US Market Wrap

15th August 2023: Stocks sold despite exuberant retail sales, China weighs heavy

- **SNAPSHOT**: Equities down, Treasuries mixed, Crude down, Dollar flat.
- **REAR VIEW**: US retail sales above expectations; NY Fed largely disappoints; NAHB slides lower; Fitch warns of bank downgrades; Dismal Chinese activity data; PBoC cuts rates; Chinese state banks reportedly intervene; Hot UK wages cements BoE September hike; Kashkari uncertain whether the Fed has done enough; Japanese GDP beats & officials jawbone.
- **COMING UP**: **Data**: UK CPI, EZ GDP & Unemployment Rate, US Building Permits & Industrial Production **Events**: New Zealand Policy Announcement & FOMC Minutes **Supply**: Germany **Earnings**: Carlsberg, Admiral Group, Balfour Beatty, Target, Cisco and JD.com.

MARKET WRAP

Stocks were lower Tuesday amid a slew of mixed macro data points and some underlying themes at play. Cyclical risk appetite was already diminished entering the US session after the slew of disappointments in the Chinese July activity data, which saw a surprise 15bp cut from the PBoC in its MLF - the Yuan notably underperformed. However, US retail sales later came in strongly above expectations, but that failed to sustain any meaningful recovery in stocks; Home Depot (HD) had a decent report too. Under the surface, US banks were particularly weak after Fitch warned of potential downgrades to the sector. On the other hand, homebuilders outperformed on the back of Berkshire stake initiations, while Nvidia (NVDA) extended its rally on more sell-side exuberance ahead of its earnings report on Aug. 23rd. Elsewhere, Treasuries steepened in volatile trade after ripping back higher off post-retail sales lows, only to pare back lower into the close. Fed's Kashkari (voter, hawkish) spoke at an event, saying he's not willing to rule out more hikes with his surprise at the outperformance of the economy, but also said Fed could cut in 2024. In FX, the DXY was flat, in line with Yen, Euro, and Swissy crosses, Sterling saw mild outperformance on hot wage data with gilt yields surging, while activity currencies suffered with stocks and the weak China data. Oil saw sizable losses too.

US

RETAIL SALES: The headline retail sales rose by 0.7% in July, accelerating from the upwardly revised 0.3% and above expectations of 0.4%, matching the highest analyst forecast. The core measure, ex-autos, rose 1%, above the 0.4% expected and 0.2% prior, and was above all analyst forecasts. The super core, ex gas and autos, rose 1% (prev. +0.4%), while the control metric, which feeds into the GDP numbers, was also hot, rising 1.0% (exp. 0.5%, prev. 0.5%). The strong data, alongside import and export prices data, saw the Atlanta Fed GDP Now estimate for Q3 be revised up to 5.0% from 4.1%, previously. Meanwhile, ING highlight the data indicates a 3% annualised GDP growth rate is possible for Q3, but looking ahead ING warn that "higher consumer borrowing costs, reduced credit availability, the exhausting of pandemic-era savings and the restart of student loan repayments pose major challenges for fourth quarter activity". Looking into the report, the nonstore retailers saw the largest jump (+1.9%), with analysts suggesting this is likely due to Amazon's July prime day. Elsewhere, sporting goods, hobbies, musical instruments, & bookstores saw a 1.5% gain, while food services and drinking places rose by 1.4%. On the flipside, furniture & home furn. stores declined by 1.8% M/M and electronic and appliance stores fell 1.3%. There was little reaction to Fed pricing on the data with the Fed aware of the resilient US economy while a lot of their attention is on inflation. Meanwhile, many on the FOMC are cognizant of the lagged effects of monetary policy and have been expecting a slowdown in the future, but not so much that it causes a recession.

EMPIRE STATE: The NY Fed's Empire State Manufacturing Survey index, the first regional mfg. survey of the month, fell to -19.0 in August from July's +1.1, a larger fall than the expected -1.0, failing to notch a third consecutive positive reading for the first time since late 2021 and reflective of the index's volatility. Regardless, the overall trend has remained suppressed over the last year or so, with 3m, 6m, and 12m averages all in negative territory. Looking within, new orders and shipments saw big declines. While delivery times were steady, and inventories moved lower. Labour market indicators pointed to steady employment levels but a shorter average workweek. Input and selling price increases picked up, and capital spending plans firmed somewhat. Looking ahead, firms grew more optimistic about the six-month outlook with new orders, shipments, and employment all expected to see noticeable increases, but with it, so are price pressures. The Philly Fed survey is next up on Thursday.

NAHB: After seven consecutive increases to start the year, NAHB in August tumbled lower to 50.0, much beneath the expected, and prior, 56.0 as the drag on demand from higher mortgage rates more than offset the shift towards new homes due to a lack of existing homes for sale. As such, Oxford Economics expects home demand and homebuilder confidence to remain subdued over the rest of the year as the economy slows. OxEco adds, “the gradual climb in mortgage rates back toward 7% over recent months is hitting housing demand, forcing a greater share of homebuilders to resort to price cuts and incentives to drive sales. The NAHB index is consistent with housing starts remaining around their current level of close to 1.4mln annualized.”

IMPORT/EXPORT PRICES: Import prices for July rose 0.4% M/M (exp. +0.2%) after declining 0.1% the prior month, while export prices rose 0.7% (prev. -0.7%), exceeding the expected +0.2%. Imports rose for only the second time in 2023 and were largely driven by higher fuel prices (+3.6%). Meanwhile, the advance in exports was the greatest monthly increase since a 1.1% rise in June 2022. Higher prices in July for both agricultural and nonagricultural exports contributed to the overall advance.

KASHKARI (voter, hawkish), who participated in a moderated discussion with Q&A at an API Group conference, said the question now is whether the Fed has done enough or if it needs to do more. He said the Fed can take a little more time to see the data to see if more hikes are needed, saying he's not ready to say the Fed is done raising rates yet. Offsetting that, he said the Fed may need to lower nominal rates sometime next year. The two-way policy commentary was also reflected in his economic outlook, where he said the Fed has been surprised by the economy's resilience, but he does feel good about the progress on inflation, caveating that it's still too high. The Minneapolis Fed President warned that policy could hit the economy with a lag, and there could be more of a slowdown in the pipeline. At the same time, he noted the housing response to rate hikes has been surprising, where he would have thought the brakes would be slammed, but said it seems like the sector has bottomed and is now recovering.

FIXED INCOME

T-NOTE (U3) FUTURES SETTLED 7+ TICKS LOWER AT 109-24+

Treasuries steepened in volatile trade after ripping back higher off post-retail sales lows. 2s -1.7bps at 4.948%, 3s +0.3bps at 4.646%, 5s +1.9bps at 4.374%, 7s +3.3bps at 4.321%, 10s +3.9bps at 4.221%, 20s +4.6bps at 4.505%, 30s +4.4bps at 4.325%.

INFLATION BREAKEVENS: 5yr BEI -3.2bps at 2.363%, 10yr BEI -2.2bps at 2.338%, 30yr BEI -0.2bps at 2.315%.

THE DAY: T-Notes hit initial lows of 109-26 in the Tokyo morning, with Japan's Q2 annualised GDP hitting 6% (exp. 3.1%), but downside extension was capped before long, where the PBoC made a surprise 15bp cut to its MLF and a slew of Chinese activity data (IP, retail sales, and urban investment) all came in beneath expectations too; Australian wage data also came in on the soft side.

New lows weren't made in T-Notes until the European handover, breaching through Monday's 109-24+ low after UK June wage data came in well north of expectations. The better-than-expected German ZEW survey also kept the pressure on govvies.

T-Notes ultimately troughed at 109-11+ on the back of the strong beats in US retail sales and Canadian CPI data (vs 109-21 pre-data levels), although soon reversed back higher. Perhaps that was a function of the deeper-than-expected fall in the NY Fed's mfg. survey, although the magnitude of the recovery, and the large post-data volume, point more to a general short unwind with the calendar thin for the rest of the week.

The post-data buying activity saw T-Notes peak at 110-07 later in the US morning, before contracts chopped back lower, again, through into the close. Little obvious for the pullback lower, which was gradual, although we did get Fed's Kashkari (voter, hawkish) speaking, saying he's not ready to say Fed is done on rate hikes, expressing his surprise at the strength of the economic data, but also said the Fed could cut rates next year - hardly surprising.

STIRS:

- SR3U3 +0.5bps at 94.593, Z3 +2.5bps at 94.61, H4 +2bps at 94.795, M4 +1.5bps at 95.10, U4 +1bps at 95.46, Z4 +0.5bps at 95.77, H5 -0.5bps at 95.99, M5 -1bps at 96.13, U5 -2.5bps at 96.19, U6 -5bps at 96.29, U7 -5.5bps at 96.265.
- SOFR flat at 5.30% as of Aug 14th, volumes fall to USD 1.333tln from 1.347tln.
- NY Fed RRP op demand at USD 1.744tln (prev. 1.799tln) across 98 counterparties (prev. 103).
- EFFR flat at 5.33% as of Aug 14th, volumes fall to USD 103bln from 105bln.

- US sold USD 60bln of 42-day CMBs at 5.285%, covered 3.01x.
- US raises 4-, 8-, and 17-week bill auction sizes by USD 5bln, 5bln, and 2bln, respectively, to USD 80bln, 70bln, and 50bln; 4- and 8-week sold on Aug 17th, 17-week sold on Aug 16th; all to settle on Aug 22nd.

THIS WEEK (US items bolded):

- WED: **Housing Starts (Jul), Industrial Production (Jul), FOMC Minutes**, RBNZ Announcement, UK Inflation (Jul), EZ GDP and Employment 2nd (Q2).
- THU: **Philly Fed Mfg., Jobless Claims**, Norges Bank Announcement, Australian Jobs Report (Jul), EZ Trade Balance (Jun).
- FRI: Japanese CPI (Jul), UK Retail Sales (Jul), EZ Final CPI (Jul).

CRUDE

WTI (U3) SETTLED USD 1.52 LOWER AT 80.99/BBL; BRENT (V3) SETTLED USD 1.32 LOWER AT 84.89/BBL

Oil prices tumbled Tuesday after big disappointments in Chinese activity data in July highlighted the economic vulnerability of the world's second largest oil consumer. WTI and Brent futures trundled to the downside through the session, ultimately hitting session lows of USD 80.40/bbl and 84.29/bbl in the US afternoon, hovering near lows into settlement. The silver lining for oil in the China data was that the nation's oil refinery throughput in July spiked 17.4% Y/Y to 63.13mln T, with production the equivalent of 14.87mln BPD, up slightly from June's 14.83mln BPD, and the third highest on record according to Reuters calculations, "as refiners kept output elevated to meet demand for domestic summer travel and to cash in on high regional profit margins by exporting fuel". Elsewhere, BofA said that energy demand has to improve materially for a sustained rally above USD 100/bbl in Brent, maintaining its USD 90/bbl 2024 forecast. Traders are now looking to the weekly US energy inventory data with the private release due later Tuesday ahead of the EIA figures on Wednesday. Current expectations (bbls): Crude -2.3mln, Gasoline -1.3mln, Distillates -0.5 mln.

EQUITIES

CLOSES: SPX -1.16% at 4,437, NDX -1.10% at 15,037, DJIA -1.02% at 34,946, RUT -1.29% at 1,895.

SECTORS: Energy -2.44%, Financials -1.8%, Utilities -1.69%, Materials -1.65%, Consumer Discretionary -1.37%, Industrials -1.27%, Real Estate -1.07%, Consumer Staples -1.02%, Communication Services -1.01%, Technology -0.91%, Health -0.36%.

EUROPEAN CLOSES: DAX -0.86% at 15,767, FTSE 100 -1.57% at 7,390, CAC 40 -1.10% at 7,268, Euro Stoxx 50 -0.99% at 4,287, IBEX 35 -0.87% at 9,348, SMI -1.12% at 10,986.

STOCK SPECIFICS: Homebuilders **D.R Horton (DHI), Lennar (LEN), NVR (NVR)** firmed after Berkshire Hathaway added the 3 names to its portfolio in its latest quarterly 13-F. **Discover Financial (DFS)** CEO and President Robert Hochschild resigned. Following this, Evercore cut the cos. PT and added it to the 'Tactical Underperform List'. Of note for banks such as JPM, MS, BAC, C, etc, who all weakened after Fitch analysts warned it may be forced to downgrade dozens of banks, including **JPMorgan Chase (JPM)**. **Home Depot (HD)** beat on the top and bottom line alongside a smaller-than-expected drop in same-store sales as demand was buoyed by Americans spending on small-scale projects amid signs of stabilisation in the housing market. Announced a new USD 15bln share buyback programme and reaffirmed FY23 guidance, but still sees sales and EPS declining Y/Y. **Nvidia (NVDA)** continued its upward trajectory - after soaring 7% on Monday - after its price target was raised at Wells Fargo, UBS, and Baird. WFC sees recent pull-back as a healthy de-risk given a very high bar set up into Q2 results. Meanwhile, Baird sees another supercycle as its channel checks suggest no competition in AI enterprise for the medium term. **Tesla (TSLA)** launched two cheaper versions of its Model S sedan and Model X SUV in the US. **Getty Images (GETY)** posted a surprise loss per share and missed on revenue. **Tencent Music Entertainment (TME)** missed on profit while revenue was marginally short alongside Mobile MAUs for social entertainment also light.

US FX WRAP

The Dollar was choppy but eventually flat on Tuesday within thin ranges after a slew of data, Fitch on banks, and Kashkari (voter) speaking, as the reserve currency failed to sustain the bid seen in wake of the disappointing Chinese activity data (more below). Starting on the US data front, US retail sales came in well above expectations, as did the control group, while the NY Fed Manufacturing survey posted a much deeper decline than forecasted, with prices paid rising but new orders and employment returning back to negative territory. NAHB, after seven consecutive increases to start the year, tumbled lower to 50.0, much beneath the expected, and prior, 56.0. In addition, there was weakness in major US banks (JPM, MS, C, WFC etc) after Fitch analysts warned it may be forced to downgrade dozens of banks, including JPM. Lastly, Fed's Kashkari (voter, hawkish), who garnered little market reaction, was uncertain whether enough has been done to tackle inflation, but did tout potential rate cuts in 2024. Looking ahead, attention will be on FOMC Minutes (Wed), US Retailer earnings (TGT, WMT), and the latest regional bank survey in Philly Fed (Thurs).

Pound was the G10 outperformer, just, against the Buck on the back of firmer-than-expected wages data for both the headline and ex-bonus readings (European data wrap here) which cemented the case for a BoE September hike. As such, Cable hit a high of 1.2752 in contrast to a low of 1.2676, as it surpassed its 55dma at 1.2746 in the process, albeit not sustaining the momentum and paring back to 1.2700 at time of writing. Looking ahead, UK inflation data will be key on Wednesday ahead of retail sales on Friday.

Antipodeans were weaker with the AUD underperforming its counterpart. The Aussie was weighed on by the Yuan weakness and broader risk sentiment in addition to Australian wages print softer-than-anticipated. Meanwhile, RBA minutes provided little in the way of new information as it stated that the Board considered raising rates by 25bps or holding steady and agreed that the case for holding steady was the stronger one. Separately, the Kiwi watchers await RBNZ rate decision Wednesday (preview here), where the central bank is likely to keep rates unchanged at 5.50%. In terms of levels, AUD/USD and NZD/USD traded between 0.6452-6522 and 0.5950-96, respectively, currently at the bottom end of those ranges with stocks.

Loonie saw losses vs the Buck, with the cross peaking at 1.3500 as the currency lost impetus after the hotter-than-expected headline inflation figure and was further accentuated by the softness in oil. Canadian inflation rose 3.3% Y/Y (exp. 3.0%, prev. 2.8%), while the 3-month measure of SA core inflation held steady at an annualized rate of 2.5%, remaining within the BoC's 1%-3% target range. On the data, Oxford notes “although it was slightly above our expectations, we anticipated an uptick in prices now that the favourable base-year effects that helped pull inflation down in June are mostly behind us”. While looking ahead, OxEco adds with base-effects no longer having a significant impact on Y/Y movements in CPI, movements in inflation are now being more directly driven by M/M changes in underlying price pressures. As such, the consultancy “expect an emerging recession this year will weaken demand, create slack in the economy and return inflation to the BoC’s 2% target by mid-2024.”

CHF, EUR, and JPY were flat, with the Yen not able to sustain its bid following strong Japanese GDP data (+1.5% in Q2 vs exp. +0.8%) and jawboning from officials. Finance Minister Suzuki said rapid FX moves are undesirable and they are to respond appropriately to excessive moves, while top FX diplomat Kanda said they will take appropriate steps against excessive moves, according to Jiji, and added that excess volatility is undesirable and monitoring with a high sense of urgency. USD/JPY hit a low of 145.11 and a high of 145.86 ahead of CPI on Friday. Elsewhere, USD/CHF was compressed inside 0.8800-0.8745 on the back of broad risk aversion rather than Swiss producer and import prices that remained unchanged Y/Y. Euro sits flat at 1.09 currently after earlier peaking at 1.0952 - little of note in the region barring the better-than-expected German ZEW survey.

The Yuan continued to slide lower on Tuesday, despite relying on state bank buying to stem losses following disappointing activity data and rate cuts by the PBoC. On the latter, China's PBoC cut its 1-year MLF rate by 15bps, and reduced its 7-day reverse repo rate and SLF rates by 10bps each. In addition, Chinese industrial production, retail sales, and urban production metrics were woeful which only continues to heighten the slow post-COVID China recovery.

EMFX was predominantly lower against the Greenback aside from the RUB, which retraced some recent losses after its emergency meeting. To recap, rates were raised to 12% from 8.5%, depo ops were tweaked, and latest reports suggest that Russia may reimplement capital controls to prop up the RUB. CLP saw weakness amid copper prices falling, while the ARS continued its slide and the Argentina Central Bank stepped in with FX intervention from record levels. For the Real watchers, Petrobras raised diesel and gasoline prices, which may renew inflation fears, while Planning Minister Tebet said her department was looking to present ways to the government to improve public spending.