WEEKLY UPDATE

Trade war – blowing hot and cold

Escalating trade war tensions between Washington and Beijing was one of the major concerns for the sharp correction in risk assets triggered in late 2018. Investors began to fear that the economic benefits of globalisation might be in peril, and that the world's two largest economies might be headed for extended confrontation. At first, the truce declared by Presidents Trump and Xi at the early December G20 summit was met with scepticism by markets and the slump continued. It was only in early January when negotiations got underway that hopes of a resolution to the conflict began to rise. Are they justified?

There are some encouraging signs. First, President Xi dispatched his key economic advisor, Vice Premier Liu He, to attend the first round of talks in Beijing, suggesting that he wanted progress. Since then, President Trump has made some encouraging statements, most recently that he could let the March 1 deadline for increased tariffs « slide for a little while ».

As we have underlined in recent reports, the rivalry between the US and China is unlikely to disappear any time soon. China has already overtaken the US as the largest economy on International Monetary Fund data and continues to grow twice as fast. In time, China seems certain to challenge US hegemony. So why might a deal be possible?

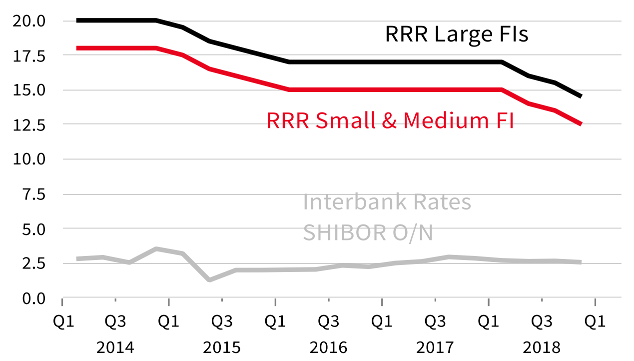
From China's perspective, escalating trade tensions come at the worst possible time. China's stimulus in the wake of the 2008/2009 financial crisis was driven by a vast expansion in debt, in particular by state-owned enterprises. As a result, China has made deleveraging a priority since 2016 – accepting slower growth in the short term to lower economic risk in the long run.

China has now embarked on a new round of stimulus – this time focused on the private sector. Reserve ratio requirements have been cut in several stages, corporate taxes have been reduced (as has income tax), infrastructure spending has been boosted and VAT and social security taxes may be cut in coming months. But these measures will only bear fruit if tariff escalation is halted.

President Trump has made no secret of his sensitivity to stock prices, viewed as a barometer of his success. With the November 2020 presidential elections looming, the market weakness in late 2018 suggested that switches in policy might be necessary. The search for a resolution to the trade war tensions is likely to be one such measure.

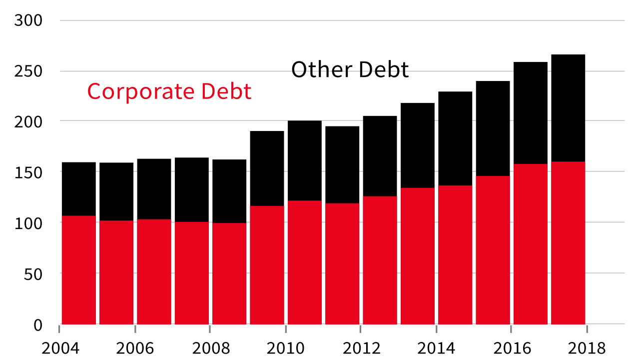
Bottom line. Given the long-term rivalry, it is unlikely that all the tariffs in place will be cancelled. But a ceasefire in the trade war by mid-2019 would be welcomed on both sides of the Pacific.

China adjusts targeted RRR policies to support small firms
China Policy Rates (%)



Sources: SGPB, Macrobond, SHIBOR, PBoC, CGSDTC, CCDC

China almost doubles its debt relative to GDP since 2000
China Total Debt (% GDP)



Sources: SGPB, Macrobond, Bloomberg, data as of end 2017

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All data taken from Bloomberg, Macrobond (15/02/2019).
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THIS WEEK AND NEXT

EUROZONE

- According to Eurostat data, Industrial production fell -0.9% MoM in December from -1.7% in the prior month, or 0,5% below market expectations – suggesting weak Q4 GDP growth.
- Economic growth slowed overall year-on-year, while Germany's GDP growth remained unchanged QoQ, printing at the previous quarter's level of 0.0%.
- As expected, preliminary figures indicate a stable eurozone GDP growth of 1.2% in Q4 and an expected improvement in employment.

Next week's key events		*Per.*	*Prev.*	*Cons.*
20 Feb	Consumer confidence	Feb (P)	-7.9	--
21 Feb	Composite PMI	Feb (P)	51.0	51.1
22 Feb	Inflation rate YoY	Jan (F)	1.6%	1.4%

UNITED KINGDOM

- Manufacturing output decreased significantly to below minimum expectations at -2.1% in December against -1.2% a month earlier. The monthly decrease in manufacturing was due to declines in 9 of the 13 sub-sectors.
- For the fifth consecutive month, headline inflation decelerated from 2.1% YoY to 1.8% in January, as expected.
- Regarding headline inflation, GDP growth deteriorated from 1.5% YoY to 1.3% in Q4 2018.

Next week's key events		*Per.*	*Prev.*	*Cons.*
19 Feb	Unemployment rate	Dec	4.0%	4.0%
19 Feb	Average weekly earnings	Dec	3.4%	--

UNITED STATES

- American headline inflation came in close to market consensus, slipping from 1.9% to 1.6% in January – the sharpest drop since June 2017.
- Initial jobless claims rose to 239k in early February, versus an expected 225k.
- US Retail sales posted their sharpest drop in over nine years in December, printing at -1.2% MoM, 1.4% below market expectations – suggesting a swift slowdown in economic activity at end-2019.

Next week's key events		*Per.*	*Prev.*	*Cons.*
20 Feb	FOMC Meeting Minutes			
21 Feb	Manufacturing PMI	Feb (P)	54.9	55.0
21 Feb	Durable goods orders	Dec (P)	0.7%	1.7%

ASIA & EMERGING COUNTRIES

- In line with market expectations, Japan's economy bounced back QoQ from -0.6% to 0.3% in Q4 after business and consumer spending recovered from last year's quake and flood damages.
- In China, trade surplus narrowed less than expected, from 57.06bn to 39.16bn. Dollar-denominated exports edged up to 9.1% YoY, while imports dropped by 1.5%. Weakening domestic demand and the ongoing trade war with the US continue to take their toll.
- Unexpectedly, Brazil posted a slump in retail sales, printing at -2.2% in December against 2.9% a month earlier.

Next week's key events		*Per.*	*Prev.*	*Cons.*
19 Feb	Russia: unemployment rate	Jan	4.8%	4.9%
21 Feb	Japan: Manufacturing PMI	Feb (P)	50.3	--
21 Feb	Indonesia: 7D Reverse Repo rate	Feb	6.00%	6.00%

Sources: DataStream, Bloomberg, 14 February 2019
Note: YoY = year-on-year; QoQ = quarter-on-quarter; MoM = month-on-month, P = preliminary figure, A = advanced figure, F = final figure, seasonally adjusted, ECB = European Central Bank

Our 3-month targets for currencies and commodities

	Thursday close	3mth target
EUR/USD	1.13	1.13
GBP/USD	1.28	1.30
EUR/CHF	1.14	1.13
USD/JPY	110	112
Brent	$64.2	$65
Gold (once)	$1311	$1250

No changes made to our 3-month targets this week.

Forecast figures are not a reliable indicator of future performance.

MARKET PERFORMANCE

Past performance should not be seen as a guarantee of future returns.

Interest rates	Last	1wk		3mth	YTD	12mth
EONIA (EUR)	-37 bp	-1 bp	→	-1 bp	-1 bp	-1 bp
3mth Euribor (EUR)	-31 bp	0 bp	→	1 bp	0 bp	2 bp
3mth Libor (USD)	269 bp	0 bp	→	6 bp	-11 bp	84 bp
3mth Libor (GBP)	87 bp	-3 bp	↓	-2 bp	-5 bp	32 bp
10-year US Treasury bond	266 bp	1 bp	→	-46 bp	-3 bp	-25 bp
10-year German bond	10 bp	-1 bp	↓	-30 bp	-14 bp	-65 bp
10-year French bond	53 bp	-2 bp	↓	-26 bp	-18 bp	-46 bp
10-year UK bond	115 bp	-3 bp	↓	-36 bp	-12 bp	-49 bp

Credit	1wk		3mth	YTD	12mth
BAML EURO Corp. IG	0,1%	→	1,4 %	1,7 %	1,2 %
BAML EURO Corp HY	0,1%	↑	0,7 %	2,7 %	-0,2 %
BAML GBP Corp IG	0,3%	↑	3,0 %	2,8 %	3,2 %
BAML US IG	0,0%	→	3,7 %	2,5 %	3,0 %
BAML US HY	0,4%	↑	2,6 %	5,3 %	4,2 %
BAML Global EM Sov. External Plus	-0,1%	↓	5,1 %	4,0 %	0,9 %

Exchange rates	Last	1wk		3mth	YTD	12mth
EUR/USD	1,13	-0,3 %	↓	-0,1 %	-1,5 %	-9,2%
EUR/CHF	1,14	-0,2 %	↓	-0,2 %	0,8 %	-1,9%
GBP/USD	1,28	-1,1 %	↓	-1,4 %	0,4 %	-8,5%
USD/JPY	110	0,6 %	↑	-2,8 %	0,8 %	3,2%
USD/BRL	3,72	0,2 %	↑	-1,6 %	-4,1 %	15,7%
USD/CNY	6,77	0,4 %	↑	-2,6 %	-1,5 %	6,7%
USD/RUB	66,7	1,1 %	↑	-0,6 %	-4,4 %	17,5%

Government bonds*	1wk		3mth	YTD	12mth
United States (3-7yr)	0,0 %	→	2,8 %	0,4 %	3,6 %
United Kingdom (3-7yr)	0,1 %	↑	1,4 %	0,6 %	2,9 %
Germany (3-7yr)	0,0 %	→	0,8 %	0,3 %	2,2 %
Japan (3-7yr)	0,1 %	→	0,3 %	0,1 %	0,3 %

Equities*	Last	1wk		3mth	YTD	12mth
MSCI AC World	495	0,9 %	↑	2,8 %	8,8 %	-1,5 %
Eurostoxx 50	3 183	1,0 %	↑	-0,2 %	6,4 %	-2,1 %
DAX	11 090	0,6 %	↑	-2,8 %	5,0 %	-10,1 %
CAC 40	5 063	1,5 %	↑	0,2 %	7,1 %	1,3 %
S&P 500	2 746	1,6 %	↑	2,2 %	9,8 %	3,8 %
FTSE 100	7 197	1,7 %	↑	3,2 %	7,3 %	4,3 %
SMI	9 143	1,2 %	↑	2,4 %	8,5 %	6,3 %
Topix	1 590	1,3 %	↑	-2,9 %	6,4 %	-4,6 %
IBOV Brazil	98 015	3,8 %	↑	14,0 %	11,5 %	17,3 %
MICEX Russia *	2 461	-2,0 %	↓	3,5 %	4,3 %	9,0 %
MSCI EM	1 039	-0,2 %	↓	7,8 %	7,7 %	-9,8 %
SENSEX 30 India	35 876	-2,9 %	↓	2,2 %	-0,5 %	6,4 %
Hang Seng (H-K)	28 432	1,6 %	↑	10,9 %	10,0 %	-3,5 %
Shanghaï Composite	2 720	3,9 %	↑	3,3 %	9,1 %	-15,0 %

Commodities	Last	1wk		3mth	YTD	12mth
Brent	$64,2	4,5 %	↑	-3,6 %	20,8 %	1,5 %
Gold	$1 311	0,0 %	→	9,1 %	2,3 %	-2,8 %
Copper	$6 137	-1,5 %	↓	0,5 %	3,2 %	-13,8 %

Source: DataStream, on 14 February 2019.
1wk = 1-week change, 3mth = 3-month change, 12mth = 12-month change, YTD = year-to-date change, YoY = year-on-year change, BAML = Bank of America Merrill Lynch, JPM = JP Morgan, IG = Investment Grade, EM = emerging markets. * Price return for MICEX equity index. Equities; total return in local currency. Government bonds = 3-7-year returns. Figures are rounded.

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