Tariffs: Tyranny of “Liberation”

Assessing Threats & Anticipating Turmoil

Quotable quotes from “Fight Club”

“Losing all hope was , freedom.”

“It’s only after we’ve lost everything that we’re free to do anything.”

“Without pain, without sacrifice, we would have nothing.”

OUR PRIORITIES

President Trump is committed to lowering costs for all Americans, securing our borders, unleashing American energy dominance, restoring peace through strength, and making all Americans safe and secure once again.

MIZUHO

Private and confidential

Photo Credit: The White House website

April 2025

Trump 2.0 Tariffs - Threats & Turmoil

1. **Tariff Shock & Psyche**: Reciprocal Hit, Sectoral Protectionism & Axe (to Grind!)

2. **Resolution Challenged**: Bad Math Hard to Reason, Harder to Resolve

3. **Miscalculations**: Impossible Trinity, Asymmetry of Risks & Evolving China Calculus

4. **Beyond Trade**: Security & Insecurity Complicate Tariff Resolution

5. **US-China Fragmentation**: Technology & Trade (Supply-Chain) Flows ➔ **"US+1"?**

6. **Splintering**: Divergent Price Shocks Outcomes & Convergent Income Shocks
   a) "Fed Put" Delayed, "Trump Put" Not Unequivocal ➔ Rates-Equities Trade-Off
   b) Asia's Central Banks Face Trade-Offs in the Interim

7. **Rates**: Softer Rates &Wider Spreads

8. **FX**:
   a) USD Losing its Tariff Mojo may be Overstated
   b) CNH & AXJ Subjected to More Discernible Downside Risks Regardless

1 (i). Trump 2.0 Tariffs: Multi-Dimensional Uncertainty

Reciprocal
- Tariff Imbalance
- VAT
- Non-Tariff Barriers
- FX

Tariffs

Sectoral
-Steel
- Aluminum
- Autos
- Pharma

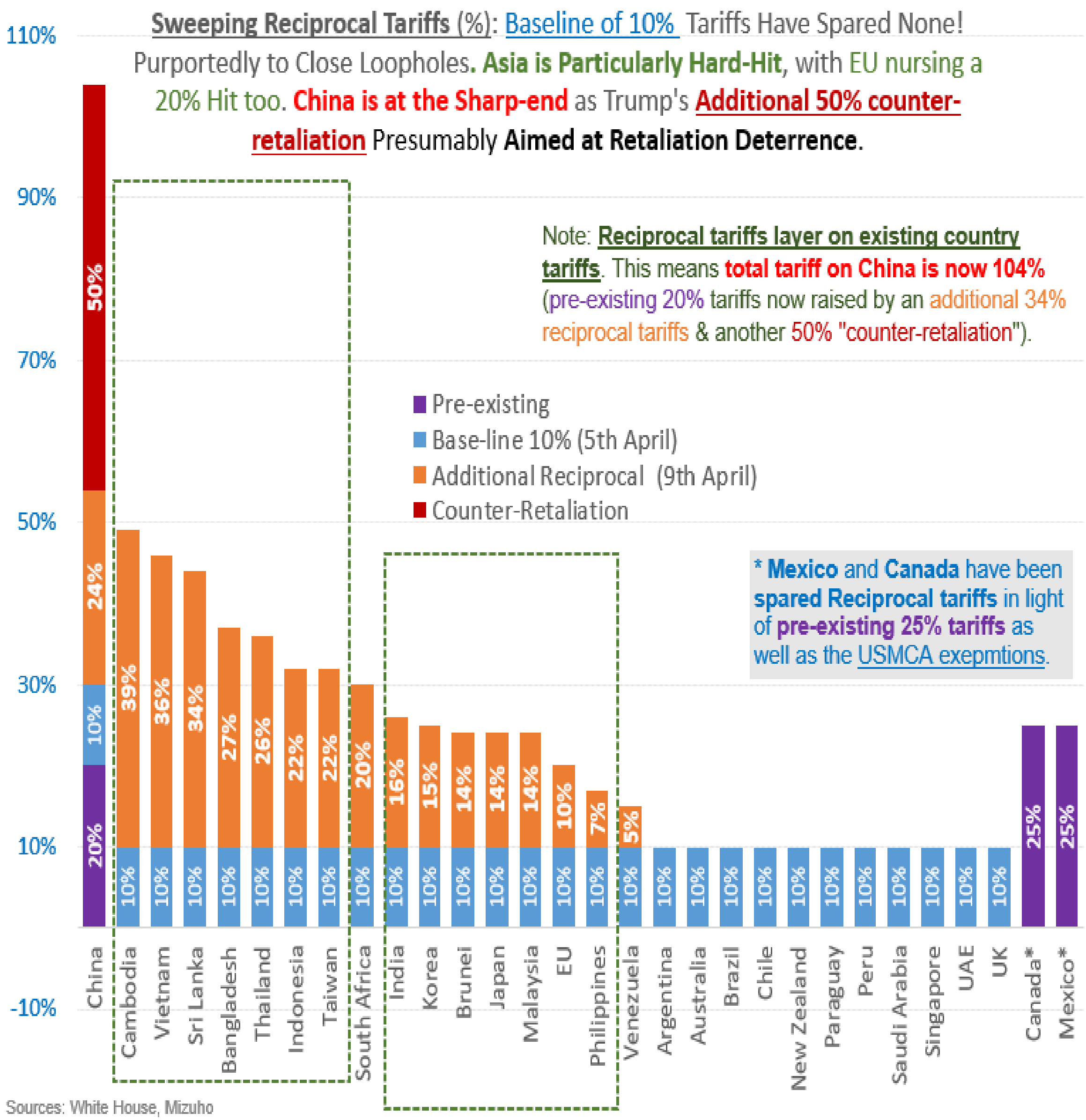
Lack of clarity on the (cross-) application. But ***without express exemptions***, **baseline assumption** is that various **tariffs are <u>additive</u>**.

Non-Trade
- Fentanyl
- Illegal Immigrants

Trump 2.0 "Escalation Deterrence" Risks

- **Trump's approach on tariffs** has hallmarks of "**escalation deterrence**" - the **capability** and **commitment to respond with escalating force**.
- So, **disproportionate US tariff threats and retaliation** is **par for the Trump 2.0 course**.
- But problem is, **"escalation deterrence" is misapplied to trade policies**, *meant to be collaborative, not combative*.
- Crucially, **"escalation deterrence" works best if backed by disproportionately superior capabilities**. Whereas **US-global trade is a case of mutual dependence** .
- Above all, **mounting risk of (US-China) miscalculation** points to the threat of **spiraling economic pain for all.**
- <u>Upshot</u>: **"Escalation deterrence" is a reckless game for the US to play**.

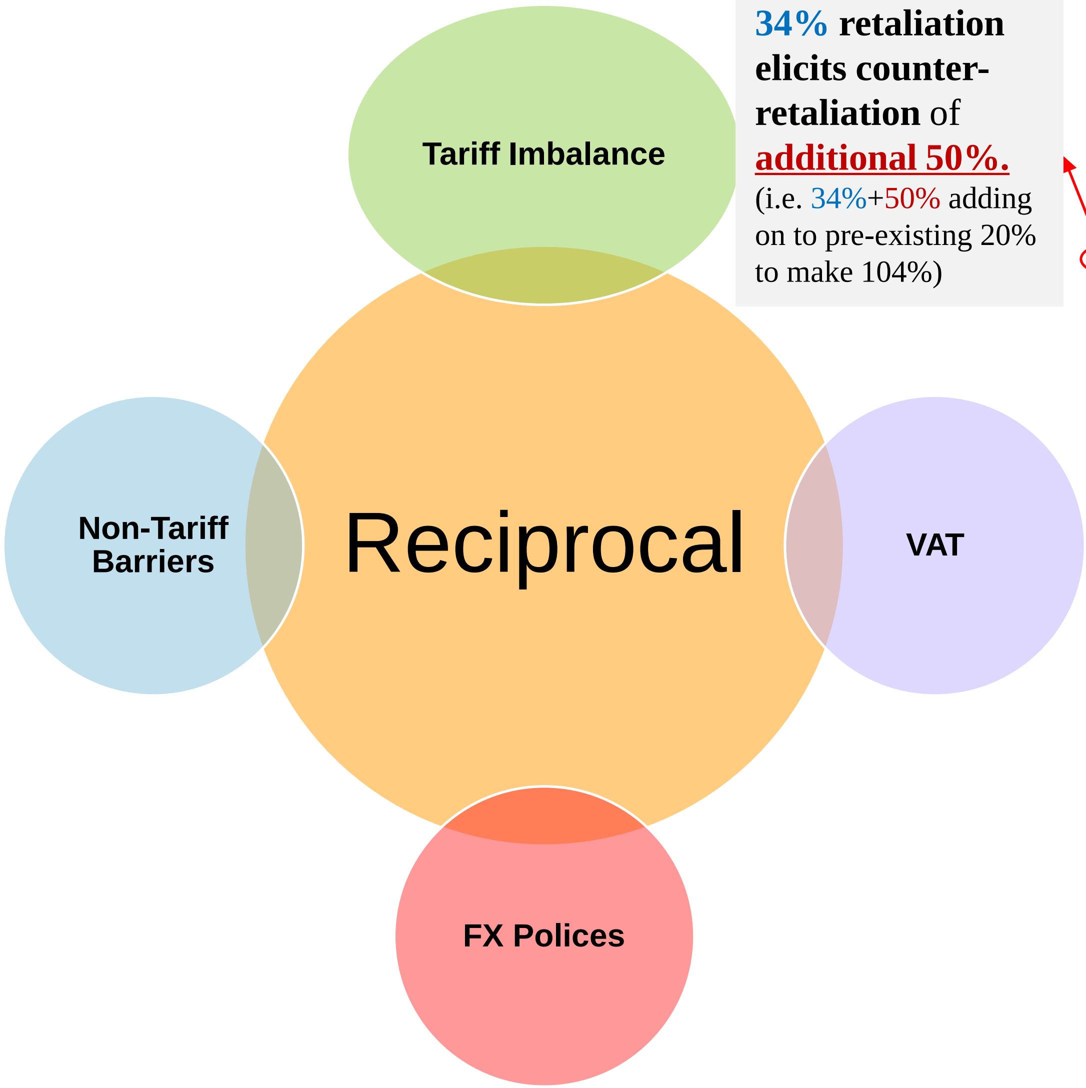
1 (ii). Tariffs Come to a Head: Reciprocal Tariffs Hit Hard



Sources: White House, Mizuho

- **Reciprocal tariffs** with a *baseline* (minimum for any country) of *10%.*
- **Elevated uncertainty** amid *threats of escalation threaten global demand*.
- **Opaque & Misguided reciprocal tariffs** complicate path to **dial back**.
- **Asia hard-hit.** Notably, ***ASEAN as "China + 1" hedge is challenged***.
- AXJ Pressures: **AXJ pressures may persist *despite softer USD***, as *demand shock*, *China spillover & FDI holdback* flag **disproportionate pain**.
- UST Curve Temporarily Flatter & Sticky: *UST yields may be flatter initially* (bets on front-loaded price shocks for US followed by adverse income drag). Accordingly, **initial Fed restraint giving way with a lag** result in *distinctly softer yields further out.*

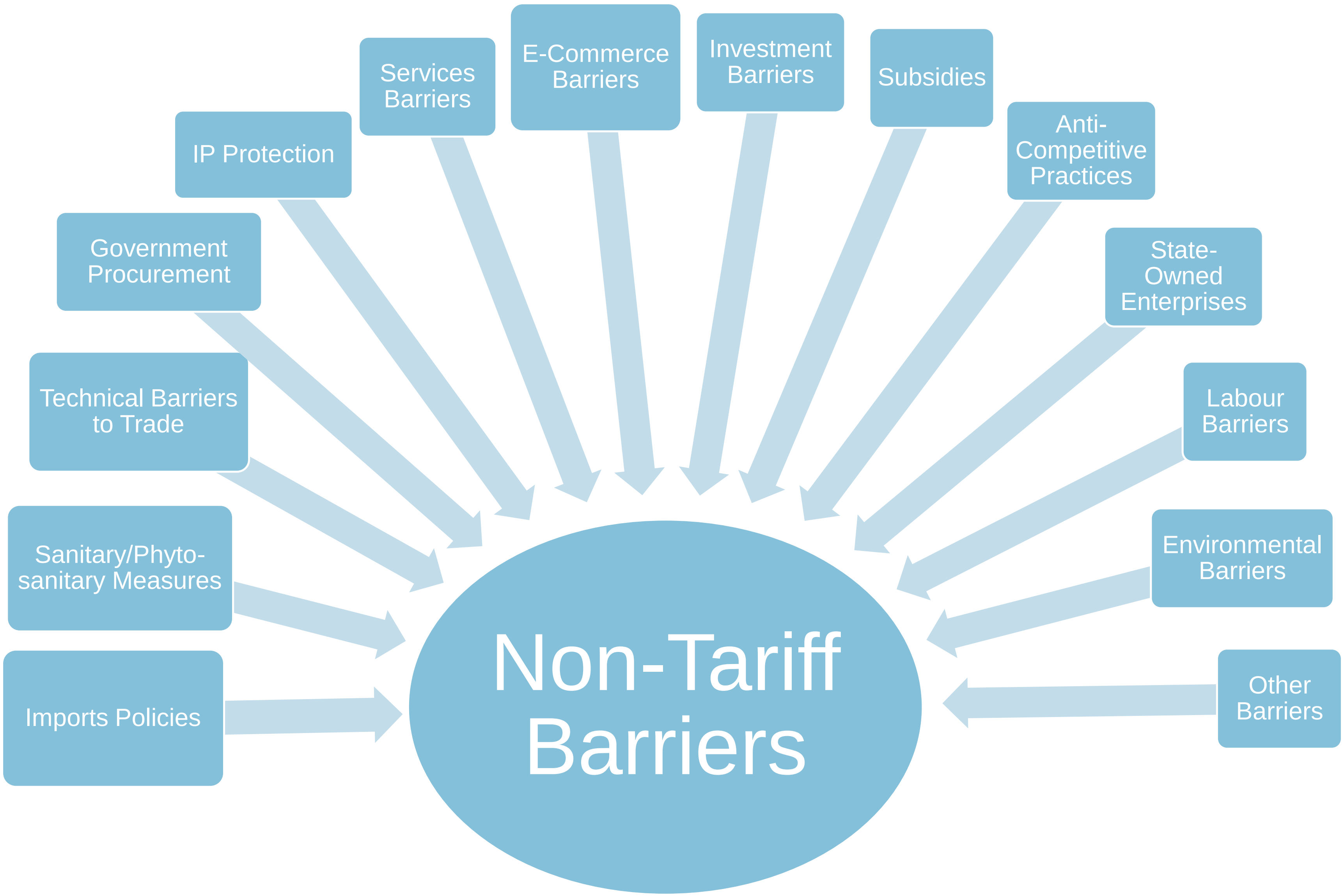
1 (iii). “Reciprocal” Ideology Complex by Nature



China’s tit-for-tat 34% retaliation elicits counter-retaliation of **additional 50%.**
(i.e. 34%+50% adding on to pre-existing 20% to make 104%)

Country	Country’s Tariff* (RHS, %)	US Reciprocal Tariffs	Base-line (5th April)	Additional (9th April)
Cambodia	97%	49%	10%	39%
Vietnam	90%	46%	10%	36%
Sri Lanka	88%	44%	10%	34%
Bangladesh	74%	37%	10%	27%
Thailand	72%	36%	10%	26%
China	67%	34%	10%	24%
Indonesia	64%	32%	10%	22%
Taiwan	64%	32%	10%	22%
South Africa	60%	30%	10%	20%
India	52%	26%	10%	16%
Korea	50%	25%	10%	15%
Brunei	47%	24%	10%	14%
Japan	46%	24%	10%	14%
Malaysia	47%	24%	10%	14%
EU	39%	20%	10%	10%
Philippines	34%	17%	10%	7%
Venezuela	29%	15%	10%	5%
Argentina	10%	10%	10%	0%
Australia	10%	10%	10%	0%
Brazil	10%	10%	10%	0%
Chile	10%	10%	10%	0%
New Zealand	20%	10%	10%	0%
Paraguay	10%	10%	10%	0%
Peru	10%	10%	10%	0%
Saudi Arabia	10%	10%	10%	0%
Singapore	10%	10%	10%	0%
UAE	10%	10%	10%	0%
UK	10%	10%	10%	0%

1 (iv). Obfuscated/Obstructed by a Plethora of Hard-to-Quantify Considerations



2. But the Math is a Bad Faith Greek Tragedy!

$$\Delta\tau_i = \frac{x_i - m_i}{(\varepsilon)(\varphi)(m_i)}$$

$$= \frac{exports_i - imports_i}{(\varepsilon)(\varphi)(imports_i)}$$

$$= \frac{exports_i - imports_i}{(4)(\frac{1}{4})(imports_i)}$$

$$= \frac{exports_i - imports_i}{imports_i}$$

$$= \frac{trade\ deficit}{imports_i}$$

Δτ_i reflects the change in the tariff rate.

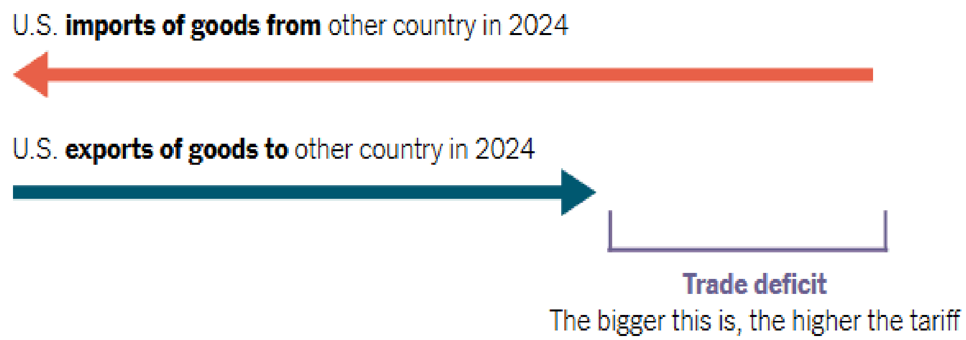
ε<0 represent the elasticity of imports with respect to import prices.

The price elasticity of import demand, ε, was set at 4.

φ>0 represent the passthrough from tariffs to import prices.

The elasticity of import prices with respect to tariffs, φ, is 0.25.

Inclusion of "greeks" accounting for elasticities & pass-through a sloppy cover for bottom-line driven tariff assault.



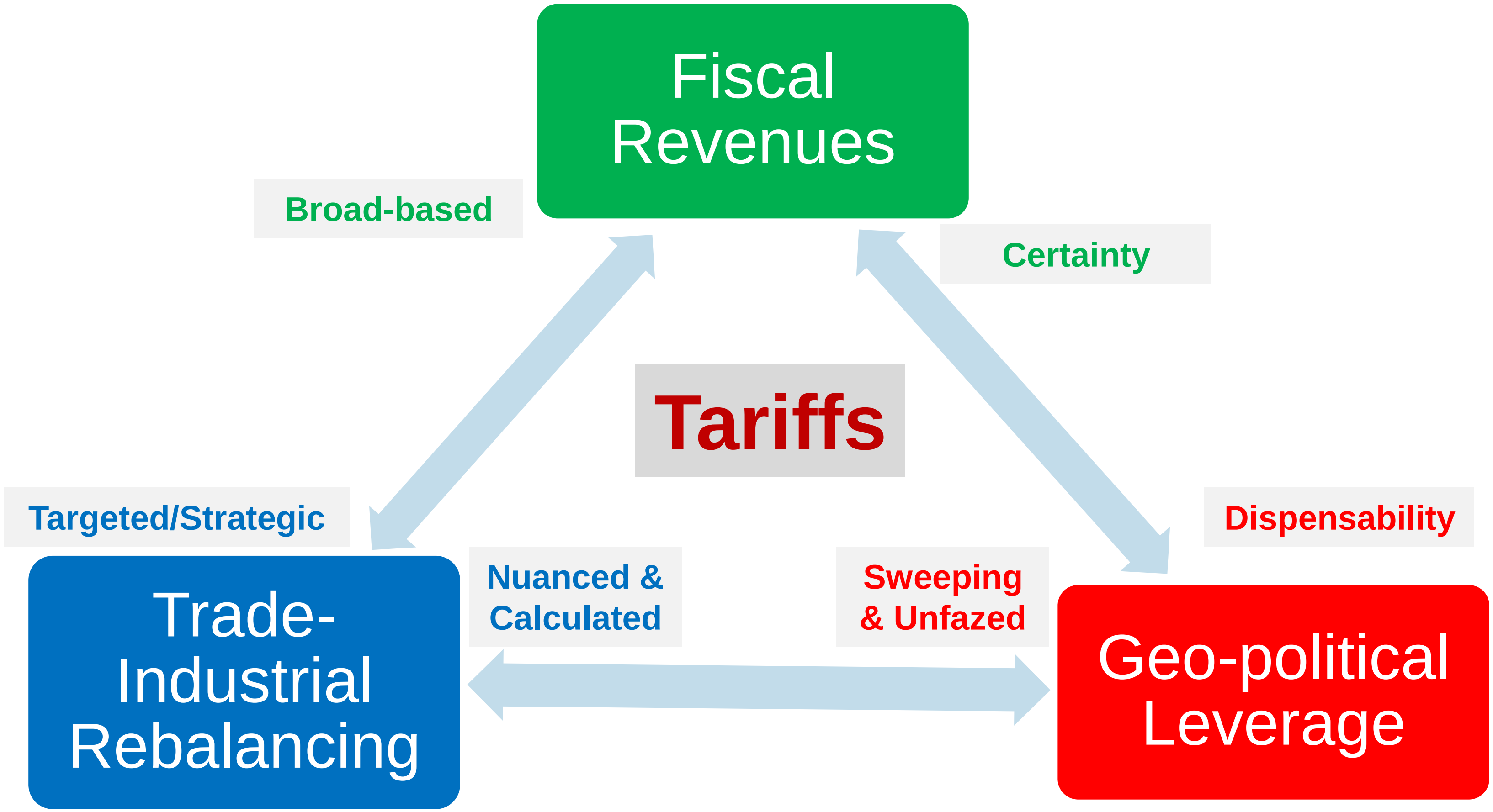
The slightly more detailed math looks like this:

$$\frac{\text{Trade deficit}}{\text{Imports}} \times \frac{1}{2} = \textbf{Tariff rate} \text{ (minimum 10\%)}$$

The **Implied Resolution** is to;
Buy/Import A Lot More US Goods or;
Export/Sell Significantly Less to the US.

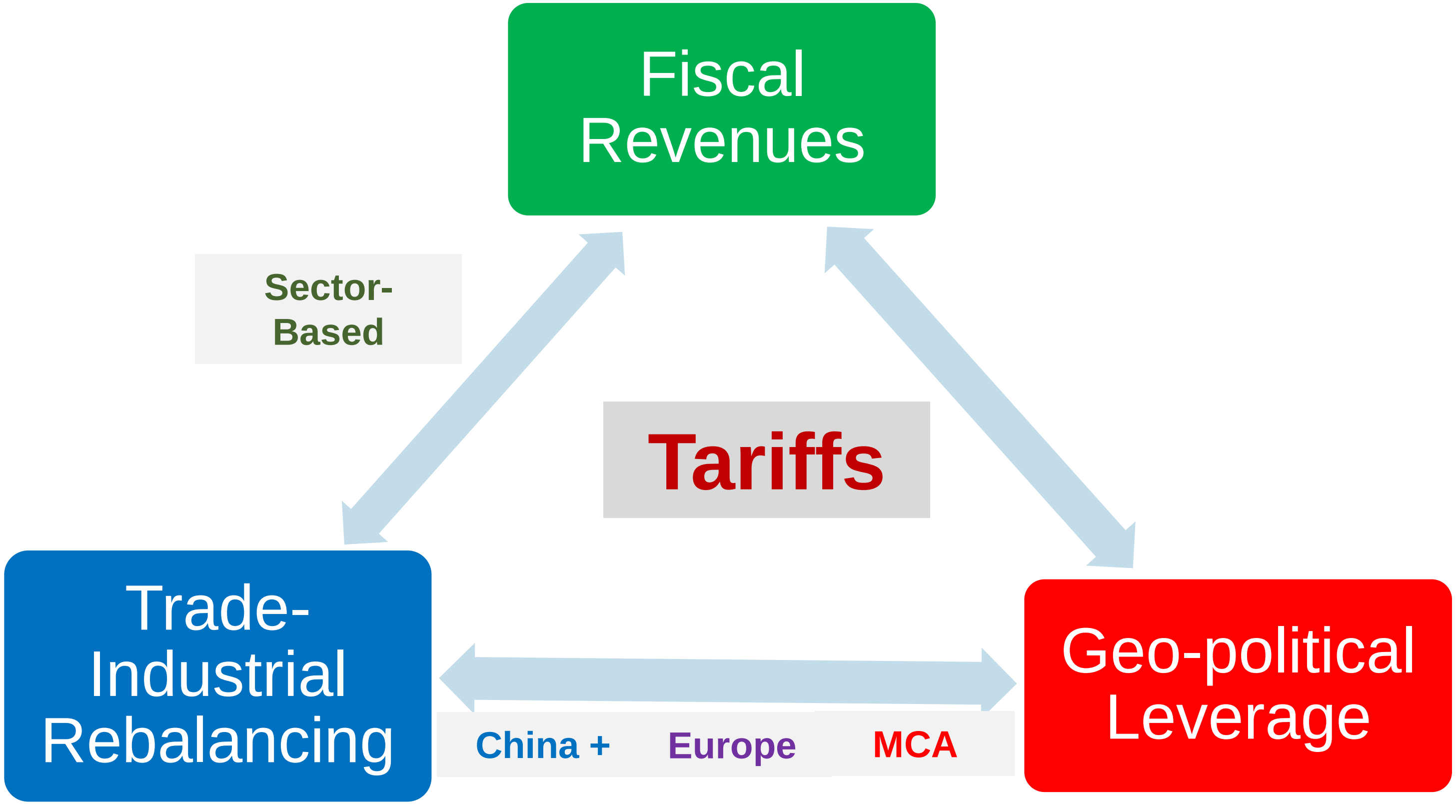
Reveals Trump's **Simplistic**, **Bottom-line View of Trade** as **Profit (Surplus)** & **Loss (Deficit)**

3 (i). The Impossible Trinity of Trump Tariffs



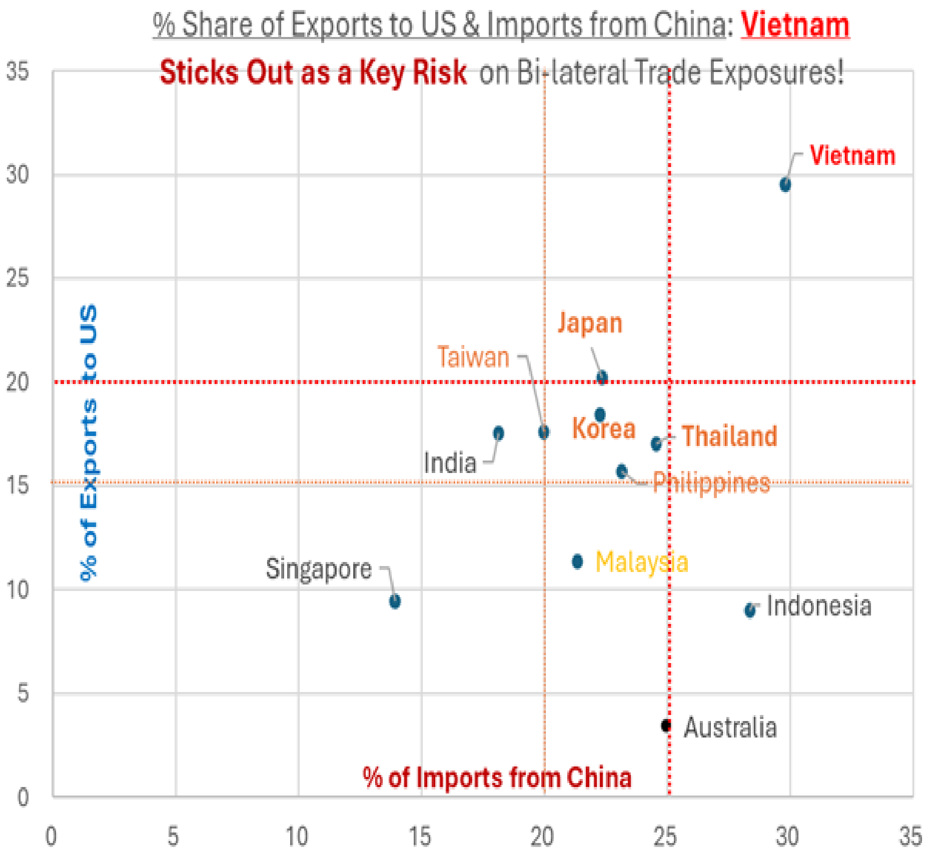
- One (Tariff) Tool, Many Objectives **Apart from the obvious motivation to force <u>trade/industrial re-balancing</u>** and ***supply-chain relocation*** (to the US), **tariffs also pursue <u>geopolitical leverage</u>** and to raise **<u>fiscal revenues</u>**.
- Conflicting Objectives: **Conflict in objectives**. **<u>Fiscal revenues</u>** argue for *steady, wide and steep tariffs*. **<u>Leverage</u>** *prioritizes non-trade deal-making* (*that entails rescinding on tariffs*) and **<u>trade rebalancing</u>** requires *strategic nuance*.
- Conflicting Objectives: **Acute tariff uncertainty** results from the one **<u>tariff tool is being exploited for multiple objectives</u>**. , **undermines a path to quick resolution**.

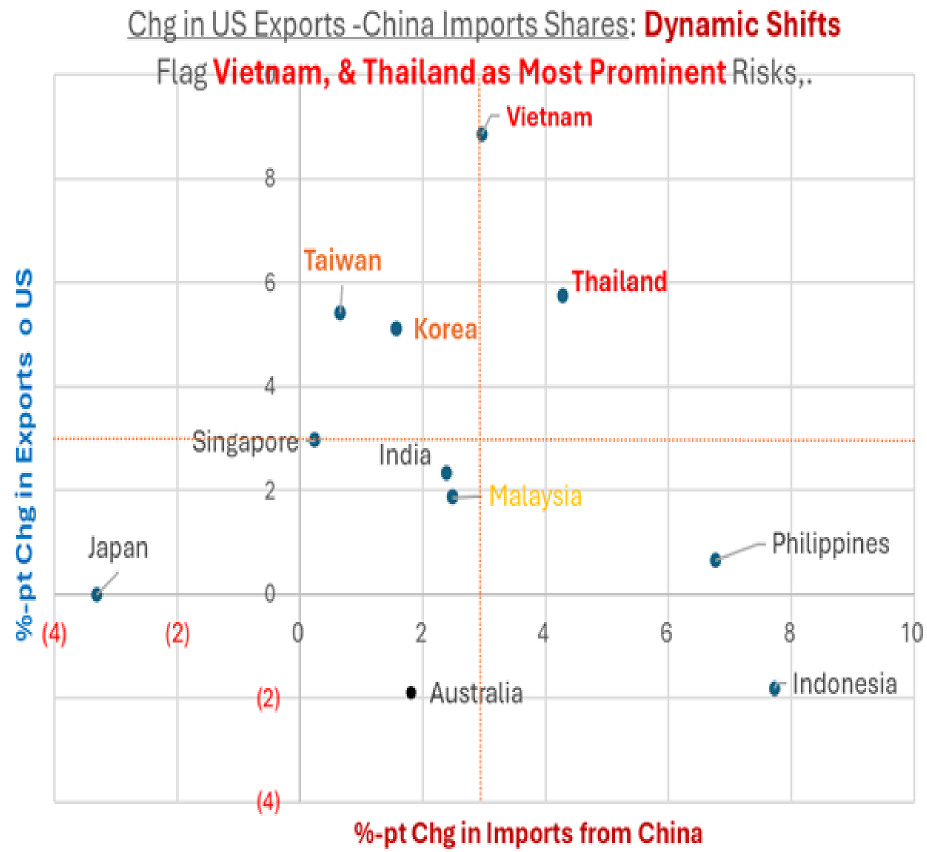
3 (ii). & the Asymmetric Inclinations *Tilted Against China+*

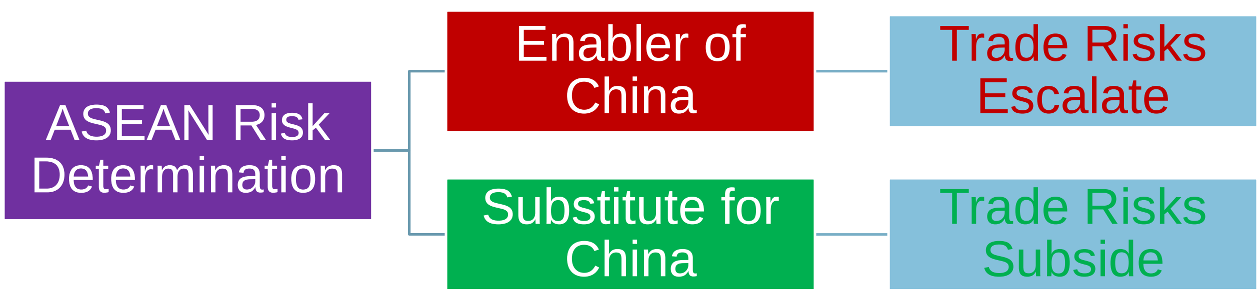


- Heightened Tariff Uncertainty: **Inherent conflict entailed in the three objectives heighten tariff-related uncertainty**.
- Recognizing Differentiated Tariff Risks: Crucially, a **more pronounced country/bloc-specific emphasis**.
- Trade/Industrial Rebalancing Bent for China-Asia: Conceivably, a **more emphatic Trade-Industrial Rebalancing bent** of stickier tariffs may *apply for China, spilling over into Asia*, **given the geo-economic rivalry**.
- Leverage Bias for North American: In contrast, **supply-chain dependencies may dictate** a **greater degree of leverage angle on North American tariffs**, which may be primed for dial-back.
- China Complex-North American Divergence: As a result of which, a more prominent divergence in the tariff threats/resolution between China-Asia complex and North America may emerge.

3 (iii). Lingering Tariff Risks: China-Linked Risks Elsewhere Not Eradicated







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4. Tariff Not Just about Trade ➔ Pure Trade Imbalance Analysis Misguided

Table 1. Emergency Powers Enacted in Tandem with Trade & Energy/Mineral Security Policies

Sector	Emergency Powers Invoked	Coordination Agencies
Trade	International Emergency Economic Powers Act (IEEPA)	Department of Commerce Trade Representative
Energy	National Energy Emergency** Defense Production Act (DPA)	National Energy Dominance Council (NEDC)*** Department of Energy Department of Defense Department of Interior Department of Commerce
Minerals	National Energy Emergency** Defense Production Act (DPA)	National Energy Dominance Council (NEDC) Department of Defense Department of Energy Department of Interior Department of Agriculture

^ The so-called **Mar-a-Lago Accord** refers to the **proposal of "burden sharing" with US' trade and security**, by **imposing an explicit cost on trade and financial assets** (associated with the "burden" of USD overvaluation that has been detrimental to US workers/manufacturing/exports). This proposal **hinges on the idea that US trade and security partners should pay for the privilege of access to US consumer** (trade tariffs), the benefit of holding US reserve assets (involving second order financial levies), and ***above all, for the benefit of the US security umbrella***. The degree of (concessions on) burden sharing will depend on security alignment/profile of partners. The ideas are **laid out in a paper** ("A User's Guide to Restructuring the Global Trading System", Nov 2024) **by Stephen Miran**, the ***Chair of President Trump's Council of Economic Advisers***.

* The pursuit of mineral security entails both the invocation of the DPA alongside the National Energy Emergency to boost domestic mineral production as well as external mineral acquisition such as the Ukrainian Minerals deal.
** The National Energy Emergency covers energy and critical minerals. And it falls under the wider umbrella of the National Emergencies Act (NEA) that covers 117 emergency statutes.
*** The National Energy Dominance Council (NEDC), established on 14th Feb 2025, is Chaired by the Secretary of Interior, with the Energy Secretary as Vice Chair. Some of the key members of this Council the Secretaries of Treasury, Defense, Agriculture, Commerce, Transportation, Attorney General and the Environmental Protection Agency (EPA) Administrator (see "Sec. 3. Membership" below for the full Council Membership).

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4. Miran & (so-called) Mar-a-Lago Accord

A User's Guide to Restructuring the Global Trading System

November 2024

Executive Summary

The desire to reform the global trading system and put American industry on fairer ground *vis-à-vis* the rest of the world has been a consistent theme for President Trump for decades. We may be on the cusp of generational change in the international trade and financial systems.

The root of the economic imbalances lies in persistent dollar overvaluation that prevents the balancing of international trade, and this overvaluation is driven by inelastic demand for reserve assets. As global GDP grows, it becomes increasingly burdensome for the United States to finance the provision of reserve assets and the defense umbrella, as the manufacturing and tradeable sectors bear the brunt of the costs.

In this essay I attempt to catalogue some of the available tools for reshaping these systems, the tradeoffs that accompany the use of those tools, and policy options for minimizing side effects. This is not policy advocacy, but an attempt to understand the financial market consequences of potential significant changes in trade or financial policy.

Tariffs provide revenue, and if offset by currency adjustments, present minimal inflationary or otherwise adverse side effects, consistent with the experience in 2018-2019. While currency offset can inhibit adjustments to trade flows, it suggests that tariffs are ultimately financed by the tariffed nation, whose real purchasing power and wealth decline, and that the revenue raised improves burden sharing for reserve asset provision. Tariffs will likely be implemented in a manner deeply intertwined with national security concerns, and I discuss a variety of possible implementation schemes. I also discuss optimal tariff rates in the context of the rest of the U.S. taxation system.

Currency policy aimed at correcting the undervaluation of other nations' currencies brings an entirely different set of tradeoffs and potential implications. Historically, the United States has pursued multilateral approaches to currency adjustments. While many analysts believe there are no tools available to unilaterally address currency misvaluation, that is not true. I describe some potential avenues for both multilateral and unilateral currency adjustment strategies, as well as means of mitigating unwanted side effects.

Finally, I discuss a variety of financial market consequences of these policy tools, and possible sequencing.

Stephen Miran, *Senior Strategist*

Scott Bessent, a Trump advisor floated as potential Treasury Secretary, has proposed putting countries into different groups based on their currency policies, the terms of bilateral trade agreements and security agreements, their values and more. Per Bessent (2024), these buckets can bear different tariff rates, and the government can lay out what actions a trade partner would need to undertake to move between the buckets.

maybe the U.S. wants to discriminate based on:

- Does the nation apply similar tariff rates to their imports from the U.S. as America does on their exports here?
- Does the nation have a history of suppressing its currency, for instance via the accumulation of excessive quantities of foreign exchange reserves?
- Does the nation open its markets to U.S. firms in the same way America opens its markets to foreign firms operating stateside?
- Does the nation respect American intellectual property rights?
- Does the nation help China evade tariffs via re-export?
- Does the nation pay its NATO obligations in full?
- Does the nation side with China, Russia, and Iran in key international disputes, for instance at the United Nations?

ASEAN Risk Determination

Enabler of China

Substitute for China

Miran's paper
[638199_A_Users_Guide_to_Restructuring_the_Global_Trading_System.pdf]

4. Miran & (so-called) Mar-a-Lago Accord ➔ Evolving Risks

These considerations suggest several consequences:

1) There is good reason to be more cautious with changes to dollar policy than with changes to tariffs.
2) Steps to strengthen undervalued currencies will likely not be taken until risks can be mitigated. The Administration will likely wait for more confidence that inflation and deficits are lower, to limit potentially harmful increases in long yields that could accompany a change to dollar policy. Waiting for turnover at the Federal Reserve increases the likelihood that the Fed will voluntarily cooperate to help accommodate changes in currency policy.
3) Tariffs are a tool for negotiating leverage as much as for revenue and fairness. Tariffs will likely precede any shift to soft dollar policy that requires cooperation from trade partners for implementation, since the terms of any agreement will be more beneficial if the United States has more negotiating leverage. Last time, tariffs led to the Phase 1 agreement with China. Next time, maybe they will lead to a broader multilateral currency accord.
4) Therefore, I expect policy to be dollar-positive before it becomes dollar negative.

Despite the dollar's role in weighing heavily on the U.S. manufacturing sector, President Trump has emphasized the value he places on its status as the global reserve currency, and threatened to punish countries that move away from the dollar. I expect this tension to be resolved by policies that aim to preserve the status of the dollar, but improve burden sharing with our trading partners. International trade policy will attempt to recapture some of the benefit our reserve provision conveys to trading partners and connect this economic burden sharing with defense burden sharing. Although the Triffin effects have weighed on the manufacturing sector, there will be attempts to improve America's position within the system without destroying the system.

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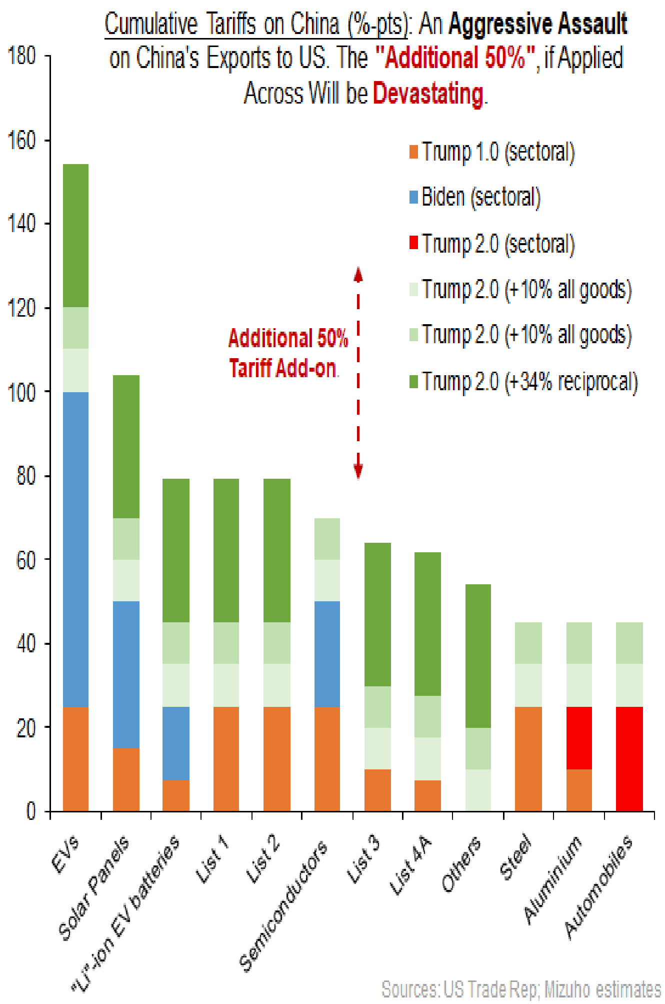
5 (i). US-China Risks Could Splinter Global Trade



Notes:

1) **Electric Vehicles (EVs):** Under Trump 1.0, EVs fell under List 1 and subject to 25% tariffs; tariffs was increased to 100% under Biden in September 2024.

2) **Solar panels:** Trump imposed 30% in 2018, which was decreased every year. Biden extended the tariffs and increased tariffs to 50% in May 2024.

3) **Lithium-ion EV batteries:** Under Trump 1.0, lithium-ion EV batteries fell under list 4A; tariffs was increased to 25% under Biden administration in September 2024.

4) **List 1/2/3/4A:** Broad range of goods subject to varying tariffs. Original value of targeted groups were as follows: list 1 - US$34bn; list 2 - US$16bn; list 3 - US$200bn; list 4 - $125bn, although various exclusions were granted for all four lists.

5) **Semiconductors:** Under Trump 1.0, semiconductors were included under List 1 and subject to 25% tariffs; tariffs were increased to 50% under Biden in September 2024.

6) **Steel:** Trump imposed 25% tariff on steel in March 2018 during his first term. Biden expanded scope of 25% tariffs to apply to steel-goods that were previously in List 4A (i.e. tariffs of 7.5%). Trump's announcement to impose tariff on steel imports in 2025 only affected previously exempted countries (e.g. Australia, Canada).

7) **Aluminum:** Trump imposed 10% tariff on aluminum in March 2018, which was increased to 25% in April 2025.

8) **Automobiles:** Under Trump 1.0, automobiles were originally included in list 1, but subsequently removed. Nonetheless, China was hit by Trump 2.0's 25% sectoral tariff.

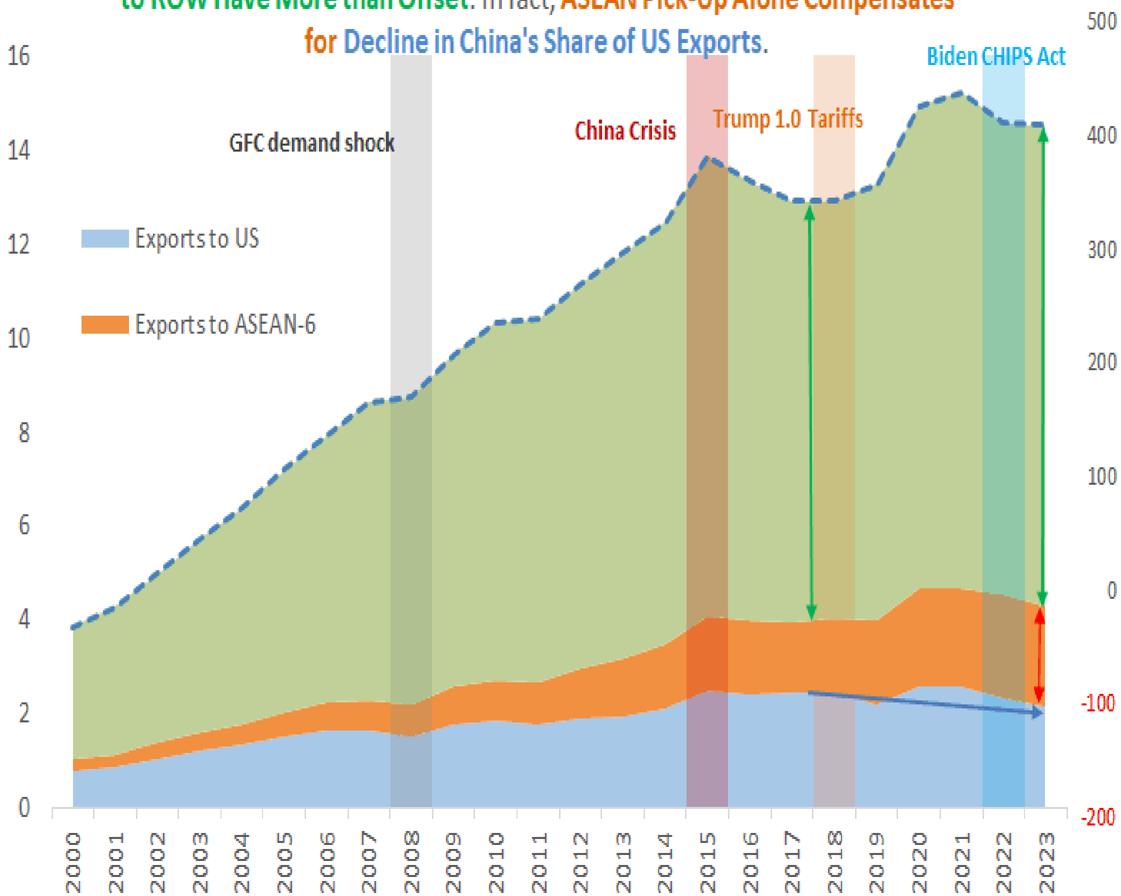
9) **10% + 10% tariffs on China** applied across the board.

10) **Exceptions for 34% reciprocal tariffs** include steel, aluminum, autos, copper, pharmaceutical, lumber, critical minerals and energy sectors. Note that we did not single out the exceptions, if any, from Lists 1/2/3/4A.

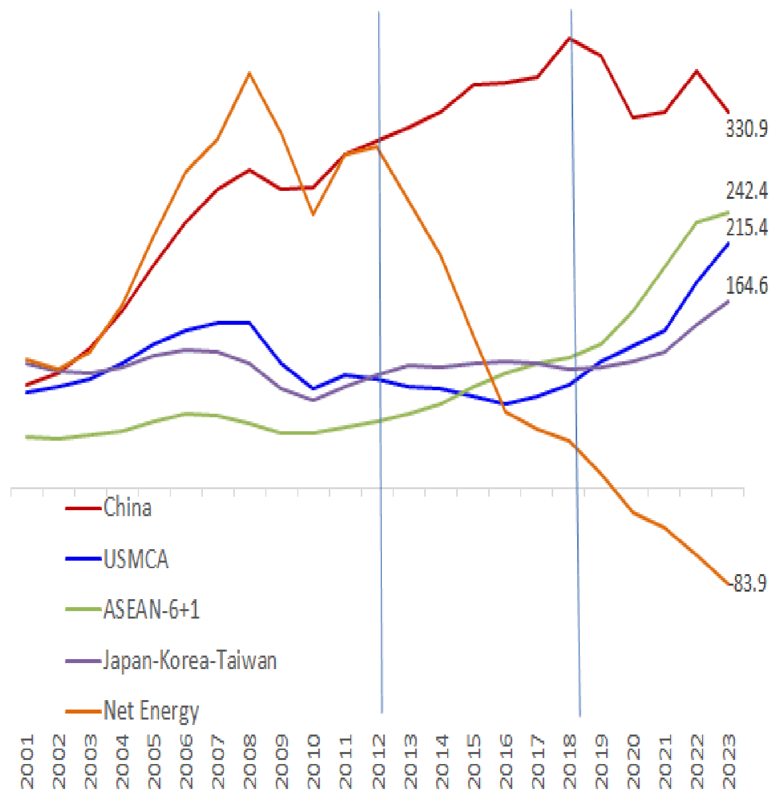
Date	Event
Jan-17	**Trump's first term commences.**
Feb-18	30% tariffs on imported solar panels and 18% tariffs on washing machines. Tariffs will reduce each year.
Mar-18	25% and 10% tariffs on steel and aluminum respectively; China not in list of exempted countries.
Jul-18	25% tariffs on List 1 goods (US$34bn).
Sep-18	25% tarifs on List 2 goods (US$16bn).
Sep-18	10% tariffs on List 3 goods ($200bn).
Jun-19	Tariffs on List 3 goods increased to 25%.
Sep-19	15% tariffs on a subset of List 4 goods (US300bn). Revised list of goods was US4120bn (i.e. List 4A).
Jan-20	**US and China sign a Phase One trade deal through which China commits to buying an additional $200bn of US goods and services over the next two years.**
Feb-20	Steel/aluminum tariffs extended to products that use aluminum and steel.
Feb-20	15% imposed on List 4A goods cut to 7.5%.
Jan-21	**Biden administration starts; Trump administration ends.**
Feb-22	Tariffs on solar panels extended.
Feb-23	Tariffs on washing machines expire.
Sep-24	Slew of tariffs adjusted on selected Chinese products, including EVs (25% to 100%); lithium-ion EV batteries (7.5% to 25%), solar cells (25% to 50%).
Jan-25	Slew of tariffs ons elected Chinese goods, including tungsten (0% to 25%), wafers and polysilicon (both 25% to 50%).
Jan-25	**Trump administration starts; Biden administration ends.**
Feb-25	10% imposed on all imports from China.
Mar-25	Additional US tariffs of 10% on all imports from China.
Mar-25	25% tariffs imposed on all steel, aluminum and derivative products.
Apr-25	Trump's announces 34% reciprocal duties on Chinese imports, with certain goods exemptions.
Apr-25	**Trump's imposes an additional 50% duties on Chinese goods.**

5 (ii). US-China Fragmentation Could Force Some Dislocations & Demarcation

China's Share of Global Exports Has Risen Through Trump 1.0 Tariffs. Exports to ROW Have More than Offset. In fact, ASEAN Pick-Up Alone Compensates for Decline in China's Share of US Exports.



US Trade Deficit (2Y Avg, US$ bn): China is in the Cross-Hairs Geo-politically Despite Stabilizing Imbalance, but Not Alone Given Trade Linkages alongside "ZSG" & Hip-Shooting Trump Risks.



ZSG: Zero Sum Game

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

5 (iii). Key Fragmentation Outcomes

- **Fragmentations Risks**
  - **Trade Bloc Fragmentation**
    - Asia Disinflation: China Overcapacity/Deflation Spills Over
    - **ASEAN: "China +1" Allure Diminished**
    - "US + 1" Could become a Theme
  - **Technology Fragmentation**
    - Green Technology Away from China's Dominance
    - Internet Platforms Diverge distinctly
    - A.I. Chips, Comms on parallel platforms

5 (iv). The Price of US Security

- **Undeniable security lens to** *increasingly **extractive** approach of* **antagonistic** (trade), **isolationist** (geo-politics) **US**.
- **Bottom-line**: The **price of US security will have to be borne more widely** across global economies – *by trade partners*, *allies*, and *adversaries* alike – **albeit arguably differentiated**.
- The so-called **Mar-a-Lago" Accord^** warns "burden sharing" by means of **sweeping tariffs** *aimed at re-ordering international economic relations* followed by **financial rent-seeking**.
- There are **three key dangers** associated with this. First, the **transactional security angle** driven by **narrowly defined self-interest** could result in **greater geo-political and/or conflict threats**.
- Specifically, the resultant **exacerbation in global trade and security fragmentation** will inevitably **bloat debt-funded** *infrastructure*, *military*, and *social* (fiscal) **spending elsewhere**, led by Europe.
- Second, the **threat of financial "confiscation" from US reserve asset allocation** could lead to *further compositional shifts in reserve asset allocation at the margin* **to the benefit of non-fiat alternatives**.
- *But* this will be a **far cry from wholesale shift away from US reserve assets** (and corresponding USD dominance) given binding limitations on viable fiat alternatives (assets denominated in other currencies)on a risk-adjusted basis.
- Finally, the **inextricable "security" dimension in determining "burden sharing"** suggests **economies most prominently in the orbit of/ reliant on, China** could be **subject to greater risks** *of enduring US economic assault*.
- Notably, **Vietnam and Thailand feature as prominent risks in ASEAN**.
- **Taiwan and Korea not spared either** on bilateral exposures.
- Especially given **profound "upstream China risks"** (sanctions by US) given >20% exports reliance on China..

- **Five discernible macro/asset market themes** that could arise are;
    i. *durable boost to Gold* and other hard assets;
    ii. structural and differentiated (**risk re-pricing**) increase in global term premium that persists
    iii. accentuated downside volatility in CNH and AXJ that lingers, and more so vis-à-vis other global currencies;
    iv. far more differentiated AXJ outcomes dependent on variable US tariff/financial risks (that accentuate onshore peculiarities) and;
    v. China deflation risks with higher probability of spill-over AXJ dis-inflation.

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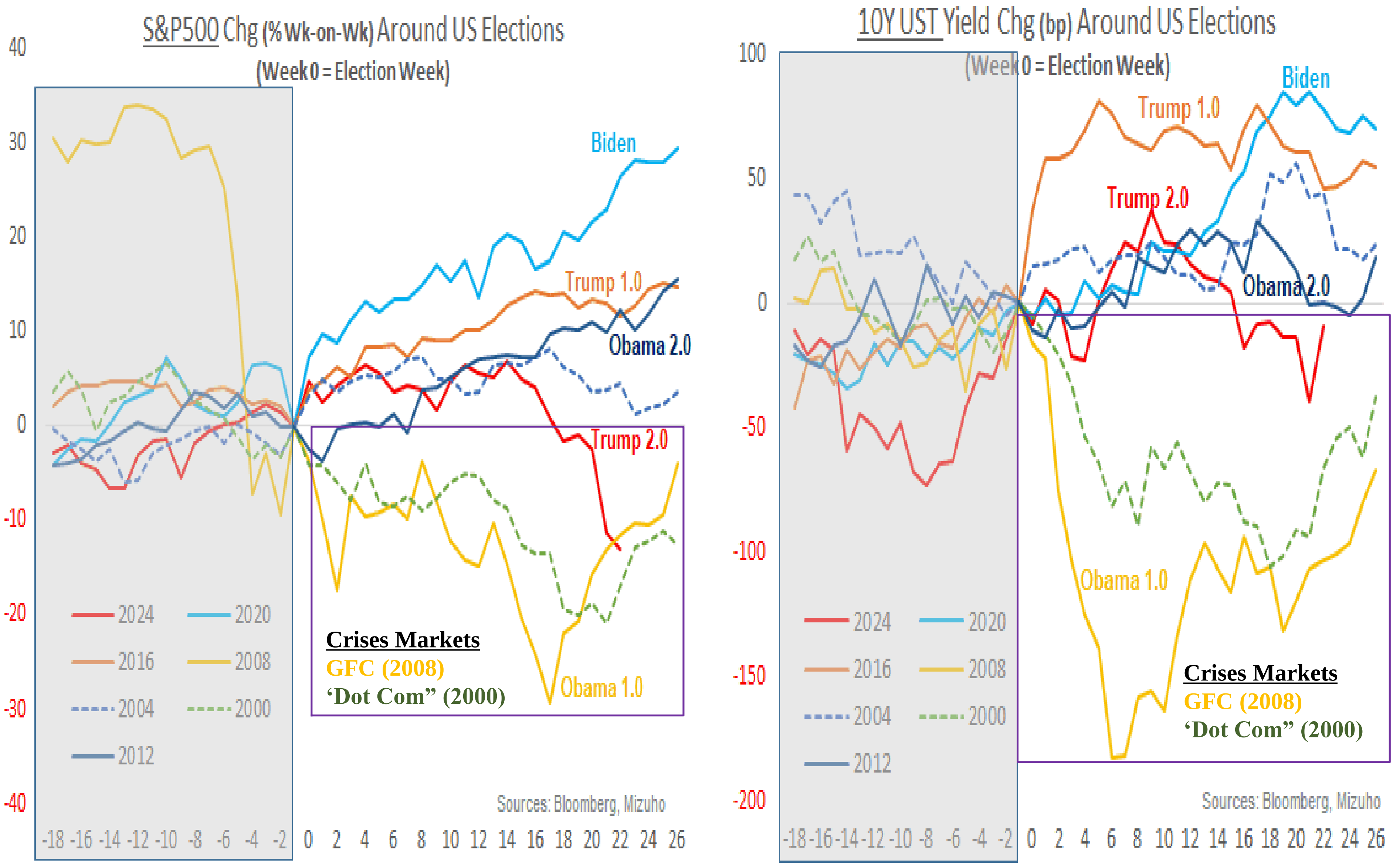
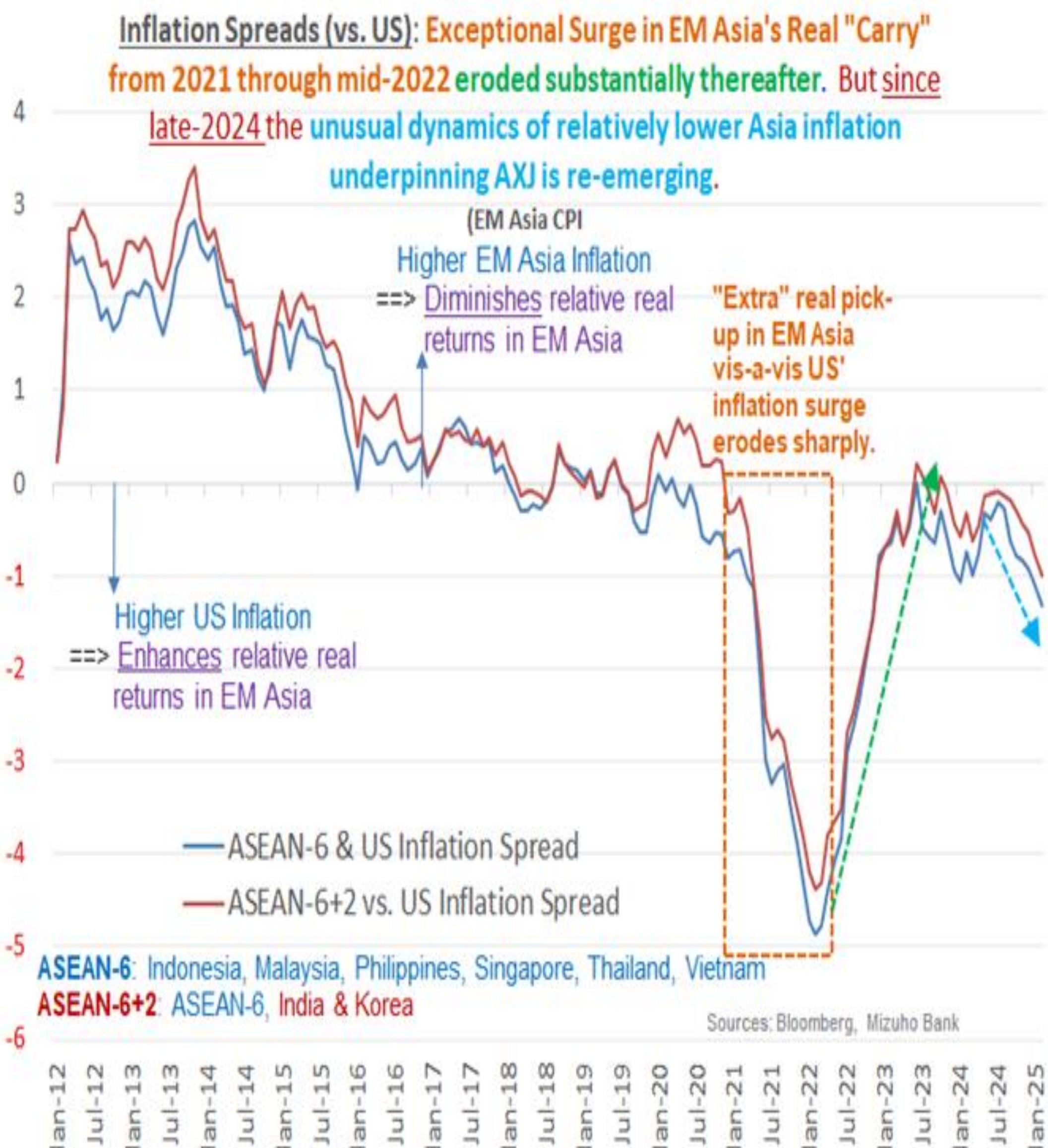
6a. Fed/Trump Put Neither Imminent nor Unambiguous



6 (i). Splintering: Inflation Divergence Leads



- **Re-emergence of negative Asia-US inflation spreads**.
- Arguably, cyclically overstated **given subsidies** and **temporary factors that flatter Asia's dis-inflation** vis-à-vis US.
- *Nonetheless*, **trend is worth monitoring** given that **US-China geo-economic forces could divert China's spare capacity to Asia**.
- Consequently, *structurally pressuring Asia-US inflations spreads*.
- But **AXJ may not benefit from modest** from the advantageous Asia-US inflation dynamics **as trade risks overwhelm**.
- Fact is, **overriding policy and geo-political risks** could **pressure AXJ**.

6 (ii). Splintering: Adverse Income Shock Convergence

US Reciprocal Tariffs by Country Announced April 2

Pre-retaliation Forecasts

Country	Country's Tariff* (RHS, %)	US Reciprocal Tariffs	Base-line (5th April)	Additional (9th April)	Pre-Tariff Forecast (2025-26 avg): Growth (%)	Pre-Tariff Forecast (2025-26 avg): Inflation (%)	Impact of Tariffs: Growth (%-pts)	Impact of Tariffs: Inflation (%-Pts)	Policy Direction: Impact (bps)	Policy Direction: End-2025
Vietnam	90%	46%	10%	36%	6.8%	3.5%	-1.2%	-0.2%	0.00	4.50%
Thailand	72%	36%	10%	26%	2.8%	1.5%	-0.7%	-0.3%	-75	1.25%
China	67%	34%	10%	24%	4.8%	0.5%	-0.3%*	-0.3%	-60	0.90%
Indonesia	64%	32%	10%	22%	5.0%	1.8%	-0.4%	-0.2%	-75	4.75%
Taiwan	64%	32%	10%	22%	3.0%	1.9%	-0.6%	-0.3%	-50	1.50%
India	52%	26%	10%	16%	6.0%	4.8%	-0.6%	-0.2%	-100	5.25%
Korea	50%	25%	10%	15%	1.8%	2.1%	-0.7%	-0.4%	-75	2.00%
Malaysia	47%	24%	10%	14%	4.8%	2.1%	-0.6%	-0.2%	-25	2.75%
Philippines	34%	17%	10%	7%	5.4%	2.5%	-0.3%	-0.2%	-100	4.75%
Australia	10%	10%	10%	0%	1.1%	2.6%	-0.5%	-0.2%	-75	3.35%
Singapore**	10%	10%	10%	0%	2.3%	1.8%	-0.6%	-0.4%	--	--

*Expectations of significant policy stimulus to boost domestic demand to largely offset margin squeeze and demand shocks, even on enlarged China trade risks. ** Singapore uses S$NEER as a policy tool

- Especially as *relatively more dovish central banks in Asia initially. At least until* as global income shocks trigger **dovish Fed convergence as** worse case Trump Tariff Turbulence asserts. Especially as the **threat of adverse income** shocks mount.

- Global policy divergence from **elevated tariff uncertainties**, **relative Fed restraint** accentuate central bank trilemma; requiring sharp trade-offs between interest rates, exchange rates and capital flows.

- This necessitates that **Asian central banks have to strike a delicate balance** between shifting economic and macro/FX stability risks. **Prevailing FX risks/volatility will sway policy decisions**.

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7. Front-Loading Not Necessarily Forestalling *“Too High for too Long”*

	End-2021	End-2022	2024				2025				2026	
			Q1 24	Q2 24	Q3 24	Q4 24	Q1 25	Q2 25	Q3 25	Q4 25	H1 26	H2 26
Fed Funds Target Rate Ceiling	0.25	4.50	5.50	5.50	5.00	4.50	4.50	4.25	3.75	3.25	3.00	3.00
Fed Funds Target Rate floor	0.00	4.25	5.25	5.25	4.75	4.25	4.25	4.00	3.50	3.00	2.75	2.75
UST 2Y Yields	0.73	4.43	4.62	4.75	3.64	4.24	3.99	3.63	3.15	2.96	2.73	2.80
UST 10Y Yields	1.51	3.87	4.25	4.40	3.78	4.57	4.28	4.01	3.77	3.68	3.55	3.62
UST 10Y-2Y Spread (bp)	77.8	-55.1	-36.8	-35.7	14.0	32.9	29.0	38.0	62.0	72.5	82.0	82.5

Conditional

Pronounced Steepening

Sources: Bloomberg, Mizuho Forecasts

Front-Loaded 100bp in 2024 May Not Cut It

- The Fed’s 100bp of cuts in 2024, initiated with 50bp Sep cut, **signals front-loaded easing**.
- But **real rates remain (too) elevated**. So early-2025 policy is more “skip” not “pause”.

An Overly Hawkish (Dot) Plot for 2025-26

- Barring significant inflationary shocks, **50bp each for 2025 and 2026** is **too little *to insure “Goldilocks”*.**
- “Sticky” inflation merely tempers but doesn’t derail path back lower “neutral”.

Rate Cuts to Cluster Around Mid-2025

- **Expect faster cuts into late-2025**, with some 75-100bp on the cards, to lower rates to ~3%.
- And then, some more by ~50bp later in 2025 if as *risks to soft-landing re-emerge* amid elevated real rates.

More Distinctly Dovish Leg Not Ruled Out

- **Scope for distinctly dovish 2025 back-end** *if jobs/demand deteriorate too sharp for a "controlled landing”*.

Premise: Consumer Slowdown, Not Crisis

- Deeper cuts are premised on **sharper consumption slowdown** as cash-flows tighten ➔ a ***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 Fiscal Volatility

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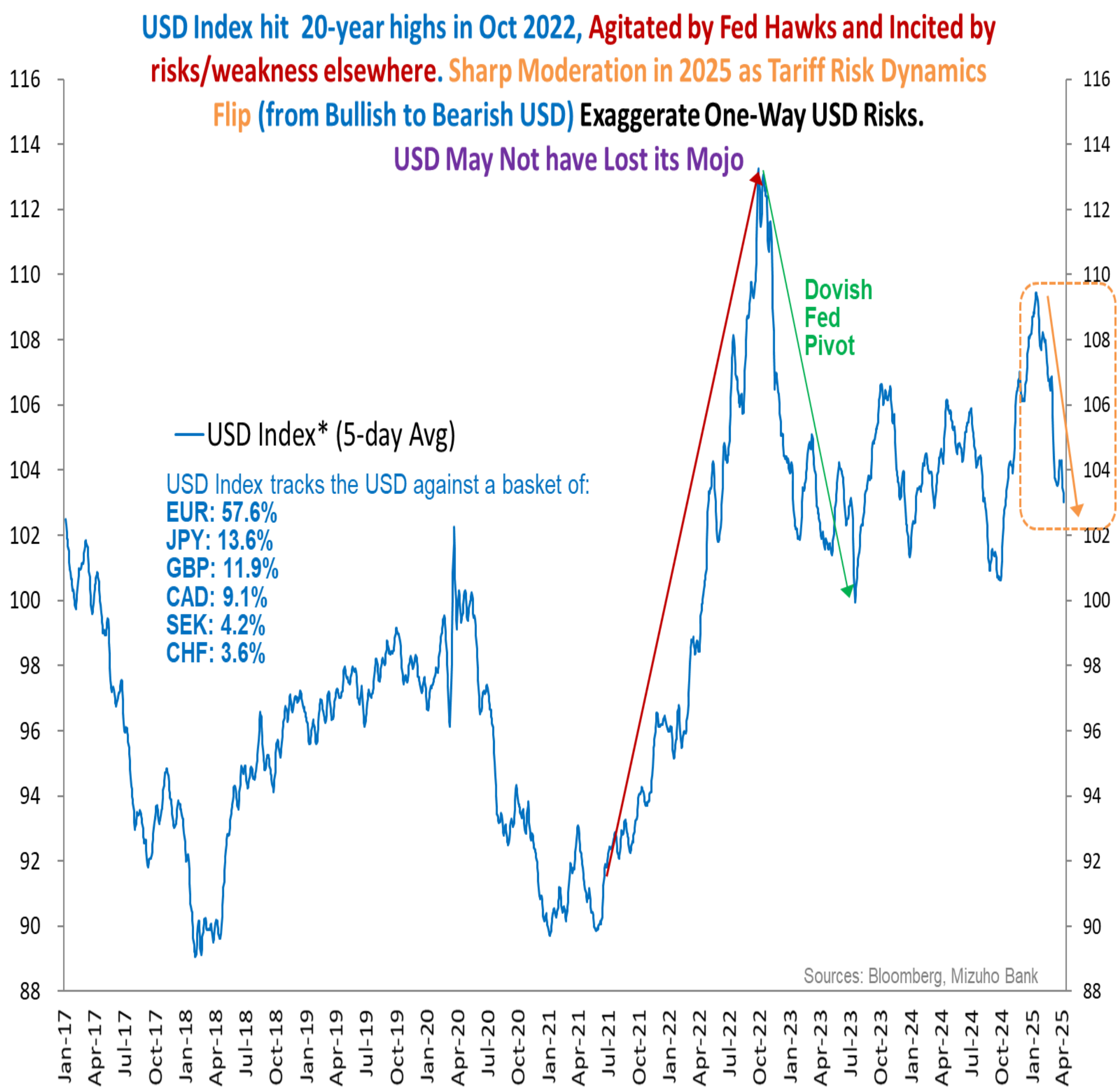
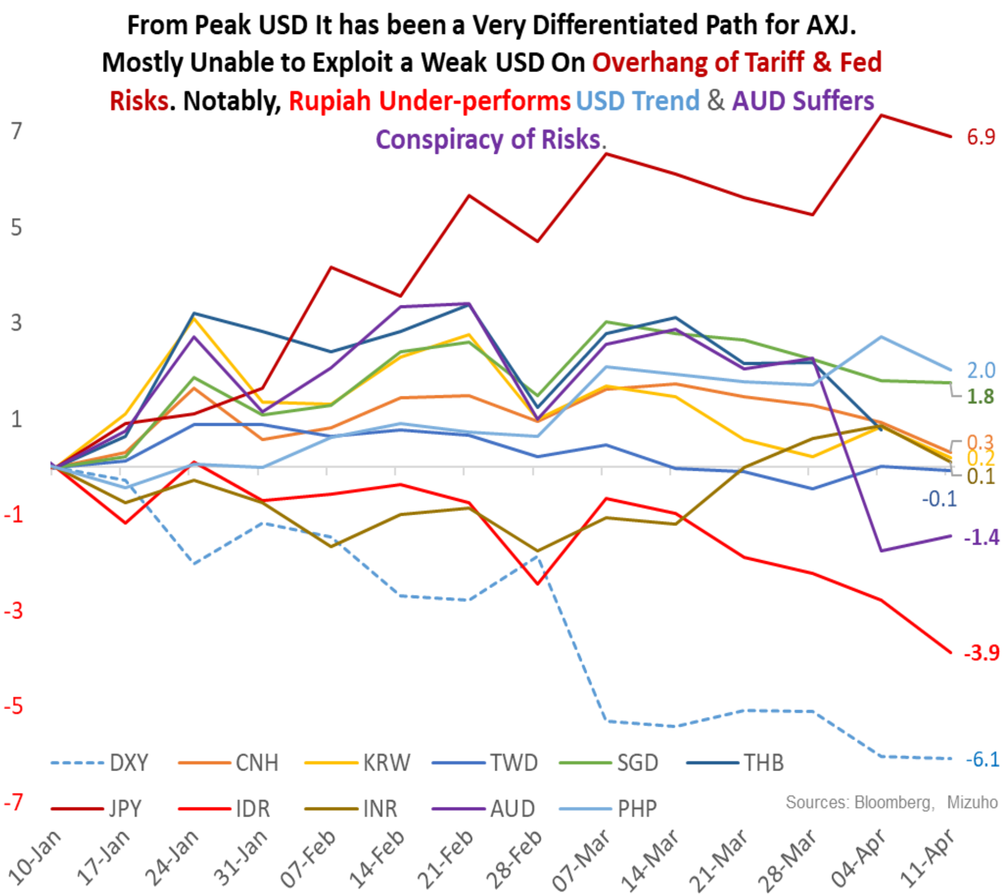
8 a (i). USD Bulls Not Unscathed, But Not All Tariff Mojo is Lost



- USD's Tariff Boost Challenges Haven Allure: Intuitive **idea that Trump tariffs boosts USD** at the expense of trade-reliant counterparts **challenged**, *suspending haven allure*.
- USD Not Unscathed: DXY pullback **rightly concedes** that **tariffs are not exclusively one-sided, to the exclusion of US**. Arguably, pricing in impact of retaliatory tariffs.
- Low-Hanging Fruits: USD recoil from rich valuations, **"low-hanging fruits"**. Especially with undervalued EUR & JPY. *But hasty*, if not negligent, *to assume persistent, one-way USD.*
- AXJ Compromised: What's more, it is evident that *AXJ have struggled to exploit corresponding, USD pullback,* suggesting **USD may retain premium vs. trade-sensitive FX**.

8a (ii). AXJ: Full Reversion of AXJ may be Challenged



Global FX Assumptions: USD Bulls – Trade & Trading Volatility

	Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025	Q1 2026
DXY	108.5	106.2	104.3	102.8	99.5	100.6
	100.7-108.5	102.5-110.8	99.0-108.8	98.8-105.8	97.5-104.3	96.0-103.8
Brent Crude (US$/brrl)	72.0	68.5	64.5	61.5	65.5	63.8
	68.5-82.5	63.5-78.8	60.5-72.5	57.5-69.6	58.5-72.5	58.5-70.5

- USD Bears Must Watch Their Backs: Longer, (late-2025/early-2026). non-linear path to mellower USD* **Premature, one-way bearish USD bets** are **vulnerable to painful squeeze**.

- Trading Risks & Trafficking in Fear: Potential for even **more pronounced USD slump neither linear nor guaranteed** amid exceptional geoeconomic threats.

*

a. Condition 1 – Fed Cuts Significantly (More than Expected): Despite the downgrade to the number of cuts (to 2 from 4) into 2025, the **Fed could deliver more cuts**. Especially as *US economic exceptionalism may turn out to be overstated*. Moreover, the *US may not be entirely unscathed by the trade conflict* that is intended as a core part of Trump 2.0 policies. Finally, the *Trump 2.0 reflationary expectations* (so-called Trump-flation) prove to be a *lesser risk in terms of constraining Fed easing*.

b. Condition 2 – Trade War Bark is Worse than the Bite: Furthermore, the **most extreme demand destruction risks associated with Trump 2.0 trade tariffs prove to be overblown** as the Trump administration dials back trade antagonism (and tariff rates) as negotiations progress. This *unwinds some of the more acute currency damage* to trading partners (e.g. MXN, CNY, CAD, EUR, etc.). And as a corollary, **exaggerated** (and perverse) **USD bullishness** *deriving from adverse trade risks* **subside**.

c. Condition 3 – China Stimulus/Support Sufficient to Avert CNH Sell-Off: Finally, sharp CNY pressures are alleviated by more encouraging China stimulus put in place to backstop the economy and insure against more destabilizing CNY outflows. In turn, this lends some support, if not scope for (partial) recovery for AXJ more widely. This is a precondition for AXJ to be better positioned to exploit measured (albeit not a full) USD pullback. Although non-reversion to pre-Fed hike levels will likely still apply, as USD retains some of the structural/geo-political advantages.

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8a (iii). USD Tail Risks Via Unilateral & Multilateral Options Not to be Ignored

Unilateral Currency Approaches

accumulation less attractive. One way of doing this is to impose a user fee on foreign official holders of Treasury securities, for instance withholding a portion of interest payments on those holdings. Reserve holders impose a burden on the American export sector, and withholding a portion of interest payments can help recoup some of that cost. Some bondholders may accuse the United States of defaulting on its debt, but the reality is that most

the U.S. taxpayer by reserve holders. If UST buyers are inelastic, then the U.S. is overpaying for the public goods it provides, and price discrimination can help the United States repcapture value.

Second, there may be concern that incentivizing too much movement out of dollar reserve assets can limit financial extraterritoriality, which President Trump has already emphasized he is determined to preserve, and threatened punitive tariffs on nations that stop using the dollar for transactions purposes. Critically, the imposition of a usage fee on foreign official Treasury holdings does not interfere with the usage of the dollar in payment systems, only in the savings function of reserve assets in the official sector; a country with substantial excess foreign exchange reserves can somewhat diminish those reserves without turning to other currencies for facilitating international

Multilateral Currency Approaches

Getting trading partners to agree to a multilateral approach to strengthening undervalued currencies can help contain unwanted volatility. An agreement whereby our trading partners term out their reserve holdings into ultra long duration UST securities will a) alleviate funding pressure on the Treasury and reduce the amount of duration Treasury needs to sell into the market; b) improve debt sustainability by reducing the amount of debt that will need to be rolled over at higher rates as the budget deteriorates over time; and c) solidify that our provision of a defense umbrella and reserve assets are intertwined. There may even be arguments for selling perpetuals rather than century bonds, in this eventuality.

In this world, both the dollar and long yields can come down together, instead of moving in opposite directions. But,

8b (i). AXJ: Downside Risks Intact; Traction Contingent on Materially Softer USD

FX Forecasts	Q2 25	Q3 25	Q4 25	Q1 26	Q2 26
USD/CNY	7.15 - 7.60 (7.38)	7.05 - 7.45 (7.23)	6.98 - 7.37 (7.12)	6.97 - 7.26 (7.12)	6.97 - 7.26 (7.13)
USD/INR	86.2 - 88.9 (87.8)	85.5 - 88.9 (86.5)	85.2 - 88.2 (86.0)	84.8 - 87.8 (86.0)	84.8 - 87.8 (86.3)
USD/KRW	1370 - 1540 (1442)	1330 - 1480 (1420)	1290 - 1400 (1385)	1280 - 1380 (1360)	1280 - 1390 (1350)
USD/SGD	1.320 - 1.388 (1.365)	1.315 - 1.375 (1.335)	1.292 - 1.344 (1.318)	1.293 - 1.337 (1.318)	1.293 - 1.337 (1.318)
USD/TWD	32.1 - 34.5 (33.5)	31.5 - 33.9 (32.5)	31.2 - 33.5 (32.2)	31.0 - 33.5 (32.2)	31.0 - 33.6 (32.2)
USD/IDR	16070 - 17070 (16570)	15760 - 16900 (16250)	15420 - 16460 (15900)	15330 - 16270 (15800)	15260 - 16380 (15900)
USD/MYR	4.37 - 4.68 (4.50)	4.27 - 4.58 (4.40)	4.19 - 4.45 (4.32)	4.16 - 4.42 (4.29)	4.13 - 4.43 (4.30)
USD/PHP	55.9 - 59.3 (57.6)	55.3 - 58.7 (57.0)	53.8 - 57.7 (56.0)	53.4 - 57.3 (55.6)	54.2 - 58.2 (56.5)
USD/THB	33.4 - 36.2 (35.2)	33.4 - 35.7 (34.3)	32.7 - 34.9 (33.6)	32.6 - 34.6 (33.3)	32.6 - 34.5 (33.4)
USD/VND	25200 - 27500 (26200)	25000 - 27100 (26100)	25000 - 26500 (25800)	25000 - 26300 (25600)	24800 - 26200 (25500)
AUD/USD	0.580 - 0.668 (0.613)	0.600 - 0.673 (0.655)	0.635 - 0.700 (0.680)	0.645 - 0.700 (0.678)	0.655 - 0.705 (0.676)

Pre-retaliation Forecasts

- Tariff Head(line) & Tail Risks: **AXJ continue to be prone to wild swings from tariff headline risks.** Especially as **"heads or tail" type of binary outcomes are repeatedly played out**. From *acute sell-off on* instances of Trump's callous *tariff threats to relief rallies when* the tariff *threats are rescinded or suspended*. With "only the first salvo" in Chinese tariffs, Europe in the line of fire, **headline tariff triggers**, and *attendant volatility* abound. And the ***tail risk of bilateral trade antagonism*** in the rest of Asia and/or ***escalatory tit-for-tat trade wars***.

- Trumped Up (Tariff) Threats & De-sensitization: Admittedly, markets may **increasingly be inclined to assume that tariff threats are trumped up**. Specifically, only **to be exploited as leverage for future negotiations**. *Consequently*, it is **tempting to suggest** markets may be emboldened to **start downgrading tariff-induced threats**. Which ***incrementally de-sensitize AXJ to tariffs headlines***.

- Bluster Not Always a Bluff: But the **luxury of linear de-sensitization to tariff risks is a tall order**. After all, **unpredictability is a feature**, not a bug, **of Trump 2.0, tariffs and all**. And more likely than not, President *Trump will be inclined to keep his audience on their toes*. He does know a thing or two about getting (TV) ratings up and truly believes in zero-sum games. So **not every bluster will turn out to be a bluff**.

- Proliferation of AXJ Pain: Instead, what's likely is a **proliferation of AXJ pain from tariff threats**. **Direct impact from bilateral US confrontation is a notable, understated** (given current US-China focus) **threat**. But *Vietnam*, *Taiwan* and *Korea* are imaginably **at risk of direct trade pressures** (and attendant FX wobbles) *if Trump's bilateral, bottom-line, zero-sum game instincts are not tamed*. And **JPY could cut both ways**, **dragging AXJ** *on the way down* given trade links and *equally via "carry squeeze" on the way up*.

- (Initial?) Fed Exceptionalism: Moreover, **a tariff-enhanced version of Fed exceptionalism** on **perceptions of accentuated (hawkish) Fed divergence**, is **primed to accentuate AXJ pain**. Specifically, as the *Fed's inclinations to guard against inflationary tariffs effects contrasts with Asian central banks (ACBs) instinct to (pre-emptively) insure against gathering trade headwinds*. So, until the Fed resumes easing ***sharper* policy trade-offs** (rate cuts vs. FX backstop) **for ACBs amplify downside AXJ sensitivities from tariff risks**.

- But Two Halves with Back-End Relief: ***But** that said*, **AXJ pain from Trump 2.0 tariff turbulence** coupled with Fed-ACBs divergence **may not be unremitting**. Instead, **partial *relief, albeit fragile, may be set to* emerge** in H2 2025/late-2025 (into 2026). Especially if the trade conflict settled into negotiated compromises rather than an escalatory spiral. For all his **unpredictability Trump** is likely to angle for a deal. Caveat being, non-**linearity** and **bumpiness will feature for now**.

- Bark Worse than Bite Relief: Sustained AXJ relief though will be **highly contingent** on the ***trade tariff bark being worse than the actual trade disruption bite***. In other words, the worst of **tariff-driven uncertainty risk premium needs to abate for AXJ to find durable traction**.

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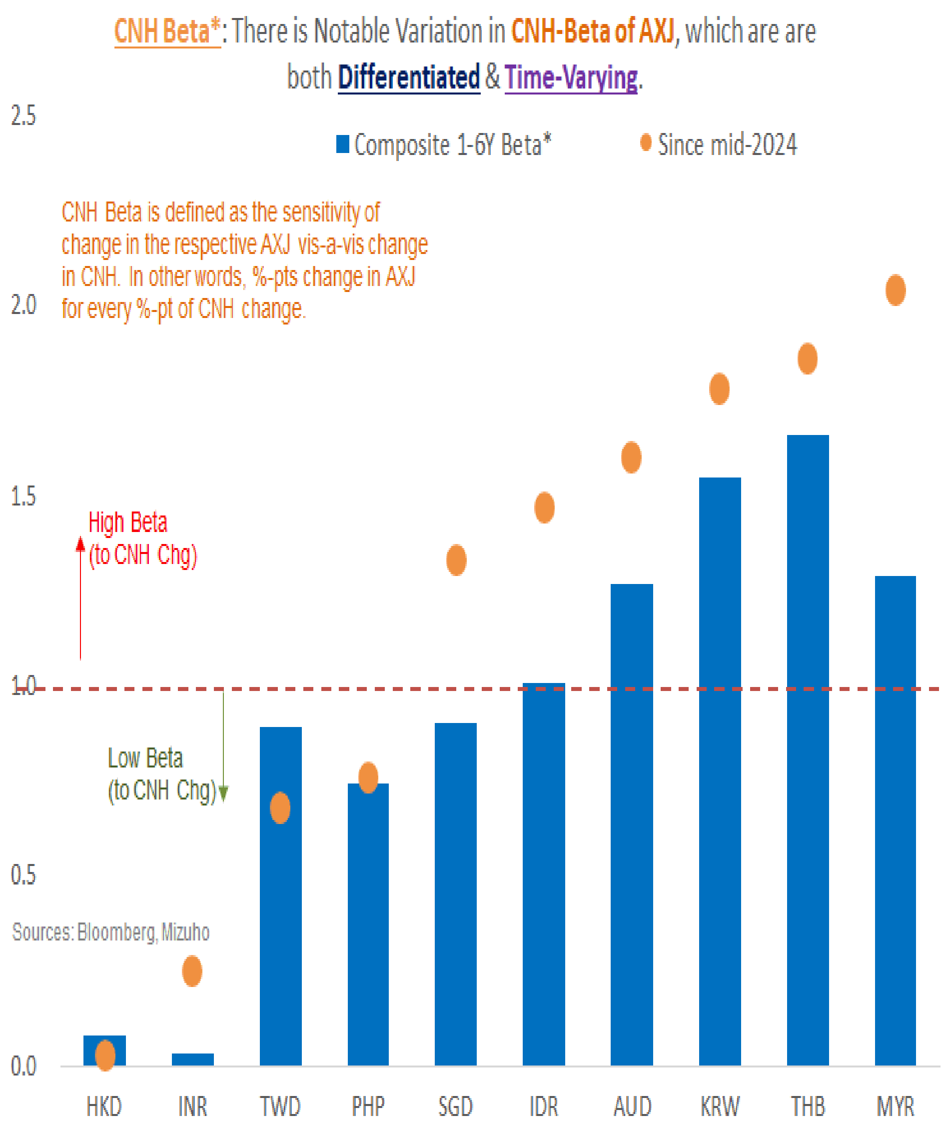
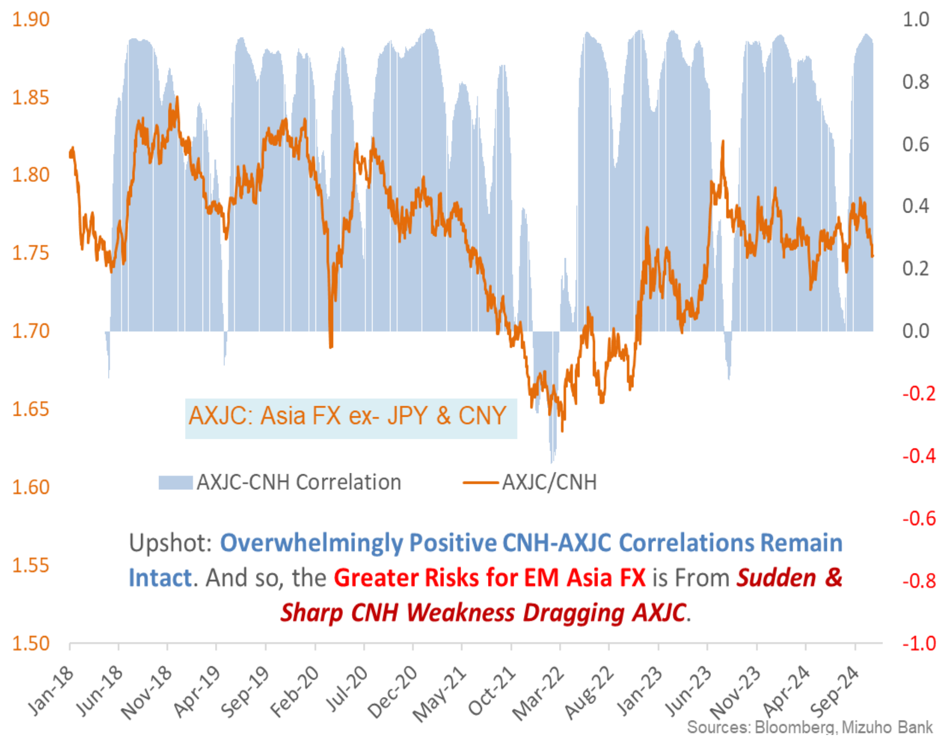
8b (ii). FX - CNH Beta: Expect AXJ Volatilities to be Heightened & Fluid





- Triggers & Transmission: But **averting direct confrontation is no real comfort**, given various transmission channels of shocks from global trade upheaval. Most conspicuous are **CNY ripples** owed to *sweeping and inextricable linkages with China*. **Spill-over EUR drag**, should Trump make good EZ tariff threats, is another channel. And transmissions from **indirect commodity shocks** could also show up.

- With "Beta" Discrimination: And this so-called **"beta"** (sensitivity to) **will vary across AXJ**. **Commodity beta** *variations even more stark across producers and importers* Notably **"CNY beta"**, will be *differentiated for trade/investment/ geo-political exposure*. In fact, some **AXJ may exceed corresponding CNY losses**.

- Devil in the Dynamic Details: Notably, **commodity FX** (AUD, IDR.) may **far more sensitive to onshore China stimulus triggers**. And the **trade sensitivities in other supply-chain reliant AXJ** may be further differentiated. ***Upstream trade assaults***, which restrict China's technology access are likely to adversely impact KRW, TWD and JPY most. Whereas downstream impact flows more to ASEAN FX (e.g. THB, MYR).

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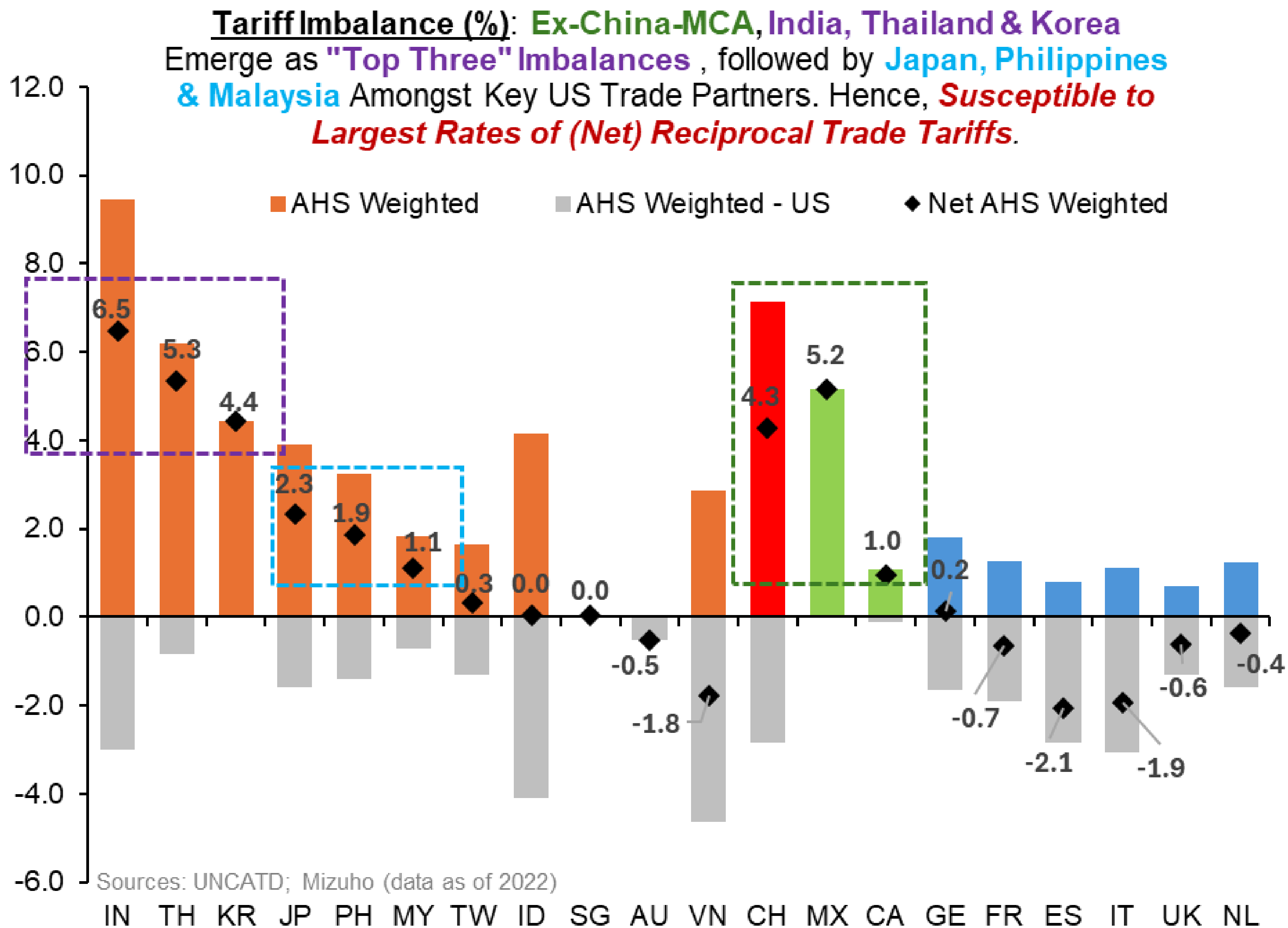
Reciprocal Tariffs: Silver-Lining of Dial-Back Potential Supplanted by "Liberation" Shock



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USD Policy Tensions ➔ Soft-Landing for USD ➔ Cool, Not Crash