newsquawk

US Market Wrap

31st January 2024: Hawkish Powell and regional banking fears weigh on market

- **SNAPSHOT**: Equities down, Treasuries up, Crude down, Dollar up.
- **REAR VIEW**: Powell pushes back on March cut; Soft US ECI & ADP; Surprising Crude EIA build; China's Manufacturing PMI remains in contractionary territory; Dismal NYCB earnings triggers regional bank woes; MSFT & GOOGL earnings underwhelm; Soft German & French Inflation figures; Treasury's Quarterly Refunding largely in line with expectations; Hawkish BoJ SoO.
- **COMING UP**: **Data**: Australian Trade, EZ & Italian CPI, US IJC **Events**: Riksbank, BoE Policy Announcement **Speakers**: ECB's Lagarde, Lane; BoC's Macklem, Rogers, BoE's Bailey post-announcement press conference **Supply**: Japan, Spain, France **Earnings**: Julius Baer, Roche, Sanofi, BNP Paribas, Shell, Deutsche Bank, Apple, Merck, Amazon, Meta.
- **DAILY US EARNINGS ESTIMATES**: Thursday's highlights include, HON, MRK, ETN, AMZN, META, AAPL. To download the full US Earnings Estimates, please click here.

MARKET WRAP

Stocks were sold throughout the session with underperformance in the Nasdaq after disappointing MSFT and GOOGL earnings while a dismal NYCB report saw the stock, KRE, and Russell 2k index tumble, igniting some fears on the regional banking sector, supporting havens. Bonds were bid pre-Fed with the regional banking woes, soft German and French Inflation figures, cooler-than-expected US ECI, ADP, and Chicago PMI supporting the move while the Treasury's Quarterly Refunding was largely in line with expectations, confirming a final round of auction size increases. The FOMC statement was mixed, where it left rates unchanged and removed reference to possible additional rate hikes as expected but it also downplayed near-term rate cuts, sending stocks lower, sending yields higher off the lows and supporting the buck. Some of the hawkish reaction was pared in the press conference, but that was before Powell explicitly stated that he does not see a March rate cut as likely, weighing again on stocks and govvies and supporting the Dollar. In FX, the Yen was the outperformer, accentuated by the hawkish BoJ Summary of Opinions, which discussed the possibility of ending NIRP, keeping the Yen propped. AUD lagged after soft inflation data while China Manufacturing PMI remained in contractionary territory for four months while the hawkish risk tone and revival of the buck post-Fed took the Aussie and Kiwi to session lows; NZD testing 0.6100 and AUD testing 0.6550. The Euro was also softer on the aforementioned soft inflation figures out of France and Germany, not to mention weak German retail sales.

FED

FOMC SNAP ANALYSIS: The Fed left rates unchanged at 5.25-5.5%, as expected, whilst also making some big changes to the statement to reflect a more balanced outlook towards cuts vs hikes. The Fed's growth description was upgraded to describing economic activity as "expanding at a solid pace" vs its December description of it having "slowed from its strong pace in the third quarter". The lines saying the US banking system is "sound and resilient" and that tighter financial and credit conditions are likely to weigh on the economy were both removed, whilst it added a line noting the risks to achieving employment and inflation are moving into better balance. On the policy guidance, the FOMC removed the line "in determining the extent of any additional firming that may be appropriate" to a more dovish/balanced "in considering any adjustments to the target range", but it gave a hawkish caveat that it "does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably towards 2%". It also maintained language on the balance sheet, as expected.

PRESSER: In his prepared remarks, Powell said the policy rate is likely at its peak for this tightening cycle and that it will likely be appropriate to begin reducing rates "sometime this year" if the economy evolves as expected, whilst caveating the Fed is prepared to maintain the current policy rate for longer if needed. Powell said reducing rates too soon or too much could reverse the progress in inflation, but at the same time, reducing the policy rate too late could unduly weaken the economy. He described inflation as having "eased notably", whilst noting risks to achieving the Fed's goals are moving into better balance. Further on inflation, Powell said the low inflation readings in H2 2023 were welcome but the Fed needs to see continuing evidence to have confidence it is returning to target.

Q&A: In his Q&A, Powell said he does not think a March rate cut is likely, saying that it is not the base case, caveating that it remains to be seen and it all depends on how the economy evolves, but he does not think the Fed will have enough confidence by March. On cuts, Powell said almost everyone on the committee believes it will be appropriate to reduce rates, whilst also saying the December SEPs (three rate cuts forecast) are a good benchmark of where the FOMC is at in terms of the rate outlook - he highlighted the wide disparity of views on the committee. Powell said if the Fed saw an unexpected weakening in the labour market, that would certainly call for cutting sooner. Meanwhile, Powell said the Fed has had confidence so far, referencing the past six months, on inflation moving to target, but repeated many times that the Fed is looking for greater confidence that it is moving sustainably down - he said the likely case is that the Fed will become more confident. He didn't go into specifics on the amount of data points that would give him that confidence, saying himself that he is not willing to put a number on it; when he was asked if the annual CPI revisions (due in February) would be sufficient, he said, "we'll just have to see". Powell pushed back against the premise that suggests stronger growth means policy isn't as restrictive. He points to areas where policy has restrained growth amid a big boost from supply: "When that peters out, the restriction will probably show up more sharply." Finally, on the balance sheet, Powell said the Fed will have an in-depth discussion at the March meeting after discussing it more briefly at this meeting.

US DATA

ADP: The January ADP report, although not the best gauge for NFP, saw 107k jobs added in January, beneath the 145k forecast and prior 158k. Pantheon Macroeconomics do however highlight that the ADP measure has been close to the official estimate in the past three months. Meanwhile, within the report the wages metrics for job stayers eased to 5.2% from 5.4%, while for job changers it eased to 7.2% from 8.0%. ADP's Richardson noted that "Progress on inflation has brightened the economic picture despite a slowdown in hiring and pay," and that "Wages adjusted for inflation have improved over the past six months, and the economy looks like it's headed toward a soft landing in the U.S. and globally."

ECI: The Q4 Employment Costs index eased to 0.9% from 1.1%, beneath the 1.0% forecast, indicative of slowing wages. Within the report, employment wages within the report eased to 0.9% from 1.2% while employment benefits eased to 0.7% from 0.9%. The easing wages should help with the Fed's fight against inflation, particularly when coupled with the latest quits rate seen in the JOLTS report. Analysts at Capital Economics highlight that the 0.9% growth (3.7% annualized) in private wages was the smallest increase in 2.5 years and the slowdown has pushed the Y/Y rate to 4.3% from 4.5%, the lowest since early 2021. Looking ahead, Cap Eco suggests "A sharper slowdown in the annual rate already appears to be in the pipeline, with the recent fall in the voluntary job quits rate to below its pre-pandemic level suggesting that annual wage growth will slow to 3.0%-3.5% within the next six months". The desk will also be looking towards productivity data on Thursday, where it notes productivity growth has accelerated to above 2% Y/Y, and wage growth at that pace would be seen as consistent with unit labour cost growth remaining well below 2% Y/Y; it explains "The latter is not only consistent with price inflation being sustained at 2%, but raises the risk of it undershooting the target."

CHICAGO PMI: Chicago PMI fell to 46.0 in January from 47.2, despite expectations for a rise to 48.0. Pantheon Macroeconomics “expected a small rise in Jan, mainly due to the 8.4-point plunge in Dec. that was a surprise and seemed likely to unwind, at least in part.” While Pantheon adds the small sample size of the survey means that monthly moves are mostly noise [alike like the Fed’s individual regional surveys], when viewed together, these regional surveys are useful, and the small decline in the Chicago PMI mirrors falls in all five of the Fed’s surveys in January. As a projection, Pantheon are now marginally more confident that Thursday’s ISM manufacturing index will dip, though nothing is guaranteed. Ahead, lower rates will probably drive a recovery in the manufacturing sector later this year, but PM see little sign of any uptick just yet.

FIXED INCOME

T-NOTE (H4) FUTURES SETTLED 22+ TICKS HIGHER 112-10+

Treasuries bull-steepened after soft ECI and banking fears despite Powell's pushback of a March rate cut. 2s -9.9 bps at 4.260%, 3s -9.9bps at 4.045%, 5s -9.9bps at 3.898%, 7s -9.6bps at 3.938%, 10s -8.2bps at 3.975%, 20s -6.7bps at 4.327%, 30s -5.7bps at 4.221%

INFLATION BREAKEVENS: 5yr BEI -2.6bps at 2.254%, 10yr BEI -1.7bps at 2.241%, 30yr BEI -0.7bps at 2.251%.

THE DAY: Treasuries caught a bid in the APAC Wednesday session, accentuated by the soft Australian CPI figures, offsetting the BoJ's SoO that showed the bank debated an end to its extraordinary monetary easing at the January meeting (which weighed on JGBs); block buys were seen at the time. The govvie bid extended into the European handover with attention on late Tuesday comments from ECB hawk Nagel, who softened his tone. T-Notes hit an interim peak of 112-02 on the heels of the fall in French CPI and soft German retail sales figures, but the bid failed to sustain. Contracts pared somewhat through the rest of the London morning to trough at 111-27 in the NY morning, with the long end leading the pullback; that's despite decent results at the German Bund auction and German state-level inflation pointing to a soft national reading.

Buying momentum picked up after the ADP Employment figure came in on the soft side ahead of this Friday's BLS report. Not long after, the soft Q4 Employment Cost Index, alongside the as-expected increases (and final set of increases) to the Treasury's auction sizes (details below), saw T-Notes spiked to fresh peaks of 112-03+. At first, the follow-through was limited. However, as shares of NYCB plunged, the market's PTSD of the SVB crisis kicked in, and massive bull-steepening was seen with money markets back to pricing six 25bp rate cuts this year alongside some risk of an inter-meeting (Jan-Mar) Fed cut. T-Notes hit session peaks at 112-15+ after the soft Chicago PMI, hovering near highs into the FOMC.

T-Notes fell from 112-10 to 111-31+ after the FOMC statement release, which pushed back on imminent rate cut expectations with its line that the Fed does not expect it will be appropriate to cut until it has gained greater confidence that inflation is moving sustainably toward 2%. However, as Powell began his presser/Q&A, his comments about the policy rate being likely at its peak and it being appropriate to reduce rates sometime this year saw USTs recover. T-Notes neared their earlier 112-15+ peaks before Powell dropped the bombshell that a March rate cut was not likely, sending contracts back lower into and through the settlement, albeit still much firmer on the session.

FED PRICING: A March rate cut is priced at a 35% implied probability vs 55% before the FOMC. There are now 140bps of cuts priced across 2024 vs 145bps beforehand.

QRA: US Treasury announced auction size increases as expected, with the US to sell USD 54bln of 3yr notes (prev. 52bln) on Feb 6th, USD 42bln of new issue 10yr notes (prev. 40bln) on Feb 7th, and USD 25bln of new issue 30yr bonds (prev. 24bln) on Feb 8th; all to settle on Feb 15th. Also, as expected, the 2yr and 5yr auctions were both increased by USD 3bln/m, the 7yr auction was increased by USD 1bln/m, the 20yr auctions were left unchanged, and the 2yr FRN new issue and reopenings were both increased by USD 2bln. The 30yr TIPS were left unchanged while the approaching 5yr TIPS new issue and 10yr TIPS reopening auctions were both increased by USD 1bln. The Treasury also confirmed it does not anticipate needing to make any further increases in nominal coupon or FRN auction sizes for at least the next several quarters. Elsewhere, the heavily anticipated Treasury buyback operation did not get formally announced - many had expected either a February or May start date - with the Treasury instead saying it intends to announce the date of the first regular buyback operation at the May refunding.

STIRS:

- SR3H4 +1bp at 94.865, M4 +7bps at 95.325, U4 +10bps at 95.75, Z4 +11bps at 96.11, H5 +11bps at 96.40, M5 +12bps at 96.61, U5 +11.5bps at 96.725, Z5 +11bps at 96.765, H6 +10.5bps at 96.76, H7 +8bps at 96.665, H8 +7bps at 96.54.
- SOFR flat at 5.31% as of Jan 30th, volumes rise to USD 1.642tln from 1.598tln.
- NY Fed RRP op demand at USD 0.615tln (prev. 0.578tln) across 82 counterparties (prev. 78).
- EFFR flat at 5.33% as of Jan 30th, volumes flat at USD 92bln.
- US sold USD 60bln of 17-week bills at 5.150%, covered 2.69x.

CRUDE

WTI (H4) SETTLED USD 1.97 LOWER AT 75.85/BBL; BRENT (J4) SETTLED USD 1.95 LOWER AT 80.55/BBL

The crude complex was lower on Wednesday and weighed on by broader risk-off sentiment, a faltering Chinese economy and a US crude stock build. On the former, a dismal New York Community Bancorp (NYCB) release weighed on regional banks, sparking haven demand on regional banking fears, while weakness in tech behemoths Alphabet (GOOGL) and Microsoft (MSFT) escalated the risk-off feel and US equity weakness. Moreover, weighing on oil was disappointing data from the largest importer – China, as the country’s Manufacturing PMI remained in contractionary territory for the fourth consecutive month. Lastly on the risk factors, there was a surprise build in Crude stocks in the weekly EIA data, with production rising 700k BPD to 13mln as producers ramped up output following freezing weather earlier this month. Elsewhere within the release, and in-fitting with the private inventory metrics on Tuesday night, Distillates drew more than expected with Gasoline building short of forecasts. Separately, according to a Reuters survey, OPEC January oil output fell to 26.33mln BPD (-410k BPD from December) on new cut pledges and Libya outages. Note, oil was largely unmoved on the more hawkish than expected FOMC statement, with WTI and Brent grinding lower throughout the US afternoon to settle at session lows. Looking ahead, participants await any further Middle East updates as well as a slew of data cumulating with US jobs report on Friday.

EQUITIES

CLOSES: SPX -1.61% at 4,845, NDX -1.94% at 17,137, DJIA -0.82% at 38,150, RUT -2.45% at 1,947.

SECTORS: Communication Services -3.93%, Technology -2.11%, Energy -1.9%, Consumer Discretionary -1.85%, Materials -1.27%, Financials -1.21%, Industrials -1.14%, Real Estate -0.71%, Consumer Staples -0.68%, Utilities -0.29%, Health -0.11%.

EUROPEAN CLOSES: DAX: -0.40% at 16,903.76, FTSE 100: -0.47% at 7,630.57, CAC 40: -0.27% at 7,656.75, Euro Stoxx 50: -0.35% at 4,646.45, IBEX 35: +0.38% at 10,077.70, FTSE MIB: +0.40% at 30,744.24, SMI: -0.95% at 11,334.00.

EARNINGS:

- **Microsoft (MSFT)** -2.7% and **Alphabet (GOOGL)** -7.5% are lower despite top-and bottom-line beats, with the former weighed on by rising AI costs and the latter a small miss on Q4 Google ad revenues. Analysts note GOOGL and MSFT weakness is largely due to heightened expectations (as opposed to operational performance), as the bar for tech earnings edged higher throughout the start of the Q4 earnings season on account of some blow-out reports (ASML, NFLX, SMCI, and TSMC).
- **AMD (AMD)** -2.5%: Key data centre unit disappointed expectations on top of a light Q1 revenue guide.
- **Teradyne (TER)** -7.7%: Revenue missed alongside very weak next quarter outlook.
- **Roper Technologies (ROP)** -4.4%: Q4 metrics solid, but FY profit view light.
- **Mondelez (MDLZ)** -1.4%: Q4 earnings were solid, but FY24 outlook was weak.
- **Boston Scientific (BSX)** +3%, **Cencora (COR)** +5.5%, **Stryker (SYK)** +5.9% topped on EPS and revenue, with the latter two lifting FY outlook.
- **Thermo Fisher Scientific (TMO)** -5%: Earnings beat but FY profit view underwhelmed.
- **Rockwell (ROK)** -17.5%: Fell short on EPS and revenue.
- **Robert Half (RHI)** -2.3%: Q4 earnings were more-or-less in line but next quarter guidance was short.
- **Automatic Data Processing (ADP)** +3%: Earnings surpassed Wall St. expectations and offered some upbeat comms.
- **Boeing (BA)** +5.3%: Posted a shallower loss per share than expected and beat on revenue, but suspended FY24 outlook.
- **New York Community Bancorp (NYCB)** -37.6%: Surprise loss per share, net charge-offs surged, and cut its quarterly dividend.
- **Mastercard (MA)** +0.9%: EPS and revenue beat.
- **Nike (NKE)** -2.6%: Co. shares took a hit after Adidas (ADS GY/ADDYY) profit guidance came in beneath expectations.

STOCK SPECIFICS:

- **Walmart (WMT)** -0.2%: Announced a 3:1 stock split to optimise trading and spread levels.
- **Cigna (CI)** +0.7%: Is to sell its Medicare business and CareAllies to Health Care Service Corporation for USD 3.7 bln; reaffirms 2024 outlook.
- **Paramount (PARA)** +6.7%: Byron Allen makes USD 14bln offer for all of Paramount Global, according to Bloomberg.
- **Tesla (TSLA)** -2.2%: Delaware judge rejected CEO Musk's USD 56bln pay package.

US FX WRAP

The Dollar was weaker heading into the FOMC, printing a low of 102.940, as it was dragged lower by dovish US data, in the form of a softer ADP and ECI. However, the Greenback pared some of these losses amid an initial hawkish reaction to the FOMC statement, as the Fed left rates unchanged at 5.25-5.5%, as expected, and while it removed reference to possible additional rate hikes it downplayed near term rate cuts. However, as Chair Powell said he "does not think March rate cut is likely, and is not the base case" there was a broad-based cross-asset hawkish reaction, highlighted by the Dollar Index rising to highs of 103.74, eliminating the earlier losses.

Prior to this, it is worth noting a dismal New York Community Bancorp (NYCB) report weighed on sentiment and regional banks (KRE -3%) potentially sparking same haven demand, in addition to both Microsoft (MSFT) and Alphabet (GOOGL) lower post-earnings. Additionally, and perhaps taking a backward seat given the wider macro themes, month-end models pointed towards modest Dollar selling. Looking ahead, participants await a slew of data on Thursday (IJC, Mfg. PMI), as well as further mega-cap earnings (AAPL, AMZN, META) ahead of NFP on Friday, and any unscheduled Fed speakers after the blackout period ends.

JPY was the clear G10 outperformer pre-and-post Fed, and the only G10 currency to firm against the Dollar. Wednesday's USD/JPY slide was fuelled by a fall in 2-year Treasury-JGB yields spreads in the wake of a hawkish BoJ summary that supported speculation of a spring rate hike, followed by below-forecast US ADP, ECI and Chicago PMI readings. In addition to this, some cited the Yen strength on haven demand amid the previously mentioned regional bank woes. However, as the Buck rose to session highs on Powell's March cut comment the Yen pared some gains heading into the APAC session.

GBP, NZD, CAD, EUR, and AUD were all more-or-flat flat vs. the Dollar heading into the FOMC but were choppy thereafter, before tumbling to weakest levels on the day after Powell's March commentary. For the Loonie, lower oil prices provided another headwind while Canadian GDP (Nov.) rose 0.2% (exp. 0.1%), while the Aussie fell in APAC trade after soft Q4 CPI with Q/Q and Y/Y printing 0.6% (exp. 0.8%, prev. 1.2%) and 4.1% (exp. 4.3%, prev. 5.4%), respectively. Looking ahead, BoE is on Thursday, with a slew of EZ data.

Before the Fed, EUR managed to eke out marginal gains vs. the USD post-ADP and shrug off initial losses in what was a busy day for European data **-** saw soft inflation metrics for France and Germany, although markets pricing was ultimately little changed as markets await further data points to cement calls. EUR/USD fell to a 1.0807 low in early trade after breaching Tuesday's low at 1.0812 before recovering to a 1.0880 high, then breaching 1.08 to the downside.

For **EMFX** watchers, Colombia Central Bank cuts rates by 25bps to 12.75%, in a "majority" decision. Analysts were split between a 25 or 50bps cut. Ahead, participants await Chilean and Brazilian Central Bank decisions, with the former expected to cut rates by 100bps to 7.25% and the latter by 50bps to 11.25%. Lastly, for the Yuan, Chinese Manufacturing PMI remained in contractionary territory for the fourth consecutive month.