

Weekly Macro & Markets View

Highlights and View

- **Global bond yields slump as US trade conflicts take a turn for the worse**

More constructive developments on global trade and geopolitics are urgently needed to safeguard the global expansion, with downside risk to global growth and bond yields persisting.

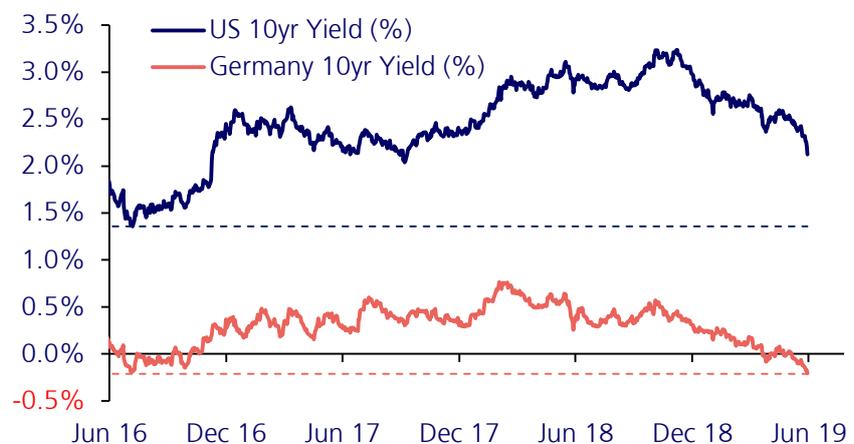
- **President Trump wants to impose tariffs on all imports from Mexico as a means to fight illegal immigration**

Trump's tariff threats weigh on the economic outlook and have the potential to severely impact business confidence and disrupt supply chains.

- **May manufacturing PMIs remain weak in China, Korea and Taiwan**

This suggests that East Asian growth remained tepid in Q2, while PMIs in India and some ASEAN countries improved.

Bond yields slump as trade concerns intensify



Source: Bloomberg

A surprise announcement from the US administration about forthcoming tariffs on Mexican goods triggered a sharp rally in global bond markets, with the 10yr Treasury yield gapping down to 2.12% on Friday in the biggest daily move since the Fed's March meeting, while the 10yr Bund yield fell to a new low of -0.21%. Investors are reassessing the global growth and policy outlook amid escalating trade tensions, and expectations are mounting that the Fed will have to cut rates to bolster the impact on the economy, with two rate cuts now fully priced in for 2019 and an additional cut next year. This justifies the collapse in the 2yr Treasury yield, which slumped to 1.92% last week and prevented the 10/2yr segment of the yield curve from inverting. While the latest trade news worked as a catalyst for the latest leg down in yields, global growth has already slowed and recent data show that hopes for a turnaround are not materialising, with trade related weakness in manufacturing persisting. The global economy is clearly vulnerable, with extended debt levels and an unhealthy dependency on the US and China as growth drivers. The risk is, therefore, that in the absence of a near-term resolution to ongoing trade conflicts a more severe downturn will materialise. Treasury yields, which are still well above their historical lows reached in 2016 post-Brexit, would in that case fall further.

Credit: Investors' search for yield leads to some resilience versus equities

A risk-off mode with struggling equity markets and the threat of a broadening trade war pushed credit spreads wider across all sectors. But cash credit remained somewhat resilient, especially in Europe and relative to equities. Mutual funds continue to experience strong inflows in the investment-grade space as investors are chasing credit spreads to compensate for falling interest rates. The shortened week and a blank Friday session have led to the lowest weekly volume in the primary market this year, with just €4.2 billion in Europe and less than \$6 billion in the US.

Despite this low level of supply, execution is becoming more challenging and new issue concessions have risen back to double-digit levels in the US. Lower yields, a flat to inverted US yield curve, and increased uncertainties are headwinds for banks' earnings while the two biggest US trading houses have warned of a slump in their second-quarter trading revenues. Details of the new TLTRO should emerge this week from the ECB, but we don't expect this to be a game changer for the fragile European bank sector.

US: Trump uses tariff threats to fight illegal immigration

The S&P 500 suffered its worst week this year, falling 2.6%. After the solid first few months of the year May proved to bring back a risk-off environment with a performance of -6.6%. The trigger for last week's selloff was President Trump's announcement that tariffs of up to 25% on all Mexican goods would be imposed if Mexico does not take decisive steps to fight illegal migration to the US. The tariffs would start at 5% as of June 10, rising incrementally to 25% in October. If imposed, the tariffs have the potential to severely impact supply chains and would burden both

US households and businesses. But even if the tariffs are not imposed, Trump's willingness to start new trade disputes and use tariffs as a means to push his policies will have an impact on business sentiment and the willingness to hire and invest both in the US and in the rest of the world. While business sentiment is already showing signs of weakness, US households remain in an upbeat mood with the Conference Board Consumer Confidence Index rising in May.

Eurozone: Bund yields hit record low on trade tensions, data show modest improvement

Eurozone equity and bond markets were again driven by the ongoing trade war, with risk aversion increasing late in the week after the US opened another front, announcing tariffs on Mexico. This also signals a possible hardening in stance in other trade disputes the US has against China and the EU. Bund yields fell to a record low of -0.21% on Friday and Eurozone equities were down 2% on the week. However, overall, the actual data last week was better than expected. Lending growth to households picked up to 3.4% YoY in April from 3.3% YoY in March, and to

3.9% YoY from 3.6% YoY to non-financial companies. Following 11 consecutive months of decline, the European Commission (EC) Economic Sentiment Indicator also unexpectedly rose in May to 105.1, from 103.9 in April. However, tensions between Italy and the EC are increasing after the EC sent a letter to the Italian government pointing out that Italy is likely to miss its fiscal targets for this year and asking for an explanation.

Switzerland: Solid first quarter growth is boosted by investment

GDP surprised on the upside in Q1, expanding 0.6% on the quarter, with all components of GDP contributing positively. Consumption picked up along with a firm rebound in investment, in line with surveys that highlight that a lack of spare capacity is putting pressure on firms to invest. Exports were solid, despite a more challenging economic environment. Inventories stabilized after a sharp drawdown in the end of 2018, indicating that firms have adjusted to a weaker demand environment, at least for now. While this is encouraging, forward

looking surveys have weakened notably, and we maintain our below consensus view on growth for this and next year. Elsewhere, Switzerland was removed from the US Treasury monitoring list of potential currency manipulators. This is positive, but is unlikely to impact the policy of the SNB, with forex interventions set to continue, whenever deemed necessary.

Asia: Despite some bright spots, economic conditions remain tough

Asian manufacturing PMIs for May paint a mixed picture. Some of the ASEAN countries like Indonesia, the Philippines and Myanmar improved and remain clearly above the 50 threshold, but the PMIs for major exporters such as Korea and Taiwan do not suggest a recovery. Korea's PMI fell a steep 1.8 points to 48.4, while Taiwan's PMI, also at 48.4, marked the seventh month below the 'boom/bust' level of 50, with the new export order index falling in both countries. In Korea, exports were down 9.4% YoY in May, worse than consensus had expected. Semiconductor

exports were down 30.5%, while mobile phone exports tumbled 41.3%, though it has to be added that they are highly volatile. Korea's exports to China were down a remarkable 20.1%. Weakness in Chinese demand is also visible in the 0.7 point drop in China's official NBS manufacturing PMI to a worse than expected level of 49.4, which suggests weak conditions for SoEs, while the Caixin PMI remained steady at 50.2, likely reflecting better conditions for private small- and medium-sized companies that benefit from better lending conditions.

What to Watch

- The ECB is expected to provide further details on its planned TLTRO 3 at its monetary policy meeting this Thursday, while the EC releases updated fiscal projections for Italy on Wednesday. Various economic releases will give more information as to the health of the Eurozone economy.
- In the US, the ISM Manufacturing and Non-Manufacturing Indices will reveal whether the trade dispute with China and the global growth slowdown are having a major impact on US business activity while labour market data are expected to remain strong.
- Following the weak GDP growth print for Q1, we think there is room for India's RBI to cut policy rates for a third time this year by another 25bps. We attach an even higher probability to a rate cut by Australia's RBA following today's weak inflation and house price data and as the federal election is out of the way. In Japan, wage data for April will be released, but we do currently not read too much into these distorted statistics. May CPI data will be released in South Korea, Taiwan, Thailand and the Philippines.

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