

China retaliates, intensifying the risk-off market mood

■ **Cautious tone prevailed in financial markets** during most of the morning, after the US and China failed to salvage a last-minute deal to avoid the latest US tariff hikes, in turn leading to the escalation of the trade war.

■ **However, markets risk-off mood intensified after China's decision to retaliate against the US**, as it raised tariffs on 2493 US goods (\$60bn) to 25% from June 1 ([see](#))

■ In Italy, concerns are mounting as the media is reporting an increase in political strains, amid worries that the increase in government deficit may prompt frictions with its European partners.

■ **Sovereign bond yields decreased in the US and in China** (-4.3 bps and -3.5 bps respectively) on the back of increasing the risk-off mood. Moreover, as trade tensions escalated further, market implied probability of a Fed interest rate cut in 2019 once again rose to close to 68%. **Elsewhere, German bond yields were fueled, while Italy's risk premium widened sharply again**, reaching its highest level in more than two months, steered by the political strains. High Yield spreads also widened as investors shifted preference, favoring investment grade bonds against High Yield bonds due to the increase in risk aversion.

■ **Risk-off mood also led FX markets. Investors sought shelter in safe-haven currencies, especially JPY and CHF, while the Euro and the GBP also appreciated**, and as cyclical currencies (those exposed to raw materials) depreciated. The CNY has continued depreciating, increasing trade-friction-fueled market expectations that China may allow the yuan to slide back to offset the impact on higher tariffs. Moreover, the EM FX continued depreciating across the board, with idiosyncratic factors continuing to sharply depreciate the TRY. Brent prices inched up due to supply concerns in Saudi Arabia, hovering around \$71 per barrel ([see](#)).

■ **Equity markets bore the brunt of investors' angst**, not only because trade war cast a shadow on global growth, but also because investors' jitters ahead of Saturday's deadline for the US government decision on car tariffs. Equity markets declined across the board, with market volatility returning to last week's levels, and with cyclical sectors leading the declines, especially the automobile sector in Europe and the technology sector in the US.

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Debt markets (10Y, %, changes in bp)					
Developed Markets	level	Daily	Week	Month	YTD
US (2-yr)	2.18	-8.6	-11.0	-17	-31
US	2.39	-7.5	-7.6	-10	-29
GER (2-yr)	-0.63	-1.2	-3.3	-5	-2
Germany	-0.07	-2.5	-7.6	-6	-31
France	0.33	-1.6	-2.6	0	-38
Spain	0.99	1.3	0.7	-1	-53
Italy	2.70	1.7	12.1	18	-19
Portugal	1.16	3.9	3.2	2	-71
Greece	3.56	5.4	21.8	21	-84
Japan (2-yr)	-0.16	0.1	-0.7	1	-2
Japan	-0.05	0.1	-0.8	1	-5
Emerging Markets	level	Daily	Weekly	Monthly	YTD
Brazil	8.81	4.0	-6.6	-9	-42
Chile	3.86	-2.0	-7.1	1	-39
Colombia	6.67	0.2	-16.6	10	-8
Mexico	8.12	1.4	0.5	20	-52
Peru	4.82	0.7	3.1	0	-54
Poland	2.85	-5.5	-17.3	-6	2
Russia	8.28	-0.7	1.0	4	-51
Turkey	19.67	-48.0	77.0	299	387
India	7.39	-2.2	-0.3	2	2
Indonesia	8.04	4.6	8.9	36	2
Country risk (bp, changes in bp)					
Developed Markets	level	Daily	Weekly	Monthly	YTD
10-yr sovereign spread vs Germany					
France	40	0.9	5.0	6	-1
Italy	277	4.2	19.7	25	12
Portugal	123	6.4	10.8	9	-33
Spain	106	3.8	8.3	5	-16
2-yr sovereign spread vs Germany					
France	6	0.3	0.9	0	-9
Italy	125	3.7	19.5	48	16
Portugal	30	2.1	3.7	8	4
Spain	29	1.5	3.2	6	-8
Emerging Markets	level	Daily	Weekly	Monthly	YTD
5-yr sovereign CDS *					
Brazil	171	-1.6	2	4	-36
Chile	44	0.6	5	4	-19
Colombia	107	-0.3	8	5	-52
Argentina	1162	7.8	-13	250	356
Mexico	119	0.0	8	4	-36
Peru	65	0.7	7	8	-30
Poland	66	0.0	0	-2	-2
Russia	128	-2.8	0	-4	-26
Turkey	485	-7.2	48	74	126
China	47	-1.7	5	3	-21
India	79	-2.6	0	-5	-34
Indonesia	102	-4.0	6	4	-35
Risk indicators					
Volatility indicators	level	Daily	Weekly	Monthly	YTD
VIX	21	4.8	5	8	-5
VSTOXX	19	0.9	4	7	-4
EM EFT volatility Index	28	6.5	9	11	3
Dollar/euro volatility	5	0.2	0	1	-2
EM FX volatility index	9	-0.5	0	1	-1
Credit spread (BAA) (change in bps)	228	7.5	10	6	-18
US bonds volatility index	53	-1.2	6	7	-13
Inflation expectations	level	Daily	Weekly	Monthly	YTD
US Inflation expectations (5Y5Y)	2.20	-	-5	-9	7
EZ Inflation expectations (5Y5Y)	1.35	-	-5	0	-26
Banking 5y CDS	level	Daily	Weekly	Monthly	YTD
US	59	-0.2	4	1	-23
EZ	85	-1.5	7	6	-34
UK	62	-0.9	5	2	-33
Large Spanish	57	-1.7	4	-3	-31
Medium Spanish	83	-0.9	-10	-20	-29
Corporate 5y CDS	level	Daily	Weekly	Monthly	YTD
US Non-financial	168	-0.2	4	1	-23
EZ Non-financial	84	-1.5	7	6	-34
UK Non-financial	107	-0.7	3	2	-12
Interbank markets (% changes in bp)					
	level	Daily	Weekly	Monthly	YTD
EONIA Index	-0.37	0	0	0	-1
Euribor 3m	-0.31	0	0	0	0
Euribor 12m	-0.12	0	0	-1	0
Libor 3m	2.53	-1	-3	-8	-27
Libor 12m	2.69	-1	-5	-5	-32
Stock markets (%)					
Main indices	level	Daily	Weekly	Monthly	YTD
S&P500	2,810	-2.5	-4.2	-2.7	12
Dow Jones	25,324	-2.4	-4.2	-3.1	9
Nikkei	21,191	-0.7	-4.8	-2.4	6
FTSE 100	7,164	-0.5	-2.9	-3.4	6
EuroStoxx 50	3,321	-1.2	-4.1	-3.3	11
IBEX	9,047	-0.8	-3.0	-4.2	6
DAX	11,877	-1.5	-3.3	-0.5	12
CAC	5,263	-1.2	-4.0	-4.1	11
MIB	20,594	-1.3	-3.8	-5.0	12
ASE Athens	725	-1.5	-3.9	-5.2	18
MSCI Latam *	90,109	-0.2	-2.1	-3.5	4
Ibovespa (Brazil)	91,881	-2.5	-3.3	-3.0	5
Mexbol (Mexico)	42,744	-1.5	-3.1	-4.1	3
Merval (Argentina)	32,680	-2.1	-0.9	3.7	8
MSCI EM Europe *	5,495	-0.5	-3.7	-5.2	4
Poland	2,173	-0.9	-5.1	-8.5	-5
Micex 10 (Russia)	4,475	-0.7	-2.6	-2.1	7
Ise 100 (Turkey)	86,283	-2.5	-7.2	-10.2	-5
MSCI EM Asia *	854	0.4	-4.7	-4.9	9
Shanghai Com (China)	2,904	-1.2	-0.1	-9.0	16
Jakarta (Indonesia)	6,135	-1.0	-2.9	-5.3	-1
Banking sector	level	Daily	Weekly	Monthly	YTD
US banks	133.7	-3.7	-6.3	-0.8	16
JPM	109.5	-2.7	-4.9	3.1	12
Citi	64.9	-4.5	-7.9	-1.6	25
BoA	28.3	-4.3	-7.1	-2.6	15
MS	44.6	-3.7	-6.5	-0.4	13
GS	194.8	-3.6	-5.6	-4.0	17
EZ banks	74.5	-2.1	-7.6	-5.4	8
BNP	44.8	-1.6	-6.5	-0.1	13
Crédit Agricole	11.3	-2.6	-8.1	-2.8	19
Deutsche Bank	6.8	-2.0	-5.5	-8.7	-2
ING	10.2	-2.0	-7.3	-10.6	9
Intesa	2.1	-1.9	-7.5	-5.2	9
SG	25.5	-2.2	-9.5	-5.3	-8
Unicredit	10.9	-2.8	-7.9	-8.5	10
UK banks	76.7	-1.5	-4.7	-5.4	5
HSBC	650.0	-0.3	-4.5	-0.2	0
RBS	226.3	-2.8	-4.8	-12.3	4
Barclays	155.1	-1.5	-5.2	-5.2	3
Lloyds	59.8	-2.1	-4.5	-6.8	15
Large Spanish banks	61.3	-1.6	-6.0	-8.2	5
Santander	4.1	-1.4	-6.5	-9.2	2
BBVA	5.0	-1.9	-5.6	-7.2	7
Medium Spanish banks	53.8	-0.9	-2.8	-1.6	-6
Caixabank	2.7	-0.5	-3.9	-3.8	-14
Sabadell	1.0	-1.2	0.7	6.6	3
Bankinter	6.7	-0.9	-3.3	-5.0	-4
Bankia	2.3	-1.5	-4.3	0.6	-10
Currencies (% red for currency depreciation)					
Developed	level	Daily	Weekly	Monthly	YTD
EURUSD	1.123	0.0	0.3	-0.2	-2
GBPUSD	1.30	-0.3	-1.1	-0.8	0
USDJPY	109.16	0.7	1.5	2.3	2
DXY	97.29	0.0	-0.2	0.1	1
Emerging	level	Daily	Weekly	Monthly	YTD
USDARS (Argentina)	45.36	-1.2	-1.5	-5.8	-17
USDBRL (Brazil)	3.98	-0.7	-0.4	-3.1	-3
USDCLP (Chile)	694.58	-1.2	-2.3	-4.2	0
USDCOP (Colombia)	3301	-0.8	-1.4	-5.8	-1
USDMXN (Mexico)	19.21	-0.5	-1.1	-1.9	2
USDPEN (Peru)	3.33	-0.5	-0.7	-1.0	1
LACI	53.21	-0.8	-1.3	-3.1	-2
USDPLN (Poland)	3.84	-0.3	-0.3	-0.8	-3
USDRUB (Russia)	65.47	-0.4	-0.3	-1.3	6
USDTRY (Turkey)	6.09	-1.7	-0.1	-5.8	13
USDCNY (China)	6.88	-0.8	-1.6	-2.3	0
USDINR (India)	70.52	-0.9	-1.6	-2.3	-1
USDIDR (Indonesia)	14423	-0.7	-0.9	-2.0	0
ADXY	104.31	-0.7	-1.1	-1.8	-1
Commodities (%)					
	level	Daily	Weekly	Monthly	YTD
Brent	70.4	-0.3	-1.2	-1	31
WTx	61	-0.6	-1.5	-4	35
Copper	272	-2.3	-4.1	-6	4
Gold	1299	1.0	1.4	0	1
S&P Spot commodity *	434	0.1	-1.2	-3	16
S&P Brent Spot *	594	0.0	-2.0	-1	30
S&P Metals Spot *	323	0.5	-1.5	-5	1
S&P Agricultural *	257	-0.9	-3.1	-8	-10

Source: Bloomberg, Datastream and Haver

* With one day delay