US Market Wrap

12th July 2023: Dollar hits YTD trough after CPI-induced rip in stocks and bonds

- **SNAPSHOT**: Equities up, Treasuries up, Crude up, Dollar down.
- **REAR VIEW**: US CPI comes in soft; BoC hikes 25bps, as expected, accompanied by hawkish rhetoric; RBNZ nods to end of hiking cycle; Solid US and German 10yr auctions; BASF adds to chemical sector malaise; Bearish energy inventory data; UK CMA says MSFT/ATVI deal may require a new probe; CSCO downgraded at BofA; LCID Q2 deliveries miss.
- **COMING UP**: **Data**: Chinese Trade Balance, UK GDP, EU Industrial Production, US IJC **Events**: ECB Minutes, BoK Policy Announcement, IEA OMR **Supply**: Italy & US **Earning**: PepsiCo.

MARKET WRAP

US June CPI came in soft on both the headline and core figures providing hope on the return to the 2% inflation target. The data saw Treasury yields and the Dollar tumble, with stocks and commodities surging, with money markets unwinding hike pricing beyond July. The NDX was the outperforming index in the US after recent underperformance on rebalancing adjustment fears, although note European equity indices outperformed the US again. In FX, the Dollar slid to a YTD trough (DXY low at 100.50) after the data with gains in XXXUSD across the board; note CAD saw smaller gains despite the BoC hike and hawkish guidance, while NZD surged with AUD, despite RBNZ signalling the end of its rate hiking cycle. Crude complex continued to fresh multi-month highs on Wednesday after the CPI data, with the upside capped by bearish EIA inventory data. China stimulus expectations continue to bubble in the background with the platform economy (Alibaba, JD.com, Bytedance) the latest to see government vows for support. Broader China stimulus would come as a blessing to the global manufacturing sector, with BASF in Germany the latest chemicals name to report a big miss on earnings and slash its guidance on Wednesday.

GLOBAL

US CPI: The US inflation report was cooler than expected as the headline M/M rose 0.2% (exp. 0.3%, prev. 0.1%), while the Y/Y rose 3.0% (prev. 4%), cooler than the 3.1% expectation. Meanwhile, the Core measurements rose 0.2% M/M (exp. 0.3%, prev. 0.4%), and 4.8% Y/Y (exp. 5.0%, prev. 5.3%). Overall, it is a welcome report from the Fed but it will do little to change the Fed's thinking going into the July meeting, although it could alter their view on the terminal rate, where the current Fed dot plot median pencils in two more rate hikes by year-end, but more welcome inflation prints could change this to see just one more. Further on this footing, WSJ's Timiraos noted it reduces the prospect of a second hike. Delving into the report, Wrightson wrote that core services ex housing ("supercore") in CPI fell by 0.1% in June, but warned that the series has not been closely correlated with the corresponding concept in the PCE price data, the Fed's preferred gauge of inflation.

BOC: The BoC hiked rates by 25bps to 5.00% in line with expectations. The statement was accompanied with hawkish inflation language, noting it foresees a slower return to target than what was forecast in the January and April projections, stating the downward momentum has come more from lower energy prices, and less from easing underlying inflation while the large price increases of last year are now out of the annual data, there will be less near-term downward momentum in CPI. The statement also acknowledged underlying price pressures appear to be more persistent than anticipated. The MPR saw the inflation expectations revised higher for both 2023 and 2024 while the 2025 forecast was left unchanged at 2.1%. Meanwhile, growth forecasts were cut for 2024 and 2025, but upgraded for 2023, where it sees growth averaging around 1% through the second half of this year and the first half of next year, noting the economy will move into modest excess supply early 2024 before growth picks up to 2.4% in 2025. In terms of guidance, the statement noted the BoC will continue to assess dynamics of core inflation and the outlook for CPI inflation, and will be evaluating whether excess demand, inflation expectations, wage growth and consumer pricing behaviors are consistent with achieving its 2% goal. The statement also dropped language from June that monetary policy was not sufficiently restrictive to bring supply and demand back into balance, implying rates are now at a sufficiently restrictive level after a 25bp hike in June and another in July, with forecasts showing inflation gradually returning back to the 2% target in 2025. Governor Macklem left open the door to more hikes, stating further rate decisions will be guided by their assessment of incoming data and the inflation outlook, adding the BoC is prepared to raise rates further. On Wednesday's decision, Macklem revealed the BoC did discuss the possibility of keeping rates unchanged, but agreed the cost of delaying action was larger than the benefit of waiting and there was a consensus that policy needed to be more restrictive to return inflation to its 2% goal. Macklem also warned that if we do not do enough now, we will likely have to do even more later.

Fed's Barkin (non-voter), after cooler than expected inflation data, said it is still too high, noting demand remains elevated at the same time supply is constrained and the process of getting back to balance has been slow. There is still a question whether inflation can settle while the labour market remains as strong as it is. Barkin, who returns to the voting slate in 2024, is comfortable doing more with policy if incoming data does not confirm inflation will return to target, warning that backing off too soon will require the Fed to do more.

Fed's Kashkari (voter), after the June CPI release, said if high inflation persists the Fed may need to raise rates further, stressing the Fed's fight against inflation must succeed. He warned higher rates could increase pressure on banks and bank supervisors should ensure all banks are prepared to withstand a higher-rate environment. Kashkari added that small and midsize banks feel deposit-constrained but the biggest banks have a lot more liquidity. The Minneapolis Fed President said higher capitalisation across US banks would better position the US, noting Fed Vice-Chair of Supervision Barr's proposal would be a step in the right direction.

FIXED INCOME

T-NOTES (U3) SETTLED 1 POINT HIGHER AT 112-08+

Treasuries saw big bull-steepening after the soft CPI data; solid 10yr auction. 2s -15.8bps at 4.738%, 3s -17.6bps at 4.376%, 5s -16.9bps at 4.070%, 7s -15.2bps at 3.973%, 10s -12.3bps at 3.859%, 20s -8.6bps at 4.136%, 30s -7.2bps at 3.949%.

INFLATION BREAKEVENS: 5yr BEI +2.3bps at 2.212%, 10yr BEI +3.3bps at 2.287%, 30yr BEI +5.0bps at 2.290%.

FED PRICING: Implied probability for a July 25bp hike to 5.25-5.50% flat D/D at 89%. Implied terminal rate falls 4bps to 5.38% (in November). Year-end implied Fed rate falls 5bps to 5.33%. Rate cut pricing through 2024 has picked up more meaningfully, for instance, the June 2024 FOMC implied rate has fallen to 4.66% from 4.79%.

THE DAY: Treasuries, led by the belly, drifted higher through the APAC session on Wednesday, with desks tying the bid in part to the fall in USD/JPY beneath 140 for the first time in a month. London lifted the offer further on arrival, with additional support after a solid German Bund auction. T-Notes hit pre-CPI resistance at 111-19 with activity in both futures and cash Treasuries particularly low in anticipation of the data.

The below forecast CPI and Core CPI figures, both in M/M and Y/Y, saw a kneejerk bull-steepener, with 2s10s jumping from -91bps to -84bps within ten minutes, with the T-Note spiking from 111-18+ to initial peaks of 112-02+. As the dust settled, T-Notes went on to extend on new highs later in the NY morning, with the belly leading the second wind, with the 30yr yield struggling to hold above the key 4% level (c. 133 in Ultra Bonds). The momentum in T-Notes saw contracts ultimately peak at 112-12 before the 10yr auction, hovering near highs into settlement. Note that the long-end ultimately succumbed to the bullishness in the belly, with the Ultra Bond breaking above resistance at 133 and ripping all the way up to 134-09 as the cash 30yr yield fell beneath 4% to lows of 3.94%, with last week's weekly close above the round figure at risk of becoming yet another false breakout.

10YR AUCTION: The USD 32bln reopening from the Treasury - sold at 3.857%, the highest since March - had solid internals, all the more impressive when considering the massive rally into the offering. The 1bp tail improves on last month's 1.5bp tail and the six-auction average 1.8bp tail. The auction was covered 2.53x, the highest since February. Dealers were left with just 12.4%, the lowest since February and well beneath the avg. 18.2%, with Directs flat on the month at 19.9% with the surge in demand stemming from the Indirects cohort, an imperfect proxy for foreign participation (more likely with DXY at YTD lows), jumping to 67.8% from 62.3%. Attention now on Thursday's USD 18bln of 30yr bond reopening.

STIRS:

- SR3U3 +4.5bps at 94.615, Z3 +8.5bps at 94.68, H4 +14.5bps at 94.99, M4 +19bps at 95.410, U4 +21bps at 95.83, Z4 +21bps at 96.15, H5 +20bps at 96.36, M5 +19bps at 96.47, U5 +19bps at 96.54, U6 +17.5bps at 96.68.
- US SOFR flat at 5.06% as of July 11th, volumes fall to USD 1.439tln from 1.506tln.
- NY Fed RRP op demand at USD 1.820tln (prev. 1.776tln) across 102 counterparties (prev. 101).
- USD 44bln RRP rise comes amid no T-Bill settlements and as market GC rate drifts lower.
- EFFR rises back to 5.08% as of July 11th from 5.07%, volumes fall to USD 121bln from 125bln.
- US sold USD 46bln of 17-week bills at 5.26%, covered 3.13x.

WEEK AHEAD:

- **THU**: *ECB Minutes, BoK Announcement, OPEC MOMR, IEA OMR, EU-Japan summit, UK GDP (May), US PPI final Demand (Jun), Jobless Claims, US 30yr auction, Fed's Waller (v)*.
- **FRI**: *German Wholesale Price, US University of Michigan Prelim. (Jul), US Import & Export Prices (Jun), Treasury dealer meeting agenda, US bank earnings*.

CRUDE

WTI (Q3) SETTLED USD 0.92 HIGHER AT 75.75/BBL; BRENT (U3) SETTLED USD 0.71 HIGHER AT 80.11/BBL

The crude complex continued to the upside on Wednesday, albeit closing off best levels, with notable tailwinds in the wake of the cooler-than-expected US CPI report and softer Dollar. As such, WTI and Brent climbed to session highs of USD 76.15/bbl and 80.55/bbl, respectively, roughly an hour after the aforementioned CPI with both notching up levels not seen since late April. As the dust settled post-CPI and bearish inventory data (more below) digested, the complex retraced off best levels into the NY afternoon, somewhat tracking stocks. Elsewhere, Iraqi officials noted the Basra refinery (210k BPD) expansion has been delayed due to a contract dispute. Reuters reported also that Russian offline primary oil refining capacity is seen increasing by 40% in August from July to 3.601mln/T. Looking ahead, PPI on Thursday to set the tone for big banks (JPM, WFC, BLK, C, STT) begin reporting Q2 earnings on Friday in addition to prelim UoM.

EIA: Crude stocks built 5.946mln (prev. -1.508mln) much greater than the expected 1.35mln, and in fitting with the private inventory data on Tuesday evening. Meanwhile, Distillates saw a surprise build, also in line with the private data, but Gasoline was more-or-less flat with Cushing drawing 1.605mln. Refining utilisation rose 2.6% (exp. 0.5%). Although desks note despite the drop in gasoline and diesel demand, that's not too surprising given it coincided with the July 4th holiday, with expectations that crude draws will resume next week.

EQUITIES

CLOSES: SPX +0.74% at 4,472, NDX +1.24% at 15,307, DJIA +0.25% at 34,347, RUT +1.05% at 1,933.

SECTORS: Communication Services +1.51%, Utilities +1.47%, Materials +1.29%, Technology +1.25%, Consumer Discretionary +0.96%, Energy +0.9%, Financials +0.63%, Real Estate +0.44%, Consumer Staples +0.24%, Industrials -0.2%, Health -0.28%.

EUROPEAN CLOSES: Euro Stoxx 50 +1.72% at 4,360, FTSE 100 +1.83% at 7,416, DAX 40 +1.47% at 16,023, CAC 40 +1.57% at 7,333, FTSE MIB +1.75% at 28,552, IBEX 35 +1.31% at 9,453, SMI +0.53% at 11,020.

STOCK SPECIFICS: UK CMA said **Microsoft (MSFT)/Activision (ATVI)** deal may need a new merger probe as whilst merging parties cannot put forward new remedies after a final report, they can choose to restructure a deal but it can lead to a new probe. **Cisco (CSCO)** downgraded at BofA on fears that Wall Street analysts' estimates are too high and sees risk of disappointment. **Broadcom (AVGO)** secured EU antitrust approval to purchase **VMware (VMW)**, after offering remedies to assist rival **Marvell (MRVL)**. EU regulators fine **Illumina (ILMN)** a record EUR 432mln for closing the Grail deal before regulatory approval. **Disney (DIS)** is exploring options for its Star India business, including a JV or sale, due to the challenges of the streaming transition, according to WSJ. **Netflix (NFLX)** PT raised to USD 525 (prev. 390) at UBS and keeps a 'Buy' rating; said checks on engagement, downloads and search interest were all constructive and expects Q2 to beat mgmt's guidance and accelerate in H2. **ZIM Integrated (ZIM)** cuts FY23 adj. EBITDA, although not as deep as feared, and was driven primarily by continued weakness in freight rates across trades, particularly in the Transpacific, which is now expected to continue during H2 '23. Volume growth is also expected to be lower than originally forecasted, as demand continues to be subdued. Kim Kardashian is reportedly in discussions to repurchase the minority stake in her beauty company, SKKN by Kim, that she had sold to **Coty (COTY)**, according to WSJ. **SunPower (SPWR)** upgraded at Raymond James; said the stock's recent weakness is "excessive." **Lucid (LCID)** Q2 vehicle deliveries miss. **Tesla (TSLA)** said Model 3 federal tax credits likely to be reduced after December 31st which relates to the USD 7,500 tax credit which is set to be reduced on some of its EVs. **Amazon (AMZN)** customers spent USD 6.4bln on the first day of its Prime event (up around 6% Y/Y), according to Adobe Digital Economy Index.

FX WRAP

The Dollar was lower on Wednesday and hit a YTD trough of 100.500 after the cooler-than-expected June US CPI report resulted in pronounced bull-steepening along the Treasury curve. Headline M/M rose 0.2% (exp. 0.3%), but up from the 0.1% prior, while the Y/Y rose 3.0% (prev. 4%), cooler than the 3.1% expectation. Meanwhile, the Core measurements rose 0.2% M/M (exp. 0.3%, prev. 0.4%), with Y/Y at 4.8% (exp. 5.0%). That served a welcome report for policymakers but will do little to alter the Fed's plans for a July rate hike, although it could begin to alter its view on whether they hike again afterwards, where further low inflation prints could set fail to see the second hike in the Dot Plot realised. Elsewhere Wednesday, Fed's Barkin (non-voter) and Kashkari (voter) spoke, where the former said inflation is still too high and demand remains elevated at the same time supply is constrained while the process of getting back to balance has been slow. Kashkari, in remarks prepared before CPI release, said if high inflation persists the Fed may need to raise rates further, stressing the Fed's fight against inflation must succeed. Looking ahead, earnings season begins on Thursday although the topical big banks (JPM, WFC, C, STT, BLK) begin reporting on Friday alongside prelim UoM.

Loonie was the G10 underperformer on Wednesday, albeit still eking out mild gains, despite the Loonie seeing initial strength on the hawkish BoC rate decision. To summarise, it hiked rates by 25bps to 5.00%, in line with expectation, accompanied with hawkish inflation language, noting it foresees a slower return to target than what was forecast in the January and April projections. USD/CAD fell to a low of 1.3149, before paring some of this move throughout the session. Note, Macklem spoke after the rate decision but USD/CAD was unreactive.

Antipodeans were the G10 outperformers and soared against the Greenback as it took advantage of the Dollar's demise even in spite of some potential negative currency headwinds such as RBA Governor Lowe softening the tone of guidance in terms of more tightening and the RBNZ effectively 'confirming' that the OCR has reached its terminal level. As a reminder, RBNZ kept the OCR unchanged at 5.50%, as expected. The Aussie was also aided by the spike in commodity prices in wake of the aforementioned CPI, not to mention increasing rumblings of China stimulus in the pipeline. In terms of levels, AUD/USD and NZD/USD hit peaks of 0.6796 and 0.6308, respectively, vs lows of 0.6683 and 0.6183.

Funders, JPY and CHF, revelled in the even lower US yield environment, with USD/JPY tumbling to 138.17 from a high of 140.39, and breaching through some key levels on the way, while USD/CHF just ran out of momentum ahead of 0.8650 vs its peak of 0.8800. On the Yen, technicians warn of USD/JPY hitting oversold levels, no doubt some will be braving for a corrective bounce if the downside loses momentum. Some desks even hypothesize that the Yen's sharp recovery could reduce the pressure for the BoJ to raise its cap on 10-year JGB yields at the July meeting.

EUR and **GBP** both firmed to differing degrees, with the single-currency outperforming the Pound significantly. Despite this, Cable has been on a tear in recent sessions and lost some momentum Wednesday as it eclipsed 1.3000, a level not seen since April 2022. Sterling took the BoE Financial Stability Report in its stride, with the top eight lenders passing the stress tests and Governor Bailey calling on banks to pass through higher rates to savers. Meanwhile, EUR/USD hit a high of 1.1139 on account of the floundering Dollar. ECB's Lane and Vujcic were on the wires where the Chief Economist noted the typical lags in monetary transmission mean that the full economic impact of the considerable monetary tightening over the last year will only play out over the next couple of years. On Thursday, market participants will be awaiting ECB Minutes and a slew of UK data.

Scandis surged again against the Buck as buoyant risk sentiment certainly suited the SEK, with the NOK bolstered by Brent climbing over USD 80.50/bbl.

EMFX was almost exclusively in the black, with only the RUB and TRY lower with the former weighed on by the known geopolitical/economic woes while the Lira was hindered by the cost of higher imported oil. ZAR profited off the gains in the yellow metal, akin to CLP with respect to copper. MXN followed on the coat tails of WTI's strength with further incentive from significantly stronger than consensus Mexican industrial production. BRL gleaned extra impetus (aside from the weak Dollar) from Brazilian services sector growth beats. Lastly, HUF gained more ground vs the EUR on favourable rate differentials.