

Rangebound markets - time for a change

From currencies to bonds, markets have been rangebound for weeks - this could be about to change



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Don't blame the data

I can't be alone in feeling a sense of disappointment that the big surge in inflation data that has been seen in a number of economies worldwide, but most notably, in the US, has not resulted in a stronger response from markets. Both the last two US CPI releases have come in much stronger than even the aggressive increases pointed to by the consensus of forecasters. And last Friday, so did the Fed's preferred PCE inflation metric, at both headline and core measures. US PCE inflation now stands at 3.6%YoY, core PCE inflation at 3.1 %. And neither CPI nor PCE has probably peaked yet.

Yet despite this, 10Y US Treasury yields actually finished lower on Friday. What's going on?

One explanation is that the so-called tantrum many market watchers have been anticipating has already happened. The big lift in US Treasury yields started in early August last year, when yields on the 10Y Government bond started rising from about 0.51%, prompted by optimistic expectations of vaccine rollout and a re-opened economy. Those expectations have now been met to a large degree in the US, though not so convincingly elsewhere in the world, and even in the US, this was not a straightforward process and took longer than expected.

There was also considerable optimism around the turn of the year, and following the US election, that President Biden would roll out a massive stimulus plan. Substantial fiscal stimulus has been forthcoming, and more will likely follow, but perhaps not to the degree or to a rapid enough timetable to satisfy some bond bears.

Payrolls week offers the possibility of directional surprise...

A further factor keeping bond yields in check, together with ongoing Fed asset purchases, is the rhetoric of the Federal Open Market Committee members, which seemed to unify around the mantra of "patience and caution" a few months ago when the bond sell-off was not looking as stale as it does today. Whether or not you buy the Fed's claims that rates will not be raised until 2024 at the earliest (and as a house, we don't), such unified rhetoric can't have failed to have some dampening effect on the market. What concerns me is what happens when that rhetoric starts to look a bit less unified, as it is starting to do now, with "...talk about talk about tapering..." starting to gain volume. Though if an announcement on an asset purchase taper is going to be unleashed at the Jackson Hole conference this August, then it is the worst kept secret in financial markets, and might well already be in the price.

On the inflation side, as noted earlier, the news has been every bit as strong as expected, and in most cases stronger. And what we see in terms of the breakdown of US bond yields is that inflation expectations, although off a bit from their recent highs, have shown a steady increase from their March 2020 lows. What has not been so steady has been the increase in real yields - a proxy for real growth expectations. As well as doubts creeping in about the pace and extent of stimulus spending, we also have bottlenecks in supply becoming more evident as economies re-open. A glaring example of this was last month's US payrolls release, where a 1 million expected jobs gain on the month was met by an actual gain of only 266 thousand. Further indicators that employers are finding it hard to fill vacancies are easy to find and have not abated. But non-farm payrolls is a highly flawed measure of employment, and with new data due this Friday, amidst a week of thin markets with US and UK holidays, there is at least a chance of a reverse surprise, which could give the real yield part of the bond market a jolt. The current consensus for this next payrolls release is for 650 million jobs to be created, and we will get plenty of pointers along the way towards the Friday releases - including the non-manufacturing ISM employment index as well as ADP to show us whether this is looking plausible or not. Not that any of these are at all reliable...

It's not just the bond market

It's not just the bond market where prices have been rangebound. Currencies have also exhibited a distinct lack of direction, though with one or two exceptions, the CNY in the APAC region for one, though that is now seeming to catch the attention of the Chinese authorities who are weighing in with soft verbal intervention now, and may well step in harder if markets do not heed the carefully placed warnings from various official sources - the latest warning that a strong currency need not be associated with strong equity markets.

But in terms of the majors, and in particular, the EURUSD, the range is very much still in place. Indeed, recent price action seems to suggest that neither USD bulls nor bears can convincingly push the currency outside its current range, though at some point, a break looks likely. Which way this will go remains an open question. Our house view for further USD weakness through the year-end as EUR vaccination roll out and re-opening gathers pace is one side of the coin and one that likely co-exists with calm financial market conditions. An alternative viewpoint would likely see risk

assets selling off, perhaps in the face of higher and more persistent inflation than previously expected, which would tend to favour the USD more. Either way, any move when it comes could be dramatic, as tugs of war rarely end without one side falling face down in the mud.

Meanwhile in Asia

It is going to be a busy start to the week here in Asia. Japan and South Korea have already released industrial production data for April, with the Japanese numbers disappointing expectations a little, but the Korean numbers beating them. Both sets of data are supported by weak base comparisons and show production growth of 15.4%YoY (Japan) and 12.4%YoY (Korea). Japanese retail sales for April fell by a greater than expected 4.5%MoM and will doubtless remain under pressure as states of emergency are extended ahead of the Tokyo Olympics. This doesn't bode well for 2Q21 GDP growth.

There's an awful lot happening elsewhere in Asia, as Prakash Sakpal notes, starting with Indian GDP. "The GDP report for Jan-Mar 2021, the fourth quarter of the financial year (FY) 2020-21, arrives today and will be an important input for the Reserve Bank of India's Monetary Policy Committee conducting its bi-monthly policy review this week (decision due on Thursday, 3 June). We are looking for a 1.7% YoY GDP growth in the reporting quarter, up from 0.4% in the previous quarter and helped mainly by low base effects. This will imply a full-year FY20-21 GDP fall of -7.2%. The more severe Covid-19 second wave is set to cause more damage to the economy in the current quarter, while the recovery from this wave is also likely to be slower than the first one. It's a delicate policy balance for the RBI - reviving growth without further stoking inflation. As elevated inflation prevents the RBI from cutting policy interest rates further, easing via liquidity support remains their most viable option. We believe Governor Shaktikanta Das will reaffirm this in his policy announcement this week.

Elsewhere, we have an update from Singapore's PM Lee on the government's pandemic measures later today, further Malaysian lockdown measures to consider, and Thai trade data. For more on these topics, [please see our sister publication Asean Bytes](#).

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