US Market Wrap

16th May 2023: Stocks and bonds lower after mixed data, Fed speak, debt ceiling talks and earnings

- **SNAPSHOT**: Equities down, Treasuries down, Crude down, Dollar up.
- **REAR VIEW**: Weak Chinese activity data; Decent US retail sales and strong IP; PFE launched $31bln jumbo M&A bond deal for SGEN; FTC files lawsuit against AMGN's acquisition of HZNP; Hawkish Holzmann; Hawkish Mester, Dovish Logan; Biden to return to US on Sunday after G7 to focus on debt ceiling talks; Higher 2023 demand forecast from IEA MOMR; Disappointing HD revenue and cut FY guidance.
- **COMING UP**: **Data**: EZ HICP (Final), US Building Permits/Housing Starts **Speakers**: Fed's Bostic, ECB's de Cos, Elderson, Panetta, de Guindos; BoE's Bailey **Supply**: Japan, UK, Germany & US **Earnings**: Siemens, Commerzbank, Munich Re; Target, Cisco, TJX.

MARKET WRAP

It was a risk off session with the majority of stocks and indices in the red with the only pockets of strength in Tech and large-cap names. Overall economic data was mixed, China data signalled a slower-than-expected rebound from the re-opening while US retail sales data was net positive with a headline miss, in line core prints but a strong control group. Meanwhile, US Industrial production and manufacturing output were above expectations. There was plenty of Fed speak again, non-voter Mester was hawkish saying she doesn't feel the Fed are at a sufficiently restrictive level yet, while Logan (voter) was more dovish warning of financial stability risks and speaking of the need to travel more slowly in an uncertain environment while others repeated familiar themes. Debt ceiling talks are ongoing but after the Congressional leaders meeting with Biden, McCarthy spoke on the closing bell and said it is possible to get a deal by the end of the week but they are still far apart while Schumer said the meeting was good and productive. Treasuries bear flattened on the US economic data, hawkish comments from Mester and the launch of Pfizer's USD 31bln bond offering. Crude prices were lower on the soft China data. US retailers were hit ahead of earnings this week after a woeful report from Home Depot (HD) which missed on revenue and same-store sales and cut its guidance. The Health Care sector was also lower after the FTC filed a lawsuit to prevent Amgen's (AMGN) USD 27.8bln acquisition in Horizon Therapeutics, raising some concerns for the Pfizer (PFE) and Seagen (SGEN) deal.

DATA

CHINA ACTIVITY DATA: China's April activity and spending data disappointed expectations. Retail Sales rose +18.4% Y/Y in April, improving from 10.6% Y/Y in March, but missing the consensus estimate for +21.0% Y/Y. Industrial Output rose by 5.6% Y/Y in April, rising from a rate of 3.9% Y/Y in March, but short of the 10.9% estimate. The rate of urban investment pared to 4.7% Y/Y in the month, missing expectations of 5.5%, although the Urban Unemployment Rate fell to 5.2% from 5.3%. "Growth on most indicators accelerated in y/y terms in April. But this was due to a weak base for comparison from a year ago when Shanghai and several other cities went into lockdown," Capital Economics explained, adding that in seasonally-adjusted M/M terms, the outturn was mixed. "The recovery in consumer spending regained some momentum and investment growth held steady but industrial activity contracted," it said, adding that "while the boost from reopening should still underpin a further recovery in the near-term, the bulk of China's rebound is now behind us." CapEco says that the recovery still has some legs, although will likely fizzle out in H2, as fiscal support is being unwound, the rebound in credit growth is stalling, while the housing market appears seems to be struggling for momentum. Additionally, global economic challenges may prevent a pick-up in Chinese exports.

US INDUSTRIAL PRODUCTION: US industrial production for April rose 0.5%, above the expected 0%, although the March data saw a revision lower to 0% from +0.4% after flatlining in February too. Manufacturing output rose 1%, well above the expected +0.1%, bolstered by a strong gain in the output of motor vehicles (a massive +9.3%) and parts, while the prior was revised lower to a 0.8% decline from the initial 0.5% decline; factory output excluding motor vehicles and parts rose 0.4%. The index for mining rose 0.6%, while the index for utilities dropped 3.1%, as milder temperatures in April lowered demand for heating. At 103% of its 2017 average, total industrial production in April was 0.2% above its year-earlier level. Capacity utilization edged up to 79.7% from 79.4%, a rate that is equal to its long-run (1972–2022) average. An area of note was the rise in business equipment output by 1.2% after two months of decline, a sector that analysts deem vulnerable to a tightening in lending standards but so far, so good. However, there is an expectation that output in the sector will struggle going forward.

US RETAIL SALES: Headline retail sales came in beneath analyst expectations at 0.4% (exp. 0.8%) but pared some of the 0.7% decline seen in March. Although the headline missed, the internals were more encouraging with ex-autos at 0.4% (exp. 0.4%, prev. -0.5%), while the ex-gas and autos rose 0.6%, above the prior -0.5%. Meanwhile, the control group, which feeds into GDP data, saw a strong reading at 0.7%, above the 0.3% forecast and prior -0.4%. The report showed a relative mix of spending in April with decent gains in Motor Vehicle and Parts Dealers, Building Materials, Health and Personal Care, as well as General Merchandise, Non-store Retailers, Food Services and Drinking places as well as Miscellaneous Store Retailers. However, on the flip side, Furniture, Electronics, Food and Beverage Stores, Gasoline Stations, Clothing and Sporting Goods saw declines. Overall a decent report shows consumers are still spending, particularly evidenced by the control group, although analysts highlight concerns ahead with tighter lending standards and a slowing labour market may see consumer spending fall towards the end of the year. Nonetheless, this release adds to the raft of strong April data seen recently, including the stellar April NFP. However, the initial surveys for May (NY Fed, UoM) have been woeful so analysts are looking to see if it translates to the hard data too. Meanwhile, looking ahead analysts are expecting a slowdown due to the lag effects of monetary policy, tighter credit conditions, slowdown in growth and as COVID savings are utilised.

NAHB: NAHB housing market index rose for a fifth consecutive month to a 10-month high of neutral 50 in May (prev. 45.0) above the expected 45.0, with Oxford Economics suggesting some upside risk to housing starts over the coming months. The consultancy notes that low inventory of existing homes is helping support new supply, and even though homebuilders are feeling more confident, Oxford Economics think “tighter lending standards for construction loans will constrain the number of new homes they are able to break ground on”. Separately, the consultancy adds, buyer traffic levels remain subdued, but most homebuilders report stronger sales and are growing increasingly confident about sales over the coming six months too, particularly in the South and West.

FED

LOGAN (voter) leant dovish, noting when there is uncertainty, you may need to travel more slowly, saying gradual policy adjustments can be helpful in mitigating financial stability risks. Logan also said the speed of increases and length of time at peak rate can influence the impact on stability. She said policies need to mitigate stability risks and they also need to offset bank stress effects on monetary policy.

MESTER (non-voter) leant hawkish, noting she would like the policy rate to get to a point where it could equally be a potential increase or decrease, but she does not think we are at that level yet given how stubborn inflation is. Mester says she does not want to put it in terms of a pause, but in terms of a hold, and said she does not think they are at that hold rate yet. On data, said it shows US rates are not at a sufficiently restrictive level.

WILLIAMS (voter) said the economy is facing unacceptably high inflation but the economy it is starting to get back to more normal patterns, with demand and supply moving back into balance. He noted inflation is moving gradually in the right direction but it takes a while for Fed decisions to fully affect the economy.

GOOLSBEE (voter) said he has not decided anything for the June rate meeting, and it would be a mistake to commit to a rate move when more data is coming. He added have seen some froth taken off labour markets, but not sure if we have put enough restraint on the economy yet. On cuts, said it is far too premature to be talking about rate cuts. Goolsbee concluded the Fed needs to look at more data besides jobs, wages, and inflation.

BARR (voter), on interest rate risk, said there is a heightened risk related to the debt ceiling. Barr added they should be careful and prudent in thinking about making capital changes, but are looking at whether changes in the value of Available For Sale (AFS) securities should be taken into account for capital requirements. The Vice Chair of Supervision concluded saying they take expected credit tightening into account as we make monetary policy.

FIXED INCOME

T-NOTE (M3) FUTURES SETTLED 10 TICKS LOWER AT 114-29+

Treasuries bear-flattened Tuesday after hot April retail sales and industrial production were aided by some hawkish Fed Speak, offsetting weak global data. At settlement, 2s +7.8bps at 4.082%, 3s +6.7bps at 3.739%, 5s +5.5bps at 3.524%, 7s +4.6bps at 3.533%, 10s +3.9bps at 3.547%, 20s +3.4bps at 3.962%, 30s +2.5bps at 3.867%.

INFLATION BREAKEVENS: 5yr BEI -0.5bps at 2.134%, 10yr BEI +0.3bps at 2.214%, 30yr BEI +0.4bps at 2.264%.

TOKYO/LONDON: Treasuries caught a bid into the Tokyo session on Tuesday with weak Australian consumer sentiment data, dovish RBA minutes, and, crucially, a big miss in Chinese April economic data (IP +5.6% vs exp. +10.

9%), all providing tailwinds for govvies. Spillover strength extended from gilts on the back of the edge higher in the UK unemployment rate as London trade got underway. T-Notes made session highs of 115-18+ not long after struggling for direction ahead of the US session, with the miss in the German ZEW survey providing some support.

NEW YORK: Gains began to fade as US players arrived, first slowly, then suddenly after the strong core US retail sales data (despite the soft headline figure) was accentuated by Pfizer (PFE) launches its USD 30bln+ jumbo M&A bond deal for Seagen (SGEN), with rate-lock related flows (Tsy selling/swap paying) taking T-Notes swiftly through their APAC lows of 115-06+. Fed's Mester (nv) saying not long after that she doesn't believe the Fed is at a pause stage yet saw continued govvie selling, as did the strong industrial production data, although the curve held onto its steepening shape at the time with the 30yr hitting 10wk highs. However, as the dust settled, and Europe started to close up shop, some pronounced bear-flattening flows were seen in lack of an obvious catalyst barring a 'delayed reaction' to the earlier data /Fed Speak. The curve completely reversed its initial steepener into the NY afternoon.

THIS WEEK'S SUPPLY: US to sell USD 15bln of 20yr bonds on May 17th, to settle on May 31st; to sell USD 15bln in 10yr TIPS reopening on May 18th, to settle on May 31st.

THIS WEEK'S CALENDAR: (Weds) Japanese GDP, Australian wage/price index, EZ CPI (final), US housing starts, **20yr auction**; (Thurs) Japanese trade balance, Australian labour report, **Philly Fed mfg. survey**, IJC, existing home sales, 10yr TIPS auction, Banxico; (Fri) G7 Summit in Japan, SARB, **Japanese CPI**, Fed's Williams and **Powell** both at a Fed conference.

STIRS:

- SR3H3 -0.3bps at 95.055, M3 -1.0bps at 94.898, U3 -6.0bps at 95.150, Z3 +0.0bps at 95.500, Z3 -8.5bps at 95.580, H4 -9.5bps at 96.110, M4 -8.0bps at 96.575, U4 -5.5bps at 96.895, Z4 -4.0bps at 97.080, H5 -3.5bps at 97.170, H6 -4.5bps at 97.160.
- SOFR rises back to 5.06% from 5.05%, volumes rise to USD 1.497tln from 1.352tln.
- NY Fed RRP op demand at USD 2.203tln (prev. 2.221tln) across 101 counterparties (prev. 103).
- EFFR flat at 5.08%, volumes rise to USD 126bln from 124bln.
- US sold USD 41bln of 1yr bills at 4.645%, covered 2.48x; sold USD 45bln of 154-day CMBs at 5.075%, covered 2.68x.
- US raised its 17-week bill auction (May 17th) size to USD 39bln (prev. 36bln); leaves 4- and 8-week bill auction (May 18th) sizes unchanged at USD 35bln each; all to settle on May 23rd.

CRUDE

WTI (M3) SETTLED USD 0.25 LOWER AT 70.86/BBL; BRENT (M3) SETTLED 0.32 LOWER AT 74.91/BBL

The crude complex was lower on Tuesday as weak economic data out of China offset decent US retail sales and a higher demand forecast from the IEA. While Chinese industrial output and retail sales (Apr) rebounded, it was not as strong as expected and the post-COVID rebound of its economy continues to be slower than anticipated. However, desks note, an 18.9% Y/Y rise in China's oil refinery throughout April, to the second highest on record, helped keep a floor on crude prices as WTI and Brent printed troughs of USD 70.45/bbl and 74.50/bbl, respectively. Meanwhile, US retail sales saw the headline miss expectations, but the core metrics were in line while the control group saw a notable rebound, which is a good sign for Q2 GDP. On supply, Libya's NOC held a meeting which outlined steps to raise oil production rates during the current year. Meanwhile, Venezuela's PDVSA restarted operations at its 80k BPD crude oil distillation unit at its El Palito refinery (146k BPD), after a stoppage due to an electrical failure last Thursday, according to Reuters sources. Looking ahead, there is private inventory data after-hours, ahead of the weekly EIA data on Wednesday, where current expectations are: Crude -0.9mln, Gasoline -1.1mln, Distillate +0.1mln.

IEA: The IEA raised its 2023 global demand growth forecast by 100k BPD from the prior report (vs Unch. in the OPEC MOMR and +120k BPD in the EIA STEO), while it also suggested "The current market pessimism, however, stands in stark contrast to the tighter market balances we anticipate in the second half of the year," and "China’s demand recovery continues to surpass expectations". Report also suggested little impact from the developments regarding the Iraq-Turkey export pipeline since March, the Canadian wildfires, Nigerian protests, and maintenance-related cuts in Brazil. In wake of the report, Goldman Sachs said the report was neutral to slightly bullish for oil prices given modestly tighter 2023 balance and downward revisions to OECD commercial stocks.

OPEC: OPEC Secretary General al-Ghais has invited Ecuador to rejoin OPEC three and a half years after it left, according to Argus Media. Ecuador produced around 489k BPD of crude oil in Jan 2023.

EQUITIES

CLOSES: SPX -0.64% at 4,109, NDX +0.09% at 13,426, DJIA -1.01% at 33,012, RUT -1.44% at 1,736.

SECTORS: Real Estate -2.61%, Energy -2.54%, Utilities -2.3%, Materials -1.64%, Industrials -1.36%, Financials -0.97%, Consumer Staples -0.88%, Health -0.82%, Consumer Discretionary -0.25%, Technology +0.16%, Communication Services +0.59%.

EUROPEAN CLOSES: Euro Stoxx 50 -0.02% at 4,315, FTSE 100 -0.34% at 7,751, DAX 40 -0.12% at 15,897, CAC 40 -0.16% at 7,406, FTSE MIB -0.17% at 27,198, IBEX 35 -0.11% at 9,191, SMI -0.50% at 11,520.

STOCK SPECIFICS: FTC filed a lawsuit to prevent **Amgen's (AMGN)** USD 27.8bln acquisition of **Horizon Therapeutics (HZNP)** with regulators concerned that the merger would limit innovation and slow the development of new drugs. Amgen responded saying it is disappointed by the FTC's decision but remains committed to completing the acquisition. **Home Depot (HD)** missed on revenue and SSS; cut FY guidance with both sales and EPS seen declining Y/Y. Exec said given the negative impact to Q1 sales from lumber deflation, weather, further softening of demand relative to our expectations, and continued uncertainty regarding consumer demand, it updated its guidance. **Nu Holdings (NU)** beat on revenue and surpassed 80mln customers in LatAm; in Brazil, 46% of the adult population is a Nubank customer, a figure that has doubled in only two years. Exec said it has an exceptional capital position and excess liquidity. Berkshire Hathaway's 13-F revealed it took a new stake in **Capital One Financial (COF)** worth over USD 950mln. **Dish Network (DISH)** director James DeFranco disclosed the purchase of 3mln shares. **Baidu (BIDU)** beat on the top and bottom line largely due to gains in online marketing and other sales. **Newell Brands (NWL)** cut its quarterly dividend. Online brokerages **Futu Holdings (FUTU)** and **UP Fintech Holding (TIGR)** will remove their apps in mainland China this week under the guidance of Chinese regulators. **Microsoft (MSFT)** announced it is continuing to deliver new AI innovation in Bing and Edge this week.

US FX WRAP

The Dollar was marginally firmer on Tuesday after the US retail sales data was overall, better than expected despite the miss in the headline, but the core metrics were in line and the control group saw a notable rise. The IP data was also stronger than expected and NAHB Housing Market Index also moved higher. DXY saw a high of 102.69 but failed to reach the prior day high of 102.75. There was plenty more Fed speak too, particularly some hawkish remarks from Mester who appeared to be swaying towards another rate hike noting she is not sure the Fed has done enough to be sufficiently restrictive, while Goolsbee and Barkin repeated commentary from Monday.

The Euro was flat vs the Dollar but saw gains vs GBP on hawkish ECB commentary from known-hawk Holzmann. EUR/USD traded in a c. 50bp range between 1.0856 and 1.0904 with the cross rising above the level in the EU morning before paring to c. 1.0860 after the US data and rise in US yields rose after hawkish Mester comments, the aforementioned data, and Pfizer issuance.

The Yen saw mild weakness vs the Buck as US yields advanced and USD/JPY hit a high of 136.68 from lows of 135.70. CHF was flat vs the buck on its haven properties with the S&P 500 lower on the session helping offset dollar strength. Nonetheless, gold prices tumbled as yields rose to see gold settle beneath USD 2,000/oz for the first time since May 1st.

The Yuan saw notable weakness after disappointing China economic data overnight which although rebounded, it was not as fast as expected and is another sign the China reopening is not living up to expectations. USD/CNH saw highs of 6.9989 finding resistance at the psychological 7.00 level, a level not seen in 2023 so far.

Cyclical currencies were generally weaker, particularly the Aussie after the aforementioned China data while NZD benefitted from the Aussie weakness with AUD/NZD falling sub 1.07. GBP also was weaker vs both the Dollar and the Euro after the UK Jobs data which saw an above expectations employment change, although the unemployment saw a surprise rise to 3.9% from 3.8% while earnings also did not rise as much as expected. CAD was flat vs the buck as a hotter than expected CPI report offset the weakness in crude prices, although the BoC eyed measures did tick lower to 4.7% from 4.97%.

In EMs, BRL saw notable weakness after the fiscal rules were toughened while MXN was only marginally weaker vs the buck ahead of Banxico on Thursday where the majority look for an unchanged decision but some forecast a 25bp hike. CLP was softer after the China data weighed on copper prices.

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