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

December 2024

“Known Unknowns” of Trump 2.0

1. Trump 2.0 Trades: Trading Uncertainty

a. “Trump Trades” – What & Why
b. Looking Past Election Cycles … Trump Effects vs. Fed Sway
c. Execution Beyond Campaign

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
c. CNY Sensitivities & AXJ Risks
d. JPY Volatility Accentuated by Trade & Complex BoJ Dynamics?

3. Trade Risks: Code Orange - Navigating Disruption Risks & Collateral Damage

a. Threats to Global Trade & Manufacturing
b. Winners & Losers in Asia amid Zero-Sum Game, Bottom-line, Bilateral, Agitations
c. Does China Have a “Trump Card”?

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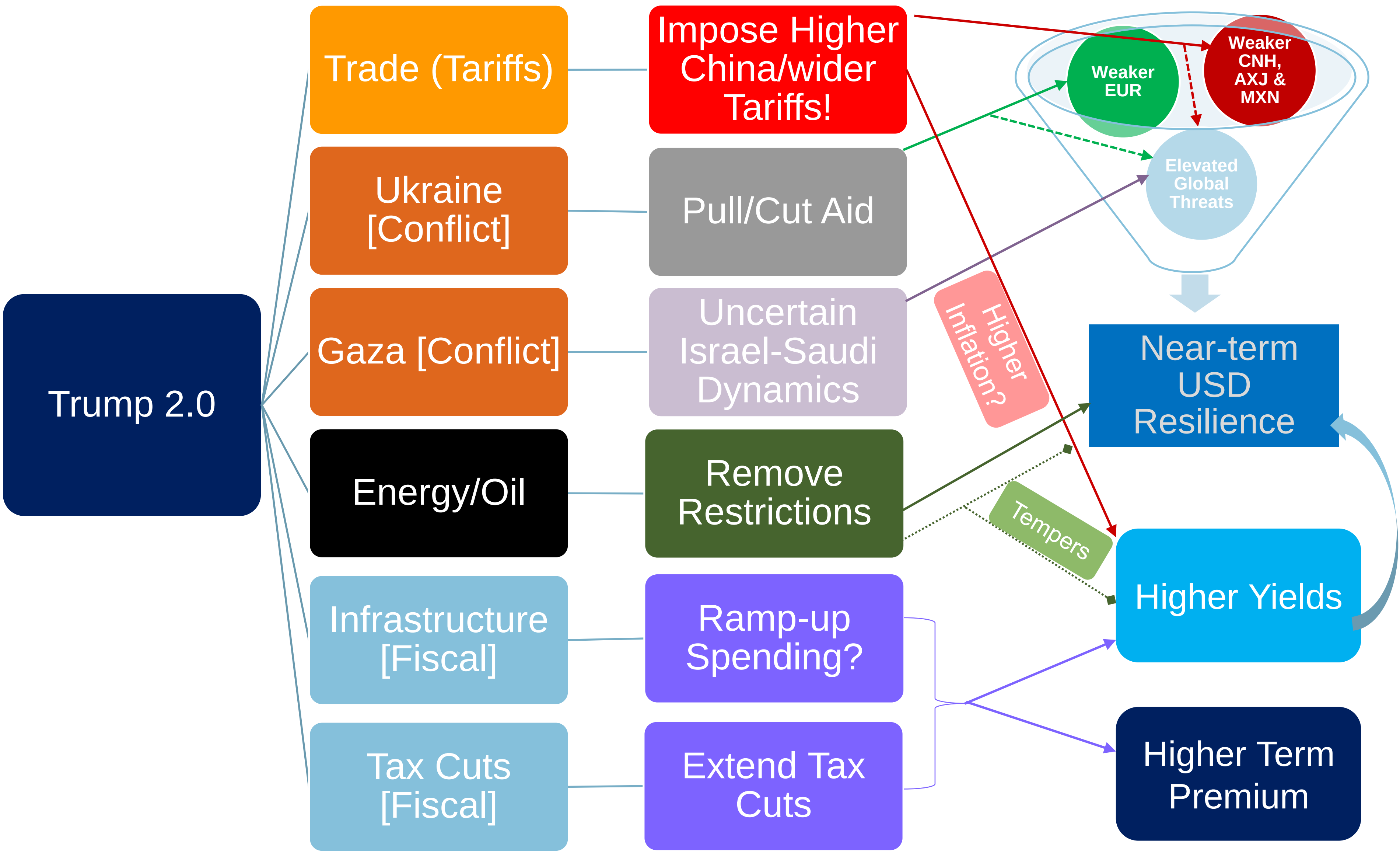
1a. Trump Trades: The What & Whys of Geo-economics



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

"Trump Trades"	Higher Equities ↑	Higher USD ↑	Higher Yields ↑	Steeper Curve ↑
Since end-Sep (amid rising Trump 2.0 bets)	+5%	+5%	+42bp	+18bp
Tax Cuts ➔ Fiscal Slippage ➔ Higher Growth	↑	↑	↑	↑
Deregulation ➔ Higher Growth	↑	↑	⇧	⇧
Trade Tariffs	Greater Differentiation	↑		

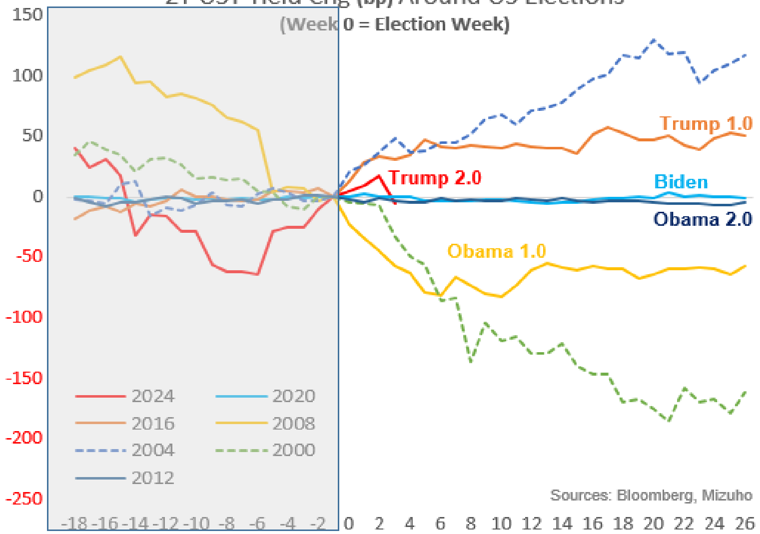
US Elections			USD	Long-end Yields	Curve
	Trump	"Red Wave"	Stronger ++++ (2-6%) ↑	Higher +++ (20-40bp) ↑	Steeper ++++ (30-60bp) ↑
		Split	Stronger +++ (1-4%) ↑	Higher ++ (10-20bp) ↑	Steeper +++ (15-40bp) ↑
	Harris	Split	Neutral	Lower -- (5-15bp) ↓	Flatter - (5-10bp) ↓
		Blue Wave	Weaker - (1-2%) ↓	Higher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

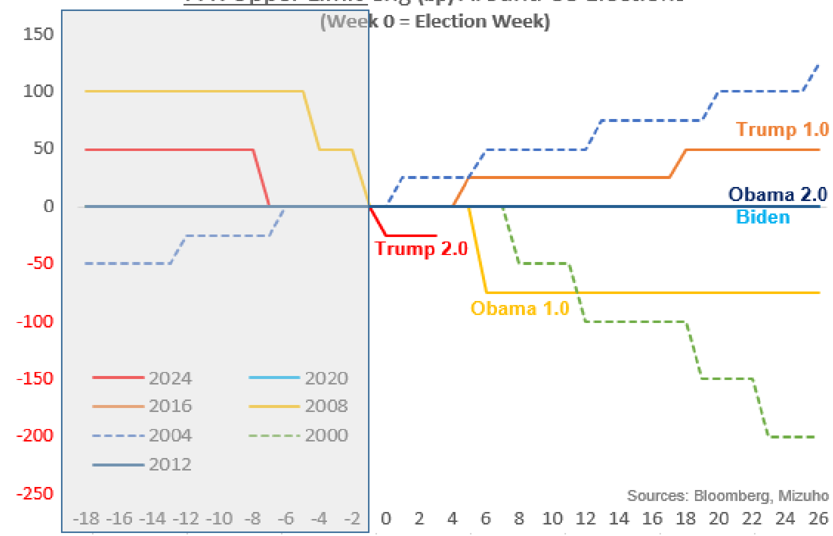
1b. Fed & Rates: Fed Cycle, Inflation Expectations & Trump

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.**

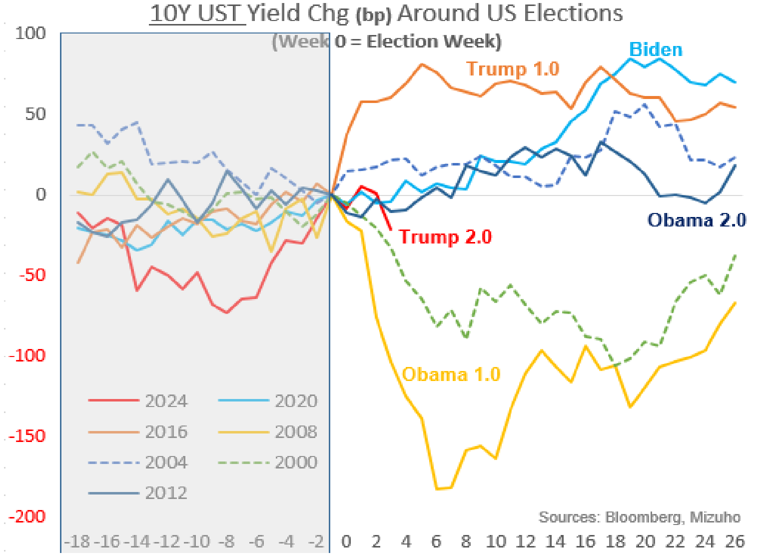
2Y UST Yield Chg (bp) Around US Elections



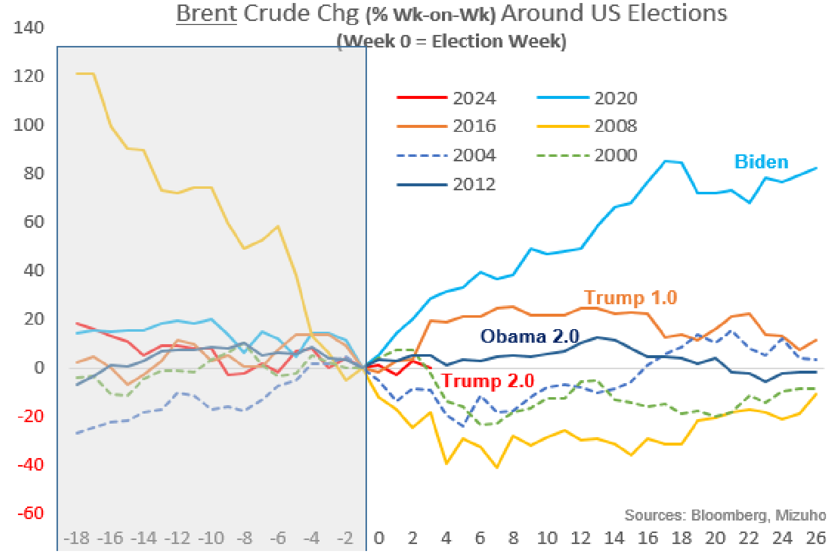
FFR Upper Limit Chg (bp) Around US Elections



10Y UST Yield Chg (bp) Around US Elections

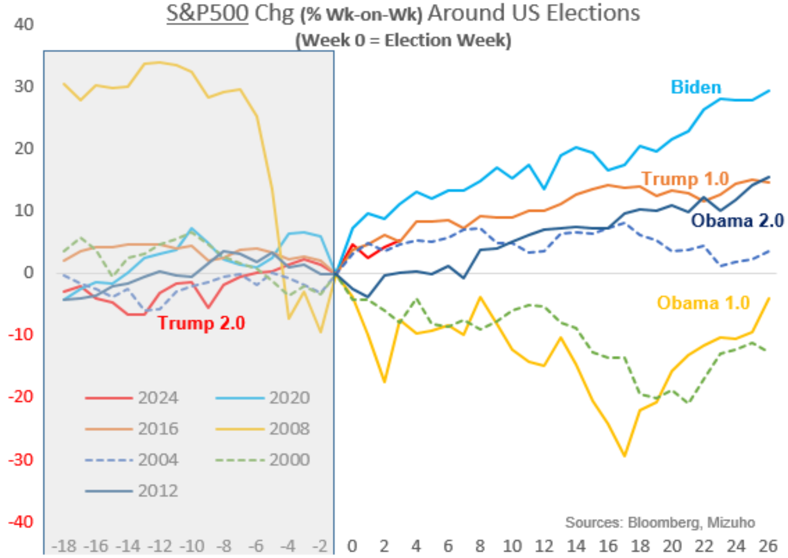


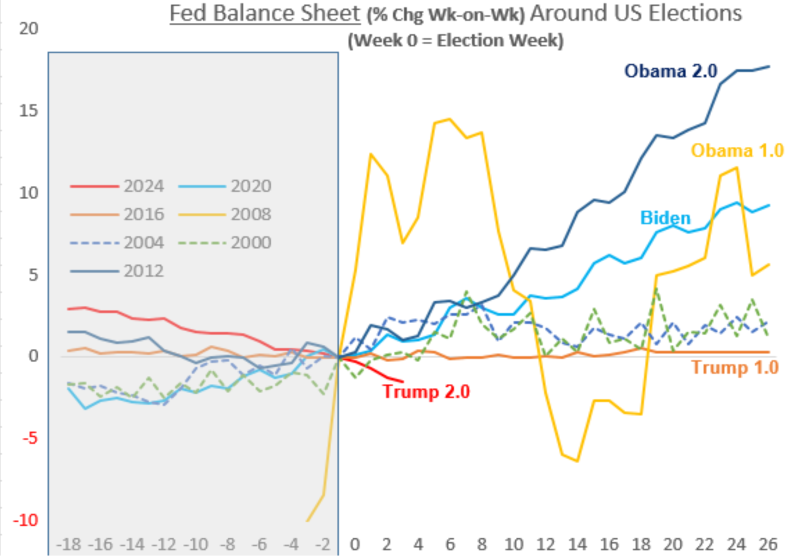
Brent Crude Chg (% Wk-on-Wk) Around US Elections

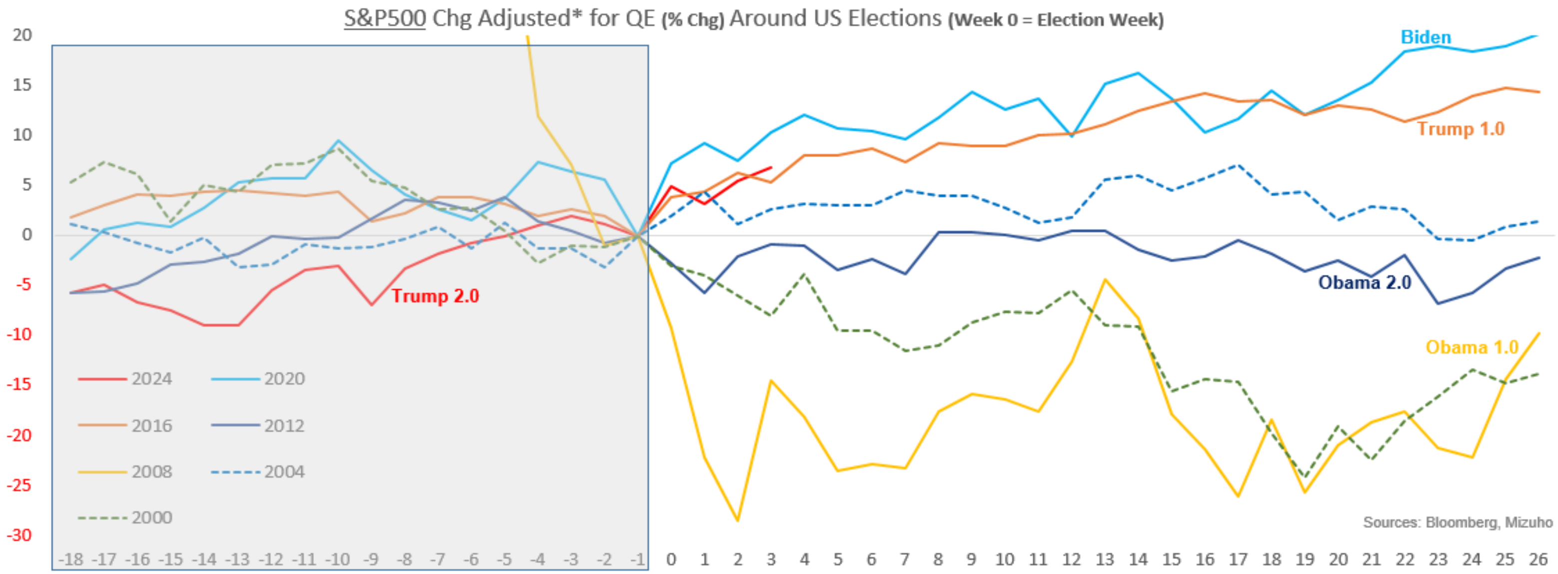


1b. Fed & Equities: Trump Effect Validated, but Equities Highly Sensitive to Fed Policy

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**







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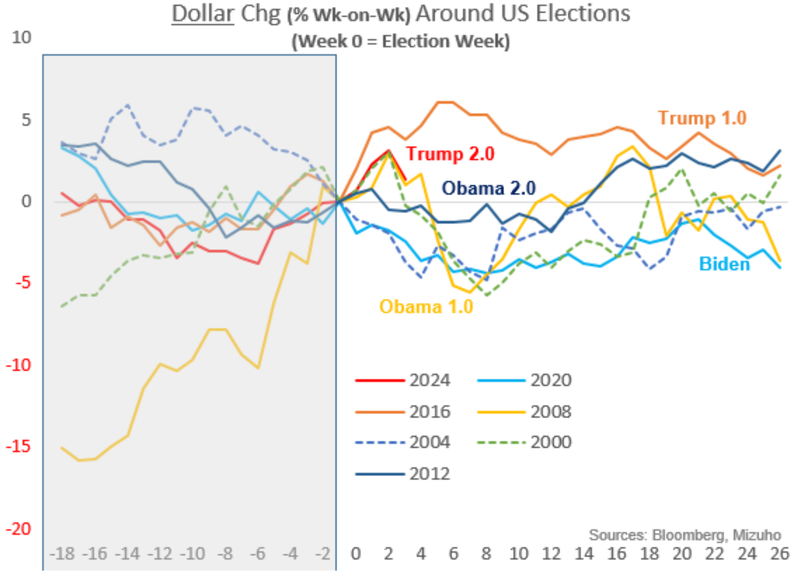
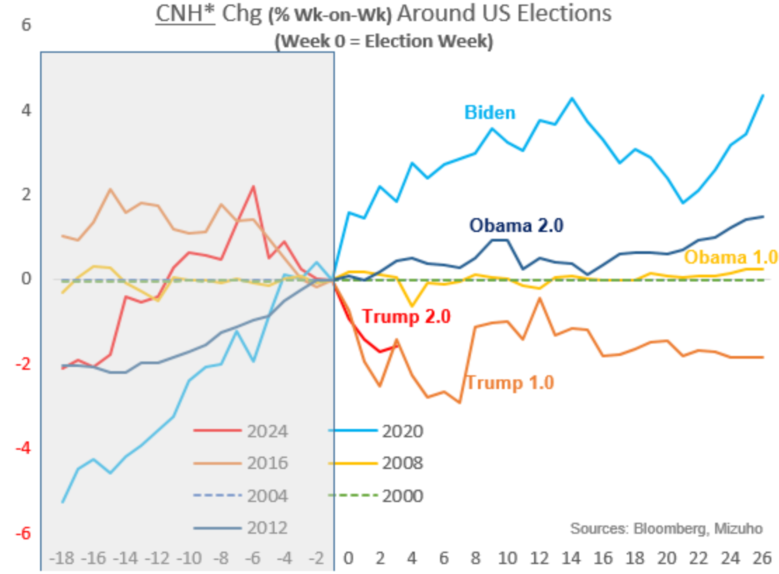
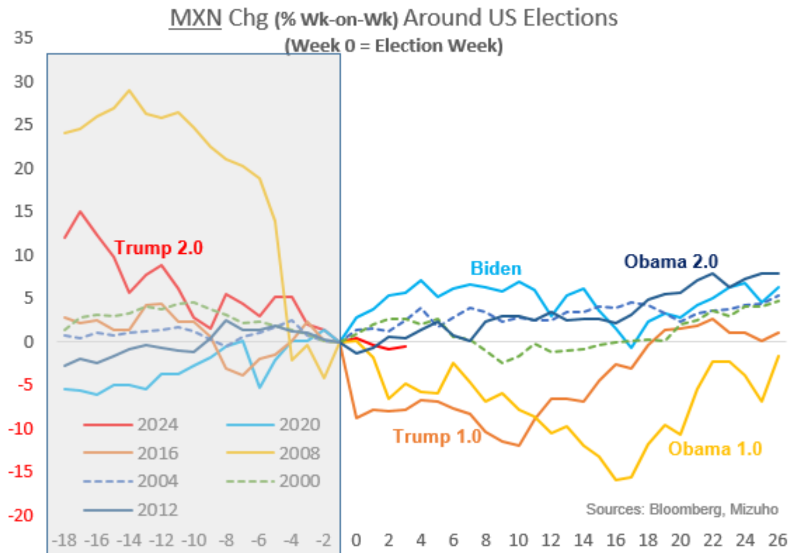
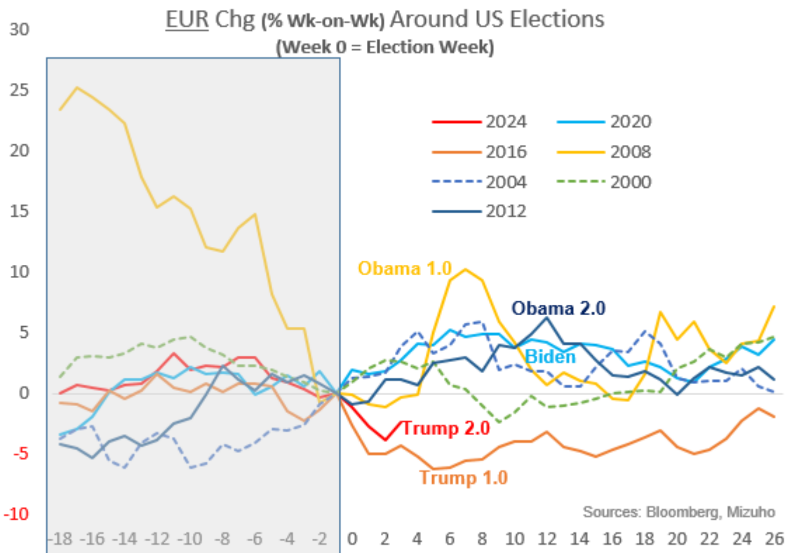
1b. Fed & USD: Trump's Incongruence (Effects vs. Intent) & the Fed's Influence

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*.









1c. 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, +3MBpd Oil Equivalent** - 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

1c. The "Bassent Effect": What to Make of the "Three 3s"

~80bp higher than CBO estimates of 2.1-2.2%

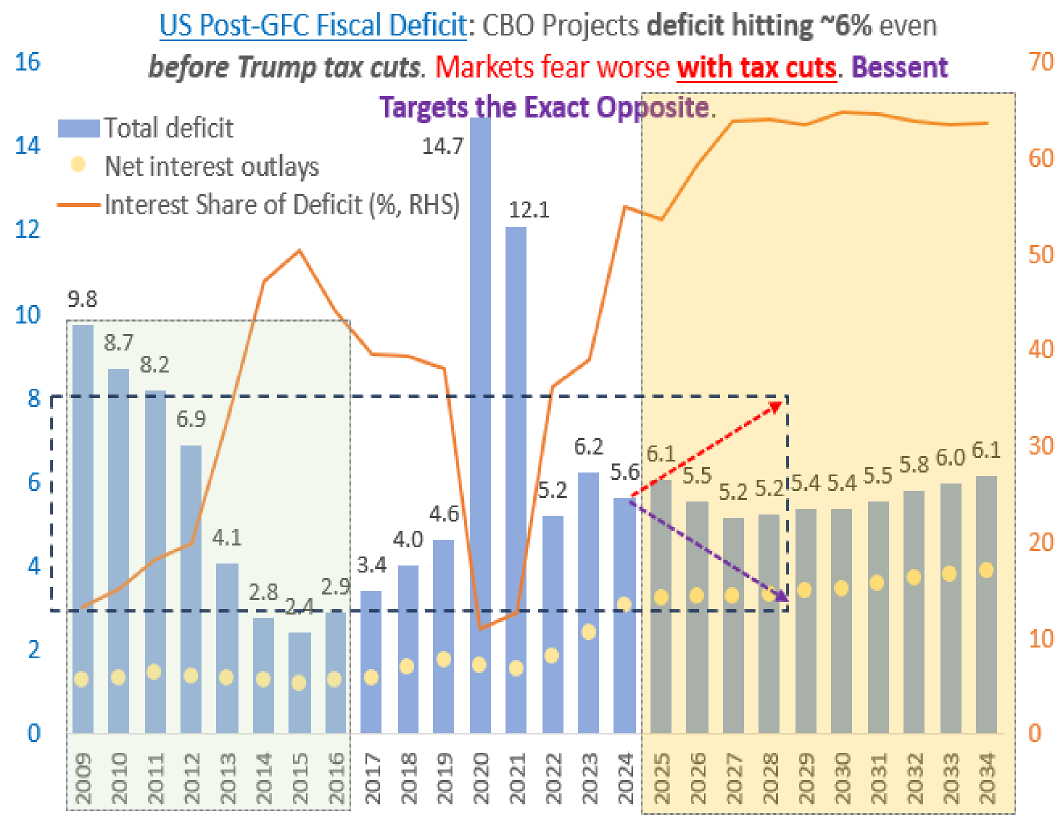
3% Growth

The "Three '3's"

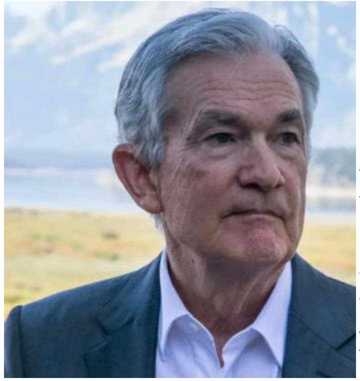
3MBpD Additional Oil Equivalent

3% Fiscal Deficit

At least 50% reduction in deficit!



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.

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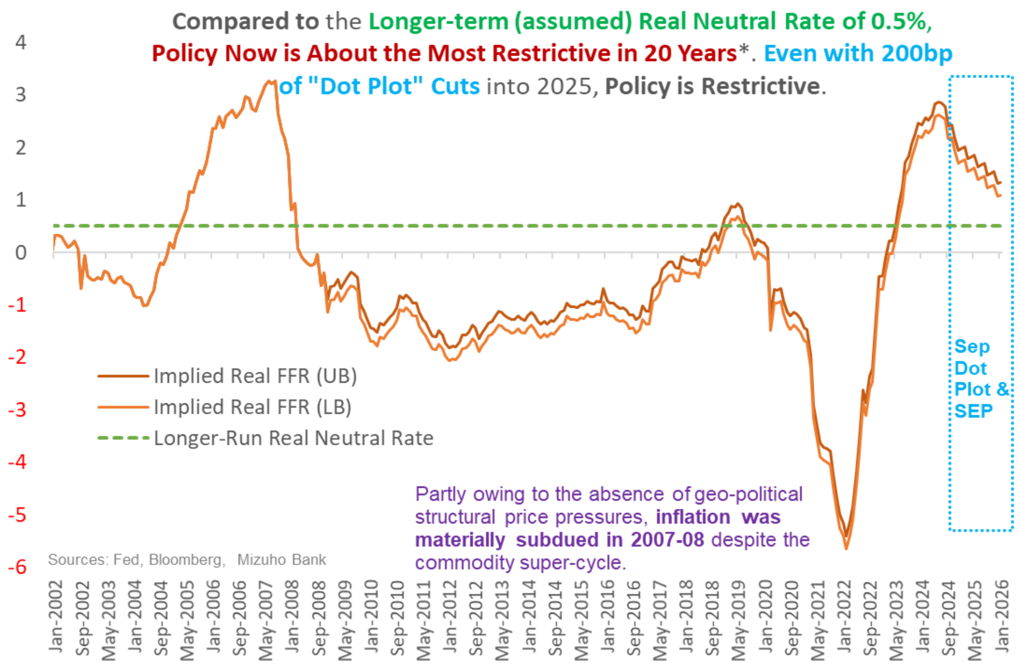
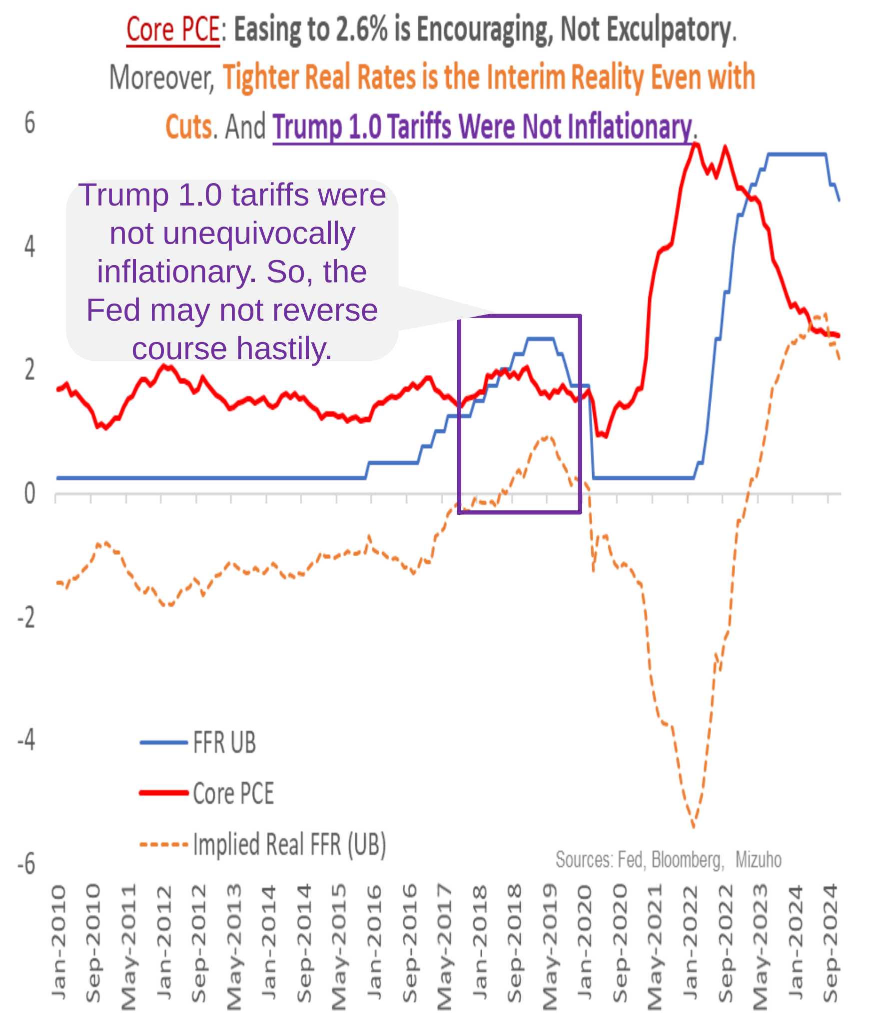
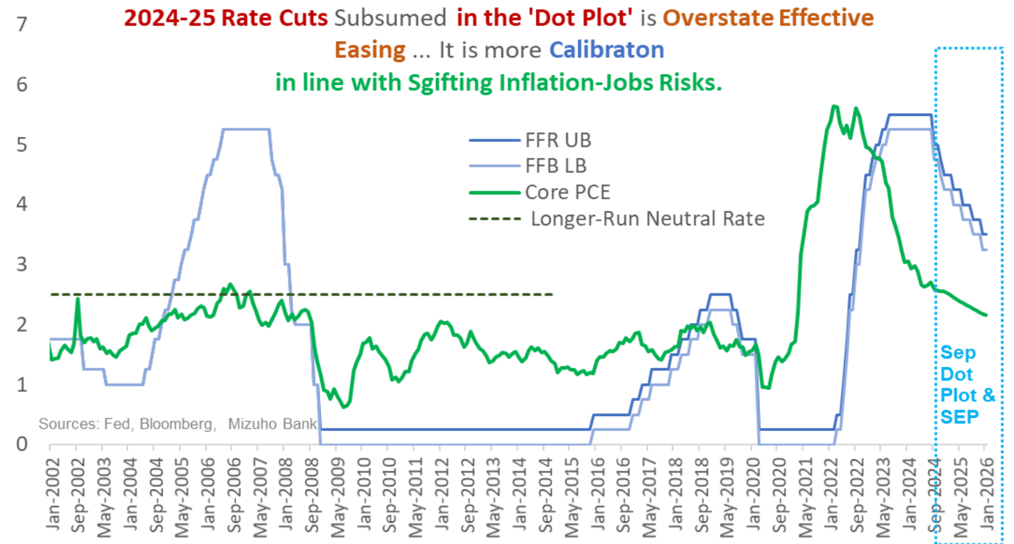
2a. Fed's Restrictive Stance Leaves Scope for Easing to Remain Intact







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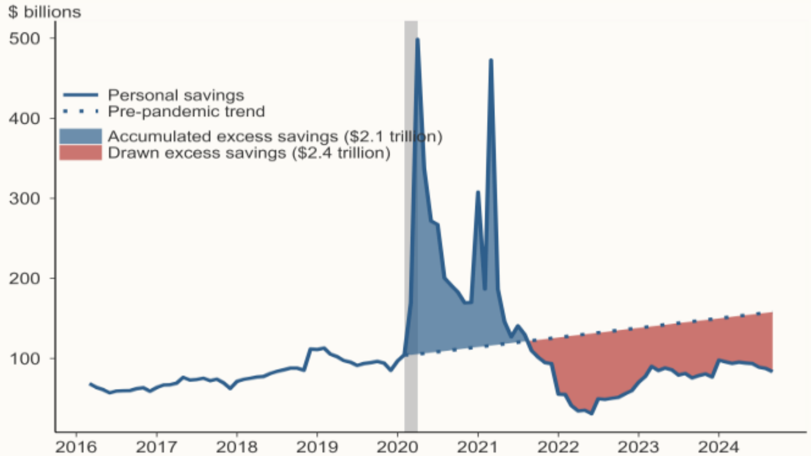
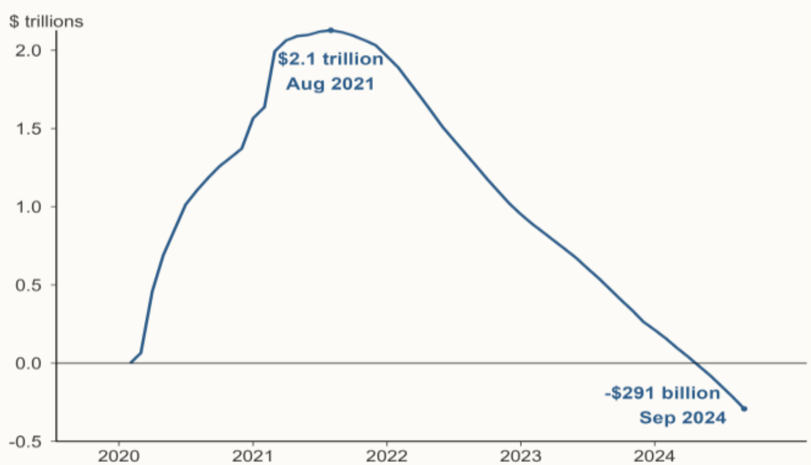
2a. Whereas US Household Cash-flow Constraints Threaten Demand Resilience

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



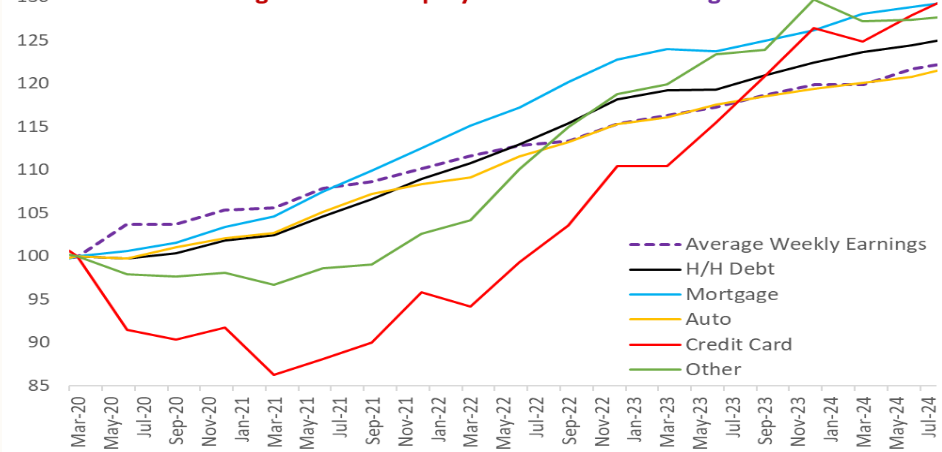
Note: Gray shaded area represents NBER recession dates. Source: Bureau of Economic Analysis and authors' calculations.

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.**

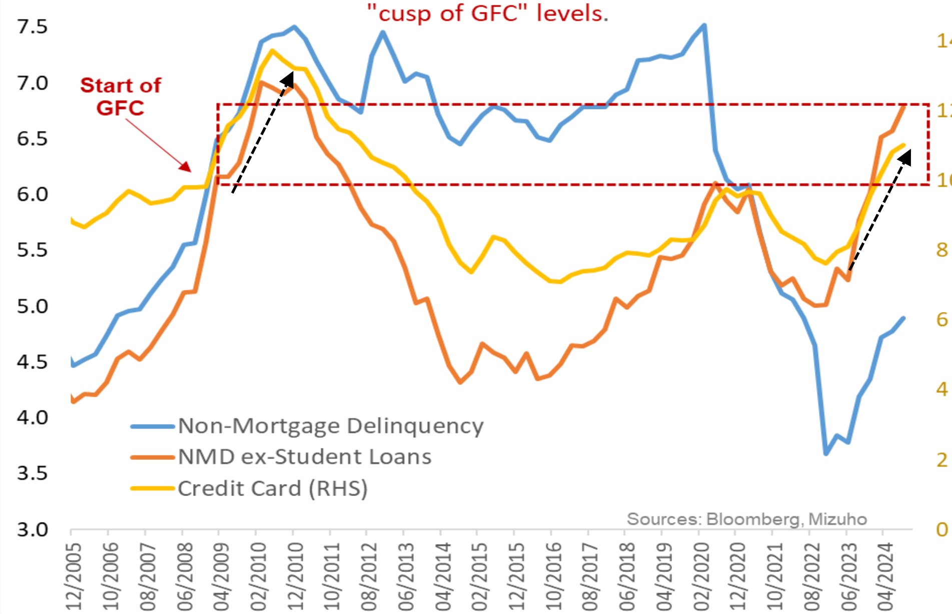


Chart from Bloomberg, San Francisco Fed,

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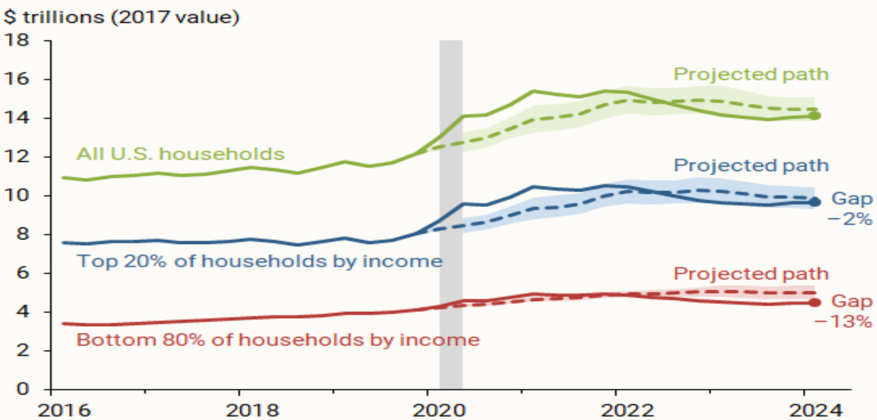
2a. Especially as Distributional hereas US Strains from Erosion of "Liquid" Wealth

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.

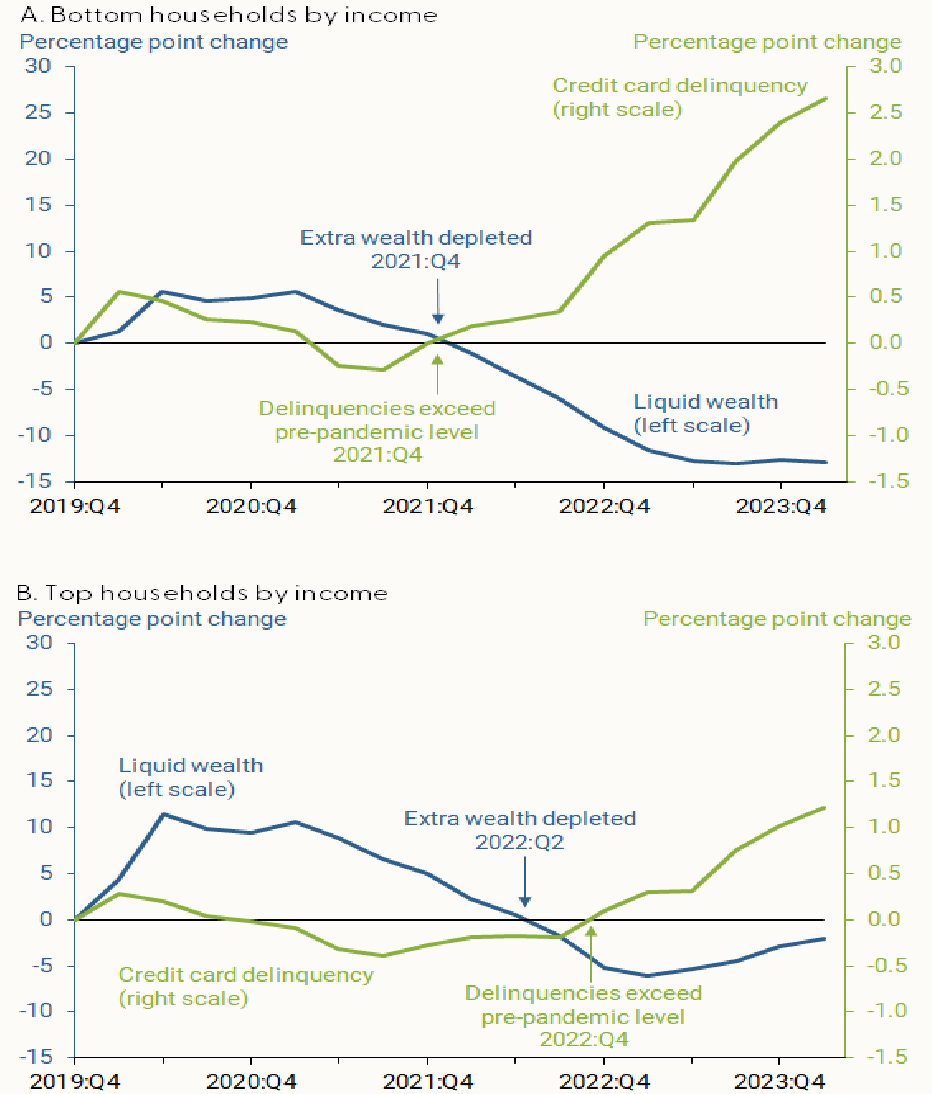
Real household liquid wealth vs. "no-pandemic" estimates



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.

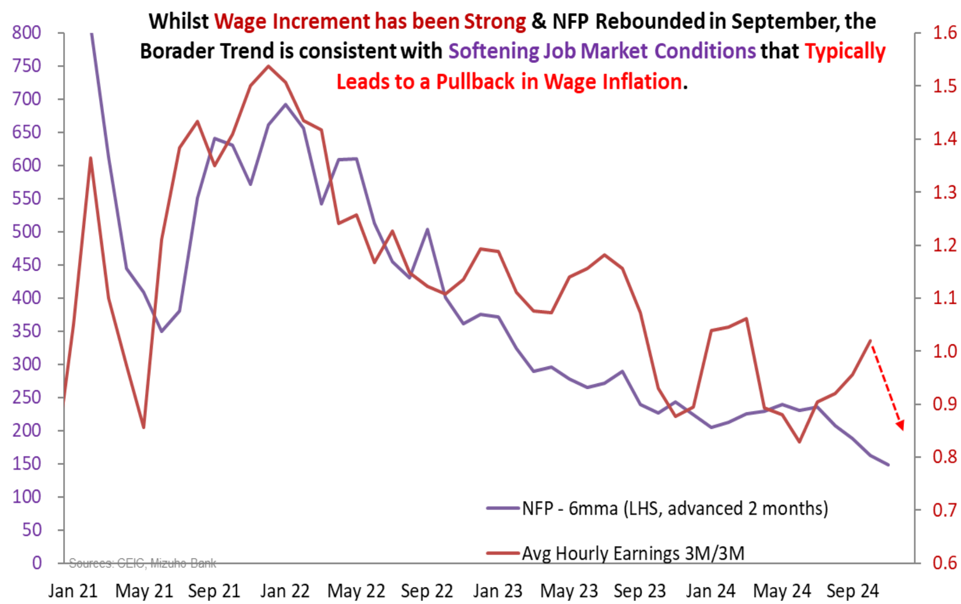
Credit card delinquencies and pandemic-era liquid assets

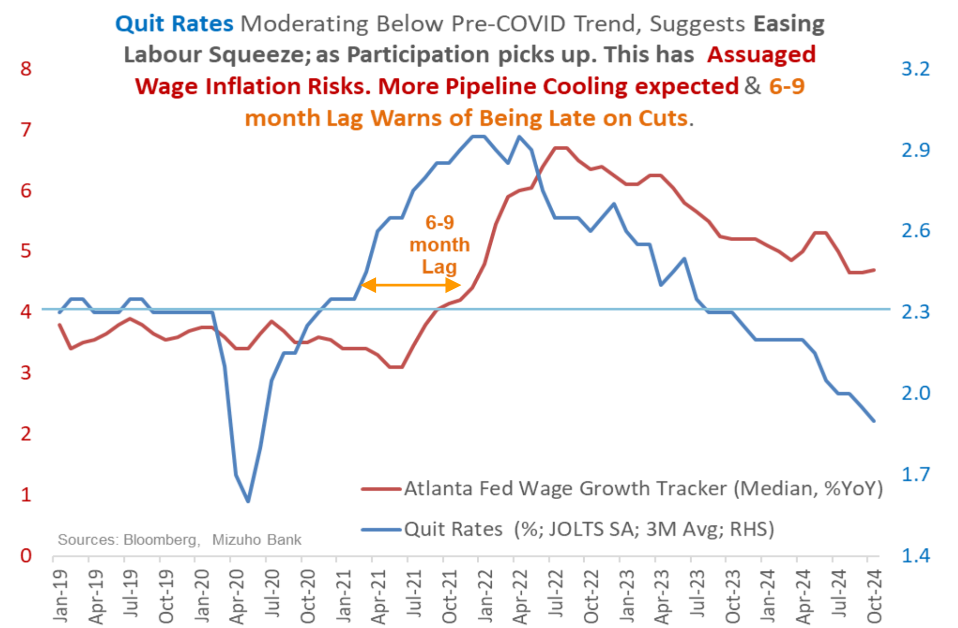


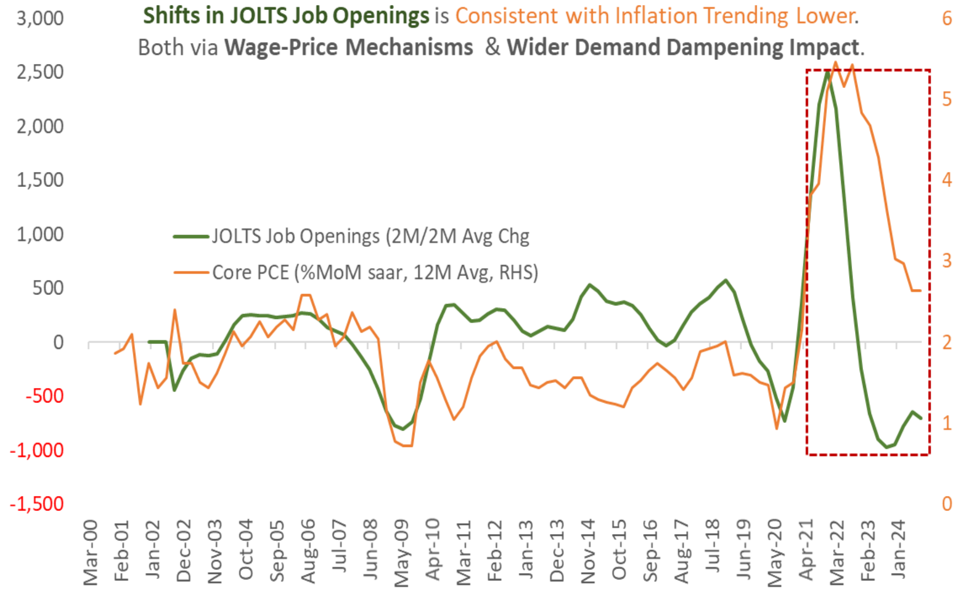
"Type-1" Error: Wrongly rejecting null hypothesis of inflation risks.
"Type-2 Error: Wrongly failing to reject null hypothesis of persistent inflation risks

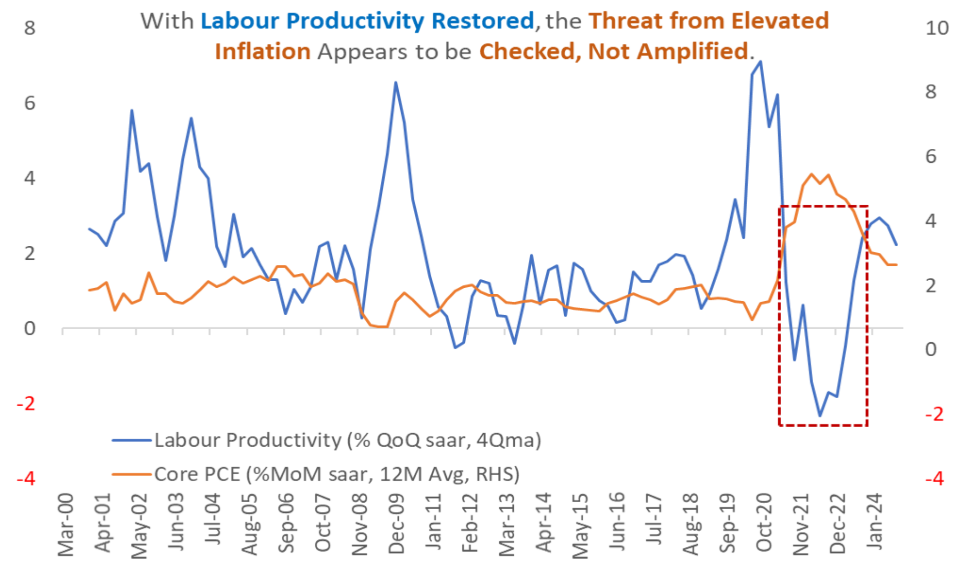
Chart from Bloomberg, San Francisco Fed.

2a. More So Given Diminished Wage-Price Spiral Risks & Downside Jobs Risks









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2b. (UST) Rates - <u>Bumpy</u> 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

<u>Flying Start, But 50 Not the New 25 …</u>
- In Sep, Fed Chair Powell went out of his way to convey <u>not to expect outsized 50bp cuts as the norm</u>.
- 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**..

<u>Mostly Following the (Dot) Plot for 2024 …</u>
- 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**.

<u>Rate Cuts to Gather Pace in H1 2025</u>
- **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.

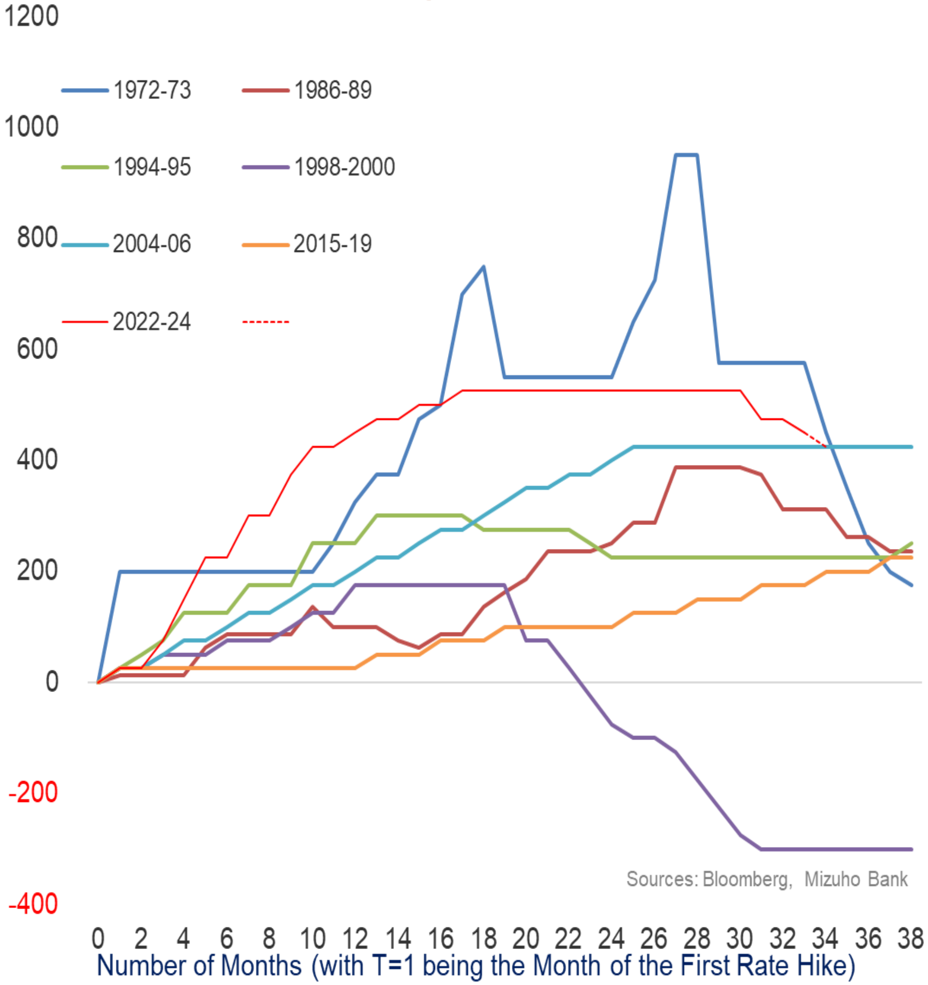
<u>More Distinctly Dovish Leg diminished, But Not Ruled Out, by Trump 2.0</u>
- **Scope for distinctly dovish Fed in 2025** *if jobs/demand deteriorate sharper than SEP* "controlled landing"*.

<u>Premise: Consumer Slowdown, Not Crisis</u>
- 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.

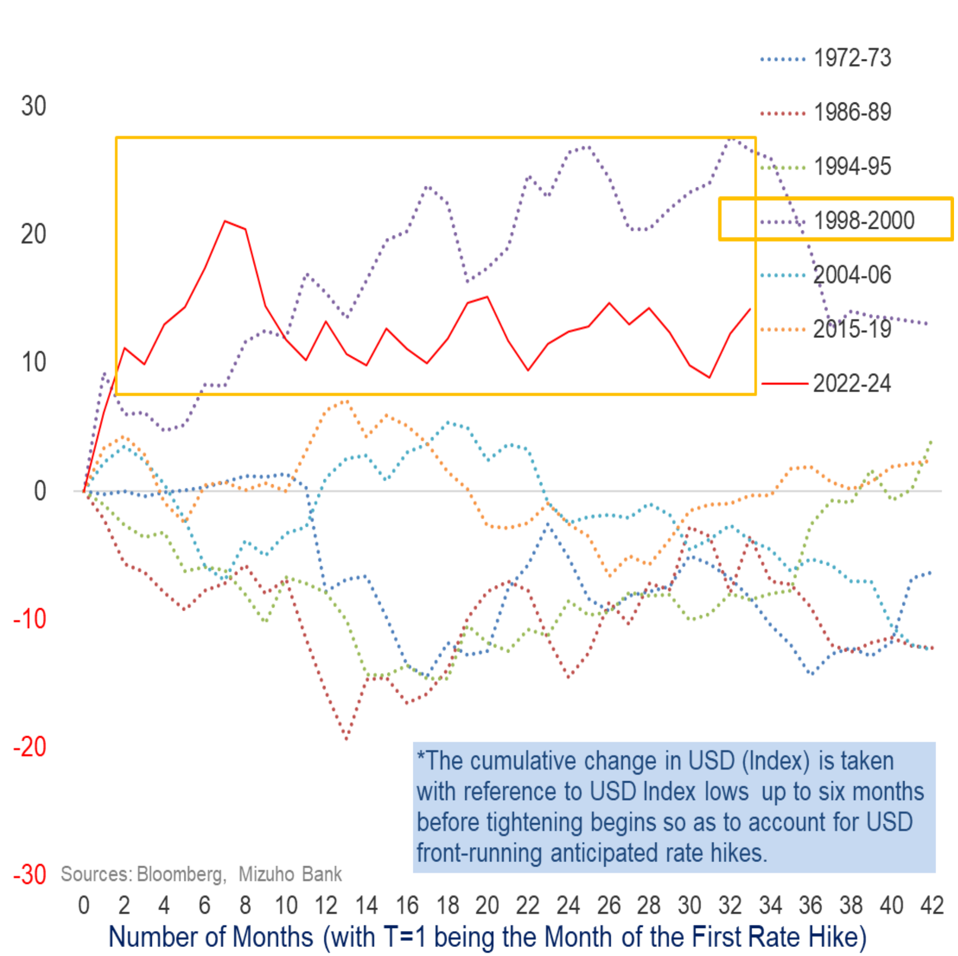
Outcomes: Lower Yields + Distinctly **Steeper Curve** + Long-end "Trump 2.0" Volatility

2b. FX – USD: Atypical Late-Stage USD Strength

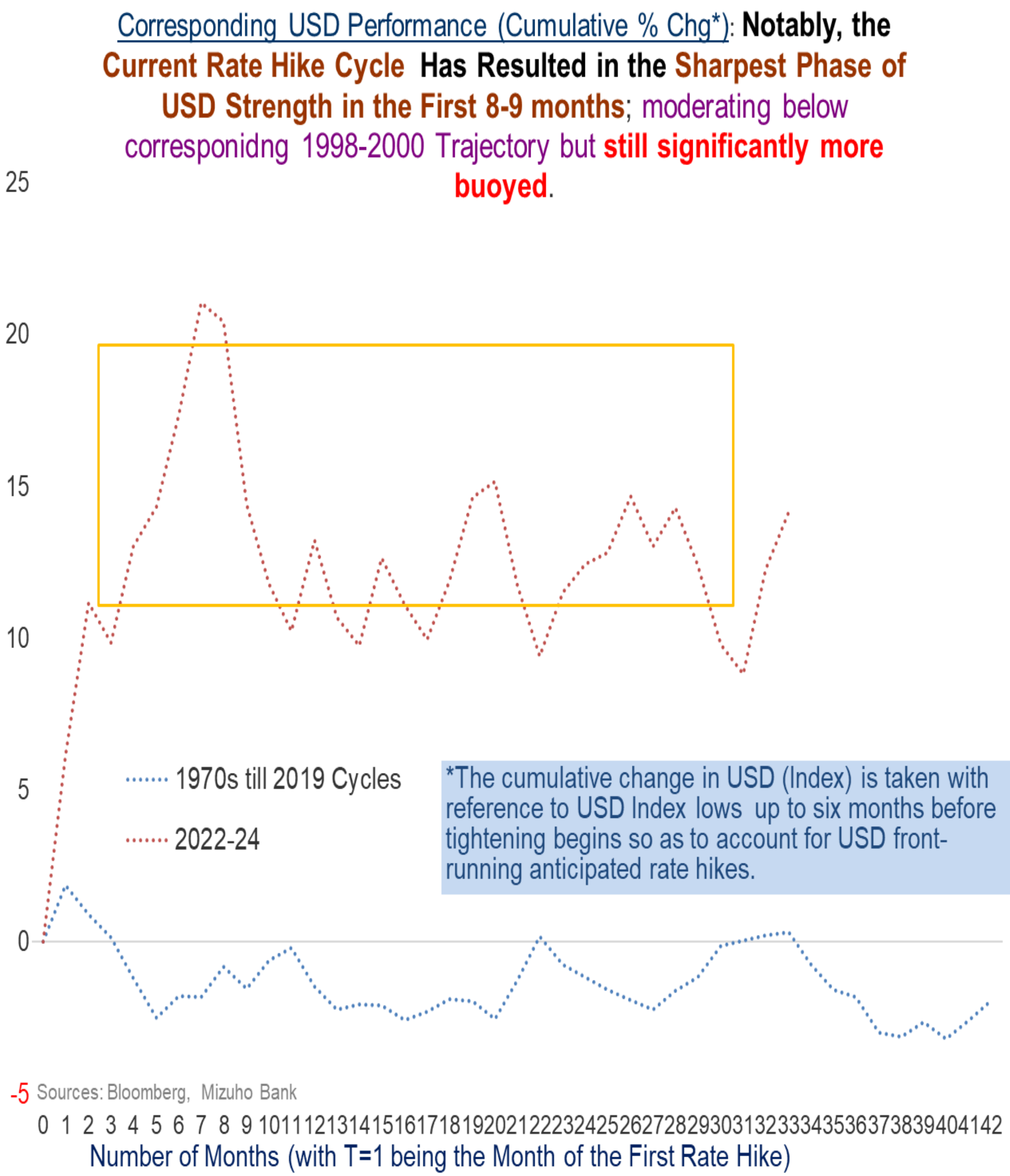
Fed Hiking Cycle (Cumulative Rate Hikes; bp): **Although not the Greatest Amplitude of Rate Hikes** (1970s More Brutal, with >700bp of Hikes), **this Cycle Marks the Fastest Pace of Hikes; 525bps Over 17 Months.**

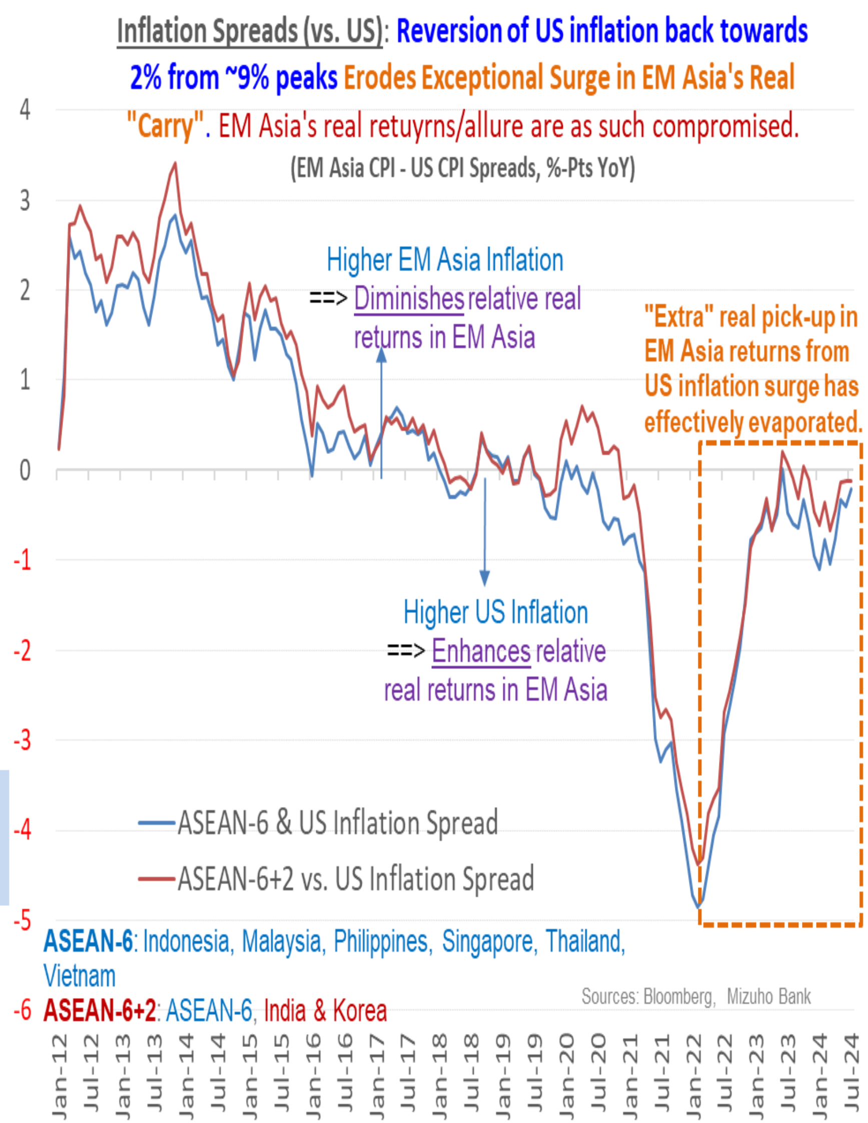


Corresponding USD Performance (Cumulative % Chg*): **Notably, the Current Rate Hike Cycle Has Resulted in the Sharpest Phase of USD Strength in the First 8-9 months**; moderating below corresponidng 1998-2000 Trajectory but **still significantly more buoyed**.



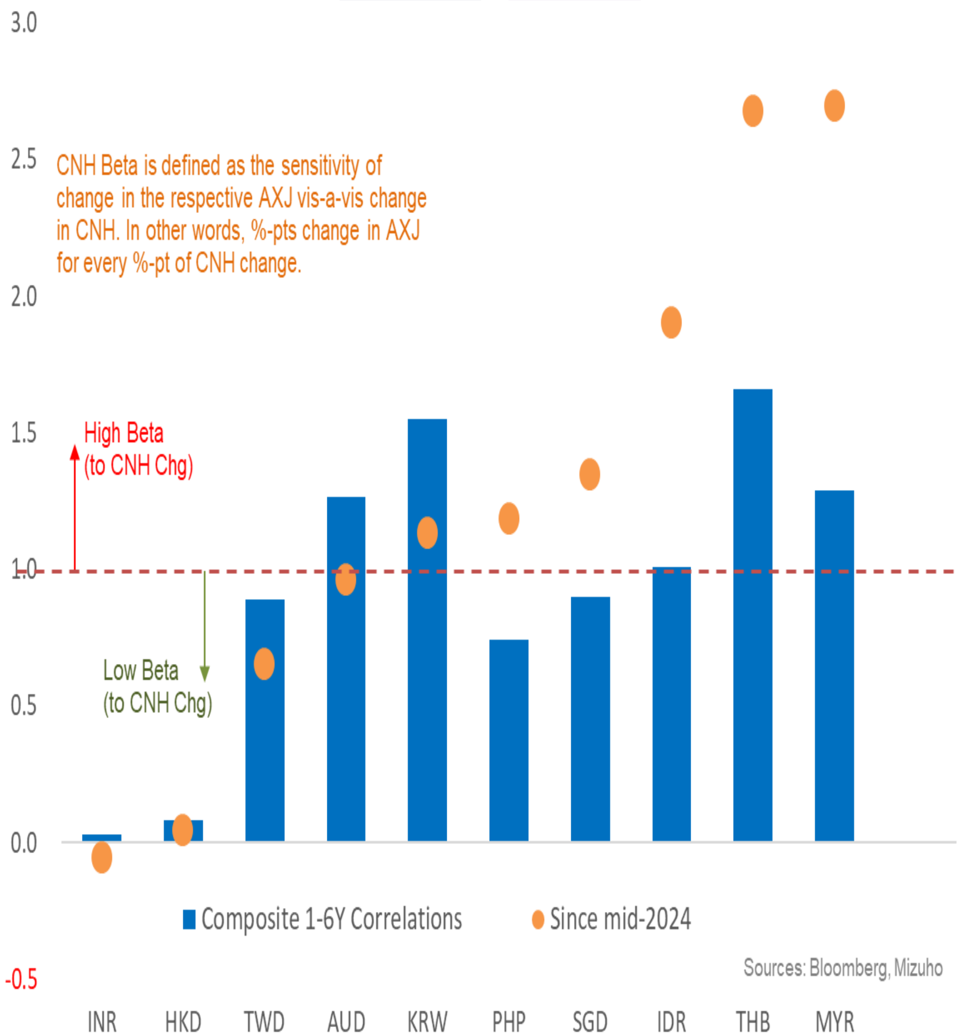
2b. FX – USD: Full Reversion of AXJ may be Challenged

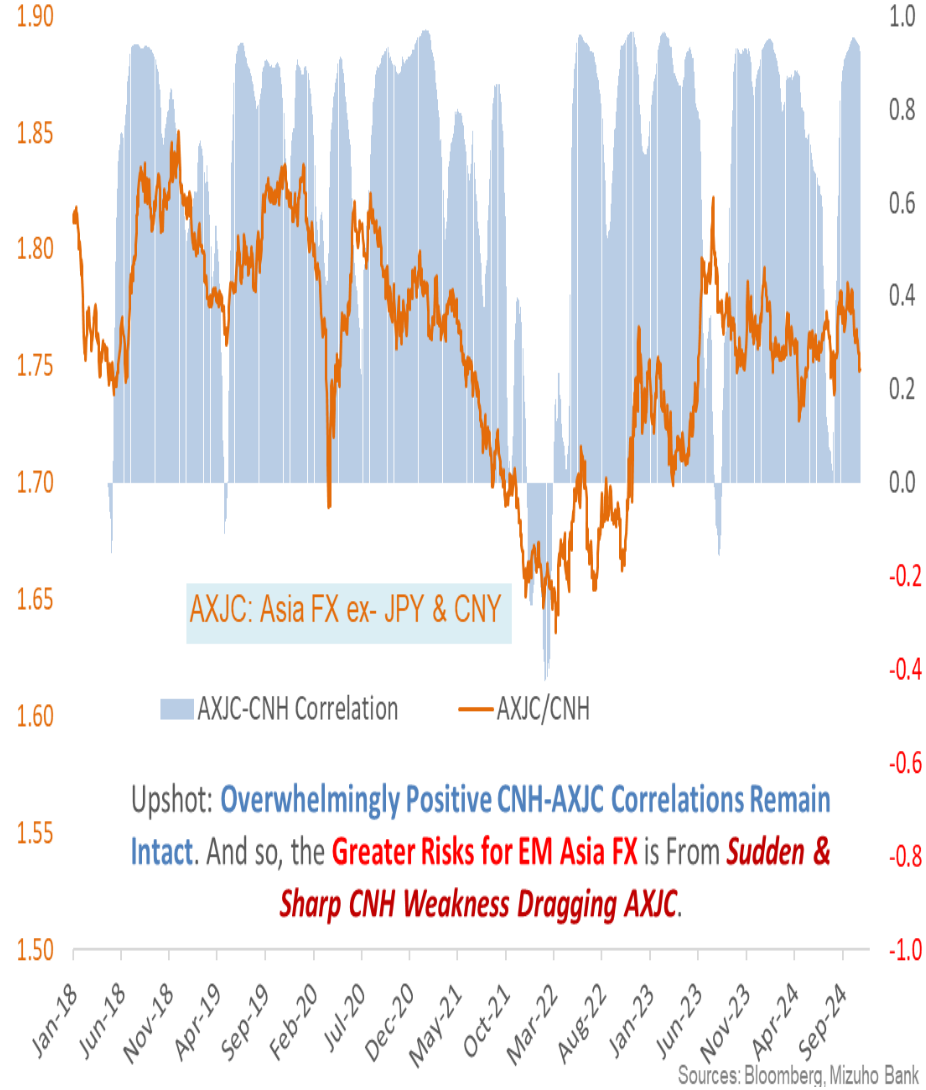




2b. FX - CNH Beta: Expect AXJ Volatilities to be Heightened & Fluid

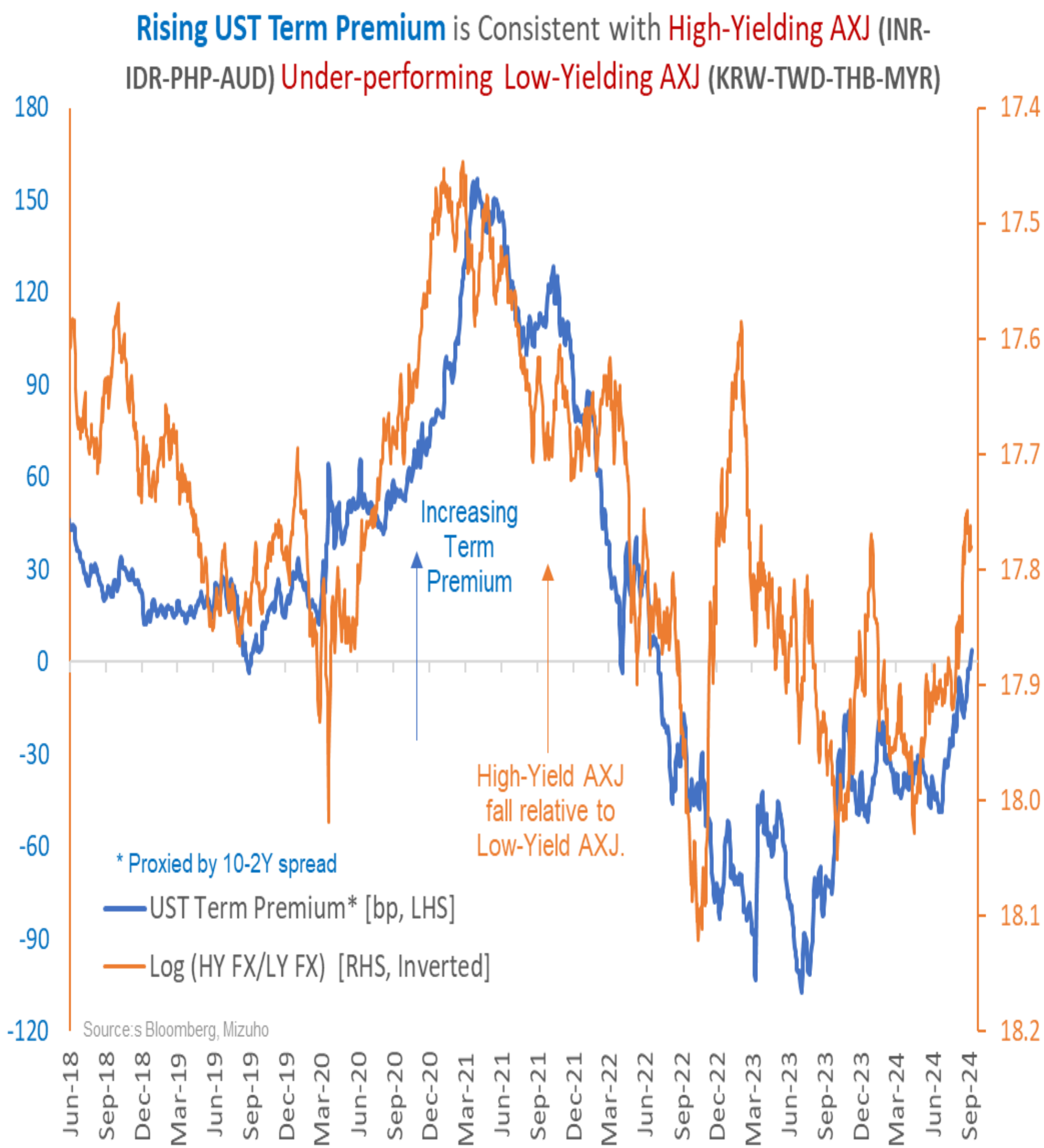
CNH Beta*: There is Notable Variation in CNH-Beta of AXJ, which are are both **Differentiated** & **Time-Varying**.





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***.

2b. FX - 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.

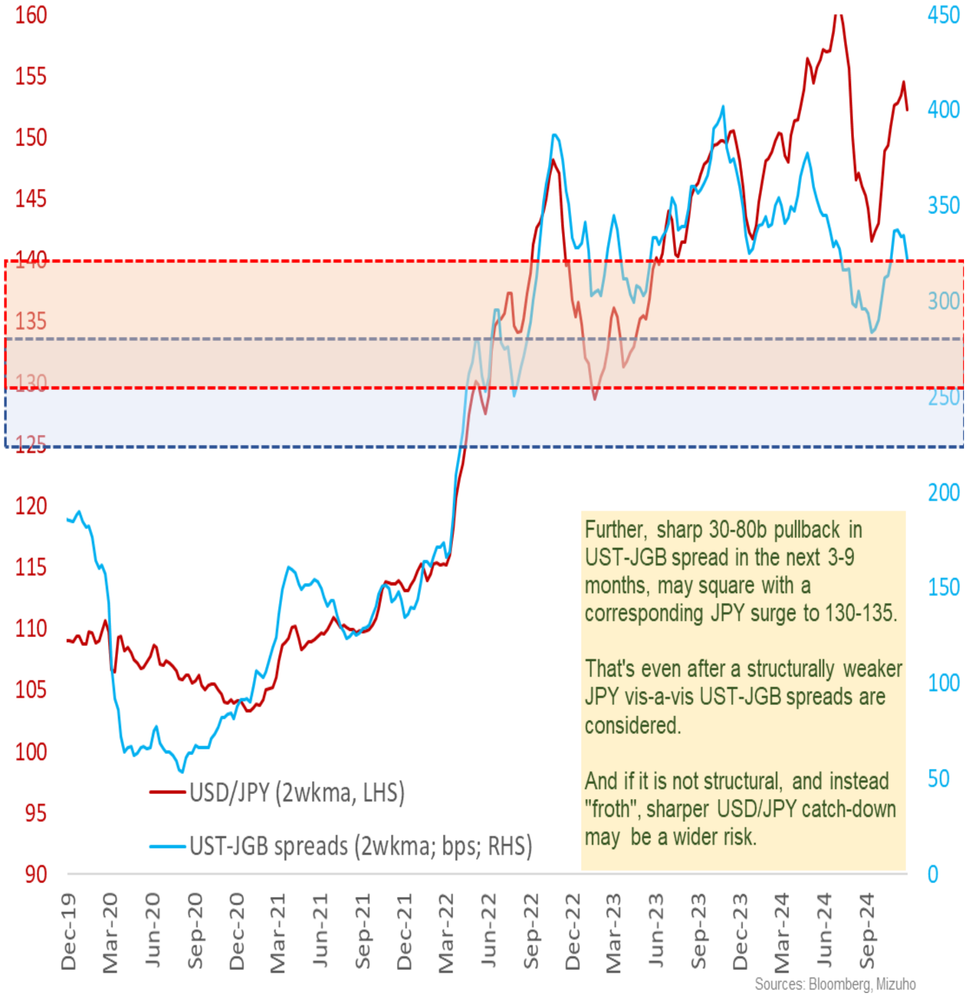
… Harsher on High-Yield AXJ

- 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).

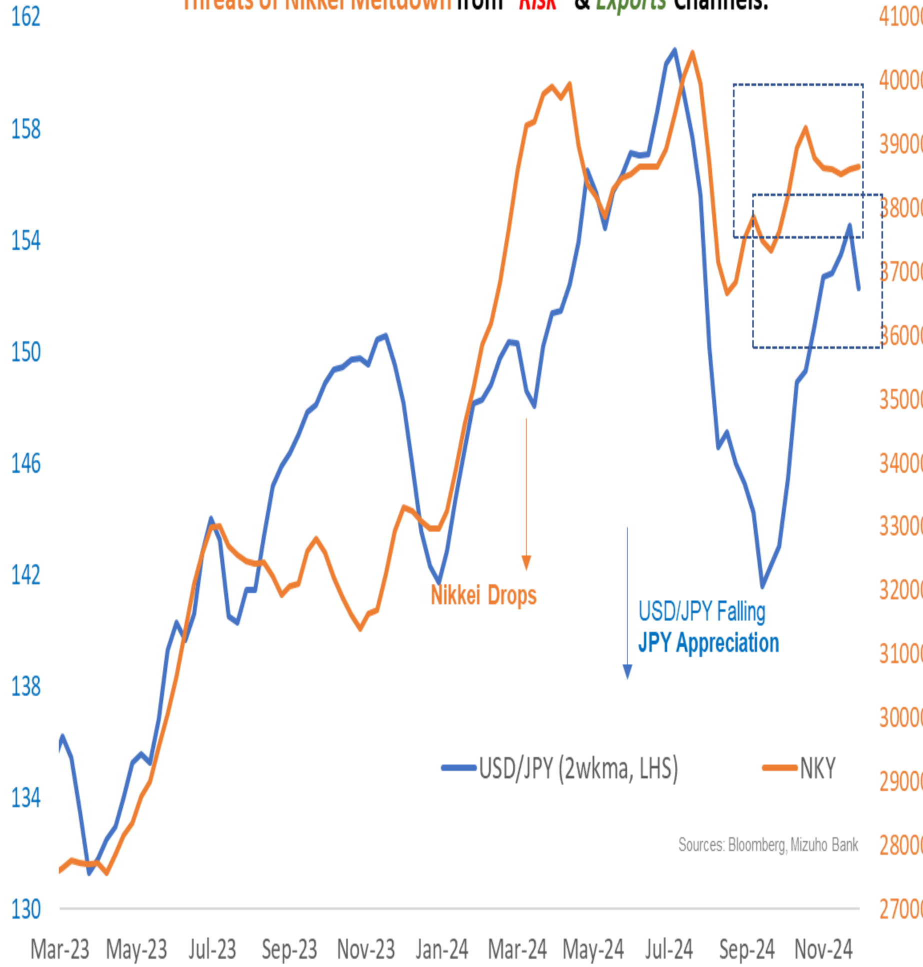
2b. FX - JPY-BoJ Risks: Trump 2.0 Heightens Inherent

1. **"JPY Problem with a Fed Solution" Distorted by Trump 2.0 Disruptions**
2. **Fed Doubt & Trade pain may inflict bouts of JPY sell-off initially**

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.

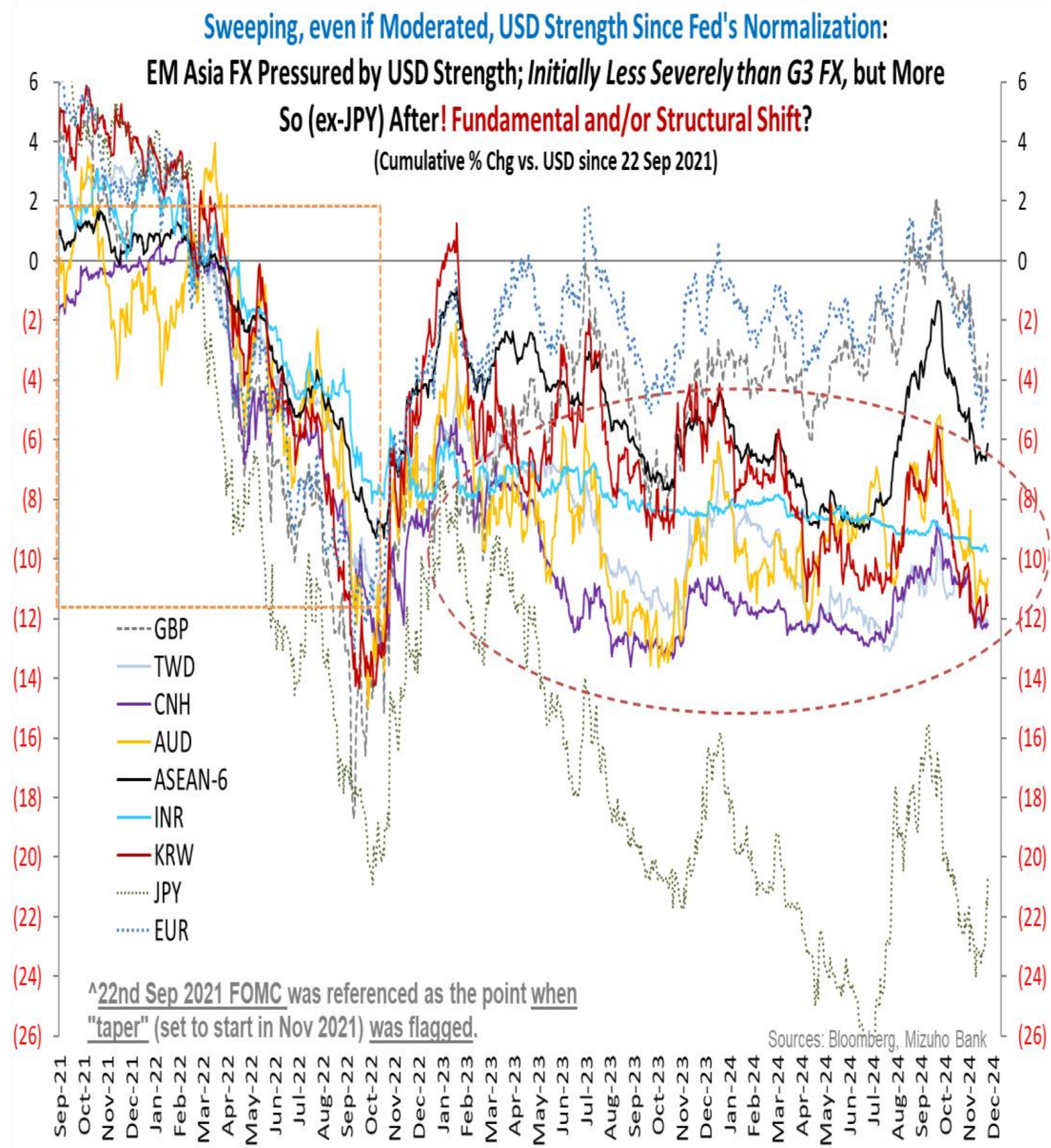


Co-Movement between Changes in Nikkei & Changes in USD/JPY Underline Negative JPY-Nikkei Correlations. Further, Sharp JPY Appreciation Poses Threats of Nikkei Meltdown from "*Risk*" & *Exports* Channels.



2b. FX Outlook

FX Forecasts	Dec 24	Mar 25	Jun 25	Sep 25	Dec 25
USD/CNY	7.13 - 7.38 (7.28)	7.10 - 7.50 (7.32)	7.15 - 7.55 (7.38)	7.05 - 7.40 (7.23)	6.98 - 7.32 (7.12)
USD/INR	83.2 - 87.3 (84.6)	83.9 - 87.4 (84.9)	83.5 - 87.6 (85.2)	83.0 - 86.5 (84.8)	82.6 - 86.1 (84.6)
USD/KRW	1340 - 1440 (1370)	1310 - 1460 (1380)	1330 - 1500 (1390)	1310 - 1420 (1365)	1290 - 1400 (1345)
USD/SGD	1.292 - 1.358 (1.348)	1.337 - 1.373 (1.356)	1.338 - 1.385 (1.365)	1.315 - 1.375 (1.335)	1.292 - 1.344 (1.318)
USD/TWD	31.1 - 33.1 (32.4)	31.6 - 34.3 (32.6)	31.7 - 34.1 (32.7)	31.2 - 33.6 (32.2)	30.9 - 33.2 (31.9)
USD/IDR	15100 - 16200 (15900)	15690 - 16210 (16050)	15900 - 16420 (16100)	15100 - 16270 (15600)	14710 - 15810 (15200)
USD/MYR	4.12 - 4.58 (4.42)	4.25 - 4.65 (4.43)	4.24 - 4.67 (4.42)	4.13 - 4.45 (4.30)	3.99 - 4.28 (4.12)
USD/PHP	56.0 - 59.3 (58.7)	56.6 - 60.2 (58.8)	57.1 - 60.5 (58.7)	55.9 - 59.3 (57.2)	54.7 - 58.2 (56.5)
USD/THB	32.6 - 35.3 (34.3)	32.9 - 35.9 (34.5)	33.8 - 36.2 (34.8)	32.9 - 35.2 (33.8)	32.5 - 34.7 (33.4)
USD/VND	24700 - 25900 (25380)	25200 - 26100 (25370)	24800 - 25700 (25080)	24600 - 25600 (24870)	24500 - 25600 (24700)
AUD/USD	0.638 - 0.694 (0.658)	0.634 - 0.681 (0.650)	0.628 - 0.677 (0.645)	0.634 - 0.685 (0.667)	0.656 - 0.700 (0.680)



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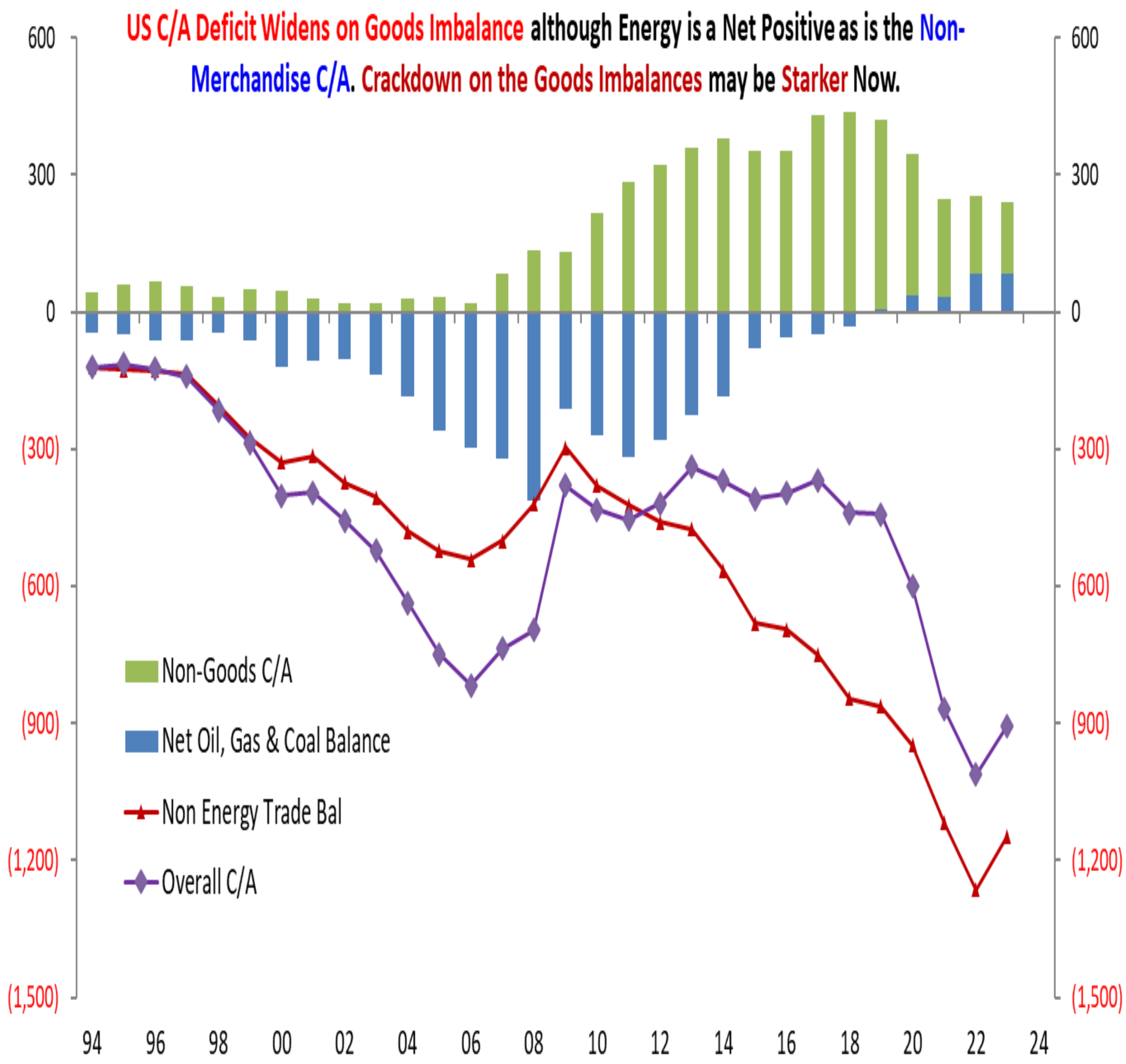
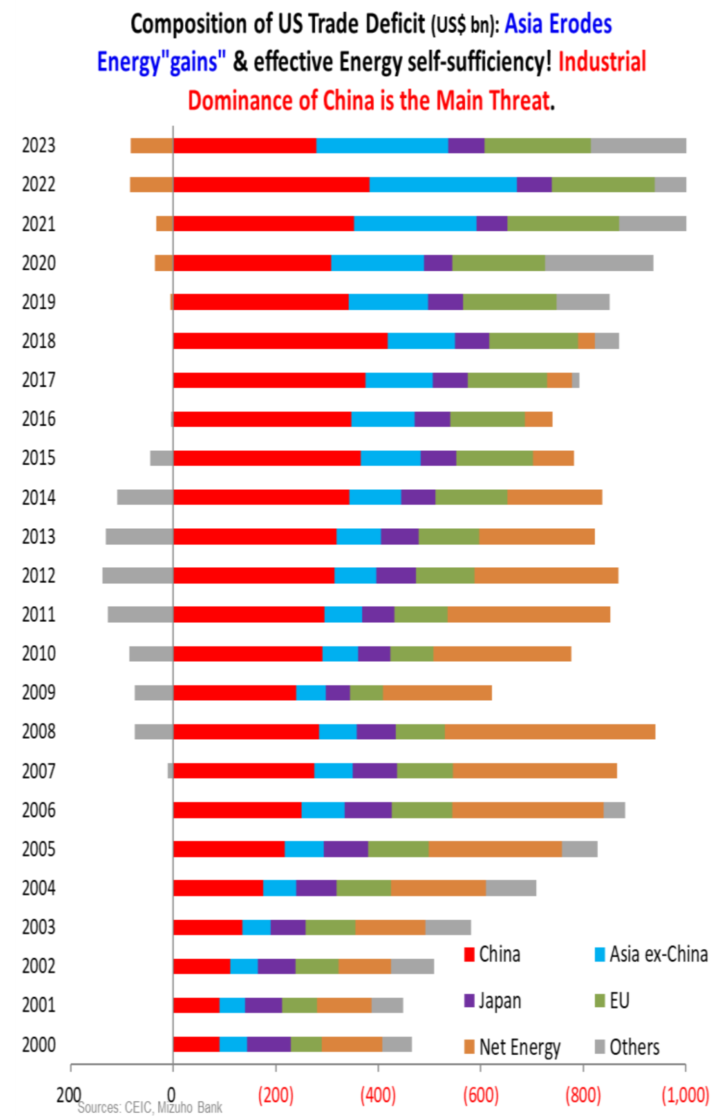
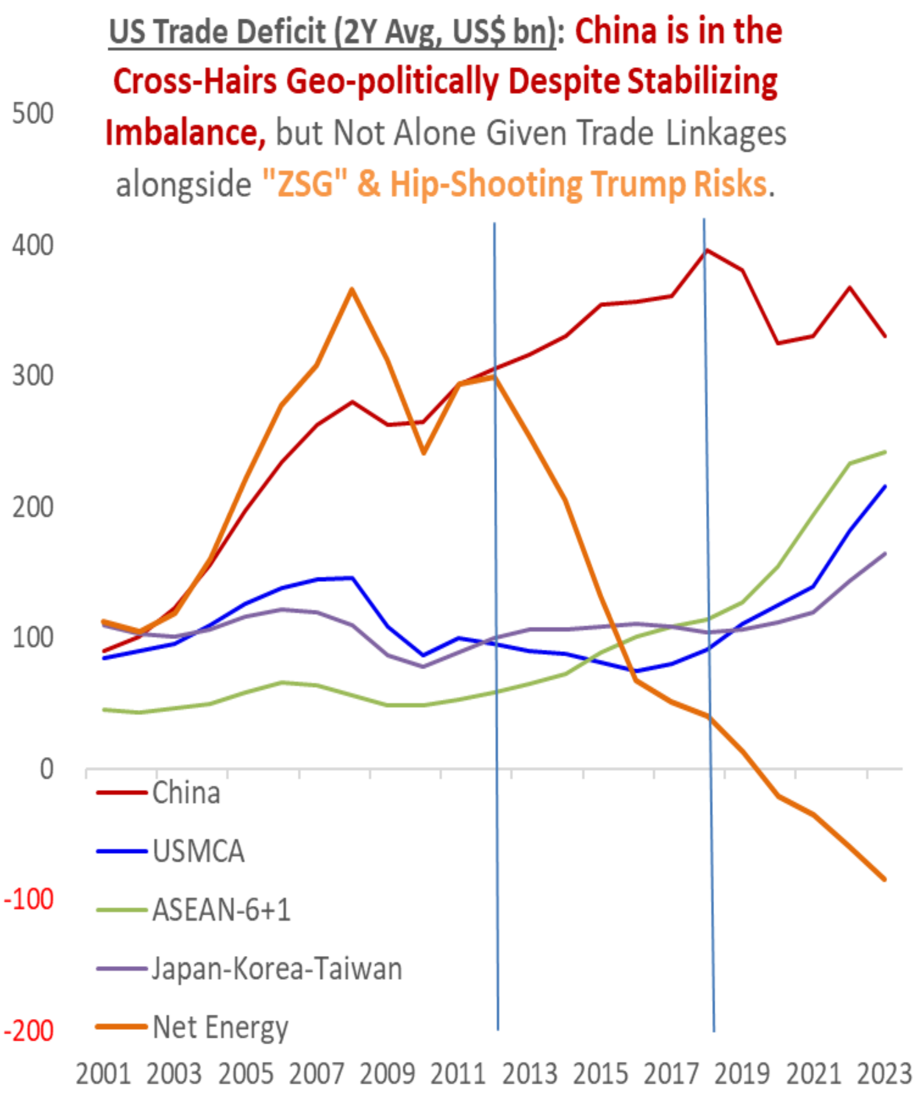
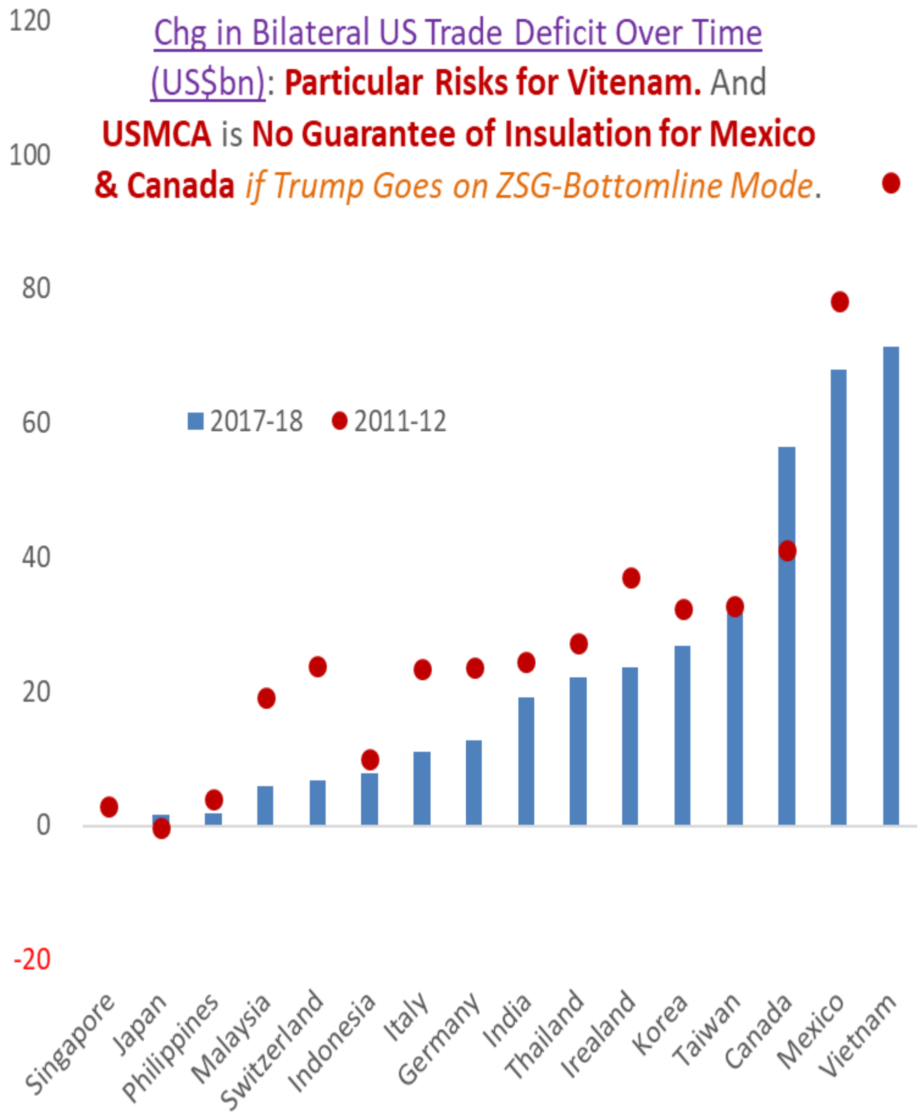
3a. Trade Risks: Risks Go Well Beyond China



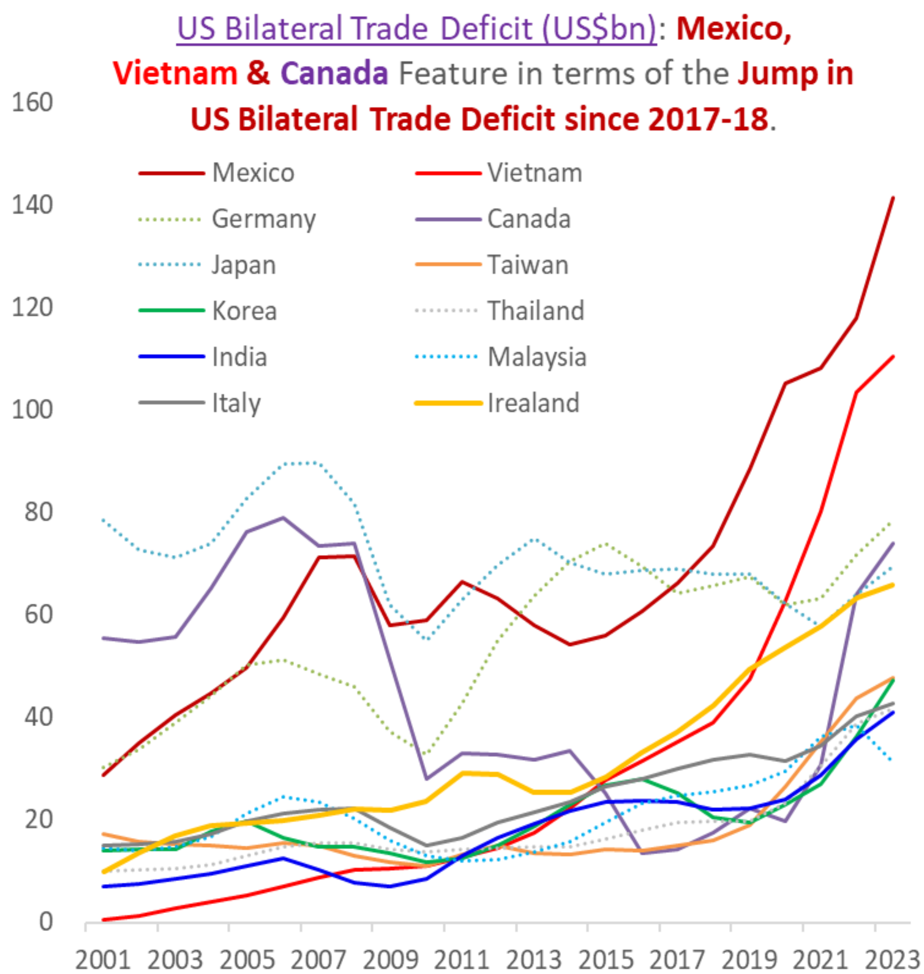


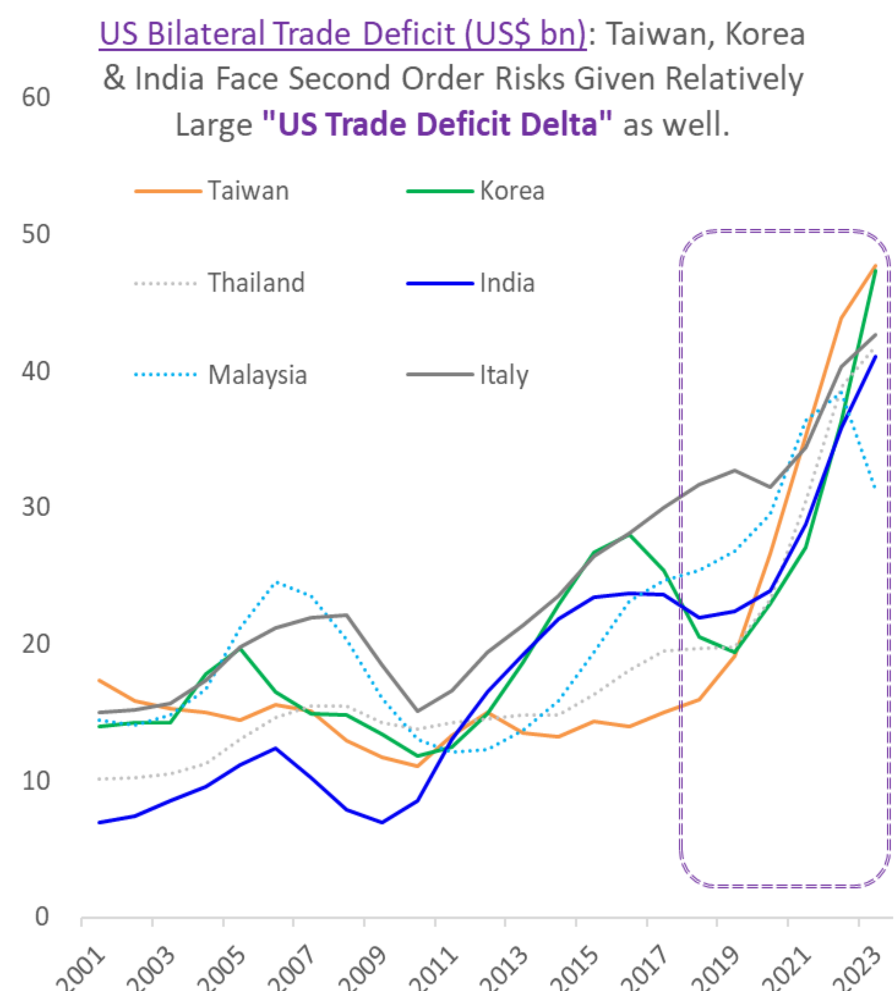
3a. Trade Risks: Excluding China, a Few Key Economies Led by Mexico & Vietnam at Risk





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



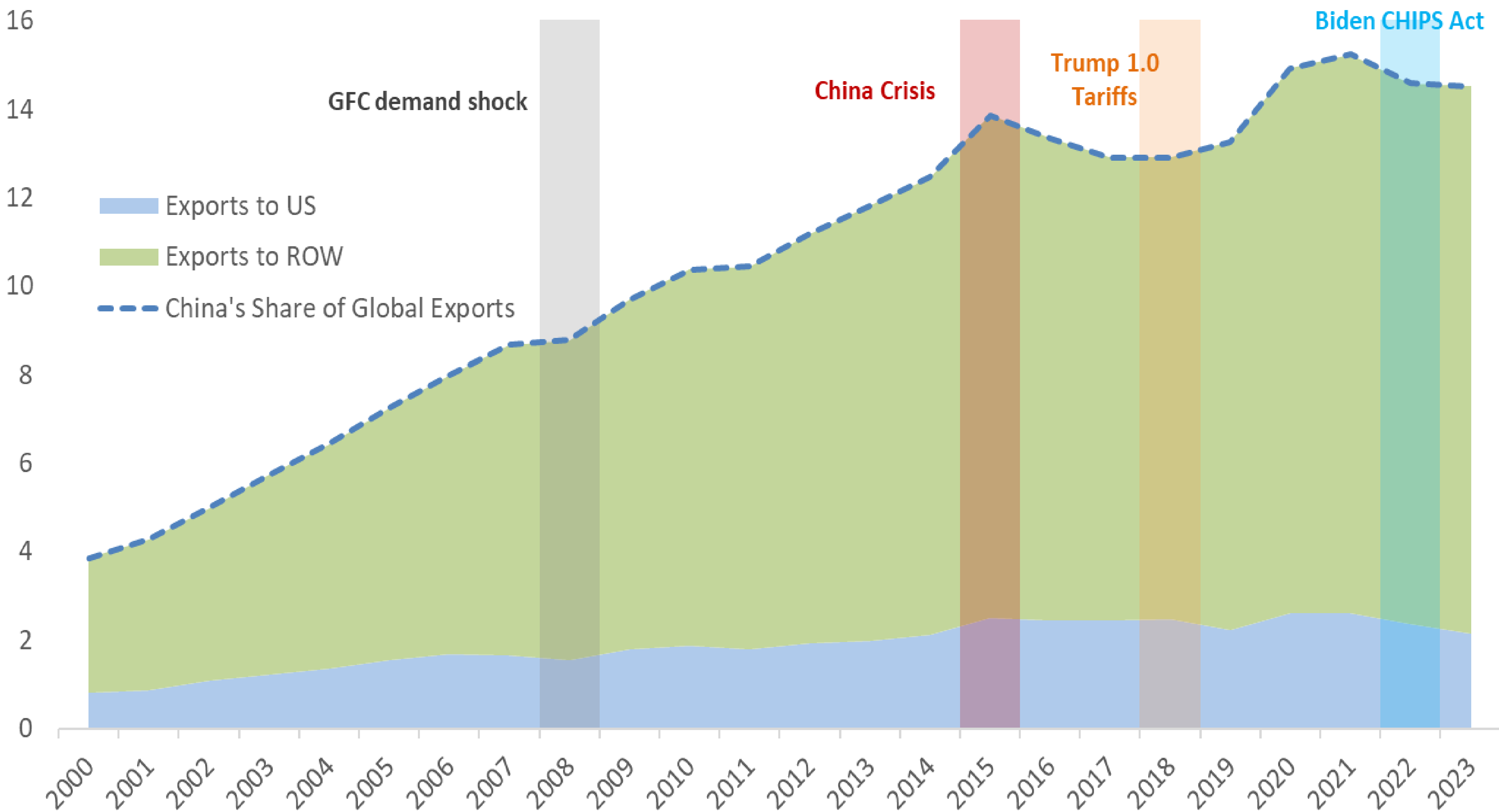


US Bi-lateral Trade Deficit

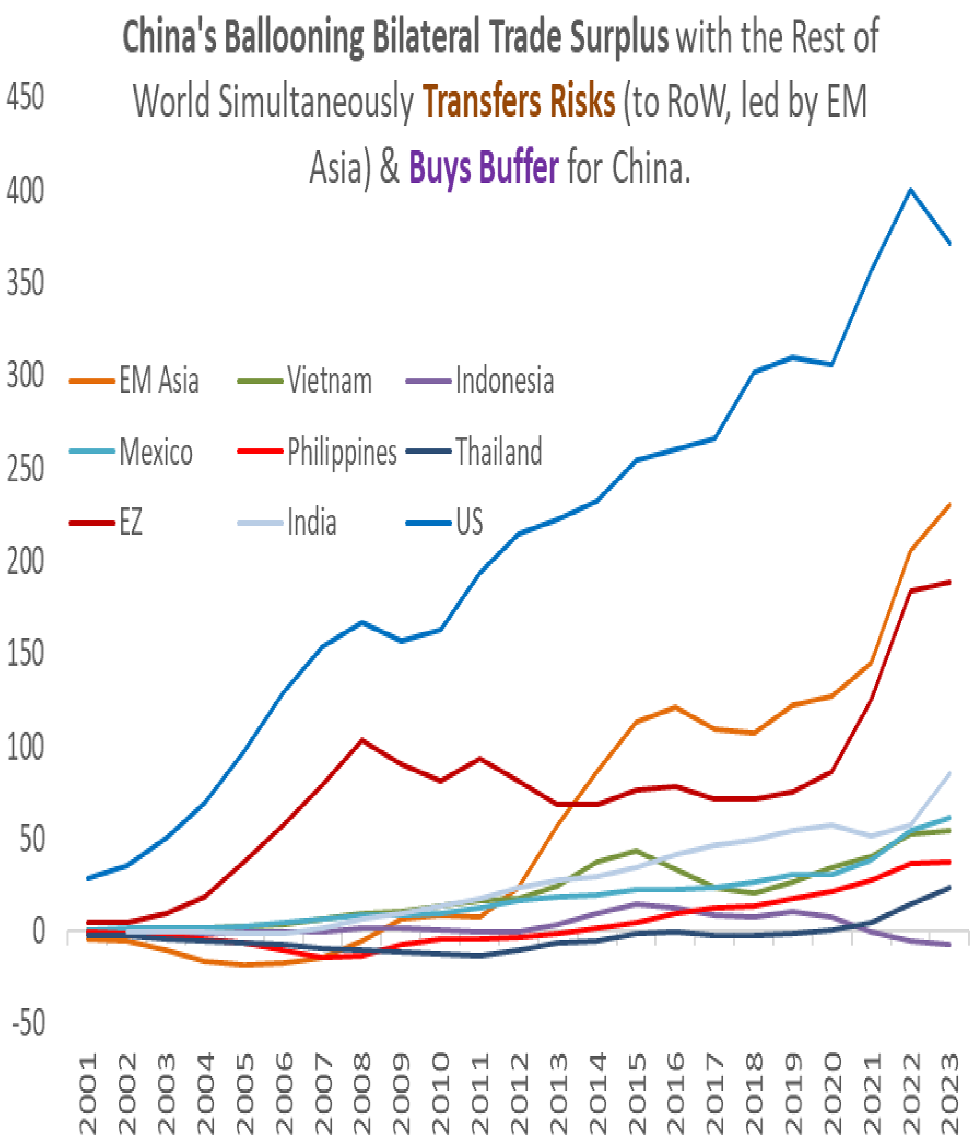
US$ bn	China	Mexico	Vietnam	Germany	Canada	Japan	Ireland	Taiwan*	Korea	Thailand	India*	Malaysia	Switzerland	Indonesia	Philippines	Singapore	Net Energy
2015-17 Avg	362.6	63.5	33.7	67.5	14.5	68.8	34.8	14.9	26.4	18.8	23.5	23.6	12.6	13.0	2.4	-9.9	61.3
2022-23 Avg	330.9	141.4	110.4	78.5	74.0	69.5	65.9	47.7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

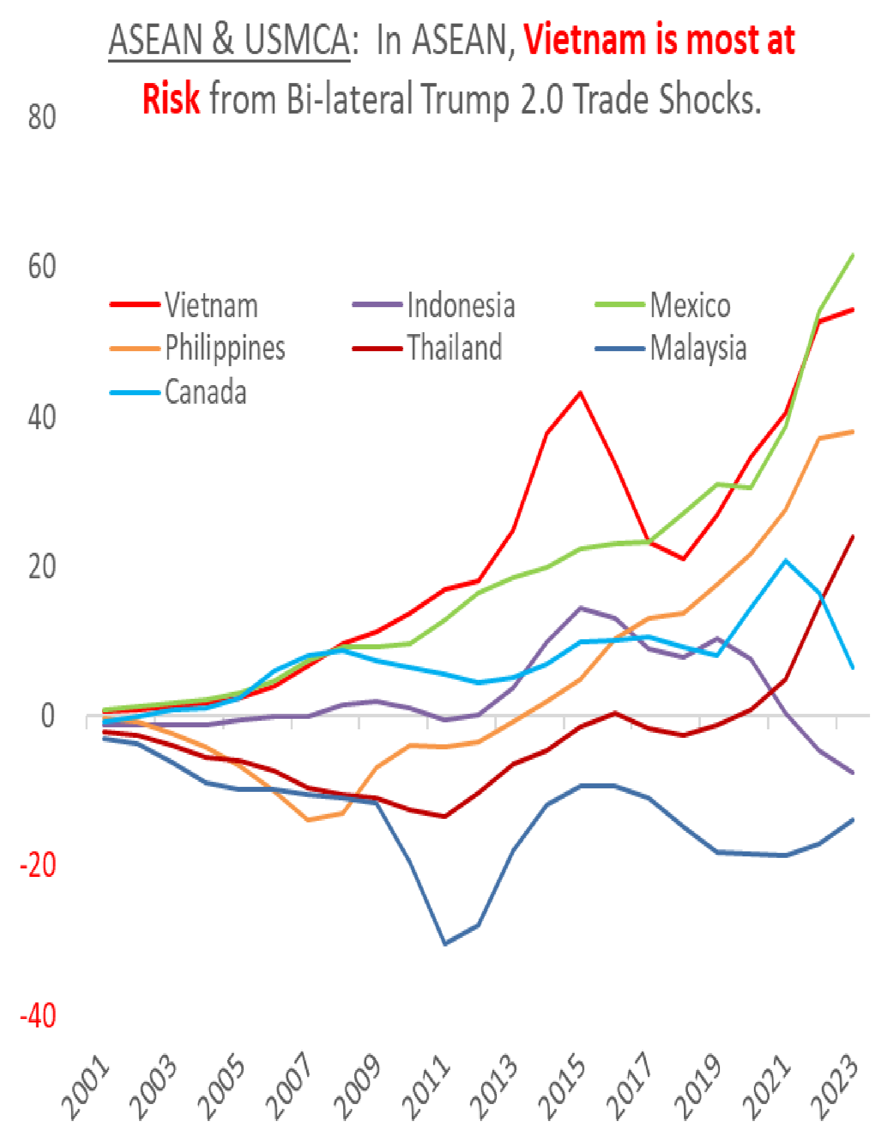
3c. Does China Have a Trump Card? ➔ Unfettered Global Exports Share

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.



3c. Does China Have a Trump Card? ➔ Undeniable Supply-Chain Sway





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China Macro Outlook

December 2024

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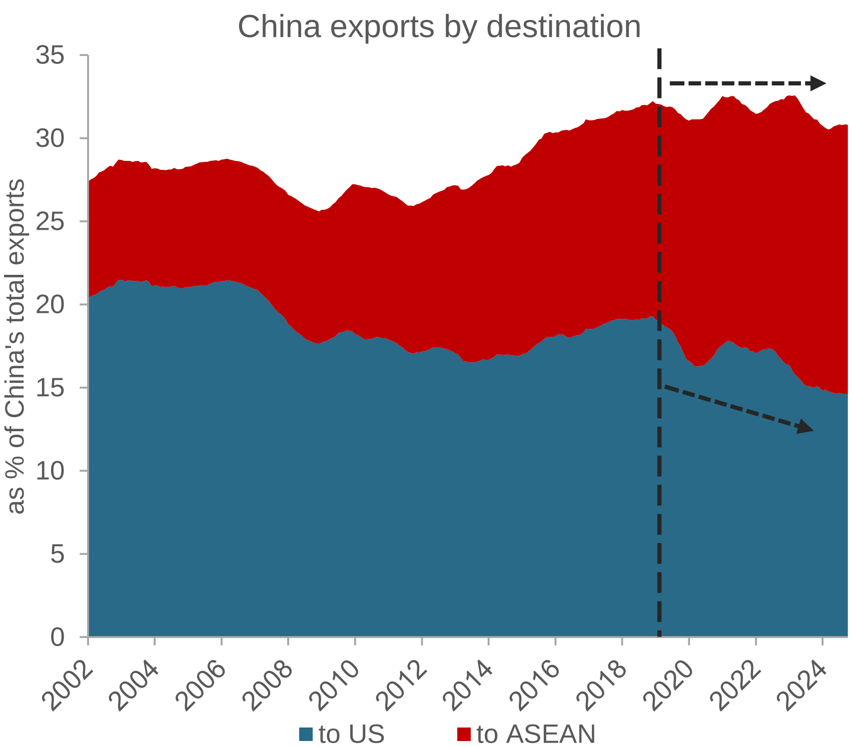
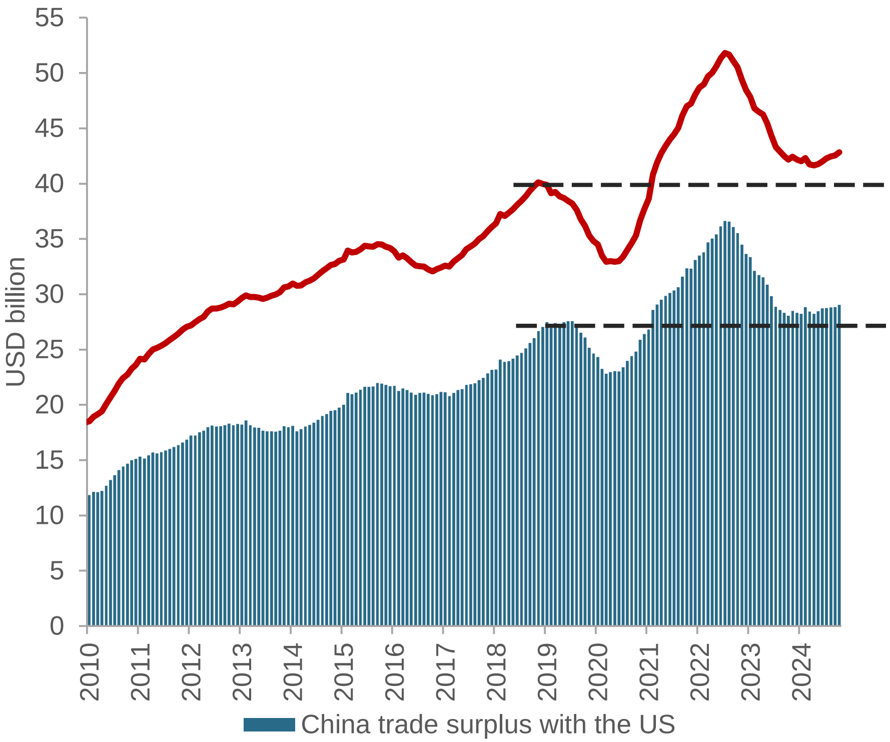
Part 1: Does the US have a “Trump card”?

Does the US still import from China?

- China's trade sector has demonstrated greater resilience than many had expected:
  - Despite a decline in China's share of exports to the US, its share to ASEAN has steadily increased during the same period.
  - Current export levels to the US remain higher than those recorded in 2019, when most additional tariffs were implemented.



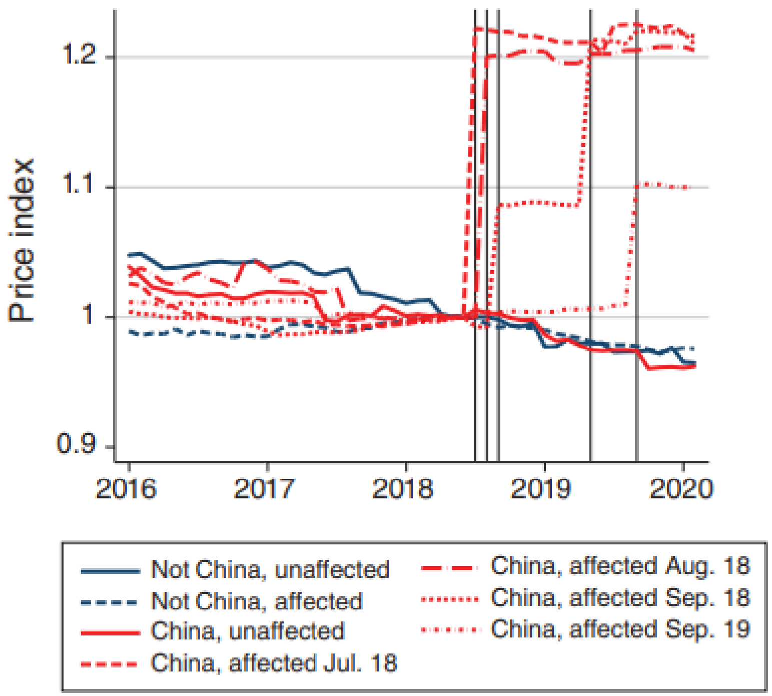


Source: CEIC, Wind, Mizuho

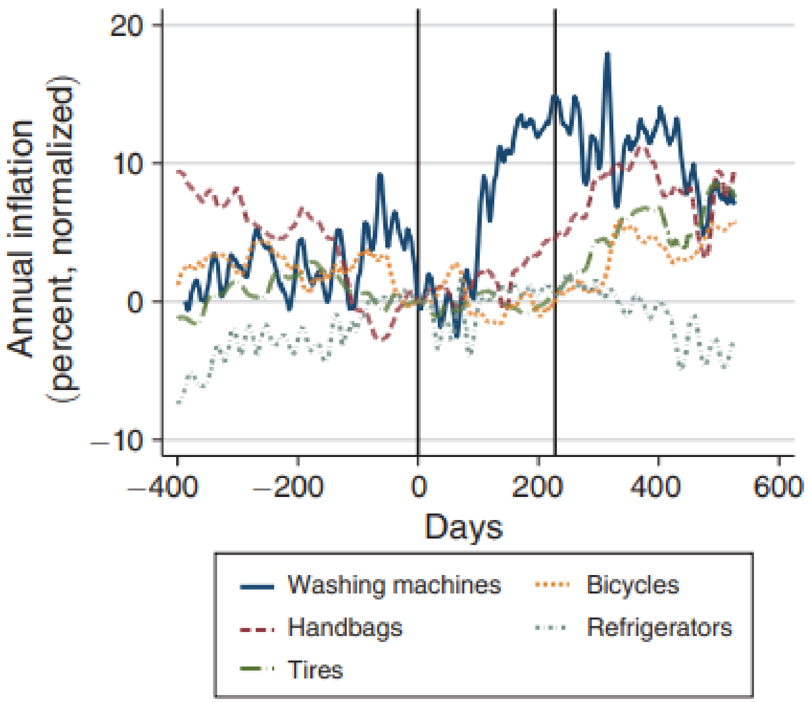
Who are paying the additional tariffs?

- The US lacks the necessary labor and public utilities required to facilitate a rapid increase in manufacturing capacity.
  - The number of people working in construction and manufacturing has remained around 25 million over the past two decades, in stark contrast with 215 million employed in China's manufacturing sector.
  - US industrial electricity consumption has remained around 1 trillion kWh per year since the 1990s (26% of total). In comparison, China's industrial sector consumed 5.1 trillion kWh, or 55% of the country's total electricity, in 2023.

Panel A. Import price indices (including tariffs)



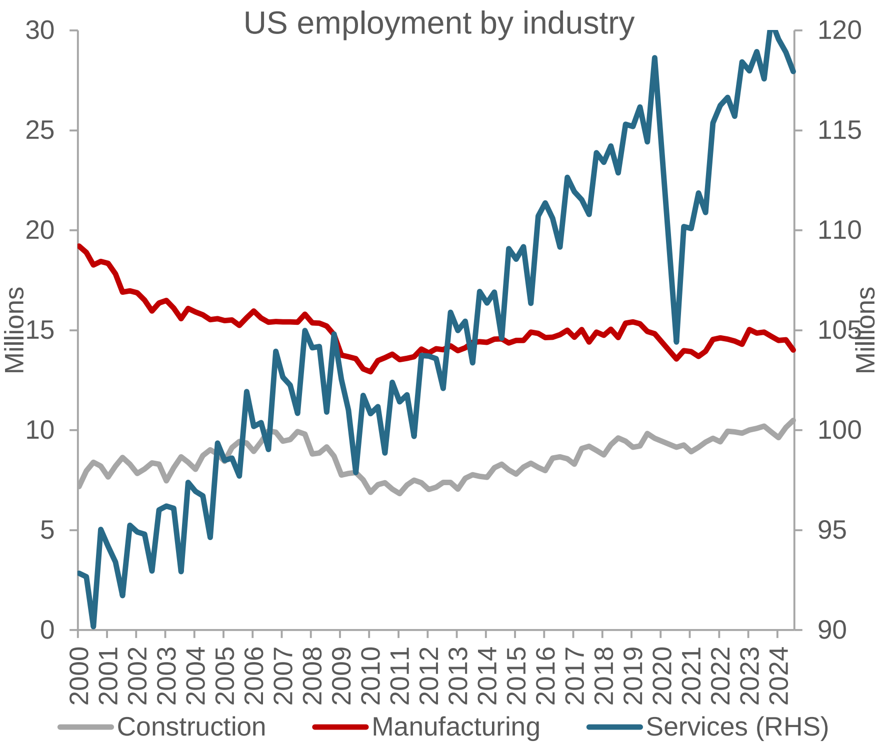
Panel B. Annual inflation

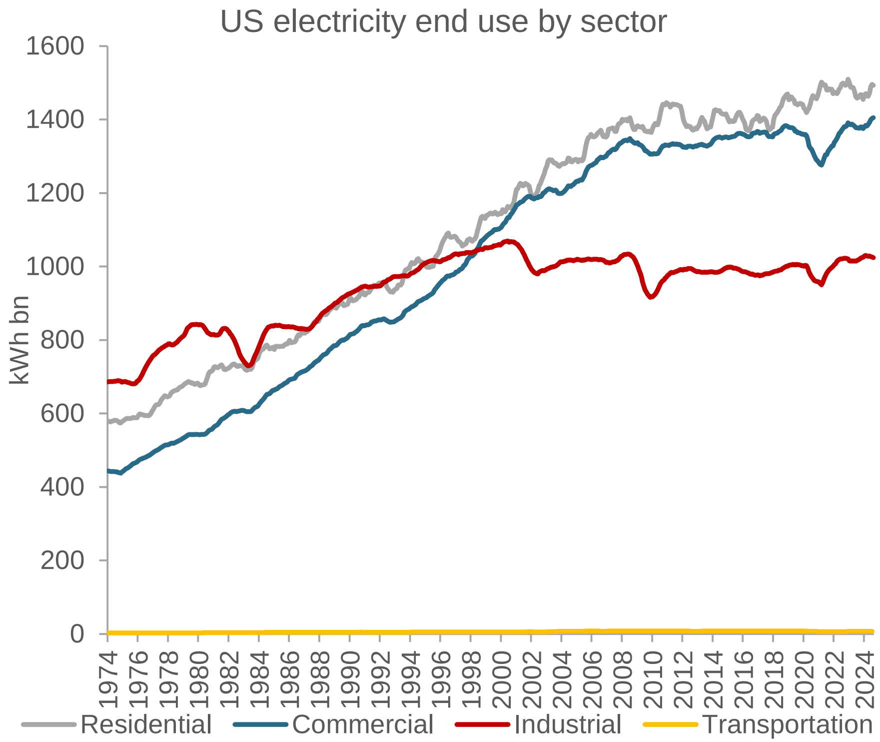


Source: Cavallo, Alberto, Gita Gopinath, Brent Neiman, and Jenny Tang. 2021. "Tariff Pass-Through at the Border and at the Store: Evidence from US Trade Policy." American Economic Review: Insights, 3 (1): 19–34.

Can the US quickly ramp up its manufacturing capacity?

- The US lacks the necessary labor and public utilities to facilitate a rapid increase in manufacturing capacity.
- The number of people working in construction and manufacturing has remained around 25 million over the past two decades, in contrast with 215 million employed in China's manufacturing sector.
- US industrial electricity consumption has remained around 1 trillion kWh per year since the 1990s (26% of the total). In comparison, China's industrial sector consumed 5.1 trillion kWh, or 55% of the country's total electricity, in 2023.



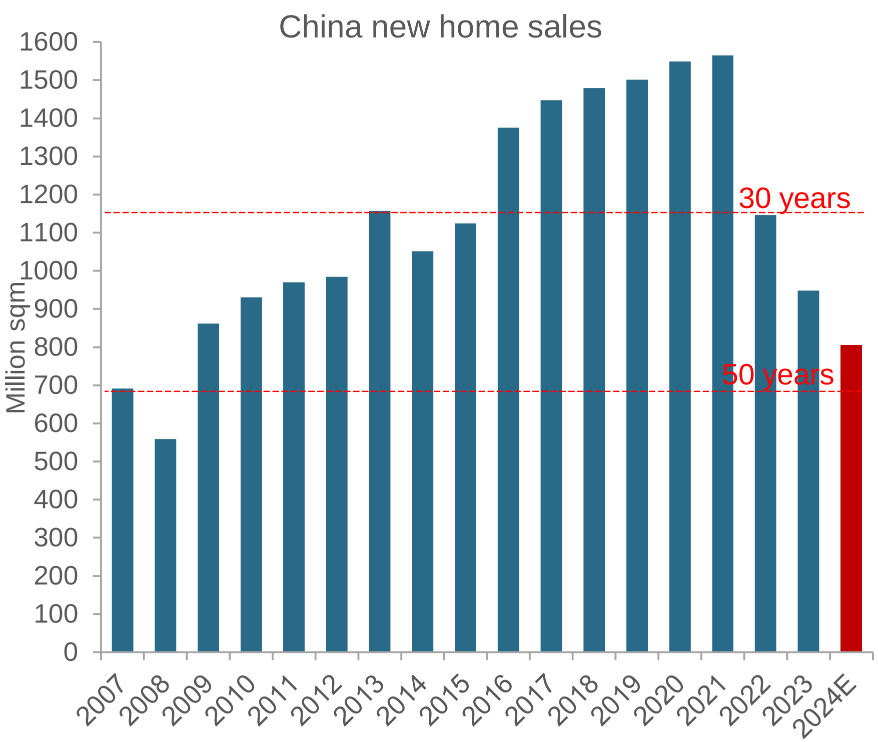


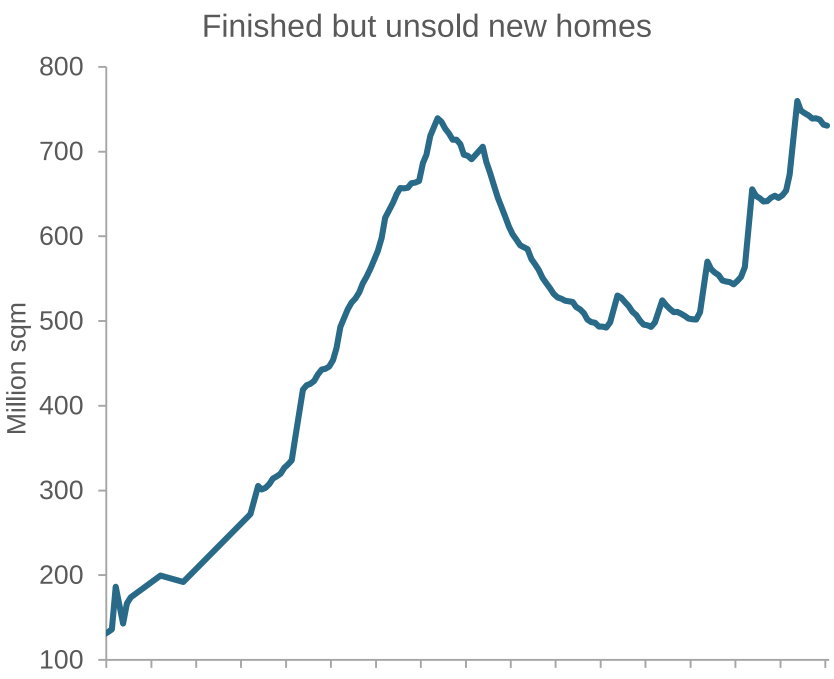
Source: CEIC, Wind, Mizuho

Part 2: Does China have a “Trump Card”?

A high level of home inventory poses a threat to the property market

- New home sales are projected to drop to ~800mn sqm in 2024, with the amount of completed but unsold homes at record-high levels.
- If China's demand for new homes is solely driven by the deprecation of outstanding homes, home sales would be:
  - ~1150mn sqm per year for 30 years of home depreciation;
  - ~700mn sqm per year for 50 years of home depreciation.

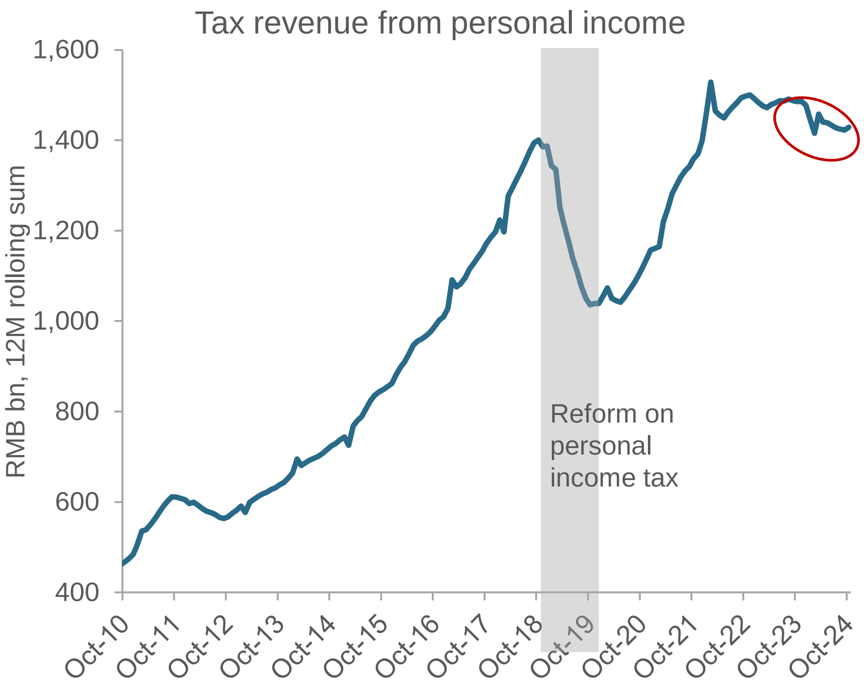


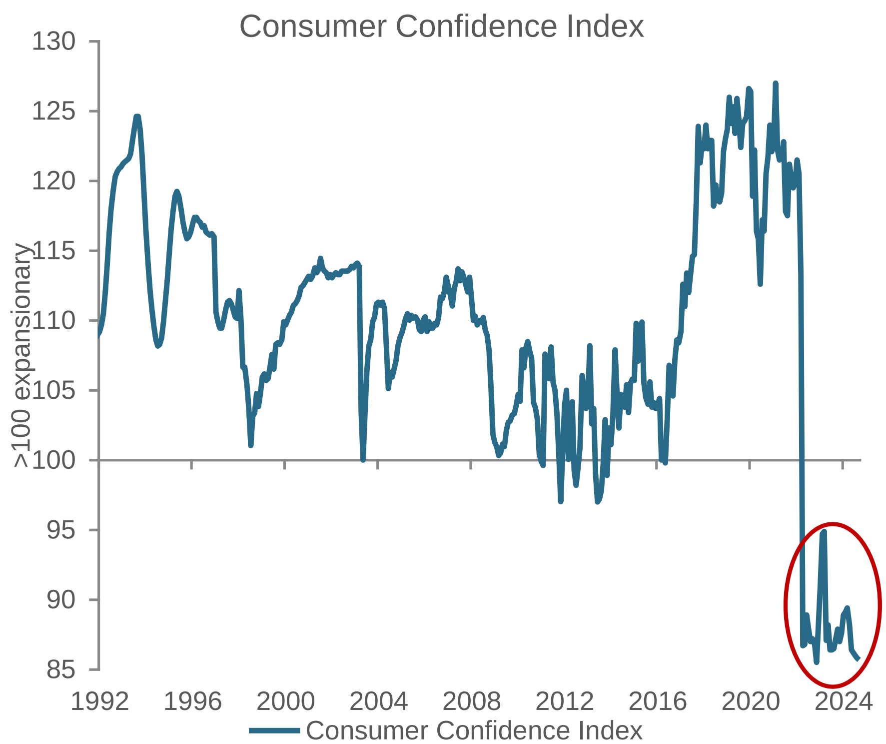


Source: CEIC, Wind, Mizuho

Soft consumer sentiment amid declining income and negative wealth effects

- China's taxable personal income has been shrinking slowly since late 2023.
- China's consumer confidence index has remained at historically low levels due to ongoing weaknesses in the property and job markets.
- Surveys by the PBoC show that expectations for falling home prices remained at an all-time high in June. Such expectations, if persist, may lead to a downward spiral and become self-fulfilling.

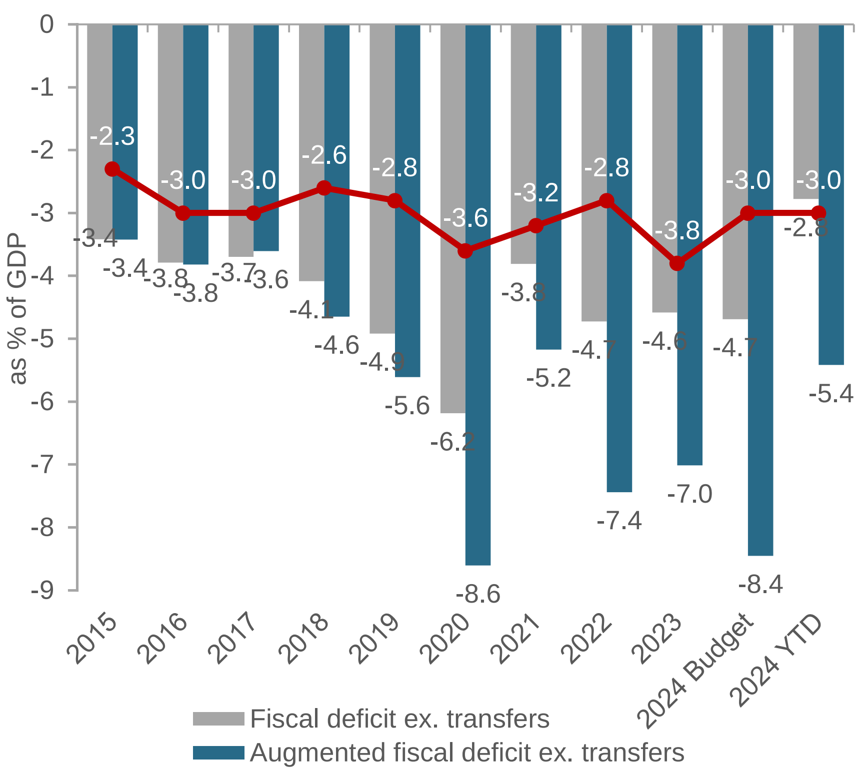




Source: CEIC, Wind, Mizuho

Fiscal support with a higher limit

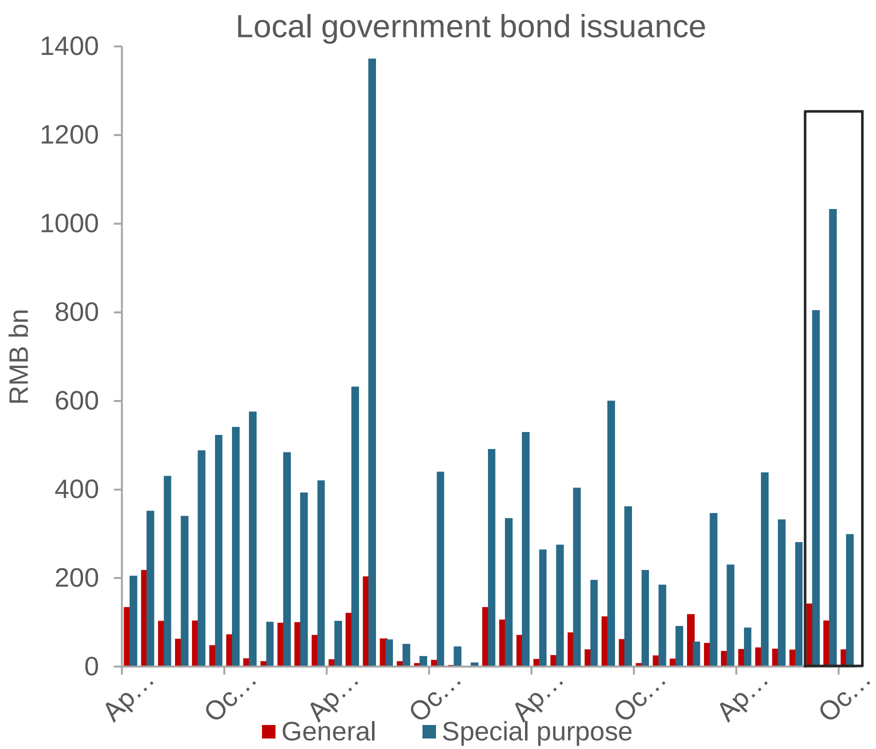
- We expect the government to set a significantly higher fiscal deficit of RMB 5.2-5.5 trillion, or 3.8-4.0% of GDP for 2025, compared to the current limit of 3.0%.
- The central government is expected to shoulder a larger share of spending obligations in 2025, especially in terms of providing more subsidies and tax incentives aimed at bolstering domestic consumption.



Source: Wind, Mizuho

Local governments with less debt burden…

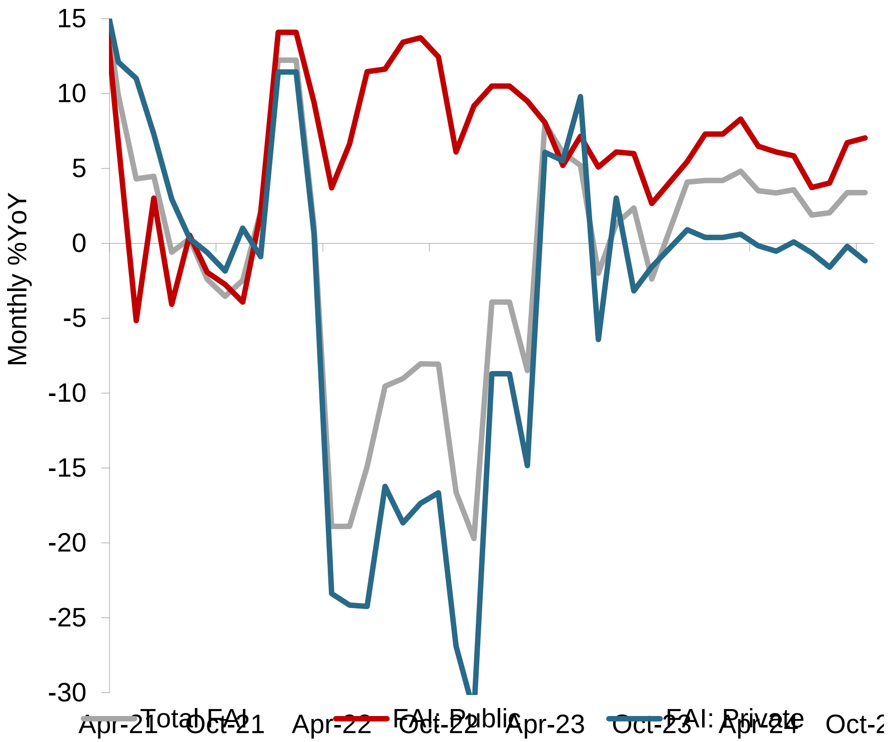
- The issuance of RMB 2.4 trillion in local government bonds since August will have a more substantial impact on enhancing domestic demand in the coming months.
- The initiative to convert RMB 5.6 trillion of hidden local debt over the next 13 months is expected to significantly enhance local fiscal conditions, providing local governments with more resources to support domestic demand.
- We expect another 50bp cut in the RRR to help facilitate the issuance of an additional RMB 2 trillion in local government refinancing bonds by the end of the year.

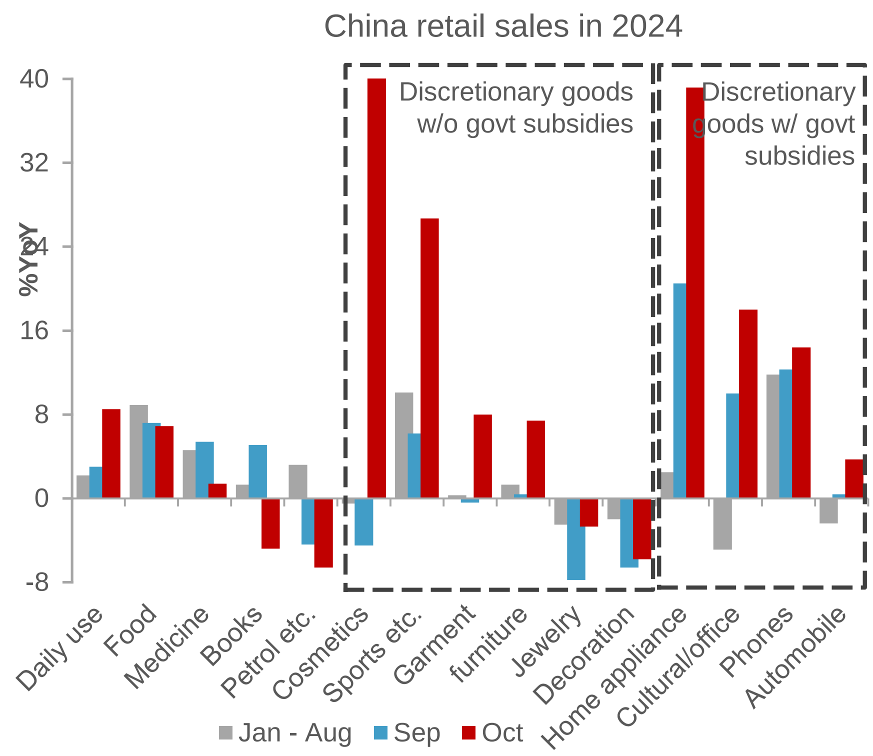


Source: Wind, Mizuho

…to restore their role as a growth engine

- Growth in public FAI has already bottomed out in the past two months.
- Retail sales also saw a notable increase in September and October, bolstered by government subsidies on durable goods through “trade-in” programs.

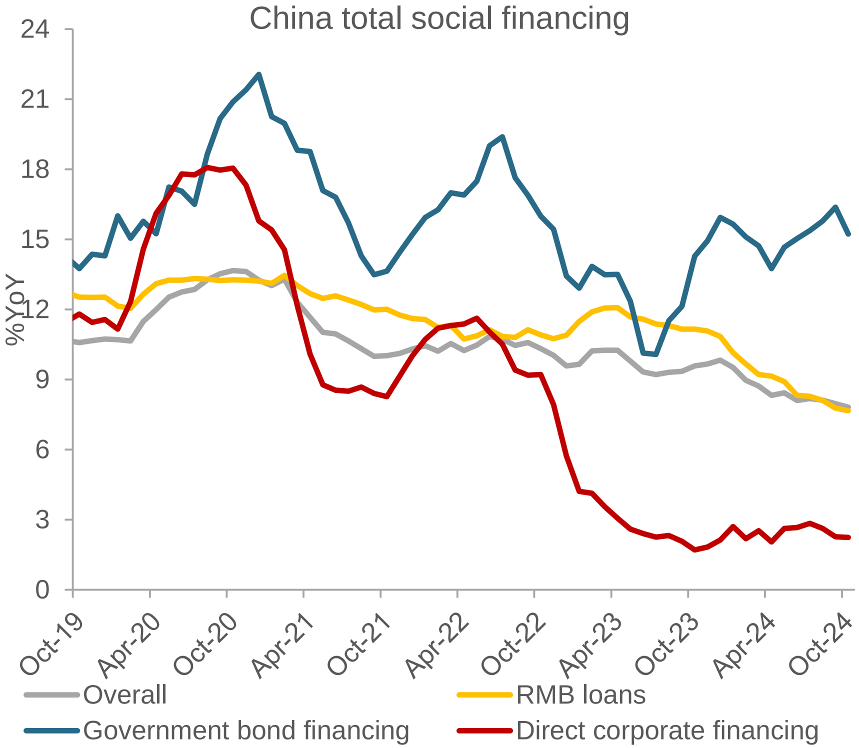


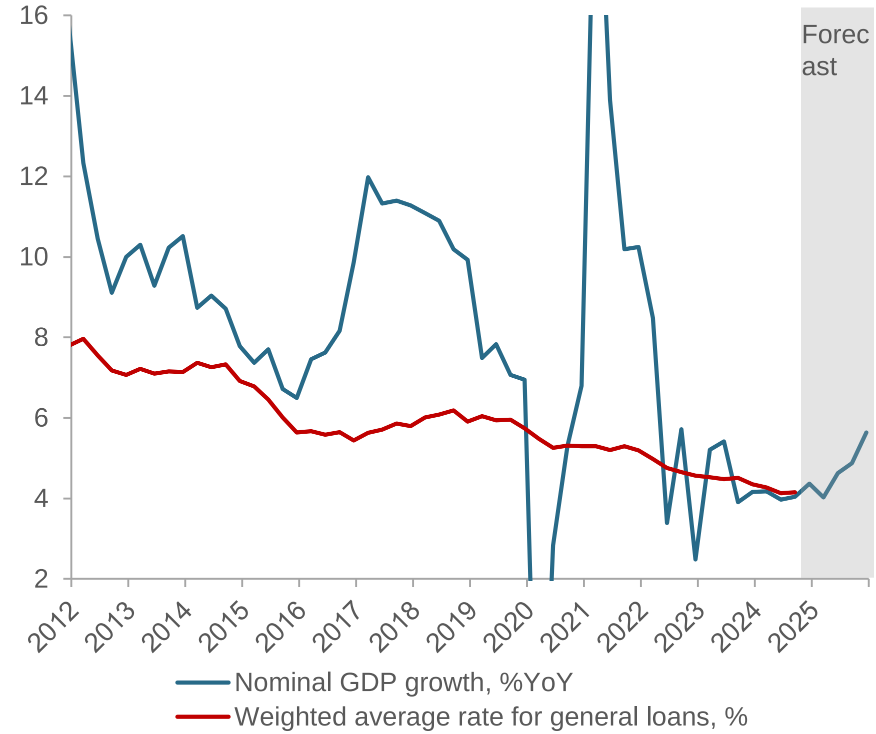


Source: CEIC, Mizuho

Lower rates to ensure business profitability

- Loans to the non-financial sector, or the real economy, have been increasing at a slower pace than total social financing.
- Interest rates on general bank loans have been higher than China's nominal GDP growth for five consecutive quarters, indicating a relatively tight liquidity conditions.
- We believe that it is crucial for the average bank lending rate to remain below nominal GDP growth rates to ensure profitability for most business owners.

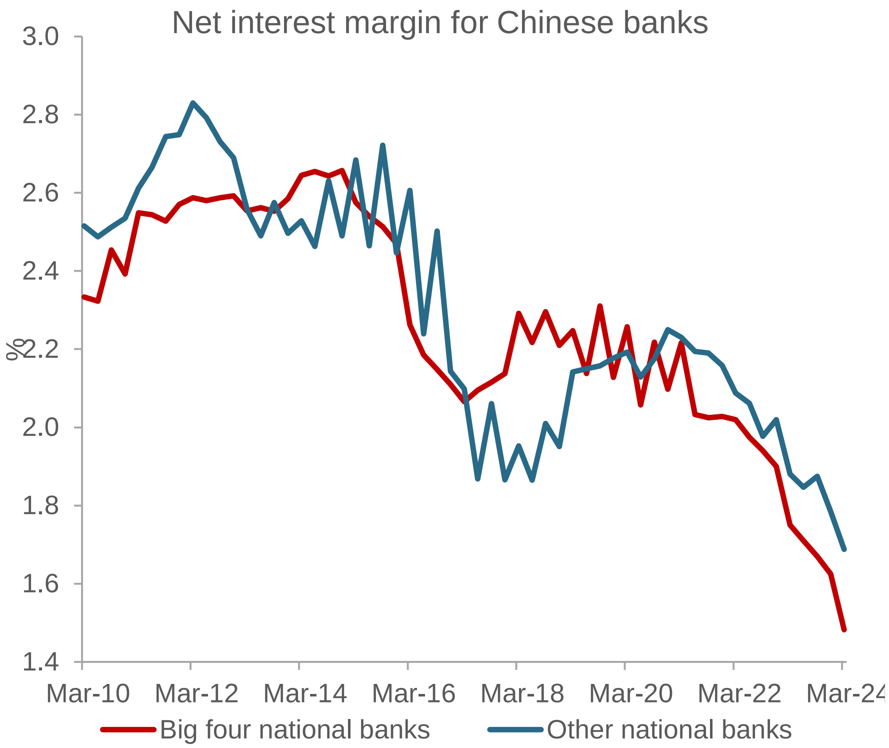


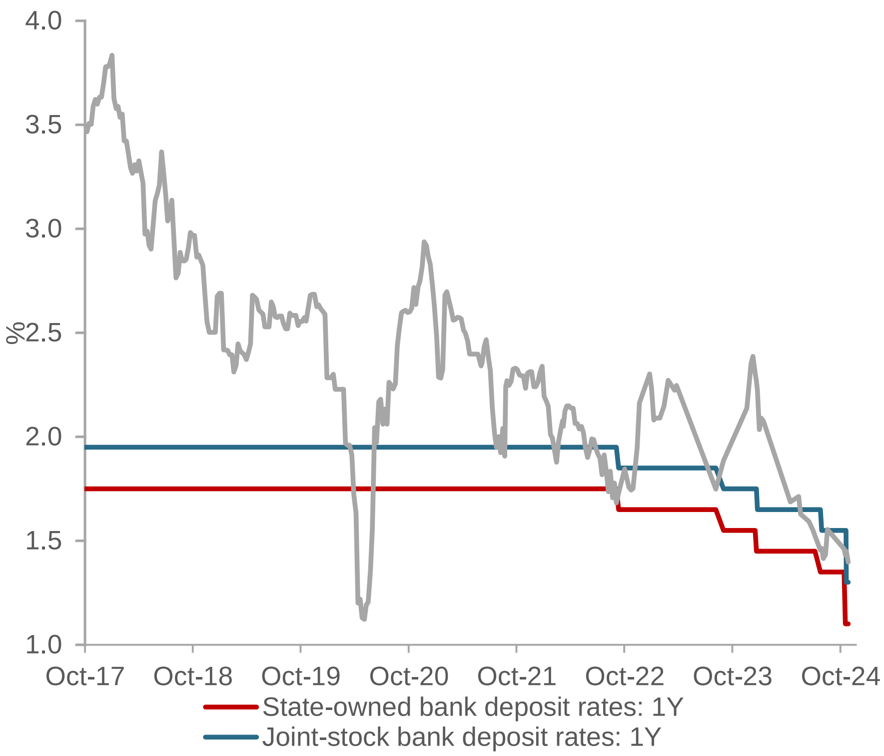


Source: CEIC, Wind, Mizuho

Faster-paced rate cuts expected in 2025

- We estimate an appropriate 1Y Loan Prime Rate to be around 2.5%, suggesting a total rate cut of 60bp from current levels.
- We foresee a 20bp reduction each quarter, allowing banks the opportunity to adjust their deposit rates accordingly and protect their net interest margins.



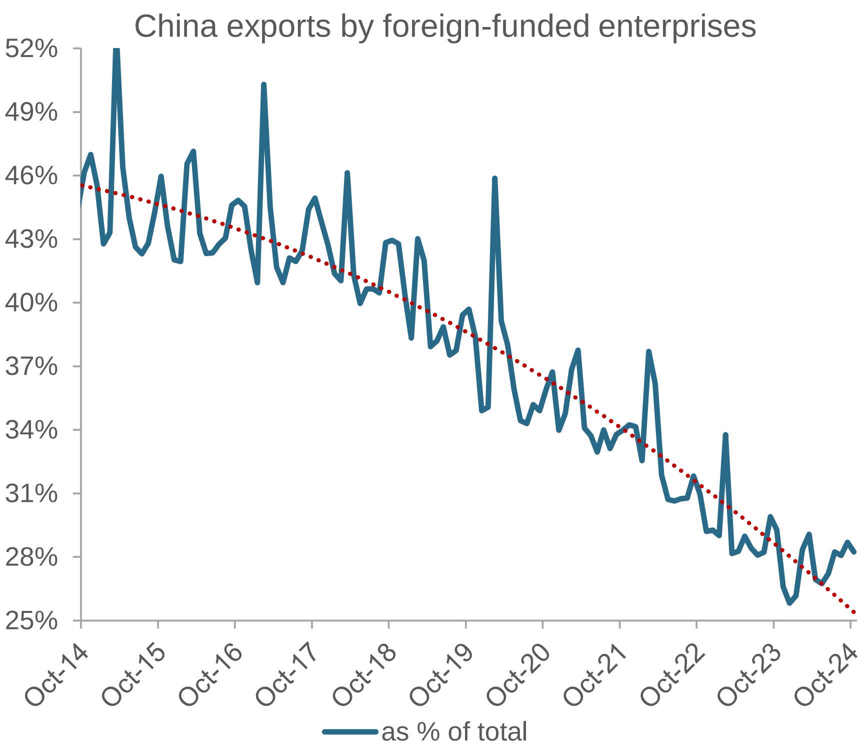


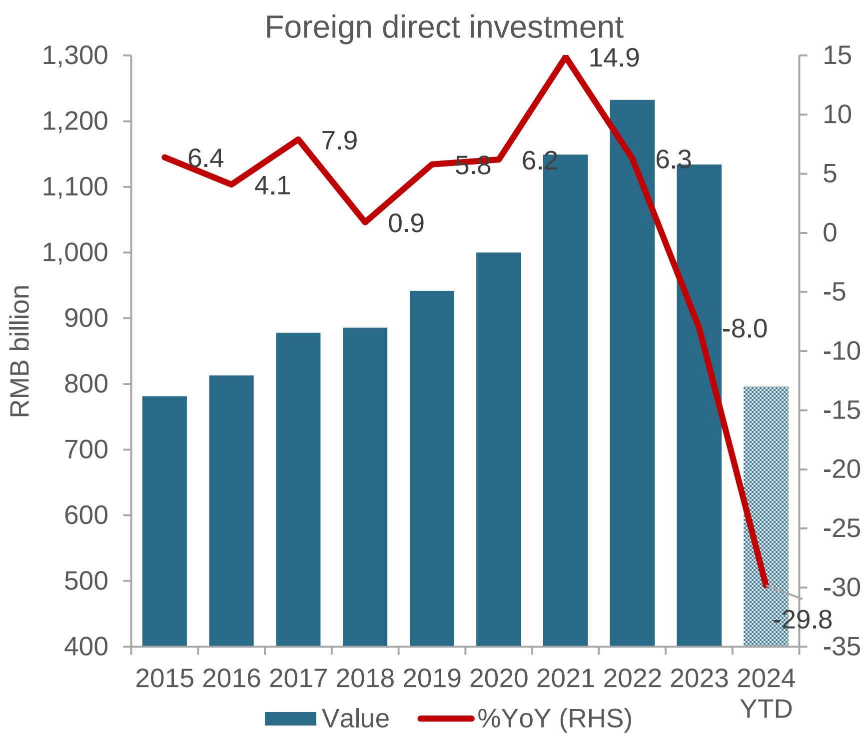
Source: Wind, Bloomberg, Mizuho

Part 3: Challenges and opportunities over the long run

Rising overcapacity as foreign-funded factories move out

- With the relocation of export-oriented factories away from China, there will be a steady rise in overcapacity along the manufacturing supply chains.
- Foreign direct investment is poised to see a YoY decrease for the second consecutive year, with its level likely reaching a new low since 2015.

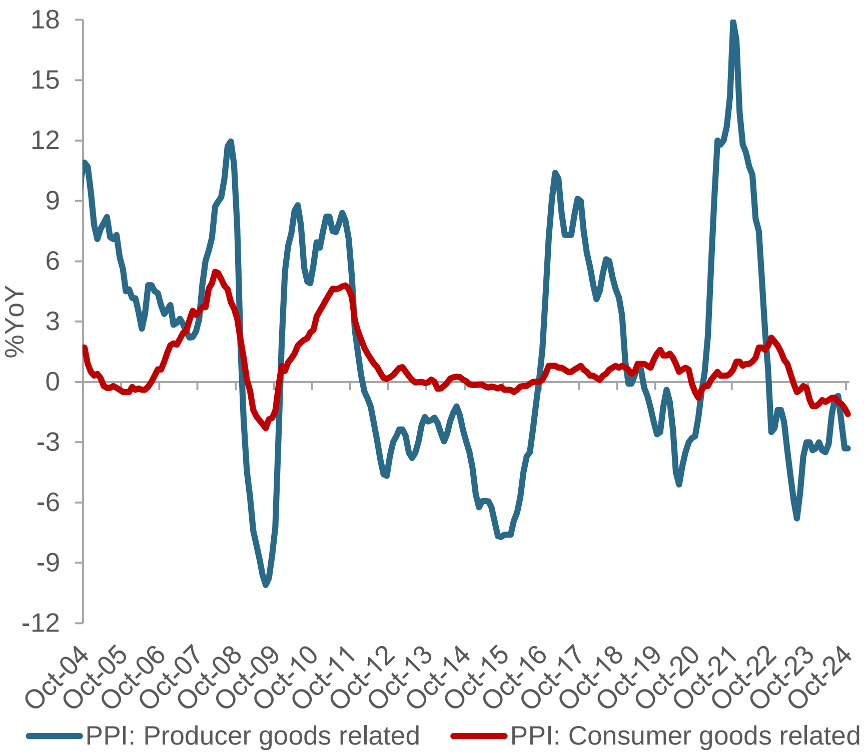


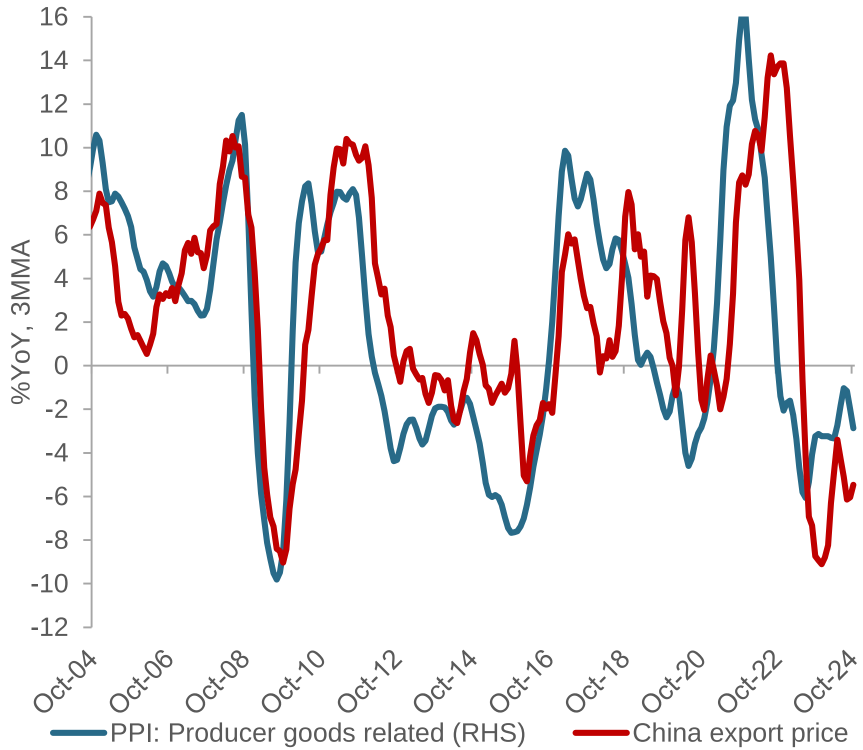


Source: CEIC, Wind, Mizuho

This gap exerts gradual but persistent deflationary pressure on the economy

- Over the past two decades, China has typically transferred deflation or inflation pressures on producer prices to export prices rather than its domestic consumer prices.
- However, this pattern may shift in the coming years, leading to an easier monetary policy in the long run.
- China's rapidly aging population and declining birth rates pose challenges for China to absorb this overcapacity with merely domestic demand.

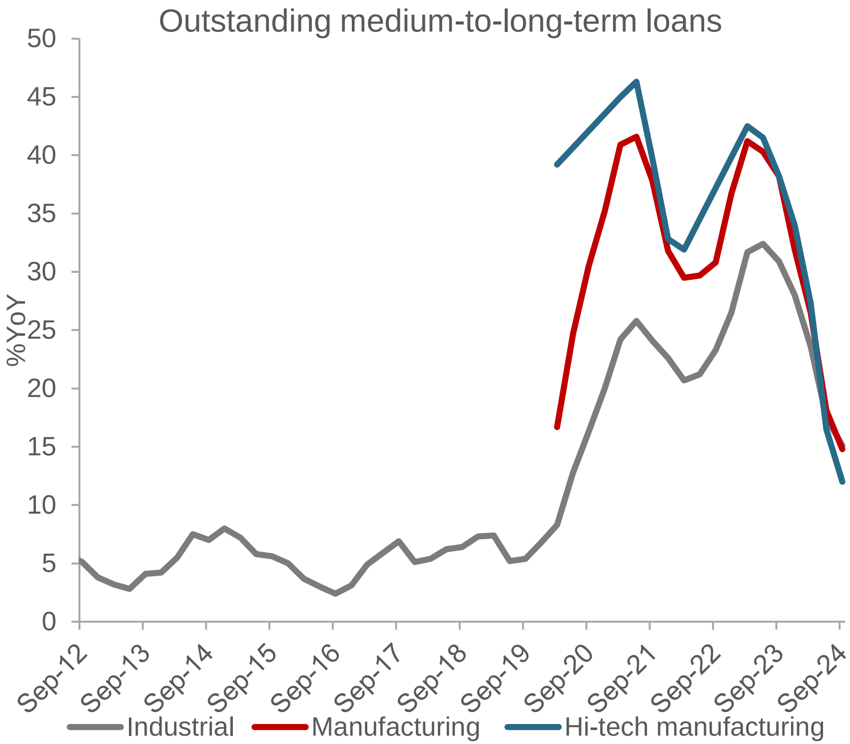


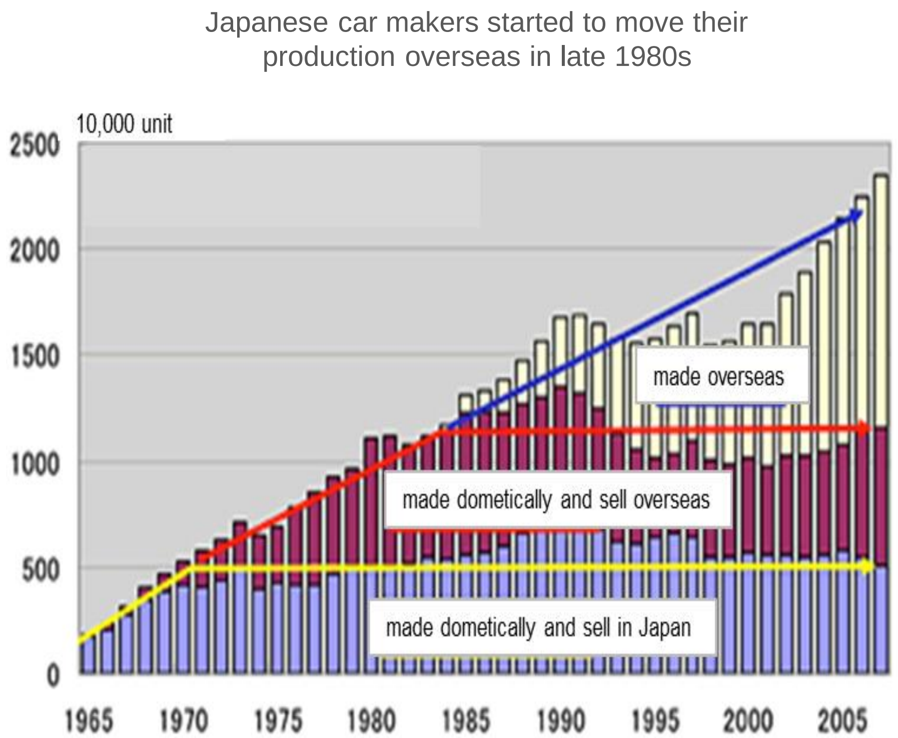


Source: CEIC, Mizuho

The boost to hi-tech manufacturing can be a double-edged sword

- China has been encouraging investment in advanced manufacturing, in order to fill the gap left by foreign capital and promoted exports of hi-tech manufacturing goods, such as new energy vehicles and solar cells.
- However, this is likely to result in increased trade protectionism against Chinese exports globally, such as recent additional tariffs envied by the EU on Chinese EVs.
- Japan was in a similar situation in the 1980s and began relocating its car production overseas during that time.

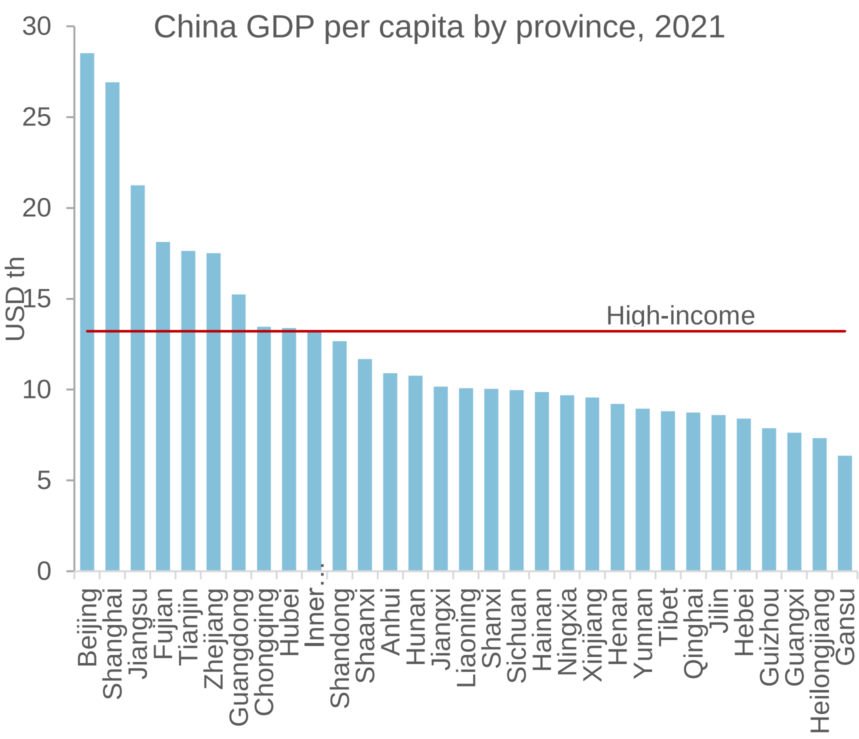


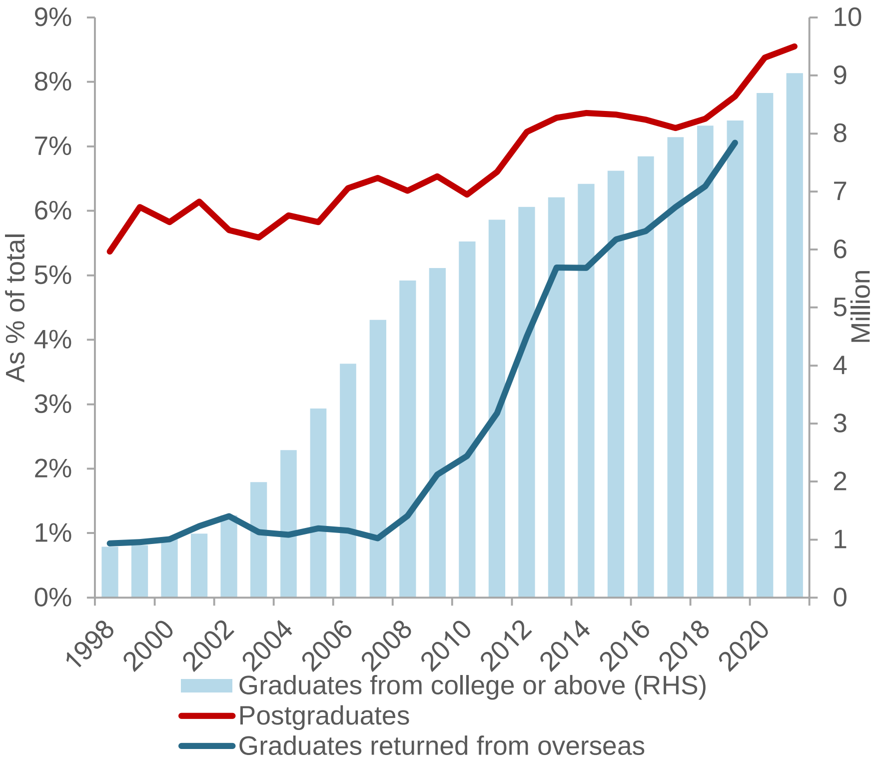


Source: CEIC, JAMA, Mizuho

China’s demographic strength - from size to quality

- China aims to become a high-income economy by 2025. Separately, ten Chinese provinces qualified as high-income economies themselves in 2021, with a total population of 494mn, which would rank the third on earth by population.
- ~40% of China’s population aged between 20 and 39 received tertiary education or above as of 2021, vs. ~12% in 2009.
- A relatively high household income and a large well-educated population have laid a solid foundation for the formation of a sizable middle class in China.





Source: CEIC, Wind, Mizuho

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Potential improvement in China's international relations

- China's opening-up efforts can help strengthen its ties with developed economies like European counties.
- China and the EU signed a bilateral investment treaty at the end of 2020, but it was suspended shortly after President Biden took office in early 2021.
- China's continued engagement along the BRI is expected to help build its connection to countries in Central Asia, ASEAN, Africa, as well as South America.

Chinese total engagement in the Belt and Road Initiative (BRI) in 2022

Source: FISF, Mizuho

Economic outlook - summary

Economic forecasts:

- GDP growth – 4.9% for 2024, 4.8% for 2025 (with government target set at “~5.0%”);
- Inflation – 0.3% for 2024, 0.5% for 2025;
- USD/CNY rate – mild appreciation in the second half of 2025.

Policy outlook:

- China is likely to maintain its growth target at “around 5%” for 2025, amid increasing external uncertainties;
- Monetary policy – We expect the PBoC to prioritize efforts to guide a moderate increase in prices in 2025. We consider an appropriate one-year loan prime rate to be around 2.5% for 2025, 60bp lower than the current level;
- Fiscal policy – The government may set a fiscal deficit up to 4.0% of GDP for 2025. The debt swap initiative should enhance local government fiscal conditions and provide them with more resources to tackle economic problems.

Indicators	2024E	2025F	3Q24	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F
GDP (%YoY)	4.9	4.8	4.6	5.0	4.4	5.0	4.9	4.8
CPI (%YoY)	0.3	0.5	0.5	0.3	0.5	0.1	0.2	1.2
FX rate (USD/CNY, eop)	7.28	7.12	7.02	7.28	7.32	7.38	7.23	7.12
7D reverse repo rate (%, eop)	1.5	0.9	1.5	1.5	1.3	1.1	0.9	0.9
1Y Loan Prime Rate (%, eop)	3.1	2.5	3.35	3.1	2.9	2.7	2.5	2.5

Source: Wind, Mizuho

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