US Market Wrap

14th February 2023: Stocks and bonds diverge on "mixed" CPI & Fed speak

- **SNAPSHOT**: Equities mixed, Treasuries down, Crude down, Dollar flat.
- **REAR VIEW**: US CPI M/M in line but Y/Y not as cool as hoped; Fed speak mixed as Harker & Barkin leant slightly dovish while Logan and Williams were more hawkish; Japan government nominates Ueda as next BoJ Governor; Biden names Brainard as top WH economic adviser; F pauses F-150 Lightning pick-up production and shipments; Makhlouf said ECB could raise rates above 3.5% and hold them there.
- **COMING UP**: **Data**: UK CPI, EZ Industrial Production, US Retail Sales, NY Fed Manufacturing, Industrial Production, Japanese Trade Balance **Speakers**: ECB's Lagarde **Event**: IEA OMR **Supply**: Germany & US **Earnings**: Heineken, Kering, Ahold Delhaize, Barclays, Hargreaves Lansdown, Glencore; Cisco, Biogen, Analog Devices, Marathon Oil, Shopify.

MARKET WRAP

Stocks and bonds were divergent once the dust settled to the US CPI and plethora of Fed speak that followed. The CPI report was in line M/M but the Y/Y figures did not cool as much as hoped. The data saw two-way trade with the upside in bonds and stocks on the seasonal adjustments (which were largely seen as inflationary) while there was optimism around the Fed-eyed core services ex shelter pricing. However, the moves swiftly reversed with the data showing CPI not slowing as fast as expected and supporting the argument that the fight against inflation will be a long one. Fed pricing also moved hawkish with the peak rate now pricing in above 5.25%, indicative of a FFR of 5.25-5.50% in July before being cut by year-end to 5.00-5.25%. Nonetheless, stocks then managed to reverse the losses with strong tech and discretionary outperformance seeing Nasdaq +0.7% while the SPX and RUT were flat. Bonds however held near the lows with the curve bear flattening in wake of the inflation data but yields were off highs in wake of some Fed commentary. Harker & Barkin leant slightly dovish but with caveats while Logan and Williams were more on the hawkish side (more below). Crude prices continued to be weighed on by Monday reports that the US is considering selling more barrels from the SPR to the market. In FX, the Dollar was ultimately flat but DXY was very volatile over CPI and the Yen continued to weaken after Japan confirmed Ueda as BoJ governor and as UST yields held firm.

US

CPI: Measures of annual headline and core inflation fell in January, but by less than analysts were expecting. Headline CPI eased to 6.4% Y/Y from 6.5% (we were expecting a decline to 6.2%), while core inflation eased to 5.6% Y/Y from 5.7% (we were expecting a decline to 5.5%). Headline inflation was buoyed as energy prices picked-up, while core prices saw a rebound in core goods prices, which offset the slower rise in core services. Looking at the details of the report, Capital Economics said that there still wasn't much evidence to suggest that underling core services inflation was slowing significantly. The consultancy said the data shows that inflation is declining only gradually, but it still expects the downward trend to accelerate soon, as easing goods shortages feed through and housing inflation starts to turn down. "Following recent revisions to the seasonal adjustments, the three-month annualised rate core CPI inflation is a little higher than previously thought and ticked up to 4.6% in January," CapEco writes, adding that "alongside the apparent resilience of real economic growth at the start of this year, that will keep the Fed on course to continue raising rates over the coming meetings." Nevertheless, CapEco still thinks a sharper slowdown in inflation is coming soon as core goods prices drop back, housing inflation slows and labour market conditions cool.

WILLIAMS (VOTER): The NY Fed President repeated there is "still a ways to go" to control inflation and the current levels of inflation are far too high, as are the underlying levels. On unemployment he revised lower his forecasts somewhat, noting he now sees unemployment rising to between 4.00 and 4.5%, previously he said he expects it to rise to 4.5% so it appears January's hot jobs report has had an impact on his estimates. His views on the terminal rate also differed slightly, in December he suggested rates between 5.00-5.50% is reasonable before last week changing the view to 5.00-5.25%. However, he has now seemingly switched back his views of the higher upper bound for the FFR to 5.50% in wake of the January inflation data. Although he did state inflation has been moderating in recent months and the January CPI is consistent with the existing story of inflation, but notes recent data supports the case for more rate hikes with the job market remarkably strong. His big worry is that high inflation gets embedded in public expectations stressing the Fed has not gotten rates where they need to be and they will need restrictive rates for some time to cool

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inflation and there is a risk the Fed may need to hike rates higher than expected, while there is also a risk that inflation stays higher than expected. On rate cuts, he said it is possible the Fed cut in 2024 and 2025 to reflect lower inflation.

HARKER (VOTER): At some point this year he expects the policy rate will be restrictive enough to hold rates in place; noting the Fed is not done yet but they are likely close. He noted that how far above 5% the Fed needs to go depends on incoming data, and Tuesday's inflation report shows inflation is not moving down quickly. He also thinks they need to continue above 5% in 25bps increments for a while. Harker forecasts core inflation around 3.5% this year, 2.5% in 2024, and back at 2% goal in 2025 - all in line with the Fed median. He noted GDP growth will be modest, and he is not forecasting a recession. Sees real GDP growth at about 1% this year, before climbing back to 2% trend growth in '24 and '25. There is little evidence of a downturn in the jobs market and thinks unemployment will rise to modestly above 4% this year (Fed median 4.6%).

LOGAN (VOTER): The Dallas Fed President said the Fed must be prepared to keep raising interest rates for longer than anticipated if needed. Although added even after pausing, the Fed needs to stay flexible and tighten further if conditions call for it, stressing tightening policy too little is the top risk. While on rate hikes, she noted the need for continued gradual hikes until they see convincing evidence inflation is falling to 2% in a sustainable, timely way, and as such should not lock in a peak Fed policy rate or precise rate path. Further, the Dallas Fed President added there has been some progress on inflation, but will need to see slower inflation in services, and reiterated a familiar theme that the number one priority is to restore price stability.

BARKIN (NON-VOTER): On the CPI report, Barkin said it was about as expected and there's going to be a lot more inertia and persistence to inflation than the Fed thought. Barkin emphasised his data-dependent approach and said if inflation settles it may not go as far on rate terminal, but it all depends on the data. He also caveated the Fed may even take rates higher if inflation persists, but again will react to the data (PCE is next Friday, which is the Fed’s preferred gauge, as well as another CPI and jobs report before the next Fed meeting). Lastly, he noted the risk of doing too much is outweighed by the risk of doing too little at this point.

BRAINARD (DEPARTING): Brainard's time at the Fed has come to an end after US President Biden named Fed's Brainard as his top economic adviser. Politico then reported that Fed's Daly, Fed's Williams, former Obama adviser Betsey Stevenson, and Morgan Stanley global chief economist Seth Carpenter are among the candidates to replace Brainard as Vice-Chair.

FIXED INCOME

T-NOTE (H3) FUTURES SETTLED 14+ TICKS LOWER AT 112-10+

Treasuries bear-flattened after January CPI showed diminishing progress in the Fed's inflation fight. 2s +9.0bps at 4.624%, 3s +10.4bps at 4.325%, 5s +8.4bps at 4.010%, 7s +6.8bps at 3.906%, 10s +4.9bps at 3.768%, 20s +2.5bps at 3.947%, 30s +1.7bps at 3.810%.

Inflation breakevens: 5yr BEI +2.4bps at 2.418%, 10yr BEI -0.7bps at 2.328%, 30yr BEI -1.4bps at 2.283%.

THE DAY: Gradual strengthening was seen in Treasuries through APAC and the European morning, with T-Notes entering the US session on the front foot ahead of the CPI report. In wake of the mixed report, T-Notes fell from 113-00 to 112-12 (new YTD lows, breaking prior lows at 112-12+ on Jan. 3rd) in an immediate reaction before reversing to session highs of 113-17+ within five minutes. But better selling soon returned and fresh lows were being made later in the NY morning, aided by Fed's Barkin (nv) and Logan (v) calling for more rate hikes, in addition to some block sales in the 2yr and 5yr futures, seeing the curve further invert from pre-CPI levels. The uptick in the Cleveland Fed's trimmed mean CPI reading didn't provide bond bulls any favours. The selling extended into the afternoon to see T-Notes find session lows of 112-03 before paring slightly into settlement aided by some dovish aspects of Fed's Harker noting the Fed is not done yet but is likely close, adding he sees inflation at 3.5% by year-end, in fitting with FOMC median.

AHEAD: Retail sales and IP on Wednesday, PPI on Thursday. While on supply, Dealers are in concession mode ahead of the USD 15bln 20yr bond auction on Wednesday and USD 9bln 30yr TIPS auction on Thursday.

STIRS:

- SR3H3 -1.0bps at 95.055, M3 +0.0bps at 94.820, U3 -6.0bps at 94.735, Z3 -11.0bps at 94.740, H4 -16.0bps at 94.965, M4 -20.0bps at 95.380, U4 -21.0bps at 95.840, Z4 -19.5bps at 96.200, H5 -18.0bps at 96.405, H6 -9.5 bps at 96.780, H7 -4.5bps at 96.830.
- NY Fed RRP op demand at USD 2.077tln (prev. 2.108tln) across 109 bidders (prev. 102)

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- US to sell USD 75bln of 1-month bills and USD 60bln of 2-month bills on February 16th, USD 36bln of 17-week bills on February 15th; all to settle on February 21st.
- US sold USD 25bln of 12-day CMBs at 4.540%, covered 3.79x.

CRUDE

WTI (H3) SETTLED USD 1.08 LOWER AT 79.06/BBL; BRENT (J3) SETTLED USD 1.03 LOWER AT 85.58/BBL

The crude complex was lower, which was largely due to reports post-settlement on Monday which alleviated supply concerns as the Biden admin is planning to sell 26mln more crude oil barrels from the SPR. On this, deliveries are estimated to happen between April and June after Congress' approval. As such, following the reports WTI and Brent carried on lower through the day on Tuesday, albeit in choppy trade in wake of the US CPI report. WTI and Brent saw lows of USD 77.46/bbl and 84.13/bbl, respectively, but after the data oil pared off the lows. Elsewhere, UAE Energy Minister stated the UAE is committed to the OPEC deal lasting until end-2023, and is more worried about supply than demand next year. On production, Exxon (XOM) upstream head noted it can reach 400k BOED in Guyana from its first two production vessels. Looking ahead, there is the monthly EIA report due Wednesday, after OPEC MOMR today (details below).

RUSSIA: Russian Urals crude supplies to China increased to a 7-month high of 230k BPD in January. Ports loaded 360k BPD of Urals to vessels heading to China over February 1-10th. Separately, oil loadings from Russia's Black Sea port of Novorossiisk suspended on February 14th amid storms.

OPEC MOMR (JAN): 2023 World oil demand growth was revised +100k BPD from the prior month; OPEC-13 production dipped M/M in January. Meanwhile, prelim data indicates that January's global oil supply increased by 0.6mln BPD M/M. According to secondary sources, total OPEC-13 crude oil production was lower by 49k M/M. Note, the report chimes with the EIA STEO last week, however, the release encapsulates a period prior to Western sanctions on Russia coming into effect, as well as Russia announcing a 500k BPD cut to its oil, and US announcing another SPR release, thus the release is likely stale. (Full details here).

EQUITIES

CLOSES: SPX -0.03% at 4,136, NDX +0.71% at 12,590, DJI -0.46% at 34,089, RUT -0.06% at 1,939.

SECTORS: Real Estate -1.04%, Consumer Staples -0.93%, Health -0.6%, Financials -0.54%, Utilities -0.48%, Industrials -0.28%, Energy -0.02%, Communication Services unch., Materials +0.22%, Technology +0.44%, Consumer Discretionary +1.18%.

EUROPEAN CLOSES: EURO STOXX 50 -0.06% at 4,238, FTSE 100 +0.08% at 7,953, DAX 40 -0.11% at 15,380, CAC 40 +0.07% at 7,213, FTSE MIB +0.22% at 27,498, IBEX 35 +0.69% at 9,273, SMI +0.02% at 11,211.

EARNINGS: **Coca-Cola (KO)** beat on revenue while profit printed in line; FY23 adj. organic revenue growth view topped expectations. KO said there will be price increases globally in 2023 to reflect both the continuing inflation in import and SG&A costs. **Marriot (MAR)** surpassed st expectations on the top and bottom line and noted that booking trends to date remain robust and have significant momentum. **GlobalFoundries (GFS)** beat on the top and bottom line; Q1 adj. EPS view surpassed expectations while the revenue guide was more-or-less in line. **Cadence Design Systems (CDNS)** surpassed street expectations on EPS and revenue, as did the Q1 and FY23 outlook. **Zoetis (ZTS)** topped analyst expectations on EPS and revenue; FY23 guidance was also strong. **Avis Budget Group (CAR)** smashed profit expectations alongside a beat on revenue. It also added USD 1bln to its share repurchase authorisation and an exec. said Q4 demand was strong, with the commercial business performing well above 2019 levels. **Palantir Technologies (PLTR)** beat on EPS and revenue; CEO said that with these results, Palantir is profitable, which is "a significant moment" as it is the first GAAP profit in cos history. Q1 and FY23 guidance light.

STOCK SPECIFICS: **JPMorgan (JPM)** CFO said there is no change in NII guidance. In earnings last month, JPM said it sees FY23 NII at about USD 73bln (exp. 74.43bln). **Apple (AAPL)** is reportedly hitting stumbling blocks in its effort to increase production in India as it faces pressure to cut its manufacturing reliance on China, FT reports. **Ford (F)** will cut approx. 3,800 jobs in Europe, the latest sign of industrial disruption caused by the sector's shift to EVs. In other news, F paused production and shipments of its electric F-150 Lightning pickup due to a potential battery issue. **Nvidia (NVDA)** PT was raised at Bank of America to USD 255/shr from USD 215/shr. BOFA suggests the AI arms race lead could 4x data centre sales over the next five years. CNBC's Faber suggested an activist could get involved in **Activision Blizzard (ATVI)**.

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US FX WRAP

The Dollar was ultimately flat, although there was plenty of volatility around the US CPI and plethora of Fed speak that followed. Nonetheless, the DXY traded within a whole point range with lows of 102.50 seen briefly after the US CPI which saw M/M in line with expectations but the Y/Y did not cool as much as hoped. Although, the brief dovish reaction was likely due to the seasonal adjustments (which were largely seen as inflationary) while there was optimism around the Fed eyed core services ex shelter pricing. Nonetheless, once the dust settled the reaction was hawkish with the Dollar reversing to hit highs of 103.52 shortly after. The buck then pared to c. 103.30 (unch.) as Fed speak was digested which saw both Barkin and Harker repeat familiar themes while Harker said the Fed is not done yet, but likely close, while he still sees Core PCE at 3.5% by year-end, in line with the December Fed median. Meanwhile, Barkin even suggested if inflation settles, they may not go as far on the terminal but he stressed data dependence many times and caveated they may or may not take rates higher if inflation persists. Williams was more hawkish, noting the Fed has a ways to go to control inflation, stressing inflation is still too high. Despite the reversal in both stocks and the dollar, it is worth noting that yields remained higher throughout the session but were off lows heading into settlement.

The Euro was flat vs the Dollar but not without volatility either, as it traded between 1.0708 at the lows and 1.0804 at the highs in similar vein to the DXY. Aside from US influence, there were also several ECB speakers and data points to digest. Makhlouf spoke to the WSJ noting ECB could raise rates above 3.5% and hold them there, while adding he sees more rate hikes beyond March but he will not predict when the hiking cycle will end. Centeno suggested interest rates will return to neutral eventually but the full impact of rate hikes may not reach the economy. The EU employment metrics in Q4 were stronger than expected Q/Q but at 0.4% but cooled Y/Y to 1.5% from 1.8%, GDP flash estimate for Q4 was in line at 0.1% Q/Q and 1.9% Y/Y.

The Yen was notably weaker and the underperforming currency as the higher US yields only add to weakness seen recently in wake of BoJ Governor nomination reports which were confirmed overnight to see Ueda as the next governor, and Uchida and Himino as Deputy Governors, all as expected. USD/JPY saw resistance at 133 in immediate reaction to the US CPI report but it later broke through the level to the upside as UST yields advanced. Elsewhere, Japan GDP came in short of expectations for Q4 while 2022 growth slowed to 1.1% from 2.1%.

Cyclical currencies were mixed. AUD and GBP saw gains while NZD and CAD weakened. NZD saw weakness overnight after the latest inflation forecasts. 1yr ahead expectations were marginally revised higher to 5.1% from 5.08%, while the 2yr expectation fell to 3.3% from 3.6%. AUD managed to firm given the RBA is still in the tightening phase after the RBA at the last meeting signalled more hikes are to come, putting them on a similar rate path to the Fed. CAD meanwhile saw weakness with the BoC now in the pause phase, putting the FOMC and BoC at different stages of the tightening cycle, although the BoC were the first to start it. However, last week's second straight stellar jobs report has raised the question of another potential hike with markets pricing in 25bps more tightening by July. Weakness in oil prices also weighed on the CAD somewhat. GBP saw gains in wake of the hotter jobs and earnings data, with the employment change rising 74k vs exp 50k, while the average earnings data to 6.7% from the prior and expected 6.5%, which noted "For regular pay, this is the strongest growth rate seen outside of the coronavirus (COVID-19) pandemic period." The data kicked off the Cable rally on Tuesday but it accelerated to highs north of 1.22 on the US CPI data, before reversing to lows of 1.2118, before then paring once again back above 1.22 but it failed to hold above the level as Europe left for the day with attention now on Wednesday's UK CPI data and retail sales on Friday.

EMFX was mixed. MXN saw continued gains while BRL tumbled on reports that President Lula wants to raise the 2023 CPI target by 1ppt, questioning Brazilian government credibility at a time of rampant inflation. The current inflation target is 3.25% with a 1.5% allowance band but Lula had a 4% target with a 2% band when he was president in 2002 to 2010. COP and CLP were firmer, particularly CLP on the back of firmer copper prices. ZAR saw weakness vs the buck while gold prices were flat.

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