US Market Wrap

12th April 2023: Stocks and bonds unwind CPI rally but Dollar fails to recover

- **SNAPSHOT**: Equities down, Treasuries up, Crude up, Dollar down.
- **REAR VIEW**: Soft headline CPI, Core as expected; Minutes reveal little new; Mixed Fed and ECB speak; Weak 10yr auction; Soft BofA card data; LVMH boosted by China.
- **COMING UP**: **Data**: Australian Employment, Chinese Trade, UK GDP (Estimate), US IJC & PPI **Speakers**: BoE's Pill **Earnings/Updates**: Imperial Brands **Supply**: Italy, UK & US.

MARKET WRAP

Stocks were ultimately lower Wednesday, fading the post-CPI rally, with tech leading the weakness. There was a market-wide dovish reaction to the headline CPI coming in softer than expected (5.0% Y/Y vs exp. 5.2%; prev. 6%), seeing stocks surge, Treasuries bull-steepen, and the Dollar sold, supporting commodities. However, the bid in stocks and bonds faded through the rest of the session, with Fed pricing reverting back to a 75% chance of a May hike, aided by Fed's Barkin calling for more tightening needed, while the new highs in oil prices weighed via the inflation outlook, although note that Fed's Daly was more dovish later on. The March FOMC minutes didn't tell us much we didn't already know, mainly that some members considered a rate pause, although there was some fanfare over staff projections for a recession later in the year. ECB's Holzmann gave some hawkish remarks, weighing on EGBs and supporting the Euro, although Villeroy gave some two-way remarks later on. European equity futures caught a bid in after-hours on the back of the solid LVMH (MC FP) earnings, with particular strength in Asia amid the reopening, although the US region saw more lacklustre demand for the luxury name. The CAD trailed other cyclicals, despite the oil strength, where the BoC held rates, as expected with a downgraded inflation forecast. Ahead of Friday's retail sales, note BofA's March credit and debit card spending data per household was up 0.1% Y/Y, the slowest growth since February 2021, and down 1.5% M/M, where weakness was broad-based across retail and services.

DATA

US CPI: Headline CPI was cooler-than-expected while Core was inline. Headline CPI M/M cooled to 0.1% (exp. 0.2%, prev. 0.4%), while the annual pace slowed to 5.0% (prev. 6.0%, exp. 5.2%); core M/M rose 0.4% (prev. 0.5%, exp. 0.4%) and Y/Y 5.6% (prev. 5.5%, exp. 5.6%). Fed pricing responded dovishly initially, but it has since returned to roughly where it was before the release. On the data, Pantheon Macroeconomics notes “the slight undershoot in the March headline largely reflects a 0.3% dip in the food at home index, the first M/M decline since November 2020.” Additionally, global food prices surged in 2021/early 2022, but have been falling since the summer, and this decline is now being passed on to consumers. Looking ahead, PM analysts say that his report will not prevent the Fed from hiking in May. Fed officials have made it clear that they want to see a run of slowing increases, particularly in core services ex-housing, and overall inflation is still well above target. However, Pantheon Macroeconomics add the Fed's "resolve is yet to be tested by real softness in the activity data, especially in the labor market.” As such, PM thinks “policymakers will not be quite so keen to keep pushing the “inflation is all that counts” line once payroll growth has weakened materially. We think that’s imminent, so the next few months are likely to bring a serious shift in the Fed’s stance.”

CENTRAL BANKS

FED'S HARKER (voter) said it is disappointing that recent readings show disinflation is proceeding slowly, and the Fed is to determine "what, if any" additional action is needed by looking at the data but he did note that all along his view has been to get rates above 5% and staying there. He did warn that if inflation does not budge, Fed would need more action. Harker also echoed commentary from dovish-sounding Goolsbee that the bank has to be a little careful not to overdo it. Harker added he is already seeing promising signs from the Fed's actions and the Fed is fully committed to returning inflation back to its 2% target. Harker expects under 1% US economic growth this year, saying the US banking system is sound and resilient, the stress is not over but it has calmed down. He also toed the line that the primary tool for financial stability is not monetary policy, and there is a high bar for using mon pol for financial stability.

FED'S KASHKARI (voter) spoke at a town hall event, noting he is less optimistic than the bond market on the speed of the fall in inflation, and he sees inflation at the middle of 3% by year-end and closer to 2% next year. He is not ready to declare an all-clear after the SVB failure, but there are hopeful signs. Adding that he doesn't want to see a build-up of the kind of risks that took down SVB in the banking sector as a whole.

FED'S BARKIN (non-voter), on the CPI report, said it was pretty much as expected and whilst certainly past peak inflation there is still a ways to go. On demand, Barkin noted he is seeing demand cooling, but is waiting for inflation to crack and is not seeing evidence of this yet. As such, he needs to see inflation down at target over successive months. Meanwhile, in the context of the BoC pausing, the Richmond Fed President said if you want to get inflation back to target, you need multiple months where it is headed there.

FED'S DALY (non-voter) expects inflation to end 2023 a little above 3% (vs March SEP Core PCE median at 3.6%) and noted that inflation expectations are anchored, allowing the Fed to take a couple of years to bring down inflation. Specifically, Daly will look in CPI inflation to see if core services ex-housing is coming down. The San Fran President noted the strength of the US economy and elevated inflation suggests there is "more work to do" on rate hikes, while prudent policy requires calibrating decisions based on "all the data". She added there are good reasons that economy may keep slowing even without more hikes. Continuing on rates, Daly noted the Fed must monitor tightening credit conditions in determining the path for rates, and later added that policy tightening is at a point now where the Fed doesn't expect to continue to raise rates at every meeting. Lastly, Daly noted that the bank stresses have stabilised.

FOMC MINUTES: The minutes added little new to what was already known, noting that many on the FOMC lowered their terminal rate forecasts in wake of the banking strains, while some had considered leaving rates unchanged but actions taken by officials helped calm the conditions, resulting in a unanimous hike in March. On the outlook, several emphasized the need to be flexible, while some noted downside risks to growth and upside risks to unemployment had increased, and with inflation above their goal, upside risks to inflation remain a key factor in shaping policy. It also repeated March guidance that some additional policy firming may be appropriate to attain a sufficiently restrictive policy stance to return inflation to 2% over time. The minutes also noted that staff forecasts included a recession later in 2023 as a result of banking woes. For a full summary of the minutes, please click here.

BOC: The Bank of Canada left rates unchanged at 4.5% as expected whilst maintaining language it is prepared to do more on rates if needed to bring inflation back to target. The average GDP forecasts were revised higher for 2023, but down for 2024, while the 2025 growth is seen picking up to 2.5%. On inflation, the 2023 average CPI forecast was revised lower to 3.5% from 3.6%, while 2024 was left unchanged at 2.3% with 2025 inflation seen at 2.1%. The statement noted it "expects CPI inflation to fall quickly to around 3% in the middle of this year and then decline more gradually to the 2% target by the end of 2024" and recent data enforces their confidence inflation will continue to decline in the next few months but getting to 2% could be more difficult as "inflation expectations are coming down slowly, service price inflation and wage growth remain elevated, and corporate pricing behaviour has yet to normalize." Within the MPR, the BoC did lower the output gap estimate to between 0.25-1.25% vs the prior 0.5 - 1.5% while leaving estimates of the neutral rate unchanged at 2-3%. The press conference saw Macklem reveal the governing council discussed whether it had raised rates enough but noted the full work through of prior hikes is not yet done and it also considered the likelihood that rates may need to remain restrictive for longer to return inflation to the 2% target. Macklem also pushed back on market pricing for rate cuts, saying that does not look like the most likely scenario. On growth, he repeated that Canada needs a period of weak growth, but still expects low positive growth and they are not forecasting a major contraction. With BoC maintaining guidance that they are prepared to do more if needed, the pushback from rate cuts from Macklem, and an expected slowdown in growth and inflation, analysts are at odds on what the next move will be. Analysts at Oxford Economics expect rates to be left unchanged throughout 2023, noting their CPI forecasts are aligned with the BoC, but they see much weaker GDP growth in 2023 than the BoC expects. Meanwhile, Capital Economics is looking for a cut in October as they expect a modest recession and expect to see both GDP and core inflation slow even faster than the BoC assumes.

FIXED INCOME

T-NOTE (M3) FUTURES SETTLED 10+ TICKS HIGHER AT 115-22+

Treasuries steepened after CPI came in soft, although Fed still priced in for another hike in May. 2s -9.6bps at 3.962%, 3s -10.6bps at 3.694%, 5s -8.7bps at 3.463%, 7s -6.5bps at 3.427%, 10s -3.2bps at 3.402%, 20s +0.2bps at 3.749%, 30s +1.6bps at 3.637%.

Inflation breakevens: 5yr BEI -6.5bps at 2.274%, 10yr BEI -1.5bps at 2.289%, 30yr BEI +1.8bps at 2.263%.

THE DAY: Treasuries were rangebound for most of APAC trade on Wednesday before modest selling crept in ahead of Europe's arrival. T-Notes printed session lows of 115-08, ahead of Tuesday's 115-06+ low, before paring somewhat as US traders arrive. Catalysts and inactivity were very light ahead of US CPI. The soft headline CPI figures and in-line core metrics saw T-Notes spike from 115-12 to session highs of 116-08, with the front-end leading as steepeners were put on and flatteners were unwound. However, the bid couldn't sustain and contracts saw substantial paring into the NY afternoon, with a Walmart USD 5bln, five-parter weighing ahead of the 10yr auction as well as a rally in crude prices. Fed's Barkin (non-voter) was eager to pushback on any imminent Fed shift expectations too, stressing that more tightening is needed. T-Notes dipped beneath pre-CPI levels (115-12) in wake of the weak 10yr auction, only to recover back above into the settlement, with the Fed minutes not offering too incremental, confirming that some considered pausing in March in wake of the banking crisis, while the minutes did show that Fed staff are forecasting a recession later this year. Some more dovishly balanced comments from ECB's Villeroy, who said the ECB may not need to hike in May with the bank completed most of its rate hike path journey already, saw some late bullish spillover from EGBs, adding to the late recovery for govvies. Portfolio balancing looked potentially a factor in late trade too with stocks dipping in absence of an obvious catalyst.

10YR AUCTION: A weak 10yr reopening from the Treasury, failing to bring out a strong demand reception despite the promising inflation data earlier, with participants likely cautious ahead of the FOMC minutes. The 3.455% high yield tailed the WI by 2bps, not as bad as last month's 2.7bps tail but worse than the six-auction average 1.3bps. The internals weren't as bad, where the 2.36x bid/cover ratio was slightly below the average 2.4x. Dealers (forced surplus buyers) were left with 17.1%, which was better than the average 17.4% and an improvement from last month's 17.7%.

NEXT UP: Traders now look to Thursday's PPI, jobless claims, and 30yr auction, and then Friday's retail sales, industrial production, 30yr auction, and big bank earnings (JPM, WFC, C).

STIRS:

- SR3H3 +0.3bps at 95.09, M3 +3.5bps at 95.06, U3 +7.5bps at 95.38, Z3 +8bps at 95.745, H4 +9.5bps at 96.205, M4 +12bps at 96.605, U4 +14bps at 96.91, Z4 +14.5bps at 97.075, H5 +13bps at 97.14, H6 +8bps at 97.19.
- US SOFR at 4.80% (prev. 4.81%), volumes at USD 1.365tln (prev. 1.366tln).
- NY Fed RRP op demand at USD 2.304tln (prev. 2.297tln) across 106 bidders (prev. 109).
- Fed pricing is still at 75% implied for a hike in May, unwinding a fall to the sub-70% area post-CPI.
- US EFFR at 4.83% (prev. 4.83%), volumes at USD 108bln (prev. 106bln).

CRUDE

WTI (K3) SETTLES USD 1.73 HIGHER AT 83.26/BBL; BRENT (M3) SETTLES USD 1.72 HIGHER AT 87.33/BBL

Oil prices ripped higher to new peaks on Wednesday in the wake of the promising CPI data and the softer Dollar, while EIA inventories were mixed. It was one-way traffic after the US inflation data, with WTI and Brent breaking above their post-OPEC surprise production cut peaks of USD 81.81/bbl and 86.44/bbl, respectively, spurring on more momentum-driven strength. The EIA reported a US crude stock build of 0.6mln bbls in the latest week, a 0.3mln bbl gasoline draw, and a 0.6mln bbl distillates draw; refinery utilisation declined; crude production rose 100k BPD back to 12.3mln BPD. We also got some late comments from IEA's Birol who said the global oil market is to see tightness in H2 2023, potentially pushing oil prices higher to above USD 85/bbl, he also said the OPEC+ cut was a bad surprise for the global economy.

EQUITIES

CLOSES: SPX -0.41% at 4,092, NDX -0.89% at 12,848, DJIA -0.11% at 33,647, RUT -0.72% at 1,774.

SECTORS: Consumer Discretionary -1.54%, Communication -0.89%, Technology -0.61%, Consumer Staples -0.45%, Real Estate -0.3%, Financials -0.2%, Utilities -0.12%, Health Care +0.02%, Materials +0.07%, Energy +0.11%, Industrials +0.33%.

EUROPEAN CLOSES: EURO STOXX 50 +0.02% at 4,334, FTSE 100 +0.50% at 7,824, DAX 40 +0.31% at 15,703, CAC 40 +0.09% at 7,396, FTSE MIB +0.38% at 27,629, IBEX 35 +0.44% at 9,278, SMI -0.28% at 11,233.

STOCK SPECIFICS: **Emerson (EMR)** confirmed it is to acquire **National Instruments (NATI)** for USD 8.2bln or USD 60/shr. Note, NATI closed Tuesday at USD 52.58/shr. EMR reaffirmed Q2 guidance. **Triton (TRTN)** is to be acquired by **Brookfield (BIPC)** for USD 13.3bln or USD 85/shr vs prior closing price at USD 63.01/shr. **Shopify (SHOP)** was upgraded at JMP Securities. **Global Payments (GPN)** was upgraded at Goldman Sachs; said it believes GPN is poised to sustain somewhat better than feared trends as currency headwinds fade, aided by a stronger start to the year in Q1 '23. **American Airlines (AAL)** prelim Q1 adj. EPS and revenue guide was short of analyst expectations; sees ASMs +9.2% Y/Y (prev. +8-10%Y/Y) and TRASM +25.5% Y/Y. Activist investor Dan Loeb reportedly exploring taking **SiriusPoint (SPNT)** private, according to Bloomberg. **Intel Foundry Services (INTC)** and **Arm (SFTBY)** announced a multigeneration agreement to enable chip designers to build low-power compute system-on-chips (SoCs) on the Intel 18A process. On DRAM prices, and of note for **Samsung (SSNLF), Micron (MU), and Western Digital (WDC)**, DRAM prices are rebounding following Samsung's output cut, boosting hopes for a sooner-than-expected market recovery, according to Ked Global. As a reminder, Samsung announced a substantial scaling back of chip production in response to a global supply glut that has driven the price of semiconductors down by more than 70%. EU said **Broadcom's (AVGO)** takeover of **VMWare (VMW)** might restrict competition in market for hardware components; Broadcom noted it remains confident VMW deal does not present any competition issues. **LVMH (MCFP/LVMUY)** posted stellar earnings with upbeat commentary as it beat on revenue with fashion & leather organic sales significantly topping the expected. **UPS (UPS)** has been accused of stalling on local agreements by teamsters and contract talks have been delayed. **Tesla (TSLA)** is preparing to launch Powerwall 3, the third generation of its home battery pack, according to information obtained by Electrek.

US FX WRAP

The Dollar sold off after cooler than expected headline CPI with the DXY hitting lows of 101.44, just beneath the April 4th low of 101.45 and nearing the April 5th low of 101.40. The FOMC minutes saw little reaction, mainly repeating that many participants had lowered their views of the peak rate due to the banking strains, although confirmed that several considered it would be appropriate to leave rates unchanged, but noted the calm conditions and lower near term risks saw them opt for a hike instead.

The Euro was supported after the data as the Dollar tumbled, seeing the pair peak at 1.1000 on the nose. There was a slew of ECB speakers, Villeroy was hawkish on inflation, but noted it is premature to decide whether the ECB hikes in May, but he did suggest there is still a little way to go with rate hikes but most of the rate hike journey has been completed. Holzmann said the inflation outlook argues for another 50bps in May, and they need to keep hiking beyond then, adding they may be able to accelerate QT from July. De Guindos said provisional data points to positive eurozone growth rates in Q1.

The Yen was supported by the CPI-induced Dollar selling and front end-led Treasury rally with Fed pricing shifting dovishly over the medium term, although a May hike is still 75% priced in. Fed speakers such as Barkin today suggested there is a ways to go in tightening.

Cyclical currencies were buoyed after the US CPI with outperformance in the Aussie also buoyed by gains in commodities seeing AUD/NZD briefly reclaim 0.6700, but it is struggling to hold the level. NZD/USD was also firmer on the session, but not to the same extent as its Aussie counterpart. AUD/NZD rose above 1.0750. GBP was also bid and tested 1.25 to the upside from lows of 1.2399 but failed to breach above the level. CAD saw gains, albeit not as much as its cyclical counterparts despite the rally in crude prices. The BoC was largely as expected where it raised near-term growth forecasts and slightly revised lower its inflation view, whilst maintaining its hawkish escape door with guidance that it is prepared to do more if needed.

EMFX was mixed with LatAm FX (BRL, MXN, COP, CLP) welcoming the Dollar decline and commodity rally. BRL continued its rally to see USD/BRL fall sub 5.00 after the US CPI data, while Brazil data saw strong retail sales. There was also commentary from Treasury Secretary Ceron who noted the fiscal rules in Brazil are boosting investor optimism, as well as the currency and it is gaining due to strong demand from foreigners. BCB Chief Neto noted inflation has declined, but pressures do remain. TRY was hit by the rising oil prices while ZAR failed to reap the benefits of rising Gold prices and the weaker Dollar.