GLOBAL MACROECONOMIC UPDATE

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Key Themes:

- The US – China trade deal imploded when China changed an already-agreed to draft document, according to the US
- The next opportunity for Presidents Trump and Xi to speak in-person looks to be at the June G20 leaders' meeting in Japan; it's too early to tell if a deal can be made by then
- We are expecting choppy markets until then, but the risk of negative headlines abounds

Back to Your Corners, Gentlemen

As many readers will recall, we've been bullish on the notion of a US – China trade deal. In early May, when Ambassador Lighthizer and Treasury Secretary Mnuchin retuned from Beijing and news followed quickly thereafter of a "totally marked up" 150 page draft document from the Chinese ahead of the DC round of negotiations, we knew our view was in trouble. As we all now know, the deal has fallen apart, the US is raising tariffs from 10% to 25% on $200bn worth of Chinese goods and looking at 25% on another $300bn while China is responding pretty much like-for-like. Not surprisingly, many people are interested in our thoughts on "What's next for markets with the trade deal seemingly on hold?"

Readers will also recall our view from early April that US – China trade was one of, if not the most important macro issue facing markets. We still think that is likely the case, so headlines suggesting regression – or progression – in talks are likely to have an outsized impact on market sentiment, yields and equities (Chart 1).

Chart 1: Shanghai A Share Index
(Daily, November 2016 – Present)

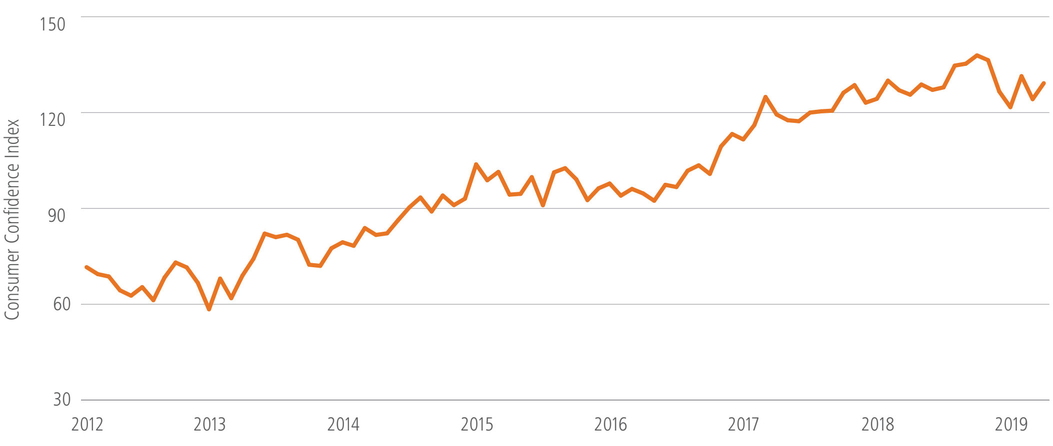
Source: Bloomberg, Mackenzie Investments

We can see a market environment where volatility increases within a choppy range between now and the end of June and negative sentiment dominates. The current state-of-play as we go to press is a G20 leaders meeting in Japan in late June as the first official opportunity for Presidents Trump and Xi to meet face-to-face, which in some ways was probably always required to get some sort of deal over the line. Between now and then could a phone call happen between the two leaders? Absolutely. Could Ambassador Lighthizer and Secretary Mnuchin head back to Beijing? For sure. And headlines to either of those effects would be constructive for risk sentiment, but in our view, the risk is the recent negative newsflow continues as it has around the technology space and with the Chinese demanding "respect" from the US before coming back to the negotiating table.

There are some market participants who think Trump's backing off on the trade deal is actually a purposeful and brilliant tactical move, the idea being with the labour market so tight and credit still relatively easy to obtain by historical standards, Trump can afford to have the economy slightly slow down in the second and third quarters but then ramp up in the fourth quarter and into early 2020 making it look more robust with greater momentum as the US heads into the home stretch of the 2020 election. While we would not completely rule it out, it sounds too finicky– even for Trump – and is a very dangerous game if something unexpectedly torpedoes the game plan of extending the economic cycle such as a more protracted European slowdown, North Korea begins significant sabre rattling or domestic consumer confidence tanks (Chart 2) – just to name a few.

What seems clear, however, is a friendly Fed for the coming months: while likely not cutting rates anytime soon, the Fed seems to be poised for an extended pause with Chairman Powell, Vice-Chair Clarida and the Minutes from the April 30 – May 1 FOMC all confirming the neutral-ish Powell press conference from May 1 when he played down lower inflation risks, insisting the low core readings were "transitory." That will be important, because as soon as the data flow catches up to early May, we suspect some of the more anecdotal / sentiment-based data will begin to factor in the lack of a China deal. That coupled with our views on market sentiment above, likely mean we are in for a choppy environment with a slight bias for negative risk sentiment and lower yields into the Japan G20 confab.

Chart 2: U.S. Conference Board
(Monthly, January 2012 – Present)



Source: Bloomberg, Mackenzie Investments

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