

Which way next?

Markets carried on the "risk-on" mode on Monday following the Mexico tariff reprieve, but the tariff threat continues to hang, and rhetoric ahead of the Osaka G20 summit is heating up from the US side. Risk on may not last.



Source: Shutterstock

Trade tension here to stay

We suggested yesterday that it might be premature to conclude that Mexico is out of the woods as far as US Tariffs were concerned. Today, the FT writes that Mexico has a month and a half to stem the flow of Central American Migrants or face new demands from Washington, while the deal reached last Friday night threatens "unspecified actions" in the event that measures undertaken do not deliver what is required in terms of falling migrant figures within the next 90 days.

That sort of approach may be a factor guiding China's President Xi when he considers whether or not to avoid a meeting with President Trump at Osaka at the 28-29 June G20 meeting. Today's FT also leads with the threat of more US tariffs on China if Xi and Trump do not meet. But even if a deal is struck, the question President Xi may reasonably ask himself and his advisers is, "What will they want next?" Followed by, "When is this going to end?"

As a negotiation tactic, President Trump certainly seems to be getting results, at least from Mexico.

But it is a high-risk tactic, with China now probably reaching a point where it could reasonably consider turning its back on talks and trying to shrug off the inevitable raft of tariffs with countervailing support measures. Both decisions bring pain, but does one set of suffering at least bring with it more certainty? If so, then that may be a price Xi considers worth paying. If not now, then maybe later. With some signs that the US economy might not be firing as smoothly as it was a few quarters ago, Xi could be feeling emboldened.

This isn't our base case. That would be that a meeting does take place, but is inconclusive, so "No deal" rather than "No deal ever". If we enter the G20 where markets currently are, then either of these outcomes would be a return to "risk off", though we probably won't have to wait that long.

The G20 may also provide a watershed from which we review the current stability of the CNY. The last 24 hours has seen some CNY weakness following comments from PBoC Governor, Yi Gang that there was no particular level that they were supporting. This has re-encouraged thoughts that USDCNY 7.0 might be breached. From where I stand, I would say that this entirely depends on where the US and China are regarding a trade deal in early July. If China does signal that is no longer interested in a deal on the terms offered, then yes, the currency can become a policy lever. If not, even with no deal, so long as the prospects of some negotiated settlement remain in place, then politically, 7.0 still looks a tough line to crack.

Treasury yields rise, dollar rallies

It now looks as if bond yields in the 2.08% to 2.15% range marks the point where the dollar no longer appreciates as a default option. We had been on a somewhat self-fulfilling "falling yields and flattening yield curve raise recession fears, equities fall, dollar appreciates, yields fall further and curve flattens" cycle. But we seem to be reaching a point where the level of yields is no longer sufficient to encourage USD holding, so that may not work from here on.

Consequently, if we do a return to further bad news/trade aggression from here, that may take EURUSD back towards the 1.10 level, but it may struggle to push through there. USD-Asia looks quite bid today.

Bedtime reading

Bedtime reading last night was this article from the internet: ["Huawei's US ban: A look at the hardware \(and software\) supply problems" | Ars Technica](#)

Now most of this is over my head. I can't tell an SOC from a CPU. But the gist of the story is this - the main challenge to a company like Huawei from a US ban is not hardware, it may not even be the operating system, though this would need some work, it may be App availability.

You will know all this far better than me, so if you have any thoughts on this, I would welcome them. You know where I am. And any similar articles you think worth reading will be appreciated.

Asia Day ahead

It is post-payrolls, pre-FOMC, and pre G20, so the developed market calendar is rather dull for the time being.

Asia may offer us some interest today in terms of aggregate financing data. April's somewhat disappointing CNY 1359.2bn in total financing is thought likely to pick up pace in May.

Philippine trade data is also out this morning. The Philippines has been less badly hit than some of its SE Asian neighbours during the trade war and global technology slump, and the export decline registered in March is expected to moderate further in April.

(from Prakash Sakpal) Malaysia's April industrial production out today comes as an initial gauge of GDP growth in the second quarter of the year. Surprising export strength in April imparts upside risk to the consensus view of moderate IP growth (2.5% YoY vs. 3.1% in March). GDP grew by 4.5% YoY in 1Q19, which we believe was the low in the current cycle. If not underlying economic strength, favourable base year effects should shore up GDP growth over the remainder of the year. We also think the BNM is done with its policy easing after a 25bp rate cut in May.

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