Mizuho Brief: US Tariffs

Economics & Strategy | Asia ex-Japan

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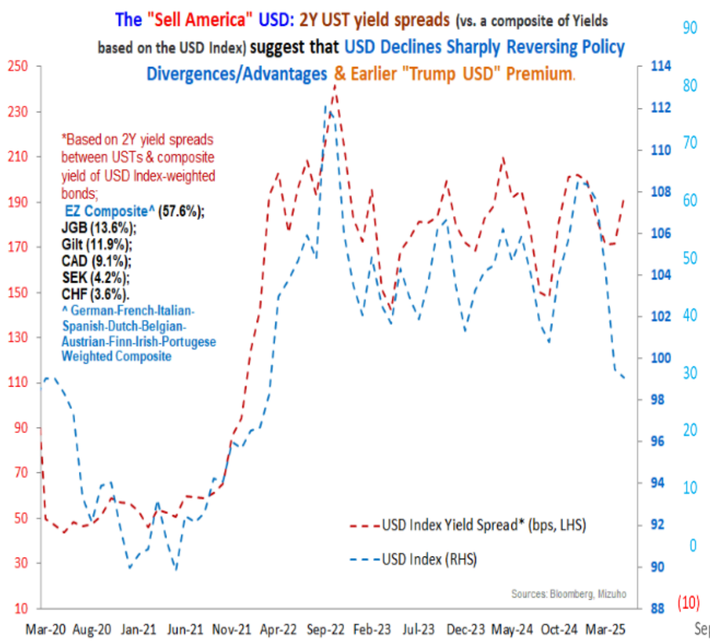
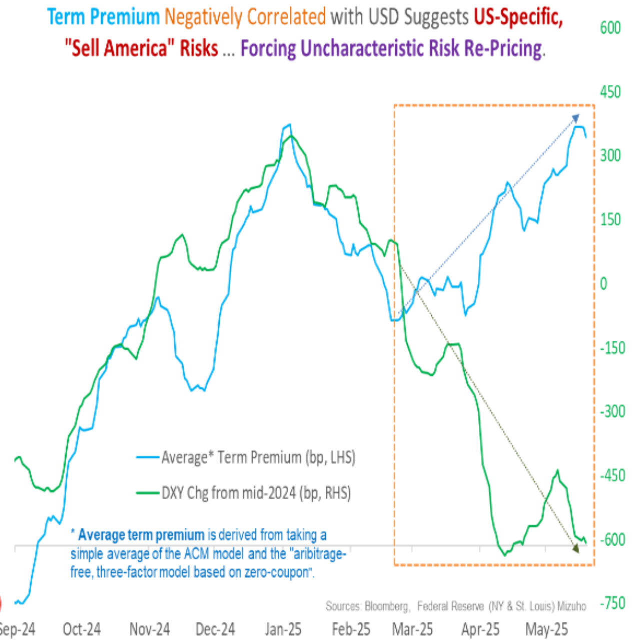
Vishnu Varathan | Head Macro Research, Asia ex-Japan

“Sell America" & Re-pricing Term Premium





“It is a capital mistake to theorize before one has data. Insensibly one begins to twist facts to suit theories, instead of theories to suit facts.” – **Sherlock Holmes**

In a Nutshell:

- **Exceptional de-coupling is USD-UST yield/spread *framed as “Sell America”*** may suggest entrenched de-dollarization underway.
- But the aggressive iteration of “Sell America”/De-dollarization narrative pointing to a collapse in USD/USTs is arguably misguided.
- Instead, the evidence suggests **term premium being re-priced considerably higher** to account for US *fiscal, trade, credit, and geoeconomic risks* alongside some hedge against USD debasement.
- The implications are:
  - i) Bets on entrenched USD bearishness may be overdone.
  - ii) USD is likely set to resume positive response to UST yields/spreads on *sufficient risk-pricing*.
  - iii) Interim pent-up volatility and potential USD-led inflections in FX markets are par for the course
  - iv) Higher UST term premium could spill-over to later compromise higher-yielding AXJ with fiscal/trade vulnerabilities.

- **Unravelling USD-UST yield (positive) correlation**, as previously discussed*, is a profound disruption, but arguably *not a permanent dislocation.*
- In other words, this may be **unfamiliar risk re-pricing to recalibrate USD and UST yields**, *not necessarily an all-out de-dollarization revolution* in FX-bond markets.
- To be fair, the **"Sell America"** narrative, with a *simultaneous drop in USD* and *rise in UST yields/spreads,* has **wrong-footed some** and **confounded many**.
- Most obviously as **established (positive) USD correlation with UST yields/spreads appear to be upended** by this **exceptional departure** (in USD and UST yield/spreads).
- In the wake of which, USD is now uncharacteristically uninspired by, *if not overtly defiant of,* yield/spread cues.
- Trouble is, this **unfamiliar USD dynamics** that has resulted **challenge the ability to reliably anticipate USD moves/risks**.
- What's more, *beyond de-coupling,* the **innate instability** in recent **USD-UST yield/spread correlations shifts further obscure clarity on FX dynamics**.
- The upshot is that it is **premature**, ***if not misguided*****, to assume** that the **breakdown in** USD-UST yield/spread **correlation is** a **permanent** feature.
- Instead, the **negative flip in USD-UST yield correlation** arguably reflects a **temporary recalibration** process of **risk re-pricing**, *even if it is abrupt and non-linear*.
- This is more revealing in the **USD-term premium divergence**, against a sharply softer USD for corresponding term premium.
- The **softer USD defying higher yields/term premium suggests** the **allure of "all-in carry" of USTs has been compromised by the demand for risk premium** to hold USTs.
- Specifically, to account for **a conspiracy of** *fiscal*, *credit, trade, geo-economic* ***risks*** **in the wake of** brutal Trump 2.0 tariff and wider geo-economic assault that has inflicted untold **US self-harm**.
- The **evidence** squares with ***sharp US fiscal/credit deterioration alongside USD debasement risks*** *(from trade and geo-economic threats)* increasingly ***priced into the term premium****.*
- And this implies several implications for the FX landscape:
    1. It is **too hasty to conclude an entrenched bearish USD** *through "risk off"*, and *despite higher yields.*
    2. Instead, **positive USD-UST yield/spread correlations to be re-established once *sufficient* term premium** and corresponding **USD moderation** are realized.
    3. *But* assessing **"sufficient" risk re-pricing** will be a **dynamic process**. So abrupt USD-led inflection and pent-up volatility are par for the course as headline risks roll on.
    4. **USD-UST risk re-pricing** could have a **wider spill-over to the detriment of higher-yielding AXJ** (now in the cover of a softer USD) with some focus on fiscal and trade vulnerabilities.

*Please see recently published note: Macro Brief - Exceptional Correlation Departures Mask FX Risks, 21st May 2025

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