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MARKET FLASH: LIBERATION DAY: THE US OVERTURNS FREE TRADE RULES

- **D. Trump's "Liberation Day" announcements have heightened uncertainty for the markets and the Fed, with a series of tariffs on all imports except Canada (which is already hit by 25% tariffs) and Mexico.**
- **Initial estimates forecast a contraction in the US GDP by -1.5% and an inflation increase of +1.5%.**
- **In Europe, the euro's appreciation against the dollar and the expectation of competitive prices for Chinese products lacking outlets on the US market could mitigate the impact of these measures**

Donald Trump's Liberation Day announcements were worse than expected and left markets still uncertain about what is next in the Trump programme. His new tariffs salvo only raises challenges for markets and the Fed.

All US imports will be taxed at a basic rate of 10%, with the exception of Canada (already hit by 25% tariffs) and Mexico. Countries which are considered as being aggressive on trade with the US will have additional levies imposed on a case-by-case basis. The Republican party says the 10% tariff will go on funding an aggressive tax cut programme so it appears to be non-negotiable. The increases on 60 countries will be based on the trade deficit with the US and not the amount of duties collected, VAT, non-tariff barriers or monetary devaluations as Donald Trump had previously claimed. The main victims of this calculation method are countries with export economies. China, for example, will be hit by an additional 34%, taking overall import duties to 54%, or close to the president's 60% campaign promise. Asian countries are also in the firing line. Vietnam will have a reciprocal tariff of 46%, a measure which is probably designed to stop Chinese exports passing through other countries. EU exports to the US will be taxed at 20%, or much more than expected.

As a result, average weighted US customs duties will jump from 2.3% to 23% based on the latest announcements, a level which takes us back to the beginning of the 20th century. The actual impact of these measures is difficult to assess, especially as we can expect to see some negotiations and also retaliatory steps. As an initial estimation, 1.5% could be shaved off GDP growth while inflation could rise by 1.5%. The US president's team risks undermining the country's exceptional resilience in recent years and at a time when the economy is already showing some signs of weakness. Services ISM, for example, fell from February's 53.5 to 50.8, with a sharp drop in the jobs and new orders indices.

The effects on the EU could be assuaged by the euro's gains against the dollar and the possibility of competitive prices on Chinese goods that previously went to the US. The EU is still planning a sector support package although for the moment only the 25% tariff on the autos sector has been detailed. European Commission president Ursula on der Leyen said a first wave of retaliatory measures to counter tariffs on steel and aluminium would be announced on April 9 with up to €26bn worth of US goods affected. Spain unveiled a €14bn support package.

We are maintaining our strategically bearish view on the dollar. Even if the Mar-a-Lago project is still lacking detail, we cannot overlook its potential. We are also still structurally cautious on equities, especially in developed countries, even if over the short term, the sell-off could pause due to rate cuts. And we are staying neutral on credit markets: the fight against inflation has recently failed to make progress, inflation and inflationary expectations risk rising because of US policies and central banks are faced with a particularly difficult task.

EUROPEAN EQUITIES

The US tariff announcements on Wednesday evening dominated trading this week. Washington's particularly hardline approach resulted in higher-than-expected increases on US import duties. Global equity markets slumped as investors worried about total economic war and recession. We are now waiting to see how the rest of the world reacts. Europe, however, held up better than Wall Street. Government bond yields fell and interest rate sensitive sectors like utilities and telecoms, which are seen as relative havens from protectionism, once again performed best. But cyclicals plunged, including banks amid worries over economic growth. Export stocks were also hit by the falling dollar. And watch-making groups like **Richemont** and **Swatch** were badly hit as Washington has slapped 31% import tariffs on Switzerland. For the moment, some companies like **Siemens** say customer decisions are paralysed. And **Continental** said its auto division was feeling the effects of high uncertainty.

US EQUITIES

Wednesday's announcement of customs tariffs reinforced uncertainty on US markets. Wall Street cratered, leaving the S&P 500 5.1% lower. The Nasdaq plunged 7% and the Russell 2000 7.4%.

April 2 was the worst day for US equity markets since the 2020 crisis. The new tariffs battered the dollar which fell 2.9% against the euro over the week, the greenback 's biggest fall since 2015.

The tech sector plummeted 7.7 % with big falls for **Apple** (-9.2%) due to its dependence on Chinese factories, as well as **Meta** (-11.8%), **Alphabet** (-7.1%) and **Amazon** (-11.4%). Semiconductors were also hit. **Nvidia** fell 8.6% even though it is not directly concerned by tariffs affecting Taiwan; an order worth several billion dollars from Chinese companies helped send the stock lower.

In consumer discretionary, the consumer is still worried. Sportswear stocks sold off with **Nike** down 15.5% and Lululemon off a massive 25.4%. **Tesla** (-2.1%) had a choppy week due to a disappointing order book for the first quarter and rumours that Elon Musk was to leave Trump's team.

At least, the consumer staples sector (+2%) played its defensive role. In mass retailing, **Walmart** gained +1.9% and **Costco** rose 3%.

The 9.5% plunge in bank stocks reflected negative investor sentiment. Leading US institutions like **JP Morgan** and **Bank of America** lost 7.8% and 12.5% because of worries over retaliatory measures in countries hit by the new tariffs.

And oil prices fell sharply after OPEC decided to increase daily output by 400,000 barrels. The cartel thinks demand is strong. The decision triggered a 6.3% plunge in oil stocks.

Amid so much economic and political uncertainty, safe haven utilities ended the period 2% higher but healthcare fell 1.3%.

EMERGING MARKETS

The MSCI EM index was down 1.55% in USD as of Thursday's close, largely outperforming developed markets. Mexico and Brazil were up by 4.52% and 1.73% on less severe tariff hits. India, Taiwan, Korea and China were down by 0.44%, 1.52%, 1.82% and 2.44% respectively.

In **China**, March official PMI inched slightly upwards with manufacturing PMI at 50.5, up from a previous reading of 50.2. Non-manufacturing PMI was 50.8 vs. 50.4, taking composite PMI to 51.4. Property sales from top 100 developers were down 11.4% YoY in March due to a seasonality effect. Trump announced worse than expected 34% reciprocal tariffs, the highest among all countries. President Xi will meet European leaders in Vietnam in the coming weeks. China has taken steps to restrict local companies from investing in the US. The government announced a pledge to optimise a drug procurement purchase programme and provide more supportive measures for innovative medicine. State banks received a $69bn liquidity injection (at a premium of 8.8% to 21.5%) to beef up capital buffers. EV maker **Seres** announced its listing plan in Hong Kong to finance capacity expansion. **Amazo**n submitted a bid for **TikTok** with the US sale deadline approaching. **Moutai**'s sales and earnings rose 16% and 15% in 2024, or in line; management expects 2025 sales to rise 9% YoY.

In **Taiwan**, **Intel** and **TSMC** recently reached a preliminary agreement to form a joint venture to operate Intel's chip making facilities, with **TSMC** taking a 20% stake in the new company. **TSMC** is entering the second phase of expansion of its new Kaohsiung plant where N2 chips will be made.

In **Korea**, March exports rose 3.1% YoY; or less than the 5% expected, while imports grew 2.3% or in line with expectations. A court removed President Yoon Suk Yeol from office over his martial law declaration. The regulator announced the lifting of the short selling ban.

In **India**, exports to the US will see a blanket tariff of 26%. Manufacturing PMI increased to an eight-month high of 58.1 in March from 57.6 in February, driven by an increase in domestic sales growth. Services PMI also increased to 58.5 vs. the previous reading of 57.7, taking composite PMI to 59.5. The output of eight key infrastructure sectors slowed to a five-month low of 2.9% in February. March GST collections for March grew by 9.9% YoY. The government confirmed Electronics components PLI with an outlay of INR 229. **Dmart** is to exceed market expectations in terms of store openings in FY 25. **HDFC Bank** deposits grew 6% QoQ and advances grew 4% QoQ, the best in 4Q and 5Q respectively. **BAF** new loans grew 36% YoY and AUM grew 26% YoY, or in line with guidance.

In **Mexico**, the unemployment rate for February was 2.51% vs. 2.70%. Gross fixed investments in January contracted 6.7% YoY vs. expectations of -5.7%. The government plans to narrow the fiscal deficit next year to 3.2% of GDP. As for the US reciprocal tariffs, there was no incremental change from the already announced 25% tariff for non-US content of Mexican made cars imported in the US. The rest of USMCA compliant will continue to pay no tariffs when entering the US.

In **Brazil**, inflation for March was 8.58%, or lower than the 8.77% expected. Brazilian meatpacker **JBS SA** announced a $100m investment to build two new plants in Vietnam. Concerning US tariffs, Brazil has a relative advantage versus other countries with only a 10% tariff.

CORPORATE DEBT

CREDIT

Credit markets moved into risk-off position as Donald Trump's tariffs increased the likelihood of a US recession. (1) The crossover and the main widened by 70bp and 16bp to 392 and 78, (2) European bond yields eased, with Germany's 5 and 10-year bond yields falling by 24bp and 21bp to 2% and 2.5%, (3) Investment grade gained 0.18% while high yield lost 1%.

Year to date, IG has gained 0.48% and HY is down 0.86%. IG is currently yielding 3.4% and HY 6%.

Autos and consumer discretionary underperformed while financials, property and domestic sectors more generally outperformed.

GLOSSARY

• Investment Grade: bonds rated as high quality by rating agencies.

• High Yield: corporate bonds with a higher default risk than investment grade bonds but which pay out higher coupons.

• Senior debt benefits from specific guarantees. Its repayment takes priority over other debts, known as subordinated debt.

• Debt is considered to be subordinated when its redemption depends on the earlier payment of other creditors. To offset the higher risk, subordinated Senior debt has priority over other debt instruments.

• Tier 2 / Tier 3 : subordinated debt segment.

• Duration: the average life of a bond discounted for all interest and capital flows.

• The spread is the difference between the actuarial rate of return on a bond and the rate of return on a risk-free loan with the same maturity.

• The so-called "Value" stocks are considered to be undervalued.

• EBITDA: Earnings before Interest, Taxes, Depreciation, and Amortization.

• Quantitative easing describes unorthodox monetary policy from a central bank in exceptional economic conditions.

• Stress Test: a process which simulates extreme but possible economic and financial conditions so as to assess any impact on banks and measure their resilience to these events.

• The PMI, for "Purchasing Manager's Index", is an indicator of the economic state of a sector.

• AT1s belong to a family of bank capital securities known as contingent convertibles or "Cocos". Convertible because they can be converted from bonds to shares (or depreciated entirely) and contingent because this conversion only occurs if certain conditions are met, such as the issuing bank's capital strength falling below a predetermined trigger level.

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