Trade tensions trip Treasuries

US Treasury yields pull back as trade deal concerns rise.

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

Trade - the dynamics are changing

In recent days, if it wasn't already crystal clear, the over-riding importance of the US-China Trade War for financial markets and the global macroeconomy has become even starker. I had a very enjoyable chat with local officials and other economists at the Ministry of Trade and Industry here yesterday, which highlighted the degree to which this is dominating thinking.

In order to provide further backing for this thesis, I did a quick search for "Trade War indices" online today. By quick, I mean about 30 seconds. Bear in mind that this note is usually put together in about 40 mins from conception to publication - so don't judge me too harshly.

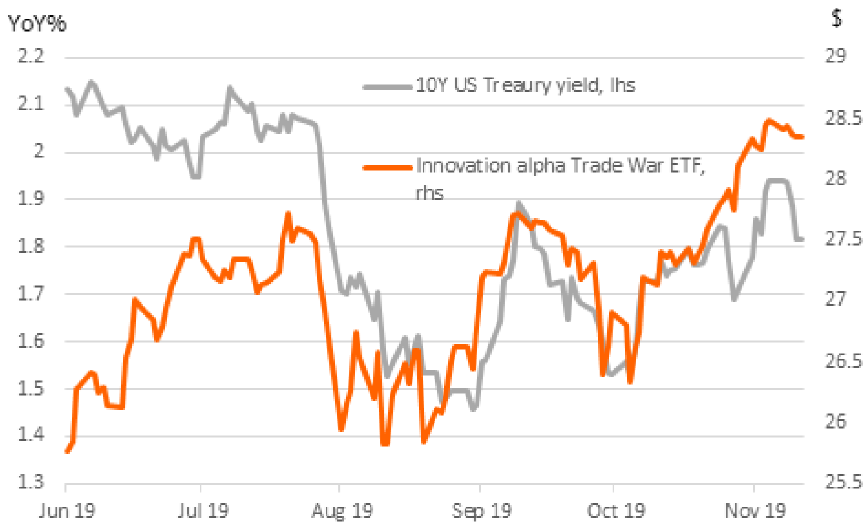
I found this one. It is an ETF based on US stocks that are supposed to outperform the index in the event of a trade war, based on their patronage by the US government. It has the advantage of being quoted daily, though the history of the series is not that long. Given an extra ten minutes, I could de-trend the series (as Treasury yields are stationary over this sort of time frame) and make it even better - I'll update you if I ever get round to that.

Imagine my lack of surprise when it tracked the 10Y US Treasury yield closely. Yes, there is other stuff going on. But if you want to explain the recent journey down to 1.5% and then back almost all the way to 2.0% and the subsequent drift back to 1.8%, then the trade war and a phone with twitter enabled is about all you need.

Recent trade chatter relates to difficulties in agreeing to monthly targets for Chinese agricultural purchases. I think this may demonstrate that China's recent agricultural purchases were mainly an expedient way of dealing with the impacts of African Swine Fever, not really a trade concession at all. The ongoing difficulties about new targets support this. China won't want to be boxed in if it doesn't suit them. But then maybe the US is getting wise to China's tactics in these negotiations. A further story cites White House Adviser, Larry Kudlow, saying that a deal is "close". But we have heard that many times before and without further detail, the market seems to be largely ignoring that.

Where markets previously were prepared to view delay as an inevitable process leading to a deal and trade in a positive fashion, they may now be more inclined to see delay as raising the chances of no deal. The dynamics of this are slowly changing.

Trade War and Treasuries



Source: Bloomberg, ING

Trade ETF and Treasury yields

China economic pressure mounting

Yesterday we got the monthly China data dump, with figures on everything from fixed asset investment to retail sales. Most of the data was very poor and highlight the pressure on China to secure some tariff rollbacks from the first phase of the trade deal, not just some way down the track and with a bunch of contingencies to meet first.

Iris Pang's note details yesterday's data and also concludes that the outcome of these negotiations will be of paramount importance for China's economy Iris' note also raises the role of 5G in 2020. China seems to be forging ahead on this despite the trade war while the rest of the world seems content to blame global uncertainty for doing very little. If the trade war was partly an attempt to keep China from reaching pre-eminence in the tech sector, it doesn't seem to be working.

Day ahead

It's relatively quiet in Asia today. Trade balance data for India and Indonesia today - two of the regions biggest deficit countries, could be important for the performance of the INR and IDR respectively.

(From Iris Pang): Final data on HK SAR GDP will also be released today. Usually, this data doesn't catch any market attention but given the recent escalating violence level the market will see if there is any revision. Preliminary GDP growth was -3.2%QoQ and -2.9%YoY in 3Q19. We don't expect revision on this data. However, the market may be more forward-looking towards 4Q19 GDP data. After the loss of tourism and consumption activity, Hong Kong may begin to lose exports of education services. For the past few days, foreign students have left Hong Kong presumably due to safety concerns"

(And From Prakash Sakpal): Malaysia's increasingly weak activity data in recent months followed by the central bank's (BNM) surprise easing (50 basis point reserve requirement cut a week ago) -- have all prepared markets for a bad third-quarter GDP report today. We have recently revised our 3Q GDP forecast from 4.8% to 4.4%, which is also the consensus median. We expect a further drift lower to 4.1% in the last quarter of the year, which we hope to be the low point in this cycle. We believe the BNM easing cycle has further to go with at least 50bp more policy rate cuts, which we have pencilled in for the first quarter of 2020"

Out in the G-7, US October retail sales will be an interesting read. The US economy is being kept going thanks to the resilience of the US household sector and their continued spending. Business investment is in contrast, in decline. So any sign of retail spending weakness (consensus is for a 0.2% MoM headline and 0.3% "control group" - strips out a lot of the volatile bits) would be unexpected, and therefore alarming.

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