Opinion | 29 May 2019

Reading the tea-leaves

There is a lot of doom and gloom, but how much of it is justified?

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Today's theme is...

My daily ritual of trying to make sense of all the various news headlines and opinion pieces starts on the way into work and usually concludes within about ten minutes of turning on my PC. It isn't a conscious process, but by then, I've usually arrived at what today's key theme will be all about, or discovered a "straw man", which I will attempt to cut down. Not always, it has to be said...

Today is a mixture of the two. Starting with extremely depressed longer-term bond yields, where yields on the ten-year US Treasury fell further overnight and now sit at 2.26%, quite a long way below 3M USD Libor (2.52%).

10Y yields this low only makes sense if you think the Fed is going to cut rates. Our house view is that they won't. So is my own personal view. Why? Well to envision rates actually being cut, and according to market pricing, quite soon, you have to really imagine the US economy to be in trouble.

That takes me to a headline about factory orders in the US being weak and that this is probably a sign of looming manufacturing weakness brought on by the trade war.

Except it probably isn't.

Yes, April durable goods orders fell (data released a few days ago, this isn't breaking news). I've been looking at this series for decades, and I can tell you that there is no, that is precisely **no** information in one month's numbers. This data swings all over the place. We would predict recessions 50% of the time if we focused on month-on-month swings in this. Which is why they very helpfully provide a three-month moving average of the core series (four-month would be better, but who's complaining...). Looking at this smoothed series, the numbers look fine, actually quite reassuring. April may be the start of a trend, and a further month of weakness would begin to sow doubts in my mind, but we haven't had that yet. Right now, this signals nothing.

Other areas of weakness include the US housing market. Here, the news continues to run luke-warm. House price growth has slowed right down. But compared to a year ago, the rate of increase is slowing at a slower pace. It looks to be moderating. This isn't alarming. It's actually a signal that there is no bubble bursting, but a market repricing.

Trade war the key

Now the additional tariffs on China may change all that, and the ping-pong of threats is beginning to look quite ugly. Proposed tit-for-tat bans of rare earth exports from China to the US and technology access to China from the US don't improve the picture. And it is possible to conjure up a very dismal outlook over a twelve-month timeframe. It would be very encouraging to hear the US President beginning to steer both sides towards some sort of deal that would also allow China to back away from its' retaliation measures. Other news stories point to further weakness in the Chinese data, though I'm less concerned about that, given China's fairly well-stocked policy arsenal, though this does take place against a steady rise in indebtedness. That is always faintly disturbing.

Harvard's Carmen Reinhart is also fretting openly about the global risk from a China recession - so this isn't all idle fancy by market participants with too much time on their hands. If it were to happen, it would be very bad.

Stocks to show the way?

But then I return to what may ultimately may matter more to policy-makers and the administration in the US, and that is the equity market. Right now, it's poised on support. If it drops, it could drop big. And that would take US Treasury yields closer to 2%.

But it is also what probably causes a rethink on the trade war. In my view, anyway.

Asia day ahead

It's quiet today - very quiet. We have had the RBNZ Financial Stability report and statements from Governor Orr - though nothing really to report here. The RBNZ still have some further easing to do in our view, though that wasn't really the subject matter fo this discussion today.

South Korea has released business survey data. Soft. This Backs up the arguments for a rate cut from the BoK. They probably won't, at this meeting anyway, though the arguments for them to do so are overwhelming, in my view.

And Prakash Sakpal writes on Thailand: Highlighting the lack of fiscal support for the economy, Thailand's finance ministry yesterday announced a delay in the budget for fiscal 2020 (Oct 2019-Sep 2020) by three months due to the transition to a new government. During the transition period, outlays would be capped at 50% of that budgeted for current fiscal 2019. Weak government spending boosts the case for a June rate cut in our view.

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