US Market Wrap

17th January 2023: Dovish ECB sources clouded by hawkish BoJ risk

- **SNAPSHOT**: Equities mixed, Treasuries steepen, Crude up, Dollar flat/up.
- **REAR VIEW**: ECB set to slow hike pace to 25bps in March; Dismal NY Fed mfg; Fed's Barkin does not want to pause too soon; China data better-than-feared; Strong UK employment; German ZEW beats; GS profit miss; Strong MS report.
- **WEEK AHEAD**: Highlights include US retail sales, ECB minutes. To download the report, please click here.
- **CENTRAL BANK WEEKLY**: Previewing BoJ, ECB minutes, Norges Bank, PBoC LPR, CBRT; reviewing BoK. To download the report, please click here.
- **WEEKLY US EARNINGS ESTIMATES**: PNC, PLD, SCHW, TFC, PG, NFLX, SLB. To download the report, please click here.

MARKET WRAP

Stocks indices were little changed on Tuesday with earlier strength on ECB dovishness proving fleeting. Bloomberg sources that the ECB is likely to step down to 25bps in March after a 50bp hike in Feb was enough to catalyse a market-wide dovish reaction in the NY morning, although momentum failed to sustain. Treasuries steepened amid the ECB sources, but also after the dismal NY Fed mfg. survey, with the long-end pressured and failing to hold strength ahead of the BoJ meeting and 20yr bond auction on Wednesday. Better than feared China output data, a strong German ZEW survey, and beats on UK employment data all added to the duration headwinds ahead of US retail sales and PPI event risks on Wednesday. In FX, the mild Dollar upside was underpinned by Euro selling after the ECB sources while Yen strengthened into the BoJ. Oil prices unwound strength in the NY session, which was initially underpinned by strong global data. Copper prices were buoyed in wake of Reuters reports that Glencore's (GLEN LN) Antapaccay copper mine in Peru is operating at restricted capacity amid anti-government protests. Bank earnings were mixed with Goldman Sachs (GS) missing on profit while Morgan Stanley (MS) prospered thanks to a strong wealth management unit.

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NY FED: The NY Fed's Empire mfg. survey tumbled to -32.9 in January from -11.2 in December, well beneath the consensus -9 and marking the lowest level since mid-2020 and the fifth worst reading in the survey's history. 11% of participants reported an improvement in conditions vs. 44% that reported a deterioration. The new orders sub-index dived -31.1 from -3.6, with the shipments index falling twenty-eight points to -22.4, "pointing to a steep decline in both orders and shipments." A positive was the dip in prices paid to +33 from +50.5, with considerable moderation reported in input price growth, albeit selling prices also moderated. The employment index fell to +2.8 from +14.0, the lowest in more than two years, "signaling that employment growth stalled. The average workweek index remained negative at -10.4, indicating a decline in hours worked." Overall, a grim growth reading from the first regional manufacturing survey of the month, which, if replicated elsewhere (Philly Fed survey on Thursday), sets up for a weak nationwide ISM print on February 1st. Although it's worth a caveat that the NY Fed survey is historically volatile.

FED

BARKIN (non-voter) said his hope is that we have seen the peak in inflation, but repeated that median CPI is still too high. Said he needs to see inflation convincingly back to target before Fed pauses rate hikes, noting he is not in favour of backing off too soon. Barkin said the terminal rate will depend on the path of inflation, while as long as inflation stays elevated, the Fed needs to hike.

WSJ SURVEY: The WSJ survey of 70 economists: 26 see the Fed's policy rate rising to between 4.75% and 5% by the end of June, 29 see the rate rising to between 5% and 5.25%, and six see the rate rising to between 5.25% and 5.5%. Six expect the Fed to keep raising rates in the second half of the year. 39 expect the Fed to hold rates steady in the second half of 2023. 31 anticipate one rate cut between July and December.

FIXED INCOME

T-NOTE (H3) FUTURES SETTLE 3 TICKS LOWER AT 114-21+

Treasuries steepened on Tuesday amid dovish ECB sources and a dismal NY Fed mfg. survey. 2s -4.3bps at 4.198%, 3s -3.4bps at 3.867%, 5s -0.3bps at 3.611%, 7s +1.6bps at 3.580%, 10s +2.7bps at 3.538%, 20s +2.1bps at 3.812%, 30s +2.7bps at 3.650%.

Inflation breakevens: 5yr BEI -2.2bps at 2.223%, 10yr BEI -2.0bps at 2.164%, 30yr BEI -0.6bps at 2.202%.

THE DAY: Treasuries saw gradual selling out of APAC and through the European morning, with beats in China output data, UK employment, and the German ZEW survey weighing as US participants return from the long weekend with some additional hawkish anticipation ahead of the BoJ. T-Notes made session lows at 114-09+ before recovering in wake of the tumble in the NY Fed Empire mfg. survey. Further volume buying was seen in wake of the Bloomberg sources that the ECB is looking at reducing its hike increment in February, leading T-Notes to session highs of 114-29+, also a WTD high/double-top from Monday. The futures then pared to little changed come the NY afternoon, holding there into the settlement, albeit the front-end held on to gains as the curve steepened. Wednesday's 20yr bond auction was likely a factor in the long-end underperformance also. Looking ahead, BoJ is next up ahead of a busy US Wednesday with highlights being the 20yr auction, retail sales, and PPI, with Fed Speak in the backdrop, albeit Brainard on Thursday looks to be the speaker of interest this week ahead of the blackout from Saturday.

STIRS:

- EDH3 +1bps at 94.97, M3 +3bps at 94.905, U3 +5.5bps at 95.035, Z3 +6bps at 95.40, H4 +7.5bps at 95.935, M4 +8bps at 96.405, U4 +7bps at 96.70, Z4 +5.5bps at 96.84, H5 +3.5bps at 96.91, H6 flat at 96.96, H7 -2bps at 96.845.
- NY Fed RRP op demand at USD 2.093tln (prev. 2.180tln) across 103 bidders (prev. 103).
- US sold USD 66bln of 3-month bills at 4.560%, covered 2.69x; sold USD 53bln of 6-month bills at 4.685%, covered 2.68x.
- US to sell USD 70bln of 1-month bills (prev. 60bln), USD 60bln of 2-month bills (prev. 55bln), and USD 60bln in new 44-day CMBs on Jan. 19th, to sell USD 36bln of 17-week bills (unchanged) on Jan. 18th, all to settle on Jan. 24th.

CRUDE

WTI (G3) SETTLES USD 0.32 HIGHER AT 80.18/BBL; BRENT (G3) SETTLES USD 1.46 HIGHER AT 85.92/BBL

Oil prices pared from highs in the NY session after earlier strength came after Chinese growth data came in better than feared. China's Q4 GDP fell less than feared, while industrial output growth for December also fell a lot less than feared, with oil throughput on the month hitting its second-highest level of the year. The oil strength grew out of the APAC session and further through Europe with stronger-than-expected German ZEW survey and UK employment data adding to the demand optimism. WTI and Brent front-month futures hit highs of USD 81.23/bbl and 86.77/bbl in the NY morning before paring into settlement. Note, the weekly US energy inventory data (both private and EIA) is delayed by a day due to the holiday-shortened week. Finally, WTI February options expire Tuesday, with futures open interest now moving into the WTI March contract.

SUPPLY: Reuters reported Russian exports of Urals oil blend from the Baltic Sea between Jan. 1st-15th have risen by 35% to 3.1mln T from 2.3mln T between Dec. 1st-15th, and within that, Asian exports have risen to 2.8mln T from 2.2 mln T. Elsewhere, Reuters reported the new CEO of Venezuela's PDVSA has suspended most contracts to export crude and fuel until revisions of contracts are completed. The freeze is reportedly leading to port delays amid vessels being sent away and awaiting new directions; it's not clear how long the freeze will last.

EQUITIES

CLOSES: SPX -0.20% at 3,990, NDX +0.14% at 11, 557, DJIA -1.14% at 33,911, RUT -0.15% at 1,884.

SECTORS: Technology +0.44%, Energy +0.12%, Real Estate +0.08%, Consumer Discretionary +0.07%, Consumer Staples 0.00%, Utilities -0.12%, Health Care -0.5%, Financials -0.58%, Industrials -0.84%, Communication Svs. -0.92%, Materials -1.07%.

EUROPEAN CLOSES: EURO STOXX 50 +0.42% at 4,174, FTSE 100 -0.12% at 7,851, DAX 40 +0.35% at 15,187, CAC 40 +0.48% at 7,077, FTSE MIB +0.31% at 25,981, IBEX 35 +0.22% at 8,890, SMI -0.17% at 11,416.

EARNINGS: **Goldman Sachs (GS)** missed on EPS and revenue, noting significantly lower revenue in the Asset and Wealth Management unit. IB revenue beat, Equities S&T in line, while FICC beat. **Morgan Stanley (MS)** EPS and revenue beat expectations, although expenses were higher than forecast, NII missed although it said it does not believe NII has peaked. Revenue breakdown was weak although it was offset by a strong quarter in Wealth Management and decent IB revenue.

M&A: **Microsoft (MSFT)** is likely to get an EU antitrust warning over its USD 69bln acquisition of **Activision Blizzard (ATVI)**. Note, MSFT was also downgraded to sell from neutral at Guggenheim. **Emerson (EMR)** announced a premium all-cash proposal to acquire **National Instruments (NATI)** for USD 53/shr. Ineos's Jim Ratcliffe has reportedly entered the bidding process to buy **Manchester United (MANU)**, according to The Times. **CVS Health (CVS)** isn't likely to buy **Oak Street Health (OSH)**, according to analysts, bankers and advisers speaking to Axios. **Whirlpool (WHR)** announced it is to divest most of its businesses across Europe, the Middle East and Africa as part of its strategic review. Raised FY22 adj. EPS view to about 19.25-19.00 (exp. 19.03). Cut FY22 revenue view to c. USD 19.7bln (exp. 19.95bln, prev. 20.1bln). **S&P Global (SPGI)** entered an agreement to sell its Engineering Solutions business to **KKR (KKR)** for USD 975mln in cash.

STOCK SPECIFICS: **Travellers (TRV)** announced initial estimates for Q4 catastrophe losses, driven by the December winter storm; expects to report EPS of USD 3.44 (exp. 4.04) and Net Income USD 819mln. Greenlight reportedly took a medium-sized long position in **Tenet Healthcare (THC)** during Q4, while **Carmax (KMX)** apparently has an activist targeting the name. **Merck (MRK)** is reportedly nearing a fix for its diabetes drug tainted with a carcinogen, according to Bloomberg. **Southwest Air (LUV)** announced it has budgeted USD 1bln+ in an operating plan for its IT systems following December's disruptions, adding the co. needs more liquidity to handle potential challenges ahead. **Apple (AAPL)** unveiled the new Mac Mini; supercharged by the M2 and new M2 pro. For **banks (XLF)**, the US OCC is considering measures to improve transparency in its escalation framework used to address concerns at big banks, suggesting measures that could lead to regulators splitting up big banks if certain conditions are not met.

JOB CUTS: **Unity Software (U)** announced 284 jobs will be cut, following on from June jobs cuts; Co. also shut its sports and live entertainment division, according to WSJ. Meanwhile, **Microsoft (MSFT)** is to cut 11,000 jobs, or 5% of its workforce, according to Sky News. **HP Inc (HPQ)** CEO said there are no plans for more layoffs. Unions in Italy announced **Amazon (AMZN)** will not cut jobs in the country.

US FX WRAP

Mild Dollar upside underpinned by Euro selling after dovish ECB sources while Yen strengthens ahead of BoJ

The Dollar saw mild upside on Tuesday as participants returned from the long weekend with initial Dollar selling following promising growth prospects out of China and the UK after GDP and jobs data, respectively. The DXY hit a low of 101.92 from a high of 102.560 during the APAC session, although the index did test 102.50 several times later on. The move from the lows was led by losses in the Euro in wake of dovish ECB sources to see DXY firmer on the session.

The Euro was weaker after Bloomberg sources said the ECB may opt to slow the pace of rate hikes to 25bp in March, after a 50bp move in February, which would be on the dovish side of December guidance from Lagarde for potentially as much three consecutive 50bps moves after the 50bp hike in December. EUR/USD hit lows in the afternoon of 1.0776 before paring to the 1.0800 area in the NY afternoon. Note, pre-sources, the Euro saw a short-lived spike higher following the significant improvement in the German ZEW Economic sentiment data which rose to +16.9 from -23.3, well above expectations of -15.0. Note that German Chancellor Scholz gave an interview on Bloomberg later on, expressing his confidence that Germany will not see a recession this year.

The Yen was bought vs the buck and Yen as participants await the BoJ rate decision Wednesday with eyes on any potential hawkish surprises; a full Newsquawk preview can be found here. Bank of America outlined the potential market reaction to several scenarios. In which, no change in policy and measures to contain yields will likely keep the 10yr JGB yield at 50bps, lift USD/JPY to between 132-133 and spur a rebound in the TOPIX to the 1900 level. Meanwhile, if the BoJ widens the upper ceiling by 25bps to boost the 10yr yield to 75bps, BofA expects USD/JPY to be flat/slightly up at between 128-130. In the event the BoJ removes YCC, BofA expects USD/JPY to decline to between 125-128, while it predicts an abandonment of both YCC and NIRP to lift the 10yr yield to 100bps, USD/JPY to drop to between 120-125 under this most hawkish scenario.

Cyclical currencies saw notable gains, particularly GBP and NZD. GBP was buoyed after strong UK wage data which resulted in traders increasing their bets for a 50bp hike in Feb to 75%. NZD outperformed with AUD/NZD slipping beneath 1.09 to test 1.0850 at the lows. AUD was subdued by base metal prices and the choppy risk tone throughout most of the session after seeing a fleeting upside (at the time) to the Chinese GDP data, which came in above expectations. CAD saw gains, while there was little reaction to the Canadian CPI data which came in softer than expected although the BoC core measures only saw a marginal decline ahead of the policy meeting next week with participants pricing in either an unchanged rate decision or likely final 25bp hike.

The Yuan was weaker (both offshore and onshore) against the Dollar despite better-than-expected activity data with GDP printing 2.9%, above the expected 1.8%, while industrial output rose more than expected and retail sales slowed less than expected. However, China's customs suggested 2022 GDP grew 3.0% Y/Y - much slower than the nation's 'abandoned' growth target of about 5.5%. On Wednesday, US Treasury Secretary Yellen is due to meet her Chinese counterpart. Although nothing material or immediate is expected from the meeting, the tone of the encounter will likely be watched to gauge the temperature between the two nations.

EMFX was mixed. RUB and ZAR were weaker while BRL saw notable gains and MXN firmed vs the Dollar. On Brazil, Analysts at HSBC write "we believe positive external accounts, low equity valuations and Brazil's high real yields will keep the BRL on a gradually appreciating path this year, and forecast USD-BRL to end the year at 4.50." ZAR weakness was accompanied by notable downside in gold prices, while the latest South African mining data continued to show a decline, albeit at a smaller pace than the prior month. For MXN, technicians note USD/MXN is consolidating after finding resistance at around 18.75.