US Market Wrap

18th January 2023: Stocks reversed BoJ rally after dismal data and hawkish Fed Speak

- **SNAPSHOT**: Equities down, Treasuries up, Crude down, Dollar flat.
- **REAR VIEW**: BoJ leaves policy unchanged; Soft US PPI, Retail Sales, and IP & Mfg. Output; Fed's Bullard and Mester see rates above the Median Dot, Bullard favours 50bp in Feb, and Harker less hawkish; Hot UK Core CPI; ECB's Villeroy pushes back on sources; Strong 20yr auction.
- **COMING UP**: **Data**: Australian Employment, US Building Permits/Housing Starts, IJC **Events**: Norges Bank & CBRT Policy Announcements, ECB Minutes **Speakers**: Fed's Williams Brainard & Collins; ECB's Lagarde, Schnabel & Knot **Supply**: Spain, France & UK **Earnings**: Procter & Gamble, KeyCorp, Fifth Third, Netflix.

MARKET WRAP

A rollercoaster session that saw stocks unwind all their post-BoJ strength after the slew of weak US data and hawkish Fed Speak. Stocks and bonds were on the up out of the APAC session after the BoJ left policy unchanged despite heavy speculation of a hawkish shift. US stock futures later rallied to their peaks in wake of the soft PPI and retail sales, as well as the tumble in industrial production and manufacturing output. The strength failed to sustain, however, with growth concerns outweighing the move lower in Treasury yields. Hawkish rhetoric from Fed's Bullard and Mester (both non-voters) only added to the woes, with the former saying he'd be in favour of a 50bps hike in February vs consensus for 25bps. Stocks leaked lower into the close with the recent optimism over a 'soft landing' taking a hit, that's despite the promising fall in PPI. Meanwhile, Treasuries held onto their strength, rallying into the close after the strong 20yr auction. The Dollar was ultimately flat after Yen pared overnight weakness. Oil prices took their cues from stocks, falling in the NY session ahead of inventory data.

US

PPI: US PPI fell 0.5% M/M in December, a deeper fall than the expected 0.1% decline, while the prior was downwardly revised to +0.2%; PPI Y/Y rose 6.2%, a big fall from the prior (downwardly revised) +7.3%, beneath the expected +6.8%. However, a great portion of that decline was a result of the volatile energy sector, nonetheless, core PPI rose at just 0.1% in December, the slowest M/M increase since November 2020. Oxford Economics said the report reaffirmed its expectations for headline PPI to cool markedly in the months ahead. The consultancy "does not expect outright year-over-year declines to the headline index in 2023, but the annual rate should fall below the 2% mark by the end of the second quarter".

RETAIL SALES: December US retail sales fell 1.1% M/M, deeper than the consensus 0.8% decline with a sizable downward revision for the prior to -1.0% from -0.6%. 10 out of 13 retail categories saw declines, with building material & garden equipment, food & beverage stores, and sporting goods, hobby, musical instrument, & book stores the only categories increasing M/M. The retail sales control group, a proxy for GDP data, fell 0.7%, deeper than the -0.3% expected and prior -0.2%. The data marks a pushback on the recent soft landing optimism and raises some questions on the state of the consumer, which has so far been resilient.

IP & MFG. OUTPUT: Industrial production fell 0.7% M/M in December, deeper than the consensus -0.1%, with the prior downwardly revised to -0.6% from -0.2%. Manufacturing output also declined by a larger 1.3%, deeper than expected -0.3% and the prior revised to -1.1% from -0.6%. Capacity Utilization also fell lower than expected to 78.8% vs exp. 79.6%. Analysts at Pantheon Macroeconomics note the biggest shock is the manufacturing output, which saw the second consecutive monthly decline, perhaps due to the Winter Storms although the consultancy is "inclined to think that the bulk of the drop in output is real and sustainable." PM also highlighted that without the second monthly rise in utilities output, the fall would have been even sharper. PM also wrote that "the downward trend in manufacturing output growth has accelerated sharply in recent months, bringing it closer into line with the survey data, which points to further weakness ahead."

CENTRAL BANKS

BOJ: BoJ defied the increased speculation for a policy tweak and kept its policy settings unchanged with NIRP kept at -0.10% and the parameters of its YCC maintained at current levels. The central bank stuck with its forward guidance on rates and that it will continue large-scale JGB buying and make nimble responses for each maturity, while it also reiterated it will not hesitate to take additional easing measures as necessary. Furthermore, the central bank's projections was also dovish leaning as it cut Real GDP forecasts across the projection horizon and although it mostly increased its core CPI view, the estimates for Fiscal 2023 and 2024 both remained below 2% which is the BoJ's target and a level that could have paved the way for policy normalisation. You can recap on the rate decision, and main headlines here.

FED'S BULLARD (non-voter) said his dot plot forecast for 2023 is just above the Fed's median of 5.1% at 5.25-5.50% and that Fed policy is not quite in restrictive territory, reiterating it needs to be over 5% at least. Bullard added the Fed should move as rapidly as it can to get over 5% and then react to data, noting his preference is for a 50bps hike at the next meeting (against the consensus 25bps). He also reiterated the prospects of a soft landing have improved markedly but core inflation has not moderated as much as suggested by markets and the risk to soft inflation is if it goes in the wrong direction and forces the Fed to react more strongly, but if it falls dramatically this year it could lead to lower recommendations for the policy rate. Said the Fed wants to lean to the "high side" on rates for insurance even if inflation declines to make sure the job is done and to allow the disinflationary process to take hold. He also noted that bullish factors for 2023 include the fact that households, states, and local governments remain flush.

FED'S MESTER (non-voter) said further rate hikes are still needed to decisively crush inflation and we are not at 5% yet, nor above it, which she thinks is going to be needed given her economic projections. She believes the Fed's key rate should rise a "little bit" above the 5.00-5.25% range that the Fed median implies (she has previously said her dot plot is a bit above the median). She did not comment on her preference for February's meeting but noted the economy and markets were able to handle the 50bp hike in December. Mester said she would need to see inflation moving down faster before she could support a pause within the next few months. Mester believes rates need to keep rising and then be held there for a while so we get back to price stability in a timely way.

FED'S BEIGE BOOK: The latest beige book found overall economic activity was relatively unchanged since the previous report. Five Districts reported slight or modest increases in overall activity, six noted no change or slight declines, and one cited a significant decline. On balance, contacts generally expected little growth in the months ahead. On labour markets, Employment continued to grow at a modest to moderate pace for most Districts. Only one District reported a slight decline in employment, and one other reported no change in employment levels. With persistently tight labour markets, wage pressures remained elevated across Districts, though five Reserve Banks reported that these pressures had eased somewhat. On prices, selling prices increased at a modest or moderate pace in most Districts, though many said that the pace of increases had slowed from that of recent reporting periods. Many retailers noted increased difficulty in passing through cost increases, suggesting greater price sensitivity on the part of consumers. In addition, some retailers offered more discounts and promotions than they had a year ago in order to move merchandise and clear out excess inventories. On balance, contacts across Districts said they expected future price growth to moderate further in the year ahead. For more details, please click here.

FED CHAIR POWELL has tested positive for COVID-19 and is experiencing mild symptoms. Ahead of the 31st January - 1st February FOMC, it is worth reminding that in the scenario that Chair Powell is unavailable for the meeting then Vice Chair Williams will perform Powell's duties in his absence.

NORGES BANK PREVIEW: Overall, the Bank is likely to wait for the full March MPR to pull-the-trigger on the guided tightening for Q1, rather than undertaking such action at this week’s interim gathering. Holding fire will provide the Bank with another two inflation readings, and a clearer view of the dynamics between the headline decrease and core increase that was seen in December; albeit, a January hike cannot be entirely ruled out given that CPI-ATE ticked up to essentially match the Norges Bank’s target. To download the full report, please click here.

FIXED INCOME

T-NOTE (H3) FUTURES SETTLE 1 POINT & 7+ TICKS HIGHER AT 115-29

The belly of the Treasury curve led a big rally on Wednesday with the post-BoJ bid accentuated by a weak US data slate and solid 20yr auction. At settlement, 2s -11.6bps at 4.076%, 3s -14.5bps at 3.719%, 5s -17.6bps at 3.433%, 7s -18.0bps at 3.399%, 10s -16.0bps at 3.375%, 20s -15.0bps at 3.661%, 30s -10.6bps at 3.542%.

Inflation breakevens: 5yr BEI -6.9bps at 2.147%, 10yr BEI -3.1bps at 2.127%, 30yr BEI -1.4bps at 2.184%.

THE DAY: Govvies shot higher initially in a bull-flattener during APAC Wednesday trade after the BoJ made no changes to policy, seeing T-Notes rally from 114-17 to interim peaks of 115-04. Some mild paring was seen in the European morning, led by EGBs after ECB's Villeroy dismissed the dovish source reports from Tuesday, as well as Gilt pressure after hot UK core CPI. However, losses in USTs were much more contained and T-Notes were already making fresh highs as US trade got underway, accelerating particularly after December PPI and retail sales both came in on the soft side, finding resistance at 115-28 in wake of the tumble in December IP and mfg. output. Some hawkish rhetoric from Fed's Bullard and Mester, both non-voters, managed to cap the strength in the late NY morning, although T-Notes later settled at highs, aided by a solid 20yr auction in the afternoon.

20YR AUCTION: A very strong USD 12bln 20yr bond auction reopening and all the more impressive given the rally ahead of time. The 3.678% stop-through marked a massive 2.7bps stop-through the WI, well above the six-auction avg. 0.5bps stop-through and the prior 1.3bps stop-through. The 2.83x bid/cover ratio exceeded the prior 2.68x and avg. 2.57 x. Dealers (forced surplus buyers) were left with a minuscule 8.1% vs avg. 10.8%, where Indirects stepped up to 76.3% vs avg. 71.9%. Similar to the 30yr, the softening US CPI data has propelled duration demand, particularly after the PPI data earlier on Wednesday, while the continued slide in the Dollar has (likely) sustained attraction for foreign participants after December's data saw a record 22.7% takedown from foreign/international accounts.

STIRS:

- EDH3 +1.5bps at 94.985, M3 +4.5bps at 94.95, U3 +5.5bps at 95.09, Z3 +8.5bps at 95.485, H4 +13.5bps at 96.065, M4 +16.5bps at 96.56, U4 +17bps at 96.86, Z4 +17.5bps at 97.005, H5 +17.5bps at 97.075, H6 +16.5bps at 97.12, H7 +16bps at 97.00.
- NY Fed RRP op demand at USD 2.132tln (prev. 2.093tln) across 103 bidders (prev. 103).
- US sold USD 36bln of 17-week bills at 4.610%, covered 2.97x.

CRUDE

WTI (H3) SETTLED USD 0.65 LOWER AT 79.80/BBL; BRENT (H3) SETTLED USD 0.94 LOWER AT 84.98/BBL

Oil prices were choppy on Wednesday after strength out of Europe unwound with risk appetite after weak US data. The Dollar had been continuing its slide earlier in the session, supporting the initial bid for oil futures, while some of the strength was pinned on commentary from Russian Foreign Minister Lavrov, who reiterated that if Finland/Sweden were to join NATO, there would be corresponding military measures. Soft PPI, retail sales, and industrial production all weighed on the demand outlook, with some of the soft-landing optimism fading, made worse by commentary from Fed's Bullard and Mester (both non-voters) talking hawkishly. Energy participants now look to the day-delayed US inventory data, coming after the massive, weather-related stock builds. This week's expectations (bbls): crude -0.6mln, gasoline +2.5mln, distillates +0.1mln.

EQUITIES

CLOSES: SPX -1.56% at 3,929, NDX -1.27% at 11,410, DJIA -1.81% at 33,297, RUT -1.59% at 1,854.

SECTORS: Consumer Staples -2.65%, Utilities -2.41%, Industrials -1.84%, Financials -1.83%, Energy -1.77%, Real Estate -1.56%, Health Care -1.42%, Materials -1.38%, Consumer Discretionary -1.3%, Technology -1.28%, Communication Svs. -0.93%.

EUROPEAN CLOSES: EURO STOXX 50 unch. at 4,174, FTSE 100 -0.26% at 7,831, DAX 40 -0.03% at 15,182, CAC 40 +0.09% at 7,083, FTSE MIB +0.27% at 26,052, IBEX 35 +0.48% at 8,933, SMI -0.31% at 11,367

STOCK SPECIFICS: **Moderna (MRNA)** announced Phase 3 study of the RSV vaccine candidate met primary endpoints; plans to submit regulatory approval in H1 23. China has cleared two of **Disney (DIS)** Marvel movies for screening in the country, a significant victory for Hollywood after years of tighter Chinese restrictions on new releases, according to WSJ. Meanwhile, Avatar 2 global box office raked in USD 1.9bln, overtaking Spider-Man for the highest-grossing pandemic-era release. Washington state's highest court will allow **Albertsons (ACI)** to pay a USD 4bln dividend ahead of its proposed USD 25bln deal with **Kroger (KR)**. **SmileDirectClub (SDC)** announced plans to realign its operating programmes and workforce to introduce additional cost savings, expected to introduce savings of USD 120-140mln in 2023. FY23 revenue guidance missed expectations but it expects to deliver positive adj. EBITDA by Q3 23. **Chesapeake Energy (CHK)** will reportedly sell its Brazos Valley operations to Wildfire Energy for USD 1.4bln in cash, according to Reuters sources. **Blackstone (BX)** raised a record USD 22.2bln for its secondaries fund, well above the USD 13.5bln target. **Robinhood's (HOOD)** request to dismiss customer litigation over order flows has been rejected by a US judge, according to a court ruling.

BIG TECH: **Apple Inc. (AAPL)** is working on a cheaper mixed-reality headset to reach more consumers, according to The Information. Bloomberg reported AAPL is still planning to unveil its first mixed-reality headset this year, but the AR glasses have been postponed due to technical challenges. Meanwhile, Apple has introduced the new Homepod with "breakthrough sound and intelligence"; availability from February 3rd. **Microsoft (MSFT)** announced it is eliminating 10k jobs by the end of Q3 23, representing less than 5% of total employees; CEO said Co. is taking a USD 1.2bln charge related to severance costs and other changes. **Amazon's (AMZN)** Prime membership may have even fallen last year, according to new estimates by CIRP cited by Business Insider

EARNINGS: **United Airlines (UAL)** results and guidance were above expectations. Co. said it feels really bullish about the outlook and the ability to achieve the revenues that they need to achieve, adding bookings for Spring and Summer look really strong. **Charles Schwab (SCHW)** missed on EPS and revenue with weak DARTs. **JB Hunt (JBHT)** missed on EPS and revenue while CEO said co. is encouraged by trends from its rail partners, a loosening labour market and modest equipment availability. **PNC (PNC)** missed on EPS but beat on revenue. **Prologis (PLD)** beat on FFO, EPS and revenue. **Interactive Brokers (IBKR)** beat on EPS and revenue.

US FX WRAP

Dollar flat as hawkish Fed speak offsets weak data; Yen whipsaws after BoJ on hold for now

The Dollar was ultimately flat in a choppy session on Wednesday as it digested the huge Yen move in wake of the BoJ keeping policy unchanged while lows were seen in wake of the slew of soft US economic data, including retail sales, PPI, and manufacturing output & IP. However, the Dollar then eased off lows as the Fed hawks were let out of the cage with both Bullard and Mester (non-voters) saying their rate projections are higher than the median view on the FOMC, with Bullard expressing support for another 50bp hike in February.

The Yen notably weakened during APAC trade, rising from 128.50 ahead of the BoJ decision to highs of 131.57 after the Bank left policy settings unchanged despite increased speculation of a hawkish shift going into the meeting. Nonetheless, the move completely reversed throughout European and US trade to see USD/JPY hit lows of 127.55 in the afternoon, beneath pre-BoJ levels for a full round trip.

The Euro was flat vs the Dollar with the latest HICP data coming inline with expectation Y/Y at 9.2% for December while the M/M print declined by 0.4%, a touch cooler than the -0.3% forecast. On ECB speak, Villeroy pushed back on the dovish Bloomberg sources piece on Tuesday, noting that Lagarde's 50bp guidance remains valid. Meanwhile, Rehn said significant rate hikes are justified in the near term to keep inflation expectations under control.

Cyclical currencies saw mixed price action with NZD and GBP bid vs the Dollar while CAD and AUD tumbled. GBP was firmer vs both USD and EUR in wake of UK CPI coming in line with expectations and the core coming in hot. Sterling is also still finding tailwinds from Tuesday's jobs data, Cable moved from lows of 1.2256 to highs of 1.2435 while EUR/GBP fell from 0.8804 to 0.8735. GBP was also supported by the weak US data but moved off highs in wake of the hawkish Fed Speak. AUD and NZD were divergent with AUD/NZD falling from highs of 1.0873 to lows of 1.0783. CAD weakness was seen as risk assets stumbled, including crude prices, while softer producer prices and raw materials price data also weighed on the Looney.

EMFX was generally weaker vs the Dollar in fitting with the broader risk tone. In Brazil, Lula announced the government will cut income tax for the poor, and raise it for the rich. ZAR tracked gold prices lower while it also sore softer than expected core inflation, but the headline CPI rose 0.4% m/m, above the 0.3% expectation while retail sales saw a surprise acceleration. Meanwhile, Turkey announced a general election will be held on 14th May 2023.