Noise & Nuance

The Volatility Around Elections & Fed

"Difficult to see. Always in motion is the future."

- Master Yoda, Star Wars

"Haste makes waste, so I rarely hurry. But if a ferret were about to dart up my dress, I'd run."

- Cheshire Cat, Alice in Wonderland

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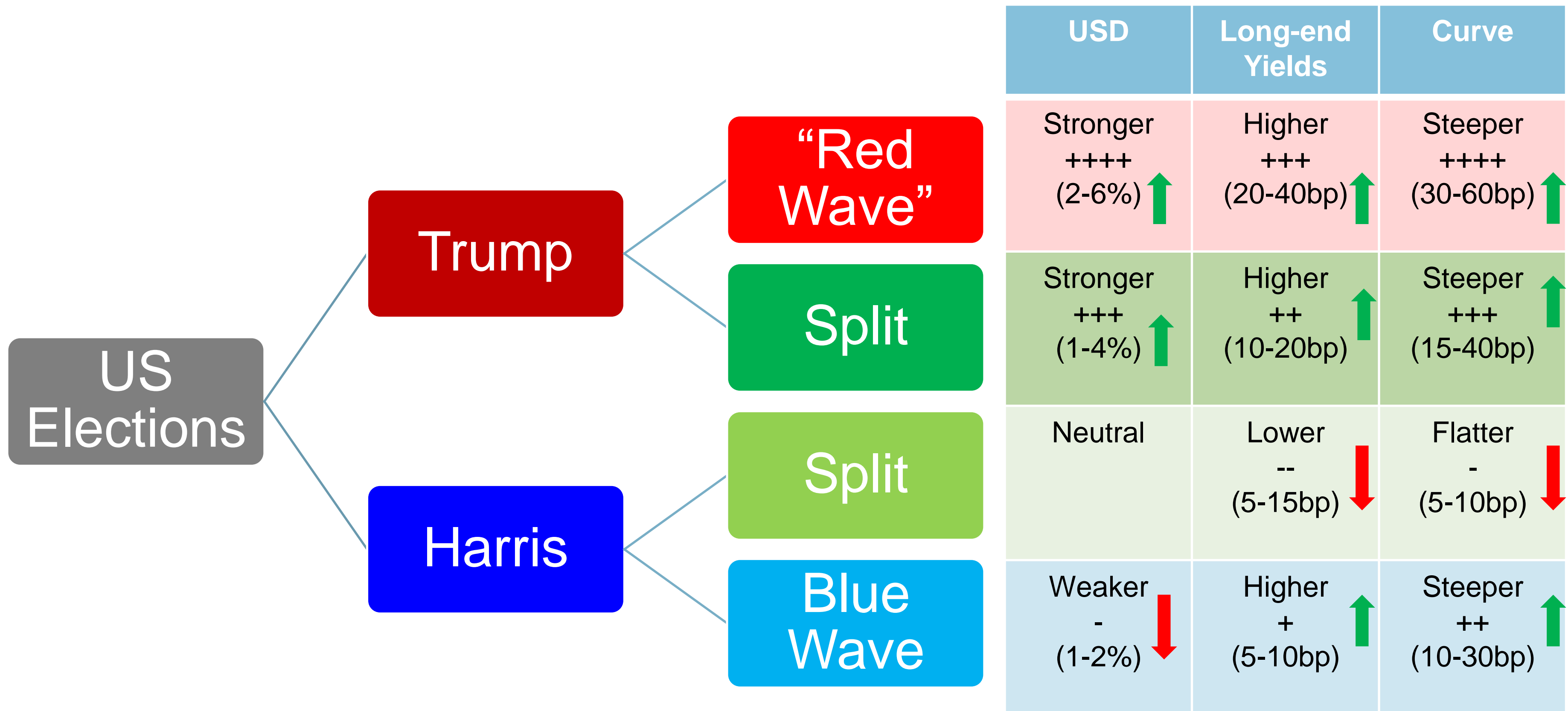
Private and confidential

Photo Credit: FT, Wikipedia

November 2024

US Elections: Details Matter for a Bit (3-6 Week Impact before Fed/Macro Dynamics Overtake)



Note: These outcomes are expected to last 4-8 weeks, reflecting perceptions and "announcement effects". Whereas our view is that Trump 2.0 may be less adverse for China than feared given Trump's transactional tendencies, inclined to water down trade actions.

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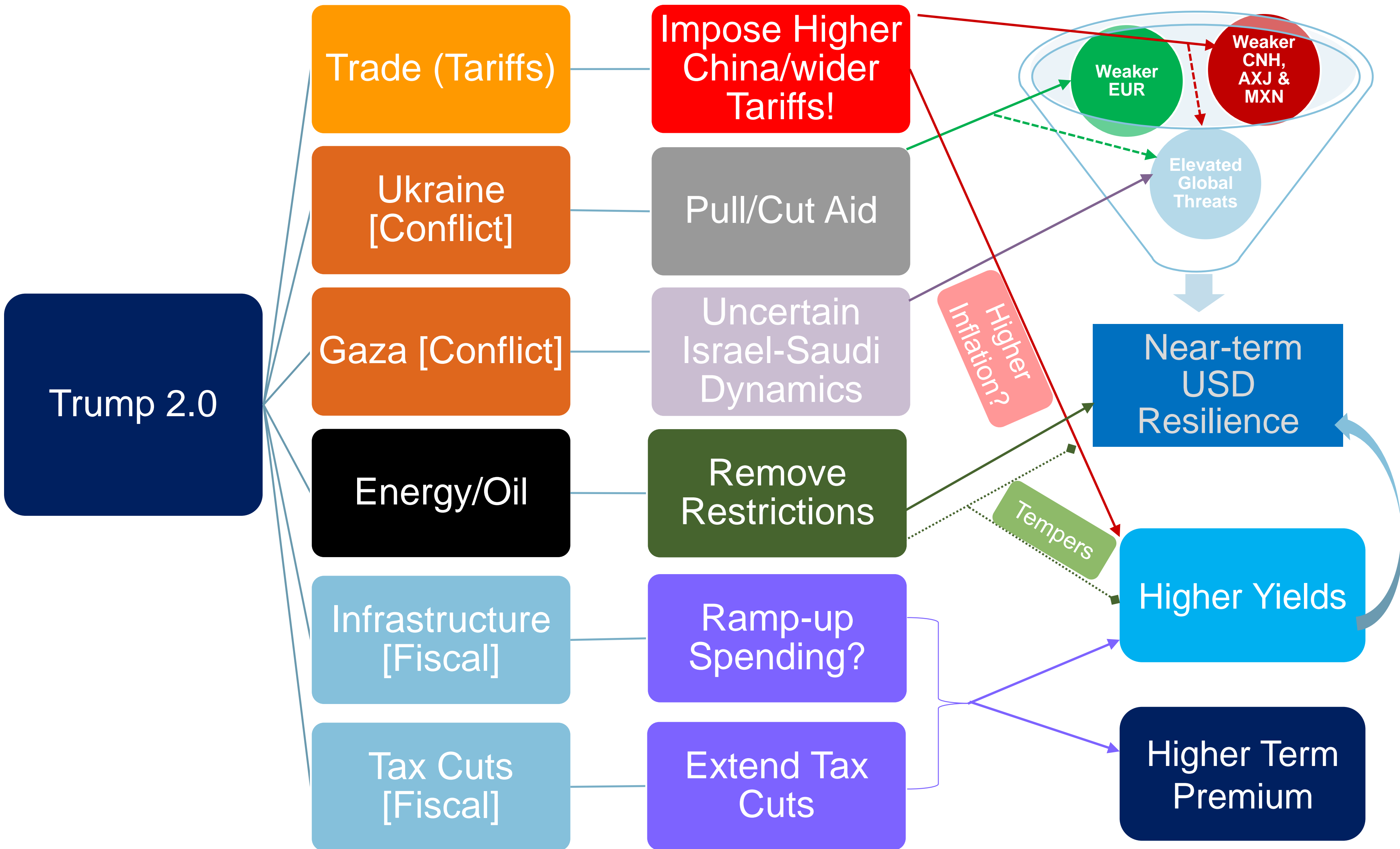
Recap - Politics: Trump 2.0 (US Elections): Bracing for Geo-economic Blows



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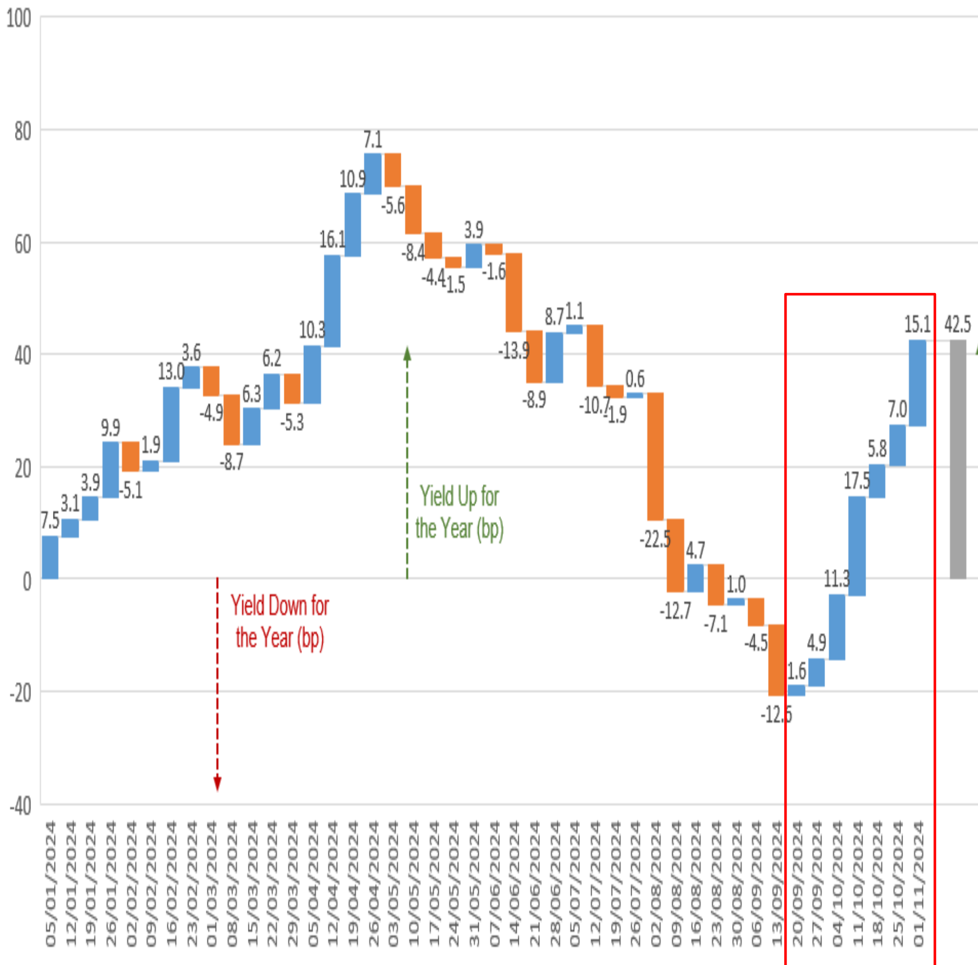
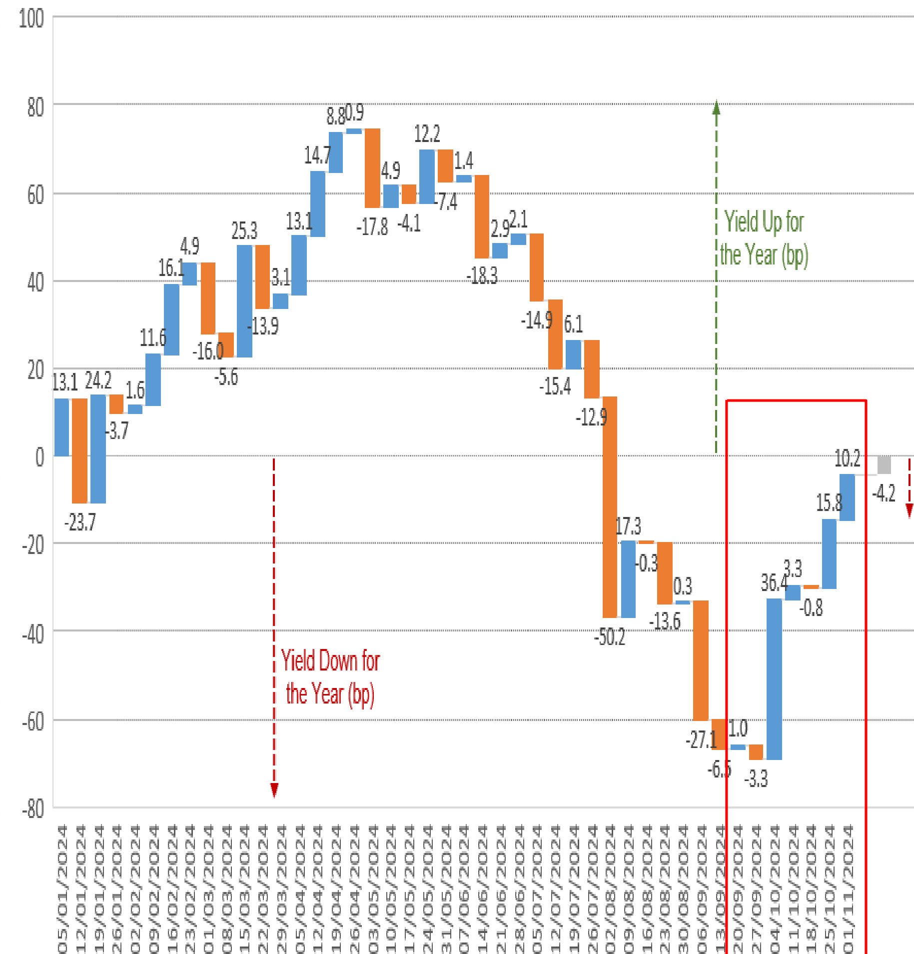
UST Yields: Elections & Pivot Pullback Squeeze Yields … But May Not



10Y UST Yields (2-week Avg Chg since end-2023; bp): *In Contrast to Softer Front-end Yields YTD,* **10Y Yields are Up 42-43bp, near-4.4%** (from 3.88% at end-2023). This partly **reflects fiscal/debt woes as well as (structural) inflation risks associated with US Elections**. Notably, a **Trump 2.0 outcome**.



2Y UST Yields (2-week Avg Chg since end-2023; bp): **Policy-Sensitive 2Y UST Yields**, which Fell Distinctly Since mid-2023, has **Partially Retraced "Pivot" Drop in October amplified by Elections**. **But Front-end Yields are Still Down YTD** (~4bp at 4.2% from ~4.25% at end-2023). ***Easing Cycle Detour, Not Derailment***.

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UST Curve: Steeper UST Curve a Cyclical Policy Outcome

Bull Steepening on Rate Cuts & Bear Flattening on Rate Hikes Well-Established

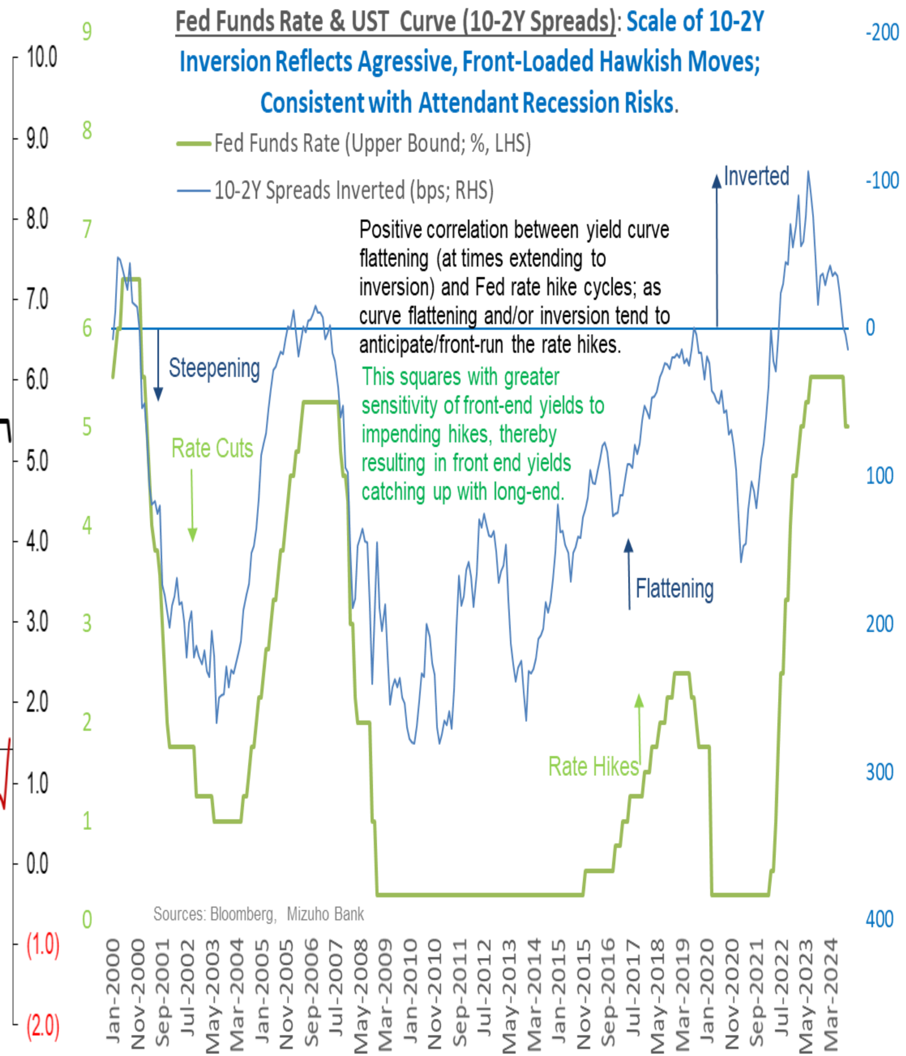
5.0
4.0
3.0
2.0
1.0
0.0
(1.0)
(2.0)

10.0
9.0
8.0
7.0
6.0
5.0
4.0
3.0
2.0
1.0
0.0
(1.0)
(2.0)

85 87 89 91 93 95 97 99 01 03 05 07 09 11 13 15 17 19 21 23

Bear Flatteing on Rate Cuts
Bull Steepening on Rate Hikes
Recession
10Y-2Y
FFR (UB)

Sources: CEIC, Bloomberg, Mizuho Bank



* Policy-sensitive front-end yields falling more sharply than long-end yields.
** Policy-sensitive front-end yields rise much faster than longer-end yields.

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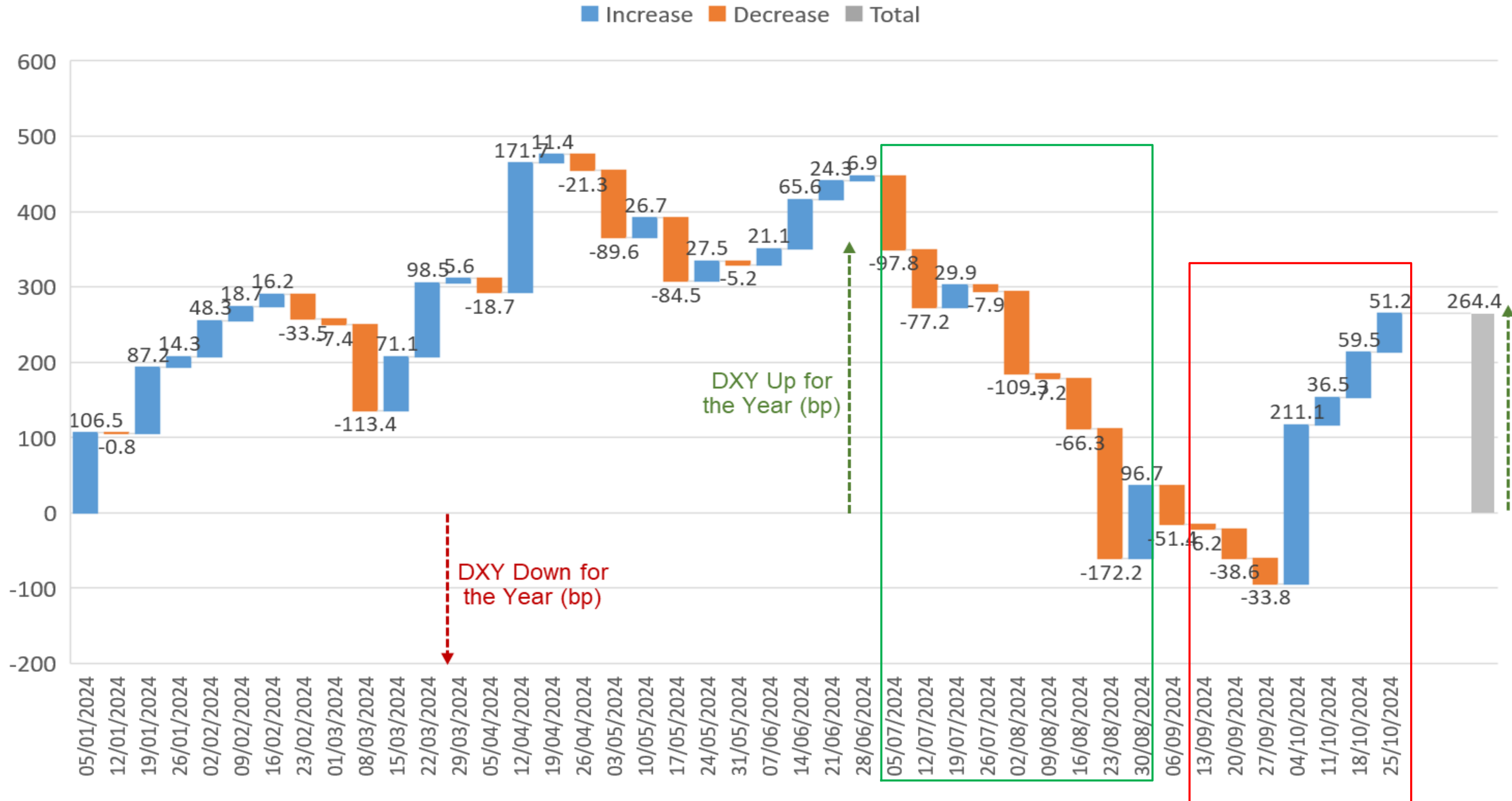
USD: Fed Expectations Volatility Spills Over into USD too

DXY Index (Weekly Chg from end-2023; bp): After a Sharp Downswing in Q3 (on Fed Pivot), **USD Index has Rebounded in Oct**, up~265bp at 104 (from 101.33 at end-2023). USD is Presumably **Reflecting Strength Associated** with *Relative US Exceptionalism* & *Election Risks*.



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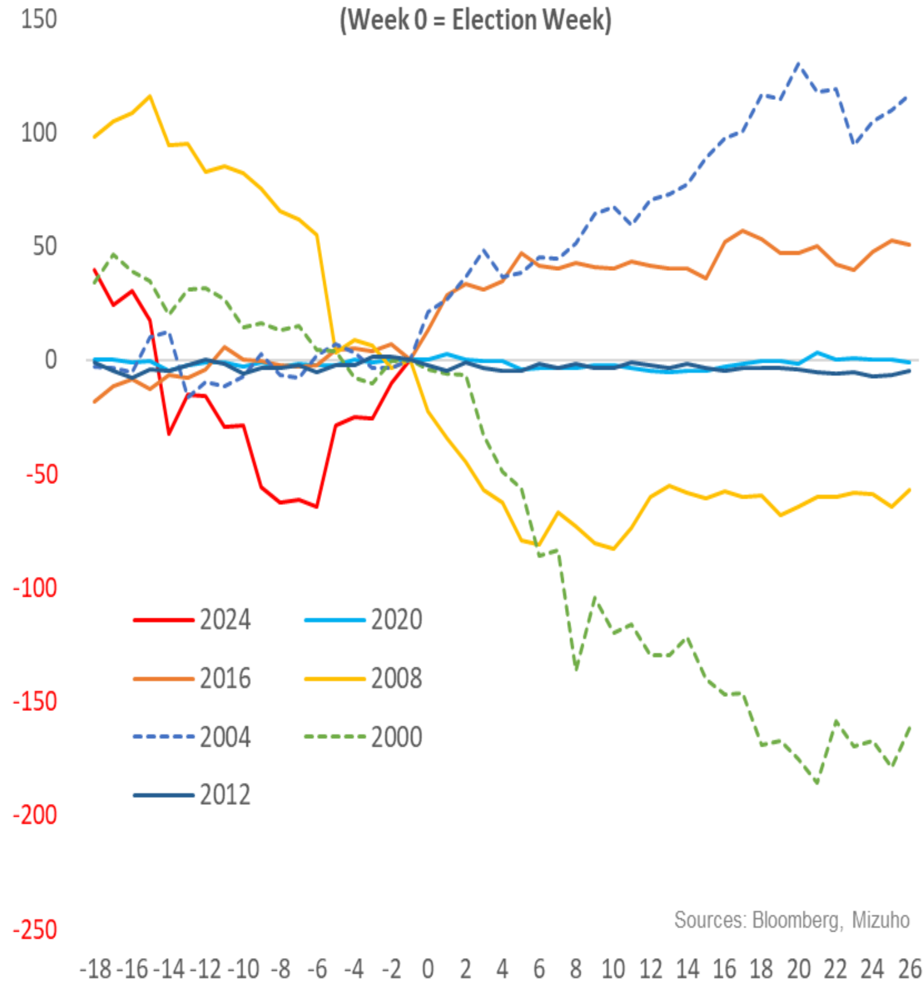
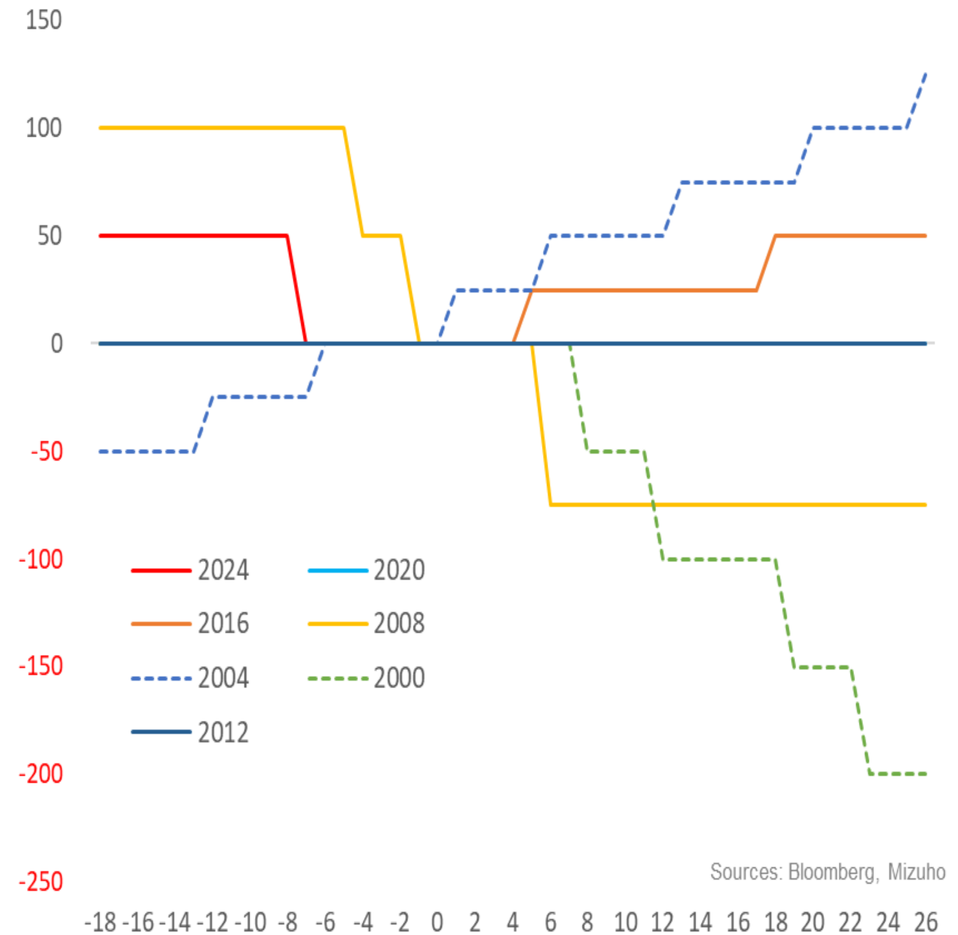
UST Yields: Fed Cycle, Brent & Trump – Separating Myth from Mechanics

2Y Yields are Tightly Tied to the Fed Cycle … Elections-/Trump-Effects Overstated?





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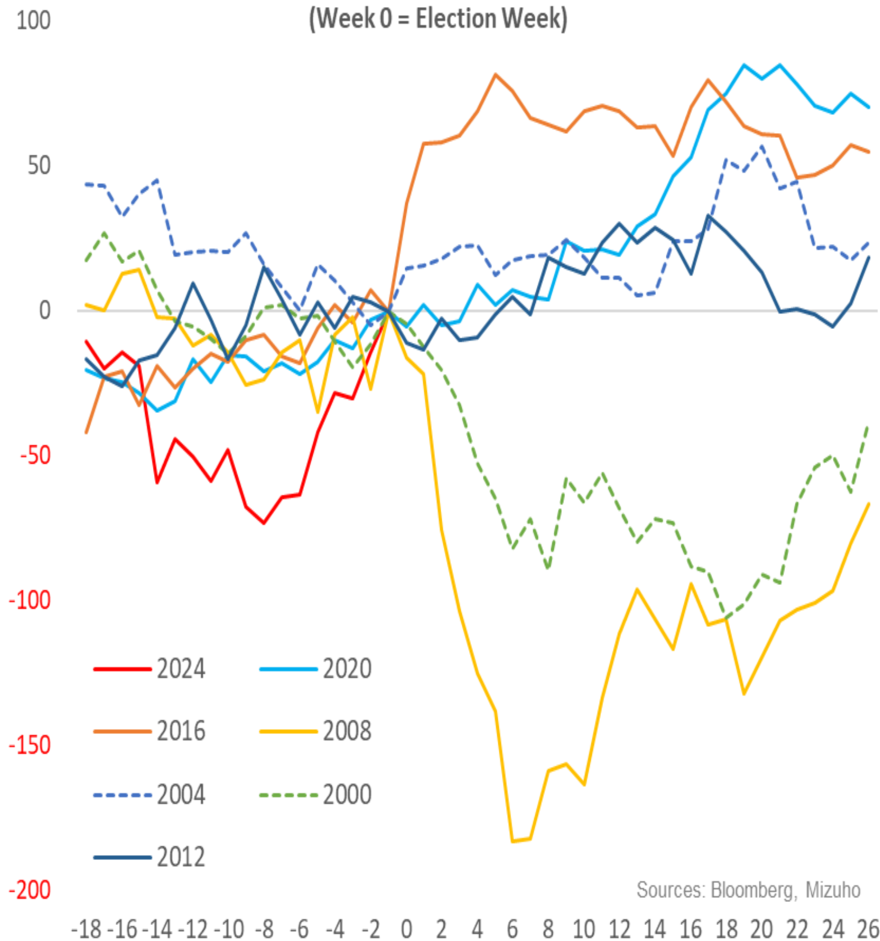
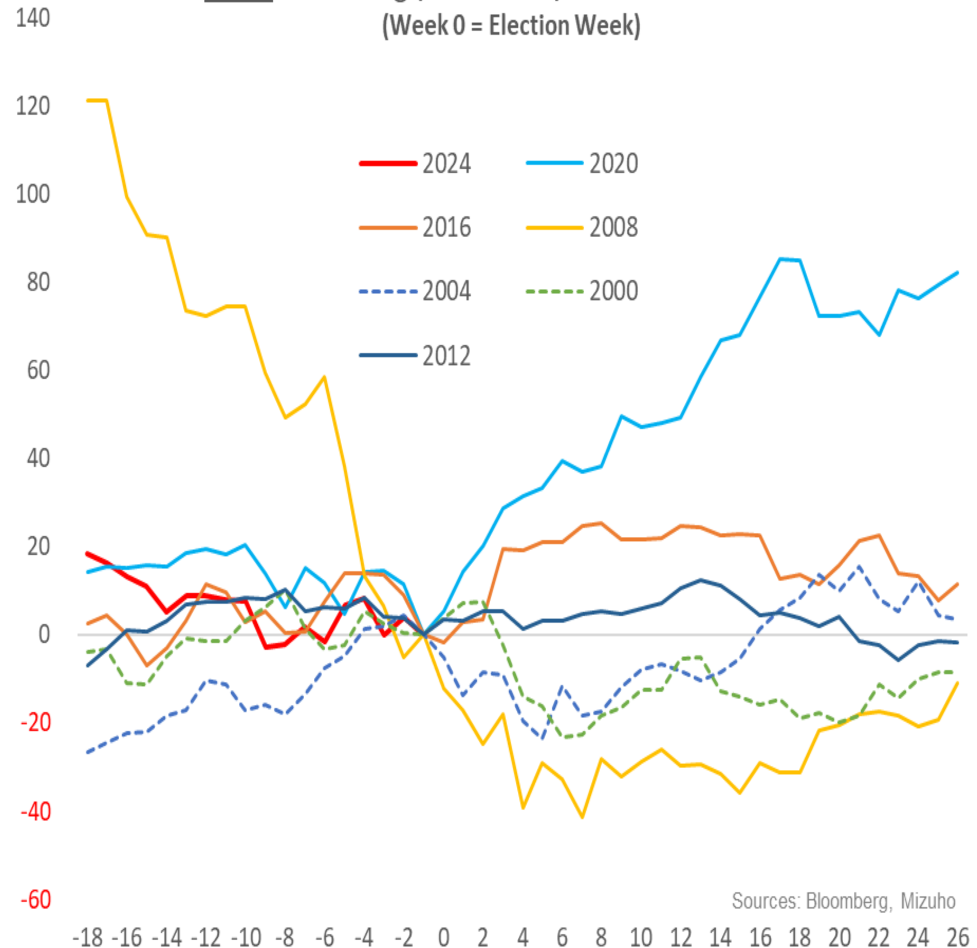
UST Yields: Fed Cycle, Brent & Trump – Separating Myth from Mechanics

10Y Yields Admittedly Not as Tightly Tied to the Fed Cycle … Taking Cues off Oil

But Fed-Cycle Steepening/Flattening is Par for the Course …





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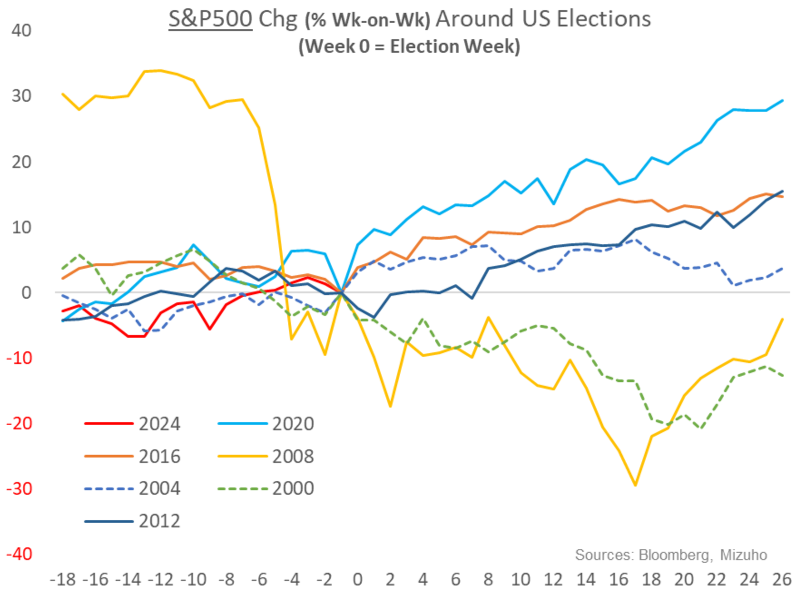
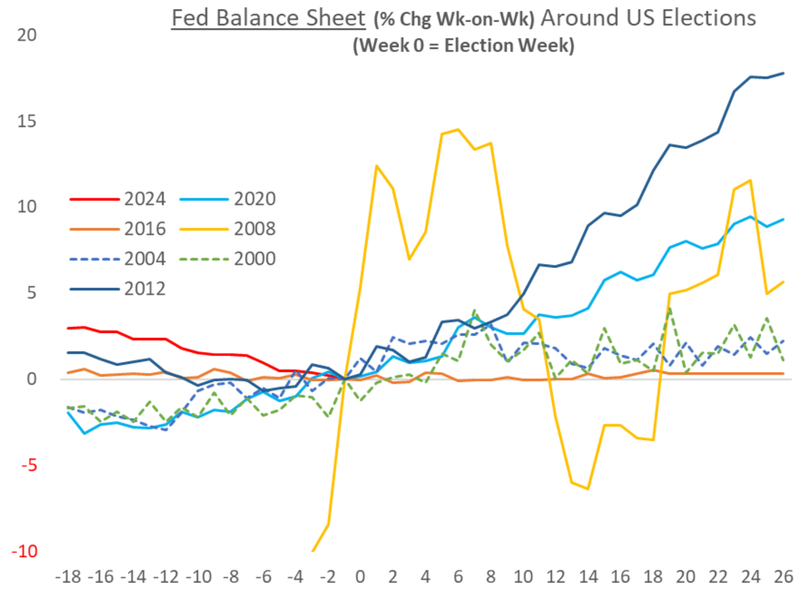
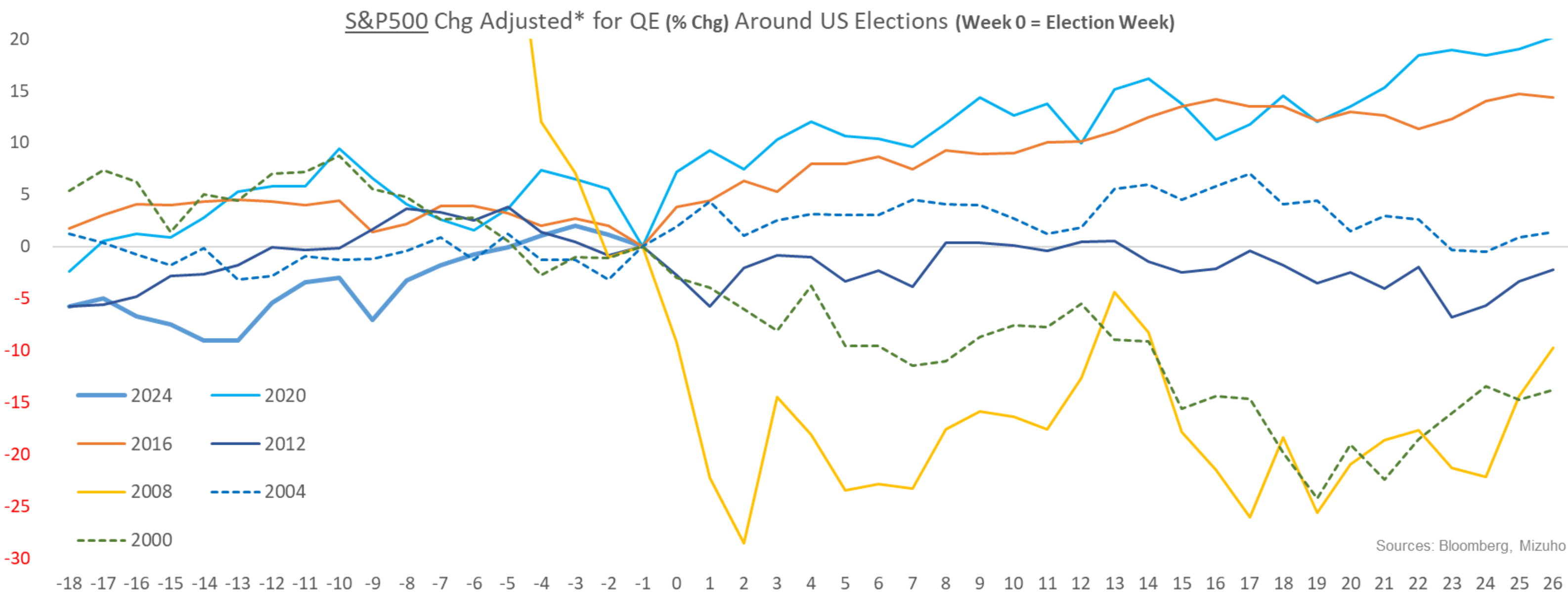
Equities: S&P500 Upside Not Disputed, But Perhaps Diminished







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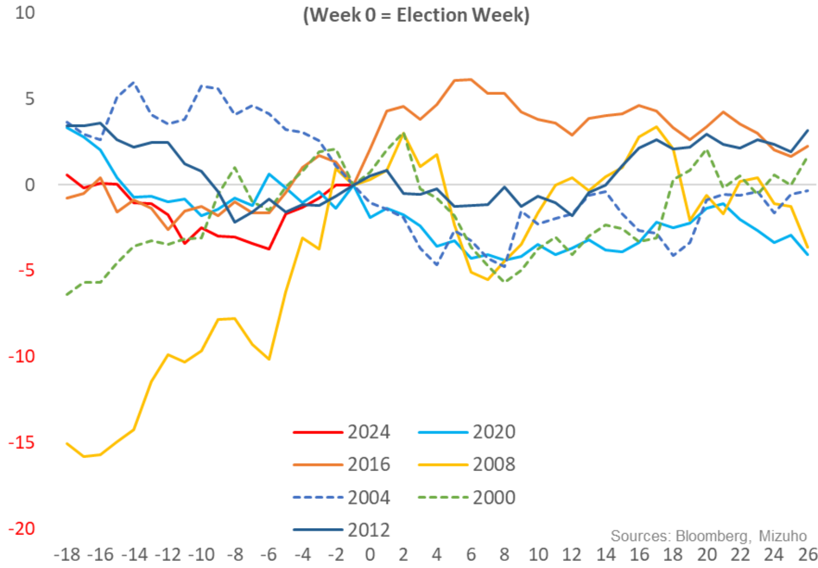
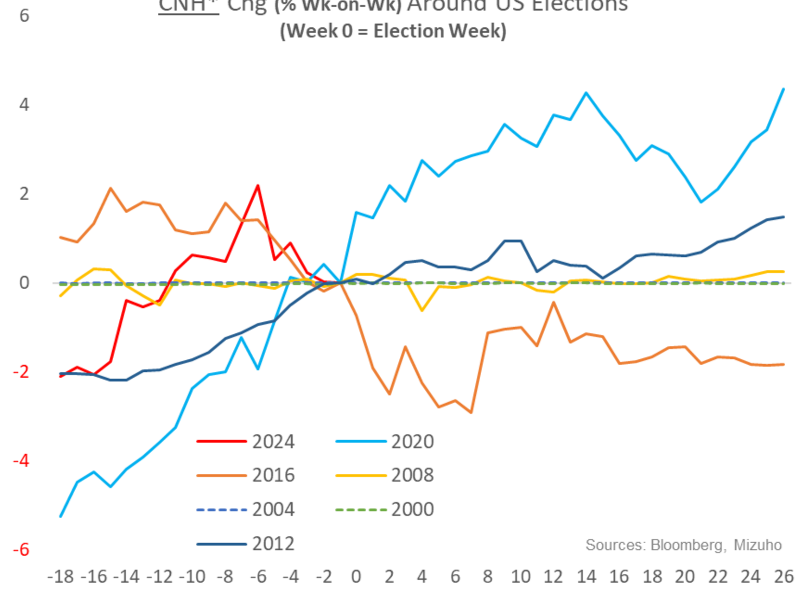
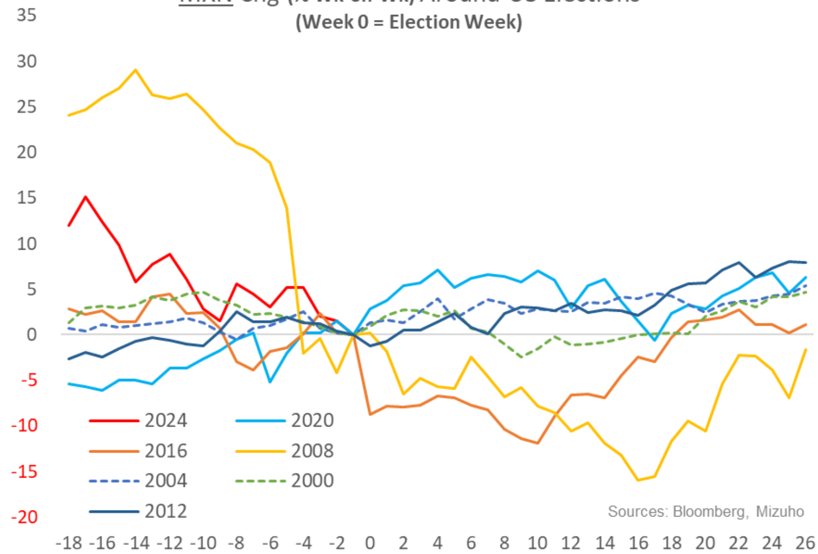
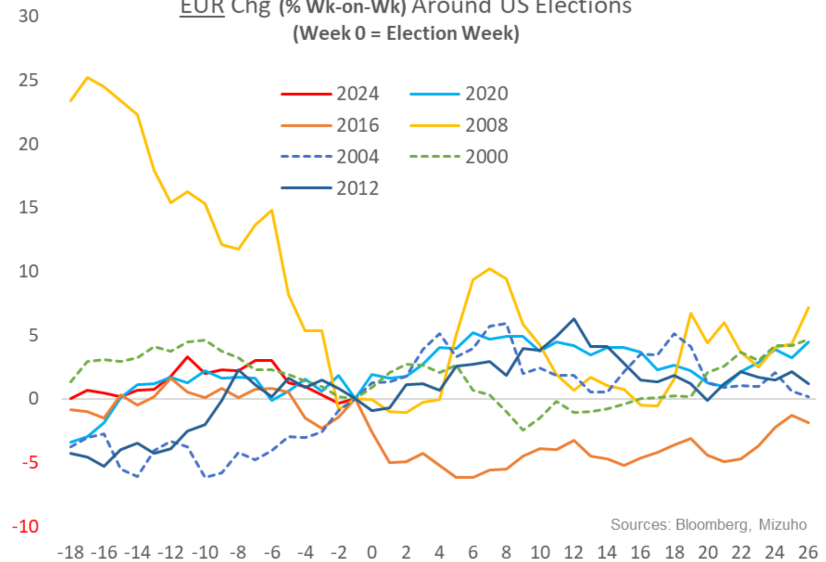
FX: "USD Trump" Effects … & Risk-Specific Dynamics









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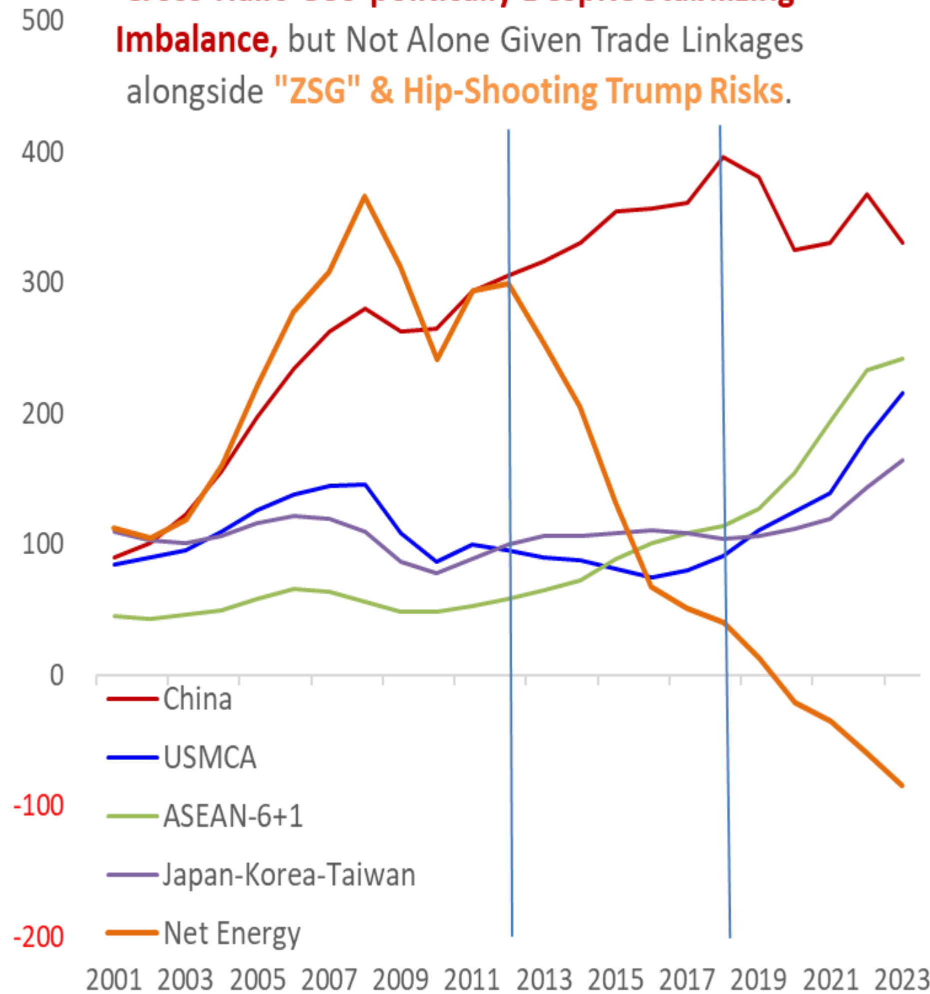
Trade & China: Risks Go Well Beyond China



Chg in Bilateral US Trade Deficit Over Time (US$bn): **Particular Risks for Vitenam.** And **USMCA** is **No Guarantee of Insulation for Mexico & Canada** *if Trump Goes on ZSG-Bottomline Mode*.

120
100
80
60
40
20
0
-20

2017-18 2011-12

Singapore Japan Philippines Malaysia Switzerland Indonesia Italy Germany India Thailand Irealand Korea Taiwan Canada Mexico Vietnam

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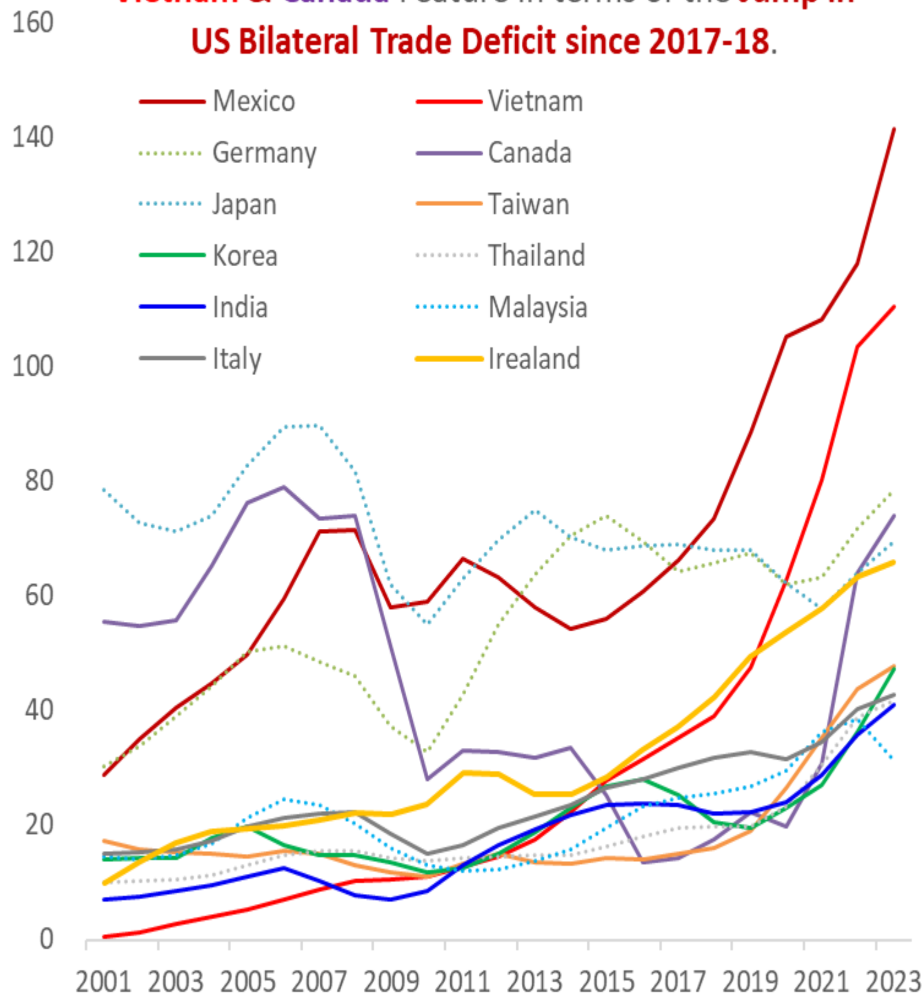
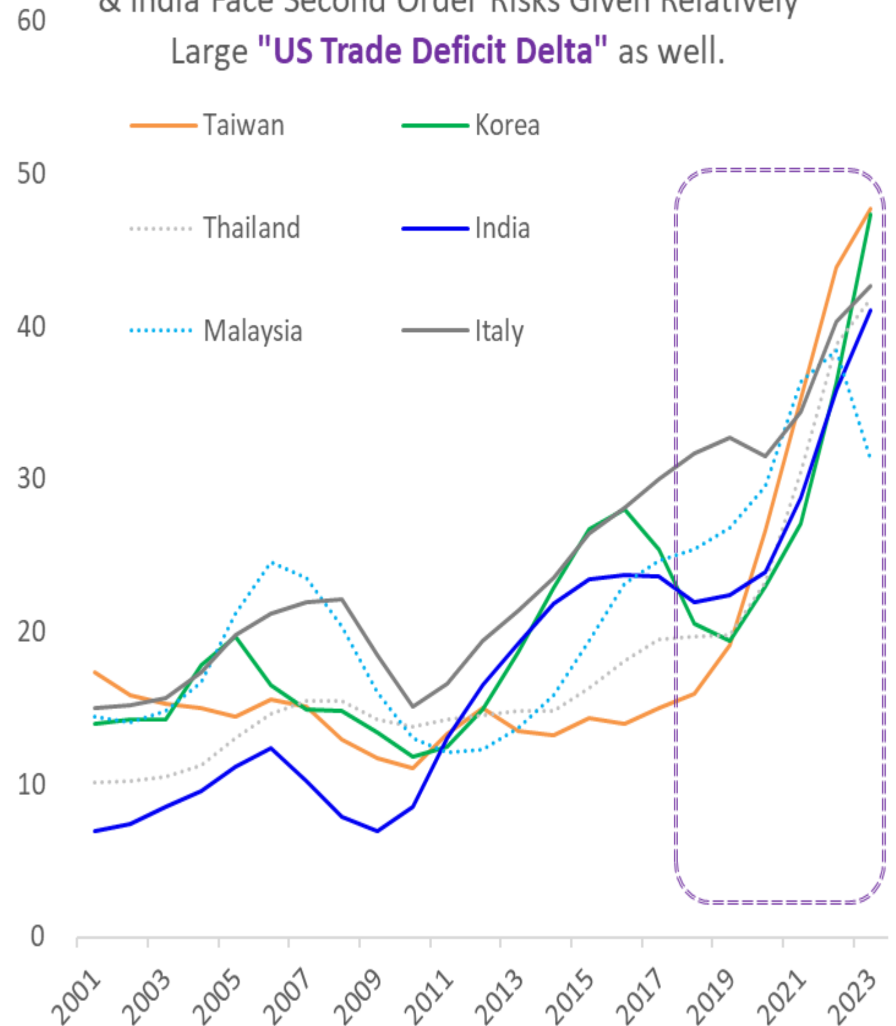
Trade & China: Vietnam is in a Precarious Position amid Trump 2.0 Uncertainties





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September FOMC Signals from Rate Cut to 'Dot Plot"

Analysis of 2024 'Dot Plot' Evolution

		2024	2025	2026
Sep-24	**Fed Fund Rate* (%)**	**4.375**	**3.375**	**2.875**
	Implied Cuts (bp)	100	100	50
Jun-24	**Fed Fund Rate* (%)**	**5.125**	**4.125**	**3.125**
	Implied Cuts (bp)	25	100	100
Mar-24	**Fed Fund Rate* (%)**	**4.625**	**3.875**	**3.125**
	Implied Cuts (bp)	75	75	75
Additional Cuts vis-à-vis March 'Dot Plot'		25	25	-25
Additional Cuts vis-à-vis June 'Dot Plot'		75	0	-50
Average Additional Dovish Shift		**50**	**12.5**	**-37.5**
Once the "extra" 25bp is backed out		**25**	**-12.5**	**-62.5**

* End-period Fed Fund rates as per FOMC median

50 is Not the New 25

- **Not a "go big or go home"**, high-roller, all-in, dovish game-book.
- Instead, a **one-off**, **"go big, and then go home"**, *insurance plan*.
- What the Fed & 'Dot Plot' convey.
- **Powell**: ***not making a habit of 50bp cuts***.
- Nov & Dec FOMC: **25bp per meeting pace**.
- 2025 FOMC: **12.5bp per meeting pace**.
- Powell's is implying a **fairly high pain threshold for 50 to be the new 25**.
- Sets Fed up for potential Dovish impulses, if data disappoint vis-à-vis SEP* resilience

Summary of Economic Projections (SEP*)

Variable	Median[1] 2024	2025	2026	2027	Longer run
Change in real GDP	2.0	2.0	2.0	2.0	1.8
June projection	2.1	2.0	2.0		1.8
Unemployment rate	4.4	4.4	4.3	4.2	4.2
June projection	4.0	4.2	4.1		4.2
PCE inflation	2.3	2.1	2.0	2.0	2.0
June projection	2.6	2.3	2.0		2.0
Core PCE inflation[4]	2.6	2.2	2.0	2.0	
June projection	2.8	2.3	2.0		
Memo: Projected appropriate policy path					
Federal funds rate	4.4	3.4	2.9	2.9	2.9
June projection	5.1	4.1	3.1		2.8

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Qualified Flying Start May Mark Bumpy Transition to *"Too High for too Long"*

	End-2021	End-2022	End-2023	2024				2025				2026	
			Q4 23	Q1 24	Q2 24	Q3 24	Q4 24	Q1 25	Q2 25	Q3 25	Q4 25	H1 26	H2 26
Fed Funds Target Rate Ceiling	0.25	4.50	5.50	5.50	5.50	5.00	4.50	3.75	3.25	2.75	2.50	2.50	2.75
Fed Funds Target Rate floor	0.00	4.25	5.25	5.25	5.25	4.75	4.25	3.50	3.00	2.50	2.25	2.25	2.50
UST 2Y Yields	0.73	4.43	4.25	4.62	4.75	3.64	3.94	3.35	2.76	2.56	2.27	2.37	2.36
UST 10Y Yields	1.51	3.87	3.88	4.25	4.40	3.78	4.16	3.73	3.42	3.34	3.18	3.25	3.28

Pronounced Steepening

Sources: Bloomberg, Mizuho Forecasts

Flying Start, But 50 Not the New 25 …

- Fed Chair Powell went out of his way to convey not to expect outsized 50bp cuts as the norm.
- Although the **100bp** (50 done & 50 more as per 'Dot Plot') **in late-2024 suggests front-loaded easing**.
- Entailed in that is the assumption of averting a hard-landing" with **sufficient "insurance" cuts**.

Following the (Dot) Plot for 2024

- Barring significant data surprises, the Fed is likely to cut by **another 50bp in 2024**. (over Nov and Dec)
- Notable, but not binding, **bias for 25bp each over Nov and Dec** to cement the guidance not to expect 50bp.

Rate Cuts to Gather Pace in H1 2025

- **Expect faster cuts in H1 2025**, with some 125bp on the cards, to lower rates to 3.00-3.25%.
- And then, some more by 50-75bp in H2 to as *risks to soft-landing persist* and real rates remain elevated.

More Distinctly Dovish Leg Not Ruled Out

- **Scope for distinctly dovish Fed in 2025** *if jobs/demand deteriorate sharper than SEP* "controlled landing"*.

Premise: Consumer Slowdown, Not Crisis

- Brisker cuts are premised on sharper consumption slowdown amid tightening cash-flows ➔ Not so soft landing
- And not a crisis from a balance sheet shock – for which far deeper and larger rate slashing will be required.

Outcomes: Lower Yields + Distinctly **Steeper Curve** + Long-end Election Volatility

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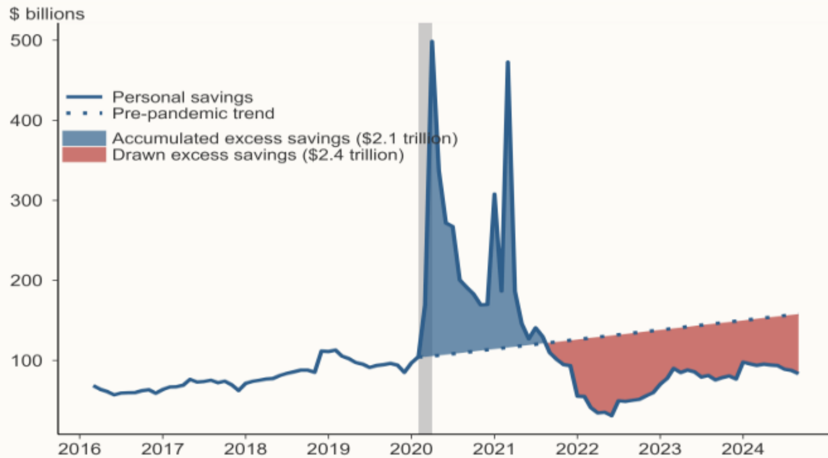
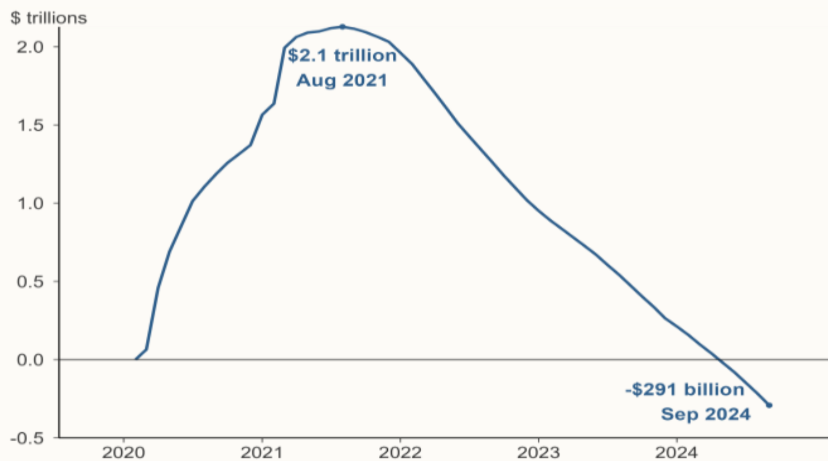
ASSUMPTION. Cash-flow Constraints Threatening Demand Resilience

Chart 1: Aggregate personal savings compared with the pre-pandemic trend

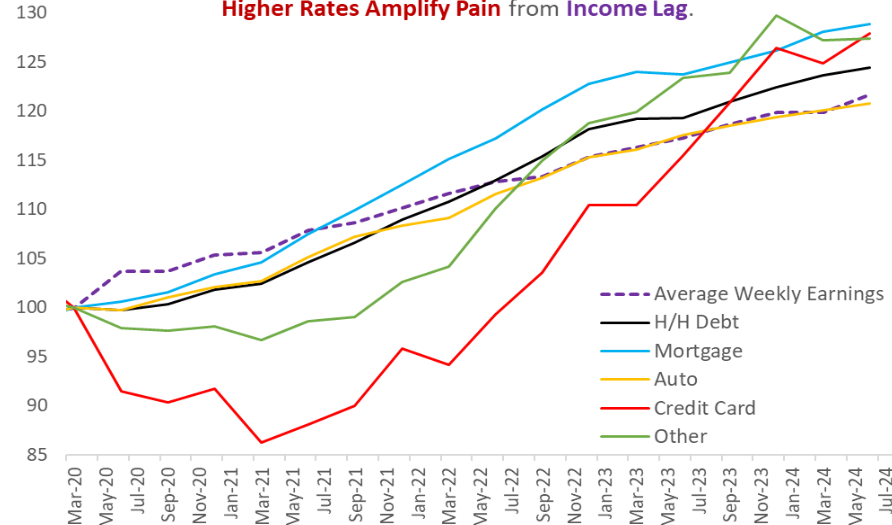


Note: Gray shaded area represents NBER recession dates. Source: Bureau of Economic Analysis and authors' calculations.

Chart 2: Cumulative aggregate pandemic-era excess savings



Source: Bureau of Economic Analysis and authors' calculations.



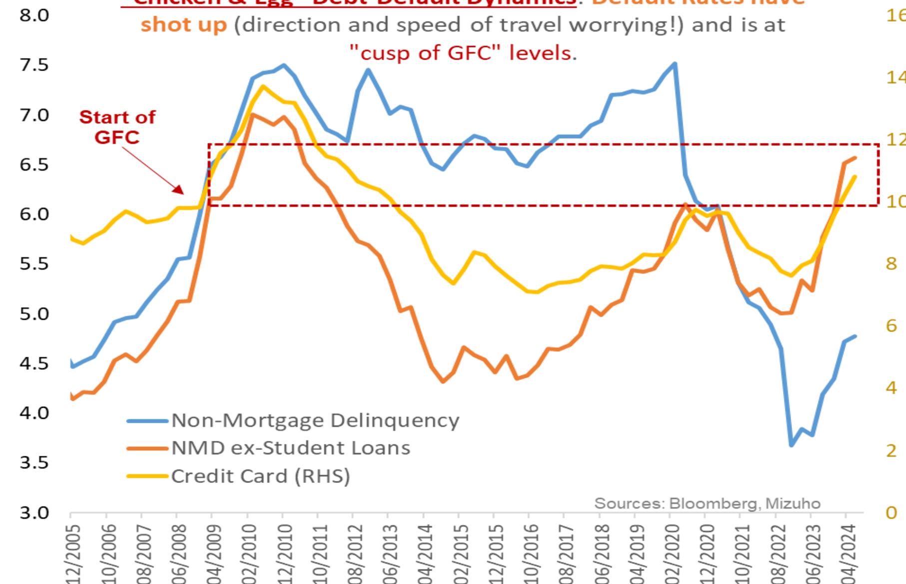


Chart from Bloomberg, San Francisco Fed,

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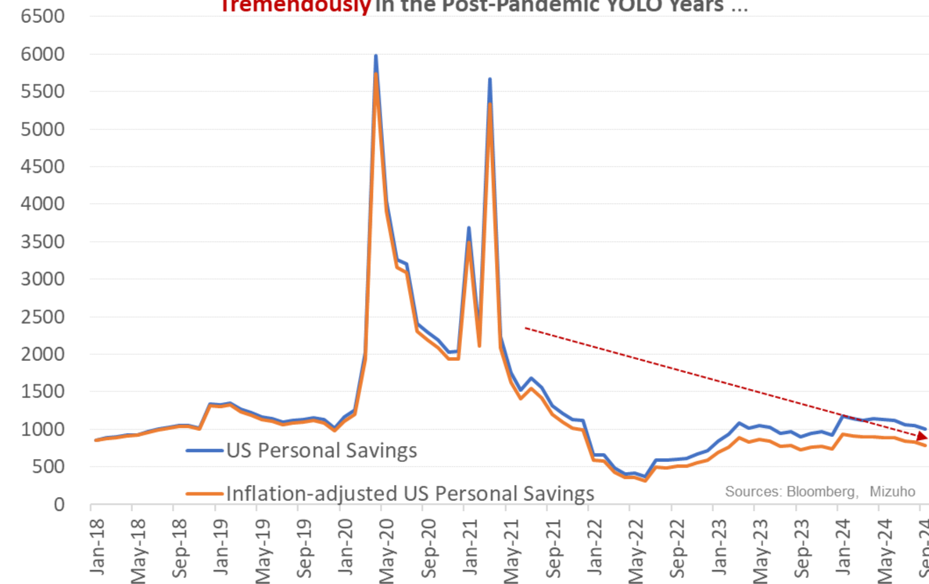
ASSUMPTION. Cash-flow Constraints Threatening Demand Resilience

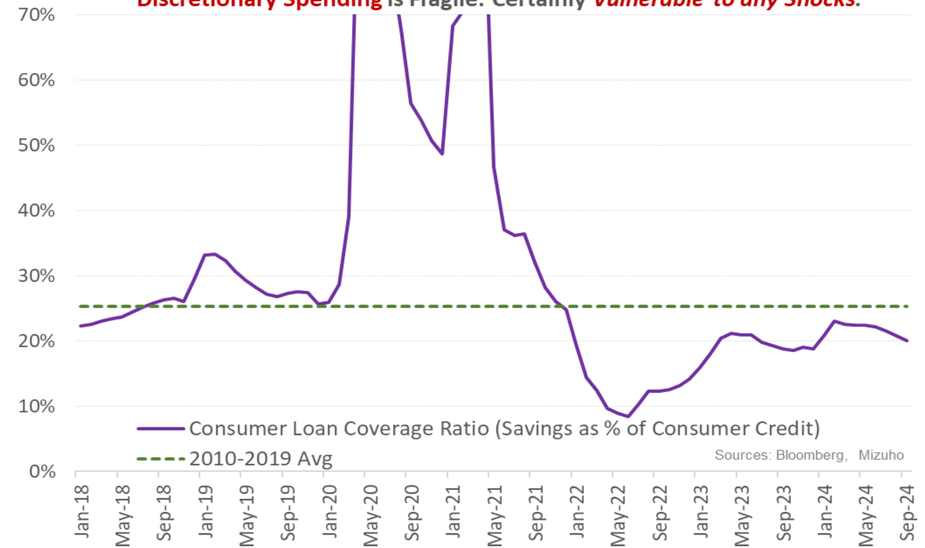
US Consumer - Tightening Cash-flows

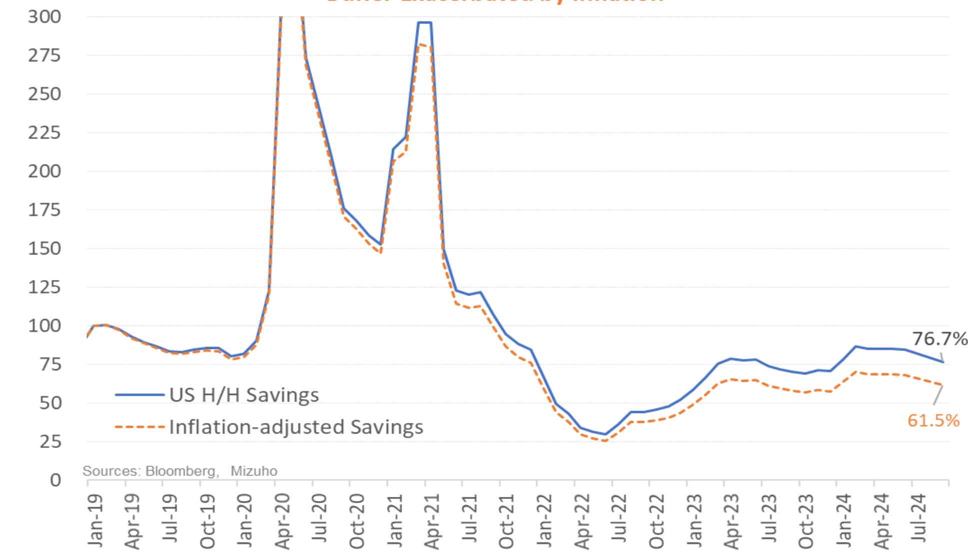
- Drawdown of savings, increased credit (and attendant servicing burden) and softening wage gains translate into tighter consumer cash-flows.
- In turn the hit on demand will have negative multiplier effects at the margin, which **significantly dampen growth** outcomes; *even if an outright recession is averted.*
- For a Fed that is decidedly not setting out to break something, this will be a jolt out of the Type 2 error resulting from the earlier Type-1 error.

"Type-1" Error: Wrongly rejecting null hypothesis of inflation risks.

"Type-2 Error: Wrongly failing to reject null hypothesis of persistent inflation risks







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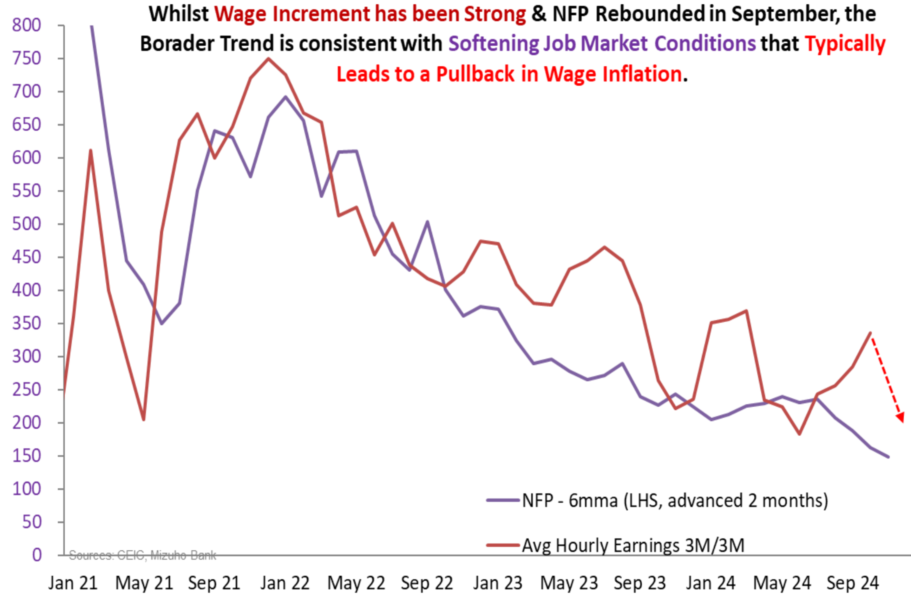
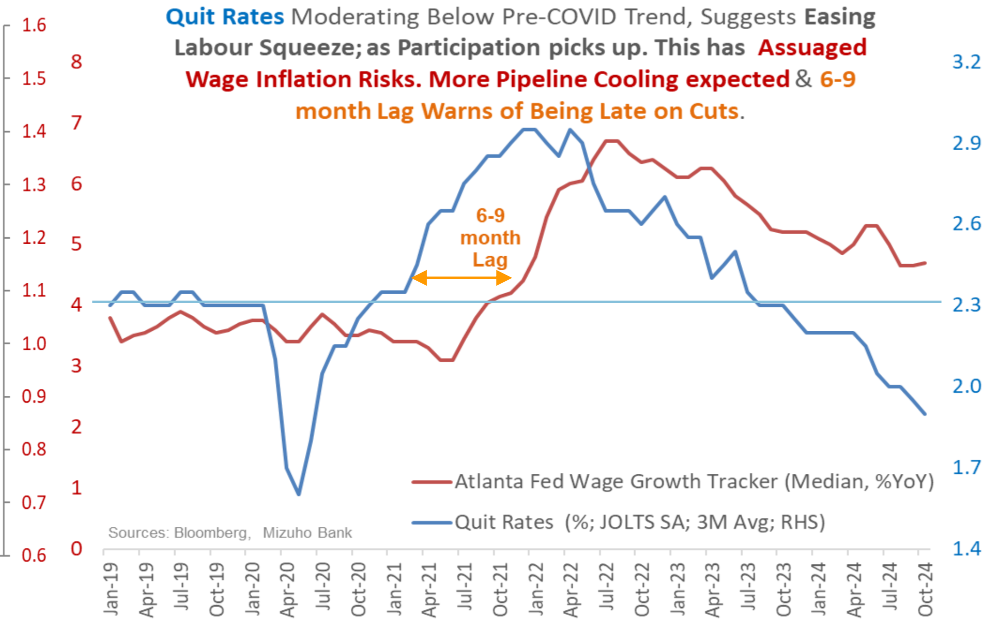
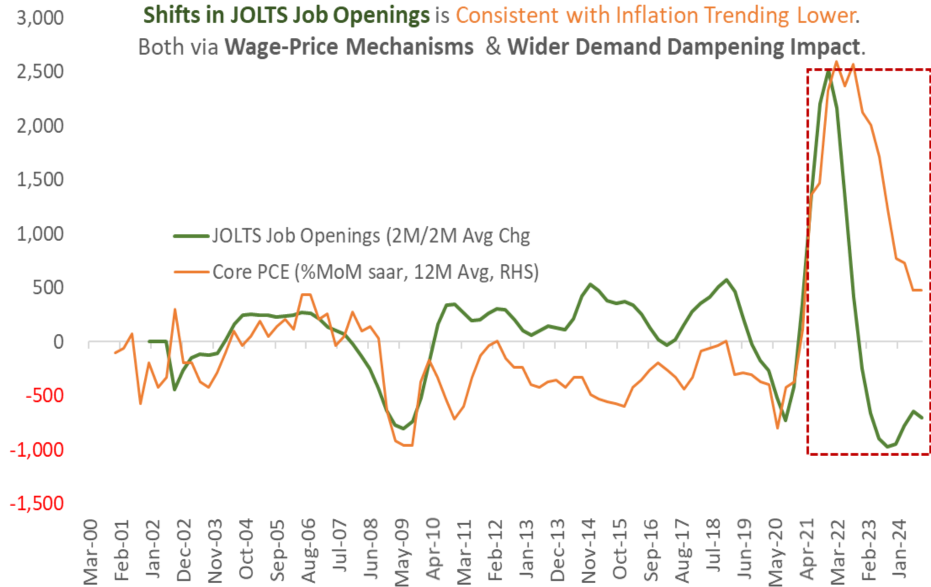
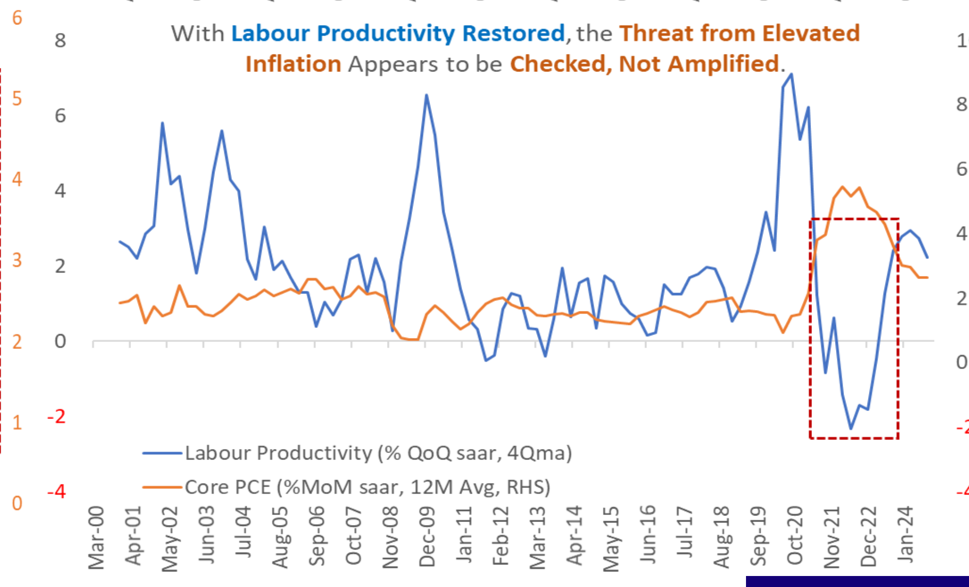
ASSUMPTION: Vastly Diminished Wage-Price Spiral Risks Accentuate Downside Jobs Risks









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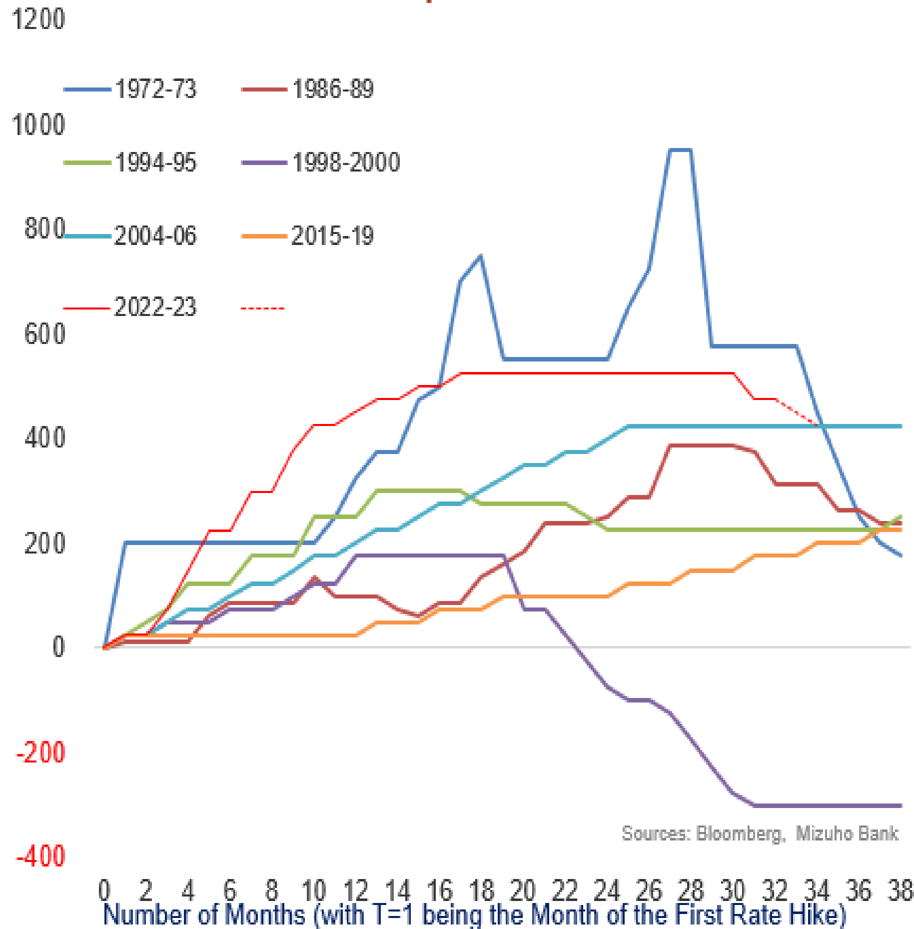
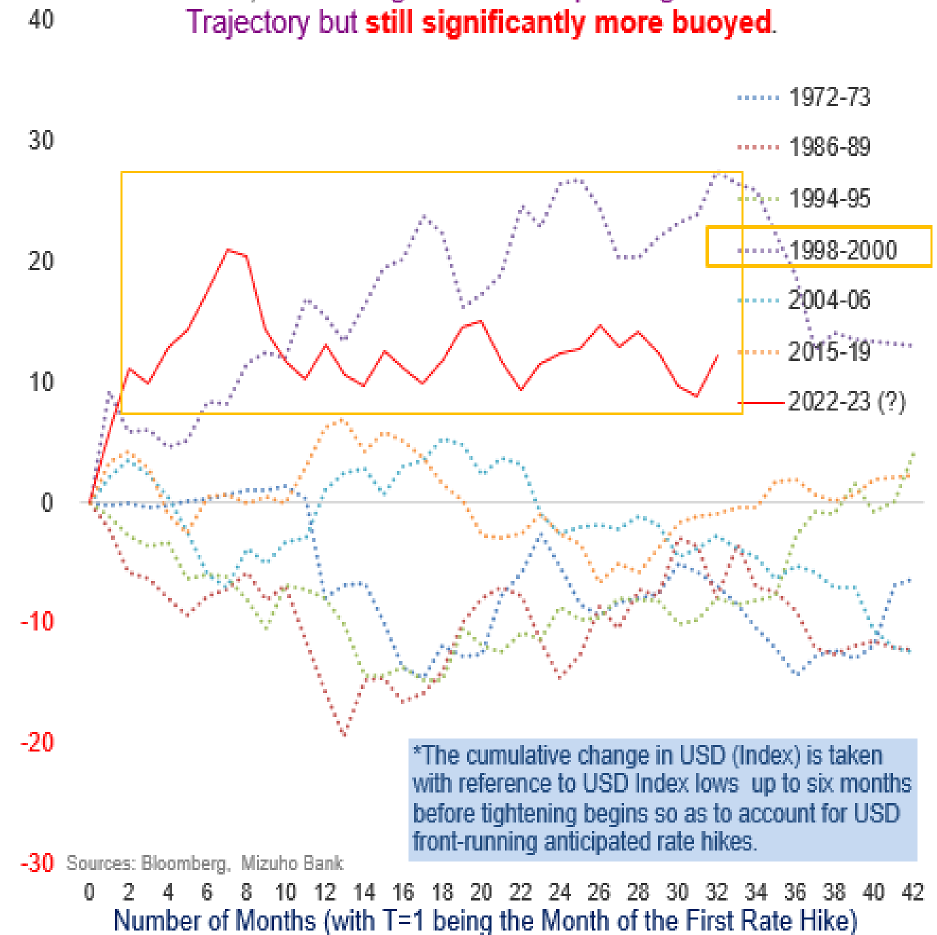
FX – USD: Atypical Late-Stage USD Strength





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FX – USD: Full Reversion of AXJ may be Challenged

Corresponding USD Performance (Cumulative % Chg*): **Notably, the Current Rate Hike Cycle Has Resulted in the Sharpest Phase of USD Strength in the First 8-9 months**; moderating below corresponidng 1998-2000 Trajectory but **still significantly more buoyed**.

25
20
15
10
5
0
-5

1970s till 2019 Cycles

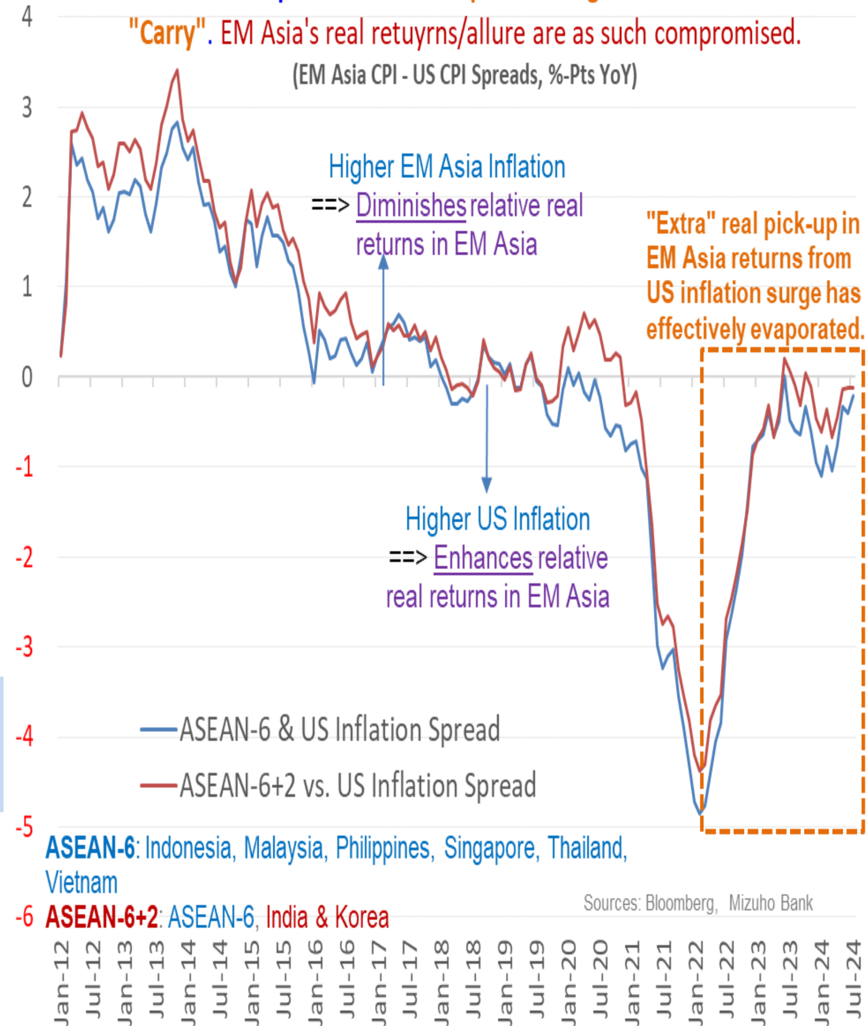
2022-23 (?)

*The cumulative change in USD (Index) is taken with reference to USD Index lows up to six months before tightening begins so as to account for USD front-running anticipated rate hikes.

Sources: Bloomberg, Mizuho Bank

0 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30 31 32 33 34 35 36 37 38 39 40 41 42

Number of Months (with T=1 being the Month of the First Rate Hike)



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FX – USD: Yield Spreads & Real Yields Suggest Backstop … USD Resiliency On Sharper Dips

Fed & USD: 2Y UST yield spreads (vs. a composite of Yields based on the USD Index) suggest that **USD Declines Will Remain Prone to Rebounds as other G7 Central Banks are Incline To Cut Aggressively too.**

*Based on 2Y yield spreads between USTs & composite yield of USD Index-weighted bonds;
EZ Composite^ (57.6%);
JGB (13.6%);
Gilt (11.9%);
CAD (9.1%);
SEK (4.2%);
CHF (3.6%).
^ German-French-Italian-Spanish-Dutch-Belgian-Austrian-Finn-Irish-Portugese Weighted Composite

USD Index Yield Spread* (bps, LHS)
USD Index (RHS)

Sources: Bloomberg, Mizuho

250, 230, 210, 190, 170, 150, 130, 110, 90, 70, 50, 30, 10
114, 112, 110, 108, 106, 104, 102, 100, 98, 96, 94, 92, 90, 88
Mar-20, Aug-20, Jan-21, Jun-21, Nov-21, Apr-22, Sep-22, Feb-23, Jul-23, Dec-23, May-24, Oct-24

***Even with a Dovish Fed,* Real UST Yields Are Likely to be have Sympathy for USD Backstops.** For now, **USD Appears to have Front-Run Dovish Bets.**

10Y UST Real Yield
USD Index

Sources: Bloomberg, Mizuho Bank

3.0, 2.5, 2.0, 1.5, 1.0, 0.5, 0.0, -0.5, -1.0, -1.5
116, 114, 112, 110, 108, 106, 104, 102, 100, 98, 96, 94, 92, 90, 88, 86
Jul-15, Dec-15, May-16, Oct-16, Mar-17, Aug-17, Jan-18, Jun-18, Nov-18, Apr-19, Sep-19, Feb-20, Jul-20, Dec-20, May-21, Oct-21, Mar-22, Aug-22, Jan-23, Jun-23, Nov-23, Apr-24, Sep-24

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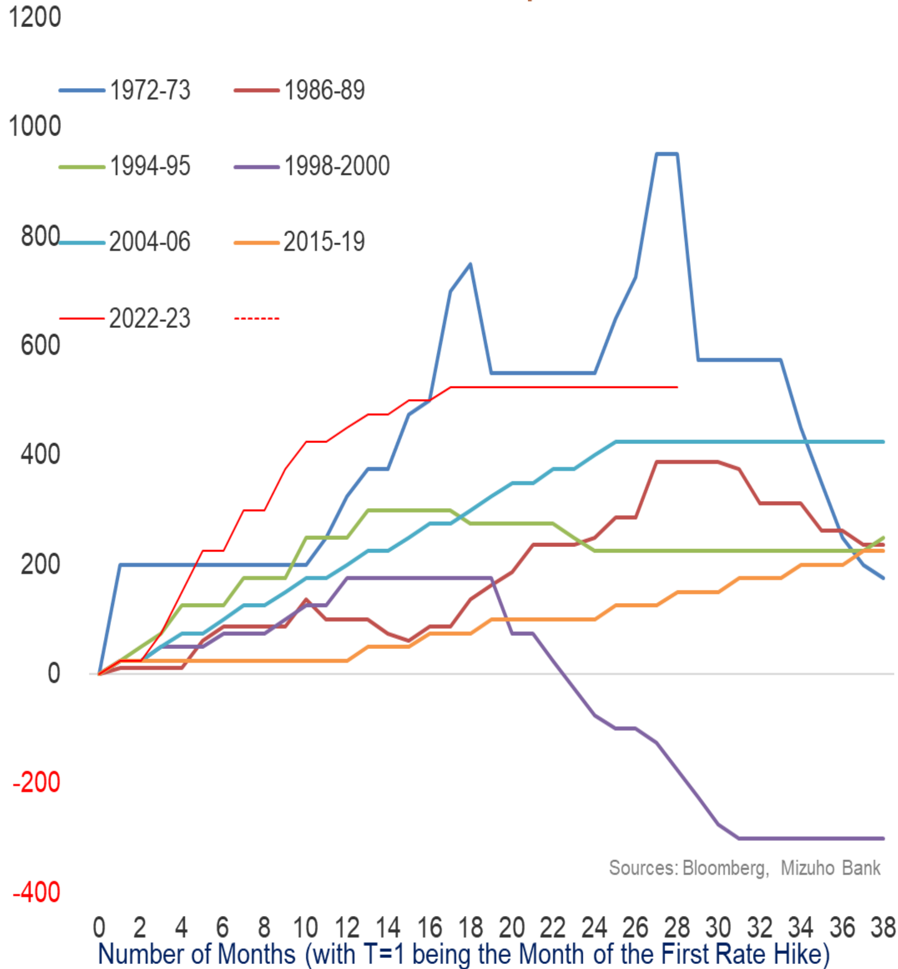
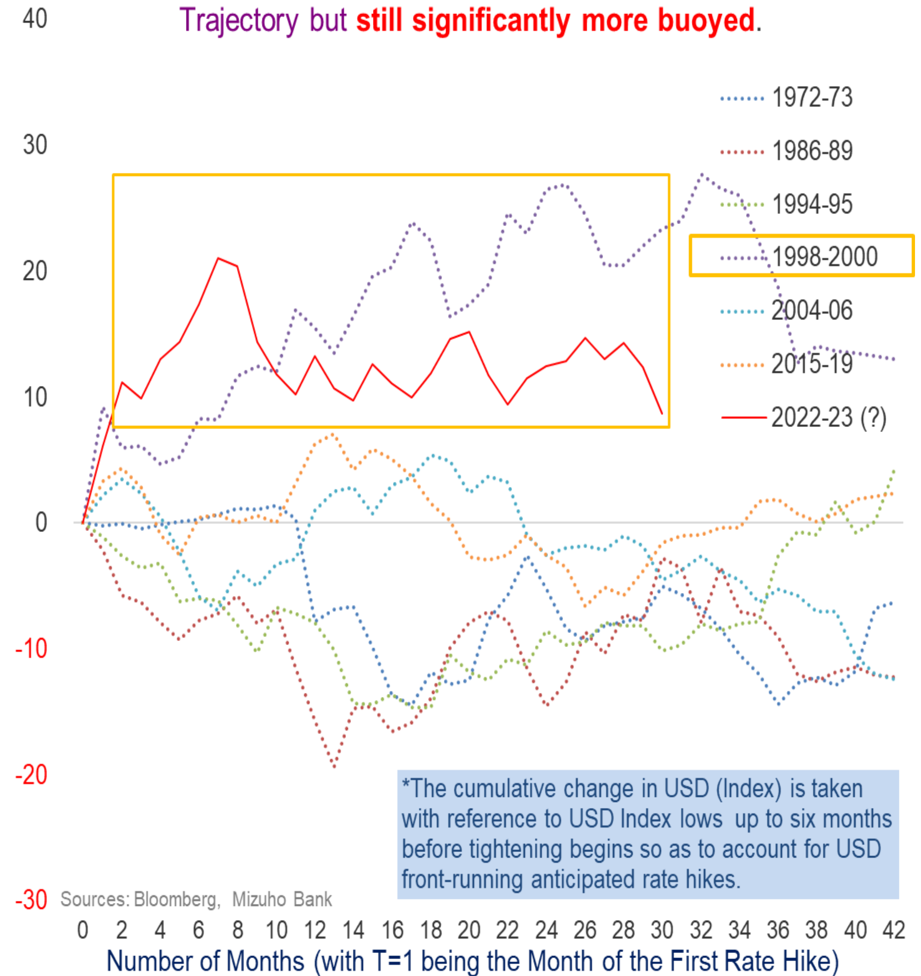
RISK - USD: Pivot USD Assumptions Breed Complacency on FX Threats

Fed Hiking Cycle (Cumulative Rate Hikes; bp): **Although not the Greatest Amplitude of Rate Hikes** (1970s More Brutal, with >700bp of Hikes), **this Cycle Marks the Fastest Pace of Hikes; 525bps Over 17 Months**.



Corresponding USD Performance (Cumulative % Chg*): **Notably, the Current Rate Hike Cycle Has Resulted in the Sharpest Phase of USD Strength in the First 8-9 months**; moderating below corresponidng 1998-2000 Trajectory but **still significantly more buoyed**.



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CNH Beta: Expect AXJ Volatilities to be Heightened & Fluid

CNH Beta*: There is Notable Variation in CNH-Beta of AXJ, which are are both Differentiated & Time-Varying.

CNH Beta is defined as the sensitivity of change in the respective AXJ vis-a-vis change in CNH. In other words, %-pts change in AXJ for every %-pt of CNH change.

High Beta (to CNH Chg)

Low Beta (to CNH Chg)

3.0
2.5
2.0
1.5
1.0
0.5
0.0
-0.5

INR HKD TWD AUD KRW PHP SGD IDR THB MYR

Composite 1-6Y Correlations
Since mid-2024

Sources: Bloomberg, Mizuho

1.90
1.85
1.80
1.75
1.70
1.65
1.60
1.55
1.50

1.0
0.8
0.6
0.4
0.2
0.0
-0.2
-0.4
-0.6
-0.8
-1.0

AXJC: Asia FX ex- JPY & CNY

AXJC-CNH Correlation
AXJC/CNH

Jan-18 Jun-18 Nov-18 Apr-19 Sep-19 Feb-20 Jul-20 Dec-20 May-21 Oct-21 Mar-22 Aug-22 Jan-23 Jun-23 Nov-23 Apr-24 Sep-24

Upshot: **Overwhelmingly Positive CNH-AXJC Correlations Remain Intact**. And so, the **Greater Risks for EM Asia FX** is From ***Sudden & Sharp CNH Weakness Dragging AXJC***.

Sources: Bloomberg, Mizuho Bank

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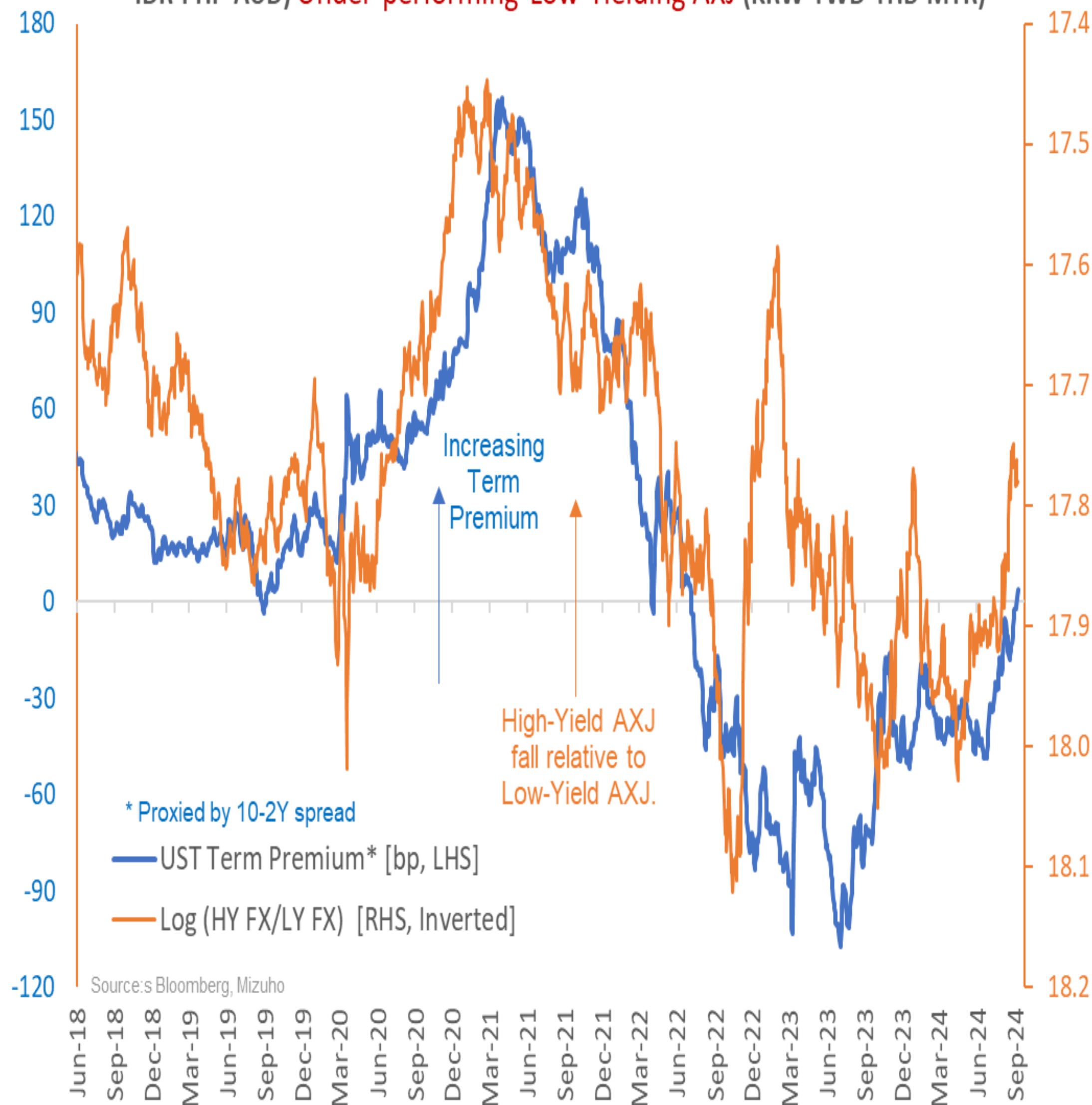
AXJ: Steeper UST Curve an Additional Interim Risk (Especially for HY AXJ)



At the Cost of Risk Re-pricing in EM Asia …

- But **path to a steeper UST yield curve** may be **bumpy for EM Asia** assets and FX too.
- Possibly even **entailing risk re-pricing** that involves spot of capital outflows.
- This is particularly in the context with a steeper UST yield curve typically diminishing the attractiveness of EM Asia yields.
- Especially given starting point of substantially eroded EM Asia spread over USTs.

… Harsher on High-Yield AXJ

- Specifically, the **ability to swap credit risk (in EM Asia) for more pronounced comparative term premium pick-up in USTs**. ➔ *going out the "risk -free" curve rather than going down the credit curve.*
- Attendant pressure on EM Asia currencies is par for the course.
- And **given the credit risk-to-term premium swap** involved, **higher-yielding EM Asia currencies are left at a relatively greater disadvantage** (vis-à-vis lower-yielding EM Asia FX).

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AXJ: Cusp of Change? Not Quite Concrete. Relative Shifts Obfuscated

Fed Impact (%-Chg): Comparing Fed Tightening Impact to Q2 2024 "Fed Pivot". THB, MYR are Notable Out-performers since Q2 2024 Pivot, in comparison to other AXJ peers.

15
10
5
0
-5
-10
-15
-20
-25
-30

JPY TWD KRW IDR CNH PHP MYR CNY INR VND AUD THB EUR SGD DXY

■ Fed Tightening*
■ Since Q2 2024 "Pivot" **
▲ Fed Tightening to Latest (mid-Oct 2024)

* Tightening impact takes FX change from the average of Sep-21 and Mar-22 vs. average of to Apr-24 and Jun-24 levels.
** Pivot Impact is change from average of Apr-24 and Jun-24. vs. prevailing (Oct average) levels.

Sources: Bloomberg, Mizuho

Enduring Shifts Since COVID (%-Chg): Since the Pandemic, Divergences Have Not All Evened Out, with *Enduring ~18% SGD-INR Wedge* at the AXJ Extremities. Sources of Pressures (Pandemic vs. Fed) have also Varied Substantially between Currencies.

15
10
5
0
-5
-10
-15
-20
-25
-30

JPY INR KRW PHP IDR THB TWD VND MYR AUD EUR CNH CNY SGD DXY

■ Fed Tightening to Latest (Avg of Sep-21 & Mar-22 to Oct-2024)
■ COVID-to-Fed Tightening (end-2019 to Avg of Sep-21 & Mar-22)
● Combined

Sources: Bloomberg, Mizuho

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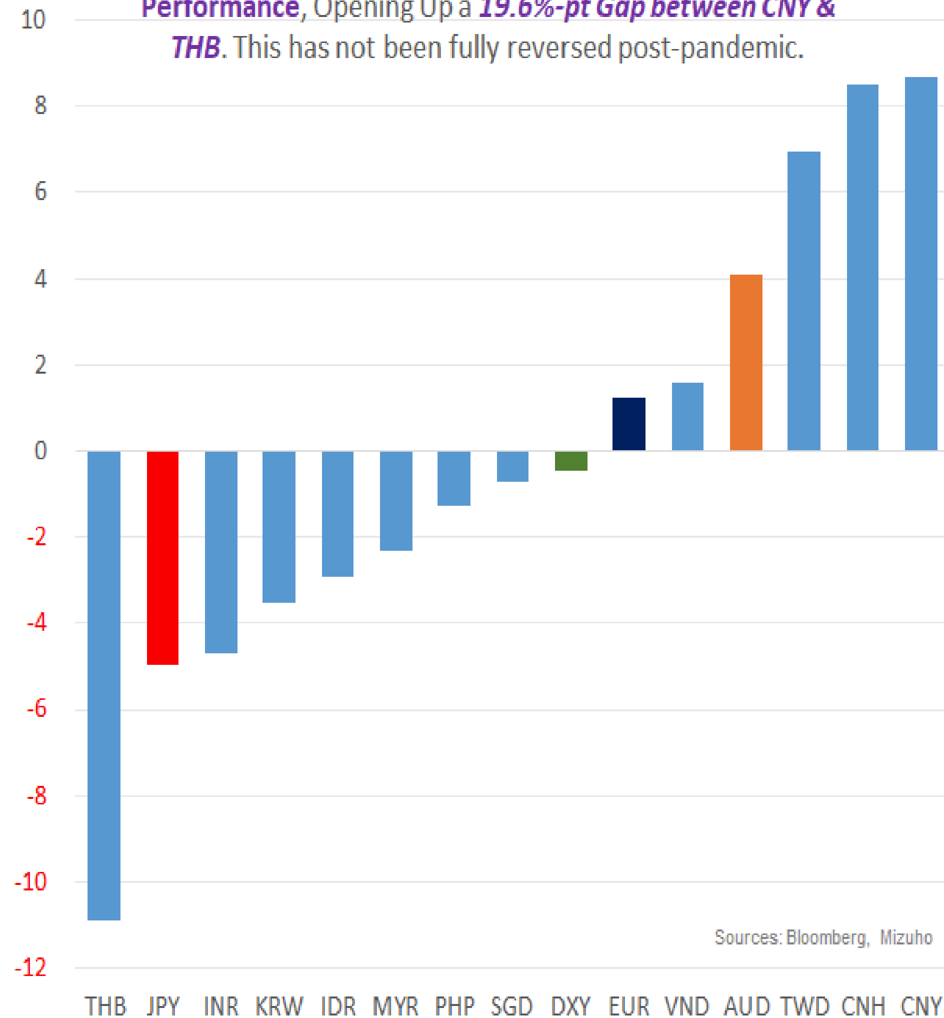
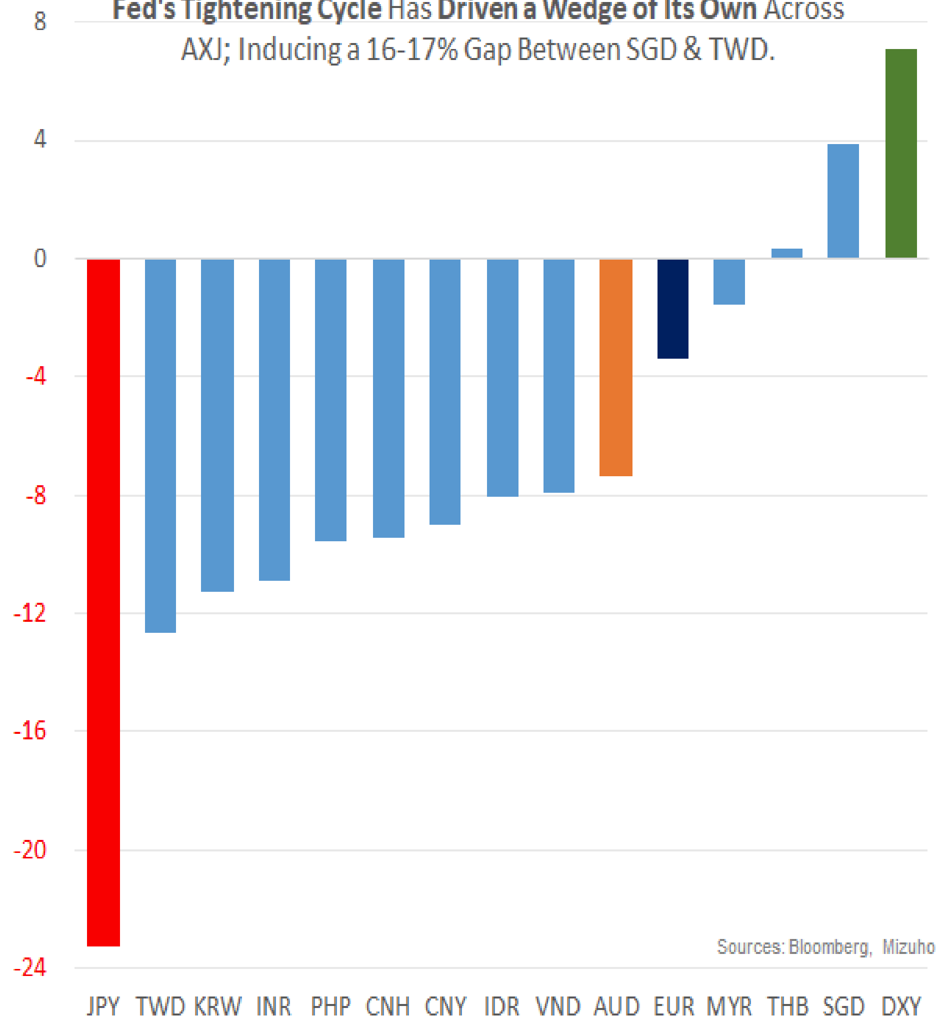
AXJ: Pandemic & Kokomo Fed Have Blurred Undulations (Cyclical) & Dislocations (Structural)





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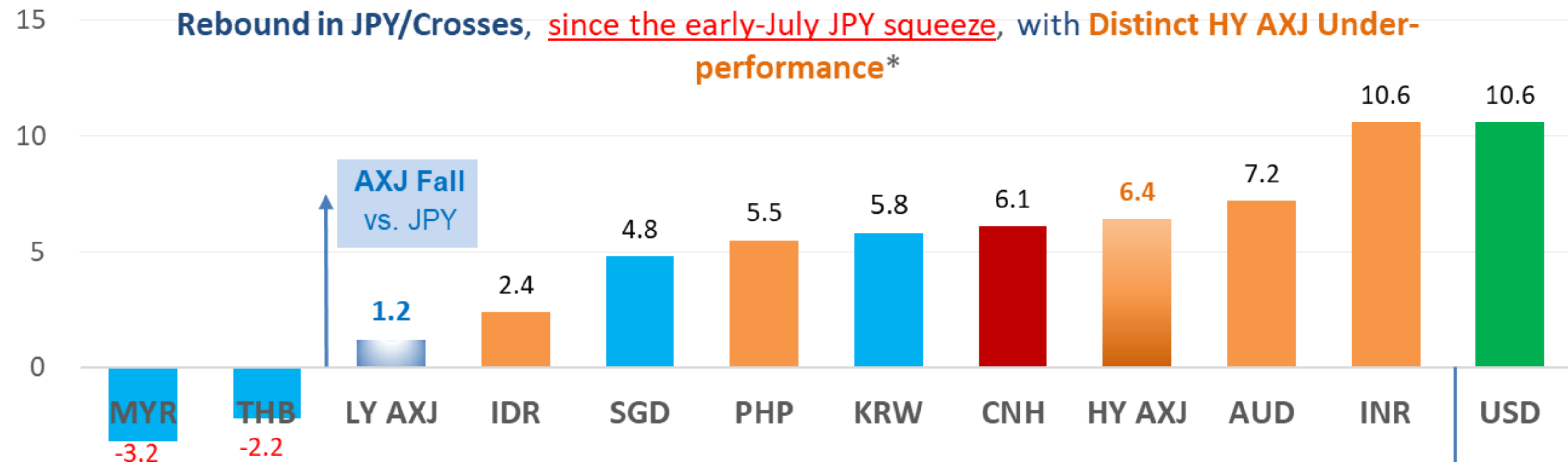
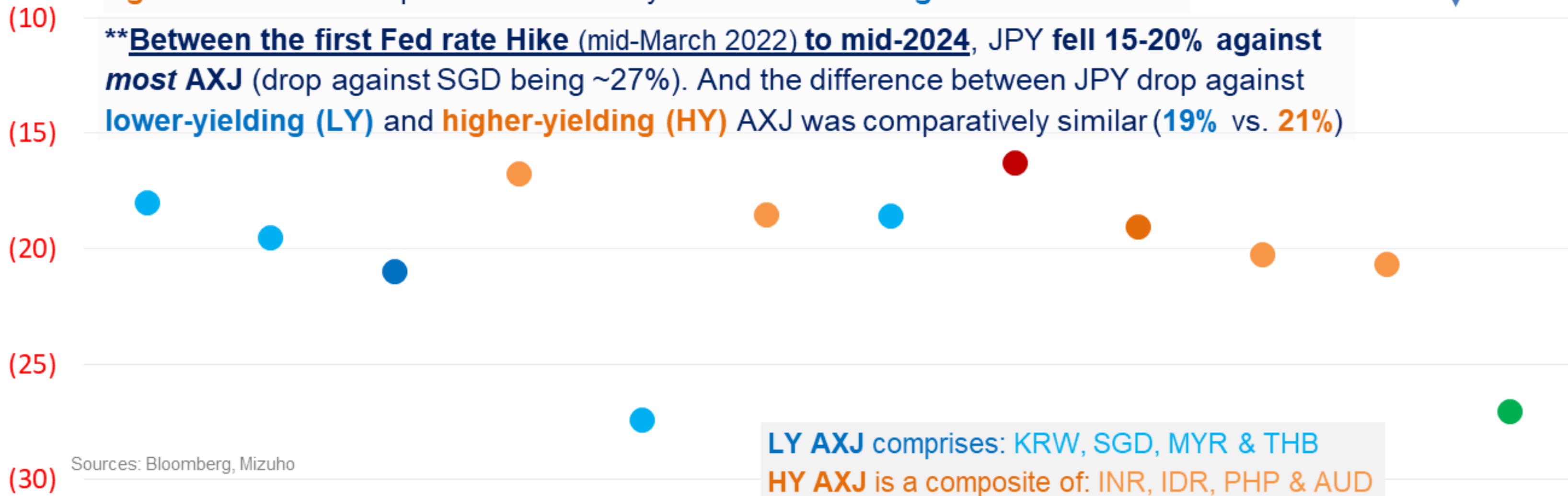
JPY-Lined Volatility Even Higher: Latent Correction Factors Accentuated





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JPY-BoJ Risks: The "JPY Problem with a Fed Solution" Could Induce Heightened Volatility

Fed Pivot Could Accentuate JPY Rebound (USD/JPY Pullback) From BoJ Tightening. Notably, the Optics of Fed-BoJ Divergence May Also Exaggerate Upside JPY Volatility.

USD/JPY (2wkma, LHS)

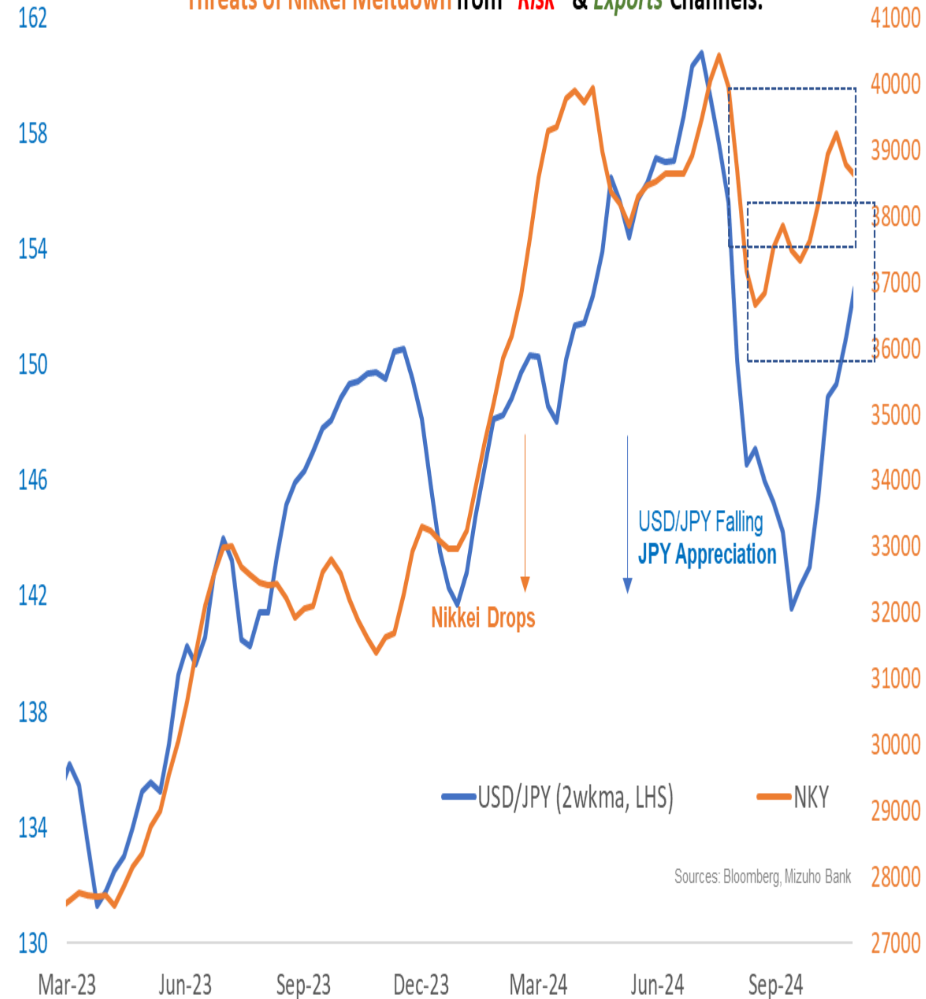
UST-JGB spreads (2wkma; bps; RHS)

Further, sharp 30-80b pullback in UST-JGB spread in the next 3-9 months, may square with a corresponding JPY surge to 130-135.

That's even after a structurally weaker JPY vis-a-vis UST-JGB spreads are considered.

And if it is not structural, and instead "froth", sharper USD/JPY catch-down may be a wider risk.

Sources: Bloomberg, Mizuho



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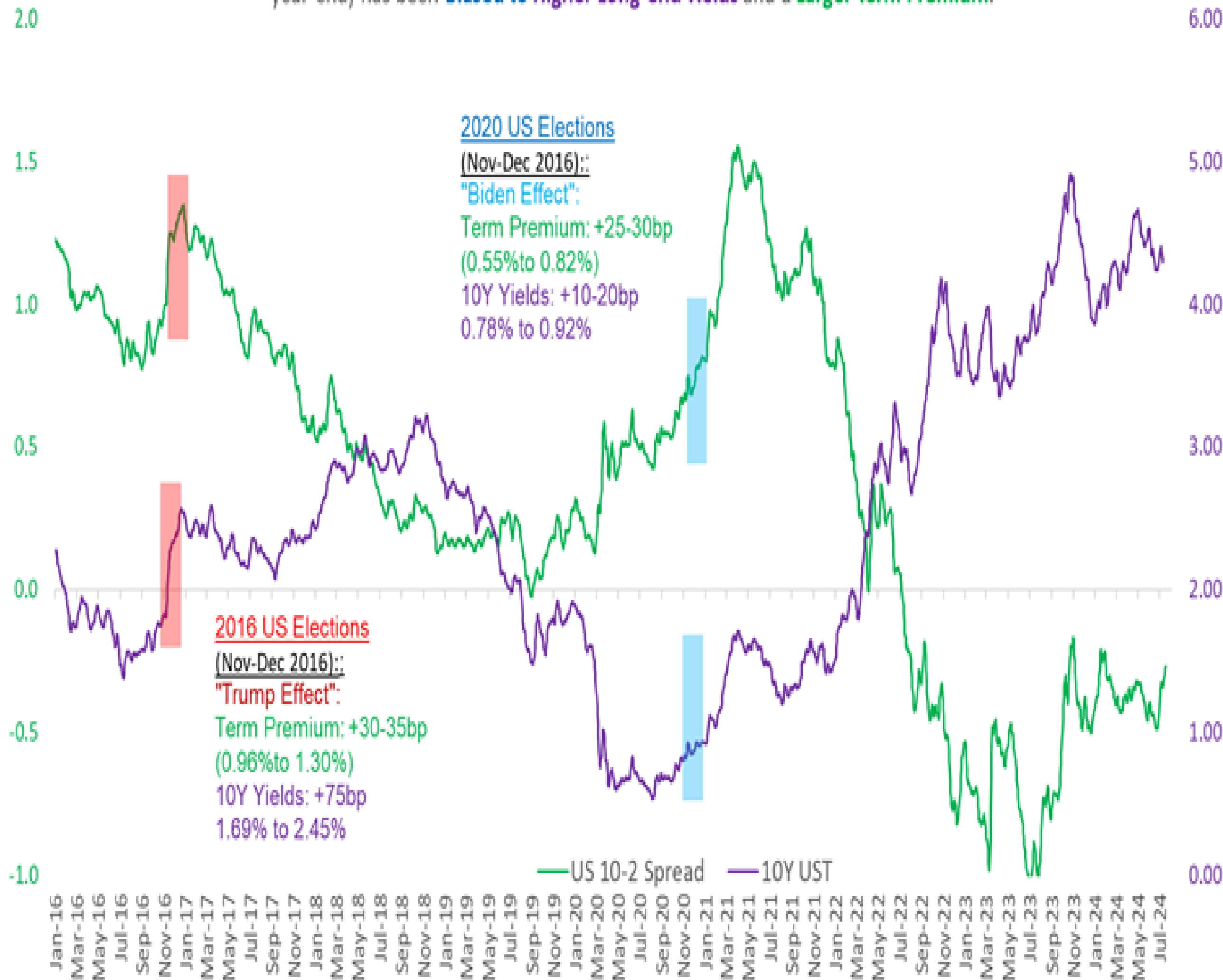
RISK – Yield Curve: Steepening & Threats to AXJ Accentuated by US Elections



US Elections

- **UST yield curve steepening as a by-product of US elections** is arguably **the lived, relatable recent experience**.
- Not just of "Trump 1.0" in 2016 as well as the Biden win in 2020.
- Admittedly, enduring **US elections effects on the yield curve may be overstated.**
- Coincident shift in *monetary policy* (out of ZIRP), *geo-politics* and the *pandemic could have had far greater sway*.
- Nonetheless, **expectations tied to US elections** resonate with **fiscal/geo-political/inflation risks**, extrapolated, and are arguably (**at least temporarily**) self-fulling.

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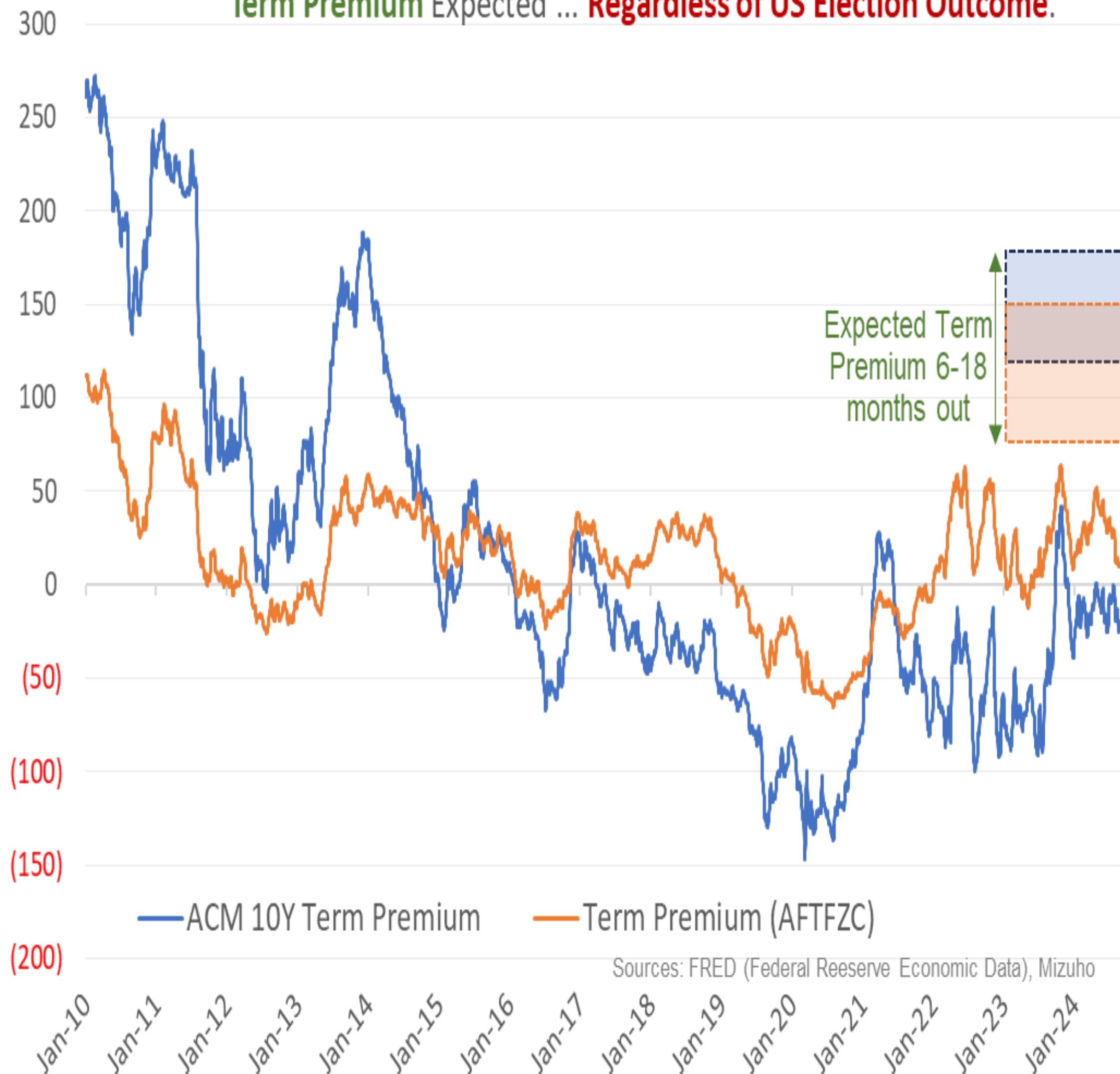
RISK – Yield Curve: Higher Term Premium Beyond Cyclical Forces



Significant & Structural lift in term premium, accentuating the policy cycle buoyancy expected in longer-end yields (in re-steepening), a key macro risk

i) Inflation Expectations: Up & Uncertain?

- First, **structurally higher inflation**, associated with *de-globalization threats that feature antagonistic US-China geo-politics**** colliding with *"green-flation"*.

ii) Geo-Political/Social Costs Termed Out

- Moreover, ***conflict/geo-political tensions raising longer-end bond supply globally***, *exacerbated by a more isolationist and less predictable US,* **feature in the term structure via higher volatility expectations**.

iii) Debt, Debasement & Dollar

- ***Crucially***, **dramatically increased, but harder-to-time, USD debasement risks** *from burgeoning debt,* may emerge as **pronounced UST term premium.**

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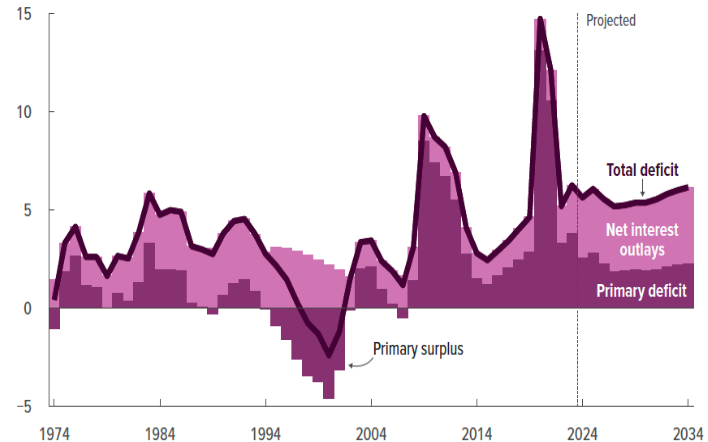
US Elections: Why Our M-T Fiscal & Yield Curve Views are Agnostic to Politics

- Partly because of obscured political projections.
- Not only is it **difficult, but arguably misguided, to holistically pin down candidate-dependent fiscal policies *in a vacuum.***
- But mostly, because our base case, limited view is that **neither the Democrats nor the Republicans have the fiscal high ground**.
- Instead, it is merely the nature of their "fiscal sins" that differ (spending vs. tax cuts).
- Hence, defaulting largely rely on the CBO's estimates for fiscal deficit is a good start.
- And the **projections for fiscal deficit to be in the ballpark of 5.5-6..0% for the next decade** (2025 through 2035) are reasonable, albeit worrying.
- Crucially, **net interest payments (NIP) starting to become the dominant source of fiscal burden** (see the CBO Figure 1.1 below), necessarily limits fiscal options and **imposes harsher constraints**.

Figure 1-1.

Total Deficit, Net Interest Outlays, and Primary Deficit

Percentage of GDP



In CBO's projections, the total budget deficit—the amount by which outlays exceed revenues—equals 6.1 percent of GDP in 2034. Net interest payments grow in relation to GDP, reaching 3.9 percent of GDP in 2034. Primary deficits increase in 2025, decline over the next few years, and then increase again.

Data source: Congressional Budget Office. See www.cbo.gov/publication/59710#data.

When October 1 (the first day of the fiscal year) falls on a weekend, certain payments that would have ordinarily been made on that day are instead made at the end of September and thus are shifted into the previous fiscal year. All projections presented here have been adjusted to exclude the effects of those timing shifts. Historical amounts have been adjusted as far back as the available data will allow.

Primary deficits or surpluses exclude net outlays for interest. When outlays exceed revenues, the result is a deficit. In this figure, deficits and surpluses were calculated by subtracting revenues from outlays; thus, positive values indicate deficits, and negative values indicate surpluses. When outlays are subtracted from revenues, as recorded in the federal budget and in the tables in this chapter, negative values indicate deficits, and positive values indicate surpluses.

GDP = gross domestic product.

- Notably, NIP is set to make-up **60-65% of total deficit** in from 2025-2034 compared to **just over a quarter of total fiscal deficit** from **2010 to 2014** when fiscal deficit averaged a comparable 6.1%).
- This means two things, that underpin a worrying fiscal trajectory with increasing incentive to term out debt.
- First, **incremental,** **policy-driven variations in primary deficits (ex-NIP) will have diminished sway on total fiscal deficit** and the **attendant bond issuances required**.
- Second, the **incentive to term out debt issuances grows** as interest rate burden crowds out current budget spending requirements.

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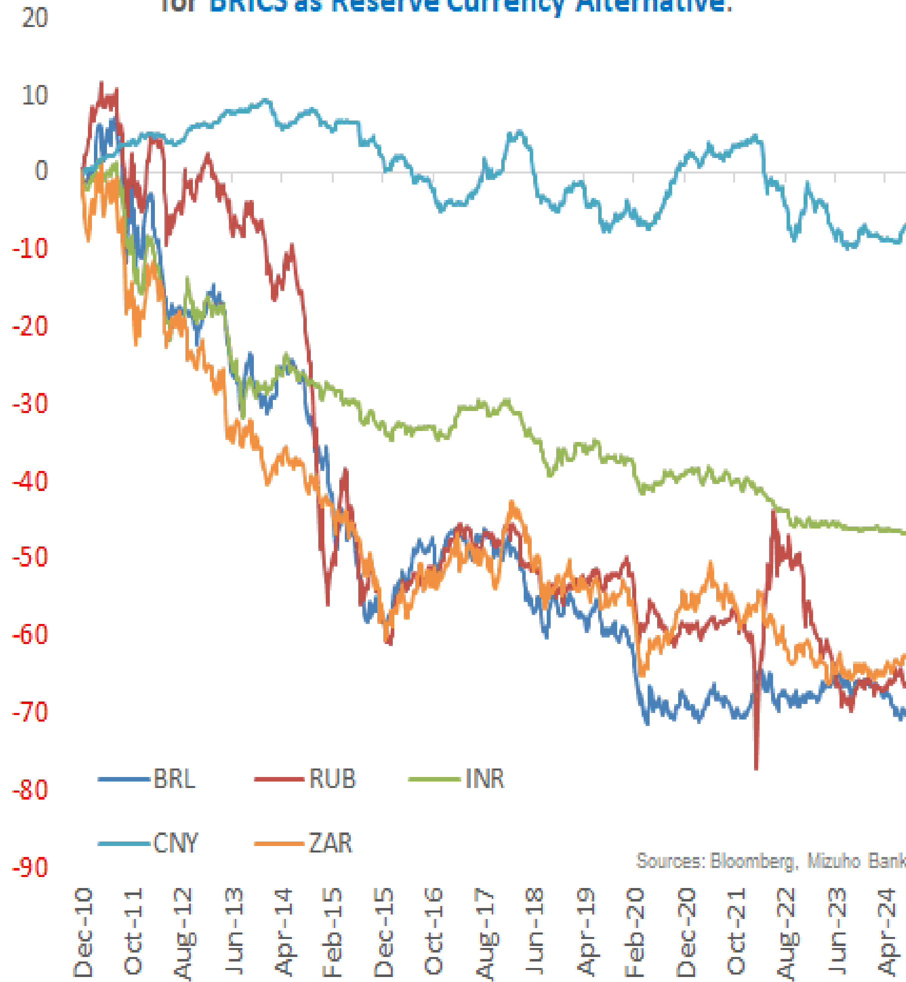
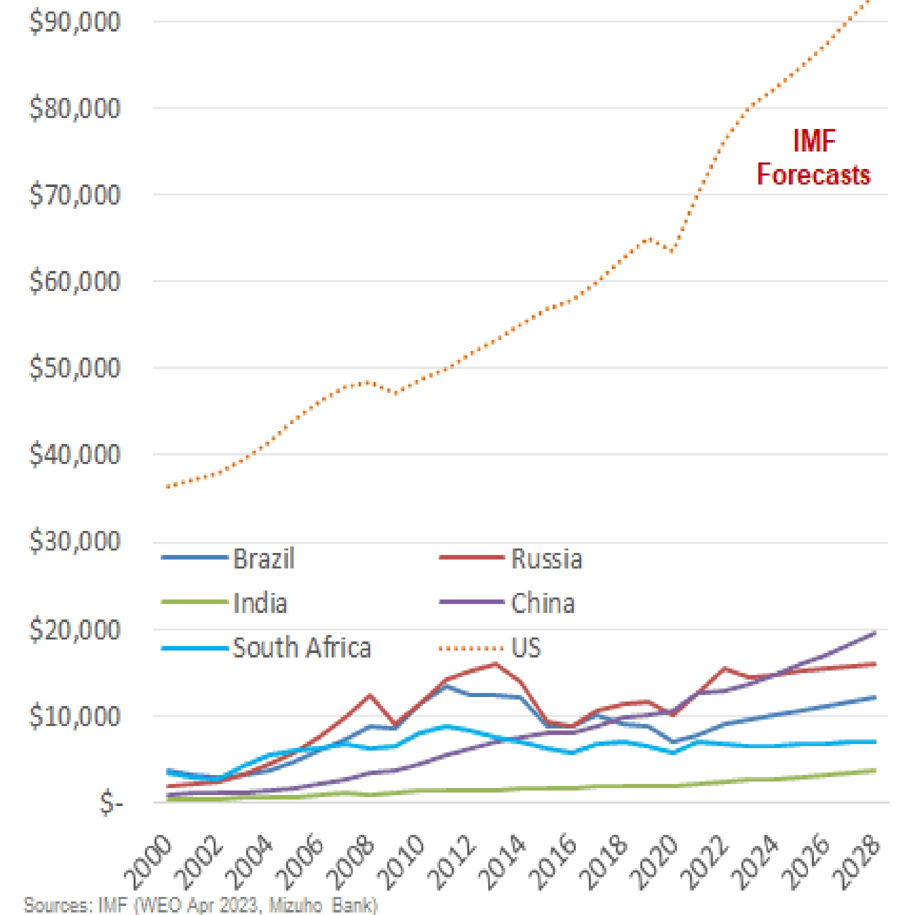
Appendix: USD's TINA Support





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