China trade

Most of the macro and market headlines for the next day or so will focus on Chinese Trade: Today, trade data for December, tomorrow, the phase one trade deal signing, and likely the removal of the currency manipulator status. USDCNY heads ever lower. But such trends have a habit of turning on you, so don't get carried away

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December Trade data for China

Not getting carried away is the theme of today's note. China's export and import data for December are likely to show slight increases. The consensus has a 2.9% and 9.6%YoY increase in CNY terms. But bear in mind that this data largely predates the reduction in the tariffs that took place as part of the phase 1 trade deal. Also, remember that the effective tariff reduction from that deal is fairly small, so any bounce in exports may not be terribly exciting even once the tariff reductions are playing a more meaningful impact on the data in the months to come.

Bottom line, China's trade circumstances are still relatively weak, and the tariffs much higher than they were 18 months ago. We should not expect miracles.

Trade War and CNY

Market sentiment on the trade war is such a dominant driver of the fortunes of the CNY, that it is worth pondering under what circumstances the recent rally could reverse. Such a reversal may already be baked into the phase-one deal, which we believe will contain measures to monitor compliance with criteria such as intellectual property rights and market access. It could also be that once the immediate pork and swine shortage is addressed, China's need for US agricultural products will abate, and the US may also find that market access for banks and credit card companies is not quite what it had thought in a market which is already quite mature.

Moreover, the political pressure for taking a tough line on trade will grow as we approach the US Presidential Election (to be balanced with whatever effect this has on the stock market). So it's all smiles and CNY appreciation now, but from the middle of the year, things may begin to look rather different.

Aggregate financing data due

We're still due the Chinese aggregate financing data for December, though it probably won't be too instructive. Consensus expects the numbers to dip as banks run out of capacity to lend in the last month of the year, having pushed loans out aggressively earlier. M2 money supply at 8.3%YoY would be a fair bit lower than nominal GDP growth assuming the underlying GDP numbers are accurate, which would come in at a little over 10% adding real GDP of about 6% to CPI inflation (as a proxy for the GDP deflator) of about 4.5%.

But the current spike in inflation is, of course, all food-related and should ease off, taking CPI back to its prior 2-2.5% range, which would leave current M2 growth about in line with nominal GDP assuming that remains steady. There's nothing abnormal going on here.

Indian CPI - high

Indian inflation exceeded the consensus estimate of 6.7% in December, climbing to 7.35% (let's call it 7.4% - 2 decimal places for inflation or any other economic data assumes a degree of accuracy in measurement that is frankly unrealistic).

This takes inflation outside the RBI's 2-6% target range, and by quite a bit. We anticipate the next meeting will see the RBI adjust its language to indicate a neutral monetary stance from it's the previously accommodative position.

The increase was mainly a food price phenomenon. Food price inflation was 12.2%, with vegetable prices up more than 60%YoY. Most other components showed inflation running well within the RBI's target band, though there was some upward movement in fuel and lighting, and transport and communication reflecting higher energy and telecoms prices. Nonetheless, Indian inflation will come down from these highs, just maybe not to a level that will enable the RBI to provide further easing anytime soon.

Could rising inflation pull the rug from under markets? Probably not.

In other data releases today, US inflation for December is due, which will likely show headline CPI coming in at 2.4%YoY, and the core rate at 2.3%. If these increases are reflected in the policy-important PCE indices, then we should see December headline and core PCE inflation rising to 1.8%YoY and 1.6%YoY respectively. That doesn't provide any excuse for the Fed to do anything in any direction with policy any time soon. That is a distinctly neutral setting, as opposed to an outright hostile one, so it doesn't threaten current market ebullience particularly.

For now, the trend is your friend.

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