

Crunch time for trade

Optimism is rising about the possibility of some rollback of US tariffs on China in a possible upcoming phase 1 deal.



Source: Shutterstock

I want to believe...

Stories in the press overnight suggest that the US may be considering rolling back some of the tariffs already imposed on China, not just withdrawing, or delaying the implementation of further tariffs.

In particular, this may include the \$112bn of so-called "4a" goods tariffs implemented on September 1. News stories also suggest that existing tariff rates may be reduced.

It seems that China is demanding a high price for its cooperation in any deal, and the US is at least considering delivering.

The effect that this is having on markets is widespread. USDCNY pushed briefly below 7.0 overnight, though it is trading a little higher than that right now. Other "beaten up" Asian currencies such as the INR and KRW have also been gaining on trade enthusiasm. In contrast, safe-haven JPY is looking decidedly soft. Outside FX markets, bond yields are still rising, and at 1.86%, 10Y US Treasury yields are up 0.4pp from their August low point. In commodity markets, safe-

haven gold (like the JPY) is weaker, but pro-cyclical commodities such as copper and oil are all stronger. Equities remain in touch with their all-time highs.

If the hype is right, then all these markets have further to go in the event that a deal like the one being talked about actually does get signed.

But...

Our current house forecasts are, in fairness, probably aligned with a more modest phase one trade deal scenario than the sort being talked about today. So if the newswires are right, and a broader phase one deal is delivered, including possibly some sort of "roadmap" to an even broader deal in the future, then we have a fair bit of re-thinking to do. This could include all our FX forecasts, not just in Asia but elsewhere, US Treasury yields, global macro indicators and our central bank forecasts, including the US Fed

But in my view, at least as far as markets are concerned, a lot of upside has clearly already been priced in. We only have to look back a few weeks to see how far we have come.

Moreover, such a deal is not in the bag yet. Critics of President Trump could suggest that he is going soft on China, which may not play well at an important time in the political calendar. It is not a given that the US will indeed play ball and deliver what China is demanding.

What you should probably be doing at this stage if you are neutral to markets' recent moves, is to consider a probability-weighted outcome. So even if you believe that there is a greater likelihood of a successful outcome being reached imminently, the skew in terms of market returns may still make it more appropriate to position for a disappointment. Only you can do the math on this. But, for example, if you think there is a 60% chance of such a deal being struck with further 10% market upside, and 40% chance of disappointment with 25% market downside, then you might still want to consider hedging the downside. You also need to consider how correlated markets are right now to see if you are netting out, or amplifying your risks.

Hail all things "mini"

Nevertheless, there is a lot to be said for a mini-deal. Especially one that lined up the US and China for a more comprehensive deal later.

Indeed when I think about it, many "mini" things are better than the "real" thing. Miniature golf for example - considerably better than the real thing (you need windmills), mini arctic rolls (the big ones are too overfacing), miniature pork-pies (one bite and they're gone, delicious!).

The best corporate entertainment I ever went to in the mid-90s was hosted by the British Merchant Bank, Flemings. I was not with ING back then, but working on the buy-side. It was a gala night for the opening of one of the new James Bond films (I forget exactly which, but I think it was the first Brosnan). In particular, the catering was amazing, because besides the martinis (shaken not stirred) they served miniature fish and chips, in miniature newspaper cones, and miniature cheeseburgers. Heavenly.

But I digress...

Asia today - Bank of Thailand tops the bill

(From Prakash Sakpal): It's "decision-day" at the Bank of Thailand. The consensus has finally come around to our view of one more 25bp policy rate cut to 1.25% this year. Inflation continued its drift toward zero rates in October. And there are no signs of recovery in GDP growth from a five-year low of 2.3% reached in 2Q19. Further threatening the recovery is rapid currency appreciation. A rate cut won't be a sure-fix for all these woes, but it will be a policy move in the right direction.

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