23 January 2019

White House Advisor Kudlow refutes suggestions US – China talks have stalled; Still no traction on US government shutdown

Top FX drivers:

- **USD:** FT reports that the Trump administration has rejected an offer by two Chinese vice-ministers to travel to the US this week for preparatory trade talks ahead of high-level meetings set for January 30-31 in Washington due to lack of progress on technology transfers and "structural" changes from China. However, **White House Economic Advisor Kudlow** refutes the FT report, adding that there are currently on-going "fulsome discussions" with China on major matters including intellectual property. **Key dates on US – China trade talks are as follows** – (1) January 30 – 31: US – China cabinet level talks on trade; (2) Section 232 auto tariff report due sometime during February; (3) March 1: Signing of a US – China trade agreement.

- **USD: Latest developments on the US partial government shutdown suggest little, if any, progress** with Reuters reporting **Senate Republican leader Mitch McConnell** will hold a vote this week on **President Trump's proposal** to end the partial government shutdown, possibly Thursday. **This will likely include a vote on two separate bills** – (1) one backed by President Trump that includes USD5.7bn for his border wall and (2) another that would simply extend funding for shuttered agencies through February 8. However, even if confirmed, the Republican - led plan would need 60 votes in the Senate to pass, while Republicans only control 53 seats and Democrats have already indicated that the Trump deal is a non-starter. Advancement would also eventually require the House to pass the deal, which is controlled by the Democrats.

USD: US housing data dip has little impact on USD where investor focus remains on geopolitical/ US political tensions

- US existing home sales for December come in well below estimates at 4.99mn versus 5.24mn expected and 5.33mn prior, representing a -6.4%MoM decline and a 3Yr low for the series. Details show single family sales down -6.4% and a drop in median prices from USD257 to USD253k.

- **This week in the US,** durables orders takes on increased significance following the plunge in ISM manufacturing orders earlier this month. However, the US government shutdown may delay its release and the focus likely turns to continuing headlines ahead of the high-level US – China meetings scheduled for 30-31 January.

EUR & GBP: ZEW expectations stabilize, current conditions still soft; MPs steadily chip away at prospect of “No-Deal” Brexit

- **Expectations for Germany and euro area stabilize in January with the headline ZEW expectations index for Germany rising moderately** for the third consecutive month from -17.5% in December to -15.0% in January (consensus -18.5, Citi -25). **Expectations also stabilize in the euro area as a whol**e (-20.9% in January vs. -21% in December). But **the current assessment component for Germany falls more than expected** in January from 45.3% to 27.6% (consensus: 43, Citi 35), the lowest since January 2015. In the Eurozone as a whole, current assessment also drops to 5.3, from 12.1 in December, the lowest since early 2017. **COMMENT:** The expectations component already incorporates most of the negative news flow related to trade wars, China slowdown, Brexit, Italian political risks, etc and the stabilization in expectations reduces risks that the ongoing economic slowdown, captured in the current assessment component, morphs into a fully-fledged recession. Markets await the **ECB meeting this Thursday that could bring forward a discussion on extending targeted longer-term refinancing operations (TLTROs)**. **Data wise**, the **Eurozone Composite PMI for J**anuary is expected to come in at 52.0 and manufacturing PMI at 51.4 (both an improvement from December).

- **GBPUSD hits fresh session highs overnight at 1.2966 as UK MPs progressively chip away at a “No-Deal” Brexit scenario. Latest developments include** – (1) A re-tabling of an earlier amendment proposed by Tory Brexiter Andrew Murrison that calls for an expiry date to the Irish backstop (a “sunset clause”) with hope that this time it may be passed when the UK parliament votes again on January 29 (note that chief Brexiteer Jacob Rees-Mogg has indicated over the weekend that Brexiteers would rather have PM May's deal than “No Deal” or No Brexit at all); (2) Opposition leader Jeremy Corbyn putting Labor’s own official amendment overnight to demand parliamentary time for a series of votes on what should happen next, including Labor’s alternative Brexit plan that calls for a second referendum.

Commodity bloc: Stronger NZ CPI puts STOP sign on RBNZ dovishness

- **NZD rallies some 30 pips on a one-tenth beat in NZD's Q4 CPI report** (up 0.1%QoQ versus consensus for 0.0% and at 1.9%YoY versus consensus for 1.8%). This is the second consecutive positive surprise since 2000 with leading indicators pointing to NZ CPI inflation in-line with the mid-point of the RBNZ’s target band this year. **Implications for the RBNZ - Citi analysts** point out that the sustained rise in annual NZ non-tradables inflation towards the RBNZ’s target carries reasonably bearish implications for NZD rates (and bullish for NZD). At the very least, today’s CPI result presents significant hurdles to realizing the 10bps OCR cut priced into RBNZ rates by mid-year 2019 and beyond.

Asia EM: China’s economy ends tough year but more stimulus seen

- With Chinese growth sliding to 6.6%YoY in 2018, lowest since 1990, **Citi analysts** expect a weak start for the economy in 2019 with growth forecast at 6.2%YoY in Q1-Q3 and 6.3%YoY in Q4. The **Chinese government has undoubtedly stepped up fiscal efforts to support growth**, which will likely continue and is likely to raise the official budget deficit to 3.0% of GDP in 2019 (vs. 2.6% in 2018), cut taxes and fees by at least over RMB1.3trn (vs. RMB1.3trn), and approve a special bond quota of around RMB2.0trn (vs. RMB1.35trn). **Citi analysts also expect more targeted easing measures** with an additional 100bp reduction in RRR in 2019 while **RMB depreciation pressure should be limited during the trade truce.**

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