Mizuho Macro Themes

Economics & Macro Strategy | Asia ex-Japan

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Dodging & Biting Bullets

In a Nutshell: The **(lead) bullet dodged Trump**, ***but Biden has not dodged the (political) bullet***. So, Beijing and the World must ***bite the bullet on Trump 2.0 risks and elevated uncertainties that accompany*** (although not all Trump outcomes are worse for China). The noisy reduction of **push-and-pull Trump 2.0 FX factors** ostensibly reduce into compelling **USD resilience** (if not strength). More because *as many key currencies are compromised*. The *UST yield curve steepener captures greater Trump 2.0 uncertainty* and *structural higher longer-term inflation* ***but*** **softer rates from more immediate global policy easing** may leave broader yield downside intact (initially). **CNH and other AXJ remain compromised by trade/geo-political risks from Trump 2.0**; deterring front-running of Fed easing on softer US inflation and consumer confidence. But **despite higher risk premium implied elsewhere**, **US equities may be upbeat** given Trump's obsession with, and thinly-veiled desire for, S&P500 buoyancy.

- **The failed assassination attempt on Trump** at his Pennsylvania rally has significantly **boosted Trump's standing** but the ***Biden campaign struggles to dodge the political bullet***.
- Consequently, **traders are increasingly assessing the preferred "Trump 2.0" trades** to pile into.
- From a **rates** stand-point, the **desirability of steepeners** may be mainstream "boring", but **has legs left** in it given the inverted curve.
- *Directionally,* **rates are likely soften initially** ***despite received wisdom about "Trump-flation"***.
- This, as the latter is likely to **underpin a steeper curve** ***without imminently hijacking scope for moderation in yields;*** at least for now.
- On **FX**, the **bias** is **for persistent USD strength** as Trump-related trade/geo-political risks pressure **currencies** elsewhere (e.g. MXN, CNY and EUR).
- US equities though might have an edge given Trump's inclination to talk up the stock markets; which was on blatant display in his first term.
- And that's ***despite conflicting threat of (mercantilist) "currency manipulation" charges by the US Treasury*** trained on significant net exporters to the US.
- All else equal, a high **bar for fresh, sustained optimism China's Third Plenum** (15-18 July) **just got higher amid Trump 2.0 risks**.
- **CNH assets may remain under pressure** given **scant chances of "big policy bazookas"** ***riding to property rescue and/or fiscal spigots reviving "animal spirits"***.
- To that end, robust industrial activity is hollow consolation as sub-5% Q2 GDP amid **chronic confidence deficit** dragging retail sales **underpin worries of softer underlying growth momentum ~4.5% or lower**.
- With **caution/uncertainty amid CNH pressures set to stymie Asia FX**, **softer US confidence and inflation are not sufficient for EM Asia central banks to front-run Fed cuts**.
- Accordingly, the onus is on **Bank Indonesia will have to navigate a cautious hold**, avoiding premature easing signals; as *rupiah slippage risks remain intact.*

Trump's Assassination Attempt: Stray Bullets

- Despite Trump escaping the attempted assassination (on him presumably) **stray bullets have nonetheless tragically claimed lives**.

- As political casualties go, it is **Biden and the Democrats who have not dodged the proverbial bullet**.
- The **Democrats** appear to be **in a political bind** that is **reinforcing probabilities of a loss**.
- **Switching candidates** (from Biden) will **not only looks desperate**, but risk being futile as a fired-up Trump base is reinforced by swing votes.
- ***Not switching from* Biden**, whose campaign's *character attacks on Trump now risks backfiring,* **faces the prospects of sleep-walking into Trump 2.0**.
- It appears that ***Democrats will just have to bite the bullet on Biden*** amid risks of back-firing.

Trump 2.0 "Smoking Gun" Trades

- Admittedly, it is **hasty to conclude prematurely what the "Trump 2.0" will mean for markets**.
- But despite the absence of details and the dearth of nuance, a few macro themes do come across compellingly.

Rates (Curve): **Case for a steeper UST yield curve is reinforced** on account of *more elevated uncertainty, higher structural inflation* and *greater US debt bloat* all **compounded into the long-end**.

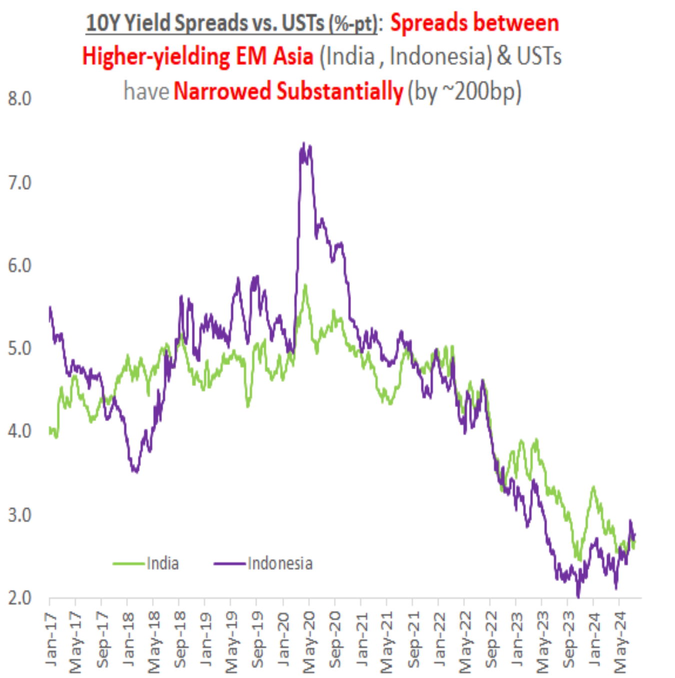
- To be sure, ***Democrats will be no less*** (perhaps even more so) ***ruinous for US fiscal position and debt bloat.***
- But that just means that **term premium restoration** has support from both sides of the aisle.
- And not that Trump provides any appreciable relief from mounting debt/fiscal woes that the US is setting itself up for.

Rates: Despite worries of structurally higher inflation and tariff-related "Trump-flation" the **initial, cyclical path for rates is down amid global policy easing**.

- Point being, exceptionally aggressive **Fed tightening will probably have to reverse first** as dis-inflation and consumer slowdown hit.
- Only further out (beyond 2025) will rate stickiness at the longer-end set in.

FX: A bias for a **supported, *possibly even stronger,* USD** is likely to play out **if the US heads into Trump 2.0**.

- This is admittedly **more from *other Major currencies*** being ***undermined*** from a conspiracy of antagonistic US trade and geo-political posturing ***rather than undisputed allure of USD***.
- A compromised MXN, CNY and perhaps even EUR reveal these impulses that favour USD.
- More so, as **Trump 2.0** *adds uncertainty/unpredictability premium* **to the known risks**.



- Moreover, the ***steepening bias in 10Y USTs could also lead pressures on higher-yielding EM Asia FX*** amid risk re-pricing given how much spreads (vs. UST yields) have compressed.

Equities: But ***despite higher risk premium elsewhere,* US equities could cheer Trump 2.0** outcomes.

- This is at least partly based on Trump's inclination to convincingly talk up the S&P500.
- But equally, market boost could be derived from promised *tax cuts,* likelihood of *energy sector de-regulation,* and *US industries/jobs support* amid *supportive liquidity.*
- What's more, any antagonistic trade action on China may prove to (at least fleetingly) be positive for US industries.

China Third Plenum: Biting Bullets

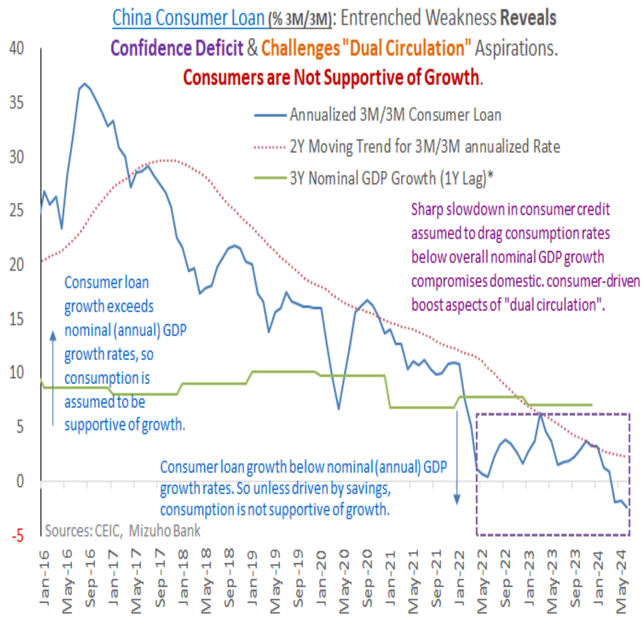
- A **high bar for fresh** and/or **sustained optimism China's Third Plenum** (15-18 July) **just got higher amid Trump 2.0 risks**.
- To be sure, the sustained screw tightening by the Biden administration may not in reality be any better.
- And in any case sure, **Beijing** was in any case set to **bite the bullet on policy constraints** imposed by inherent ***conflicts between CNY stability and unbridled stimulus***.

- But **Trump 2.0 highlights a greater degree of uncertainty** around and beyond US elections.
- Specifically, a *compromised ability to predict as well as project policy/geo-political risks ahead*.

- In which case, it may be argued that ***Beijing will want to keep "gunpowder dry"*** and ***retain some policy flexibility*** to potential, extrinsic shocks.
- Whereas a **no-holds-barred to stimulus *at the Third Plenum*** has **neither compelling historical precedent nor convincing present economic-financial benefits**.

CNY: No Silver Biting Bullets

- The upshot is that there is **no combination of "big bazooka" stimulus** plan that **offers a silver bullet for Beijing's policy conundrum.**
- Which is *inherited from geo-politics* and *(self-)inflicted by socio-economic tensions* (under Xi Jinping's "Common Prosperity")
- **CNY woes encapsulate** acute **trade-offs between short-lived and shallow credit push** (amid increasing credit intensity) and **latent risks to financial stability**.
- Consequently, the *PBoC is not inclined to respond with "high-cost" cuts/credit push;* as suggested by the recent run of underwhelming credit growth.



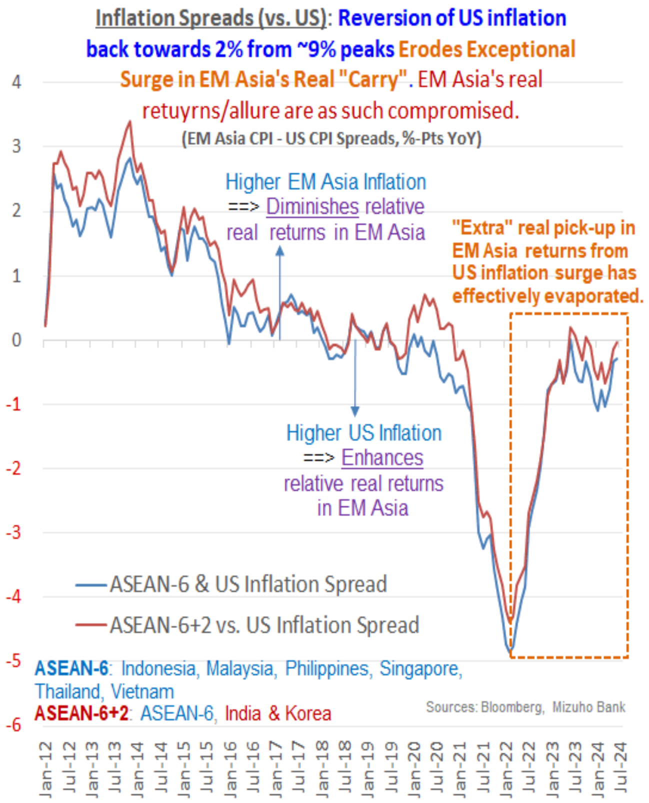
- Arguably, some camps (of China bulls-in-waiting) are **wagering on distinct and central government-led fiscal bazooka**.
- More so if China's *softer-than-expected Q2 GDP* amid evidence of chronic confidence

deficit hampering domestic demand, is taken as the catalyst to trigger a policy response.

- But the scope for significant, knee-jerk policy stimulus, s is ***checked by* inclination to prevent *moral hazard risks*** as well as align with private sector ***restraints inherent in "Common Prosperity"*** objectives.
- All said, **Trump 2.0 has a tendency to accentuate pre-existing China/CNY risks *even though not all Trump 2.0 outcomes are worse for China***.

Asia (FX): Not Dodging Bullets …

- With the CNY likely to remain compromised, if not somewhat more vulnerable, other **Asia FX unlikely to dodge the strong USD bullet**.
- And this is not purely due to the well-established **sympathetic correlation** (in the shifts) **between CNY and other AXJ**.
- Instead, on a stand-alone basis many of **EM Asia currencies** are liable to ***Trump 2.0 uncertainties exacerbating pre-existing pressures from dis-advantageous real rate shifts alongside enlarged fiscal risks***.
- **Complicating potential for adverse geo-economic dynamics** is ***Trump's propensity for transactional, piece-meal, unilateral trade action against net exporters to the US*; *in isolation of the wider US-China strategy***.
- What's more, a reversion in **US-Asia inflation spreads**, *turning sharply less supportive of AXJ,* underpins **why a "higher for longer" Fed has been increasingly more detrimental for AXJ.**



& Not Jumping the (Fed Cut) Gun

- Upshot being, as a **conspiracy of *uncertainty amid Trump 2.0*** and ***real rates erosion*** feed into, and off, each other, **pressures on EM Asia FX**, will ***raise the stakes involved in front-running Fed rate cuts***.
- So, despite softening US CPI and consumer sentiments starting to harden rates market bets on a September Fed rate cut, **jumping the gun with overt easing signals could sabotage scope for EM Asia central banks to otherwise commence with easing plans**.
- Bank Indonesia's monetary policy meeting the week could be just the case in point. A 1.4-1.5% gains in rupiah since the last policy meeting is mere a reprieve, and not lasting relief, amid similar corresponding broad-based USD drop.
- Whereas ***Bank Indonesia will have to exhibit adequate restraint on pipeline dovish tendencies* to avert fresh rupiah wobbles.**

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