

Opinion | 6 March 2019

Lost without a compass

Markets are struggling for direction - today, so am I.



Give me a sign!

There are times when the US labour report is pivotal, times when it is merely interesting, and other times when it can be ignored as spurious noise. Tomorrow's report comes at a time when the world is waiting to see what the FOMC will do with their dot plot diagram, and the latest labour market report may have a lot to do with how far and how many of the dots fall.

The fact is, that although markets have started to price in the probability of cuts from the Fed, they may have jumped the gun. The US economy is still moving forward, and parts of it quite fast, including the labour market. In the last three months, the US has created a net 695 jobs. Hourly earnings remains a lot less impressive, and the wages rate has failed to make ground, though the January fall was mostly base effects, and February will have to be very bad not to see the year on year rate rise.

Normally, a combination of employment strength and wages growth would be causing the Fed's hawks to start twitching. But they seem remarkably quiet right now. Perhaps chastened that the stock market seems unable to make it past 2820 resistance (S&P 500), they fear that its next move could be down.

Moreover, even with a decent slew of FOMC members downgrading their forecasts, there will

still likely:

1. Be a noticeable gap between the Fed's median dot and
2. be a bias to tightening in the dot summary

That, I think, is a reasonable assessment of where things might lie post the March 20 FOMC meeting. But I'm not sure the market will find it as reasonable.

EUR/USD and bonds present the same problem

FX and bond markets are presenting similar conundrums. Despite some intra-period noise, the 10Y US Treasury has essentially bounced between a yield of 2.60% and 2.80% since the beginning of the year. That is partly because it is lacking any cue from the equity side. But the short rate view remains equally opaque. Even if you buy into the market story that the next FOMC move will be a loosening, and that isn't at all obvious, then the rest of the story runs that any such loosening may be very modest and stretched out over a very long time.

In other words, not a lot is going to be happening in either direction for ages.

This is weighing on currencies too. The flat trend for EURUSD, which is where most currencies take their cue, has been flat between 1.15 and 1.12 since October last year. There have been periods of USD strength and weakness within that, with the trade war playing its role, FOMC outlook too, but increasingly, the ECB is stepping into the picture with talk of TLTRO's - ostensibly a currency weakening tool, to add to the mix of offsetting news and fundamental forces

In our Asian region, this offsetting newsflow is also evident. Currencies like the KRW have been rangebound in a 1110-1140 range for 9 months. Even the high yielders, like the IDR, have been steady year-to-date. The same goes for the INR, a currency which we feel really ought to be permanently on the back foot, but has been relatively steady this year (ignoring the noise over the border skirmishes). Only the THB has shown any directional bias, strengthening throughout January only to give most of those gains back again in February on political worries. March is as yet unremarkable. But give it time.

Day ahead

Yesterday was pretty boring. That said, the Aussie GDP figures disappointed and helped nudge the AUD a little closer to breaking the 0.70 barrier. Weak capital investment spending sums up where it all went wrong in Australia in 4Q18. The contribution to GDP from capex in 4Q18 was -0.3pp, and government dragged the total down another tenth of a percentage point offsetting more robust figures from the household sector. Retail sales data for January came in at only 0.1%MoM a few minutes ago, suggesting that even the household sector may now be weakening. Perhaps there is some merit in the RBA cut thesis after all.

Besides that, regional FX reserve data may not have too big a market impact, or Philippine unemployment, though the PHP is being driven more by comments from new Governor, Diokno, that he will accelerate RRR cuts this year.

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