Fear Factor returns to markets

Another turn on the trade war, this time negative, weak China data, curve inversion, but the only real change is one of attitude. Plucky market resolve and a rose-tinted outlook seem to be giving way...at least until the next dollop of central bank "valium" calms nerves again.

Time to face up to some hard truths

I've talked at length about yield curve inversion in this note in the past, noting that if we were to adjust it for central bank asset purchases, which total over $11tr, then it would likely not be all that flat at all. But whether it has inverted in "real" terms or not, and the 2s10s slope is now virtually flat if not actually inverted, recent moves do indicate a distinct flattening. In my view, that isn't out of whack with what is going on in the wider world. James Knightley adds to that narrative here.

For sure, the US economy doesn't quite adhere to this story, with core inflation nosing higher, and a still-strong labour market. But indicators of business investment, like core goods shipments and inventories, haven't looked all that perky for some time, and it is a fair bet that the trade war is crimping business confidence, and at least, delaying some investment plans for lack of a clear route forward.

Overnight, a more somber assessment of the trade war from US Director of Trade and Manufacturing, Peter Navarro, has nudged the market to the view we expressed yesterday - that despite the delay of implementing some of the new tariffs, nothing had really changed. Stock markets in the US have dropped sharply. Asia will likely follow suit this morning.

Outside the US, China data yesterday was rather disappointing. Iris Pang offers a sober assessment of the situation here. In spite of government measures to keep the economy ticking along on a drip-feed of infrastructure spending. industrial production at 4.8%YoY hasn't been this weak outside of a few one-month dips since the early 1990s. Retail sales were also soft, and fixed asset investment, at 5.7%YoY, is stable, rather than accelerating. So the world's second-biggest economy is showing clear signs of a slowdown, even if the world's biggest economy is steady, though uninspiring.

Look further afield - Europe for example - and even outside the Brexit-inspired mess of the UK, growth is notable by its absence. Here's a link to a piece on Germany, which has just registered negative growth. And if you haven't had enough on Brexit, here's another looking at the "no-deal" likelihood. Elsewhere, non-China Asia is still coming to terms with a global tech slump.

Yep, I think the curve slope is reflecting the global direction fairly well. I just don't think it adds much extra value to a story that is already fairly clear. if you want the market to hold a mirror to the global economy, I think the commodity markets, which are real assets after all, and devoid of much of the flim-flam of financial products, do a much better and more consistent job. The ratio of gold to copper prices, for example, is worth comparing against your favourite measure of global activity (inverted). Chart below.

Gold Copper ratio

Source: bloomberg

Asia Day ahead

Australian employment data are our regional equivalent of US non-farm payrolls and every bit as quixotic. But this data release also has the power to drive markets, especially now the RBA is firmly in "active" mode. Yesterday's 2Q19 wages data didn't add much to the picture. A strong employment figure coupled with a rise in the unemployment rate could dampen thoughts of further imminent RBA easing and give the AUD a lift - and vice versa.

Meanwhile, Independence Day in Korea means a speech from President Moon - will he try to mend ties with Japan, or will this be a more nationalistic speech that draws a further reaction from Tokyo? My gut feeling is the latter. It plays better to local politics. But it might not be so supportive for Korean stocks and the KRW...

And here's some further commentary from Iris Pang on yesterday's weak China data "The cause of such low manufacturing growth was shrinking car manufacturing, which reflects declining demand for car ownership in China. This was also reflected in negative sales growth of cars in the retail sales data. The underlying cause was the trade war and technology war, which has weakened consumer confidence. These two factors will stay for a long time. China will push forward its planned infrastructure projects together with easing monetary policy to keep growth stable".

Indonesian trade for July, which should see the trade balance swinging back into deficit and Philippine overseas worker remittances round off the main data events of the day in Asia. Neither is likely to provide a massive boost to confidence.

US retail sales for July will be the main event out of the G-7 today. They have been holding up well so far. But that probably means the market risk is skewed to the downside, even if the data risk is fairly balanced.

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