29 June 2018

# Week Ahead: The CNY conundrum

Martin Enlund | Kjetil Olsen | Erik Bruce | Janne von Gerich | Torbjörn Isaksson | Jan Størup Nielsen | Anders Svendsen | Andreas Wallström | Amy Yuan Zhuang | Tuuli Koivu | Joachim Bernhardsen | Morten Lund | Tatiana Evdokimova | Denis Davydov

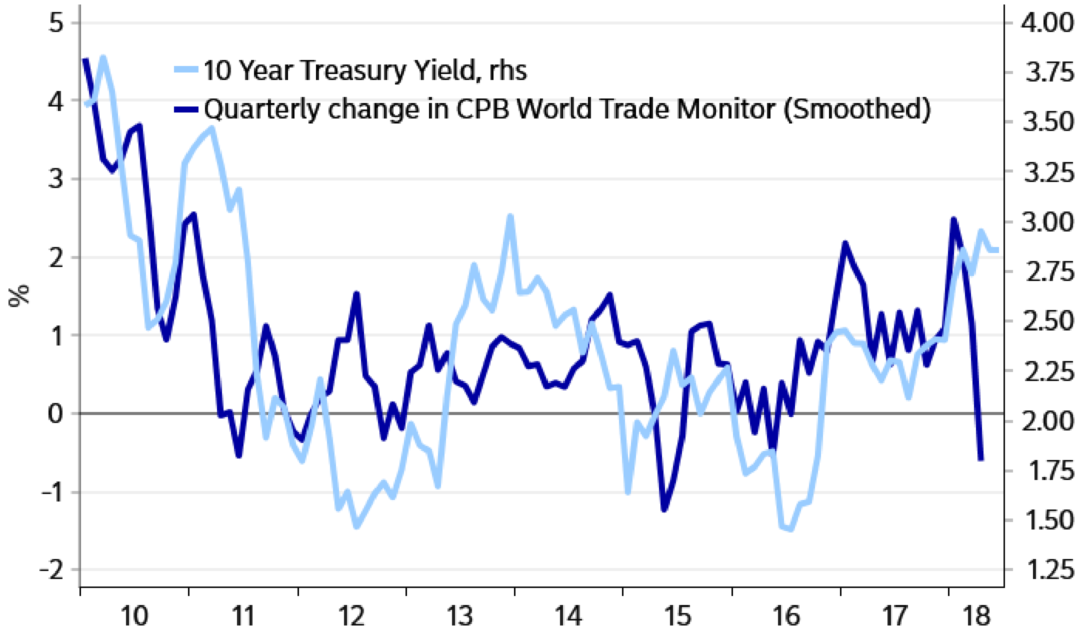
What's up with USD/CNY, and is it trade war-related?
Flows are leaving EM - destination small cap equities?
Will the Riksbank pave the way for Scandis?

## Has the PBoC deliberately weakened CNY as part of the trade war?

It has been another trade war week, as the market has been looking for clues on the Chinese retaliation measures against the Trump tariffs that are planned to go live on 6 July.

**Global trade momentum started to weaken even before the trade conflict escalated.** The three months from February until April marked the weakest running 3-month period for world trade since early 2015. A bad sign given that the period included a temporary cease-fire between Trump and Xi Jinping. **Usually it adds downwards pressure on 10yr bond yields**, when world trade is slowing (at least initially). A further slowdown of global trade in June/July/August could keep long bond yields under pressure over the summer. In other words, the trade war fog needs to dissipate for the 10yr US Treasury yield to unfold its upside potential to the range between 3.25%-3.50% (Major Forecast Update: USD to remain in the driving seat)

## Chart 1: Less global trade, lower long bond yields



Source: Nordea Markets and Macrobond

Last week we wrote that we found trade-based Chinese retaliation measures more likely than attempts to retaliate via the financial markets. **The fact that Trump is threatening with new tariffs on goods worth a total of USD 450bn makes the retaliation process trickier for China.** It is simply not possible to retaliate symmetrically, as there are not enough US exports into China to tax. **This leaves an elevated risk of unorthodox retaliation measures being used**. Prohibiting symbolic US products from entering Chinese territory could be one way of doing it. Expect more clarity on whether Xi Jinping will deliver an ALL-IN answer as early as this weekend.

Earlier in the week, stories emerged that the PBoC had been told by Xi's administration to stop buying or even off-load Treasuries. While it is hard to prove whether that was actually the case this week, there are signs that especially the Chinese market is discounting a marked escalation of the conflict. The Shanghai Composite is down almost 23% since its peak in January. The general risk off and lack of faith could be the reason for the weakening CNY.

We wrote earlier this year that 10yr bond yields in China and US rarely move out of tandem for prolonged periods (not observed since 2008), but this time around it could be that markets are sending a signal that US growth momentum holds up much better than Chinese growth trends. Just this week the PBoC cut its reserve requirements in the attempt to add some needed stimuli to the Chinese momentum.

## Chart 2: 10yr bond yields in China and US rarely move out of tandem for long

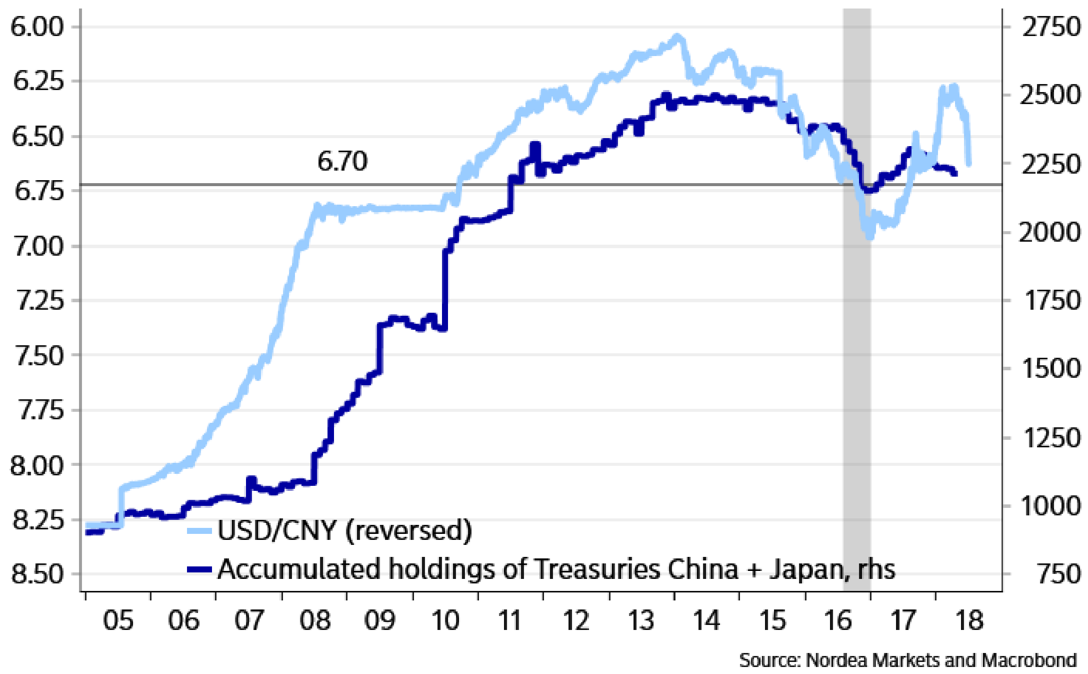

Source: Nordea Markets and Macrobond

This is another sign that US economic performance and market variables look substantially more resilient to the trade war than in the Euro area and China, which Trump is currently targeting. This is sadly something that will likely increase Trump's appetite of continuing down the current path and also a sign that Trump has the upper hand on both China and Europe currently.

No matter whether or not the PBoC has been a part of weakening the CNY (some Chinese sources indicate that the PBoC has helped the weakening trend), **the current market situation may not be too bad for China, as a market-based upside pressure on USD/CNY allows China to 1) sell USD, 2) sell Treasuries and 3) ride the impulse from a slightly weaker currency.**

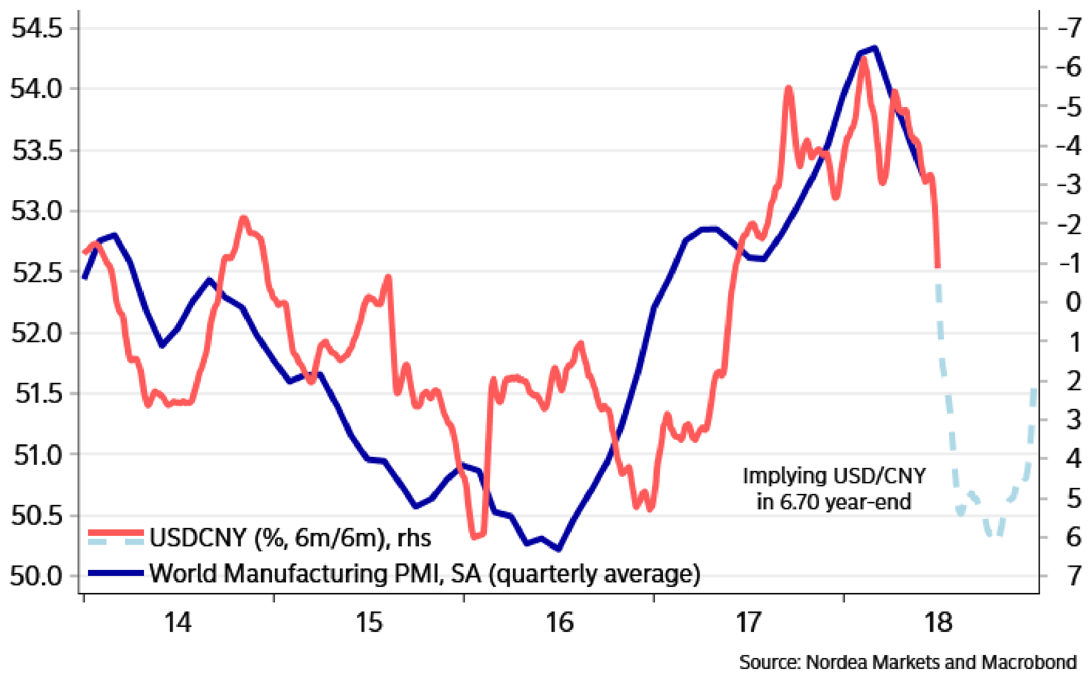
**We ultimately think that the PBoC will safeguard the 6.70 level in USD/CNY**, as it would otherwise risk spurring another round of massive capital outflows as was seen after the devaluation in the autumn of 2016 (Read: CNY: Too weak too fast)

## Chart 3: Weaker CNY and Treasury selling? A combo that was possible in the autumn of 2016




Should USD/CNY at 6.70 be seen as an issue for global growth in general? It could be if it is a sign of broader tightening of financial conditions in EM due to outflows or EM central banks combatting these outflows.

## Chart 4: Weaker CNY, stronger USD. A general problem for PMI momentum?

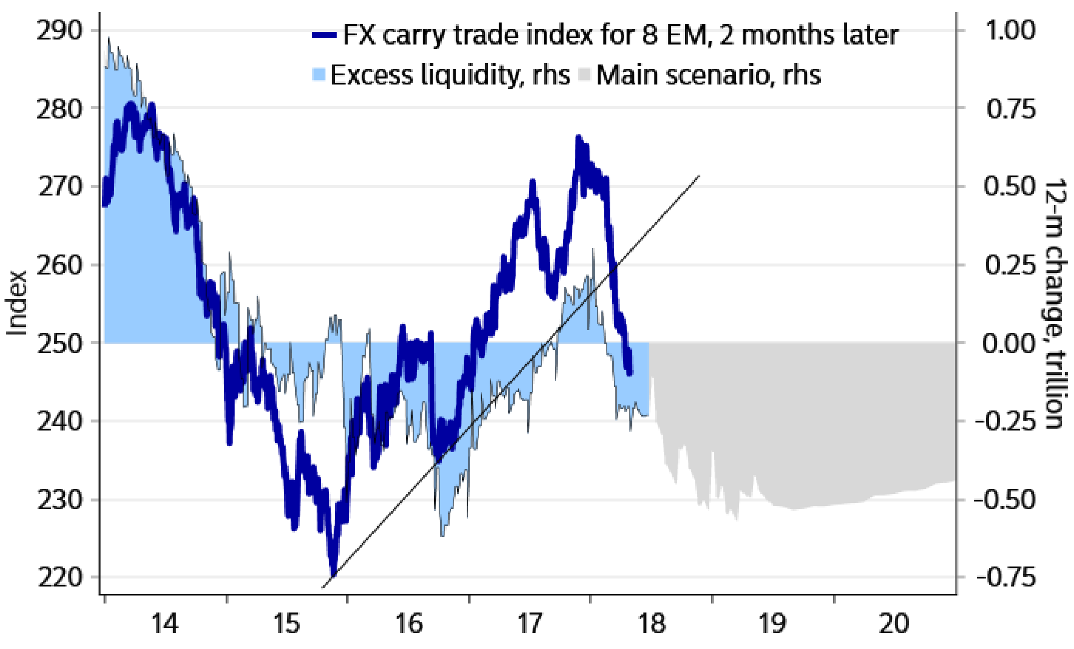


**And as a side-effect, the weakness of the CNY has added to the downside pressure on other Asian EM currencies, as the capital flows continue to leave Emerging Markets broadly**. The Indian central bank, which pleaded with the Fed for help a few weeks back, has been forced to support inventions in the rupee.

# Flows fleeing EM ... destination US small caps?

It is for the eighth or ninth straight week visible that flows are leaving Emerging Markets. That is not particularly surprising given the increased pace of tightening of USD liquidity that is on the cards due to the Fed's QT.

## Chart 5: EM won't be sprinting, as long as Fed is aggressively "un-printing"



Source: Nordea Markets and Macrobond

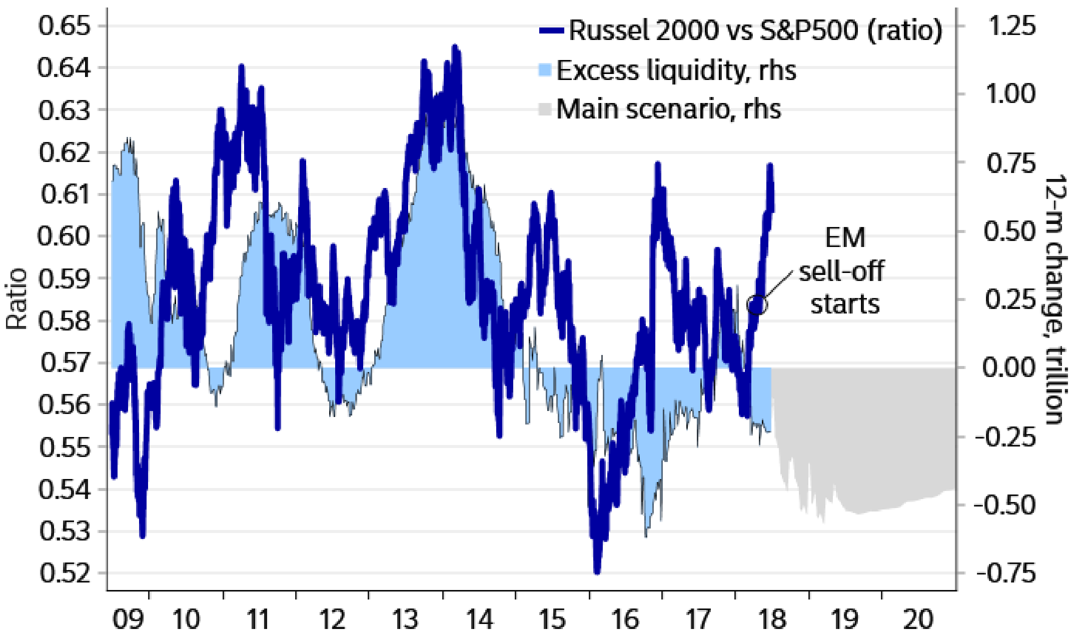
The destination of those outflows is much more surprising, though. **Currently it seems like flows that are leaving Emerging Markets are filtering into US small caps.** Russel 3000 has performed relative to S&P 500 since the EM sell-off started in mid-April. Maybe it is just a sign that investors are slowly but surely moving inwards on the risk curve (EM credit is riskier than Russel 3000). Could small caps be the next nice asset class that is set for a round of weakening as the central bank balance sheet policies will get less and less benign over the coming months?

As the Bank of England [writes on its webpage](#) on the effects of the British QE programme:

*"The purchases are of such a scale **that they push up the price of assets**, lowering the yields (the return) on them. This encourages those selling these assets to us to use the money they received from the sale to buy assets with a higher yield instead, like company shares and bonds."*

**If increased private risk-taking was the consequence of QE, then it must hold that QT will work to drag private investors' risk-taking in the opposite direction** ([Central Bank Liquidity: Into the desert](#)). We have interesting times ahead, indeed.

**Chart 6: Small caps have performed vs large caps, since EM outflows started. Risks are rising**



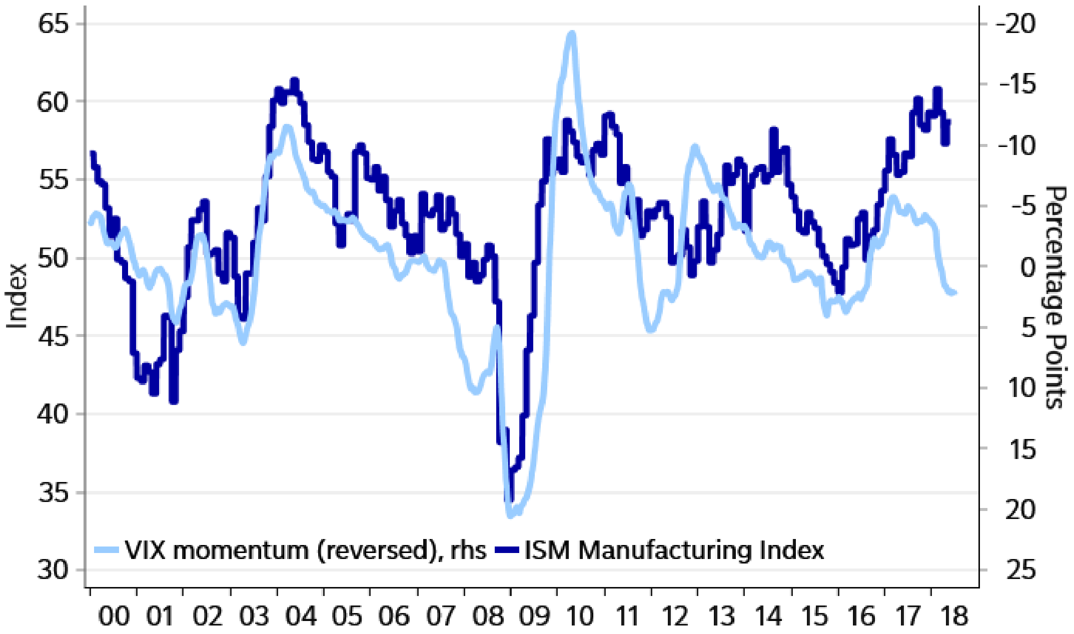
Source: Nordea Markets and Macrobond

# Will a trade war risk premium soon show up in US key figures?

**We have been surprised by the impressive resiliency in US key figures** despite substantially increased volatility after the equity market correction in early February. Trump's fiscal stimulus has worked to hold up US momentum despite weakening momentum more or less all over the globe. Past volatility, trade risks and regional surveys point to downside risks for the ISM index next week.

**Overall the story of very upbeat growth in US remains intact**, but we expect the momentum to dampen sooner rather than later. A trade war risk premium has to show up in sentiment indicators.

## Chart 7: Past volatility, future ISM weakening




Source: Nordea Markets and Macrobond

# What is most important in the week ahead?

**The week starts off with a temperature check on the Chinese economic momentum on Monday** and given the recent weakness seen in the Shanghai Composite, we see downside risks.

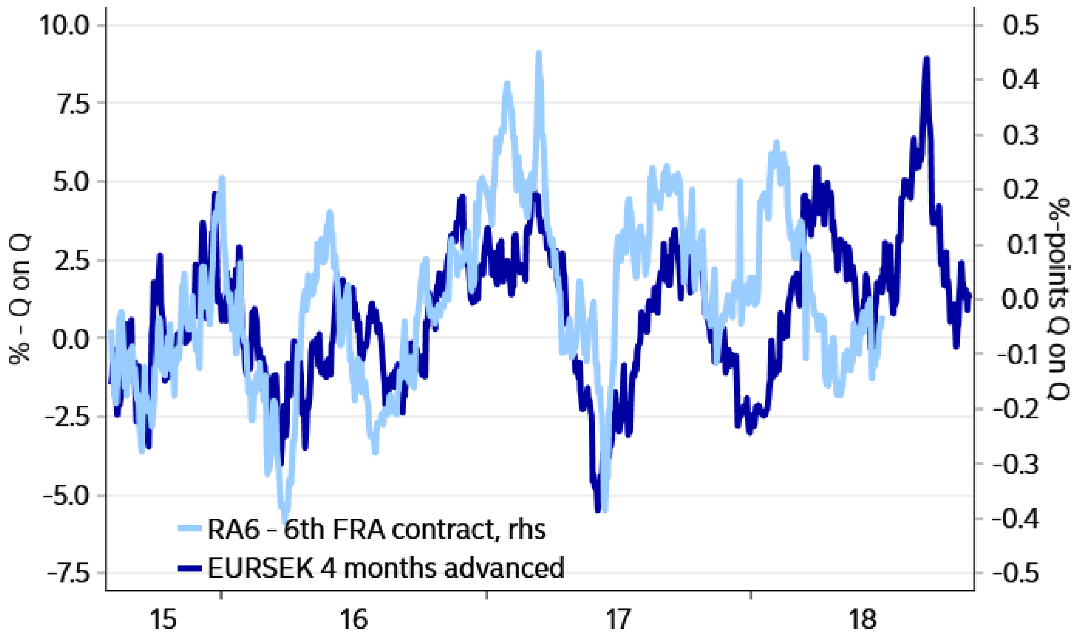
## Chart 8: Shanghai composite indicates downside risks for the Chinese economic momentum.


Source: Nordea Markets and Macrobond

**In Scandinavia, the Riksbank will announce its monetary policy decision on Tuesday** when we expect the bank to continue keeping the door ajar for a rate hike at the October meeting (40% implied in the rate path – unchanged from last meeting).

This could pave the way for hawkish Riksbank bets in both the Fixed Income and FX space. Usually past weakness in the SEK has spilled over to a steeper FRA curve with a time lag. We don't see any reason to expect that it should not be the case this time around. **Ironically, the Riksbank could end up as the catalyst for a positive NOK reaction also**, as it seems like the weak SEK has been one of the factors holding the NOK back despite a hawkish Norges Bank.

## Chart 9: Weakness in SEK leads to steeper FRA curve with time lag




Source: Nordea Markets and Macrobond

**From the US**, the most important key figures will be released on Monday and Friday with the ISM manufacturing index and the monthly job report due out. We see downside risks for the ISM index, while we continue to expect US wage growth to continue on an upwards path due to the tightening labour market.

**On Wednesday, the minutes of the most recent FOMC meeting will be published**. The Fed lifted its IOER rate by only 20 bp in June, even as it hiked the target range for the effective Fed Funds rate by 25bp. The Fed opted for this technical change as a result of unexpected upward pressures on the effective Fed Funds rate in recent months. Minutes may contain further clues on how the Fed might react should the upward pressures on the EFF rate continue. If the Fed delivers according to the dot plot, we expect the fair value of the 10yr Treasury yield to rise to the range of 3.25%-3.50%, once/if the trade war fog dissipates. We still see signs that the USD could continue to perform in the current environment.

**Editorial by Andreas Steno Larsen**

# Key research pieces over the past week:

Market pulse SEK: Thoughts ahead of the Riksbank (29 Jun)

Mexico election: Another populist president arises (29 Jun)

CNY: Too much weakness too fast (27 Jun)

Major forecast update: USD to remain in the driving seat (26 Jun)

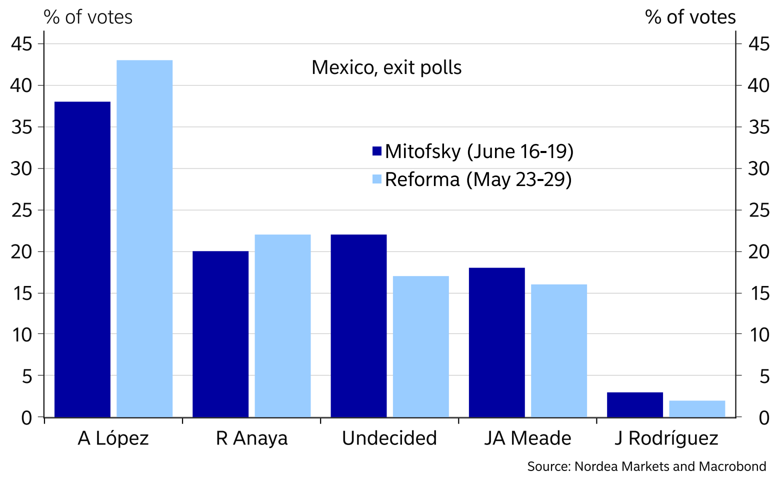
FX weekly: The USD is the best carry currency in the world (24 Jun)

## Table 1: Main releases to watch

| Date | Key figure | Nordea | Consensus | Last |
|---|---|---|---|---|
| 01-Jul | US: ISM, manufacturing | | 58.0 | 58.7 |
| 02-Jul | China: PMI, manufacturing, Caixin | | 51.1 | 51.1 |
| 03-Jul | Sweden: Riksbank, rate decision | -0.5% | -0.5% | -0.5% |
| 04-Jul | US: Minutes of FOMC rate meeting | | | |
| 06-Jul | US: Nonfarm payrolls (absolute change m/m) | | 198k | 223k |
| 06-Jul | US: Hourly earnings, average (y/y) | | 2.8% | 2.7% |

# Sunday

| Sunday, 01/07/2018 | | | | Nordea | Consensus | Previous |
|---|---|---|---|---|---|---|
| | MX | **Presidential and parliamentary elections** | | | | |




On Sunday 1 July, Mexico will hold elections for both the presidency, the Senate and the Chamber of Deputies. After two failed attempts in the last presidential elections in 2006 and 2012, the populist and negative perceived by markets candidate, Andrés Manuel López Obrador (better known by his abbreviation AMLO), looks like a certain winner. If selected, the ongoing NAFTA negotiations could be complicated which in turn would spell trouble for the Mexican economy and be a weighing factor on the Mexican peso. Read more here.

# Monday

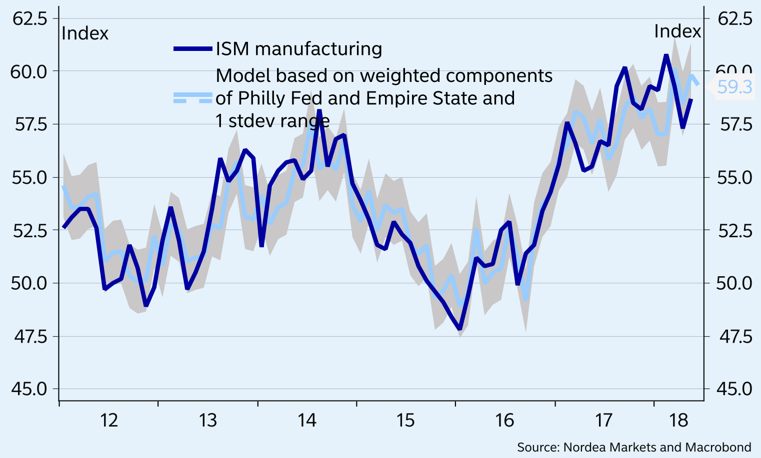
Today is filled with important growth indicators. Early in the morning, the Chinese Caixin Manufacturing PMI index is due before a number of corresponding releases are out from Europe, including Norwegian, Swedish, Russian and British numbers. Final Euro-area PMIs are also out. In the evening, the most important soft indicator, the US ISM manufacturing index, is released.

| Monday, 02/07/2018 | | | | Nordea | Consensus | Previous |
|---|---|---|---|---|---|---|
| | EU | Unemployment rate | May | | 8.5% | 8.5% |
| 00:50 | JP | Tankan, large manufacturers, Index | Q2 | | | 24 |
| 00:50 | JP | Tankan, large manufacturers, Outlook | Q2 | | | 20 |
| **03:45** | **CN** | **PMI, manufacturing, Caixin** | **Jun** | | **51.1** | **51.1** |


The Caixin manufacturing PMI has been robust during the past two months thanks to resilient domestic demand. However, sentiment will likely deteriorate from here amid escalating trade tensions with the US, which will suppress export orders. In addition, the latest financial market turmoil clouds the outlook for China. While the PMI reading for June will surely remain above 50, it may disappoint the consensus expectation of 51.1.

| | | | | | | |
|---|---|---|---|---|---|---|
| 07:00 | IN | PMI, manufacturing | | | | 51.2 |
| 08:00 | RU | PMI, manufacturing | Jun | | | 49.8 |
| 08:30 | SE | PMI, manufacturing | Jun | | | 55.8 |

| Monday, 02/07/2018 (continued) | | | | Nordea | Consensus | Previous |
|---|---|---|---|---|---|---|
| 09:55 | DE | PMI manufacturing (final) | Jun | | | |
| 10:00 | EU | PMI, manufacturing (final) | Jun | | | |
| 10:30 | GB | PMI, manufacturing | Jun | | 54.2 | 54.4 |
| 11:00 | NO | Auction of Treasury Bills | | | | |
| 11:00 | NO | Auction of Treasury Bills | | | | |
| 14:00 | RU | GDP (y/y) (Exp 2-3 Jul) | Q1 | | | 1.3% |
| 15:45 | US | Markit manufacturing PMI (final) | Jun | | | 54.6 |
| 16:00 | US | Construction spending (m/m) | May | | 0.4% | 1.8% |
| **16:00** | **US** | **ISM, manufacturing** | **Jun** | | **58.0** | **58.7** |



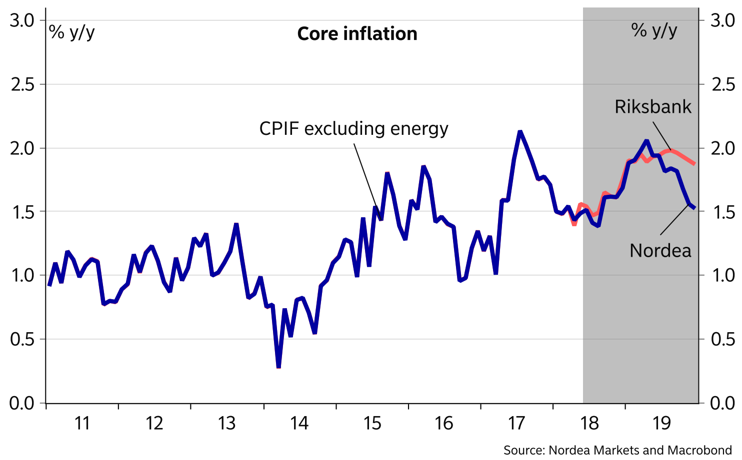

The regional Philly Fed and Empire State indices (see chart) indicate that we could see some downside in the overall ISM Manufacturing index. Combined with the ongoing trade war talks, volatility in the financial markets and the strengthening of the USD, we see the risk tilted to the downside of the consensus reading of 58.0.

| | | | | | | |
|---|---|---|---|---|---|---|
| 16:00 | US | ISM, new orders | Jun | | | 63.7 |
| 16:00 | US | ISM, prices paid | Jun | | | 79.5 |

# Tuesday

The Riksbank meeting will take centre stage today. The RBA will also announce its interest rate decision. In the US, the markets close early due to Independence Day the next day.

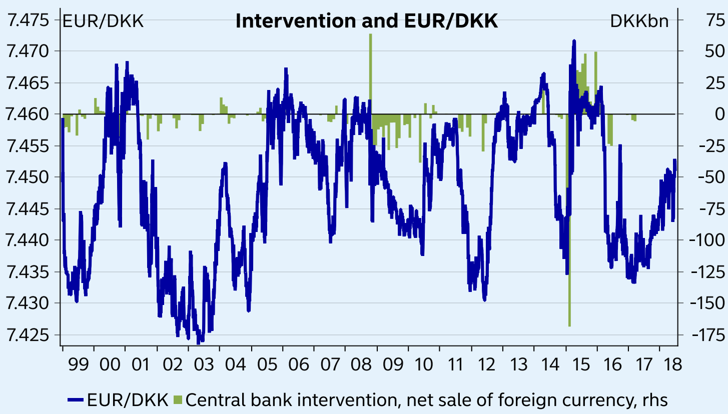
| Tuesday, 03/07/2018 | | | | Nordea | Consensus | Previous |
|---|---|---|---|---|---|---|
| 06:30 | AU | RBA announces interest rates (cash rate target) | Jul | | 1.50% | 1.50% |
| 09:30 | SE | Registration of vehicles (y/y) | Jun | | | 6.2% |
| **09:30** | **SE** | **Riksbank, rate decision** | | **-0.5%** | | **-0.5%** |




Inflation and GDP growth have largely turned out as the Riksbank expected in April. This suggests a wait-and-see stance at the July meeting. In April, the Riksbank's interest rate path indicated a 40% chance of a rate hike in October. We expect that the interest rate path in July will show the same likelihood of an increase in the late autumn; a rate hike that will not materialise according to our view. More likely, the Riksbank will revise down the interest rate path in September as it will be more evident that GDP growth is slowing down and as the October meeting will be closer in time. Read more here.

| Tuesday, 03/07/2018 (continued) | | | | Nordea | Consensus | Previous |
|---|---|---|---|---|---|---|
| 11:00 | EU | Retail sales (m/m) | May | | | 0.1% |
| 12:00 | SE | Riksbank's af Jochnick speaks on economic outlook (not publ.) | | | | |
| 13:00 | SE | Riksbank's Skingsley speaks on digital currencies (not publ.) | | | | |
| 14:30 | US | Durable goods orders (m/m) | May | | | -0.6% |
| 14:30 | US | Durable goods orders, ex transportation (m/m) | May | | | -0.3% |
| 15:00 | SE | Riksbank's af Jochnick speaks on cashless society (not publ.) | | | | |
| **16:00** | **DK** | **Foreign currency reserves (DKKbn)** | **Jun** | **468bn** | **468bn** | **468bn** |

In June the DKK has weakened against the EUR but the upward movement in EUR/DKK has probably not been strong enough to trigger any intervention from the Danish central bank. If our assumption is correct, this will mark the longest continuous period without intervention by the central bank since the introduction of the euro. However, the situation may change before the autumn when the different monetary approaches by the ECB and the Danish central bank will become more explicit. Read more about this in [EUR/DKK: Back above central parity?]



Source: Nordea Markets and Macrobond

| | | | | Nordea | Consensus | Previous |
|---|---|---|---|---|---|---|
| 16:00 | SE | Riksbank's af Jochnick speaks on banking union (not publ.) | | | | |
| 16:00 | US | Factory orders (m/m) | May | | -0.2% | -0.8% |
| 16:00 | US | Factory orders, ex transportation (m/m) | May | | | 0.4% |
| 23:00 | US | Vehicle sales, domestic | Jun | | | |
| 23:00 | US | Vehicle sales, total | Jun | | 17.0m | 16.8m |

# Wednesday

US markets are closed because of Independence Day. Services PMIs are out from China, Sweden, Russia, the UK and the Euro-area (final numbers).

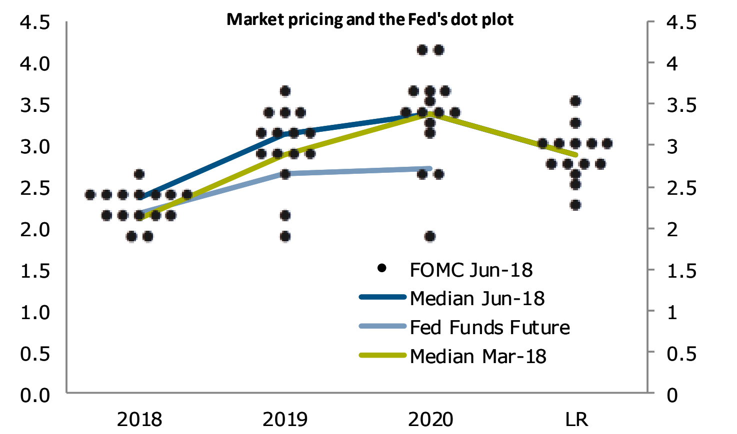
| Wednesday, 04/07/2018 | | | | Nordea | Consensus | Previous |
|---|---|---|---|---|---|---|
| | US | Independence Day | | | | |
| 06:00 | SE | House prices, Mäklarstatistik (y/y) | | | | |
| 08:30 | SE | PMI, service sector | Jun | | | 57.0 |
| 09:00 | SE | Riksbank's Skingsley speaks on monetary policy (not publ.) | | | | |
| 09:30 | SE | Riksbank's af Jochnick speaks on financing housing (not publ.) | | | | |
| 09:55 | DE | PMI composite (final) | Jun | | | |
| 09:55 | DE | PMI services (final) | Jun | | | |
| 10:00 | EU | PMI, composite (final) | Jun | | | |
| 10:00 | EU | PMI, services (final) | Jun | | | |
| 10:30 | GB | PMI, composite | Jun | | | 54.5 |
| 10:30 | GB | PMI, services | Jun | | 53.9 | 54 |
| 11:00 | NO | Auction of Treasury Bonds | | | | |
| 11:00 | NO | House prices EFF (m/m, sa) | Jun | | | |
| 11:00 | SE | Riksbank's Skingsley speaks on future of payments (not publ.) | | | | |
| 11:00 | SE | SNDO to auction T-bills (SEK 5 bn) | | | | |
| 13:00 | US | Mortgage applications, MBA | Jun | | | -4.9% |
| 15:00 | SE | Riksbank's Skingley speaks on "e-krona" (not publ.) | | | | |

# Thursday

The day kicks off with Swedish average house prices from June and industry production figures from May. Then focus will turn to the US with the release of the ADP job report, the ISM non-manufacturing index and the FOMC minutes. The ECB's Mersch (neutral), Nowotny (neutral, Austrian Governor) and Weidmann (hawk, German Governor) will speak during the day.

| Thursday, 05/07/2018 | | | | Nordea | Consensus | Previous |
|---|---|---|---|---|---|---|
| 08:00 | DE | Factory orders (m/m) | May | | -0.4% | -2.5% |
| 09:15 | CH | CPI (m/m) | Jun | | | 0.4% |
| 09:15 | CH | CPI (y/y) | Jun | | | 1.0% |
| 09:30 | SE | House prices, Statistics Sweden (y/y) | Jun | | | 3% |
| 09:30 | SE | Industrial orders (y/y) | May | | | 3.2% |
| 09:30 | SE | Industrial production (m/m) | May | | | -2.0% |
| 09:30 | SE | Industrial production (y/y) | May | | | 3.6% |
| 09:30 | SE | Private service sector production (m/m) | May | | | |
| 09:30 | SE | Private service sector production (y/y) | May | | | |
| 09:30 | SE | Total business sector production (y/y) | May | | | 3.3% |
| 12:30 | EU | ECB's Mersch, Nowothy at Austrian Central Bank conference | | | | |
| 13:30 | US | Challenger job cuts (y/y) | Jun | | | -4.8% |
| 14:15 | US | Employment, ADP (absolute change m/m) | Jun | | 185k | 178k |
| 14:30 | US | Jobless claims, continuing | Jun | | | |
| 14:30 | US | Jobless claims, initial | Jun | | | |
| 15:45 | US | Markit composite PMI (final) | Jun | | | 56.0 |
| 15:45 | US | Markit services PMI (final) | Jun | | | 56.5 |
| 16:00 | US | ISM, non-manufacturing, composite | Jun | | 58.0 | 58.6 |
| 16:30 | US | EIA Crude Oil stock change | Jun | | | |
| 19:30 | DE | Bundesbank President Jens Weidmann speaks in Linz, Austria | | | | |

**20:00 US Minutes of FOMC rate meeting Jun**



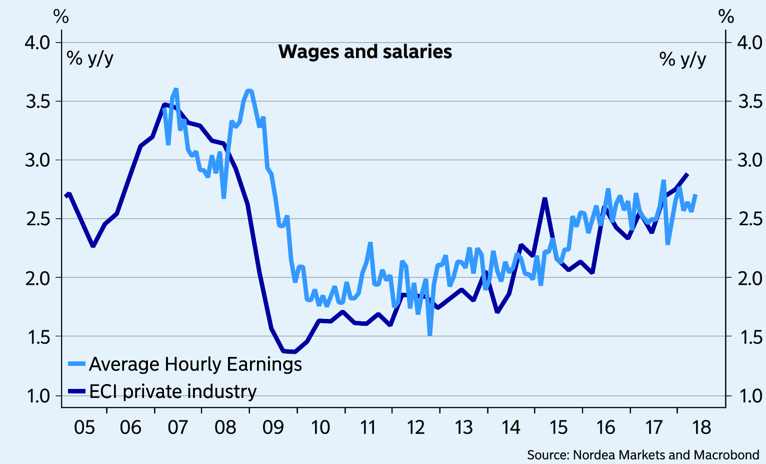

*Source: Nordea Markets, Federal Reserve and Macrobond*

In the June FOMC meeting, the federal funds rate was increased for the second time this year and the dot-plot was revised up to show a total of four hikes this year. The general impression from the statement and the press meeting was a more confident Fed and the tone was fairly upbeat. We will therefore look for signs of whether there is a growing uniformity in favour of four hikes in total for 2018, as was indicated by the June dot plot. But we will also look for signs on whether the Fed is growing slightly more concerned about the signs of liquidity stress that we have seen lately.

# Friday

The US Nonfarm Payrolls is today's main event. Otherwise, Norwegian manufacturing production figures are released along with the UK Halifax house price index.

| Friday, 06/07/2018 | | | | Nordea | Consensus | Previous |
|---|---|---|---|---|---|---|
| 08:00 | DE | Industrial production (m/m) | May | | | -1.0 |
| 08:00 | NO | Manufacturing production (m/m) | May | | | |
| 09:00 | GB | House prices, Halifax (m/m) | Jun | | | 1.5% |
| 09:00 | GB | House prices, Halifax (y/y, 3mma) | Jun | | | 1.9% |
| 09:30 | SE | Central Government Debt | Jun | | | 1231 bn |
| 13:30 | US | Nonfarm payrolls (absolute change m/m) | Jun | | 198k | 223k |
| 14:00 | RU | CPI (y/y) (Exp 6-9 Jul) | Jun | | | 2.4% |
| 14:30 | US | Average weekly hours | Jun | | 34.5 | 34.5 |
| 14:30 | US | Hourly earnings, average (m/m) | Jun | | 0.3% | 0.3% |
| **14:30** | **US** | **Hourly earnings, average (y/y)** | **Jun** | | **2.8%** | **2.7%** |




Job gains in the US have averaged slightly above 200k so far this year and consensus is looking for an increase of 190k in June. This would be consistent with continued strengthening of the labour market and another indication of solid growth in the US economy. Unemployment dropped to 3.8 % in May, the lowest level in close to 20 years, and while consensus expects unchanged unemployment in June, the pace of job growth is more than enough to bring unemployment further down over time. The market will yet again focus on wage numbers, which are expected to have increased 0.3% m/m and 2.8 % y/y (up from 2.7 % in May). Signs of increased wage growth will give support to further rate hikes from the Fed.

| | | | | | | |
|---|---|---|---|---|---|---|
| 14:30 | US | Labour force participation rate | Jun | | | 62.7% |
| 14:30 | US | Trade balance | May | | -46.7bn | -46.2bn |
| 14:30 | US | Unemployment rate | Jun | | 3.8% | 3.8% |

Martin Enlund
Chief Analyst
martin.enlund@nordea.com
+46 8 407 91 22

Jan Størup Nielsen
Chief Analyst
jan.storup.nielsen@nordea.com
+45 5547 1540

Joachim Bernhardsen
Analyst
joachim.bernhardsen@nordea.com
+47 2248 7791

Kjetil Olsen
Chief Economist, Norway
kol@nordea.com
+47 2248 7788

Anders Svendsen
Chief Analyst
anders.svendsen@nordea.com
+45 55471527

Morten Lund
Analyst
morten.lund@nordea.com
+45 3333 1726

Erik Bruce
Chief Analyst
erik.bruce@nordea.com
+47 22487789

Andreas Wallström
Chief Analyst
andreas.wallstrom@nordea.com
+46 8 407 9116

Tatiana Evdokimova
Chief Economist, Russia
Tatiana.evdokimova@nordea.ru
+7 495 777 3477

Janne von Gerich
Chief Analyst
jan.vongerich@nordea.com
+358 953005191

Amy Yuan Zhuang
Chief Analyst
amy.yuan.zhuang@nordea.com
+65 6221 5926

Denis Davydov
Analyst
denis.davydov@nordea.ru
+7 495 777 34 77

Torbjörn Isaksson
Chief Analyst
torbjorn.isaksson@nordea.com
+46 8 407 91 01

Tuuli Koivu
Senior Analyst
tuuli.koivu@nordea.com
+358 50 583 8573