US Market Wrap

16th February 2023: Mester and Bullard tout 50bps, hitting stocks and bonds further after hot PPI

- **SNAPSHOT**: Equities down, Treasuries down, Crude down, Dollar up.
- **REAR VIEW**: Bullard rules nothing out for next meeting, Mester also open to 50bps; Hot PPI; Initial jobless claims fall back lower; Housing starts/permits and Philly Fed soft; Mixed ECB commentary; China to include LMT & RTX on unreliable entities list; Stellar CSCO report.
- **COMING UP**: **Data**: UK Retail Sales, US Export/Import Prices **Speakers**: Fed's Bowman, Barkin **Earnings**: Mercedes-Benz, NatWest, Segro; Deere.

MARKET WRAP

Stocks were lower with the NDX leading losses in the major US indices. The bulk of the losses came in wake of the hawkish reaction post-hot PPI and fall back lower in initial jobless claims, which only accelerated when Fed's Mester opened up the door to a 50bps Fed hike. This was further accentuated in late trade when Bullard also said he would not rule anything out for the next Fed meeting. As a result, Treasuries bear-steepened (2s30s +5bps). Inflation breakevens widened across the curve. The buck saw upside against most currencies in wake of the mixed US data and was accentuated by hawkish Mester rhetoric. The crude complex was choppy within fairly contained ranges, influenced by broader risk sentiment and mixed US data, as opposed to anything energy-specific, where the stronger Dollar capped strength.

US

FED: **Mester (non-voter, hawk)** who could potentially step in as a temp voter this year if Austin Goolsby is appointed as Fed Vice Chair, said she saw a compelling case for a 50bp hike at the January FOMC meeting, stressing that the Fed has more work to do to control inflation. She later added that she is not ready to say if the Fed requires a bigger rate rise at the March FOMC; said more upside inflation surprises could make Fed policy more aggressive and can accelerate the pace if conditions warrant it. On the terminal rate, she said the Fed would need to go above 5% and stay there for a while, but how far above depends on the data. Mester said upside risks to inflation remain in place, where transitioning back to price stability will bring some pain. She said Fed actions will slow growth and push up unemployment. **Bullard (non-voter, hawk)** noted he advocated for a 50bps hike at the last Fed meeting to get to an adequately restrictive level faster, whilst looking ahead he would not rule anything out for the next Fed meeting. Do note, although not a voter, he adds to Mester in showing an openness to a shift back to 50bps hikes. Elsewhere, Bullard said the recent firming of market pricing is welcome and at this point, reaffirms his view from January for policy terminal rate in 5.25-5.5% range as appropriate. In addition, St Louis Fed President noted continued rate increases would lock in slowing inflation and market-based expectations of inflation now relatively low.

PPI: The PPI data was hot and adds to the slew of hot data points we've seen this week. The headline M/M rose 0.7%, above the expected 0.4% and above the hottest forecast of 0.6%, jumping from the prior month's -0.2% print (revised up from -0.5%). Y/Y prices cooled from 6.5% to 6.0%, though not as much as the expected 5.4%. The core M/M was also hot at 0.5%, above the expected/prior 0.3%, while Y/Y slowed to 5.4% from the upwardly revised 5.8%, but also not as much as the expected 4.9%. Additionally, super-core M/M accelerated to 0.6% from 0.2% while Y/Y cooled marginally to 4.5% from 4.7%. The data, just like the January CPI report, supports the narrative that inflationary pressures are not cooling as much as hoped and shows more evidence of a bumpy road ahead for the disinflationary process, as Powell has said. January saw increased producer prices for goods and services, with goods rising 1.2% and services rising 0.4%. The upside in good prices is a change in the narrative we saw in H2-22 where goods prices had been slowing, but this month saw the largest jump since June 2022 and reversed a lot of the December 1.4% decline, while the services maintained December's price pace of 0.4%, despite services pricing being seen as the more sticky component. The good prices were the primary reason behind the headline jump but this was due to the price of gasoline, the report notes "Nearly one-third of the January rise in the index for final demand goods can be traced to prices for gasoline, which increased 6.2 percent." However, even the ex-energy components were still hotter than expected, indicative of broader producer pricing pressures. If the PPI pressures do not slow as much as hoped in upcoming reports, it could potentially result in a delayed improvement of company margins.

JOBLESS CLAIMS: Initial jobless claims data was beneath expectations, and still beneath the watched 200k level, printing 194k against an expected 200k, while continued claims were in line with expectations at 1.696mln, picking up from the prior 1.68mln. The initial claims data was only slightly beneath the prior revised 195k while the 4-week average rose to 189.5k from 189k. The data was for the week ending 11th February, thus next week's initial claims data will be the report that corresponds with the BLS' NFP report survey window, while the week thereafter for continued claims will coincide with that survey week. Claims data remains historically low and still sub-200k; analysts have said that it is consistent with what we have been seeing in the labour market after the hot January jobs report, however, the initial regional Fed surveys (NY & Philadelphia) for February have had employment metrics slowing vs January levels. Nonetheless, claims data shows the labour market remains tight and money markets are still pricing in a 25bps hike in March, with the terminal rate seen at 5.25%, indicative of an FFR of either 5.00-5.25% (in line with Fed median in the recent SEPs) or 5.25-5.50%. The March FOMC meeting will be accompanied by the latest dot plots so we can expect to see how high the Fed thinks they have to go above 5% based on the data, which includes the February CPI and NFP reports due in March.

HOUSING STARTS: Both permits and starts disappointed expectations in January; permits were expected to rise from 1.372mln to 1.35mln, but only rose 0.1% M/M to 1.339mln; starts were expected to pare back from 1.371mln to 1.35mln, but fell by 4.5% M/M to 1.309mln. Analysts noted that starts are now almost 28% off the peak seen in April, which is a reflection of plunging mortgage demand as rates ticked higher. "We had expected this steep downward trend in starts to be temporarily offset by warmer-than-expected weather in January, but to no avail," Pantheon Macroeconomics says. That said, the consultancy has been arguing that housing construction is close to a floor after the recent bounceback in mortgage demand. It notes that single-family building permits fell for the 11th straight month, but January's decline was the smallest in the sequence and suggests single-family permits will be more or less flat in the months ahead, while multi-family permits are pointing towards a rebound ahead. "The big picture here is that housing construction—and home sales—have largely already adjusted to the slump in demand caused by higher rates, but home prices have much further to fall."

PHILLY FED: January's Philly Fed disappointed consensus expectations. The headline declined from -8.9 to -24.3; we were looking for a minor improvement to -7.4. The details under the bonnet were similarly disappointing: the prices paid component rose two points to 26.5, new orders fell 2.7 points to -13.6, the employment sub-index eased to 5.1 from 10.9. Additionally, the six-month outlook dropped to 1.7 from 4.9. Oxford Economics said the Philly Fed data failed to reassure after this week's sour Empire State Manufacturing report. "Weakness in manufacturing has been persistent amid a weakening in the global economy, past appreciation in the US dollar and higher interest rates stifling demand for goods," it writes, "with flaring worries of the economy falling into a mild recession this year, the worst is likely ahead for manufacturing."

FIXED INCOME

T-NOTE (H3) FUTURES SETTLED 5 TICKS LOWER AT 111-28+

Treasuries bear-steepen after hot PPI and falling jobless claims accompanied by 50bps hike chatter from Mester and Bullard. 2s +0.9bps at 4.636%, 3s -0.2bps at 4.346%, 5s +2.5bps at 4.064%, 7s +3.9bps at 3.982%, 10s +5.0bps at 3.857%, 20s +7.1bps at 4.054%, 30s +6.8bps at 3.920%.

Inflation breakevens: 5yr BEI +0.6bps at 2.469%, 10yr BEI +2.4bps at 2.388%, 30yr BEI +3.8bps at 2.354%.

THE DAY: The curve entered the NY handover Thursday already in a steepener, coming off its most inverted levels, with bullish momentum seen in the APAC session led by the front-end, aided by the soft Aussie jobs report. The lacklustre 20yr auction and the USD 24bln Amgen corporate debt from Wednesday were likely factors in the long-end's underperformance from the get-go. T-Notes peaked at 112-11+ in the European morning before paring into NY handover. Heavy selling was seen in Treasuries in wake of the dip back lower in US initial jobless claims and above-forecast PPI data, with a dip in the Philly Fed survey and soft housing starts/permits data providing somewhat of a cushion. But new lows were made after Fed's Mester opened up the door to a 50bps Fed hike. T-Notes made session lows of 111-20+ before paring somewhat into the NY afternoon, finding a double-top resistance level at 112-01 before settlement. The weak 30yr TIPS auction (2bps tail) saw little spillover effects, although post-settlement remarks from Bullard opening the door to 50bps hikes saw some knee-jerk selling, but earlier lows were respected.

NEXT WEEK'S AUCTIONS: All sizes were left unchanged, as expected: US to sell USD 42bln of 2yr notes on Feb. 21st, USD 43bln of 5yr notes on Feb. 22nd, and USD 35bln of 7yr notes on Feb. 23rd; all to settle on Feb. 28th. To sell USD 22bln in 2yr FRN reopening on Feb. 22nd, to settle on Feb. 24th.

AHEAD: Friday sees Fed's Barkin (nv) and Bowman (v), with import/export prices the data "highlight" in the US. Otherwise, attention to next week's Treasury supply and shorter week on account of the Presidents' Day holiday on Monday. Other items of note for next week in the US include Flash PMIs, FOMC minutes, and PCE.

STIRS:

- SR3H3 -1.5bps at 95.045, M3 -1bps at 94.755, U3 flat at 94.78, Z3 +1.5bps at 95.00, H4 +3.5bps at 95.395, M4 +4bps at 95.83, U4 +1bps at 96.15, Z4 -1bps at 96.34, H5 -2bps at 96.47, H6 -4bps at 96.725, H7 -4.5bps at 96.74.
- NY Fed RRP op demand at USD 2.032tln (prev. 2.012tln) across 98 bidders (prev. 96)
- US sold USD 76bln of 1-month bills at 4.510%, covered 2.77x; sold USD 61bln of 2-month bills at 4.650%, covered 2.51x.
- US to sell USD 60bln of 3-month bills, USD 48bln of 6-month bills, and USD 34bln of 1yr bills all on Feb. 21st; all to settle on Feb. 23rd and all sizes unchanged.

CRUDE

WTI (H3) SETTLED USD 0.10 LOWER AT 78.49/BBL; BRENT (F3) SETTLED USD 0.24 LOWER AT 85.14/BBL

The crude complex was choppy Thursday within fairly contained ranges, influenced by broader risk sentiment and mixed US data, as opposed to anything energy-specific; the stronger Dollar capped strength too. However, the buck's strength did fade as the session continued but WTI and Brent failed to benefit. The session was light for energy newsflow, but a slew of US data in the form of PPI, Philly Fed and jobless claims, in addition to a raft of central bank speakers were all in focus. Nonetheless, albeit not garnering a reaction, Saudi Energy Minister in local press noted OPEC decisions are taken unanimously and it is "unfair" to say that Saudi Arabia is taking unilateral decisions. He added OPEC+ current deal will continue until the end of the year and can't increase output only based on initial signals about demand. Looking ahead, the calendar is fairly sparse on Friday with the Baker Hughes US rig count the only scheduled event for the space.

EQUITIES

CLOSES: SPX -1.38% at 4,090, NDX -1.93% at 12,442, DJI -1.26% at 33,696, RUT -0.96% at 1,942.

SECTORS: Consumer Discretionary -2.16%, Technology -1.75%, Communication Services -1.55%, Materials -1.15%, Industrials -1.09%, Financials -1.07%, Energy -1.03%, Health -1.02%, Real Estate -0.93%, Utilities -0.83%, Consumer Staples -0.79%.

EUROPEAN CLOSES: EURO STOXX 50 +0.40% at 4,297, FTSE 100 +0.18% at 8,012, DAX 40 +0.18% at 15,533, CAC 40 +0.89% at 7,366, FTSE MIB +1.16% at 27,853, IBEX 35 +0.35% at 9,327, SMI -0.65% at 11,199.

EARNINGS: **Cisco (CSCO)** exceeded Wall St. expectations on top and bottom line; lifted quarterly dividend 3% to USD 0.39/shr. Raised Q3 and FY23 outlook. **Synopsys (SNPS)** topped consensus on EPS and revenue. Q2 revenue and EPS guidance was light, although it raised FY23 outlook. **Datadog (DDOG)** surpassed expectations on top and bottom line; outlook for both Q1 and FY23 was short. **Hasbro (HAS)** beat on profit while revenue was in line. FY23 guide was light as HAS was hit by a sharp decline in demand as more customers cut back spending on its toys and games amid rising prices. **Paramount (PARA)** missed on EPS and revenue. To take USD 1.3-1.5bln impairment charge in Q1 related to Showtime-Paramount+ integration. **Roku (ROKU)** reported a slightly shallower loss per share than expected and beat on revenue. Q1 revenue view topped expected. Through a combination of operating expense control and revenue growth, sees a path that delivers positive adj. EBITDA for FY24.

STOCK SPECIFICS: **Tesla (TSLA)** CEO Musk confirmed Tesla was happy to support other EVs via its Supercharger network. In other news, Tesla has sold out the Model Y for the quarter in the US with no more production builds until April, according to Electrek. Tesla also filed a recall of 362,758 US vehicles, according to NHTSA. China's Commerce Ministry to include **Lockheed Martin (LMT)** and **Raytheon (RTX)** on its list of unreliable entities, banning the companies from engaging in China-related trade activities. Lockheed Martin CFO said they feel confident for the FY guide provided, though Q1 is going to be somewhat bumpy, partially due to the supply chain. **YouTube's (GOOGL)** CEO Susan Wojcicki is stepping back from her role with Neal Mohan to be the new head. **Snapchat (SNAP)** users increase to more than 750mln a month and user growth gained 25% in past 10 month. White House said **Norfolk Southern (NSC)** will be held accountable for Ohio train derailment. Qatari Royals reportedly planning a GBP 5bln opening bid for **Manchester United (MANU)**, according to Bloomberg. Telegraph also reported that Saudi Arabia was mulling a bid ahead of the Friday deadline for offers.

US FX WRAP

The Dollar was firmer and hit a high of 104.24, but is back beneath the psychological 104 at pixel time. On the day, the Buck saw upside in wake of the mixed US data and was accentuated by hawkish Mester rhetoric. Recapping this, PPI was firmer than expected, in line with Tuesday's hotter-than expected CPI prints, initial jobless claims remained beneath 200k, while housing starts/permits and Philly Fed mfg. both disappointed. Fed's Mester (non-voter, hawk) noted she saw a compelling case for a 50bp hike at the last FOMC meeting, stressing that the Fed has more work to do to control inflation. Later, Bullard (non-voter, hawk) also opened the door for a 50bps hike. Looking ahead, Friday's calendar is light with only Fed's Barkin (voter) and Bowman (voter) with no tier 1 data. Next week, there is the Fed's preferred gauge of PCE next Friday, as well as ISMs and FOMC minutes.

Activity currencies, GBP, AUD, NZD, and CAD, were all slightly weaker against the Greenback, albeit off respective lows, with the Loonie the G10 underperformer and was weighed on by broad Dollar strength as well as the slight weakness seen in the oil complex. BoC Governor Mackem spoke but did not say much new, with the main takeaway him noting if evidence begins to accumulate to show that inflation is not declining in line with forecasts, BoC is prepared to raise the policy rate further. USD/CAD rose over one big fig, after it saw lows of 1.3358 in contrast to highs of 1.3478. Aussie was flat, at pixel time, but saw weakness in the APAC session after another decline in Australian employment. Although, AUD/USD hit lows of 0.6841 in the NY morning after the aforementioned Buck strength after data and Fed rhetoric as did NZD/USD of 0.6233. Cable hit lows of 1.1966, and again was on broader macro impulses, although do note BoE chief economist Pill noted Tuesday's labour market report pointed to signs that it loosened a little in Q4, in line with the MPC narrative, and that the labour market remains tight in an absolute sense. RBA's Lowe is speaking Friday, as is BoC's Beaudry, which comes ahead of UK retail sales.

JPY was the G10 outperformer, and saw slight gains against the Greenback, as technicians note 134.50 offered some respite for the Yen rather than anything fundamental.

EUR was offered and found support at 1.0650 as EUR/USD hit lows of 1.0655 and could not pierce the psychological level to the downside. There was a slew of ECB Speak on Thursday, via dove Panetta and hawk Nagel, while Lane towed the middle line. On the latter, he said ECB monetary policy actions are clearly tightening financial conditions, and reiterated the ECB has signalled that it intends to raise the deposit facility rate by another 50bps at our March meeting, will then evaluate the subsequent path of our monetary policy.

CHF saw slight losses, although CHF/USD traded within tight parameters, illustrated by a high of 0.9271 and a low of 0.9215.

NOK and **SEK** both saw weakness against the Buck, as the **PLN** did vs the Euro. Nonetheless, the SEK largely took comments from Riksbank's Jansson in stride, even though he talked the Krona up, and the same went for the NOK in regard to a raises in Norwegian oil investment projections for this year and next. Conversely, the PLN got little time to glean impetus from a hawkish NBP Tyrowicz as the ECJ's Advocate General in the Polish FX Mortgage case said banks may not demand remuneration for use of capital in contracts rendered invalid, while the possibility of demanding remuneration from banks by consumers should be based on Polish law.

EMFX was mixed, as CNH and BRL were more-or-less flat, while the MXN saw gains, but the RUB and ZAR saw losses. For the Real watchers, as was previously suggested, CNN Brasil further touted Brazilian President Lula said the minimum wage will increase to BRL 1.32k/month from May, but he separately noted he is not interested in fighting with central bank governor which comes amid debate of the inflation target. On which, the latest CMN meeting saw no adjustment made to the inflation target, coming amid market fears it may be hiked. Lastly, the Yuan continues to be undermined by the geopolitical tensions between itself and the US, which was heightened on Thursday in wake of the Chinese Commerce Ministry announcing it will include Lockheed Martin (LMT) and Raytheon (RTX) on the unreliable entities list immediately, banning the companies from engaging in China-related trade activities.

Disclaimer