Global Economy

Eyes wide open in the financial markets

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The resumption of the trade tensions between the US and China has taken the financial markets by surprise, causing considerable corrections in the equities markets.

It is true that the markets had become quite complacent given the prospect of an imminent trade agreement and the measures implemented by China to boost growth, along with the support of the central banks. Moreover, the low inflationary pressure in an economy at levels of full employment, like that of the US, persuaded investors that the US Federal Reserve (Fed) would allow inflation to temporarily exceed the 2% target, which spurred expectations of an interest-rate cut by the Fed this year.

All this portrayed such a favourable scenario that market risk measures were relaxed, driving investors to take on more risk. Thus, the stock markets exceeded or came close to their peak levels, and the taking of positions in emerging markets was resumed.

But the decision by the United States to increase the trade tariffs for China once again has brought the trade truce to a halt and fired up China's tit-for-tat policy. Added to this is the risk of thwarting growth prospects, at a time in which there are still no definite signs that the economic stimuli are supporting recovery. This has led to a moderation of risk by investors and the downward adjustment of the stock markets, which nonetheless continue to accumulate important gains, and capital has sought refuge in sovereign debt.

Once again, investors trust that monetary authorities will be driving growth, to the extent that the implied likelihood in the market that the Fed will lower interest rates in 2019 is now above 70%. However, the capacity of the central banks to relaunch the economy is hampered by the high levels of business debt in some countries; whereas the room for manoeuvre of some governments, such as that of the US, is affected by a less favourable political climate.

Although trade tension is expected to lessen, the high volatility scenario is likely to remain for some time. Particularly at a time when geopolitical uncertainty is being rekindled, the friction between Italy and the European Union may surface once again and the risk of a no-deal brexit is still on the horizon. All these fears are reflected in the low debt yields which, in the case of Germany, has meant negative yields once again for the ten year bund.

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