

Capital Market Flash: Relaxation after the financial market tensions

The capital markets continue to be characterized by extreme human-made volatility. A "tariff retreat" or a noticeable de-escalation by President Trump — a comprehensive global tariff pause except towards China — initially provided relief in the financial market. However, the stock market euphoria following the de-escalation and the outlook for negotiations "in good faith" is still overshadowed by partial financial market tensions in the US capital market and the hardening of the US-China tariff dispute. Recent yield movements in the US give some cause for concern and may have contributed to the de-escalation. It remains unclear whether only "technical market" factors, a declining economic policy credibility of the US itself, or a geopolitically motivated selling pressure are at play in the background.

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Geopolitical confrontation beyond economic policy rationality

Donald Trump continues to dominate the global news flow and financial markets in an unprecedented manner. For the first time, the **US President** is now sending a **clear signal of a return to economic policy rationality**. Initially, yesterday's trading day seemed to be slipping into "hyperprotectionism," as the US announced escalatory high tariffs against China. There was also talk of potential escalation against European pharmaceutical companies. Then, Donald Trump delivered a comprehensive relaxation signal to the rest of the world. During a **90-day suspension of the escalatory global reciprocal bilateral extra tariffs**, exploratory talks are to be conducted "in good faith" with willing countries. For the rest of the world, including Canada and Mexico—but **excluding China**—a manageable 10% base tariff is expected to apply for 90 days following the "tariff retreat." This is a noticeable de-escalation and allows for some degree of international policy coordination on economic issues. US tariffs on aluminum and steel imports are apparently set to remain in place.

The strong stock market recovery in the US that began yesterday is indeed justified. We have always considered global **tariff policy de-escalation** as a prerequisite for **sustainable market stabilization**, especially since this de-escalation significantly reduces the risk of a deep US recession. However, caution regarding further financial market volatility is still warranted. The geopolitical conflict between the US and China appears to be intensifying, leaving the risk of a significant economic slowdown in both countries. Moreover, this geopolitical conflict could further extend beyond economic relations and the financial market (see the following remarks). This is relevant because yesterday's signals of noticeable tensions in the US Treasury market indeed sparked concerns about broader financial market tensions—but could also be a reason for the de-escalation.

Despite stock market recovery, signs of financial market tensions?!

Yesterday's trading day—before Trump's relaxation signals—was marked by increasing signs of financial dislocations beyond the stock markets. The sharply rising US Treasury yields, especially at the very long end of the yield curve, are a notably confusing market signal in the

Gunter DEUBER

Analyst Editor

+43 1 71707-5707

gunter.deuber@rbinternational.com

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current environment. Particularly noteworthy was the opposing trend between safe-haven assets like German Bunds and US Treasuries. It's important to emphasize that noticeable increases in US capital market rates can also strain consumer and debtor confidence in the US, in addition to stock market losses. Moreover, such **erratic US interest rate increases** during a market phase characterized by risk aversion signal certain tensions in what is otherwise the most liquid financial market in the world.

It remains **unclear** to what extent the **sharp rise in US yields** is "only" due to declining confidence in the economic policy credibility of the US, additional technical market factors among US investors or hedge funds, or possible active sales of US Treasury holdings by China. The latter is somewhat contradicted by the lack of a significant downward movement in the USD yesterday. Beyond the relaxation in stock markets, a "weaponization" of economic relations and financial markets cannot be ruled out. This is evidenced by efforts from the Trump administration to pressure the Fed towards interest rate cuts, even as capital market yields have risen sharply and the Chinese currency continues to depreciate.

In light of the outlined tensions in the US interest rate market yesterday, we view it positively that the Trump administration at least provided some relief in the stock markets. Increasing financial market tensions alongside weak stock markets would have posed growing challenges to financing conditions in the US and globally, significantly raising recession risks in the US.

As long as there is no further substantial escalation between the US and China involving the use of financial markets, **stock markets could now stabilize sustainably**. However, the ongoing **news flow regarding US tariff policy** is likely to **keep volatility elevated**. We believe the US administration may continue to make tough demands on the rest of the world to reduce bilateral trade deficits. For Europe, this could imply not only trade liberalizations but also substantial energy deliveries from the US and payments for the US security umbrella.

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Thomas Sternbach
Legal and Compliance
Raiffeisen Bank International AG
Am Stadtpark 9, 1030 Wien
Tel: +43-1-71707-1541
Fax: +43-1-71707-761541
thomas.sternbach@rbinternational.com

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FABIAN BLASCH

📍 Austria  ,
 ✉ fabian.blasch@rbinternational.com

AMADEA HIESS

📍 Austria  ,
 ✉ amadea.hiess@rbinternational.com


MARKUS TSCHAPECK

📍 Austria  ,
 ✉ markus.tschapeck@rbinternational.com

VALBONA GJEKA

📍 Albania  ,
 ✉ valbona.gjeka@raiffeisen.al

ASJA GRDJO

📍 Bosnia Herzegovina  ,
 ✉ asja.grdjo@raiffeisengroup.ba

ELIZABETA SABOLEK-RESANOVIC

📍 Croatia  ,
 ✉ elizabeta.sabolek-resanovic@rba.hr


GERGELY PÁLFFY

📍 Hungary  ,
 ✉ gergely.palfy@raiffeisen.hu

ANDREEA-ELENA DRAGHIA

📍 Romania  ,
 ✉ Andreea-Elena.DRAGHIA@raiffeisen.ro

STANISLAV MURASHOV

📍 Russia  ,
 ✉ stanislav.murashov@raiffeisen.ru

JURAJ VALACHY

📍 Slovakia  ,
 ✉ juraj_valachy@tatrabanka.sk

GUNTER DEUBER

📍 Austria  ,
 ✉ gunter.deuber@rbinternational.com


MATTHIAS REITH

📍 Austria  ,
 ✉ matthias.reith@rbinternational.com


FRANZ ZOBL

📍 Austria  ,
 ✉ franz.zobl@rbinternational.com


FJORENT RRUSHI

📍 Albania  ,
 ✉ Fjorent.Rrushi@raiffeisen.al

IVONA ZAMETICA

📍 Bosnia Herzegovina  ,
 ✉ ivona.zametica@raiffeisengroup.ba

ZRINKA ZIVKOVIC-MATIJEVIC

📍 Croatia  ,
 ✉ zrinka.zivkovic-matijevic@rba.hr

ZOLTÁN TÖRÖK

📍 Hungary  ,
 ✉ torok.zoltan@raiffeisen.hu

IONUT DUMITRU

📍 Romania  ,
 ✉ Ionut.Dumitru@raiffeisen.ro

LJILJANA GRUBIC

📍 Serbia  ,
 ✉ [ljiljana.grubic@raiffeisenbank.rs](mailto:ljliljana.grubic@raiffeisenbank.rs)

SERHII KOLODII

📍 Ukraine  ,
 ✉ serhii.kolodii@raiffeisen.ua

CASPER ENGELEN

📍 Austria  ,
 ✉ casper.engelen@rbinternational.com

GOTTFRIED STEINDL

📍 Austria  ,
 ✉ gottfried.steindl@rbinternational.com


BRISIDA BUZI

📍 Albania  ,
 ✉ Brisida.BUZI@raiffeisen.al


ARISTEA VLLAHU

📍 Albania  ,
 ✉ Aristea.Vllahu@raiffeisen.al

MIRZA ZORNIC

📍 Bosnia Herzegovina  ,
 ✉ mirza.zornic@raiffeisengroup.ba

HELENA HORSKA

📍 Czech Republic  ,
 ✉ Helena.Horska@rb.cz

NICOLAE COVRIG

📍 Romania  ,
 ✉ Nicolae.Covrig@raiffeisen.ro

ANASTASIA BAYKOVA

📍 Russia  ,
 ✉ ABAIKOVA@raiffeisen.ru

TIBOR LORINCZ

📍 Slovakia  ,
 ✉ tibor_lorincz@tatrabanka.sk

OLEKSANDR PECHERYTSYN

📍 Ukraine  ,
 ✉ oleksandr.pecherytsyn@raiffeisen.ua

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Raiffeisen Bank International AG

Registered Office: Am Stadtpark 9, 1030 Vienna
 Postal address: 1010 Vienna, Postfach 50
 Phone: +43-1-71707-1846
 Fax: + 43-1-71707-1848

Company Register Number: FN 122119m at the Commercial Court of Vienna
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