US Market Wrap

17th January 2024: Rate cut expectations unwind after hot UK CPI and US Retail Sales

- **SNAPSHOT**: Equities down, Treasuries down, Crude mixed, Dollar flat.
- **REAR VIEW**: Hot US retail sales; Import/Export prices mixed; IP sees slight beat; NAHB above expectations; Hot UK inflation; ECB's Lagarde touts summer rate cut; Mixed China activity data; Weak US 20yr bond auction; SCHW and USB fall post-earnings; VZ records near USD 6bln charge.
- **COMING UP**: **Data**: UK RICS Survey, Australian Employment, US Building Permits, IJC, Philly Fed Business Index, NZ Manufacturing PMI, Japanese Industrial O/P, CPI. **Events**: ECB Minutes, BoE Credit Conditions Survey (Q4'23) **Speakers**: Fed's Bostic; ECB's Lagarde **Supply**: Japan, Spain, France, US **Earnings**: Flutter, Sage, Richemont.

MARKET WRAP

Stocks were sold on Wednesday amid the hawkish repricing of central bank rate paths amid a slew of hawkish economic data and central bank speak. Hot UK CPI figures and more hawkish ECB pushback were followed by big beats in the US retail sales figures; the US industrial production data and NAHB Housing Market index both came in above expectations too. As a result, the small-cap Russell 2k index saw the largest losses vs US index peers given the index's high sensitivity to rates right now. Treasuries bear-flattened, particularly after the retail sales figures, with 2s10s (-8bps) and 2s30s (-11bps) spreads seeing their largest one-day flattening since early November; note the 20yr auction was poor, capping the long end's recovery attempt in the NY afternoon. Fed Pricing is now down to 140bps of cuts for the year ahead vs the 170bps figure on Friday after the soft PPI data. Oil prices were little changed with losses seen in Europe on the heels of mixed Chinese activity data fading through the NY session. The Dollar Index was little changed with strength against most pairs except Sterling, which outperformed after the CPI data saw a big unwind of BoE cut pricing. Note the weak Chinese retail sales figures hit China-related stocks, although the Yuan was little changed, with industrial production strong in December. Elsewhere in stocks, defensive sectors such as healthcare, staples, and utilities outperformed with tech failing to hold up as a hedge for higher rates today.

US DATA

RETAIL SALES: Retail Sales data was hotter-than-expected in December with the headline rising 0.6%, above the 0.4% consensus and above the 0.3% seen in November. Ex-Autos rose 0.4%, above the 0.2% consensus and prior. Ex Gas/Autos rose 0.6%, matching the prior pace and above the 0.3% consensus. The Retail Control metric surged 0.8% in December, accelerating from the upwardly revised 0.5%, above the 0.2% forecast, a strong sign for Q4 23 GDP. Looking into the report, outside of Autos and Gas, Clothing saw a 1.5% jump, rising from the 1.0% gain in November, while General Merchandise rose 1.3%, jumping from the prior -0.2% M/M. Nonstore Retailers rose 1.5%, accelerating from the 1.2% in November. On the downside, furniture pared some of the 2.4% gain in November with a 1.0% decline, while Health and Personal care stores declined 1.4%, vs the prior -0.2%. Although the report was hotter than consensus, it was more in line with Bank of America's forecasts, who typically have a strong track record on US Retail Sales estimates. It is also worth highlighting Fed Governor Waller's commentary on Tuesday, who said he would be looking at this report to see if the slowdown in consumer spending is tentative. This report, particularly the Retail Control metric, would imply the consumer slowdown is not as steep as feared and could give support to those on the Fed who have been pushing back on near term rate cuts, albeit the focus does remain on inflation. The US PCE report is due January 26th, and follows the above expected CPI and below expected PPI reported last week, and comes ahead of the January 31st FOMC.

INDUSTRIAL PRODUCTION: US industrial production in December rose 0.1% against the expected 0.0%, while the prior was downwardly revised to 0.0% from +0.2%. The headline was lifted by a 0.9% rise in mining output, while utilities output fell for a fourth straight month. Manufacturing output rose 0.1%, above the expected 0.0%, although the prior was downwardly revised to +0.2% from +0.3%. Pantheon Macroeconomics highlights, "The small gain in manufacturing output is largely due to a 1.6% increase in auto production, following a 7.4% leap in November, after UAW strikes ended at the end of October." Adding, "The decline in long rates towards the end of last year likely will start to lift capital spending intentions soon, but an upturn in actual spending is still several months away, at least."

NAHB: NAHB Housing Market Index rose to 44.0 in January from 37.0, well above the expected 39.0. The NAHB notes that the improvement was largely due to the continued fall in mortgage rates as borrowing costs in the US economy remained below their peaks from Q4 ‘23, owing to expectations of an incoming rate cut for the Fed. Looking at the sub-indices, current single-family homes rose by 7 points to 48, while single-family home sales rose to 57 (prev. 45) and the gauge for prospective buyers ticked higher to 29 (prev. 24). Overall, Oxford Economics said, “Homebuilders became much more optimistic about future home sales, and the improvement in homebuilder attitudes should support single-family housing starts in the months ahead.” Although, OxEco added, despite the decline in mortgage rates from their October peak, mortgage rates close to 7% still makes homebuying unaffordable for many potential buyers.

IMPORT/EXPORT PRICES: US import prices were unchanged in December, above the expected and prior 0.5% decline. Y/Y import prices fell 1.6% however, accelerating the decline from the prior -1.5%. Export prices meanwhile declined by more than expected at 0.9% (exp. -0.6%), matching the pace in November. Note, prices for import fuel declined 0.3% in December following decreases of 6.4% in November. While all imports ex fuel were unchanged. Foods, feeds and beverages edged down 0.1% while nonfuel industrial supplies and materials rose 0.4% and finished goods were mixed. Analysts at Oxford Economics summarise that "Global energy prices were volatile in the second half of last year, causing some noticeable swings in US import prices but the monetary implications were minimal at best."

FED

BEIGE BOOK: The Fed's January Beige Book saw the majority of contacts report little change in economic activity since the November report, although looking ahead, contacts cited lower rates as a source of optimism. The report noted that consumer spending was on the hot side during the holiday season, although manufacturing remained suppressed. Overall employment levels were described as little changed and the labour market continued to be described as tight. However, nearly all Districts cited one or more signs of a cooling labour market, such as larger applicant pools, lower turnover rates, more selective hiring by firms, and easing wage pressures. Firms from many Districts expected wage pressures to ease and wage growth to fall further over the next year. On prices, a small majority of districts reported inflation as having subsided to some degree. Districts also noted that increased consumer price sensitivity had forced retailers to narrow their profit margins and to push back in turn on their suppliers’ efforts to raise prices. Three Districts noted that their firms were expecting price increases to ease further over the next year, while four Districts’ firms anticipated little change.

BOWMAN (voter, hawk) gave remarks on bank capital regulations. She said that the proposal to hike bank capital requirements (Basel III "endgame") needs substantive changes to address known deficiencies. Bowman said she is cautiously optimistic policymakers can strike a reasonable compromise on bank capital rule-writing. She warned that imposing tougher capital requirements as proposed could result in significant harm to the US economy. Bowman is just the latest official to indicate coming changes to the current proposal.

FIXED INCOME

T-NOTE (H4) FUTURES SETTLE 13+ TICKS LOWER AT 111-13+

Treasuries bear-flattened after hawkish ECB speak and hot UK CPI was followed by hot US retail sales. 2s +11.8bps at 4.346%, 3s +10.4bps at 4.123%, 5s +7.2bps at 4.017%, 7s +5.7bps at 4.066%, 10s +3.2bps at 4.098%, 20s +0.9bps at 4.431%, 30s +0.3bps at 4.308%.

INFLATION BREAKEVENS: 5yr BEI +1.1bps at 2.266%, 10yr BEI +0.4bps at 2.306%, 30yr BEI -0.4bps at 2.304%.

THE DAY: Treasuries saw a recovery attempt into the APAC morning on Wednesday after the Waller sell-off on Tuesday. T-Notes peaked for the session at 112-01+ on the heels of the Chinese activity data, which was mixed, with December retail sales coming in on the soft side but industrial output rising above expectations. Contracts began paring lower into the Tokyo afternoon.

The sell-off gained momentum in the London morning, led by the front end while the long end was supported, amid the rise in UK December CPI figures but also more hawkish ECB Speak with Lagarde pushing back cut expectations to the "summer", while hawk Knot went as far as saying that the more easing the markets do for the ECB, the less likely the ECB will actually cut. T-Notes hit support at 111-22+, which was the post-Waller low on Tuesday. The proceeding German 30yr auction taps were received ok, although the UK 10yr saw more noted demand. Citi's rates desk noted steepener interest - a key theme of the new year - emerged at the curve's flattening extremes.

T-Notes stretched out a fresh low of 111-18+ just ahead of the US retail sales data and dived even lower after the strong report. Contracts ultimately bottomed at 111-09 later in the NY morning with above forecast industrial production and

NAHB housing index weighing. However, the curve flattening extended into the NY afternoon, with duration recovering ahead of the 20yr auction (the poor results capped the recovery) while 2yr futs stretched out new lows ahead of settlement; 2s10s and 2s30s cash spreads both saw their largest one-day flattening since early November.

20YR AUCTION: A poor 20yr auction from the Treasury with the USD 13bln reopening sold at 4.423%, a c. 20bps of cheapening from December's offering but still a 0.8bp tail of the When Issued yield, worse than the six-auction average 0.3bp stop-through but better than December's 1.5bp tail. The auction was covered 2.53x, a bit beneath both the prior 2.55x and avg. 2.58x. Dealers were left with a chunky 17.3%, indicative of poor demand, worse than the prior 12.9% and avg. 10.6%, mainly on account of Indirects taking a dip M/M to 62.2% from 66.4%. This is the last 20yr auction before the February refunding, where some analysts have suggested the Treasury could ramp the size of 20yr auctions given their strong auction performance, although the last two tails may temper the appetite for that.

FED PRICING: March implied cut probability down to 56% from 68% seen after Waller on Tuesday, and down from 86% seen on Friday after the misses on PPI. There are now 139bps of cuts prices across 2024 vs 157bps priced after Waller on Tuesday and 170bps after PPI on Friday.

THIS WEEK'S AUCTIONS: US to sell USD 18bln of 10yr TIPS on Thursday; to settle on Jan 31st. Elsewhere on Thursday, Spain and France are issuing across multiple tenors, and Japan is selling a 20yr.

STIRS:

- SR3H4 -5.5bps at 94.89, M4 -13bps at 95.33, U4 -17bps at 95.74, Z4 -18bps at 96.09, H5 -17.5bps at 96.37, M5 -16.5bps at 96.555, U5 -14.5bps at 96.65, Z5 -12.5bps at 96.675, H6 -11bps at 96.65, H7 -6bps at 96.545, H8 -3 bps at 96.415.
- SOFR rises to 5.32% as of Jan 16th from 5.31%, volumes rise to USD 1.854tln from 1.590tln.
- NY Fed RRP op demand at USD 0.590tln (prev. 0.583tln) across 77 counterparties (prev. 65).
- EFFR flat at 5.33% as of Jan 16th, volumes fall to USD 85bln from 93bln.
- US sold USD 58bln in 17-week bills at 5.185%, covered 3.22x.

CRUDE

WTI (G4) SETTLES USD 0.16 HIGHER AT 72.56/BBL; BRENT (H4) SETTLES USD 0.41 LOWER AT 77.88/BBL

Oil prices were ultimately little changed after paring initial losses on Wednesday. The downside began at the APAC/Europe handover with desks pointing to the mixed China activity data and pullback in pricing of central bank easing, seeing WTI and Brent trough in the NY morning at USD 70.50/bbl and 76.50/bbl, respectively. There were also some comments from Saudi Aramco's CEO saying the Red Sea attacks are manageable in the short-term but may create tanker shortage and weigh on the market if it lasts longer. Crude futures recovered gradually through the NY session in the absence of an obvious catalyst, potentially finding some demand support from the stronger-than-expected US industrial production and retail sales figures. Possibly some geopolitical risk too with the Iranian Foreign Minister saying "We are witnessing an expansion of the conflict in the Middle East". Meanwhile, a US DoD official told Sky News Arabia that "Houthis in Yemen have prepared plans to target US bases in the Arab region". Traders are now looking ahead to the US energy inventory data, with the private release due later Wednesday. Current expectations (bbls): Crude -0.3mln, Gasoline +2.2mln, Distillates +0.9mln.

EQUITIES

CLOSES: SPX -0.56% at 4,739, NDX -0.56% at 16,736, DJI -0.25% at 37,267, RUT -0.73% at 1,913.

SECTORS: Real Estate -1.87%, Utilities -1.52%, Consumer Discretionary -0.91%, Energy -0.84%, Materials -0.80%, Industrials -0.67%, Communication Services -0.63%, Technology -0.50%, Financials -0.28%, Health -0.24%, Consumer Staples -0.12%.

EUROPEAN CLOSES: DAX -0.84% at 16,431.69, FTSE 100: -1.48% at 7,446.29, CAC 40: -1.07% at 7,318.69, Euro Stoxx 50: -1.00% at 4,401.85, IBEX 35: -1.26% at 9,867.80, FTSE MIB -0.79% at 30,098.86, SMI -0.73% at 11,148.10.

EARNINGS:

- **Charles Schwab (SCHW)** -1.4%: Revenue missed while EPS and many internals (deposits, total client assets, daily avg. trades, trading rev., new brokerage accounts) topped forecasts. Net income declined 47% Y/Y, with Bank deposits - 21% Y/Y, and total assets -11% in the same period.

- **Citizens Financial Group (CFG)** +1.7%: Topped St. expectations on the bottom line, but revenue fell short with guidance disappointing.
- **US Bancorp (USB)** -1.4%: Mixed report. EPS was essentially in line, while revenue fell short as did deposits, net-interest income, and non-interest income.
- **Interactive Brokers (IBKR)** +2.3%: Top line slightly beat, while bottom line was light.

STOCK SPECIFICS:

- **Apple (AAPL)** -0.5%: US Appeals Court says ban on US Apple (AAPL) watch imports to be reinstated on Jan 18th after the pause. Meanwhile, US DoJ is preparing to file antitrust case against the co. as soon as March, via Bloomberg.
- **Verizon (VZ)** -1.1%: In Q4 2023 it recorded a USD 5.8bln non-cash goodwill impairment charge.
- **Tesla (TSLA)** -2%: Reduced Model Y prices in Germany, following a similar move in China.
- **JPMorgan (JPM)** -0.5%: COO said the bank will increase headcount this year.
- **Fisker (FSR)** -8%: NHTSA is probing Fisker's Ocean SUV over braking loss complaints.
- **Albemarle (ALB)** -4.2%: Outlined actions to preserve growth, reduce costs and optimise cash flow. Analysts note while investors will welcome steps to save costs/bolster cash, it is only cutting back spending due to the reduced growth prospects in key end markets, namely EVs. In other news, ALB is trying to sell its stake in Australia's Liontown Resources.
- **Spirit Airlines (SAVE)** -23% **JetBlue (JBLU)** -9%: SAVE continued on its slump seen on Tuesday after JBLU proposed USD 3.8bln acquisition of the Co. was blocked. Since then, SAVE has been downgraded at BofA, Susquehanna and Seaport.
- **Boeing (BA)** +1.3%: US FAA said the first 40 inspections of grounded 737 MAX 9 airplanes are complete and the agency will thoroughly review the data. Elsewhere, WSJ reported the plug door was produced by **Spirit AeroSystems (SPR)** +3.7% in Malaysia.
- **Nutanix (NTNX)** +5%: Upgraded at William Blair.
- **Morgan Stanley (MS)** -1.8%: Downgraded at KBW and JPM post-earnings.
- **SolarEdge (SEDG)** -6%: Downgraded at Barclays; cited a tougher road to recovery vs. peers.

US FX WRAP

DXY peaked at 103.69 alongside the unwinding of priced Fed cuts after the December US retail sales report came in stronger than expected on all metrics. At the same time, import prices were also above forecasts M/M in December although export prices were cooler than forecast. Industrial production and the NAHB Housing Index also beat expectations.

Euro sold off with EUR/USD briefly dipping beneath 1.0850 to lows of 1.0845 amid the Dollar strength but there were several more hawkish speeches from ECB officials to digest too. Lagarde noted inflation is not where the ECB wants it to be, but it is likely the ECB will cut rates by the summer. Knot and Vasle were downplaying market expectations of rate cuts while Villeroy said their job is not finished yet, with both Villeroy and Panetta stating it is premature to say when the ECB will cut rates and more data is needed to confirm the disinflation outlook.

Pound saw gains vs the buck and the Euro after the hot December UK CPI report. GBP/USD peaked at 1.2696, just failing to breach 1.2700. In response to the inflation report market pricing saw a hawkish shift with now just 100bps of easing priced by year-end vs 123bps priced pre-data.

Yen saw notable weakness throughout the session with weakness accelerating after the US retail sales report which eventually took USD/JPY to rise above 148.00 with US yields rising, particularly the front end on less dovish Fed prospects in response to the data and Waller's remarks on Tuesday. If momentum extends, 150 comes into play, and with it, BoJ intervention speculation. Note, on inflation expectations, a BoJ quarterly survey found 79.3% (prev. 86.8%) of Japanese households expect prices to increase a year from now and 76.5% (prev. 80.7%) of households expect prices to increase 5 years from now. JGB yields on watch on Thursday amid the 20yr JGB auction.

Swissy was weaker vs the Euro and the Dollar with EUR/CHF rising to a peak 0.9422 from lows of 0.9359 after SNB's Jordan said the Franc is now appreciating in real terms which pushes inflation down. The SNB Chair did note that current conditions are currently adequate, however, and noted that a stronger Franc needs to be taken into account.

Forint was softer vs the Euro after commentary from NBH Deputy Governor Virag who stated rate cuts of 75 or 100bps will definitely be on the table at the next meetings, but noted if the NBH decides to accelerate rate cuts, it can only be temporary, for 1, 2 or 3 months. Virag also noted market expectation of rates at 6-7% by mid-year is realistic based on current information. Elsewhere, Politico reported the EU is now considering an "emergency brake" for the Ukraine funds;

in order to prevent Hungarian PM Orban from having a veto opportunity in 2025, while providing enough of a compromise that the funding can be in the EU budget.

Sekky was softer vs the Euro amid remarks from Riksbank's Bremen who said it is very unlikely Sweden's central bank would purchase covered housing bonds to support the sector.

Yuan saw marginal weakness vs the Dollar. Chinese activity data was mixed, where weak retail sales figures were offset by strong industrial output.