/cover ratio sits above the avg. 2.37x. The takedown was solid with Dealers (forced surplus buyers) left with just 9% after a record Indirects participation of 74.6% (avg. 69.4%). Overall, another solid offering from the Treasury, marking a home run for the week after the strong 3yr and 10yr offerings, with the fall in Dec. CPI giving additional allure to today's offering.

REFUNDING: US to sell USD 17bln of 10yr TIPS on Jan. 19th and USD 12bln in 20yr bond reopening on Jan. 18th, both to settle on Jan. 31st. In bills, US to sell USD 60bln of 3-month bills (raised from 57bln) and USD 48bln of 6-month bills (unchanged) on Jan. 17th, both settling on Jan. 19th.

STIRS:

- EDH3 +4.5bps at 94.965, M3 +3.5bps at 94.90, U3 +3.5bps at 95.05, Z3 +5bps at 95.445, H4 +8bps at 95.975, M4 +10.5bps at 96.445, U4 +9bps at 96.73, Z4 +9bps at 96.875, H5 +10bps at 96.945, H6 +12bps at 97.01, H7 +12.5bps at 96.915.
- NY Fed RRP op demand at USD 2.203tln (prev. 2.199tln) across 101 bidders (prev. 99).
- US sold USD 61bln of 1-month bills at 4.370%, covered 2.76x; sold USD 56bln of 2-month bills at 4.465%, covered 2.73x; sold USD 60bln of new 35-day CMBs at 4.490%, covered 2.45x.

CRUDE

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WTI (G3) SETTLED USD 0.98 HIGHER AT 78.39/BBL; BRENT (H3) SETTLED USD 1.36 HIGHER AT 84.03/BBL

Oil prices rallied on Thursday as the Dollar tumbled and growth conditions improved as the cooling inflation data keeps a "soft landing" in play. The upside in energy prices gained momentum in the London morning in lack of an obvious catalyst with Dollar weakness and broader risk appetite cited by desks. Energy-specific newsflow was thin today, leaving prices susceptible to the broader macro conditions, which saw WTI and Brent front-month futures print peaks of USD 79.16/bbl and 84.62/bbl, respectively, in wake of the softening in US CPI, finding support from the tumble in the Dollar, in addition to the improved likelihood of a soft landing. The benchmarks go into the end of the week at session peaks, unwinding most of the losses seen last week.

EQUITIES

CLOSES: SPX +0.34% at 3,983, NDX +0.50% at 11,460, DJI +0.64% at 34,189, RUT +1.74% at 1,876.

SECTORS: Energy +1.87%, Real Estate +1.09%, Communication Services +0.83%, Technology +0.72%, Industrials +0.57%, Materials +0.32%, Financials +0.23%, Consumer Discretionary +0.17%, Health Care -0.39%, Utilities -0.64%, Consumer Staples -0.79%.

EUROPEAN CLOSES: EURO STOXX 50 +0.66 at 4,127, FTSE 100 +0.89% at 7,794, DAX 40 +0.74% at 15,058, CAC 40 +0.74% at 6,976, FTSE MIB +0.73% at 25,734, IBEX 35 +1.17% at 8,828, SMI +0.31% at 11,281

AAPL: **Apple Inc. (AAPL)** is reportedly working to add touch screens to its Mac computers for the first time, which co-founder Steve Jobs once called "ergonomically terrible," Bloomberg reported. Elsewhere, TF International Securities Analyst Ming Chi Kuo wrote the next-gen AirPods will likely begin mass shipments in H2 24 or H1 25. Meanwhile, reports on DigiTimes suggest "Shipments of the Apple MacBook will likely drop 40-50% sequentially in the first quarter of 2023, according to sources in the supply chain for the notebook series."

STOCK SPECIFICS: Activist Trian Fund Management, which owns around 9.4mln **Disney (DIS)** shares, will nominate its CEO Nelson Peltz to Disney's Board. Disney said it does not endorse Trian's nominee and recommends shareholders do not support the nomination and instead vote for all of Disney's nominees. **Marvell Technology (MRVL)** appointed Willem Meintjes as CFO, following the resignation of Jean Hu, who will join **AMD (AMD)** as CFO following the retirement of Devinder Kumar. MRVL also narrowed its Q4 revenue outlook to USD 1.4bln +/- 3% (exp. 1.4bln, prev. guidance was for +/- 5%). **Logitech (LOGI)** Q3 revenue view missed expectations while it also cut its FY23 revenue view to -15 to-13% (prev. -8 to -4%). **TSMC (TSM)** reported solid earnings, but gave a mixed outlook; Q4 22 (TWD) net profit 295.9bln (exp. 289.4bln), revenue 625.5bln (in line with the prelim. update). Guides Q1 revenue between TWD 16.7bln-17.5bln (exp. 16.4bln), and sees H1 revenue down mid-to-high single-digit percentage. CapEx view for 2023 was cut. **Tesla's (TSLA)** Shanghai plant expansion has reportedly been delayed due to data concerns, according to Bloomberg citing sources. Meanwhile, reports in InsideEVs reported Elon Musk is to prioritise Tesla over Twitter, citing an internal email. **American Airlines (AAL)** posted a very strong update: Q4 22 view (USD) EPS 1.12-1.17 (exp. 0.60), revenue view +16-18% vs Q4 19 (prev. +11-13%). CASM-ex to be +10% vs prior guidance of +8-10%. Total revenue per ASM expected to be +24% vs Q4 19. **Las Vegas Sands (LVS)** announced it intends to pursue the development of a multi-billion dollar casino project on Long Island, New York. **KB Homes (KBH)** earnings were very weak, missing on EPS and revenue while homes delivered and net orders also missed analyst expectations. **WWE (WWE)** is reportedly looking to sell the company by mid-2023, according to F4Wonline. **Goldman Sachs (GS)** CEO Solomon is reportedly contending with a mini uprising from partners who are at odds with his management, the board is behind him for now but that could change if anti-Solomon sentiment grows, according to FBN's Gasparino. A **Google (GOOGL)** Cloud spokesperson said the media article on top US sales executives departing is "inaccurate". **Eli Lilly (LLY), Sanofi (SAN FP), and Novo Nordisk (NOVOB DC)** have all reportedly been sued by California over insulin prices, according to Bloomberg. **Nike (NKE)** CEO said they are seeing continued strong consumer demand for the co.'s products and brands. **Google (GOOGL)** and **Nvidia (NVDA)** have joined **Sony (6758 JT)** in raising concerns about the **Microsoft (MSFT)/Activision (ATVI)** deal, according to Bloomberg. **Warner Brother Discovery (WBD)** is reportedly exploring a sale of its music library that could be valued at over USD 1bln, according to FT, who add the sale would be to pare its debt.

US FX WRAP

The Dollar sold off hard on Thursday after a choppy reaction in wake of the CPI release. The Dec. CPI was in line overall with expectations, although the headline M/M printed a surprise decline of 0.1% despite expectations for an unchanged print. Market expectations, and Fed rhetoric so far, has now started to cement expectations for another downshift in February to a 25bp hike from the 50bp hike seen in December. However, the Fed is still talking of "a few more" rate hikes taking the FFR to at least 5.00-5.25%. Markets, however, are pricing in a terminal rate of 4.85-5.00%

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with the latest inflation data adding strength to the market's case that the inflation peak is behind us, although the Fed are reluctant to declare victory on inflation, despite welcoming the three consecutive months of slowing CPI readings. DXY lost hold of 103.00 and found support at 102.00.

The Euro reaped the benefit of the softer buck taking EUR/USD above 1.08 and 1.0850 to highs of 1.0866 on Thursday before returning to the 1.0850 handle. Note, the latest ECB Consumer Expectations survey saw a decline in the inflation forecasts to 5% over the next 12 months, down from 5.4% previously, while the 3yr was lowered by 0.1% to 2.9%. Meanwhile, there was an Econostream article citing an insider at the ECB that the stronger-than-expected EZ economy favours the council hawks.

The Yen surged, taking USD/JPY from highs of 132.48 overnight to lows of 128.88 in the US afternoon, troughs not seen in over six months. The USD/JPY selling kicked off during APAC trade on reports the BoJ is to review the side effects of massive monetary easing at its policy meeting next week. The review is reportedly due to skewed interest rates in markets despite the widening of its YCC policy band in December, according to Yomiuri. The article supported the Yen at the time while the fall in CPI and cementation of 25bps in Feb. for the Fed gave even further support to the Yen on the narrowing policy differentials between the BoJ and Fed with the former appearing to back away from super easy policy, while the market expects the Fed to be more dovish than the central bank is leading on.

Cyclical currencies were supported by the weaker Dollar and gains in US equity prices but the Aussie outperformed alongside gains in copper while there were some hefty swings in the antipodeans around the US CPI data with AUD /USD finding a high of 0.6984, before reversing, and then again gradually returning to highs as US trade progressed. The Aussie outperformed its Kiwi counterpart with AUD/NZD rising above 1.09 briefly before returning to just beneath the round level supported by a wider trade surplus in November than expected and the prior month. The Pound firmed against the Dollar but not the Euro, Cable reclaimed 1.22 but failed to reach 1.2250 while EURGBP found resistance at 0.8900. On Brexit, Bloomberg reported the UK and EU are preparing to enter an intense phase of negotiations from next week, according to sources, who note the aim of this is to move into the negotiating "tunnel", ahead of the April N. Ireland agreement anniversary. However, Ireland said the EU is not in a Tunnel while the UK did not want to set a deadline as there will still be significant issues. USD/CAD fell sub 1.3340 as the Dollar tumbled while firmer crude prices only supported the Loonie.

The Yuan (both onshore and offshore) firmed against the Dollar as the reserve currency dominated price action with a mixed inflation picture in China after M/M CPI printed hotter than expected at 0.0% while Y/Y was in line at 1.8%, while PPI data was much cooler than expected. Elsewhere, the PBoC set the USD/CNY mid-point at 6.7688-, firmer than the expected 6.7698 and prior 6.7756. There were also Axios reports that the US is leaning towards narrowing its executive order on US investments in China, which if confirmed, would be an incremental thawing in Sino-US relations.

EMFX was also supported by the weaker buck with BRL and ZAR outperforming while TRY lagged, sitting flat. In Brazil, Finance Minister Haddad announced a tax debt renegotiation programme, offering instalments, discounted fines, and interest; expects to increase 2023 revenue by BRL 50bln with the programme and the whole package is expected to take the 2023 primary deficit of BRL 232bln to a BRL 11bln surplus. ZAR was supported by the jump in gold prices while TRY was hampered by the gains in crude prices. In CEE, CZK was flat vs the stronger Euro while CNB's Frait noted it would be cautious to promise that rates will begin falling soon. PLN was marginally weaker vs the Euro, NPB's Kotecki said there is no room for rate cuts in 2023, although NBP's Dabrowski said markets are not necessarily wrong when pricing in rate cuts for the end of 2023.

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