

Opinion | 21 November 2019

Optimism returns

Hope for a trade deal returns after China's Liu He expresses cautious optimism and invites Lighthizer et al to Beijing for more talks



Chinese Vice Premier Liu He, centre, with U.S. Trade Representative Robert Lighthizer, right, and Treasury Secretary Steve Mnuchin before talks in Shanghai

No more bets

Bond yields are up again today a couple of basis points, and the dollar index has come off yesterday's highs. The only thing marring the picture is the stock market, where yesterday saw renewed losses and Asian futures markets look patchy this morning.

That is unusual. Usually, the equity market would seize on the tiniest snippet of hope to trade upwards. The newswires I am reading this morning put the slide down to "conflicting signs on trade". But normally, if there are two sides to an argument, equities will always side with the positive view, so this is mildly perturbing.

Yesterday's suggestion from China's Liu He that he was still "cautiously optimistic" on a trade deal and invitation of Robert Lighthizer to Beijing for more talks, should have had a more positive effect than that. The US spending bill also passed yesterday, though not related to trade, this should also have been positive. And the Congressional pro-democracy bill for Hong Kong SAR, though awkward, does not seem to be wrecking the deal's chances either. That bill has resulted in a fully anticipated rebuke from China. There is, however, no suggestion as yet that China is inclined to link this bill to any trade deal, and that is also positive. The furore over

the bill could die down in a couple of days.

We have also heard more suggestions, as I wrote yesterday, that tariffs due on 15 December could be deferred. And that has to be good news, if true. We await confirmation.

There's little extra to be said on this. But the next few days market action could be interesting.

Japan's CPI rises 0.2%YoY

I confess that I have been wrong-sided on both Japanese GDP and CPI in this latest consumption tax episode. On GDP, I failed to account for the inventory drawdown that offset the front-loading of purchases, and on CPI, I didn't account for the freeing of pre-school daycare to offset the impact of the consumption tax hike on other prices. More time to knuckle down on the detail on this sort of stuff would be nice, but isn't likely. Fortunately, the data from now on should be smoother than I had expected, so these sort of errors will hopefully become less likely in the coming months.

OK - so the outcomes of both CPI and GDP were far smoother than I had anticipated - that does mean that I can smooth Japan's inflation profile for next year, and the full-year totals will be substantially smaller than anticipated. This doesn't really make any practical difference to anything though since it was always realized that the tax hike impacts would be temporary and have no policy implications.

In any case, the BoJ really only has room to move policy in one direction - tighter, as it has run out of room on the downside. And as a tightening of policy probably won't happen this side of my retirement, then we can more or less ignore all this data anyway.

Australian flash services PMI falls

Australia's service sector PMI fell to 49.5 in November versus a 50.1 figure in October. This is both the wrong direction and the wrong level as far as the RBA will be concerned. Anything below 50 indicates contraction. And as the RBA has made the performance of household consumption a key factor in its decisions on what to do with monetary policy, this could be significant.

One offsetting positive note was that the index on employment did nudge higher to 50.5 from 50.2, but service sector inflation seems distinctly absent with prices charged falling from the previous month. We might yet get the cut that markets are 60% pricing in for February next year. We aren't forecasting that yet. But our "easing is done" forecast is under some pressure after this, the last labour report, and the RBA minutes that indicated they considered easing at the last meeting. We are looking for some better news from the next labour report to support it, or possibly cause us to downgrade our assessment. And I also note that Australian QE chatter is on the rise - [see also this note I co-wrote with my FX colleagues last month](#).

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