US Market Wrap

10th July 2023: Cyclicals extend gains amid promising inflation proxies ahead of CPI on Wednesday

- **SNAPSHOT**: Equities up, Treasuries steepen, Crude down, Dollar down.
- **REAR VIEW**: Short-term consumer inflation expectations ease, longer-term rises; China sees deflation; Mixed Fed Speak; Manheim used cars price index falls further; Turkey agrees to advance Sweden's NATO bid; Nasdaq to announce special rebalance on Friday.
- **WEEK AHEAD PREVIEW**: US CPI; BoC, RBNZ, BoK; ECB and Riksbank Minutes; UK Data. To download the report, please click here.
- **CENTRAL BANKS WEEKLY**: Previewing Riksbank, ECB Minutes, BoC, RBNZ, BoK; Reviewing FOMC minutes, RBA. To download the report, please click here.

MARKET WRAP

Stocks were flat to firmer Monday with the small-cap Russell 2k outperforming the SPX and NDX, similar to Friday. There are growing concerns around the NDX with reports late on Friday noting an impending rebalancing decision, with index's heavyweights nearly all trading lower. As far as Monday's news/data was concerned, there were some promising signs ahead of Wednesday's CPI data with the Manheim used car priced index tumbling further in June, something which will be crucial for bringing down core CPI in the months ahead. Meanwhile, there was a lot of fanfare on the NY Fed's fall in 1yr-ahead consumer inflation expectations to the lowest since April 2021 (3.8%), but surprisingly little focus in the Fed release on the strong rise to series peaks again in the 5yr gauge at 3%. There was a slew of Fed commentary with Fed's Barr laying the groundwork for some bank capital regulation tweaks, while non-voters Mester and Daly gave balanced remarks with some typically dovish comments from Bostic. The Treasury curve steepened (2s -6.5bps at 4.87% and 30yr +1bp at 4.04%) after the front and belly outperformed the dovish Fed Speak and promising inflation proxies. In FX, the DXY is now testing lows not seen since mid-May, with the particular strength in Yen continuing as rate differentials narrow (whereas it benefitted from the mini-collapse in carry trades late last week); Swissy, Euro, and Sterling all outperformed the Dollar, while Aussie was a particular underperformer on weak China CPI and PPI data. Lastly, oil prices were ultimately lower after rejecting multi-month highs in the NY morning, with the downbeat Chinese data weighing despite the broader bid in cyclical stocks and the falling Dollar.

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FRBNY SCE: The NY Fed's Survey of Consumer Expectations for June saw the median 1yr-ahead inflation gauge fall to 3.8% from 4.1%, marking the lowest reading since April 2021. While the progress in the 1yr-ahead gauge caught all the headline attention/optimism ahead of CPI on Wednesday, it's worth stressing the longer-term (and Fed-followed) 3yr-ahead gauge remained unchanged at 3% and the 5yr-ahead gauge saw its largest M/M increase (since introduction in Jan'22) to 3% from 2.7%, back to its joint highest reading. The NY Fed figures are not as closely scrutinised as the Uni of Michigan survey's figures, which are next scheduled to be released on Friday. The June FOMC minutes went as far as to namecheck the Michigan survey (for the first time since February), revealing that Fed staff view inflation risks as skewed to the upside, citing risks of inflation expectations becoming "unanchored" after a prolonged period of elevated prices. The minutes noted that long-term inflation gauges remain within the range of values reported in the decade before the pandemic. So, policymakers will be hoping the jump in the NY figures in June isn't echoed in the Michigan July figures on Friday.

USED VEHICLES: The Manheim June used-vehicle price index fell 4.2% M/M (prev. -2.7% in May) and down 10.3% Y/Y (prev. -7.6% in May). The report noted the 4.2% drop is among the largest declines in series history and the largest decline since the start of the pandemic in April 2020 when the index plunged 11.4%. The Y/Y decline was also large, another 2.7% drop from May’s annualized 7.6% decline, but as mentioned last month, auction prices were lower in the fall last year, and we expect these increasing year-over-year moves to shrink in the months ahead as the market normalizes. Buyers at auction look to have taken an early summer break, and while used retail inventory has been improving over the last several weeks, we are expecting less volatility in wholesale price movements through year-end. Note, many forecasts of declining Core CPI over the rest of the summer are contingent on falling used auto prices, to which the Manheim survey has so far shown a vote in favour of ahead of the June data on Wednesday, with Core CPI M/M expected to fall to 0.3% M/M from 0.4% M/M.

FED

Barr (voter) said in a speech Monday that the existing capital framework is sound but there are plans to build on such requirements, where he plans to propose several changes to bank capital rules in the coming months. The Vice Chair for Supervision said he will recommend enhanced capital rules apply to those with USD 100bln or more in assets and the changes would increase capital requirements overall, principally for the larger/complex banks. He is not considering any major overhaul to the Global Systemic Surcharge (G-SIB) or the Countercyclical Capital Buffer. However, and potentially important for money markets, he is proposing some adjustments that mean G-SIB calculations are made throughout the year rather than just at year-end, which could reduce "turn" funding effects where banks "window dress" (reducing Dollar funding availability) each Q4. Barr noted that banks needing to raise capital could do so in under two years with retained earnings while maintaining dividends, crucially, noting that the majority of banks already have enough capital for new requirements. On monetary policy, Barr said inflation is far too high and he is quite attentive to bringing it down to target, noting a lot of progress has been made on inflation, but they still have a bit more work to do, but they are close.

Mester (non-voter, hawk) revealed she would have voted for a hike in June but she understands why rates were left unchanged, while she said she has not yet decided on the need for a July rate hike as she needs more data (CPI due on Wednesday). She said her outlook for the terminal rate matches, or just eclipses, the Fed Median forecast, while on the neutral rate, she said it is too early to say whether it has shifted much. Mester said Fed policy is less restrictive vs history, noting core inflation gains are too high and too broad-based. She expects housing inflation to ease, but it is still an upside rise for price pressures. Ahead of CPI, she said it would be a mistake to think that inflation is on a sustainable path toward 2% even if the June CPI falls, "The expectation is that we could get a low reading this week, but we'll see". Mester, who return to the voting board in 2024, noted she is fully aware the economy's performance could surprise Fed officials' view, but warns the economy would be better off if the FFR goes higher. She said she is not seeing signs of excessive credit tightening.

Bostic (non-voter, dove) repeated he does not see rates needing to rise any further from here, noting this is a hard judgement call but the path forward is no longer obvious, although inflation reduction will take longer than expected. Bostic, who doesn't vote until 2024, added that even with a 25bp move at the next meeting, it will still require patience from there and he is not expecting any dramatic sea changes in inflation. However, he notes the underlying data on inflation is telling a very positive story, and it is a "pretty straight forward story" that inflation could return to 2% without rates rising further. Said businesses are expecting wage growth to normalise, while he considers wages a lagging indicator of price setting (echoing fellow dove Goolsbee on Friday) and there is a lot of evidence that services spending has peaked. Bostic stated that in many regards, the US is still in a pandemic economy, and a lot of the strength is due to pandemic support. He states the current inflation is not due to excessive risk-taking, but the response to the pandemic. A recession is not Bostic's baseline outlook and he noted policy right now is "clearly" in restrictive territory.

Daly (non-voter, dove) said the Fed is likely to need a couple more rate hikes this year, but it is appropriate to slow the pace of hikes, although the Fed is at the last part of its rate hiking cycle. The San Fran Fed President, who doesn't vote until 2024, said the US economic momentum continues to surprise, and in the context of that momentum, there is more the Fed needs to do to raise rates. She also noted the need to balance against risks and the need to be data-dependent, but she did state risks have become more balanced. On policy lags, said there are longer lags than the Fed assumed. Said it is too early to declare victory on getting demand in balance with supply. Refusing to be pinned to a certain path, Daly suggested the Fed may end up doing less or more than a couple rate hikes this year, depending on the data (she said recently that two hikes as a modal outcome is reasonable). Said one lesson learned from the last cycle is that the Fed could raise rates even if the balance sheet is still expanding. Interestingly, she said the credit tightening from the March banking stress is probably less than the 25-50bp hike that she initially thought, but warned that credit shocks have a lag that we still could see in the months ahead. She also noted that community banks are tightening more than big and regional banks, but it is hard to know how much more.

FIXED INCOME

TREASURY WRAP: T-NOTE (U3) SETTLE 15 TICKS HIGHER AT 111-04+

The Treasury curve steepened further after the front and belly outperformed on dovish Fed Speak and promising inflation proxies ahead of CPI and duration supply. 2s -6.5bps at 4.866%, 3s -9.0bps at 4.553%, 5s -8.9 bps at 4.246%, 7s -7.2bps at 4.140%, 10s -4.2bps at 4.006%, 20s -1.4bps at 4.247%, 30s +0.9bps at 4.043%.

INFLATION BREAKEVENS: 5yr BEI -2.5bps at 2.213%, 10yr BEI -1.8bps at 2.275%, 30yr BEI -0.9bps at 2.263%.

THE DAY: Treasury futures trundled lower a few ticks into the APAC morning after the long-end-led weakness into the close on Friday post-NFP. T-Notes hit troughs of 110-13 not long after June Chinese CPI and PPI missed expectations, both falling 0.2% M/M, indicative of the lack of growth impulse in the region post-reopening.

London came in and lifted the belly with some size behind it, reflected by a chunky 12.5k 5yr fut block buy (DV01 0.5 mln) at the handover. Although there were some opposing flows with some block 5yr/10yr flatteners, but that didn't dissuade from the overall recovery. A mixture of the soft China data and some increasing appetite for the 5yr sector from Wall Street likely all played their part, with duration lagging as part of the broader steepening flows we've seen over recent sessions, not to mention the impending long-end Treasury supply this week.

There was a big flush out of longs across the curve as bond cash trade opened up in NY, with T-Notes falling from interim peaks of 110-27 to 110-14 in lack of any fresh catalysts - perhaps some Dealer hedging for this week's supply if one wants to speculate. But, the continued tumble in the Manheim used card index for June saw buyers step back in before long, with the belly leading the recovery.

T-Notes extended past their NFP peaks (111-00) in the wake of the fall in NY Fed's 1yr-ahead consumer inflation expectations (despite the rise in the 5yr), which also coincided with some balanced commentary from Fed hawk Mester as well as Fed dove Daly, who both don't vote until 2024, but given the promising data ahead of the expected decline in CPI on Wednesday, it was their dovish comments that held more weight on Monday. T-Notes hit session highs of 111-08 later in the session right on the back of a slew of dovish prepared remarks from Fed's Bostic, who didn't add anything particularly new but just doubled down in his call for no more hikes whilst raising his confidence in data being on the right path. Note that the 10yr T-Note, 5yr T-Note, and Ultra 10yr T-Note have all surpassed their NFP peaks now.

REFUNDING: US to sell USD 40bln of 3yr notes on July 11th, USD 32bln of 10yr notes (reopening) on July 12th, and USD 18bln of 30yr bonds (reopening) on July 13th; all to settle on July 17th.

STIRS:

- SR3U3 +0.5bps at 94.585, Z3 +1.5bps at 94.63, H4 +5bps at 94.88, M4 +8.5bps at 95.255, U4 +11bps at 95.65, Z4 +11.5bps at 95.96, H5 +12bps at 96.165, M5 +13bps at 96.275, U5 +13.5bps at 96.34, U6 +12bps at 96.465.
- SOFR flat at 5.06% as of July 7th, volumes fall to USD 1.547tln from 1.573tln.
- NY Fed RRP op demand at USD 1.812tln (prev. 1.822tln) across 102 counterparties (prev. 99).
- The USD 10bln fall in RRP Monday comes in the lack of any T-Bill settlements, with usage drifting to further recent troughs as market repo rates offer pick-up over the Fed's facility (GC bid at 5.10% at time of operation) - we get a USD 45bln settlement on Tuesday.
- EFFR flat at 5.08% as of July 7th, volumes rise to USD 127bln from 119bln.
- US sold USD 70bln of 3-month bills at 5.250%, covered 3.12x; sold USD 63bln of 6-month bills at 5.270%, covered 2.93x.

THIS WEEK:

- TUE: EIA STEO, NFIB index (Jun), IBD/TIPP economic optimism (Jul), 3yr auction, Fed Discount Rate minutes.
- WED: BoC Announcement, RBNZ Announcement, German CPI Final (Jun), UK Jobs Data (May/Jun), German ZEW Survey (Jul), US CPI (Jun).
- THU: ECB Minutes, BoK Announcement, OPEC MOMR, IEA OMR, EU-Japan summit, UK GDP (May), US PPI final Demand (Jun).
- FRI: US University of Michigan Prelim. (Jul), German Wholesale Price.

CRUDE

WTI (Q3) SETTLES USD 0.87 LOWER AT 72.99/BBL; BRENT (U3) SETTLES USD 0.78 LOWER AT 77.69/BBL

Oil prices were ultimately lower Monday after rejecting multi-month highs, with downbeat Chinese inflation data weighing despite the broader bid in cyclical stocks and the falling Dollar. The 0.2% decline in Chinese PPI for June set the tone for the session, with the biggest declines in the headline figure stemming from the energy, metals, and chemicals sectors, reflective of the lacklustre rebound in the region, and a timely catalyst for oil longs to take profit after last Friday's breakout higher. However, there was a renewed spurt of strength in the NY morning which saw WTI and Brent front-month contracts stretch to fresh multi-month peaks of USD 74.15/bbl and 78.77/bbl, respectively, coinciding with the bid in cyclical stocks and as the Dollar unwound initial strength. But the bid failed to sustain and contracts reversed beneath prior resistance levels and down to lows of USD 72.67/bbl and 77.36/bbl for WTI and Brent, respectively, in the NY afternoon. There was no obvious catalyst for the pullback.

Other items of note on the session included a fire breaking out in Iran's Bandar Abbas refinery (300k BPD). Chevron's (CVX) El Segundo, California (290k BPD) refinery experienced an equipment malfunction at one of its process units, although the refinery notes it will still be able to deliver products as needed. Some bullish jawboning from IEA's Birol failed to make a dent too, who reiterated his warning of oil market tightness in the second half of the year, noting oil demand from China and developing countries is set to strengthen. While for OPEC+, Tass reported Russia and top diplomats from the Gulf have agreed to work on the development of energy resource supply chains.

EQUITIES

CLOSES: SPX +0.24% at 4,410, NDX +0.06% at 15,046, DJI +0.62% at 33,944, RUT +1.64% at 1,895

SECTORS: Industrials: +1.39% Health: +0.81% Energy: +0.76% Financials: +0.44% Real Estate: +0.34% Cons Disc: +0.11% Cons Stpl: +0.03% Materials: -0.01% Technology: -0.02% Utilities: -0.42% Communication Svs: -0.92%

EUROPEAN CLOSES: DAX +0.45% at 15,673.16, FTSE 100: +0.23% at 7,273.79, CAC 40 +0.45% at 7,143.69, Euro Stoxx 50 +0.47% at 4,256.51, IBEX 35 +0.04% at 9,252.90, FTSE MIB +0.34% at 27,872.00, SMI +0.43% at 10,922.01.

STOCK SPECIFICS: Several chemical names gave some cautious updates, **Evonik (EVK GY)** prelim earnings disappointed and it noted it expects demand to remain weak while **FMC Corp (FMC)** cut guidance due to unprecedented volume declines in three out of four operating regions as partners rapidly reduced inventory levels. **Icahn Enterprises (IEP)** surged after Carl Icahn untied personal loans to the IEP stock price. **General Motors (GM)** cut the price of its Lyric EV in China. A Wall Street Journal investigation has found that telecom giants like AT**&T (T) and Verizon (VZ)** have left behind a vast network of toxic lead-covered cables across the US. The French Finance Minister expressed optimism that **Tesla (TSLA)** CEO Elon Musk will choose France for a significant investment related to electric vehicle production in Europe, Reuters reported. **Rivian's (RIVN)** PT was upgraded to USD 30/shr (prev. USD 22/shr) at Barclays, where analyst Dan Levy maintained an overweight rating on the shares noting he expects a Q2 beat and for the momentum trade to continue. **Fisker (FSR)** announced a USD 340mln convertible notes offering with the potential to increase that to USD 680mln; offering expected to close on 11th July 2023. Ant Group, founded by Jack Ma, has launched a share buyback plan at a valuation much lower than its proposed IPO price, FT reported. Sarah Silverman, Christopher Golden, and Richard Kadrey are suing **Microsoft (MSFT)-backed OpenAI** and **Meta Platforms (META)** for copyright infringement, The Verge reported. **Meta's (META)** Threads surpassed 100mln users.

NASDAQ WEIGHTINGS: Nasdaq is set to issue a special rebalance on Friday, July 14th to limit over concentration within the index. Note, no stocks will be added or removed and the redistribution will take place before the market opens on July 24th. Investors Business Daily note the rebalance will spur stock allocation shifts among ETFs such as QQQ and mutual funds that track the index. There is particular attention on the heavyweights, including Microsoft (MSFT), Apple (AAPL), Nvidia (NVDA), Amazon (AMZN), Tesla (TSLA), Tesla (TSLA), and Google (GOOG, GOOGL), which were all lower on Monday on fears funds will have to sell the stock to adjust to the new weightings. Meta (META) was bid however on Threads optimism after it surpassed 100mln sign-ups.

US FX WRAP

The Dollar sold off on Monday accompanied by lower UST yields on signs of cooling inflation after the Manheim used vehicle index fell 4.2% M/M in June from May's decline of 2.7% ahead of the June CPI release on Wednesday - many forecasts of declining Core CPI over the rest of the Summer are contingent on falling used auto prices. Not all was positive though, later the NY Fed consumer inflation expectations survey saw a notable move higher in the longer term gauge, with the 5yr rising to 3% from 2.7%, although the 3yr was unchanged at 3% with 1yr falling to 3.8% from 4.1%, but the Fed pay closer attention to the longer-dated expectations given the volatility in the short term, but more attention to the Uni of Michigan which is next released on Friday. DXY tested 102.00 to see a brief dip beneath, flirting beneath it later in the session.

The Euro saw gains thanks to the weaker buck with EUR/USD testing 1.10 to the upside, the highest level since June 22nd. There was a limited reaction to the latest July Sentix index which came in worse than expectations. ECB's Nagel was on the wires too, albeit saying little new reaffirming that inflation remains too high, adding that while GDP may slow, he is convinced a hard landing can be avoided.

The Yen saw solid gains, falling from peaks of 143 vs the buck to lows of 141.30, extending the post-NFP move ahead of US CPI with moves in the Yen supported by the move lower in UST yields. Note, the BoJ raised its assessment for three of Japan's nine regions and maintained assessment for six of the regions, while it stated that all of Japan's regions saw economies pick up or recover moderately and many regions saw tightness in labour conditions intensifying. The report noted that many regions saw small, mid-sized firms hike wages unseen in recent years and some regions saw firms mulling hiking prices with an eye on higher wage costs ahead. The Osaka Branch Manager noted that many big firms, which are predominantly export-driven firms in Western Japan, do not see a weak Yen as something negative at this stage, but many want FX to move stably when asked. Meanwhile, the Nagoya Branch Manager said they have not received any calls from firms to review the BoJ's ultra-easy policy and many see the need to keep raising wages, but whether they will actually do so will depend on the business environment ahead, while some firms are starting to pass on rising labour costs to consumers but most are still focusing on passing raw material costs.

Cyclical currencies were mixed. The Aussie fell vs the buck while Loonie and Kiwi were flat, but the Pound saw mild gains with Cable rising lows of 1.2751 to c. 1.2860, taking it to a fresh (marginal) YTD high. BoE Governor Bailey spoke at Mansion House, albeit largely repeated familiar themes, noting inflation is unacceptably high, but stressed headline inflation is set to fall markedly over the remainder of the year. The Kiwi outperformed the Aussie once again with AUDNZD falling sub 1.0750, and to test the Friday low of 1.0733 with the pair at levels not seen since May. The China CPI and PPI data dragged both currencies lower on signs of weak demand in China given both are large trading partners with China. CAD was rangebound ahead of the BoC on Wednesday, which is expected to hike rates by 25bps to 5.00% with a minority looking for rates to be left unchanged.

Scandis saw gains vs the Euro with particular outperformance in NOK after much hotter than expected inflation data with the Core Y/Y at 7.0% (exp. 6.6%, prev. 6.7%). SEK saw gains with some support seen both ahead of and after Turkey announced it has agreed to advance Sweden's NATO bid, noting it received the assurances it needed, sending it to a vote in Turkish parliament.

EMFX was mixed. RUB saw decent gains while ZAR and TRY were flat while MXN was bid, BRL was softer, CLP was weaker, and COP was flat. BRL pared some of its Friday gains after the lower house approved reforms to consumption taxes ahead of inflation data on Tuesday. Copper prices weighed on CLP, while MXN and COP ignored the weaker oil prices, with USD/MXN testing 17.0000 to the downside once again after a volatile end of last week with big EMFX outflows on Thursday and the US NFP on Friday. TRY was flat vs the Dollar but Turkey did agree to advance Sweden's NATO bid while Erdogan had earlier said they would consider Sweden's application to NATO in exchange for progress on Turkey's own bid to join the EU.