

A tricky week ahead

Bans of HK products for US transactions is a taster of what this week may offer



Joe Biden, President of the United States of America

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Will Biden have to look East sooner than he expected?

One of the things I neglected to mention in my first note of the year yesterday, which provides me with a little bit of content for today, is the messy week ahead that beckons with House Democrats likely to begin an impeachment process against President Trump, to try to force the hand of VP Mike Pence into invoking the 25th amendment and pushing the President out before Jan 20th - inauguration day for President-elect Biden. That doesn't look likely. Nor does it appear likely that the President will step down early voluntarily.

And what we have seen in the last couple of days, is a flurry of executive orders that could deliver quite a bit of market volatility. These include the relaxation of US official relations with Taiwan, and the banning of hundreds of HK listed financial products linked to Chinese firms alleged to have links with the PLA, not to mention putting Cuba back on the terror list. All of these seem to be a clear attempt to box Biden in diplomatically as he starts his term.

Not all of these announcements are Asia-oriented, for example, the Cuba issue. And Trump is apparently headed to the Mexican border to make a speech today - that probably won't be a peacemaking event. But many of these executive orders are aimed at Asia, and China in particular,

with China-hawk, Mike Pompeo apparently also keen to squeeze in as much as possible in the last few days of the Trump administration. I think we should be on our guard for any new announcements affecting this region in the lead-up to the inauguration.

The net result of all of this is that while the wise political pundits around the world have all been suggesting quite reasonably that Biden will focus on the domestic economy and Covid clear-up as his main priority, he will not entirely be able to ignore events in Asia when he takes office, and he may have to deal with matters relating to our region much sooner than he would otherwise have imagined.

Markets messy

I wrote yesterday of my concern that rising bond yields could be a factor behind the dollar's recent strength. I updated some spreadsheets later on, and I have to confess that the jury is still out in terms of rising correlations, though it is a slow 20-day correlation, and you can probably pick up signals from shorter periods, though with less conviction if you really want to.

Yesterday, US 10Y Treasury yields did rise further, reaching about 1.14% from 1.11% at this time of writing yesterday. And the USD has strengthened further still, including against Asian FX. I'm not saying my spreadsheets are wrong, it's just that they will take a little time to provide confirmation that this is happening, that's all.

In the meantime, where to next for yields seems a reasonable question. The answer would seem to be "higher". This is good, because [this is also in line with our house forecasts](#).

Much of the motivation for these forecasts stems not just from Biden's likely big spending plans when he gets into office, but also the direction of inflation. Talking recently to James Knightley, our US economist, he pointed out that US inflation is likely to hit 3%. Now it is only 1.2% now and expected to rise to only 1.3% at Friday's release, so 3% sounds shockingly high. But on checking, 3% looks not just possible, but entirely probable, all due to the big drops in inflation in April last year, and some further decline in May. As a result, all the monthly inflation figures have to do is slightly exceed 0.1% mom each month until May (about their current run rate), and 3% is in the bag. Any upwards short-term price level adjustments above that will make that May peak even higher.

In fairness, the same is true of most of the economies in Asia, with big base effects lifting headline inflation at roughly the same time. The point is, this is temporary, and without a self-fulfilling mechanism to embed higher inflation, which I don't believe exists (anywhere), then inflation will rapidly drop again from June. That need not stop markets from reacting (perhaps over-reacting), and a mid-year Treasury sell-off could well be on the cards (see also our bond yield forecasts - 1.75% year-end 10Y UST- forecast, but maybe higher at the peak?). That's why it's worth keeping an eye on the correlation between Treasury yields and the USD. I'll let you know if anything changes.

Day today

Besides keeping an eye open for political announcements, it should be pretty quiet today, with limited data of strong interest in Asia (India's inflation and production figures are probably the picks of the bunch), and the small business survey in the US (NFIB) is also worth a look. Things should pick up towards the end of the week.

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