Opinion | 3 June 2019

Another day, a lower bond yield

US 10Y Treasury yields drop to 2.12%, and equities also retreat in what looks like another trade war defined market moment

The trade war, not macroeconomics is driving markets

I might as well stop doing my job. All I need to know, to decide whether or not Treasury yields are going to go up, down or stay put, is to know which way the trade war will turn next. At the moment, I don't even need a lucky coin for that. Casual observation shows that the trade war is alive and well, and that China, far from being cowed by the recent Mexican tariffs, seems to be thinking of new ways to retaliate. Published white papers on the trade war over the weekend, the publication of unreliable entities and an investigation into FedEx shows that China is not about to roll over.

The more this trade war goes on, the bigger the tariffs, the more global it's spread, the bigger the dangers. I have been very dismissive of global recession fears in the recent past. The trade war is the single thing that I think has the potential to deliver that outcome. We aren't there yet, perhaps not by a long way, but I am far less sanguine than I was.

As far as markets go, the self-reinforcing equity sell-off, bond market rally, equity sell-off shows no signs of abating. And the circuit breaker for this has to be some movement on the trade war. That isn't evident yet. With the US President Travelling through Europe this week, including Brexit-ravaged-Britain, his mind will most likely be on other things. I don't see China making the first overtures towards peace.

The USD is looking a bit weaker, not just against the EUR, but also some Asian currencies. On a longer time frame, this just looks like the top-end of the current downtrend and nothing too out of the ordinary. That downtrend (USD getting stronger) remains in place, but the current rules of the trade war, which would normally benefit the USD as the US ramped up its trade aggression, may be coming under strain as bond yields fall this low. This is worth watching, we might have to rethink the way this works shortly.

RBA Watch - we are not alone

This week, we hope to make up for last week's Bank of Korea disappointment by getting at least one central bank call correct. Sure, the BoK decision did have one dissenter, but Governor Lee Ju-yeol's comments were decidedly hawkish still, so a July cut is by no means a done deal despite dreadful export numbers over the weekend -9.4%YoY) . We continue to believe that lower rates, sooner rather than later, will save the BoK from having to do more in the longer run and that the focus on structural issues like household debt should be addressed better with macroprudential measures, rather than with cyclical tools like rate policy.

We are in much better company on the RBA call, where all but two of the consensus are also looking for a cut on Tuesday (incidentally, Australian household debt is also very high). This probably will be the first of several cuts from the RBA. The question is, how many, and how quickly? That is the question the market will want to be answered from the press briefing, though we almost certainly won't get a straight answer. For more on this and the implications for the AUD, please see our RBA preview piece put out last week.

Asia Day ahead

Japan has already released capital spending figures for 1Q19, and like much of the recent Japanese newsflow, it has been rather better than we might have expected and suggest that 1Q19 GDP may buck the regional trend and show some decent growth. The JPY is looking considerably more resilient as a result, coming close to 108 against the USD.

Its PMI day for much of the rest of the region, including the Caixin PMI for China. Following last week's fall in the official manufacturing PMI, these numbers take on more significance.

PMI's also dominate the G-7 calendar, including the US, where the manufacturing ISM is released. This has been falling on balance since the middle of last year. Last month saw a big fall, and this series tends to saw-tooth from one month to the next, which explains the consensus expectation for a small bounce. The real story is, however, of a slowdown in US manufacturing.

Author

Robert Carnell
Regional Head of Research, Asia-Pacific
robert.carnell@asia.ing.com