US Market Wrap

10th August 2023: Dovish CPI reaction unwinds while yields hit highs after weak auction

- **SNAPSHOT**: Equities flat/down, Treasuries down, Crude down, Dollar up.
- **REAR VIEW**: Core & headline Y/Y inflation cooler-than-expected; Jobless claims rise, but not outside recent peaks; Weak 30yr auction; Daly said whether the Fed hikes or holds is premature; Banxico leaves rates unchanged, as expected; TPR to acquire CPRI; DIS to raise price on its ad-free streaming tier
- **COMING UP**: **Data**: French Unemployment Rate, UK GDP, Trade Balance, US PPI, UoM (Prelim) **Speakers**: RBA's Lowe, Bullock, & Kohler.

MARKET WRAP

The highlight of the day was the US CPI report which was in line for the M/M metrics but Y/Y metrics were marginally softer than expected. The data sparked a knee-jerk dovish reaction with the Dollar hitting session lows while T-Note futures hit session highs. Stocks also saw gains on the release but they then went on to hit session highs just after the cash equity open with the SPX hitting a high of 4527. However, the gains had gradually pared throughout the remainder of the US session to hit a low of 4457, paring all gains and more before gradually recovering into the closing bell to see a flat finish, albeit the RUT closed red. T-Notes had also pared the initial CPI rally, with downside accelerating in the wake of the weak 30yr bond auction to see yields at highs across the curve heading into the APAC session, particularly the long-end. The upside in yields helped support the Dollar to see DXY finish with marginal gains and at session highs, paring all the initial weakness seen in the immediacy of the CPI release. Nonetheless, despite the unwind of the initial move, money market is now only pricing in a 10% probability of a 25bp hike at the September meeting, vs 15% pre-data. Note, alongside the US CPI release, the jobless claims data saw a notable jump on the weekly initial claims, rising above all analyst forecasts, albeit it was not as high as the jump seen a few weeks ago. Attention on Friday turns to US PPI and the Prelim UoM survey, particularly the inflation expectations.

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CPI: Headline M/M rose by 0.2%, in line with expectations and the prior pace of 0.2%, while the Y/Y was cooler than expected at 3.2% (exp. 3.3%), but it did accelerate from the prior 3.0% pace. A similar story was seen in the core metrics, the M/M rose 0.2%, in line with the expected and prior 0.2% and the Y/Y rose by 4.7% vs the Refinitiv estimate of 4.8% but was cooler than the prior 4.8%. Looking into the release, the index for shelter was by far the largest contributor to the monthly all-items increase, accounting for over 90% of the increase, with the index for motor vehicle insurance also contributing. The food index increased 0.2% in July after increasing 0.1% in the previous month. The index for food at home increased 0.3% M/M while the index for food away from home rose 0.2%. The energy index rose 0.1% in July as the major energy component indexes were mixed. Analysts at Pantheon Macroeconomics write the details for the July core print were mixed, but they see no cause for a major alarm. The desk also notes that core services ex-rents rose 0.2% following an unchanged print in June, and warn of a "pop up" in the August metric. However, the consultancy remains doubtful this will lead to a sustained surge higher, adding "The trend in core services CPI ex-rents has broadly tracked our re-adjusted version of the NFIB selling prices index, which clearly signals a further downshift". Looking ahead, Pantheon note the core CPI print in August will be a close call between 0.1% and 0.2%, stating "Three decent core CPI prints is not definitive, but we think it will be enough to dissuade the Fed from another hike, unless the August payroll report, due on September 1, is really ugly".

JOBLESS CLAIMS: Initial jobless claims rose to 248k from 227k, above the expected 230k and above the top end of the forecast range. Continued claims dipped to 1.684mln (prev. 1.7mln) underneath consensus of 1.710mln. Note, the seasonal factors had expected an increase of 1,363 from the prior week. On the headline, Oxford Economics thought that the closure of the Yellow trucking company (employed ~30k) would lift claims, but there was no clear indication those workers boosted claims in the latest week as Ohio accounted for a large share of the increase, with Yellow’s HQ in Tennessee. Nonetheless, OxEco thinks the Fed's July rate hike will be the last of the cycle, but the risks are tilted in favor of one more rate hike if the labor market doesn't soften. On jobless claims, the consultancy thinks jobless claims will rise later in the year as the economy falls into a recession, but anticipate job losses and increases in jobless claims during this recession will be modest compared to prior downturns.

DALY (2024 voter), on the CPI data, said it was as expected but it does not mean victory is ours on inflation and the Fed still has more work to do. Looking ahead, she said whether the Fed hikes or holds, it is premature to say. The San Fran President added they are a long way from a conversation about rate cuts, and will expect to have that conversation next year, but it will depend on the economy and path of inflation. Moreover, Daly reiterated her data-dependency and said there is further information coming prior to the September meeting and before year-end. On inflation, Daly noted the key is good price inflation, which is coming down, and shelter price inflation, which we project is coming down, while the price the Fed will be watching is core services inflation ex-housing, as it has not made much progress so far. Concluding, Daly said she needs to see the supercore inflation back to pre-COVID levels before feeling confident Fed has done enough.

FIXED INCOME

T-NOTE (U3) FUTURES SETTLED 17 TICKS LOWER AT 110-27+

Treasuries were steeper in choppy trade, failing to sustain a bounce higher despite the soft-leaning CPI figures; 30yr auction was lacklustre. 2s +1.9bps at 4.821%, 3s +4.8bps at 4.476%, 5s +7.2bps at 4.200%, 7s +7.8bps at 4.156%, 10s +7.7bps at 4.084%, 20s +7.3bps at 4.411%, 30s +6.7bps at 4.245%

INFLATION BREAKEVENS: 5yr BEI +1.9bps at 2.371%, 10yr BEI +1.0bps at 2.350%, 30yr BEI +0.3bps at 2.306%.

THE DAY: Treasuries saw some gradual downside in very light trade through the APAC session, seeing T-Notes trough at 111-06+ at the London handover. Europe rejected the downward range extension bringing T-Notes back into their Wednesday ranges ahead of the US CPI data.

T-Notes were already pushing higher just before the CPI data, going on to peak at 111-29 right as the data printed, with core M/M in line with expectations and the core Y/Y soft, not to mention a sizeable rise in initial jobless claims. But for whatever reason, the bid couldn't stick and better selling kicked in, with T-Notes going on to print initial session lows of 111-05+ later in the NY morning with eyes to the 30yr auction - the front end held up relatively better. The weak 30yr auction saw Ultra Bond futures pressured into late trade, with the long-end particularly hit as the 10yr hit new lows of 110-23+.

30YR AUCTION: A lacklustre USD 32bln, 30yr new issue auction from the Treasury, with the highest yielding stop of the cycle, 4.189%, still tailing 1.4bps, which is better than last month's 2bp tail but worse than the six-auction average 0.5 bps for the largest 30yr auction since February 2022. Thus, the auction failed to buck the trend of 30yr refundings tailing, where BMO highlights 13 of the last 17 having done so by an average of 1.6bps. The bid/cover ratio of 2.42x was similar to the prior 2.43x and average 2.39x. The breakdown was disappointing. Dealers (forced surplus buyers) were left with a sizeable 12.5% (prev. 10.9%; avg. 11.1%), with both Directs and Indirects taking smaller shares than July's offering.

STIRS:

- SR3U3 +1.0bps at 94.610, Z3 +0.0bps at 94.645, H4 -1.0bps at 94.890, M4 -2.5bps at 95.245, U4 -4.0bps at 95.640, Z4 -4.5bps at 95.975, H5 -5.5bps at 96.210, M5 -6.5bps at 96.355, U5 -7.0bps at 96.425, U6 -10.0bps at 96.505, U7 -10.5bps at 96.440.
- SOFR flat at 5.30% as of Aug 9th, volumes fall to USD 1.322tln from 1.340tln.
- NY Fed RRP op demand at USD 1.759tln (prev. 1.797tln) across 103 counterparties (prev. 106).
- EFFR flat at 5.33% as of Aug 9th, volumes rise to USD 111bln from 110bln.
- US sold USD 76bln of 4-week bills at 5.280%, covered 2.62x; sold USD 66bln of 8-week bills at 5.280%, covered 2.96x.
- US raises 6-, 13-, and 26-week bills by USD 5bln, 2bln, and 2bln, respectively, to USD 60bln, 69bln, and 62bln; 13- and 26-week sold on Aug 14th, 6-week on Aug 15th; all to settle on Aug 17th.

FRIDAY: **US PPI (Jul), US Uni of Michigan Prelim. Survey (Aug)**, IEA OMR, UK GDP (Jun), French/Spanish Final CPI (Jul).

CRUDE

EQUITIES

CLOSES: SPX +0.03% at 4,468, NDX +0.18% at 15,128, DJIA +0.15% at 35,175, RUT -0.42% at 1,922.

SECTORS: Communication Services +0.43%, Consumer Discretionary +0.28%, Materials +0.10%, Financials +0.08%, Energy +0.08%, Technology +0.01%, Health -0.04%, Consumer Staples -0.20%, Industrials -0.28%, Real Estate -0.31%, Utilities -0.32%.

EUROPEAN CLOSES: DAX +0.91% at 15,997, FTSE 100 +0.41% at 7,619, CAC 40 +1.52% at 7,434, Euro Stoxx 50 +1.56% at 4,385, IBEX 35 +1.58% at 9,502, FTSE MIB +0.94% at 28,575, SMI +0.65% at 11,153.

STOCK SPECIFICS: **Disney (DIS)** beat on profit but missed on revenue, Disney+ and ESPN+ subscribers; the co. also announced it is to raise prices on its ad-free streaming tier and to launch Disney+ ad-supported subscription offerings in several countries across Europe and in Canada starting November 1st. **Tapestry (TPR)** is to acquire **Capri Holdings (CPRI)** for USD 57/shr in cash or USD 8.5bln, with the move aimed to enhance competition against European giants such as **LVMH (LVMUY) and Kering (PPRUY)**. Note, CPRI closed Wednesday at 34.61. **AppLovin (APP)** surpassed expectations on the top and bottom line alongside posting strong guidance. **Wynn Resorts (WYNN)** beat on EPS and revenue. Exec said Wynn Las Vegas and Encore Boston Harbor continue to perform well, while in Macau the post-COVID recovery accelerated. **Illumina (ILMN)** earnings beat but it lowered FY23 guidance as it said H2 sales will be negatively impacted by a larger temporary decline in high throughput consumables as customers transition to Novaseq X. **Trade Desk (TTD)** beat on the top and bottom line with the next quarter revenue outlook better-than-expected. Analysts cited management's enthusiasm about improving advertiser sentiment, with early success in OpenPath displacing ineffective SupplySidePlatforms, though high valuations may be acting as a headwind for the stock. **Sonos (SONO)** posted a shallower loss per share than expected and beat on revenue. Exec noted a challenging environment but remains on track to deliver FY23 guidance. **Alibaba (BABA)** beat on EPS and revenue, while Commerce Retail Business and Wholesale Business rose +13% and +1% Y/Y, respectively. CFO said it sees strong business momentum in Q1. **Amazon (AMZN)** reportedly cut dozens of house brands as it battles costs and regulators, according to WSJ.

US FX WRAP

The Dollar saw mild gains heading into APAC trade despite the US CPI Y/Y headline and core metrics coming in underneath analyst expectations, but there was still an acceleration from the prior month. Elsewhere, the jobless claims data saw a notable rise above expectations, but not above recent peaks. Meanwhile, in wake of the data, Fed's Daly still warned the fight against inflation is not over and the Fed is not done yet, but she did not commit to another hike and stressed her data-dependent stance. Nonetheless, the overall reaction was net dovish with money markets now implying just a 10% probability of a hike in September vs 15% pre-CPI. Despite some knee-jerk reaction in assets to the data, the move was quickly unwound with UST yields higher across the curve, which extended in wake of the weak 30yr bond auction taking longer-end yields to session highs, keeping the buck supported. DXY hit a high of 102.64 in the afternoon post-bond auction, from the lows of 101.76 which printed in the immediacy of the cooler-than-expected inflation report.

The Euro was also firmer on the session, but only marginally. EUR/USD managed to trade above 1.10 throughout the majority of the European session before hitting a post-CPI high of 1.1064, although the rise in bond yields post auction took EUR/USD back beneath 1.10 heading into the APAC session. Note, the ECB economic bulletin was released on Thursday, which highlighted inflation continues to decline but is still expected to remain too high for too long, in fitting with the latest ECB announcement. Meanwhile on EZ energy, the Dutch nat gas prices had pared some of the rally seen on Wednesday, but still remained above levels not seen since the last month.

The Yen was weaker on Thursday vs the Dollar despite seeing lows of 143.31 in the immediate aftermath of the US CPI release, but the move swiftly pared and USD/JPY went on to hit highs of 144.78 ahead of the US close given the Yen's sensitivity to US yields.

The Yuan was weaker vs the buck, albeit only marginally. It is worth noting that Country Garden Holdings, a Chinese property developer, was downgraded further into Junk at Moody's to Caa1/Caa2 from B1, implying substantial/extremely substantial risk. The downgrade follows reports earlier in the week that the co. had not paid two USD bond coupons due August 6th, worth USD 22.5mln. However, there was little reaction to the news, with many expecting any issues China is facing to be offset or at least helped with governmental support given all the recent jawboning from officials.

Antipodeans were mixed, AUD was flat vs the Dollar but NZD saw some weakness, although it managed to hold above 0.6000. AUD/USD hit a high of 0.6617 (vs low 0.6521) on the CPI-induced Dollar knee-jerk before trimming gains as the DXY regained ground. AUD/USD currently trades c. 0.6530 at pixel time, now flat on the session with the recent concerns surrounding LNG and subsequent price reaction potentially underpinning the currency. NZD/USD saw a similar story and looks to end the session towards the bottom end of its daily range of 0.6027-0.6118.

GBP was weaker vs the buck and the Euro with Cable falling from highs north of 1.28 to lows of 1.2671, and currently residing towards the bottom end of that range and back beneath the 50dma of 1.2760. Note, similar to other major FX pairs the highs in Cable were hit after the US CPI report. On UK housing, the latest UK RICS report for July saw further pressure in the housing market as mortgage rates continue to increase given the BoE's tightening cycle and expectations for further upside. RICS highlighted that both house enquiries and sales decline further and near-term market expectations remain negative.

The Loonie was slightly weaker vs the buck with the tumbling oil prices weighing on the CAD into the close. Any early gains were wiped out as the Dollar rose, stocks sold and crude prices took a hit with USD/CAD hitting a high of 1.3440 in the latter part of the session, from lows of 1.3374.

NOK was weaker vs the Euro and the Dollar on Thursday with the weakness in Brent prices weighing on the petro-currency. However, the latest inflation report came in marginally above expectations at 6.4% (exp. 6.3%), but slowed from the prior 7%. The data saw a slight hawkish repricing in the immediacy with the odds of a 50bp hike increasing to 35% from 25% pre-release.

In EMFX, the LatAm's saw notable strength vs the Dollar, particularly CLP and COP while the MXN and BRL gains were still solid in wake of the US CPI report, although the LatAm currencies managed to hold onto their gains, unlike currencies mentioned above. The Banxico decision had little impact and the bank left rates unchanged as expected while maintaining guidance, while it lifted some of its near term core inflation forecasts, and lowered its immediate Q3 23 headline inflation forecast, but inflation is still seen returning to near 3% target at the end of 2024 (more below). In Brazil, BCB Chief Neto noted service inflation has not fallen like other readings, and that the BCB is concerned by this. However, he did suggest if Brazil manages to reach its fiscal targets, rates will be lower. Neto later added that what the BCB wants most is to lower interest rates in a structural and sustainable way. The solid gains in COP and CLP were seen despite losses in each of the country's main exports, Crude and copper, with the LatAm's benefitting the most from the softer than expected US CPI report.

BANXICO REVIEW: The Central Bank of Mexico left rates unchanged as expected at 11.25% in a unanimous decision. The bank also maintained its guidance that "it considers that it will be necessary to maintain the reference rate at its current level for an extended period". Commentary on the economy saw it state activity has shown resilience and register higher-than-anticipated growth (prev. said it has shown resilience in a complex external environment), it maintained its view the labour market remains strong and that the balance of risks to growth is equilibrated. On inflation, it repeated that the balance of risks remain biased to the upside and that the inflationary outlook is still very complex, it also repeated the inflationary outlook will be complicated and uncertain throughout the entire forecast horizon, with upward risks. Banxico made some minor changes to its inflation forecasts. On the headline inflation, the Q3 23 forecast was revised down to 4.7% from 5.0%, but left unchanged throughout the rest of the forecast horizon to Q2 25. While for the core metrics, the Q3 23 forecast was left unchanged at 6.2%, but Q4 23 to Q2 24 forecasts saw revisions higher by 0.1% for each quarter, to 5.1% in Q423, 4.2% in Q124 and 3.6% in Q224. However, it still sees both headline and core inflation returning more or less to target by the end of 2024. There was nothing in the statement to indicate rate cuts are coming, but analysts are expecting rate cuts in Q4 23, and Banxico officials (namely Heath) have also expressed rate cuts could occur later this year if the economy unfolds as expected.