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Opinion

Cold feet

Having briefly dabbled with a US Treasury yield above 3% intraday earlier this week, markets can't seem to pluck up the courage to take the plunge more decisively - we may not have long to wait...

Markets remain stranded

Markets are still struggling to find direction. The US Treasury market is a case in point, remaining within a whisker of 3%, without finding an excuse to decisively move beyond this psychological barrier. Equities are not giving them that excuse. Despite a generally positive run of earnings statements, the equity market is held back by higher yields. Good economic / earnings news can become bad news in this environment, ensuring a faster pace of Fed action, higher terminal Fed funds rate and higher bond yields. Equities want to move higher on the earnings figures but are held back by higher discount rate assumptions. That leaves them in a kind of Catch-22 rut, where they are unable to move up or down.

It is much the same on the currency front, though there is a bit more direction here. Markets have been unwilling to assign any weight this year to rising US rates in a foreign exchange context, waiting instead for the bigger move of ECB ending QE. But as we get closer to the dates we imagined the ECB would provide a clearer signal of policy change, the data has dropped away on both growth and inflation fronts. Yesterday's ECB meeting suggests we are as far away as ever from a decisive end to the ECB's monthly easing. That has taken the EUR to the lower end of its 1.20-1.25 range, though the range remains fairly comfortable for now.

Next week though, payrolls plus another Fed meeting might provide a catalyst for a Treasury break above 3.0%, and it might also bring the lower bound of the current EURUSD trading range into sight. Our Asian FX forecasts are predicated on a weaker USD for the rest of the year. That assumption looks enormously challenged right now. I anticipate that by early next week, our published Asian FX numbers will look considerably flatter than they do right now, and overall, weaker than the current forecast range.

Day ahead

The Asian day has already got off to a slightly soggy start, with Japanese labour market data bang on consensus, but the Tokyo CPI numbers indicating a further moderation in what was already very minimal inflation. A few weeks ago, some market participants were harbouring thoughts of the BoJ looking for an exit strategy. I thought that this might be done covertly under the cover of ECB moves. Neither central bank looks in the running for a change in policy any time soon, and that is weighing on the JPY as well as the EUR. Today's numbers add to the likelihood of a prolonged period of BoJ inaction.

NZ trade data showed a return to small deficits, with stronger imports more than subsuming stronger exports. The differences between consensus and last month's data are minor, and I don't believe this should be viewed as particularly relevant release for markets.

Taiwanese GDP should come out later today. Iris Pang, who forecasts these figures is currently top the polls for the accuracy of these numbers on Bloomberg, and she is looking for a 3.0% number (lower than her reported 3.3% on Bloomberg) and some way below the 3.28% consensus. This difference is mainly due to weaker export assumptions.

On the geopolitical front, the historic North-South Korea meeting of leaders today will provide plenty of photo-shoots and positive words. But little of substance is likely so rapidly. This is the first step in a long journey that will likely have many set-backs along the way. That said, the longest journey always starts with a single step.

GDP dominates the G-7 calendar too. The soft-patch that envelopes US data at this time each year, looks set to repeat its annual performance, with growth dropping from in 1Q18 from about 3% in the prior quarter to only about 2%. This data is tainted - no one will pay any attention. And a bigger fall than predicted just means a bigger bounce back in 2Q18.

European GDP is also lower - French GDP today is expected to come in at only 0.4% from 0.7% in 4Q17, whilst UK 1Q18 GDP will be a shade weaker still at 0.3%QoQ (was 0.4% previously). This could give the EUR the upper hand in EURGBP moves today.

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