Bullard not so bullish

The St Louis Fed President, James Bullard, thinks rate cuts may not be so far off (FOMC voter this year), the market, which loves this idea, has moved further in this direction - ISM data also softer

2.07% Yield on 10Y US Treasury

Still falling

Down, down, deeper and down

Saying that the Fed may need to cut rates soon to prop up inflation and inflation expectations, as St Louis Fed President, James Bullard did yesterday, has provided US bond markets with the nudge to keep going in the direction that they seem perfectly happy to keep following. 10Y US Treasury yields hit 2.07%. Can they go further?

The answer is obviously, yes. But at these levels we should begin to ask ourselves at what point we want to jump off this runaway train? The equity market is clearly a very key factor in the direction of Treasuries currently. Last night, it was the tech stocks that took a hammering on antitrust investigation reports. Macro also helped though. The manufacturing ISM also fell, though importantly not the employment component, which rose strongly to 53.7 - perhaps a snippet of good news just days before Friday's jobs report and a reminder not to get too carried away.

Just like many other writers in this field, I am struggling to reconcile the macroeconomic backdrop with the market Fed view. Of course, the latest Mexican tariffs and China's more aggressive retaliation amplify the trade war downside risks. And yes, I can see that this will weigh on stocks. But how far would you need to see the stock market decline before it merited a countervailing rate cut? I don't think there is a ready reckoner for this (email me if you have one). But quite a long way I would think. So does this mean that Bullard thinks the equity market is about to tank? Well if the S&P500 falls below 2720, it will probably make it down as far as 2650. Under those circumstances, I think yields could break 2.0%, and then, maybe yes, I will find it less of a stretch to consider some Fed easing. Though we would still be a long way North of last year's correction. We aren't there yet though.

Impact on the USD

We wrote yesterday that we might be reaching a turning point for the USD. Bullard's comments make that seem a bit of an understatement. But it does indeed look as if at these yields, and expectations for the Fed, the USD is no longer a one-way bet.

I have also been thinking more about the possibility that greater retaliation against the US in the trade war. We also wrote yesterday about China's Trade White paper, "unreliable entities" and threats to rare earth exports. This morning I read about Mexico's threats of retaliation. This is news because so far, the trade war has been pretty one-sided. The US has slapped tariffs on a great many countries, and the retaliation has been minimal. That is a dollar-positive backdrop. But as patience reaches its limits, and hopes for trade deals give way to pessimism, and retaliation surges, then this becomes much more of a two-way street for the USD. There is certainly scope for the USD to depreciate as countries decide that they aren't simply going to sit back and take it anymore. Could this mark the bottom? For that, I think some change in tack by the US on trade will be needed. But I don't think we can just expect to automatically revert back to the previous USD strengthening trend now.

RBA - cutting

We wrote about the RBA yesterday - here is the link to our longer piece again too. There's little new to add. PMI data yesterday were a little softer, and inflation expectations also fell a bit. Retail sales figures this morning might add a little to the gloom. The consensus is for the month-on-month growth rate to slow to 0.2% from 0.3%.

Markets will be focussed on the forward guidance from this rate decision, which is unlikely to be an isolated cut. How much and how soon can we expect rates to fall? We may know a little more later today. The US/Fed story obviously is not totally isolated from future RBA decisions on rates either.

Korean 1Q19 GDP revised down to -0.4%

I don't want to point any fingers following the Bank of Korea's decision not to cut rates at its meeting last week, but since then, the data out of Korea has been rotten. Continued sharp falls in exports, big falls in the manufacturing PMI, and today, a revision to the 1Q19 GDP print, which takes it down to -0.4% (previously -0.3%) and smaller than anticipated rise in inflation, which remains a meager 0.7%YoY.

I've bored you all enough with the reasons the Korean economy would have benefited from a rate cut last month. It may be too much to hope for a change of view before the July meeting, but I don't expect the dataflow to stop pushing in this direction.

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