US Market Wrap

24th May 2023: Stocks fall on default risk, yields rise on hot UK CPI and hawkish Waller

- **SNAPSHOT**: Equities down, Treasuries down, Crude up, Dollar up.
- **REAR VIEW**: Waller to favour hike or skip, depending on data; Minutes in fitting with recent comms; humongous US crude stock draw; Mixed Debt Ceiling rhetoric; RBNZ ends hiking cycle; Hot UK CPI; Strong 5yr auction.
- **COMING UP**: **Data**: US IJC, GDP (2nd), PCE Prices Prelim., German GfK **Events**: CBRT & SARB Policy Announcements **Speakers**: Fed's Barkin, Collins; ECB's Lane, de Guindos, Wunsch, Makhlouf, Vujcic; BoE's Haskel **Supply**: Japan, Italy & US **Earnings**: Generali, United Utilities, Ralph Lauren.

MARKET WRAP

Stocks were lower on Wednesday as we move closer to a US default with no deal on the table, although rhetoric has been optimistic in nature. Treasuries bear-flattened on hot UK CPI and positive debt ceiling rhetoric (albeit still no deal), despite a solid 5yr auction and mixed FOMC minutes while Waller talked down prospects of a pause. RBNZ signalled the end of its rate hiking cycle, seeing the Kiwi post its worst day of the year. The Dollar was bid on risk off trade with USD/JPY at its highest level since December, Pound was weaker vs Dollar and Euro amid CPI woes but prospered amongst activity currencies which generally were sold on the poor risk tone, with commodity currencies largely suffering. Oil prices were firmer after a titanic 12.5mln bbl draw in crude stocks and potential Russian gasoline export restrictions. However, metals were largely sold across precious and industrial groups.

FED

WALLER (voter), the most influential hawk at the Fed, toed the line between a skip or a hike for the June meeting, stressing that his decision will be highly dependent on data leading into the event: April PCE on May 26th, NFP and AHE on June 2nd, and May CPI on June 13th (also the first day of FOMC). The Board Governor said he will be assessing the "critical" CPI and PCE data to learn more about inflation dynamics and "if we are seeing some easing in inflation pressures"; Waller also said he is concerned inflation won't come down much unless the growth of average hourly wages nears 3%, compared to the 4.4% Y/Y level in April. He will also be assessing the evolution of the data on credit conditions "to evaluate how much potential tightening is coming from the banking sector", specifically looking at "both interest rates and non-rate conditions, such as the number of new loans, the size of loans, and the lending terms." Waller makes it clear he is not in favour of a pause, warning that he is concerned about the lack of progress on inflation and goes as far as to say he is not expecting any data in the next couple of months to make it clear the terminal interest rate has been reached, adding, "I do not support stopping rate hikes unless we get clear evidence that inflation is moving down towards 2%." Compared to his colleagues, Waller was not as hawkishly blase as Dallas Fed's Logan (v), who explicitly said June was not the time for a skip, although perhaps more in line with the likes of Bullard (nv) in keeping a June skip on the table, whilst simultaneously guiding for more hikes to come beyond June. And of course, somewhat offsets the likes of Powell, Jefferson, and Williams on the board who have all been foaming the runway for rates to be held unchanged at the June FOMC.

MINUTES: The May FOMC minutes were very in fitting with recent Fed commentary and showed that officials are somewhat split on support for more rate hikes, where the extent to which further rate hikes may be appropriate had become less certain. Where several said if the economy evolved along the lines of their outlooks, further policy firming might not be needed, but some said with inflation expected to take a while to return to 2%, additional firming would likely be appropriate. However, some did stress it was crucial the policy statement did not signal the likelihood of rate cuts this year, or rule out further rate hikes and participants emphasized the importance of communicating their data-dependent approach. For a full recap, please see the Newsquawk FOMC Minutes key points..

GLOBAL

DEBT CEILING: US House Speaker McCarthy announced he had sent negotiators to the White House on Wednesday for negotiations to finish things in a number of places where we are still far apart. McCarthy said to the press he does not think there'll be a default but he warns there are still differences over spending and he repeated the red line for him is that we have to spend less than what was spent last year. McCarthy said after negotiations later on that things are going a little better, and believes they can get back to a 2022 spending level. The House speaker added there should not be any fear in markets and negotiations will continue this evening as a number of issues remain unresolved, but some progress has been made and things are better than they were yesterday.

RBNZ REVIEW: The RBNZ lifted rates by 25bps to 5.5%, and suggested that it will not be raising interest rates further after lifting the OCR to the highest level in over 14 years. The decision surprised the market, as some expected (and still expect) more rate hikes. Westpac noted that the Committee had a vote for the first time on whether to keep rates the same, or raise by 25bps; Two members voted for no change, while the others voted for the increase. Policymakers also talked about the possibility of higher house prices and economic risks from migration, but overall, the Committee believes that a 5.5% interest rate will help manage those risks. "The bottom line is that this is a central bank that sees itself on hold for a protracted period," Westpac wrote, "key risk factors are likely to be around the judgement of the RBNZ that the quite significant boost in population growth will quickly reverse and not add to housing market or inflation pressures," and the bank added that "data on house prices and migration will be important to watch in that regard, and similarly labour market indicators will be important to watch." Westpac now sees that RBNZ on hold in July, but warns that there remains some potential for a +25bps hike in August. "Should this not eventuate we anticipate the RBNZ to remain on hold until after the election in October," adding that "by this time we expect that the housing market and migration pressures will be showing up fairly strongly and require a further adjustment in the OCR to the 5.75-6.00% range."

UK INFLATION: UK inflation metrics were hotter than expected in April, with the annual headline rate easing to 8.7% Y/Y from 10.1%, but above the expected 8.2%; the core measure rose to 6.8% Y/Y from 6.2% against expectations that it would be unchanged in the month. Money markets moved hawkishly, and now a +25bps rate rise at the June meeting, which would take rates to 4.75%, is full priced. The significant decrease in inflation was primarily attributed to a sharp decline in utility prices, which can be attributed to the smaller decrease this year compared to the previous year when prices were frozen under the Energy Price Guarantee imposed by the government. Furthermore, utility inflation is expected to decrease further in July when energy price caps drop below the government's price guarantee. The specific cap for July will be announced on Thursday. Meanwhile, the increase in core inflation has pushed the annual measure beyond the previous perceived peak of 6.5% in April of the previous year, reaching the highest levels since 1992. This rise was attributed to an increase in prices for core goods, while the growth in services inflation from 6.6% to 6.9% exceeded the Bank of England's forecast of 6.7%. "In other words, the recent resilience of economic activity appears to be stoking domestic inflationary pressure," Capital Economics said, adding that "with inflation proving stickier than the Bank expected, it now seems all-but certain that the Bank will raise interest rates in June, and perhaps a bit further in the months after." Following the release, money market pricing now sees the UK terminal rate at just over 5.25% in December (from around 5.00% before the release).

FIXED INCOME

T-NOTE (M3) FUTURES SETTLE 6 TICKS LOWER AT 113-13+; JUNE-SEP ROLL 60% COMPLETE

Treasuries bear-flattened Wednesday on hot UK CPI and positive debt ceiling rhetoric (despite no deal), despite a solid 5yr auction and mixed FOMC minutes. 2s +7.2bps at 4.355%, 3s +5.7bps at 4.041%, 5s +4.8bps at 3.796%, 7s +4.4bps at 3.763%, 10s +3.2bps at 3.730%, 20s +2.6bps at 4.114%, 30s +2.0bps at 3.972%.

INFLATION BREAKEVENS: 5yr BEI -3.1bps at 2.203%, 10yr BEI -2bps at 2.270%, 30yr BEI -1.3bps at 2.315%.

TOKYO/LONDON: Treasuries extended their recovery into the Tokyo session on Wednesday with debt ceiling angst remaining and tailwinds from the solid 2yr auction - cash desks noted real money demand in the belly from Asia accounts. T-Notes hit resistance at 113-23+ before tumbling at the London handover amid spillover from Gilts after a bounce in UK April core CPI and a smaller fall in the headline than expected - BoE rate hike expectations ramped. T-Notes hit troughs of 113-13 before recovering into the European morning, with the soft German Ifo survey providing support. Duration led the bid into the NY handover, flattening the curve despite a 17.4k Sept 2yr fut block buyer, with further reports around the lack of progress in debt talks driving T-Notes to session peaks at 113-25.

NEW YORK: Treasuries trundled gradually lower through the NY morning in the absence of an obvious catalyst, although House Speaker McCarthy did note discussions were still positive, for what it's worth. The selling became a bit more abrupt into the NY afternoon. Firstly after McCarthy's press conference noting he does not think there will be a default, speaking in an optimistic tone despite the differences over spending. Then again after Fed Governor Waller (hawk) said the data over the next three weeks would decide whether he agrees to a skip or a hike, whilst saying he doesn't expect to be done with hikes anytime soon even if they do skip June. T-Notes made fresh session lows at 113-

06+ before paring into the FOMC minutes, with the hot 5yr auction supporting the recovery. There was little immediate reaction to the May meeting's minutes, which are somewhat stale given all the commentary in wake of the meeting, but there was some bull-steepening flow as the dust settled, but that failed to sustain into settlement.

5YR AUCTION: Yet another stop-through for the May refunding cycle, with USD 43bln of 5yr notes sold at 3.749%, the highest auction stop for the 5yr sector since the banking crisis. The solid auction comes despite the 5yr offering little appeal from a relative value perspective, with the 5yr trading at its richest level on the 2s5s10s fly in over a decade, although the fly did see some significant cheapening running into the auction on Wednesday. The offering stopped through the WI by 1.4bps, better than the prior stop-through of 0.6bps and six-auction average 0.4bps. The bid/cover ratio rose to 2.58x from last month's 2.54x, above the avg. 2.50x. Dealers (forced surplus buyers) were left with a minuscule 9.3%, down from April's 13.6% and against the avg. 13.1%, thanks again to a step-up in Indirects participation (as seen in the 2yr on Tuesday) to 72.7% from 69.1% (avg. 69%).

REFUNDING: US Treasury to sell USD 35bln of 7yr notes on May 25th; to settle on May 31st.

FED SPEAK: For Thursday, we get Barkin (nv) at 09:50ET, speaking in Virginia, and Collins (nv) at 10:30ET, at a fireside chat. No scheduled speakers on Friday.

DATA/EVENTS THIS WEEK: (Thurs) CBRT, SARB, German GDP, GfK Consumer Sentiment, US Q1 GDP/PCE Prices 2nd, Chicago Fed NAI, IJC, Pending Home Sales, KC Fed; (Fri) Tokyo CPI, UK Retail Sales, US PCE (Apr), Durable Goods, UoM Final, June Tsy OpEx, US recommended early close for Memorial Day Holiday.

STIRS:

- SR3M3 -5.5bps at 94.73, U3 -8.5bps at 94.875, Z3 -10bps at 95.215, H4 -10bps at 95.685, M4 -8.5bps at 96.14, U4 -6.5bps at 96.485, Z4 -4bps at 96.73, H5 -2bps at 96.87, M5 -1bps at 96.915, M6 -3.5bps at 96.865.
- SOFR flat at 5.05%, volumes fall to USD 1.383tln from 1.434tln.
- NY Fed RRP op demand at USD 2.251tln (prev. 2.257tln) across 105 counterparties (prev. 102).
- EFFR flat at 5.08%, volumes rise to USD 126bln from 124bln.
- US sold USD 22bln in 2yr FRNs reopening at high discount margin of 0.170% (prev. 0.169% on April 26th).

CRUDE

WTI (N3) SETTLES USD 1.43 HIGHER AT 74.34/BBL; BRENT (N3) SETTLES USD 1.52 HIGHER AT 78.36/BBL

Oil prices were firmer Wednesday after a titanic 12.5mln bbl draw in crude stocks and Russian supply risks, that's despite the firmer Dollar and poor risk tone. The upside in oil prices picked up in the European morning amid Russia's Energy Minister confirming Moscow is considering restrictions on gasoline exports, albeit not a ban, following the Reuters reports Tuesday that Russia is mulling a possible export ban to prevent domestic fuel shortages and price hikes. Prices chopped sideways through into the late NY morning, where right after Russian President Putin said energy prices are approaching an economically justified level, the EIA inventory data saw a 12.5mln bbl US crude stock draw, a massive surprise against the expected build of 0.8mnl bbls, albeit somewhat cushioned by the private data indicating a 6.8mln draw late on Tuesday; gasoline and distillate stocks also both drew by 2mln and 0.6mln bbls, respectively. WTI and Brent peaked at USD 74.73/bbl and 78.66/bbl, respectively, in the wake of the data. Prices looked as if they were going to pare gains significantly later into the close before some late, pre-settlement short-covering saw the benchmarks re-approach their highs.

EQUITIES

CLOSES: SPX -0.73% at 4,115, NDX -0.50% at 13,604, DJIA -0.77% at 32,800, RUT -1.16% at 1,767

SECTORS: Real Estate -2.21%, Financials -1.31%, Industrials -1.27%, Materials -1.13%, Health Care -0.66%, Consumer Staples -0.65%, Utilities -0.63%, Technology -0.62%, Communication -0.6%, Consumer Discretionary -0.23%, Energy +0.52%.

EUROPEAN CLOSES: Euro Stoxx 50 -1.81% at 4,263, FTSE 100 -1.75% at 7,627, DAX 40 -1.92% at 15,842, CAC 40 -1.70% at 7,253, FTSE MIB -2.39% at 26,254, IBEX 35 -1.12% at 9,163, SMI -0.80% at 11,393.

STOCK SPECIFICS: **Blackstone (BX)** CEO said it is in talks with several US regional banks to explore assets and loans purchases, according to Bloomberg. **First Citizens BancShares (FCNCA)** reportedly to cut circa. 500 SVB employees, according to Axios. **Citizens (CFG)** CEO said the bank is making sure it has liquidity and is "more judicious" on extending credit. CFG will see less loan growth and lessened NIM, and it is remaining careful in regards to CRE and wants to rein in real-estate lending. Jana Partners confirmed is it to nominate four highly qualified directors to the **Freshpet (FRPT)** board. **Microsoft (MSFT)** is to lodge a formal appeal against British regulators' decision to block its USD 75bln takeover of **Activision Blizzard (ATVI)**, according to Sky News. Microsoft (MSFT) later announced that China hackers attacked US infrastructure, according to CNBC, which weighed on cyber security firm **Fortinet (FTNT)**. **Apple (AAPL)** is set to unveil iOS 17 software at WWDC show next month, and iOS 17 feature will turn iPhones into smart displays. **Avid Technology (AVID)** is reportedly working with Goldman Sachs to explore a sale, according to Reuters citing sources. **Amazon (AMZN)** CEO, at AGM, said they are working on second version of key machine learning chips; all 18 Amazon shareholder-led proposals lose in preliminary vote. The SEC is reportedly reviewing **First Republic (FRC)** trading; looking for signs of insider trading by employees, according to Bloomberg.

EARNINGS: **Analog Devices (ADI)** beat on EPS and revenue, but next quarter guidance was light as CEO noted looking to the second half of the year, it expects revenue to moderate given the continued economic uncertainty and normalizing supply chains. **Intuit (INTU)** missed on revenue partly due a decline in tax returns, but profit beat with solid guidance. **Palo Alto (PANW)** topped Wall St. expectations on EPS and revenue, while outlook for both the next quarter and FY was stellar. **Toll Brothers (TOL)** sales and profits topped expectations alongside raising FY deliveries view. Noted homebuyer appetites were improving and it eased back on incentives and increased price by average of USD 25k /home in Q2. **XPeng (XPEV)** posted a deeper loss per share than expected and missed on revenue. **Agilent (A)** reported solid metrics for the quarter, but guidance was light accompanied by cautious commentary. On consumer discretionary, there was a slew of strong earnings: **Kohl's (KSS)** reported a surprise profit per share and beat on revenue. Gross margin rose while merchandise inventories fell. Looking ahead, the co. affirmed its FY23 outlook. **Abercrombie & Fitch (ANF)** posted an unexpected profit per share and topped on revenue and raised its FY revenue growth view. **Urban Outfitters (URBN)** topped Wall St. consensus on profit, revenue, and SSS.

US FX WRAP

The Dollar saw mild gains on Wednesday supported by the risk off tone and to some extent commentary from Waller who ruled out a pause in June, but said the data will tell if they have to hike or skip in June. The FOMC minutes had little sway in the Dollar as it was rather in fitting with recent commentary from officials and showed officials are split on support for more hikes. The DXY saw a high of 103.91 but failed to breach above 104 before paring somewhat while upside in US yields helped keep the dollar afloat. Debt limit woes remain rife and there is still yet to be much progress on talks with McCarthy noting they are still far apart on spending, nonetheless, he has remained optimistic saying he doesn't expect the US to default. Focus now looks to US PCE data on Friday, a key data point for the Fed decision-making in June, while the 2nd estimate of US GDP will also be a highlight more imminently on Thursday.

The Euro was relatively flat vs the Dollar but the single currency did attempt to rise above 1.08, hitting a high of 1.0801 before paring back to c. 1.0750. In Germany, the Ifo report was softer than expected with the Expectations and Business Climate metrics markedly below forecasts/prior. This echoed the ZEW and Flash PMIs in terms of the overarching findings, with ECB implications somewhat dovish, for more information on the IFO please read the Newsquawk European Data Wrap. Meanwhile, President Lagarde spoke, reiterating the ECB will bring rates to sufficiently restrictive levels and keep them at those levels for as long as necessary.

The Yen was weaker vs the Dollar with the pair hitting highs of 139.39 in wake of Fed's Waller remarks after he ruled out a pause. The Yen matched the prior day's low in the morning around 138.24 before rebounding to see it take out the Tuesday peak of 138.90 above the round 139 handle, a level it returned to in late US trade. The Yen is at its weakest point vs the Dollar since early December, where it saw a high of 139.31. **Gold** prices saw weakness too as US yields rose while the Swiss **Franc** saw weakness vs both the Dollar and the Euro with havens taking a hit on Wednesday despite the risk-off tone in equities.

Cyclical currencies were notably weaker vs the Dollar, particularly the **antipodes** after the RBNZ rate decision, which hiked rates by 25bps as expected, unwinding some hawkish market pricing for a risk of a 50bp move, but it also signalled an end to the rate hike cycle, which sees the NZD on track to post its worst day of the year. The AUD also saw downside vs the Dollar on the risk tone, lower metals prices but also in sympathy with NZD. However, AUD/USD saw notable gains rising from a trough of 1.0570 to highs of 1.0712 while the RBA still expect further tightening (based on recent language) ahead of the June 6th meeting, where there will be particular attention on guidance after the RBNZ decision last night. Note, early morning RBA Official Jacobs said the balance sheet is starting to unwind pandemic bond purchases, and around AUD 20bln of purchased bonds have matured but the pace will increase to circa USD 35-45bln /year.

GBP and **CAD** were also softer. GBP weakness came despite a hotter-than-expected inflation report, which did provide some fleeting upside to the Pound with Cable posting a high of 1.2469 before swiftly pairing on bets the BoE will have to do more than initially expected, where the growth concerns started to kick in, alongside downbeat risk sentiment taking the pound off its highs. Although GBP was lower vs the buck and the Euro, it was the relative cyclical outperformer. CAD weakness was driven by risk sentiment and failed to yield much support from the higher oil prices after titanic draws in the US EIA inventory report.

EMFX was mixed:

MXN rebounded from lows despite cooler-than-expected half-month inflation data but with the figure still well above the Banxio's target, it gives the central bank leeway to keep policy tight for some time after recently signalling the end of its hiking cycle, depending on the data. However, analysts point to the trend of disinflation in the headline figure, with the 5% handle seemingly in reach, which gives credence for the central bank's plans to pause, and potentially even cuts heading into the end of the year.

BRL saw gains after the lower house approved the main text for a new fiscal framework bill on Tuesday, helping support the Real through Wednesday. **CLP** was hit on the slide in copper prices while **COP** gained on the rise of oil prices.

ZAR was weaker with gold prices and as inflation data came in a touch cooler than expected on some prints, while others were in line. Note, there were also more reports that the White House is looking to play down the rift with SA over the allegation it covertly shipped arms to Russia. Attention turns to the SARB on Thursday, which is expected to hike 25bps to 8%, with many expecting that to complete its rate hiking cycle.

TRY saw mild weakness ahead of CBRT on Thursday amid reports that Turkey is asking banks to buy Dollar debt to support default swaps, while Reuters source reports suggested that Turkish President Erdogan's party is split on the economic plan if he wins the runoffs; some look for gradual rate hikes while others suggest the present course should be continued.