EUR whipped around by Merkel fears

The euro is swinging around on the spat between German Chancellor Angela Merkel's CDU party and their Bavarian CSU coalition partners - a weaker euro typically means weaker Asian FX.

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It's miles away, but the German political tussle could be important in Asia

One of the biggest selling jobs I have is to persuade a US-focussed Asian clientele that they also need to keep an eye out on Europe. Right now would be a very good time to do that. The political argument between Germany's Chancellor, Angela Merkel, her CDU party and the coalition CSU party over immigration has reached new heights, with the CSU's Horst Seehofer (Interior Minister under the coalition) threatening to resign over the deal struck by EU leaders at the end of last week. This deal, which would facilitate the removal of immigrants back to their country of arrival in the EU, does not seem to have gone far enough for some of the CSU leadership, including Seehofer.

At the moment, the CDU are overwhelmingly backing Merkel, and that is providing the EUR with a little support. But if that shifts and the coalition looks threatened, then as well as the EUR, which would soften abruptly, at stake would be Merkel's chancellorship, the Schengen border arrangement, some might even say the future of the EU itself (though that might be going a little far).

So what? Well if that happens and the US dollar strengthens by default, then Asian FX will be unilaterally weaker, inflation will rise, and central banks will need to take a more hawkish rate stance, weighing on domestic demand. Right now, that is the last thing the global market needs. So, don't ignore Europe!

Worth also giving the Mexican elections a quick squiz

I am going well off-piste when I say that Asian investors might want to give the Mexican elections a once-over too. With the votes not yet counted, newswires seem to believe that that the left-leaning Andres Manual Lopez Obrador will win a landslide.

Markets are anxious. Left-leaning politicians are regarded as less market-friendly than right leaning ones. Moreover, Obrador has apparently taken a tough line on US trade policy and NAFTA negotiations. Opening up trade wounds with the US at this juncture seems like pouring fuel on the already smoldering trade fire. This could provoke a more generalized risk-off sentiment in financial markets. Not good for Asian FX.

Tankan - not so cheery now

Japan's Tankan survey still commands some interest in markets, given the choppiness of the GDP data, and its message today was a modestly negative one. I say modestly because although the headline index for large manufacturers was down more than expected, the 'outlook' index for the same group of firms actually ticked up a point (not clear why). Also, the capex intentions were also stronger than had been expected, though this is typically a back-weighted index, so it was always likely to rise to some degree as we move through the year. If nothing else, this data suggests that current momentum is stronger than was previously thought, though coming off faster. Smaller firms too and the non-manufacturing sector also held up better than the headline index. Though overall GDP growth in Japan is still tightly linked to the manufacturing production cycle, and this is clearly weakening.

Asia week ahead

After last week's Bank Indonesia 50bp hike, which could provide some (though perhaps short-lived) support to the rupiah today, there isn't too much central bank action in the region this week. Australia's Reserve Bank is thought unlikely to hike rates at all this year, so we doubt we will get so much as a hint at policy direction from them, though, following last week's RBNZ suggestion that rates can go down as well as up, there is always a risk their bigger neighbour might follow suit.

The week is otherwise dominated by PMI data (today) which could indicate the degree to which trade tensions are already hurting in advance of Friday's implementation of tariffs by China and the US (Canadian levies took effect on Sunday, whisky and jam…). Inflation data is the other big print this week. Today delivers Thai and Indonesian inflation, later in the week, Taiwan, Korea and the Philippines all release their price data. A soft print on the Indonesian figure (was 3.23% in May), may help BI to persuade markets that its hikes are working…

Korean trade figures released over the weekend weren't brilliant, but they weren't too bad either. The 0.1%YoY decline in exports overstates the downside for a choppy figure that seems in levels terms to be growing slowly, after flattening out through the second half of 2017 and early 2018. Imports are rising more strongly, and the trade surplus will likely narrow over the rest of the year if this pattern continues. That isn't particularly worrying if the import story reflects stronger domestic demand. Although that story could do with a bit more support to become convincing.

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