The Known Unknowns of Trump 2.0

Tariffs, Taxes & Tantrums




"Known must be your fear before banish it you can."

- Master Yoda, Star Wars

Private and confidential

Photo Credit: FT

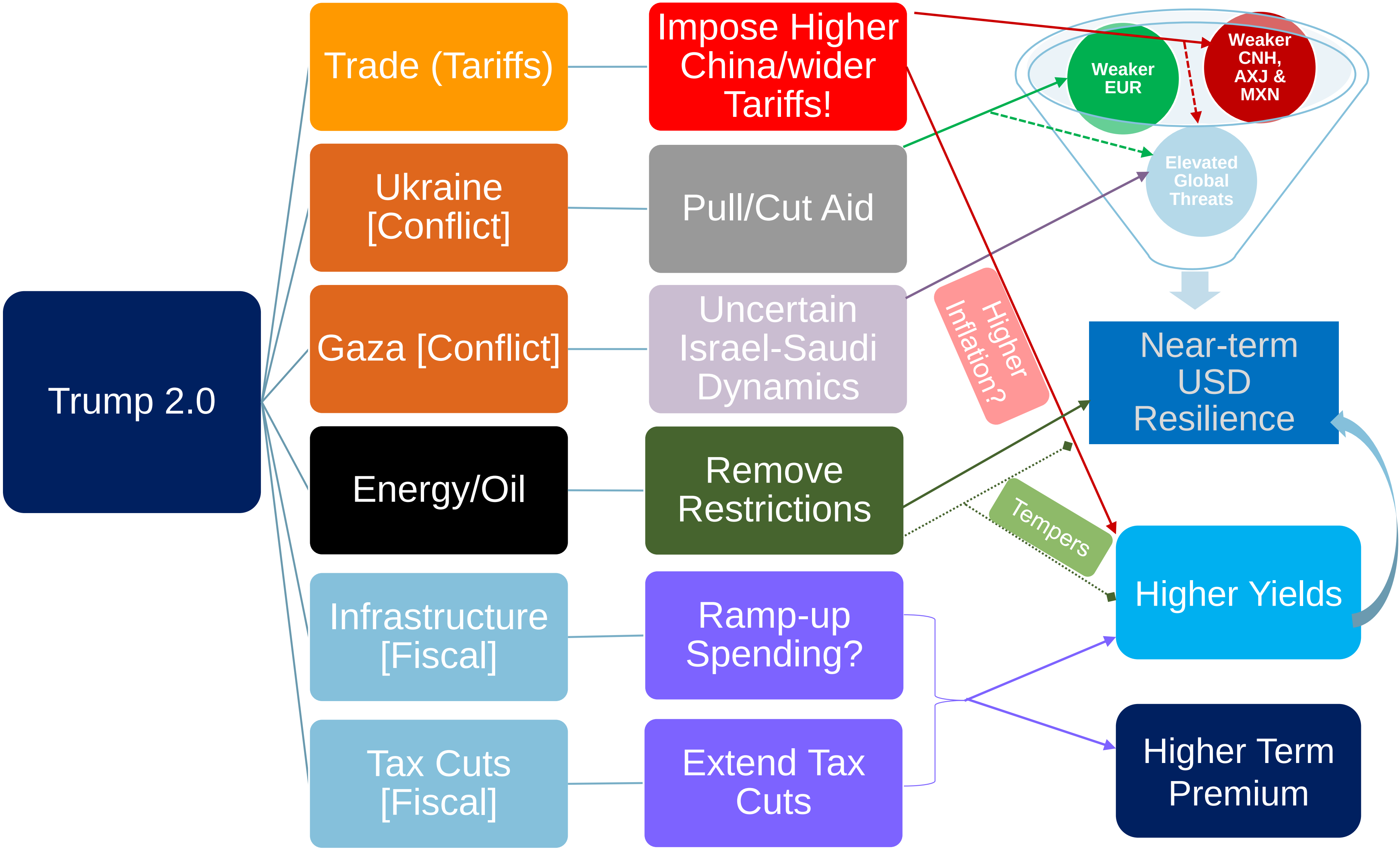
MIZUHO

November 2024

“Known Unknowns” of Trump 2.0

1. **Trump 2.0 Trades: Trading Uncertainty**
    a. “Trump Trades” –What & Why
    b. Execution Beyond Campaign
    c. Looking Past Election Cycles … Trump Effects vs. Fed Sway
2. **Policy Risks: Will the Fed (Easing Cycle) be Trumped?**
    a. Will Trump-flation (from fiscal-trade-immigration)” Hijack the Fed Cut Cycle?
    b. What this means for Rates, USD & Wider Markets
3. **Trade Risks: Code Orange - Navigating Disruption Risks & Collateral Damage**
    a. Threats to Global Trade & Manufacturing
    b. Does China Have a “Trump Card”?
    c. Winners & Losers in Asia amid Zero-Sum Game, Bottom-line, Bilateral, Agitations
4. **FX Quirks: Code Orange - Navigating Disruption Risks & Collateral Damage**
    a. CNY Sensitivities & AXJ Risks
    b. JPY Volatility Accentuated by Trade & Complex BoJ Dynamics?

1a. Trump Trades: The What & Whys of Geo-economics



1a. Trump Trades: Details Matter, Execution will Nuance & Fed Still in the Game!

"Trump Trades"	Higher Equities ↑	Higher USD ↑	Higher Yields ↑	Steeper Curve ↑
Since 18th Oct (amid rising Trump 2.0 bets)	+2%	+4%	+32bp	+12bp
Tax Cuts ➔ Fiscal Slippage ➔ Higher Growth	↑	↑	↑	↑
Deregulation ➔ Higher Growth	↑	↑	⇧	⇧
Trade Tariffs	Greater Differentiation	↑		

US Elections		USD	Long-end Yields	Curve
Trump	"Red Wave"	Stronger ++++ (2-6%) ↑	Higher +++ (20-40bp) ↑	Steeper ++++ (30-60bp) ↑
Trump	Split	Stronger +++ (1-4%) ↑	Higher ++ (10-20bp) ↑	Steeper +++ (15-40bp) ↑
Harris	Split	Neutral	Lower -- (5-15bp) ↓	Flatter - (5-10bp) ↓
Harris	Blue Wave	Weaker - (1-2%) ↓	Higher + (5-10bp) ↑	Steeper ++ (10-30bp) ↑

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.

1b. Trump 2.0: Execution is Key & Personnel a Clue … But Highly Uncertain for Now

	In Charge of	Nomination	Remarks
Energy Secretary	- Nuclear Weapons Program - Manages energy infrastructure and oil stockpile - Funds energy research	Chris Wright	- Runs oil and natural gas fracking company - Public paper to conclude that climate change is far from world's greatest threat to human life
Secretary of Defense	- Head of defense departments and subject only to orders of the President - Army, Marine Corps, Navy, Air Force	Pete Hegseth	- Fox News Host
Treasury Secretary	- Financial Stability Oversight Council (Recent issues: Crypto, Climate) - Debt Management - International economic diplomacy	Scott Bessent	- Found of Macro Hedge Fund - 3% Growth, 3% fiscal deficit, +3mpd/barrels of oil - Acknowledges USD Policy Inconsistencies
Secretary of State	- 4th in line to Presidential Succession, ranked Second in Cabinet - Supervise foreign services and immigration policy.	Marco Rubio	- China hawk - Sanctioned by China
Commerce Secretary	- Promote American commerce	Howard Lutnick	- Alliance with Tether Holdings (Crypto) - Alludes to "anti-competitive" global trade elements
Health & Human Services Secretary	- Health programs - Oversees FDA, CDC…	Robert F. Kennedy, Jr	- Vaccine Skeptic
Ambassador to UN		Elise Stefanik	- Says UN corrupted, defunct and paralysed.
Border Czar (no Senate confirmation needed)	- Oversight of immigration, maritime and aviation security	Tom Homan	- Criticized for separating migrant families.
National Security Adviser		Michael Waltz	- China hawk - Encourage military buildup

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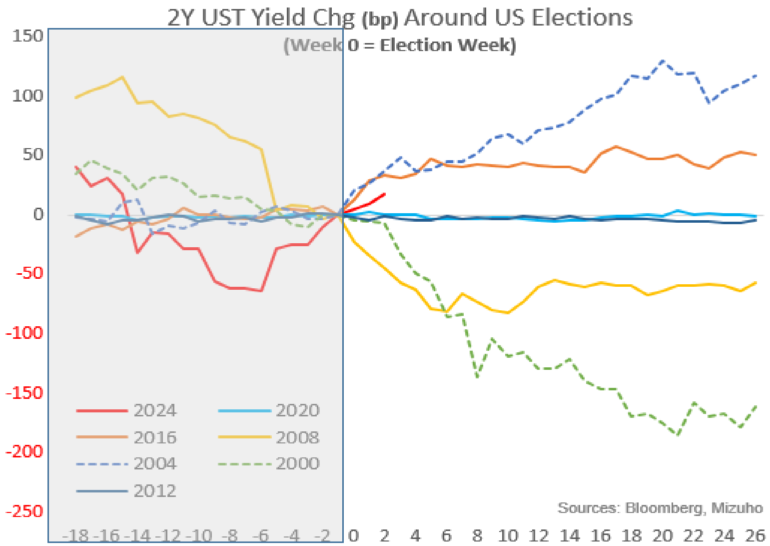
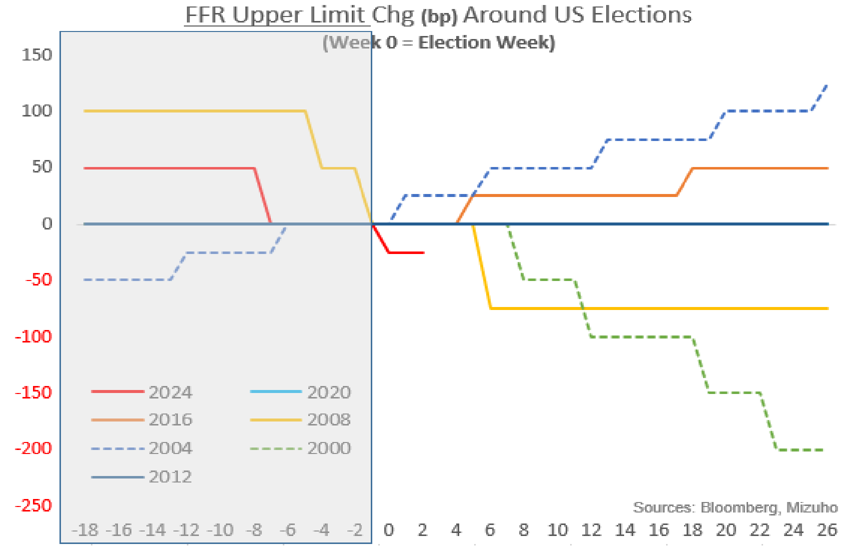
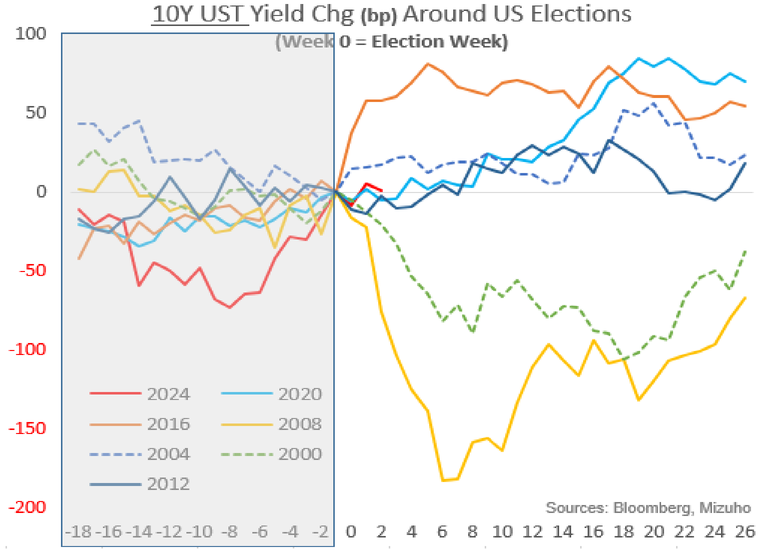
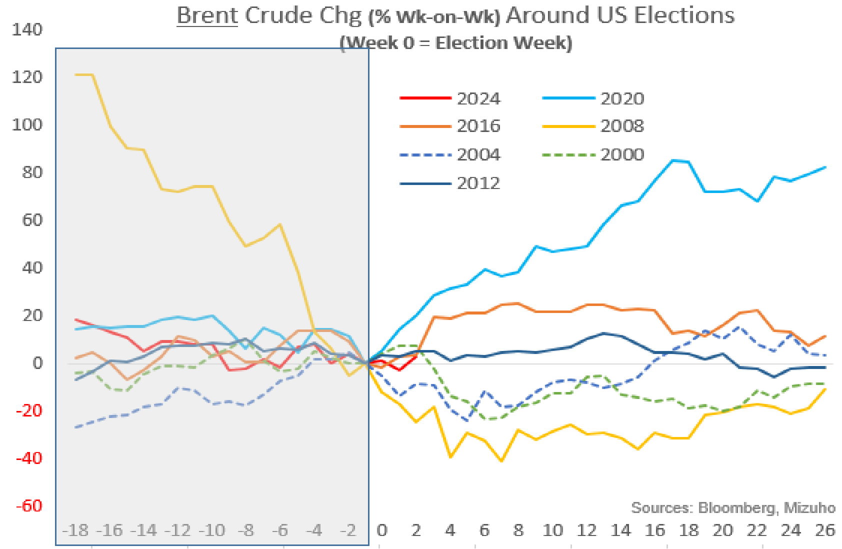
1c. Fed & Rates: Fed Cycle, Inflation Expectations & Trump

1. **Front-end** (2Y) **Yields are Tightly Tied to the Fed Cycle,** Not the Elections ➔ **Trump-Effect Overstated?**
2. **Long-end** (10Y) **Yields** admittedly more **affected by inflation expectations and fiscal path.**



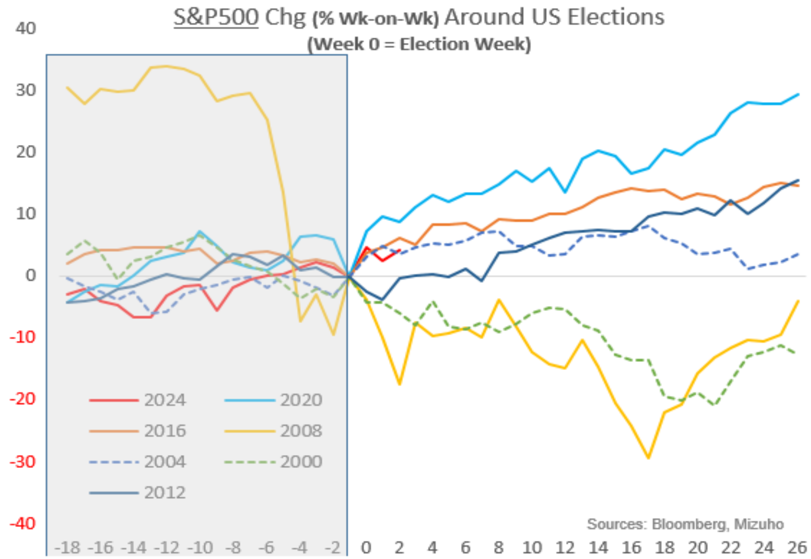


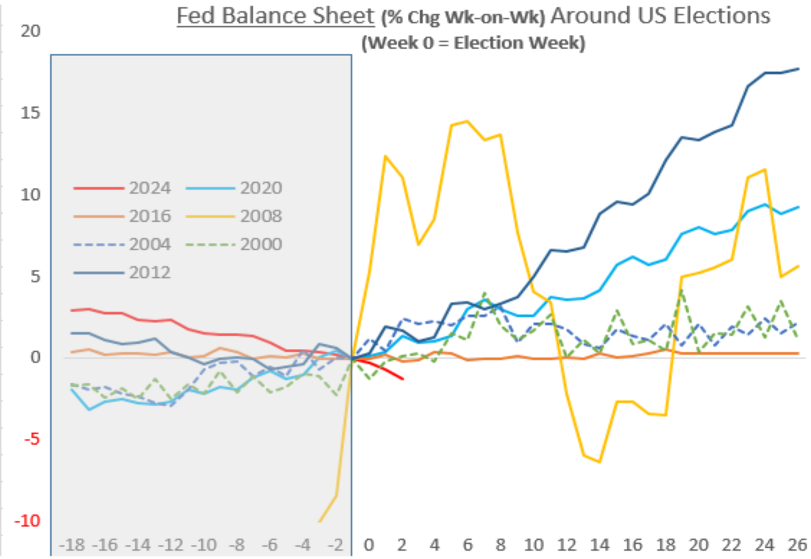


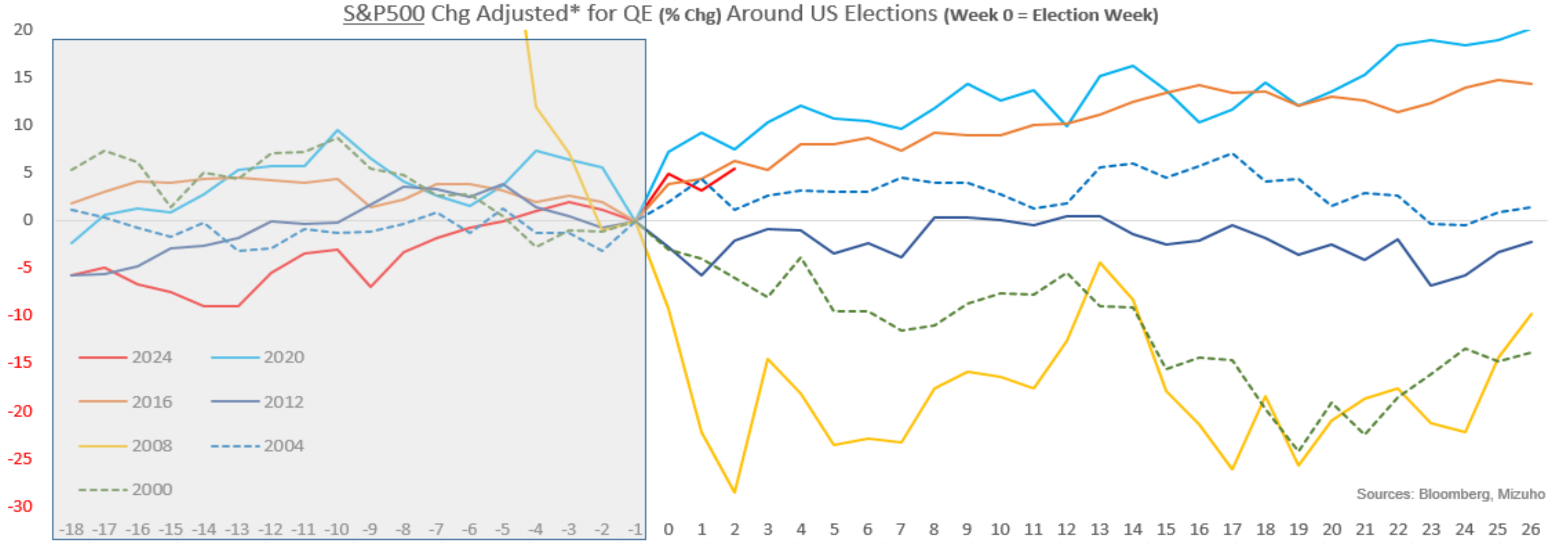


1c. Fed & Equities: Trump Effect Validated, but Equities Highly Sensitive to Fed Policy

1. **Fed QE** (Balance Sheet) has **Significant Sway on Equities** (via cheap Liquidity)
2. **Adjusting for Fed QE Effects, Trump Premium is Validated, albeit Overstated**

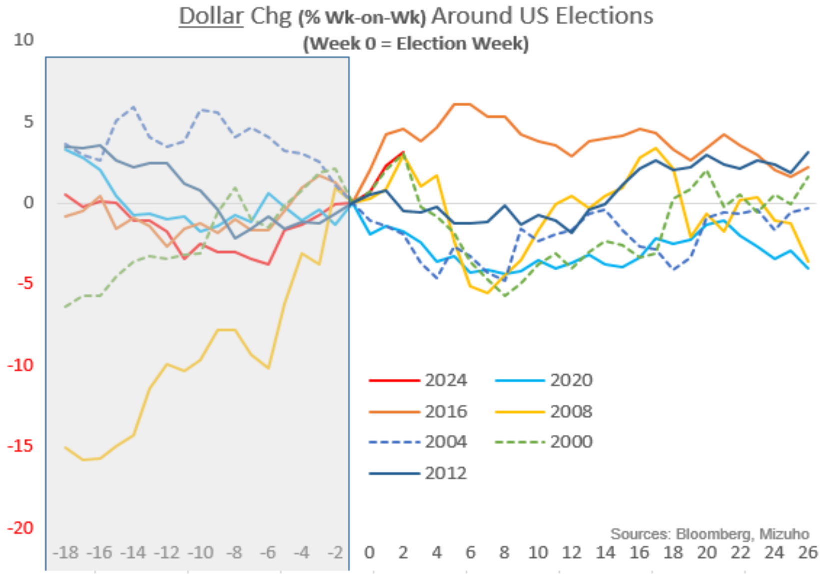


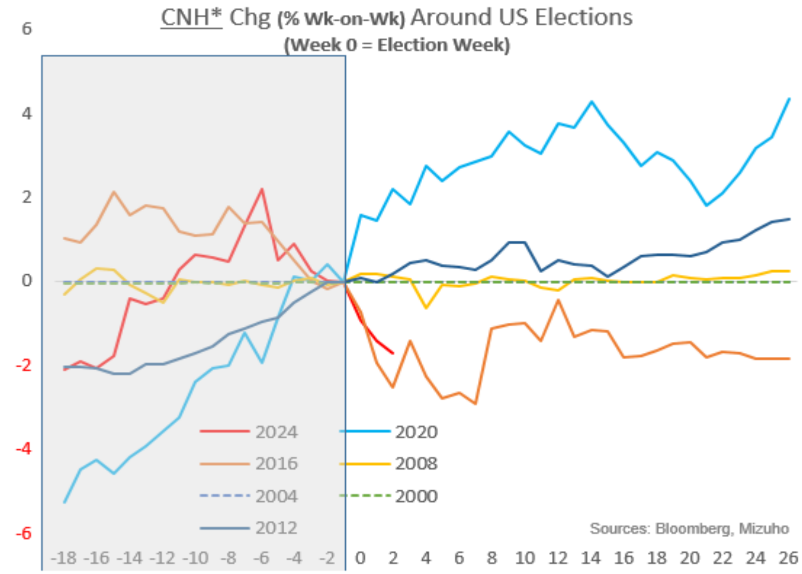


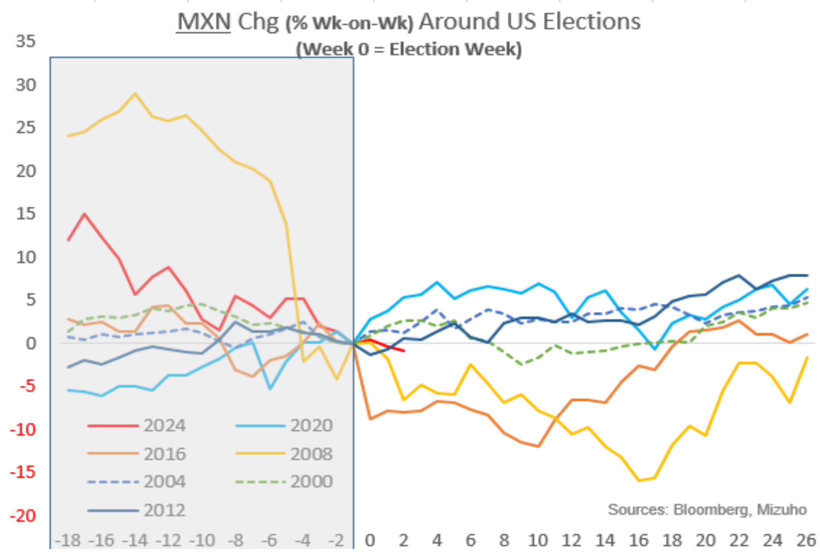


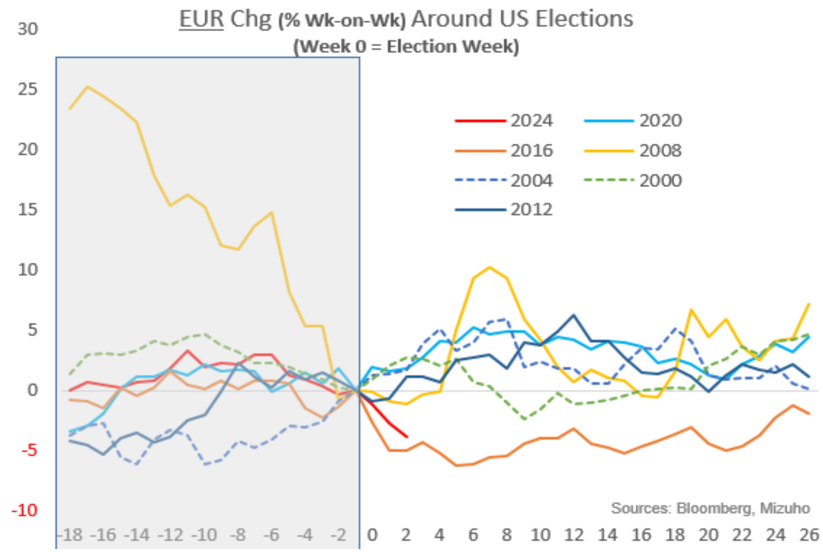
1c. Fed & USD: Trump’s Incongruence (Effects vs. Intent) & the Fed’s Influence

1. **USD Strength is Not Typical Post-Elections, but Some Currency to Inadvertent Trump Boost for Greenback.**
2. But again, the **Fed’s Cycle** is Not Only **Highly Relevant**, but *Could Even Override*.









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2a. FOMC Predisposition is for Restraint in, Not Suspension of, Easing

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 (done) & Dec FOMC: **25bp/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**.
- **A lot hinges on December FOMC**, led by "Dot Plot" quantification of policy dilemma

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

+40bp

No sustained deterioration?

~60bp of policy flexibility for Sep?

-20bp

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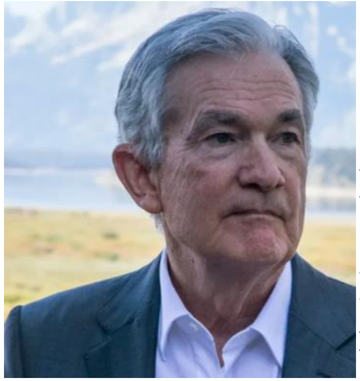
2a. Trump-flation Will Not Necessarily Hijack Fed Cutting Cycle



Doesn't rule in or out a December rate cut

Economic activity has continued to expand at a solid pace

Labour market conditions **are less tight than before the pandemic**

It is not permitted under law for the Fed to remove the Fed Chair. He would not resign if asked to leave.

We don't guess, we don't speculate and we don't assume.

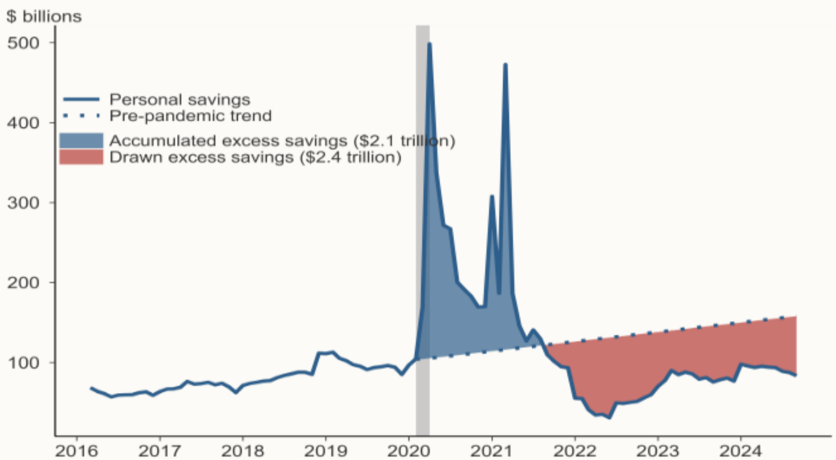
We **don't know what the timing or substance of economic policy changes** going forward. The **Fed is not going to assume or guess** what's going to happen. In the near term, the election will have **no** effect.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. ~~The Committee has gained greater confidence that inflation is moving sustainably toward 2 percent, and~~The Committee judges that the risks to achieving its employment and inflation goals are roughly in balance. The economic outlook is uncertain, and the Committee is attentive to the risks to both sides of its dual mandate.

Recent indicators suggest that economic activity has continued to expand at a solid pace. ~~Job gains~~Since earlier in the year, labor market conditions have ~~slowed~~generally eased, and the unemployment rate has moved up but remains low. Inflation has made ~~further~~ progress toward the Committee's 2 percent objective but remains somewhat elevated.

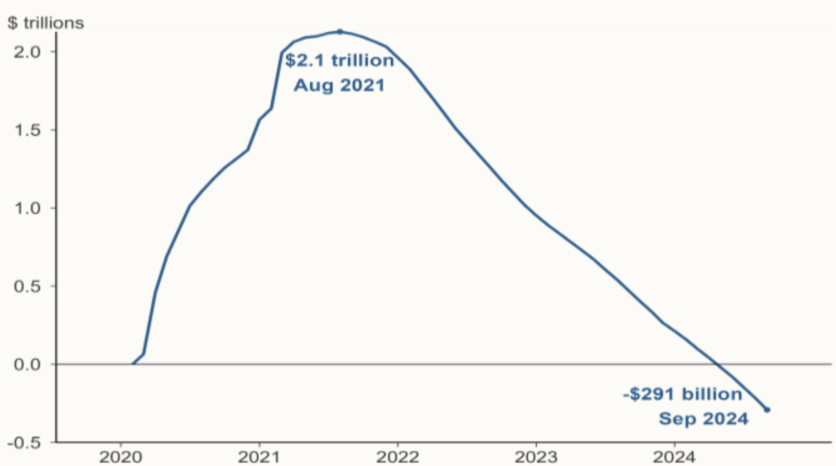
ASSUMPTION. Cash-flow Constraints Threatening Demand Resilience

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



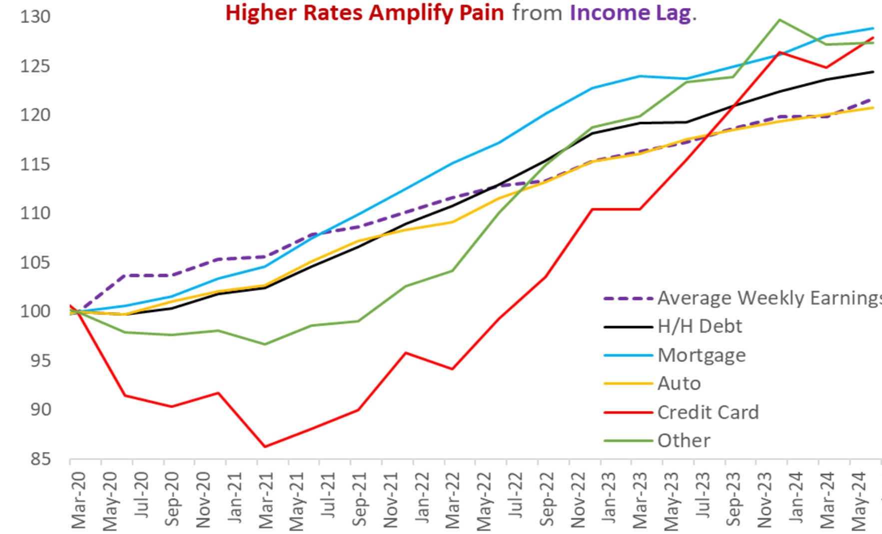
Note: Gray shaded area represents NBER recession dates. Source: Bureau of Economic Analysis and authors' calculations.

Chart 2: Cumulative aggregate pandemic-era excess savings



Source: Bureau of Economic Analysis and authors' calculations.

Household Debt Since COVID (Mar 2020): Sharper Surge in Unsecured Debt (CC & Others) as Pandemic Savings Drawn Down. Higher Rates Amplify Pain from Income Lag.



"Chicken & Egg" Debt-Default Dynamics: Default Rates have shot up (direction and speed of travel worrying!) and is at "cusp of GFC" levels.

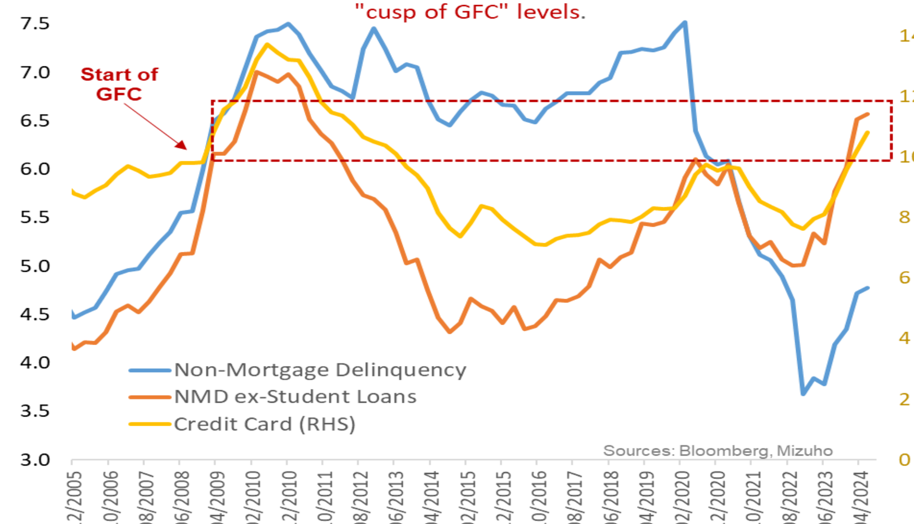


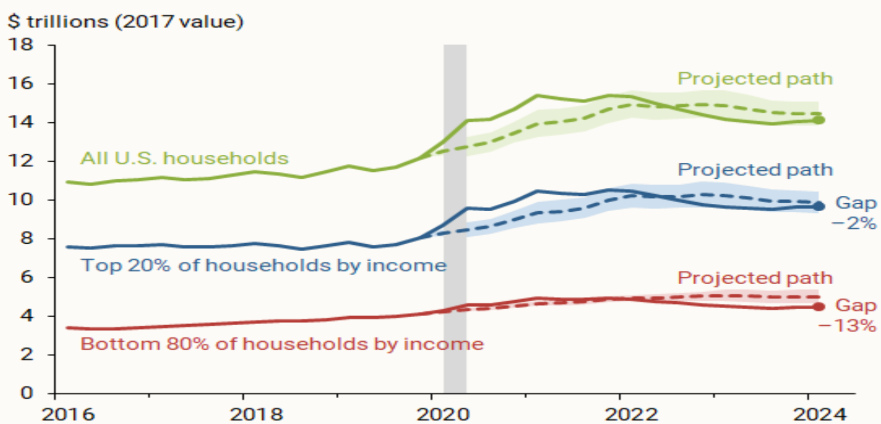
Chart from Bloomberg, San Francisco Fed,

<u>ASSUMPTION</u>. Strains from Erosion of "Liquid" Wealth

<u>US Consumer - Tightening Cash-flows</u>

- 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.

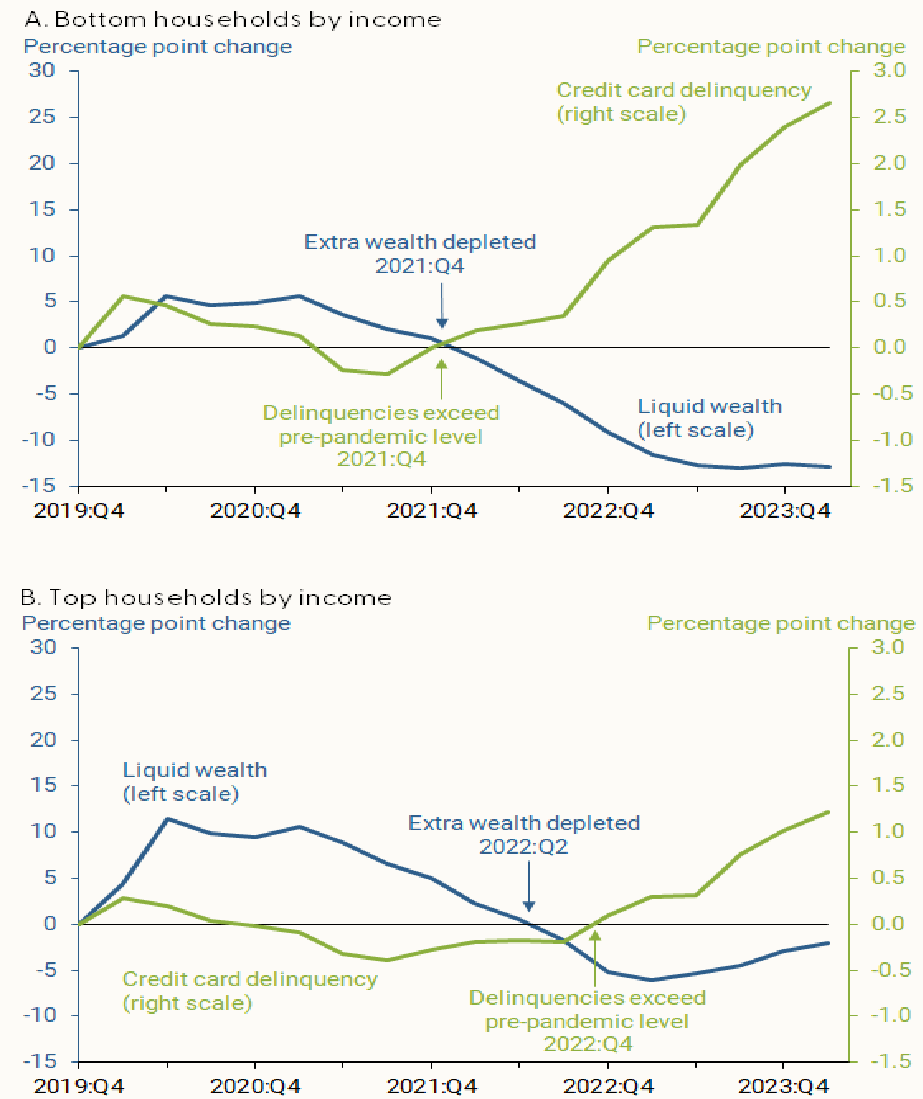
Real household liquid wealth vs. "no-pandemic" estimates



Note: Quarterly data adjusted for inflation using the overall personal consumption expenditures price index. Gaps show the changes between the pre-pandemic projection and the latest data as of end of 2024:Q1. Shaded areas around dashed line projections represent 90% confidence bands. Gray bar marks pandemic recession as defined by the NBER.

Source: Federal Reserve Board of Governors and authors' calculations.

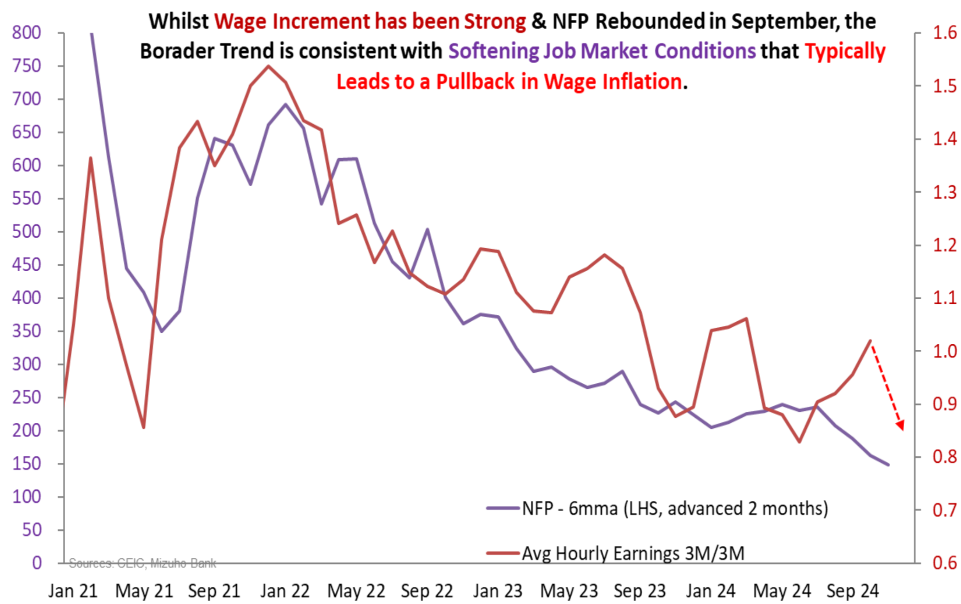
Credit card delinquencies and pandemic-era liquid assets

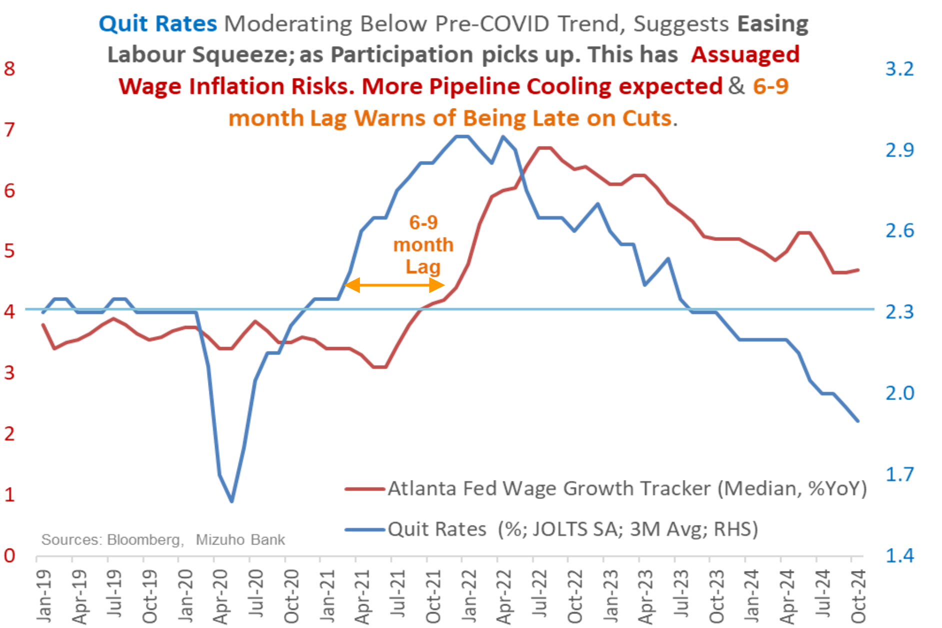


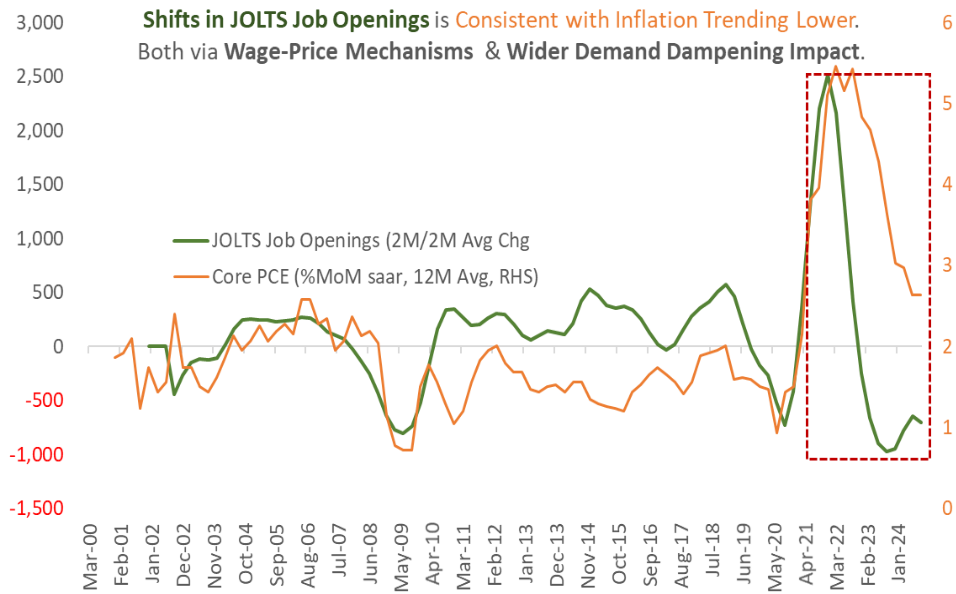
"Type-1" Error: Wrongly rejecting null hypothesis of inflation risks.
"Type-2 Error: Wrongly failing to reject null hypothesis of persistent inflation risks

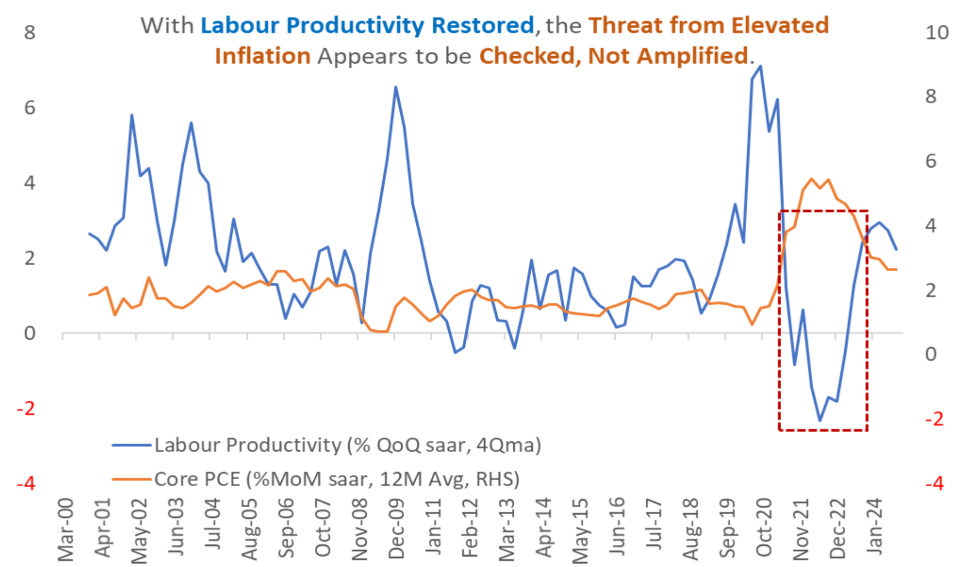
Chart from Bloomberg, San Francisco Fed,

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









2b. Rates - Bumpy Transition to *"Too High for too Long"*

	End-2021	End-2022	End-2023	2024				2025				2026		2027	
			Q4 23	Q1 24	Q2 24	Q3 24	Q4 24	Q1 25	Q2 25	Q3 25	Q4 25	H1 26	H2 26	H1 27	H2 27
Fed Funds Target Rate Ceiling	0.25	4.50	5.50	5.50	5.50	5.00	4.50	4.25	3.50	3.00	2.75	2.75	3.00	3.00	3.00
Fed Funds Target Rate floor	0.00	4.25	5.25	5.25	5.25	4.75	4.25	4.00	3.25	2.75	2.50	2.50	2.75	2.75	2.75
UST 2Y Yields	0.73	4.43	4.25	4.62	4.75	3.64	3.99	3.60	3.22	2.87	2.47	2.64	2.66	2.44	2.47
UST 10Y Yields	1.51	3.87	3.88	4.25	4.40	3.78	4.21	3.98	3.88	3.65	3.38	3.52	3.58	3.32	3.44

Pronounced Steepening

Sources: Bloomberg, Mizuho Forecasts

Flying Start, But 50 Not the New 25 …

- In Sep, Fed Chair Powell went out of his way to convey not to expect outsized 50bp cuts as the norm.
- In fact, since then (with another 25bp cut in Nov), he has suggested slowing the pace of cuts.
- Our sense is that the Fed sees **sufficient front-loaded "insurance" cuts**..

Mostly Following the (Dot) Plot for 2024 …

- Barring significant data surprises, the Fed **will pause either in Dec or Jan** (Dec cut is a coin toss).
- But **2025 pace** of, and propensity for, cuts is **now the main watch**.

Rate Cuts to Gather Pace in H1 2025

- **Expect faster cuts into mid-/Q3-2025**, with some 125bp on the cards, to lower rates to ~3.00%.
- Trump 2.0 execution to determine timing and depth. *Risks to soft-landing persist* and real rates remain elevated.

More Distinctly Dovish Leg diminished, But Not Ruled Out, by Trump 2.0

- **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 "Trump 2.0" Volatility

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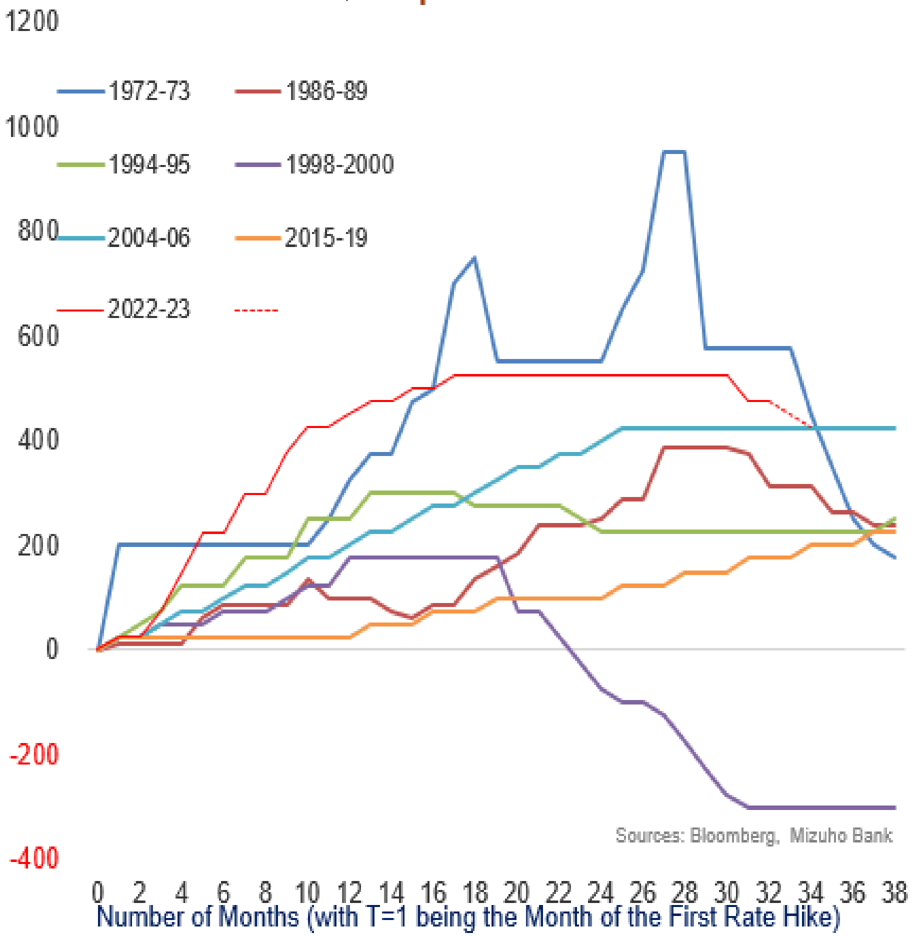
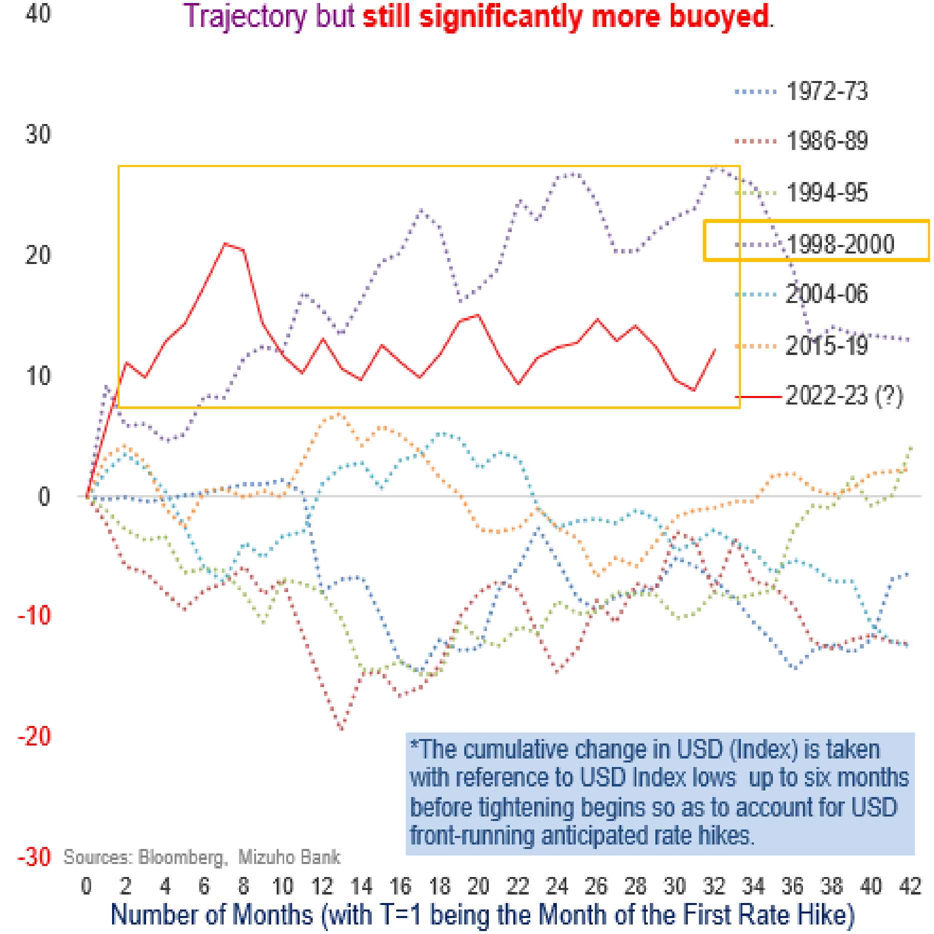
FX – USD: Atypical Late-Stage USD Strength

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.**

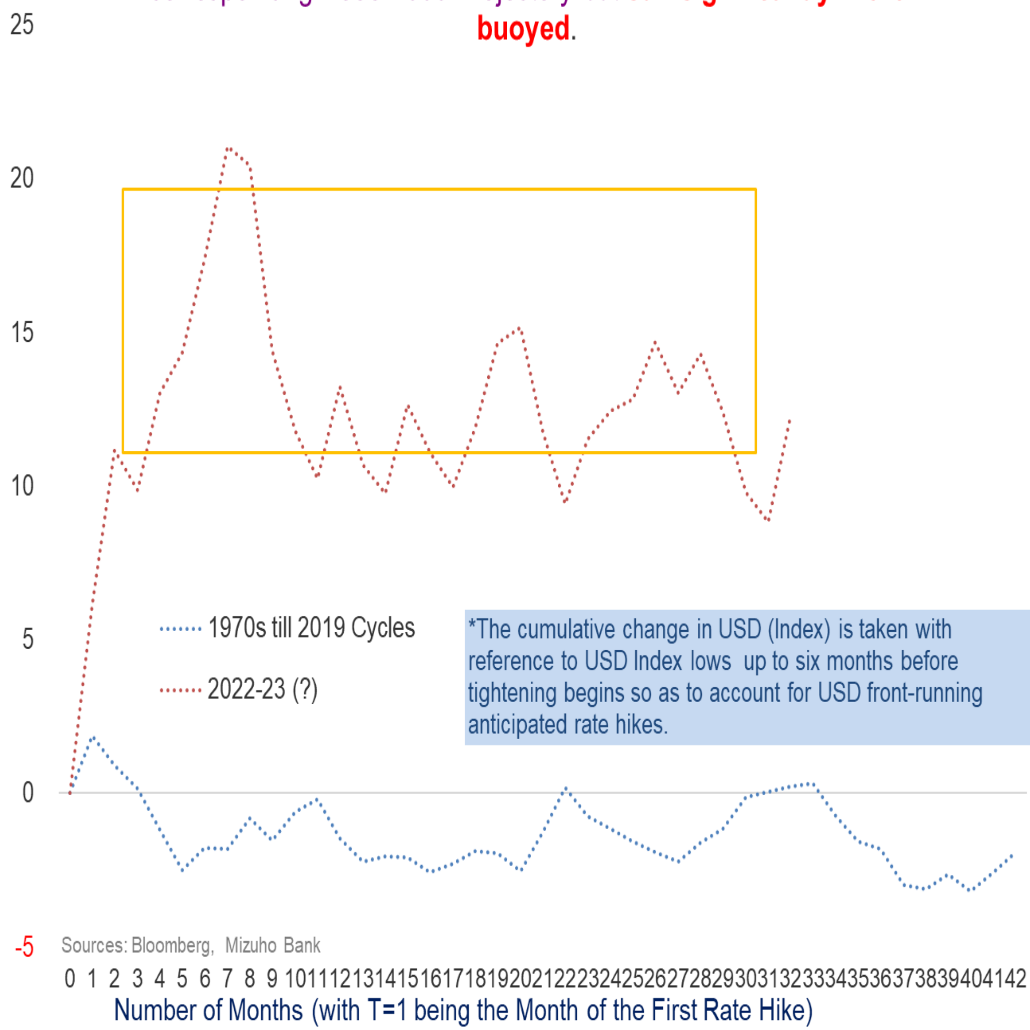


Corresponding USD Performance (Cumulative % Chg*): **Notably, the Current Rate Hike Cycle Has Resulted in the Sharpest Phase of USD Strength in the First 8-9 months**; moderating below corresponidng 1998-2000 Trajectory but **still significantly more buoyed**.



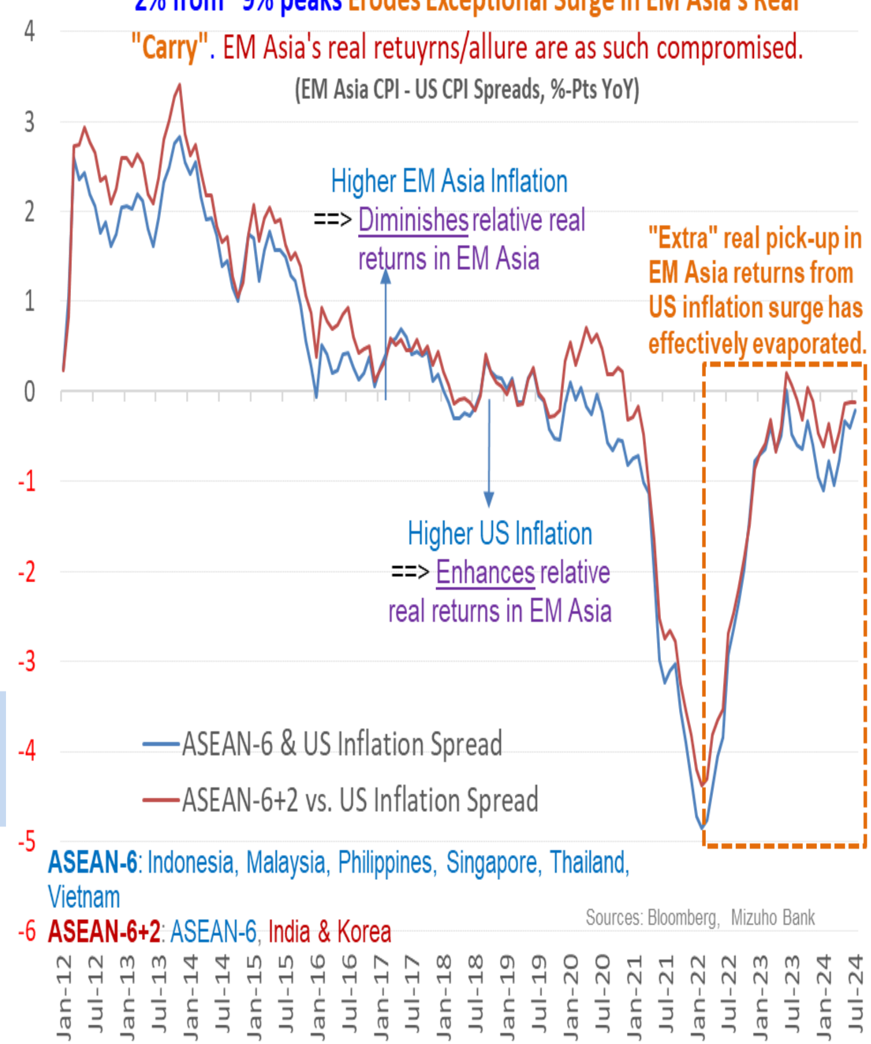
FX – USD: Full Reversion of AXJ may be Challenged

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**.

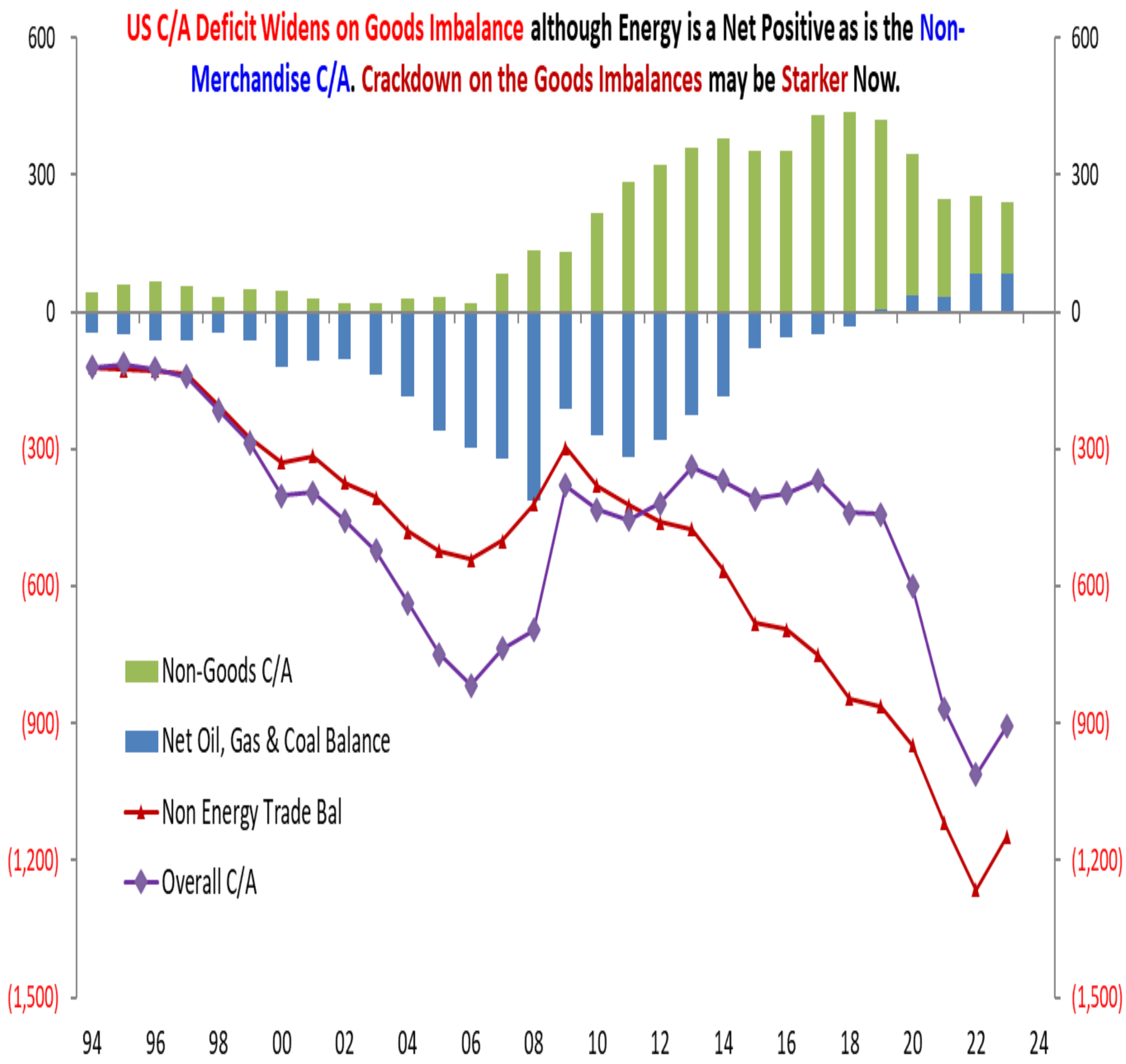


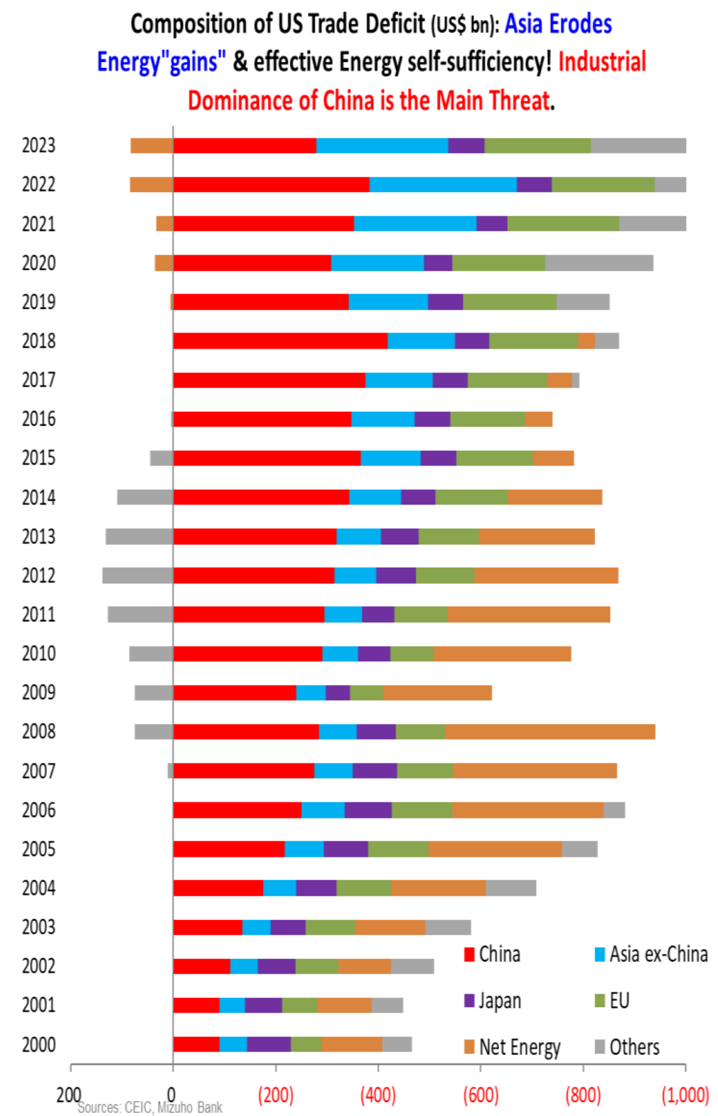
Inflation Spreads (vs. US): **Reversion of US inflation back towards 2% from ~9% peaks Erodes Exceptional Surge in EM Asia's Real "Carry"**. EM Asia's real retuyrns/allure are as such compromised.

(EM Asia CPI - US CPI Spreads, %-Pts YoY)



3a. Trade Risks: Risks Go Well Beyond China





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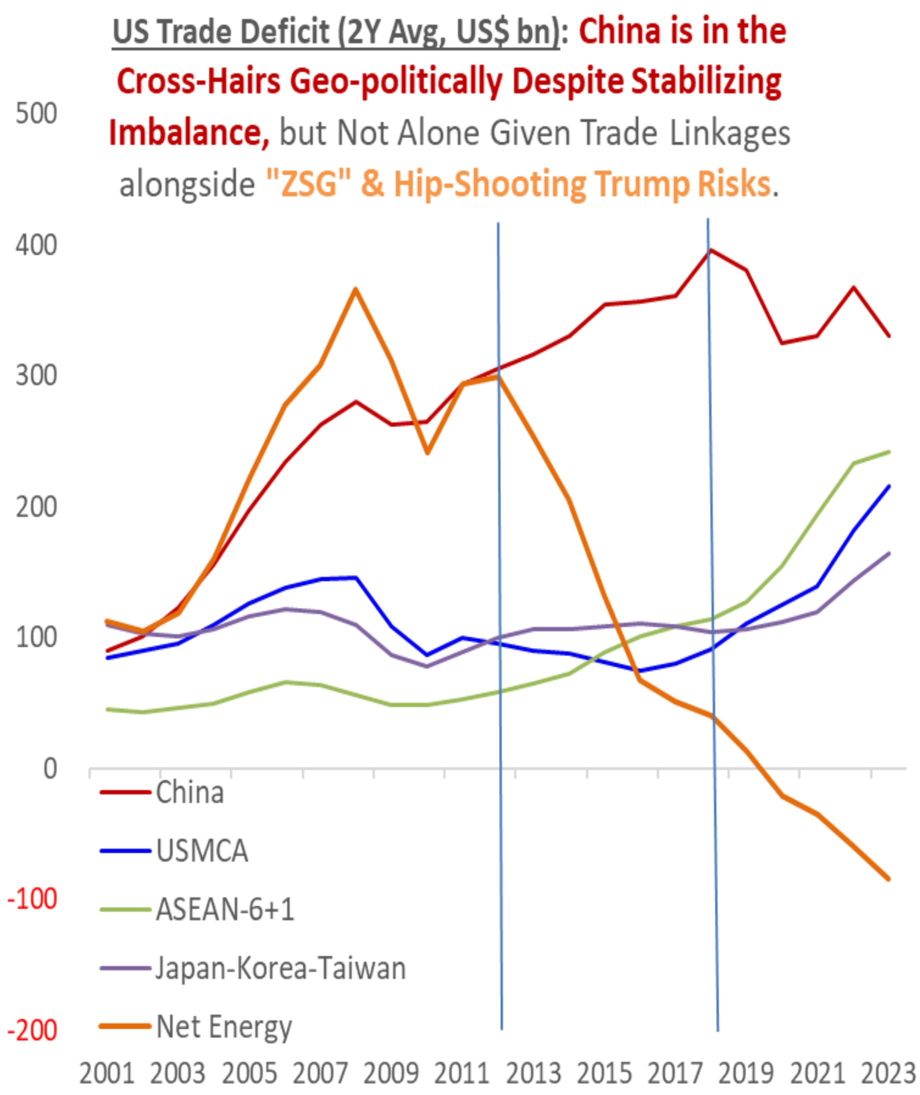
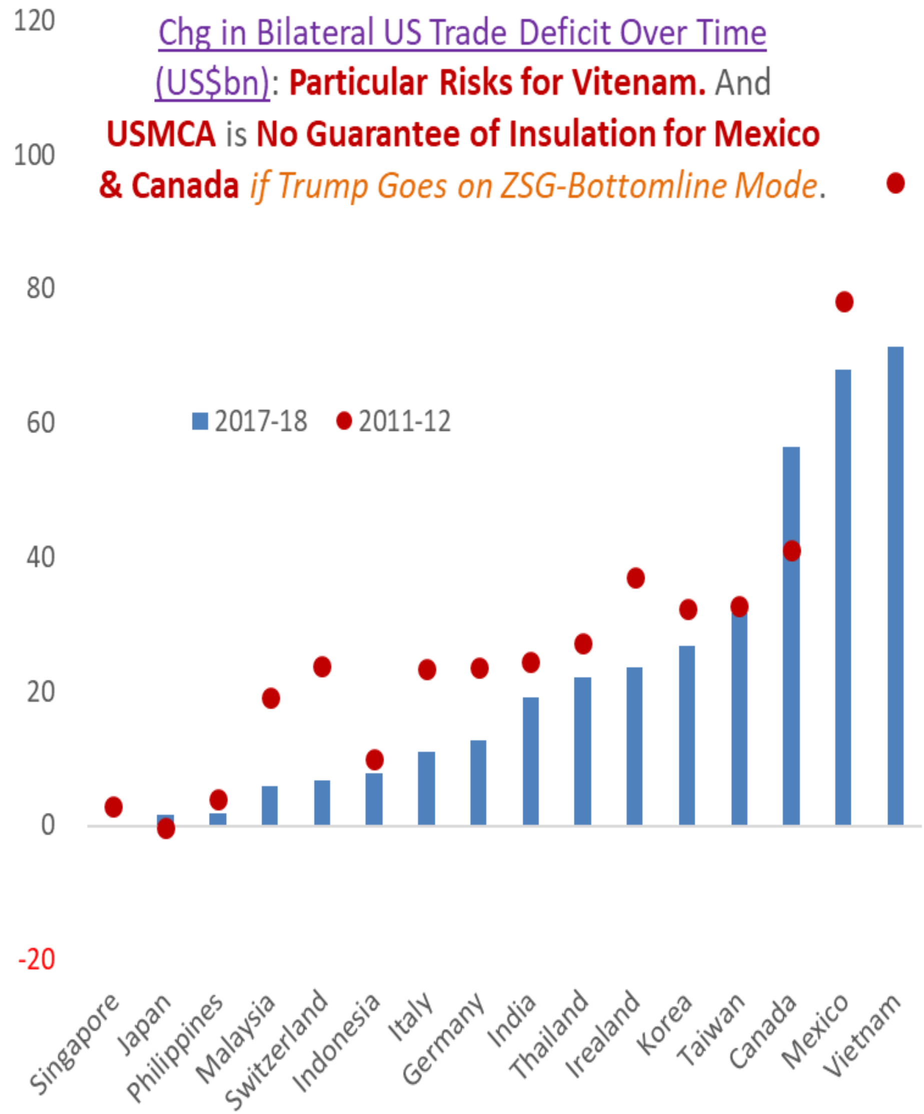
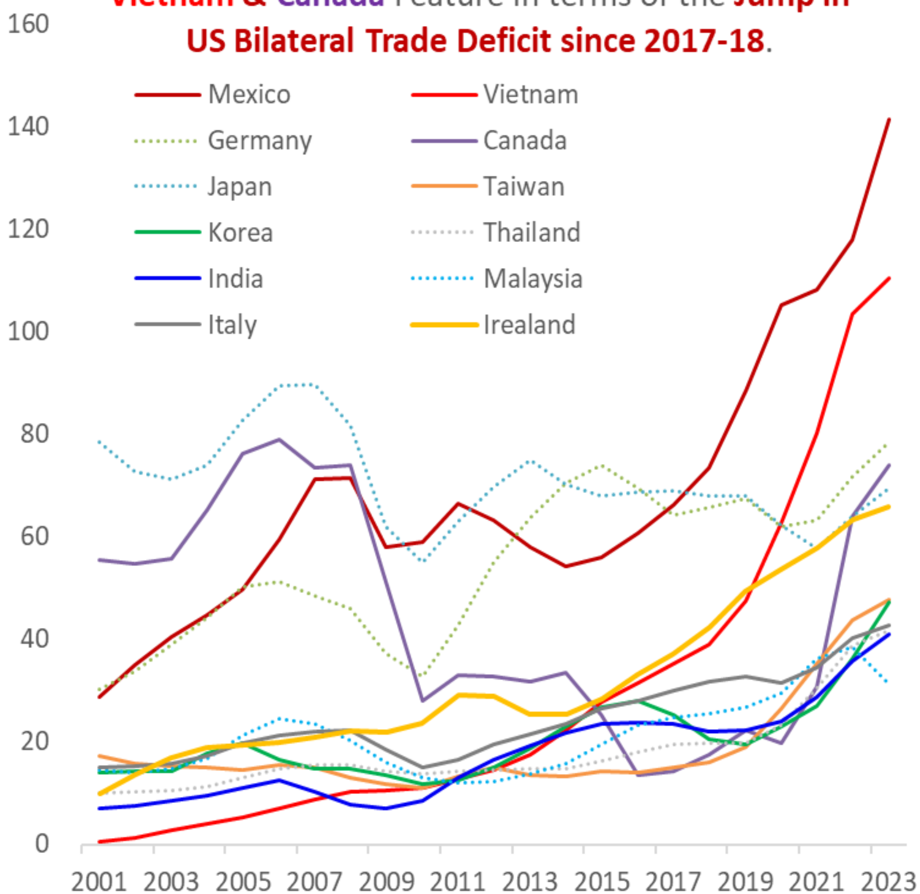
3a. Trade Risks: Excluding China, a Few Key Economies Led by Mexico & Vietnam at Risk



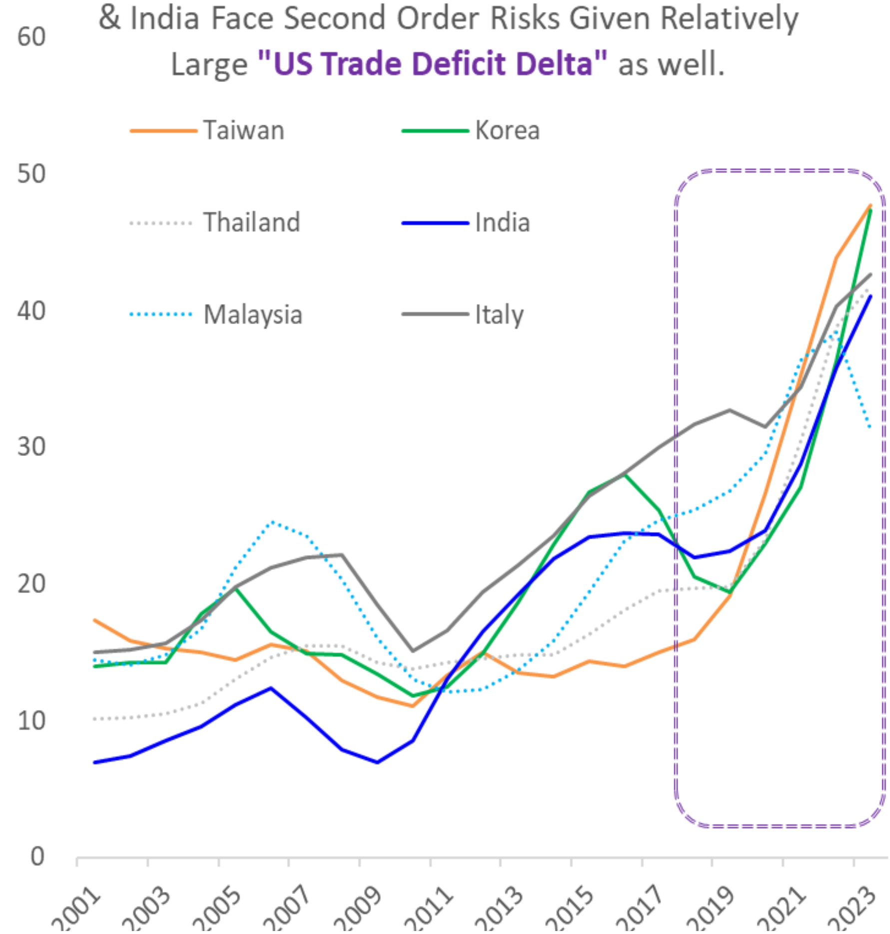


3b. Winners & Losers: Vietnam is in a Precarious Position amid Trump 2.0 Uncertainties

US Bilateral Trade Deficit (US$bn): **Mexico, Vietnam & Canada** Feature in terms of the **Jump in US Bilateral Trade Deficit since 2017-18**.



US Bilateral Trade Deficit (US$ bn): Taiwan, Korea & India Face Second Order Risks Given Relatively Large **"US Trade Deficit Delta"** as well.

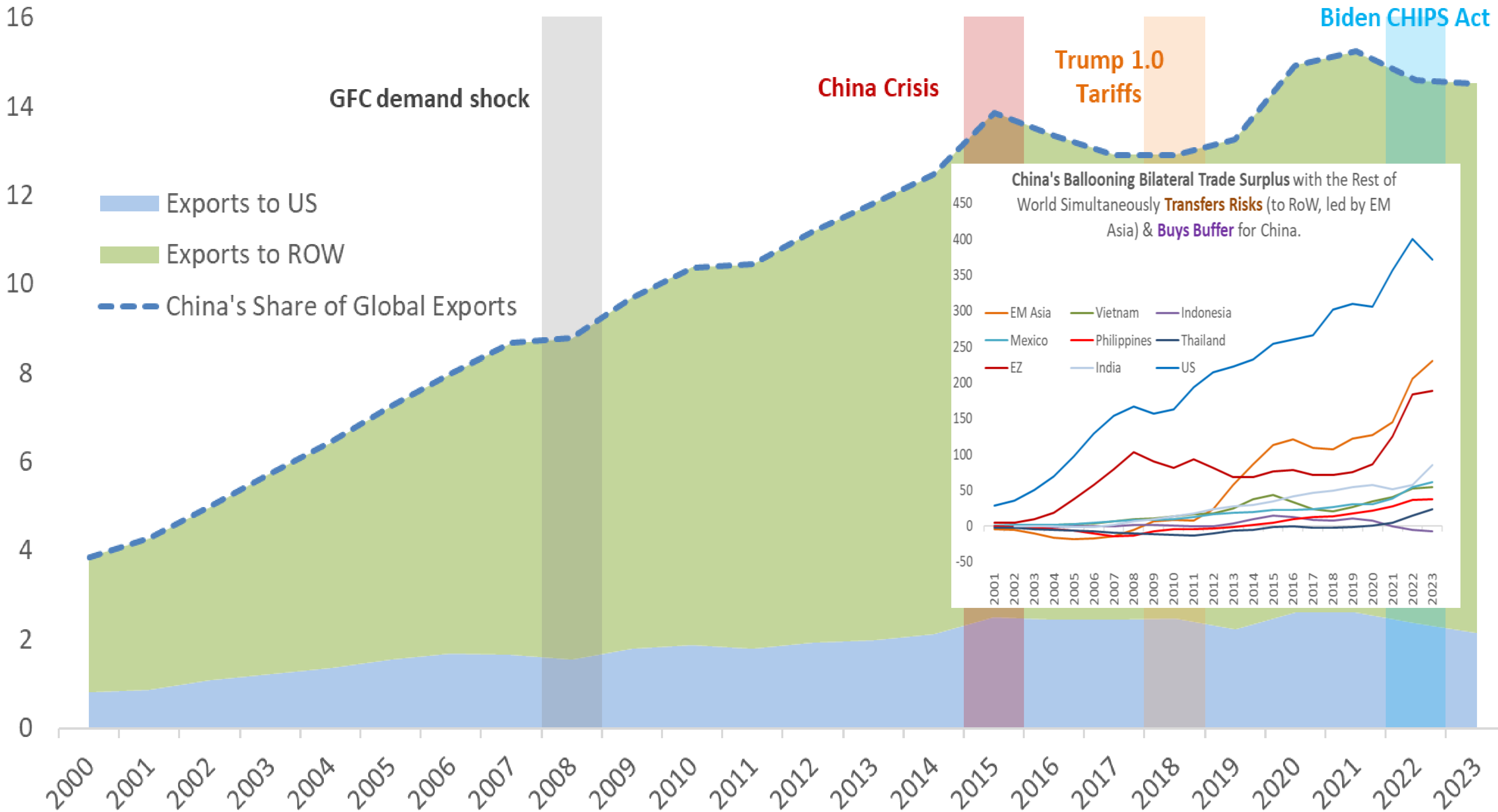


US Bi-lateral Trade Deficit

US$ bn	China	Mexico	Vietnam	Germany	Canada	Japan	Ireland	Taiwan*	Korea	Thailand	India*	Malaysia	Switzerland	Indonesia	Philippines	Singapore	Net Energy
2015-17 Avg	362.6	63.5	33.7	67.5	14.5	68.8	34.8	14.9	26.4	18.8	23.5	23.6	12.6	13.0	2.4	-9.9	61.3
2022-23 Avg	330.9	141.4	110.4	78.5	74.0	69.5	65.9	47.7	47.3	41.8	41.0	31.4	23.7	20.8	5.4	-8.3	-83.9

3c. Does China Have a Trump Card?

China's Share of Global Exports Not Adversely Affected by Trump 1.0 Tariffs. In fact Trade Biden's Targeted CHIPS Act might have had some Dampening Impact.



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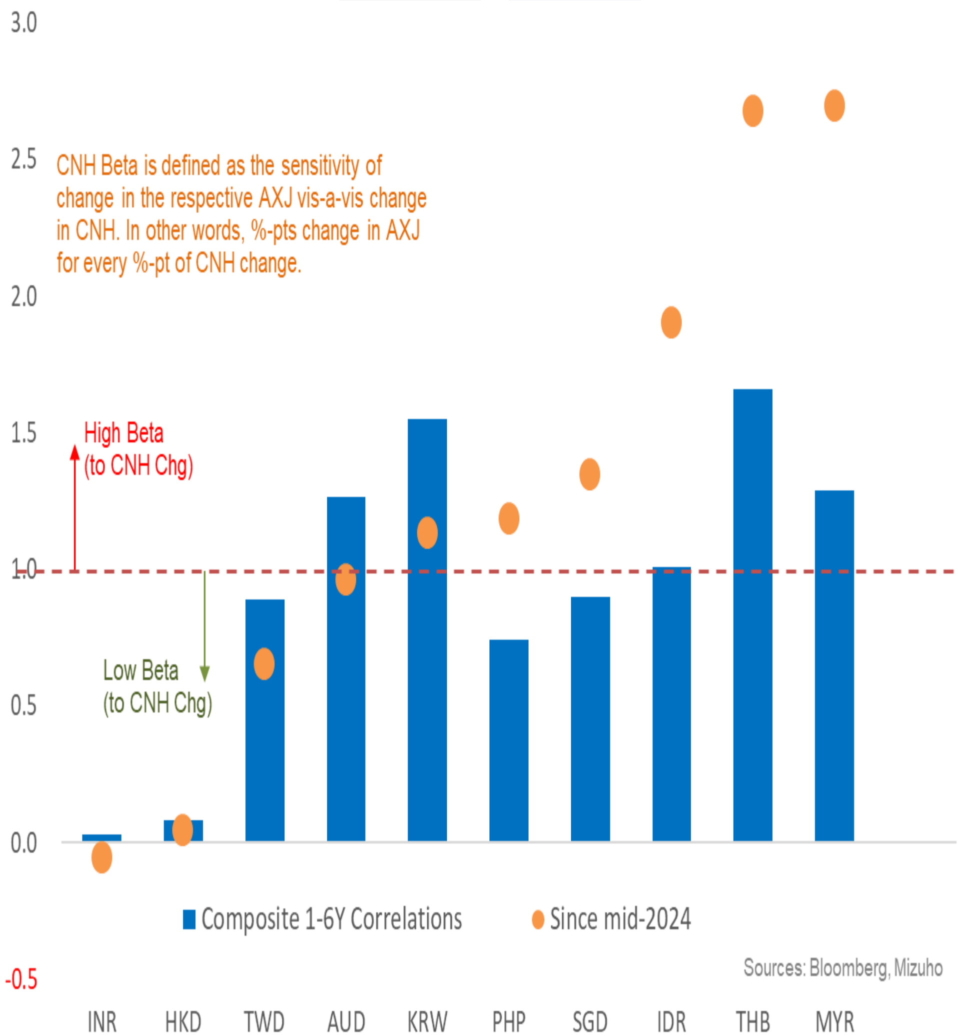
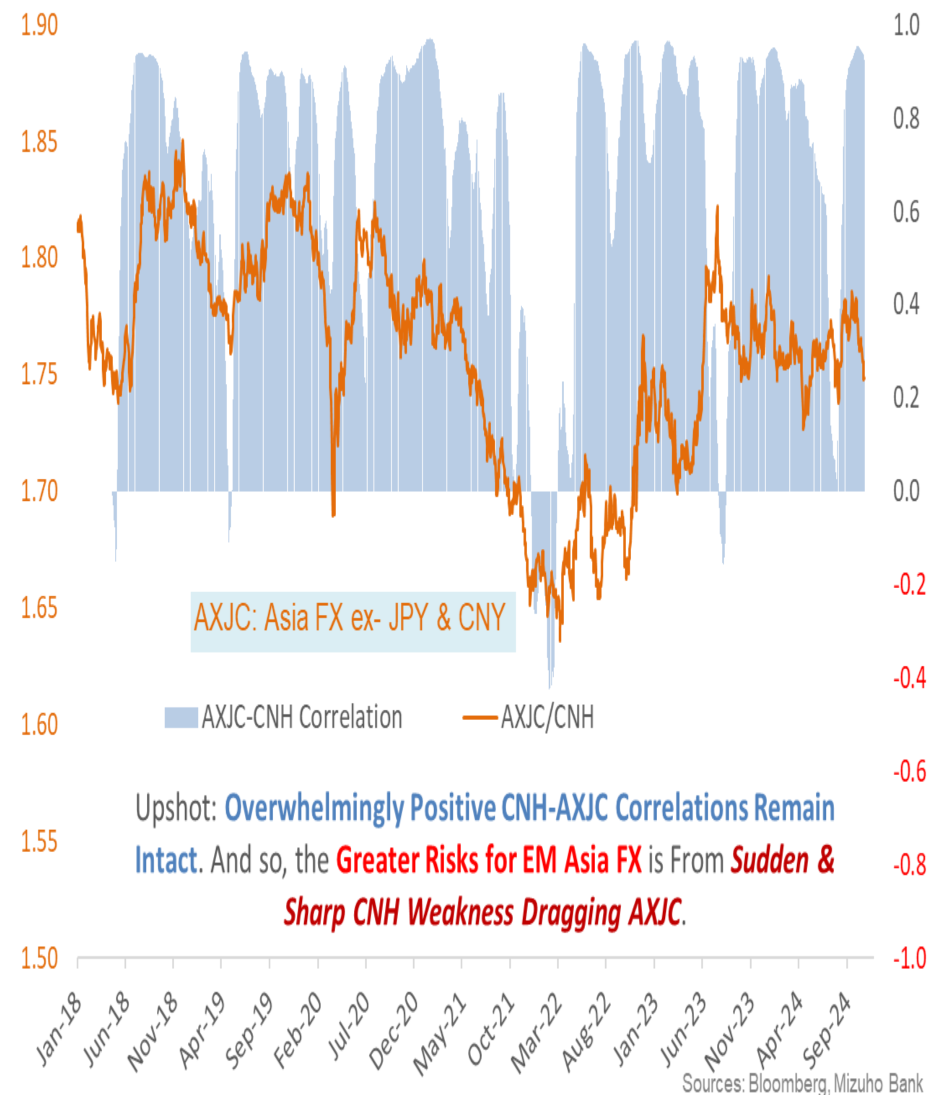
4a. CNH Beta: Expect AXJ Volatilities to be Heightened & Fluid

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





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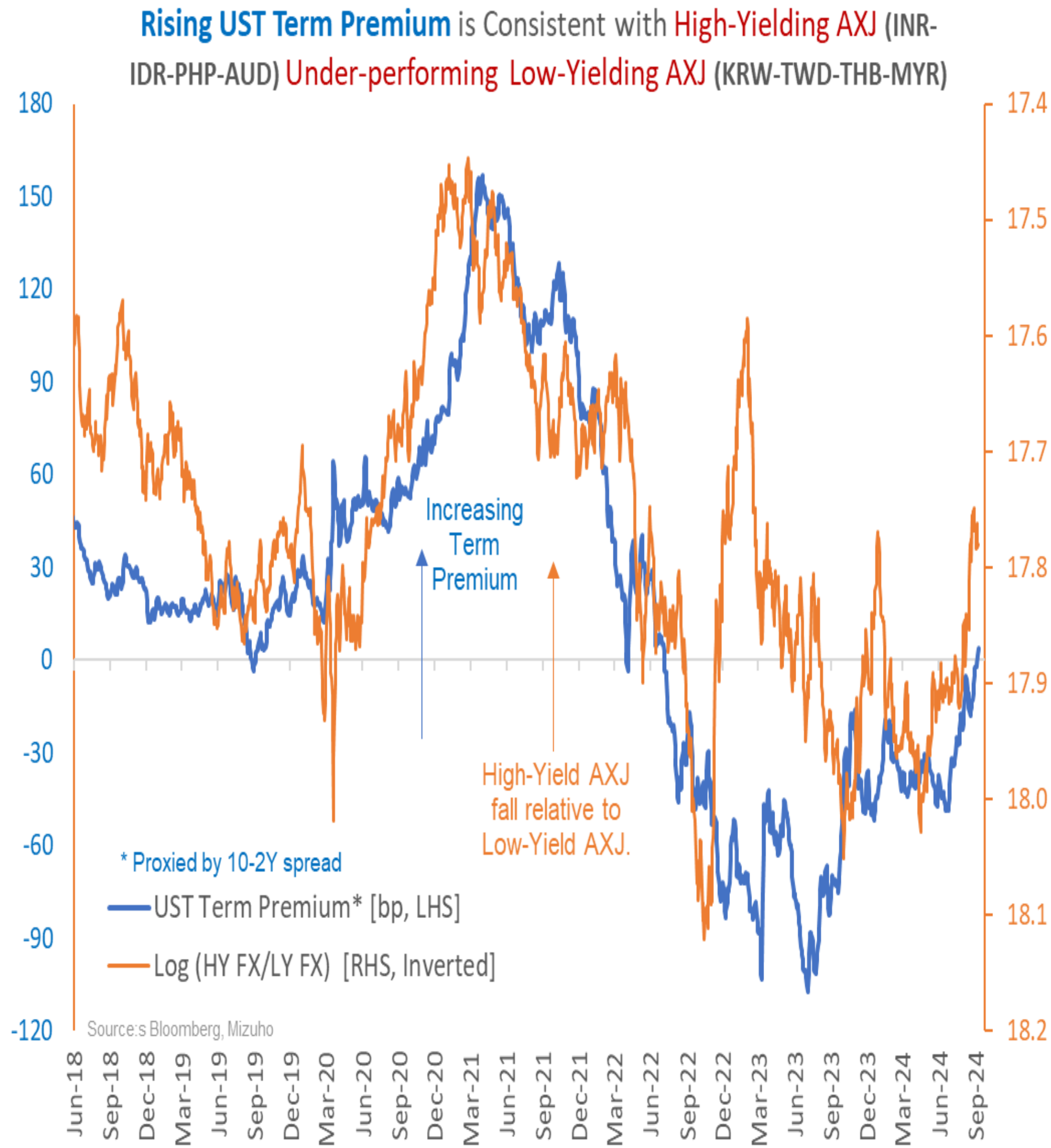
4a. AXJ: Steeper UST Curve an Additional Interim Risk (Especially for HY AXJ)



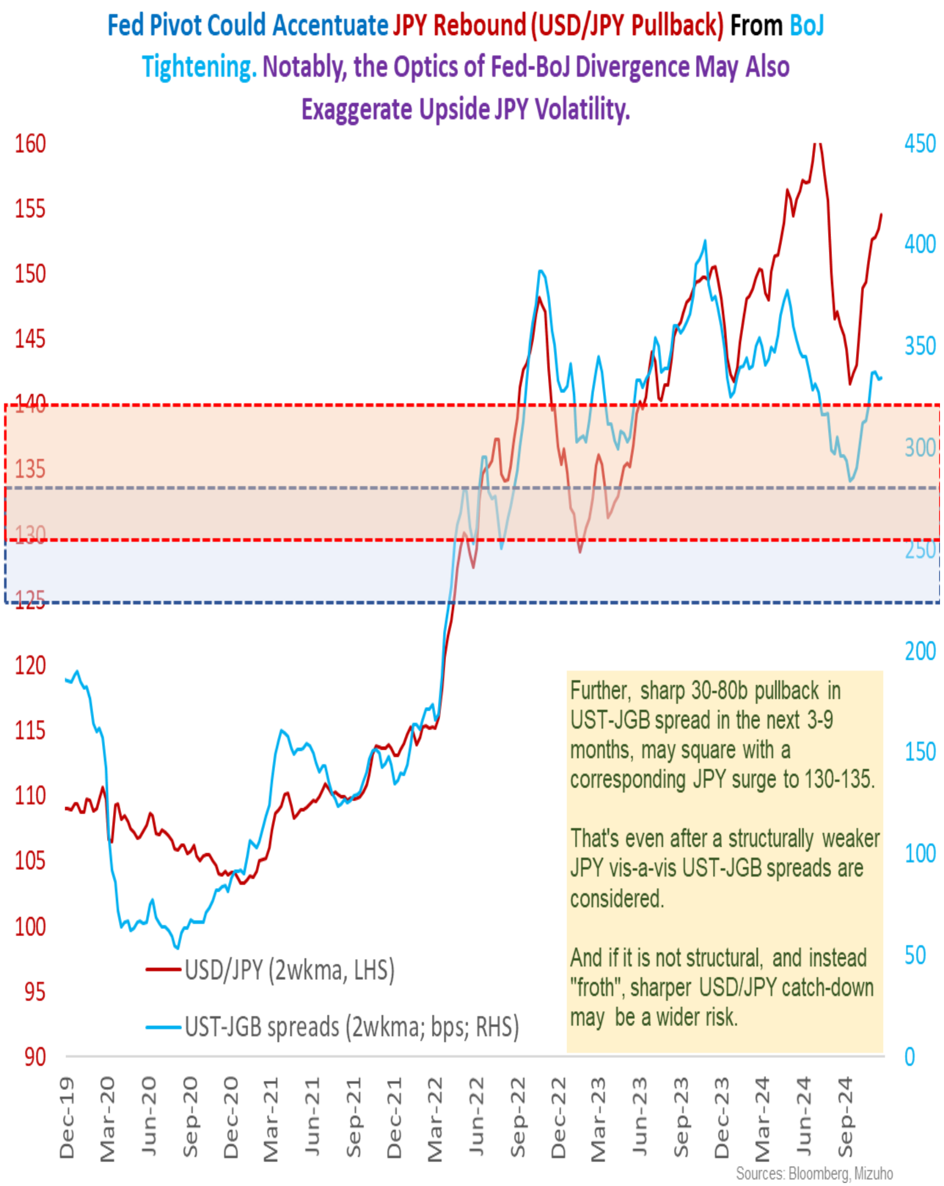
At the Cost of Risk Re-pricing in EM Asia …

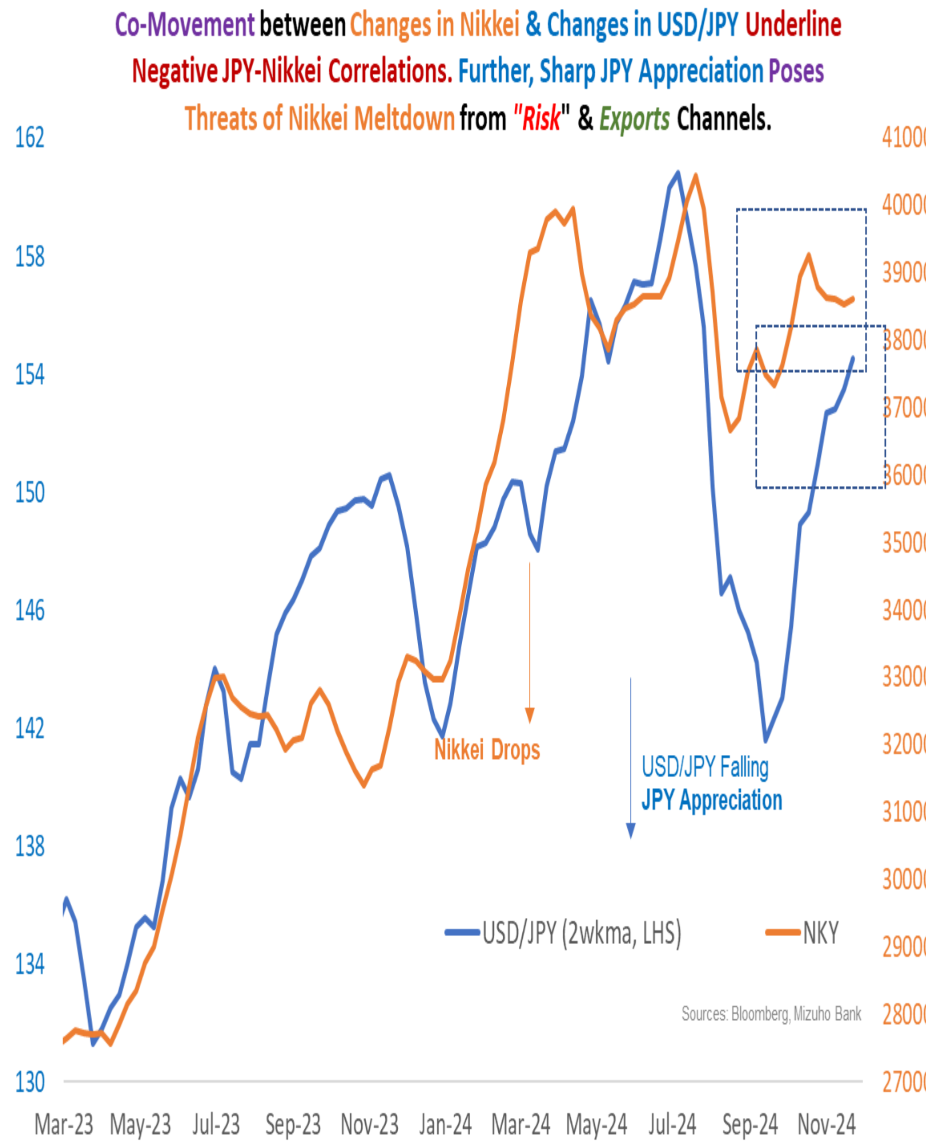
- But **path to a steeper UST yield curve** may be **bumpy for EM Asia** assets and FX too.
- Possibly even **entailing risk re-pricing** that involves spot of capital outflows.
- This is particularly in the context with a steeper UST yield curve typically diminishing the attractiveness of EM Asia yields.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

4b. JPY-BoJ Risks: "JPY Problem with a Fed Solution" Induces Heightened Trump Volatility





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