

Mizuho Brief: Macro Tail Risks

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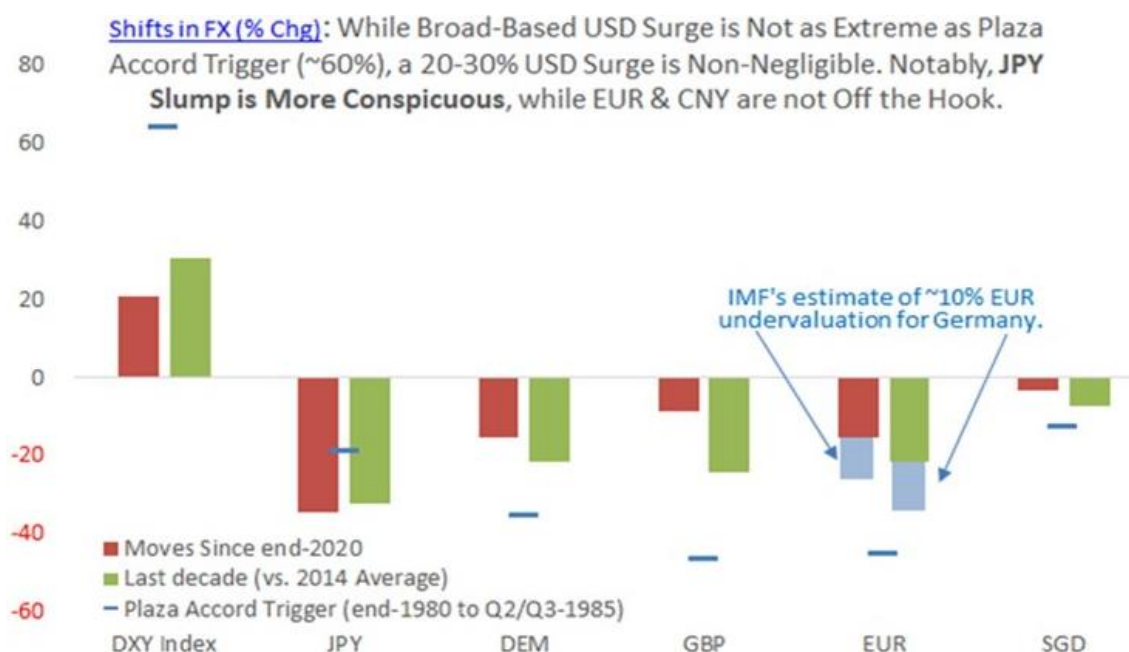
21 Jan 2025 | Vishnu Varathan | Head Macro Research, Asia ex-Japan

Macro Tail Risks: The “Trump Plaza

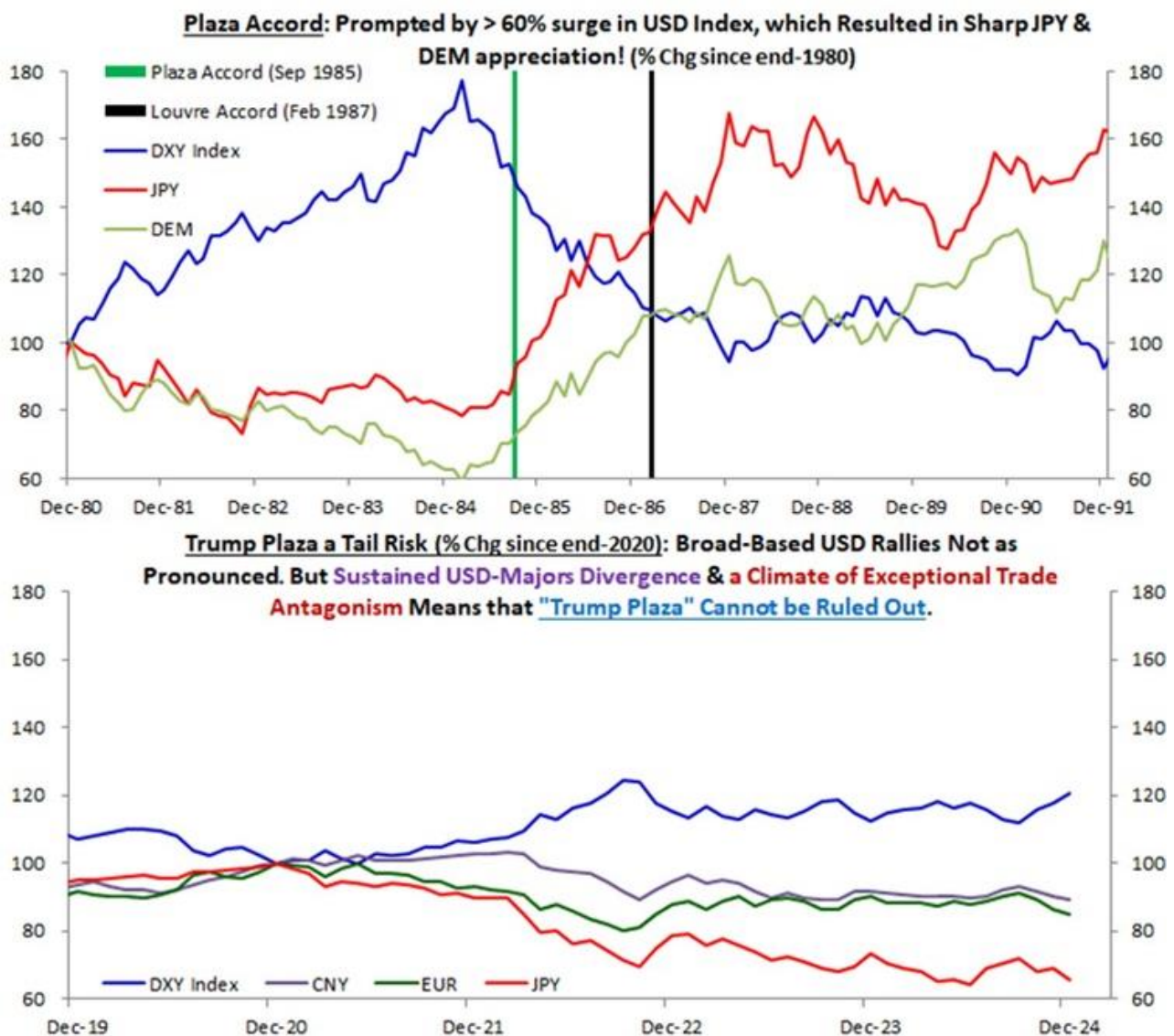
“Never tell me the odds” – Han Solo, Star Wars (The Empire Strikes Back)

In a Nutshell:

- A **Plaza Accord-type reflex** from the Trump Administration is *admittedly a “tail risk”* (of *extreme consequence but very low probability*).
- Especially given **broad-based currency valuations** (vis-à-vis the USD) *have not diverged as violently as compared to the 1980-1985 Plaza Accord run-up*. Nonetheless, coordinated policy action to revalue major currencies (JPY, EUR) higher (and soften the USD) **cannot be dismissed summarily**.
- Not *when global trade antagonism is exceptionally elevated* amid US tariff threats. **Perversely**, *currency pressures* on US partners *from tariffs threats* may **increase the odds of a “Trump Plaza” outcome**.
- Upshot: With **JPY exceptionally undervalued**, *USD significantly stronger* (on broader measures) and the *US intent on forcefully correcting trade imbalances*, **nothing is off limits**.
- Especially insofar as a **carefully managed calibration of currencies** (vs. USD) **helps to achieve the USD’s dual objective** of an *uncontested reserve currency* yet *sufficiently competitive*.
- **While certainly not the first resort**, there is **an identifiable path to Trump Plaza** (Plaza Accord 2) **amid heightened geo-economic tensions**.
- If this comes to bear, the *sharpest appreciation shocks may come through the JPY* with **significant collateral damage** to *Nikkei* and *risk sentiments amid “carry unwind”*.
- **AXJ assets could inevitably be swept up in volatility** and **pressured**. Although opposing FX (appreciation) forces via JPY and CNY cues will obfuscate the “end game”.



- [The Trump Plaza \(Accord 2.0\) Tail Risk](#): The “Trump Plaza” reference is less to real estate and **tail risks** (of *extreme consequence but very low probability*) **of the 1985 Plaza Accord-types of event trigger*** from this Trump (2.0) Administration.
- [Exceptional USD Strength - Subduing Excessive & Unabating](#): Specifically, flagging the risk of **exceptional USD strength, if unabated, triggering** the possibility of **a coordinated G10/Major central banks/Finance Ministries plan to guide check extended, excessive and unabating USD strength**.
- [Orderly Markets & by Order of US Manufacturing Ambitions](#): The stated aim of this Plaza Accord-type course will be **to restore orderly FX markets t remove trade distortions**. Notably, **US ambitions to revive strategic manufacturing advantage** also features.
- [Critics of Scale & “Success” Not Wrong](#): Critics of the idea have good reasons to reject the idea of a Plaza Accord reboot 40-years on. For one, the experience of *materially higher FX imbalance thresholds* and *lessons of mixed success*



- JPY is the Sore Thumb: Notably, JPY is more than 33% weaker (vs. the USD) since end-2020, **reminiscent of Plaza Accord-type perceived currency imbalance**.
- EUR Masks Trade Imbalance: Sure, EUR is “only” 15% softer (vs. USD) from end-2020. *But IMF estimates of EUR being ~10% undervalued for Germany* is smoking gun for a US Treasury inclined to re-balance currency shifts based on effective German-led trade imbalances with the Euro-zone.
- CNY a Chronic Undervaluation: And while CNY slippage is deemed even less extreme, it is less the recent depreciation than it is notions of chronic undervaluation.
- The Balanced USD “Bessent Agenda”: Crucially, **Treasury Secretary Bessent’s desire for a USD uncontested** in its position **as the global reserve currency but not untenable** (from excessive strength) **as a globally competitive manufacturer**, arguably can square with coordinated calibration of USD strength.
- Albeit Requiring Steady Hands: The caveat is that this attempt at surgical precision in recalibrating a “Goldilocks USD” requires exceptionally steady hands, given two-way risks associated with reflexivity.
- Mitigating Uncontrolled USD Tailspin: **Bessent’s time in stress-testing FX markets and structurally far less desirable fiat alternatives** (in other Majors) may **mitigate risks of setting off a disorderly plunge in the USD**.
- The “Louvre” Fear Lingers: Nonetheless, the **memories of the “Louvre Accord” that was subsequently required to arrest excessive USD weakness** s **warns of inadvertent oversteer** if “reflexivity” risks take hold.
- Underpins “Tail” & Tool: Accordingly, this, **puts the “tail” in Plaza Accord reboot risks**. *But while* a “**Trump Plaza**”, so to speak, is clearly **not the first port of call**, it would be a *mistake not to recognize it as a potential tool in the box for strident trade hawks*.
- JPY the Most Pronounced Risk?: **If “Trump Plaza”/Plaza Accord 2.0 tail risk materialize, sharp revaluation shocks may be most pronounced in the JPY**. Not only *given the depth of JPY fall*, but perhaps from *memories of the original Plaza Accord*.
- Adverse Nikkei & “Risk Off” Spill-over: In which case, the collateral damage from a **coincidence of adverse Nikkei spill-over** and “**carry unwind**” **accentuating “risk off”** may be considerable.
- CNY Cues & AXJ Stress: Consequently, **AXJ assets could also come under pressure**, although the *opposing FX (appreciation) forces from JPY* and (imaginably) *CNY cues* will **create tensions and set off attendant volatility**.

* To realign Major currencies higher (vis-à-vis the USD) to address entrenched trade imbalances

** Extrapolated from the 7.5% from the IMF Article IV, (conservatively) adjusted for a drop in EUR since.

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