US Market Wrap

1st March 2023: Stocks and Bonds take a hit on hawkish Fed bets after Kashkari and ISM

- **SNAPSHOT**: Equities down/flat, Treasuries down, Crude up, Dollar down.
- **REAR VIEW**: Hot German inflation; Strong Chinese PMI data; Hawkish Fed Kashkari & ECB's Nagel; Bostic still sees peak rate between 5-5.25%; BoE's Bailey avoids concrete guidance; Weak ISM manufacturing as prices paid soars; EIA crude build, again; US lobbying allies on possible China sanctions if it provides Russia aid; Poor RIVN report; NVAX future in doubt.
- **COMING UP**: **Data**: EZ CPI (Flash), Unemployment Rate, US IJC, Japanese CPI, Unemployment **Events**: BoE DMP, ECB Minutes **Speakers**: Fed's Waller, Kashkari; ECB's Schnabel, BoE's Pill **Supply**: Japan, Spain, France & UK **Earnings**: Covestro, UMG, Evonik, Fortum, AB InBev, Flutter, LSE; Costco, Dell, Macy's, HP.

MARKET WRAP

NDX, SPX and bonds finished in the red with lows seen during the US session in wake of the February US ISM Manufacturing PMI showing a return to expansionary territory in the prices paid component, adding to persistent inflationary concerns after the string of hot January prints. Accompanying the move was commentary from Fed's Kashkari, who joined the hawks in suggesting he is open to either 25 or 50bps in March, while he also said he is leaning towards a higher terminal rate than his 5.4% dot in December. However, Fed's Bostic still sees a peak rate of between 5.00-5.25%. The hawkish developments saw stocks and bonds lower while markets briefly started to price in a peak rate of 5.5-5.75% by September before reversing to a peak of 5.45%. The DXY closed in the red due to gains in the Yuan and Euro after strong China PMI data overnight and hot German inflation this morning ahead of the EZ CPI data on Thursday. Crude prices settled firmer after a choppy session with downside seen in the morning on hawkish central bank concerns and their impact on demand, although a rebound was seen in wake of the EIA data which showed a larger build than expected, although it was not as large as the 6.2mln build in the private inventory report last night, while the Saudi Aramco CEO was also optimistic on US, Europe and China demand.

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KASHKARI (VOTER): Fed's Kashkari joined the FOMC in hawks in signalling an openness for a 50bp hike at the March meeting, saying he is open to both 25bps and 50bps. However, he did repeat the line that the terminal rate is more important than the size of rate hikes. On terminal, he said he leans towards continuing to push up his policy path vs his December view of 5.4%. Note, after the January jobs report said he would maintain his terminal rate view but since the slew of hot economic data since then (CPI, PPI, PCE, retail sales), he appears to have upped his rate forecast. Kashkari added that overtightening policy is definitely a risk but the risk of under-tightening is a much bigger risk for the US economy. He added that if we declare victory too soon, there will be a flood of exuberance and we will need to do even more work. On a soft landing, Kashkari said he does not know if the Fed can achieve it, but he would like to avoid recession, but getting inflation down is "job one". On inflation, he said inflation is not being driven by the labour market, not yet at least, while noting wage growth is now too high to be consistent with 2% inflation. Kashkari finds it concerning that rate hikes so far have not brought down services inflation.

BOSTIC (NON-VOTER): Maintained his view that the Fed policy rate needs to rise to 5.00-5.25% range, in line with the December Fed median, and repeated the policy rate will need to remain at that level well into 2024. Bostic said the Fed needs monetary policy to have a greater dampening effect on demand and slower wage growth before concluding inflation is moving steadily lower. He noted the economy has the momentum to weather higher rates without a major downturn and they are not there yet on the inflation battle.

ISMs: ISM Manufacturing marginally rose to 47.4 from 47.4 but was beneath the expected 48.0. Looking at the sub-components, new orders lifted to 47.0 (prev. 42.5), while employment fell to 49.1 (prev. 50.6), entering contractionary territory. The inflationary gauge of prices paid alarmingly rose back into expansionary territory to 51.3, well above the prior 44.5 and the expected 45.1, largely due to higher metals and electronic component costs. Elsewhere, production and supplier deliveries fell to 47.3 and 45.2 from 48.0 and 45.6, respectively. Meanwhile, inventories marginally fell but remained in expansionary territory while the backlog of new orders rose, but still well beneath 50. Overall, the reading signals modestly weaker US factory activity. Oxford Economics notes “while we take it with a small grain of salt since survey-based data have recently painted an overly negative picture of the economy, we nonetheless see it as a sign that activity is on a weakening trajectory." Looking ahead, Oxford foresee stronger headwinds in the coming months as higher interest rates bite and goods demand cools. Concluding OxEco notes "external demand for manufactured goods exports won't offer significant relief from challenging US domestic demand conditions."

FIXED INCOME

T-NOTE (M3) FUTURES SETTLED 21 TICKS LOWER AT 111-00

Treasuries saw large bear-flattening on hot German CPI, a jump in ISM prices paid, and hawkish Kashkari comments. At settlement, 2s +8.6bps at 4.883%, 3s +10.2bps at 4.605%, 5s +9.3bps at 4.261%, 7s +9.6bps at 4.166%, 10s +8.0bps at 3.994%, 20s +5.3bps at 4.163%, 30s +2.2bps at 3.952%.

Inflation breakevens: 5yr BEI +5.9bps at 2.566%, 10yr BEI +5.4bps at 2.450%, 30yr BEI +3.2bps at 2.363%.

TOKYO/LONDON: Choppy trade was seen during the APAC session and European morning on Wednesday for Treasuries, being pulled by opposing forces in EGBs and Gilts. EGBs led initial govvies softness on hot German State CPIs and commentary from ECB's Nagel; however, Gilts led a subsequent bounce in the wake of BoE's Bailey. T-Notes initially found support at 111-08+ in wake of the German state CPI, respecting WTD lows of 111-06, before going on to peak at 111-19+ after BoE's Bailey, failing to make a run on Tuesday and Monday peaks at 111-23+ and 111-25+, respectively.

NEW YORK: T-Notes began dipping back lower as the US session got underway with additional Bund-led weakness after Germany's nationwide CPI figures came in hotter than expected. Fed's Kashkari (voter, hawk), speaking at a conference, only added to the selling after the official said he was open to 50bps at the March FOMC and also is leaning towards raising his terminal rate dot from his December view of 5.4%. The nail in the coffin for Treasuries was the release of the ISM Mfg. survey which saw an alarming jump in the prices paid component. Simultaneous comments from Fed's Bostic (2024 voter) about holding rates at terminal "well into 2024" and Econostream reports that ECB insiders are paying particular attention to the lack of progress in core inflation accentuated the move, taking T-Notes to session and YTD lows of 110-30, with the cash 10yr yield eclipsing 4% for the first time since early November. T-Notes, and the long-end more broadly, hovered near lows through the NY afternoon, but front-end yields stretched to new highs on the back of giant 30.6k ZTM3/27.8k ZFM3 block flattener.

AHEAD: EZ flash inflation and ECB minutes on Thurs are the macro highlights, although we get US jobless claims on Thurs and ISM Services on Fri. With key data on the light side, Fed Speak will hold more weight on tape action with Kashkari and Waller on Thurs, followed by Logan, Bostic, and Bowman all on Friday. Otherwise, Dealers will be setting up for next week's 3yr, 10yr, and 30yr auctions ahead of the February NFP report next Friday.

STIRS:

- SR3H3 -1.5bps at 94.913, M3 -5.0bps at 94.420, U3 -6.0bps at 94.275, Z3 -7.5bps at 94.415, H4 -10.0bps at 94.710, M4 -11.5bps at 95.110, U4 -12.5bps at 95.500, Z4 -12.0bps at 95.800, H5 -11.5bps at 95.985, H6 -10.5 bps at 96.275, H7 -9.0bps at 96.360.
- US EFFR remained at 4.57% on February 28th, for a second day, but many expect this to rise back to 4.58% as of March 1st as month-end factors fade.
- US sold USD 36bln of 17-week bills at 4.885%, covered 2.92x.

CRUDE

WTI (J3) SETTLED USD 0.64 HIGHER AT 77.69/BBL; BRENT (J3) SETTLED USD 0.86 HIGHER AT 84.31/BBL

The crude complex was choppy on Wednesday, but ultimately firmer, with initial weakness in the European morning attributed to familiar hawkish central bank concerns before rebounding in wake of the EIA data and optimistic demand commentary from the Saudi Aramco CEO. As such, WTI and Brent hit peaks of USD 77.76/bbl and 84.36/bbl, respectively, heading into settlement. The gains came despite the crude builds (albeit the EIA data saw a smaller build than the private report on Tuesday) while in other signs of plentiful supply, Russian Urals oil supplies to Turkey hit 860k T in February, a four-month high (prev. 620k T in Jan. and 370k T in Dec.), as the STAR refinery (220k BPD) resumed Russian imports. Separately, there was encouraging demand commentary from the Saudi Aramco CEO, who sees excellent oil demand in US and Europe and very strong oil demand from China. Looking ahead, US jobless claims is due on Thurs followed by ISM Services on Fri. With key data on the light side, Fed Speak will hold more weight on tape action with Kashkari and Waller on Thurs, followed by Logan, Bostic, and Bowman all on Friday.

EIA: Crude inventories rose for the 10th straight week to their highest level since May 2021, growing by 1.165mln BPD (exp. 0.457mln) to 480.2mln barrels last week, albeit the build was not as large as the 6.2mln bbls in the private inventory report on Tuesday. Distillates saw a surprise build of 0.179mln (exp. -0.462mln), while gasoline saw an unexpected draw. Refining utilisation fell 0.100%, less than the expected -0.4%, while crude production remained unchanged at 12.3mln.

EQUITIES

CLOSES: SPX -0.47% at 3,951, NDX -0.86% at 11,938, DJI +0.02% at 32,661, RUT +0.08% at 1,898.

SECTORS: Utilities -1.72%, Real Estate -1.49%, Consumer Discretionary -1.28%, Technology -0.81%, Consumer Staples -0.76%, Communication Services -0.61%, Financials -0.38%, Health -0.18%, Industrials +0.38%, Materials +0.68%, Energy +1.94%.

EUROPEAN CLOSES: EURO STOXX 50 -0.53% at 4,215, FTSE 100 +0.49% at 7,914, DAX 40 -0.39% at 15,305, CAC 40 -0.46% at 7,234, FTSE MIB -0.59% at 27,315, IBEX 35 -0.76% at 9,322, SMI -0.38% at 11,056.

EARNINGS: **Rivian (RIVN)** missed on revenue, deliveries and vehicle production, with FY production guide also light. **Monster Beverage (MNST)** fell short on profit and revenue alongside declaring a 2-for-1 stock split. Execs noted certain supply chain pressures were moderating, and while FX was a headwind, there will be further price hikes in H1 23. **Lowe's Companies (LOW)** beat on profit but missed on revenue and comp. sales. Guidance was mixed, as FY EPS view was in line but revenue fell short. **Kohl's (KSS)** reported an unexpected deep loss per share alongside a miss on revenue, SSS, and the FY23 EPS view was light. Exec said sales pressure driven by the ongoing persistent inflationary environment. **Dollar Tree (DLTR)** profit guidance was light for both the next Q and FY. However, results for the past Q were decent with revenue outlook also solid.

STOCK SPECIFICS: **Novavax (NVAX)** said it has substantial doubts on continuing as a co. **Caterpillar (CAT)** reached a tentative six-year labour agreement with a union that represents workers at its four facilities, possibly fending off a strike. **General Motors (GM)** is cutting several hundred salaried jobs, with most in the US, as it looks to launch several new EVs this year in a bid to gain new market share. GM also plans to cut USD 2bln in costs over the next two years. **Tesla (TSLA)** is reportedly preparing a revamp of its Model Y, according to Reuters citing sources; named "project Juniper" with a production start target of October 2024. Reminder, Tesla is holding an investor day on March 1st at its Texas facility. **Eli Lilly (LLY)** cuts insulin prices by 70% and caps insulin out-of-pocket costs at USD 35/month. **Boeing (BA)** chief engineer Greg Hyslop is to retire. **Alphabet's (GOOGL)** robotaxi developer Waymo laid off 137 employees, or 8% of its workforce, on Wednesday, according to The Information; the second round of cuts this year as GOOGL reins in spending across its subsidiaries.

US FX WRAP

The Dollar was lower on Wednesday, primarily due to the moves in the Euro and Yuan although DXY saw quite volatile trade printing highs of 105.09 and lows of 104.09. The DXY hit lows as US players arrived before gradually paring some of the move, which extended to 104.67 in wake of the PMI data which showed a notable jump in the prices paid component. The component rose back to expansionary territory and rang the inflationary alarm bells and resulting in a shift higher in Fed pricing, once again, for Fed Funds Futures to imply a terminal rate of 5.50% at one point. Also supportive was commentary from Fed voter Kashkari who is open to 50bps or 25bps in March and said he is leaning towards a higher policy rate than his 5.4% view in December. Nonetheless, as the Fed pricing move unwound slightly, so did the Dollar with DXY now hovering around 104.50.

The Yuan saw notable gains and was an outperformer after strong Chinese PMI data which saw the fastest pace of expansion for manufacturing in over a decade, while the Caixin mfg. PMI also returned to expansionary territory. The gains in the Yuan saw USD/CNH hit a low of 6.8638, testing the 55dma of 6.8546.

The Euro saw decent gains tracking the Yuan overnight while the German CPI print added to the chorus of hot inflation prints in the Eurozone, with support seen in the Euro in the morning after the regional prints in the morning were on the hot side. EUR/USD rose above 1.06 but failed to reach 1.07 with the intra-day peak hitting 1.0691 before paring to 1.0650 with eyes on the ECB minutes due Thursday. ECB's Nagel was hawkish, suggesting significant hikes may be needed beyond March.

The Yen was initially firmer vs the Dollar with USD/JPY printing a low of 135.27 before paring gains back above 136.00 to unchanged levels as the Dollar moved off lows and UST yields jumped in wake of more signs of continued hot inflation after the US ISM PMI prices paid returned to expansionary territory.

Cyclical currencies were mixed. NZD saw notable outperformance, once again, to see NZD/USD peak at 0.6275 before paring to 0.6250 at pixel time but well above the lows overnight of 0.6167 as attention turns to NZD trade data. AUD was bid, but not as much as the NZD. The Aussie found tailwinds from the strong China PMI data but headwinds were seen following cooler-than-expected GDP and CPI reports. Nonetheless, the weaker dollar and China data helped take AUD/USD above 0.6750. GBP was flat against the Dollar and notably weaker vs the Euro with EUR/GBP posting a high of 0.8896 from lows of 0.8783 while cable hovers around 1.20 after hitting a high of 1.2088 from lows of 1.1966. Commentary from BoE Governor Bailey saw him avoid concrete guidance stating he would caution against suggesting either the BoE is done with hiking rates, or that BoE will inevitably need to do more; stating they have to monitor carefully how the tightening already done is working its way through the economy. CAD saw some gains vs the Dollar with USD/CAD trading c. 1.3600 but failed to convincingly hold beneath the level.

EMFX was mixed. TRY was flat despite reports from Turkish banks that loans offered under the CBRT's scheme to help exports have hit the maximum limit of TRY 100bln. BRL was choppy, the Real initially saw weakness after Brazil's Finance Minister Haddad spoke on the problem of interest rates and called for rate cuts from the BCB, while he also noted he does not see any deposition in reviewing the central bank's formal autonomy. However, on the data, the S&P Global manufacturing activity saw a moderate improvement in February. MXN also firmed while commentary from Banxico officials mainly saw a repeat of the February statement, although the Governor did say they want to avoid surprising markets again while the deputy governors Mejia and Borja agreed they are near an adequate level for interest rates. Elsewhere in LatAm, The COP, CLP and PEN also saw gains with the former two buoyed by further gains in copper prices.