Tariffs: Tyranny of "Liberation"

Assessing Threats & Anticipating Turmoil

"Losing all hope was freedom."

- Fight Club

He that breaks a thing to find out what it is, has left the path of wisdom."

— Gandalf

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

May 2025

False Dichotomies & Persistent Threats – Disturbance, Disruptions & Departures

The (False) Deal Dichotomy:

Trump has global economies fixated on striking a deal, in desperate hopes of averting US trade tariffs. So, "deal" or "no deal" has become the misguided dichotomy of risk sentiments. This is but a tragic distraction from the inevitability of geoeconomic turbulence ahead. The deals are meant to divide, disorientate and fragment. Not provide a resolution for a resumption of global commerce as the world knew it. In which case, industries will invariably be adversely impacted. Supply chains will be disrupted. Margins will be battered. And financial markets will be forced to re-price risks.

Dealing with (US-China Geoeconomic) War:

Whereas the "real deal" is that the (US-China geoeconomic) war will remain unresolved, with the negative spill-overs likely to overwhelm any trade deal relief. Point being, the US deems;

i) unilateral redefinition of the global order as the only means for the US to secure the upper hand against China and;

ii) dire economic, geo-political and environmental consequences merely the necessary cost of ensuring US supremacy.

Crucially, this cost (economic or geopolitical) will be imposed on the rest of the world. Geo-economic shocks of this order inevitably trigger;

a) major **disturbance** *in the flow, allocation and cost of capital;*

b) Involving **disruptions** in *global trade/industry* and;

c) Consequent **departures** from known *geopolitical, economic & market dynamics* and associated correlations.

FX: Brace for Shocks:

Elevated uncertainty entails greater two-way volatility hinging on a cascade of acute headline risks. Non-linearity of FX dynamic and rapid shifts in correlations accentuate vulnerabilities and amplify pain *if markets are caught wrong-footed*. Moreover, a dynamic re-ordering of haven asset allure that stress-tested USD and USTs enlarges the threat of abrupt inflections/"level shocks". What's more, **mounting JPY tensions** from **evolving BoJ-haven-trade dynamics** and **sharp CNH trade-offs** (conflicting trade and geopolitical objectives) may **spillover as latent AXJ shocks**.

Softer, But Steeper Rates:

Softer front-end rates are underpinned by growing dovish bets, edging out "higher for longer" narrative at the margin as overriding adverse demand shocks from tariffs are more widely conceded. In addition, significantly and structurally higher term premium, reflecting the new geo-economic realities, is also par for the course. But that said, sharp lurches in US fiscal-tariff balance is likely to accentuate two-way, long-end volatility. In Asia, more pronounced term and risk premia, from inherited UST dynamics rubbing off and inflict6ed US risks rubbing the wrong way.

"Without pain, without sacrifice, we would have nothing."

– Fight Club

Trump 2.0 Tariffs - Threats & Turmoil

1. **Tariff Shock & Psyche**
   - Strategic Ambiguity or Just Chaos?
   - Divide & Rule?

2. **Disruption Or Deal?**
   - What does the US want?
   - Who's most at risk?

3. **Beyond Trade: Bringing a Trade Knife to a Geo-Economic Gun Fight**
   - The Security Angle
   - Baby (Exorbitant Privilege) Not Bathwater (Shared Burden)

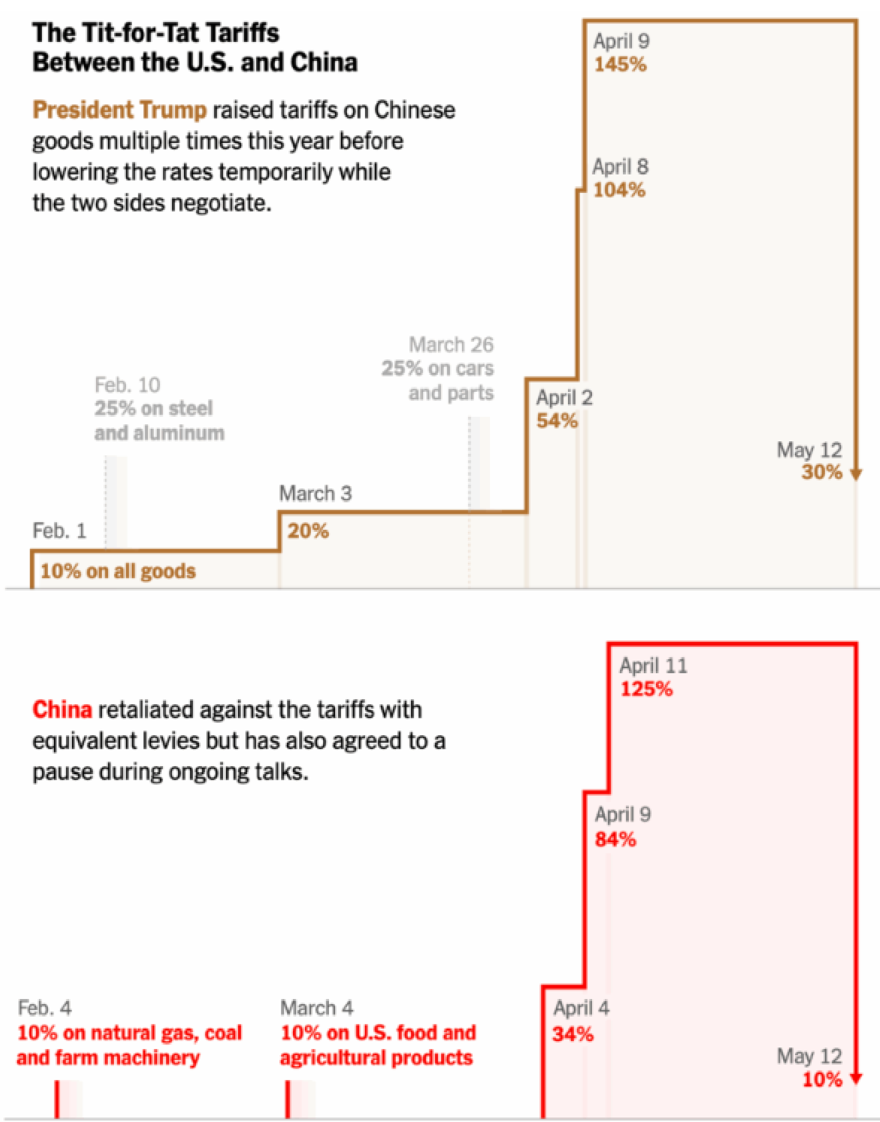
4. **Fragmentation Risks**
   - US-China Geoeconomic Polarization Matter of Degree
   - Consequent Global Divergences

5. **Market Outcomes**
   - USD: Exaggerated Risks
   - Confounding Correlations
   - CNH Taking Cover & AXJ Assuming Structural Vulnerabilities

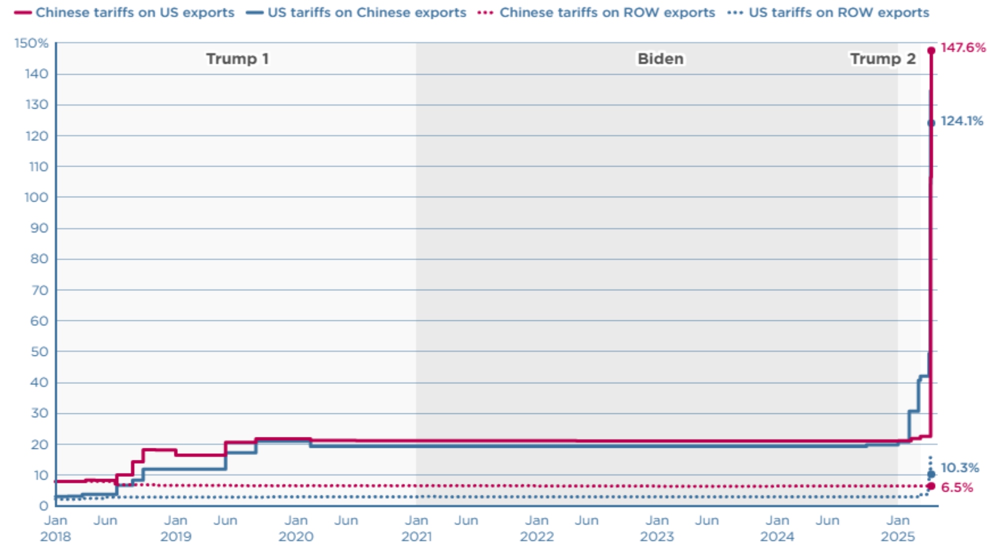
1. Tariff: Underlying Turbulence, Not Lasting Truce

> "Great, kid, don't get cocky."
> —Han Solo, Star Wars: *A New Hope*

Tariff timeline with China, so far



a. US-China tariff rates toward each other and rest of world (ROW)



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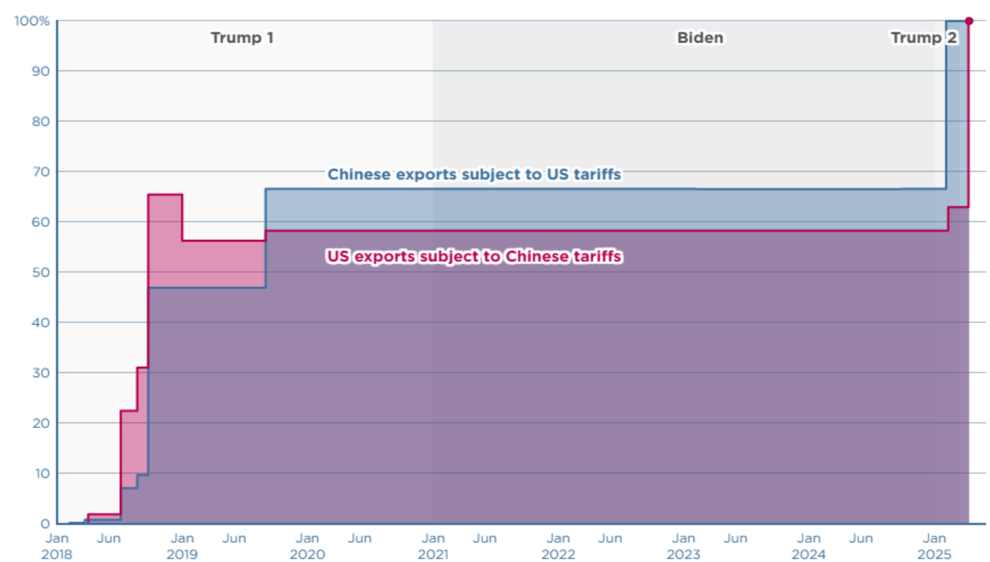
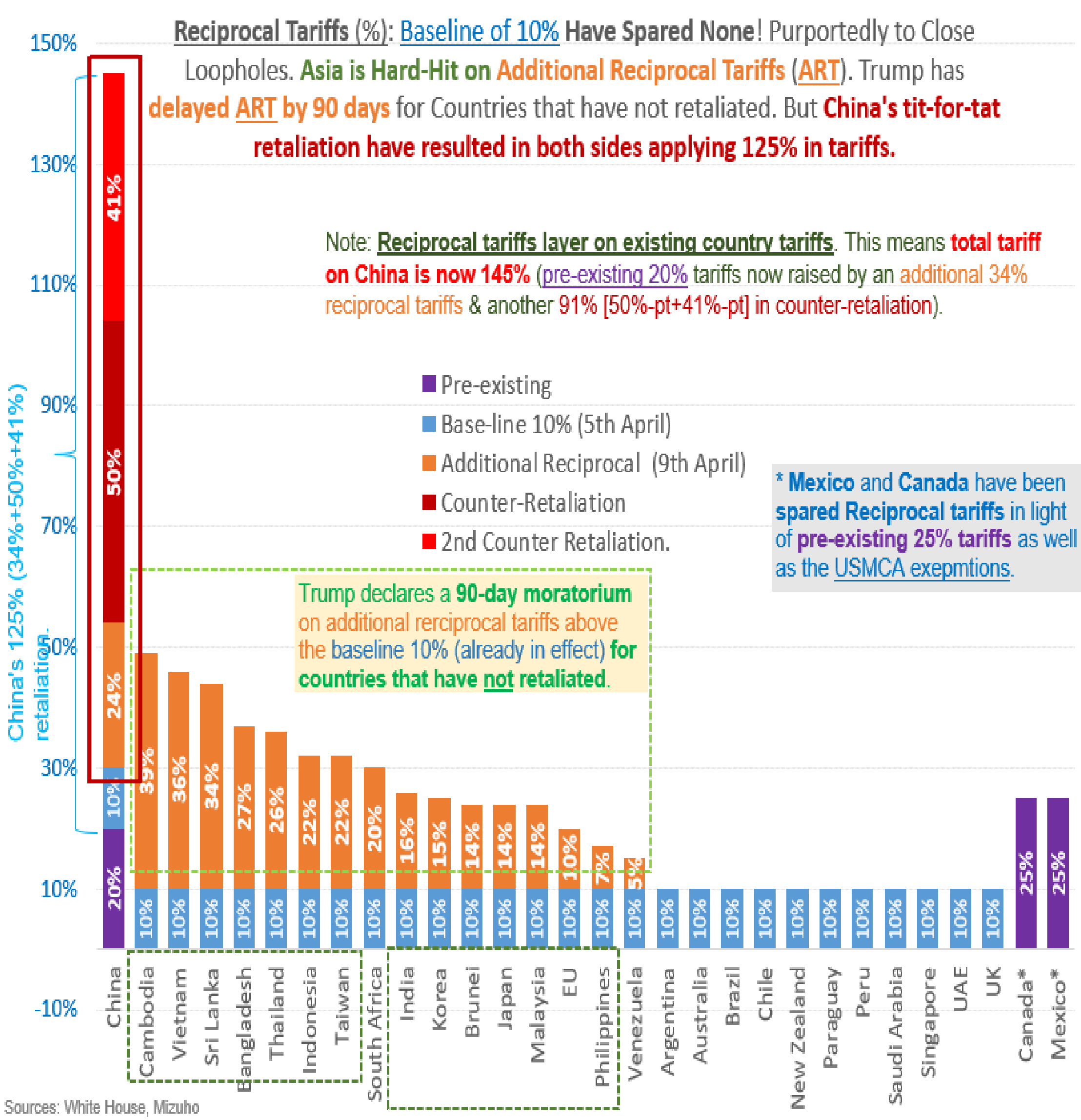
b. Percent of US-China trade subject to trade war tariffs



1. Tariffs: US-China Reprieve, Not Resolution

> *"Great warrior. Wars not make one great."*
> – **Master Yoda, Star Wars**

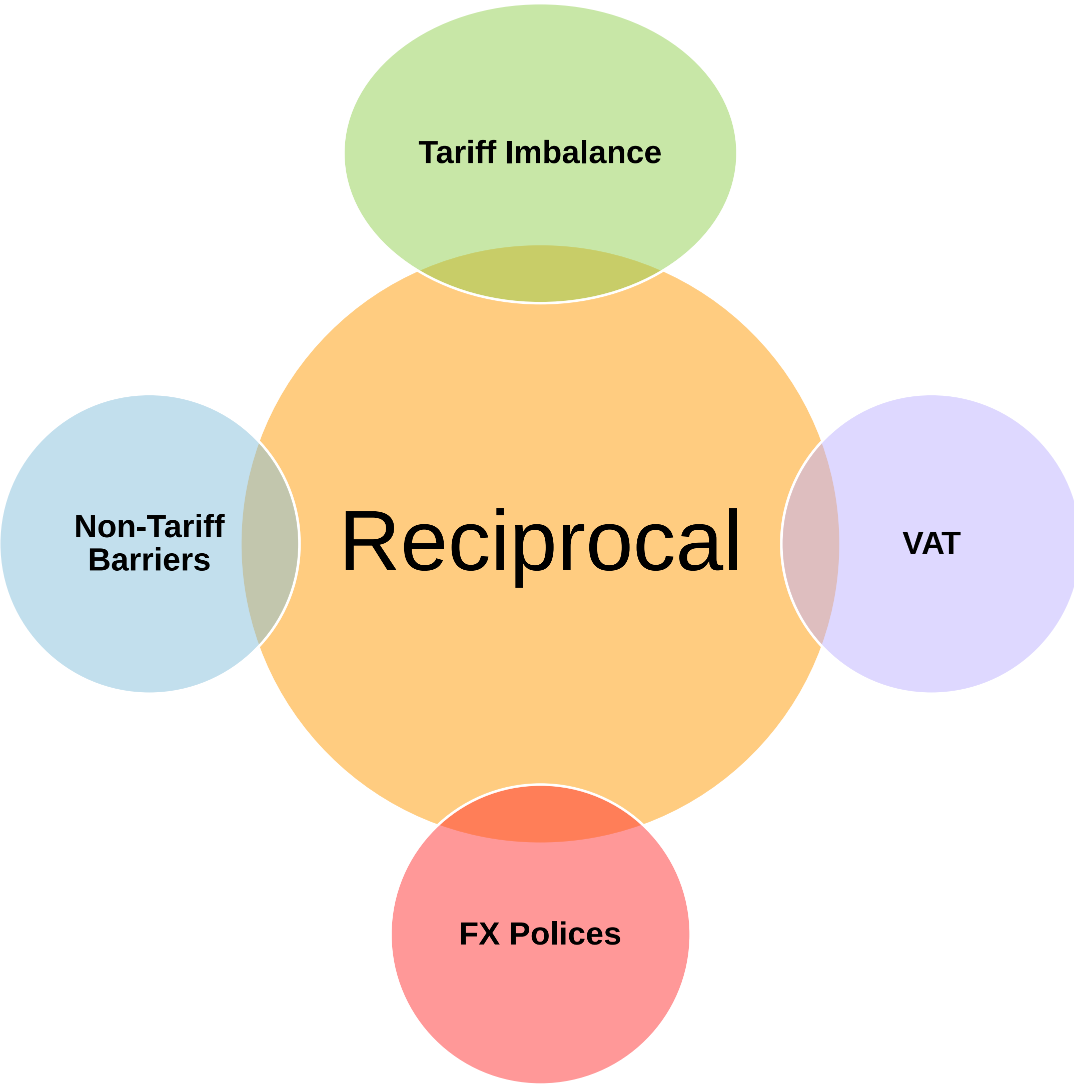


Sources: White House, Mizuho

- **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**.
- US-China Temporary Relief: *While it is encouraging that US & China have agreed to **de-escalate (by 125%-pts)**, it is **premature to declare a resolution**. Negotiations are set to be tough. Both sides subject to miscalculations. US' overestimation of leverage is worrying.*

1. "Reciprocal" Ideology Complex by Nature

"In a dark place we find ourselves, and a little more knowledge lights our way."
– **Master Yoda, Star Wars**



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%

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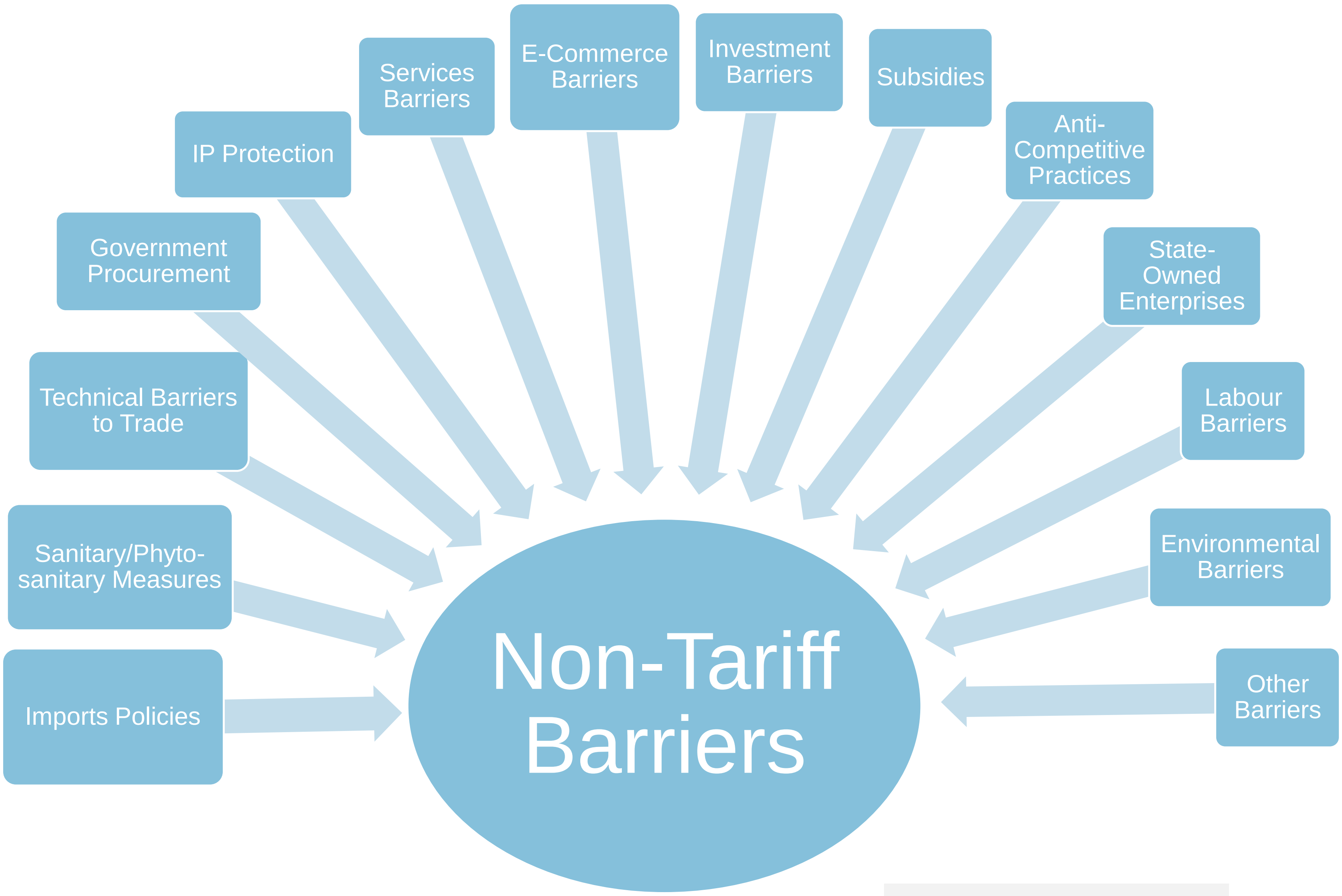
1. Obfuscated/Obstructed by a Plethora of Hard-to-Quantify Considerations



"Never tell me the odds"
– Han Solo, Star Wars

1-2. Trump 2.0 Tariffs: Multi-Dimensional Uncertainty & Execution Risks

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

Tariffs

Escalation Deterrence

Execution Risk

Sectoral
-Steel
- Aluminum
- Autos
- Pharma
- Chips

Non-Trade
- Fentanyl
- Illegal Immigrants

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

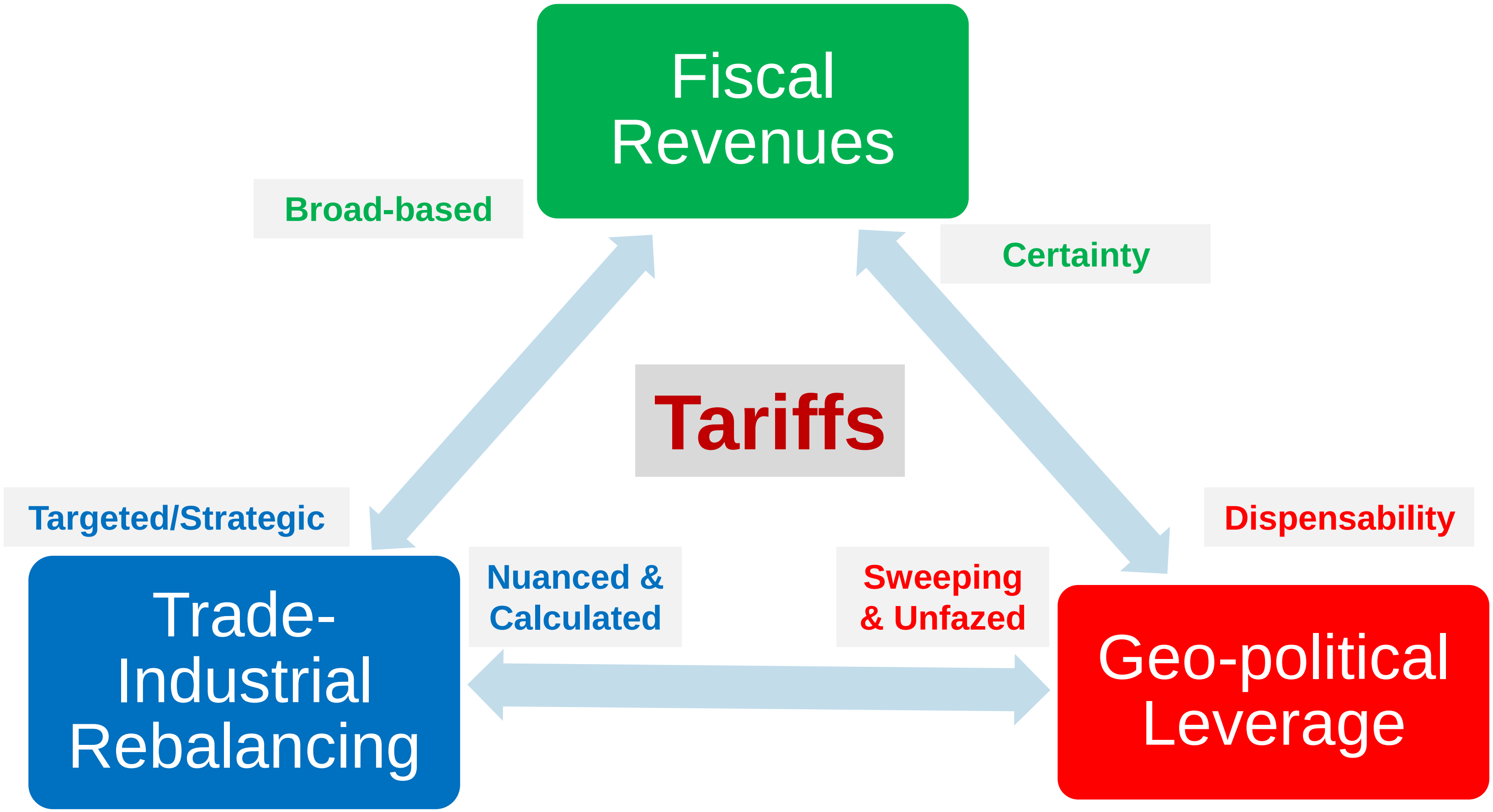
"Escalation Deterrence"

- **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**.
- Upshot: **"Escalation deterrence" is a reckless game for the US to play**.

"The dark side clouds everything. Impossible to see, the future is."
– **Master Yoda, Star Wars**

2. The Impossible Trinity of Trump Tariffs

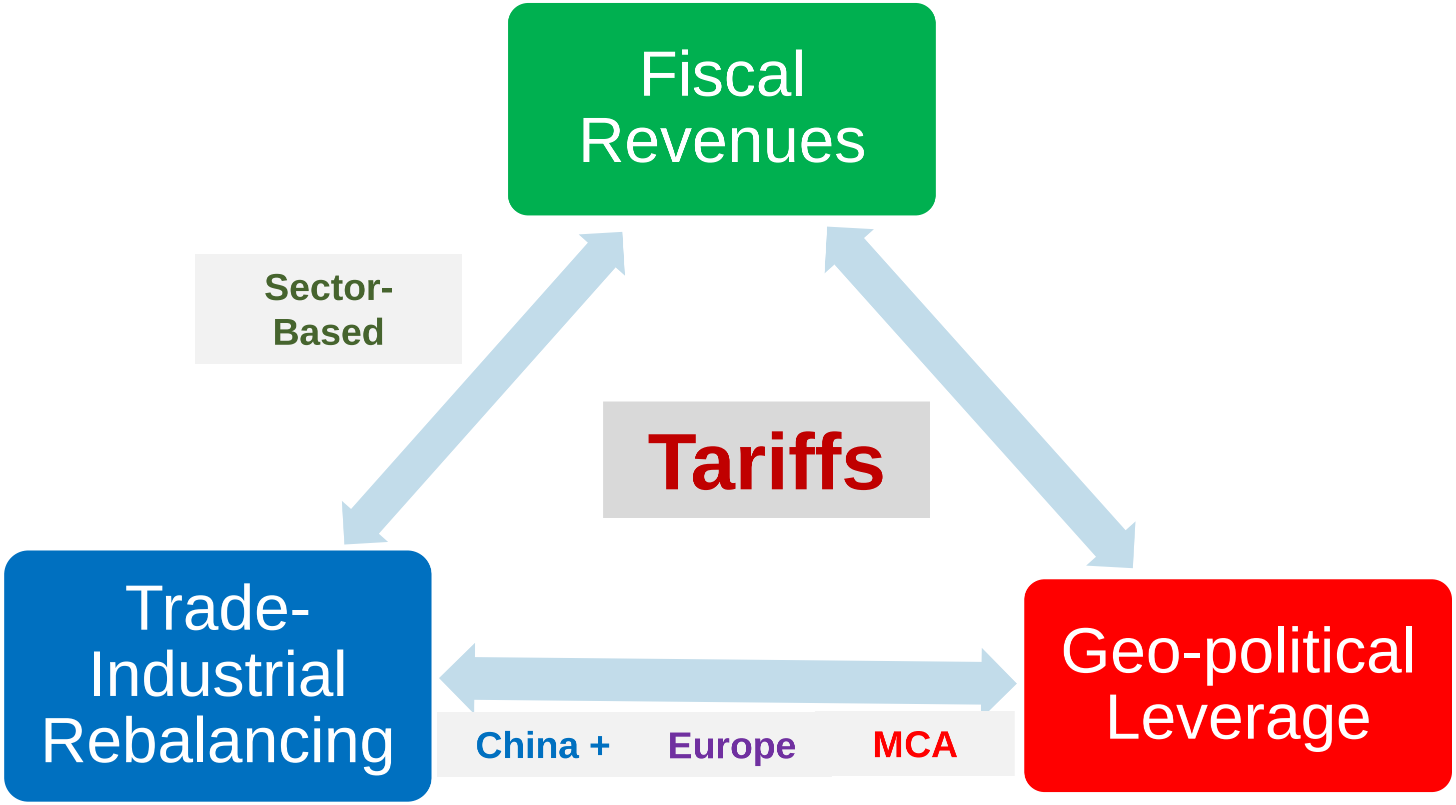
> "How puzzling all these changes are! I'm never sure what I'm going to be, from one minute to another."
> – Alice's Adventures in Wonderland



- 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**.

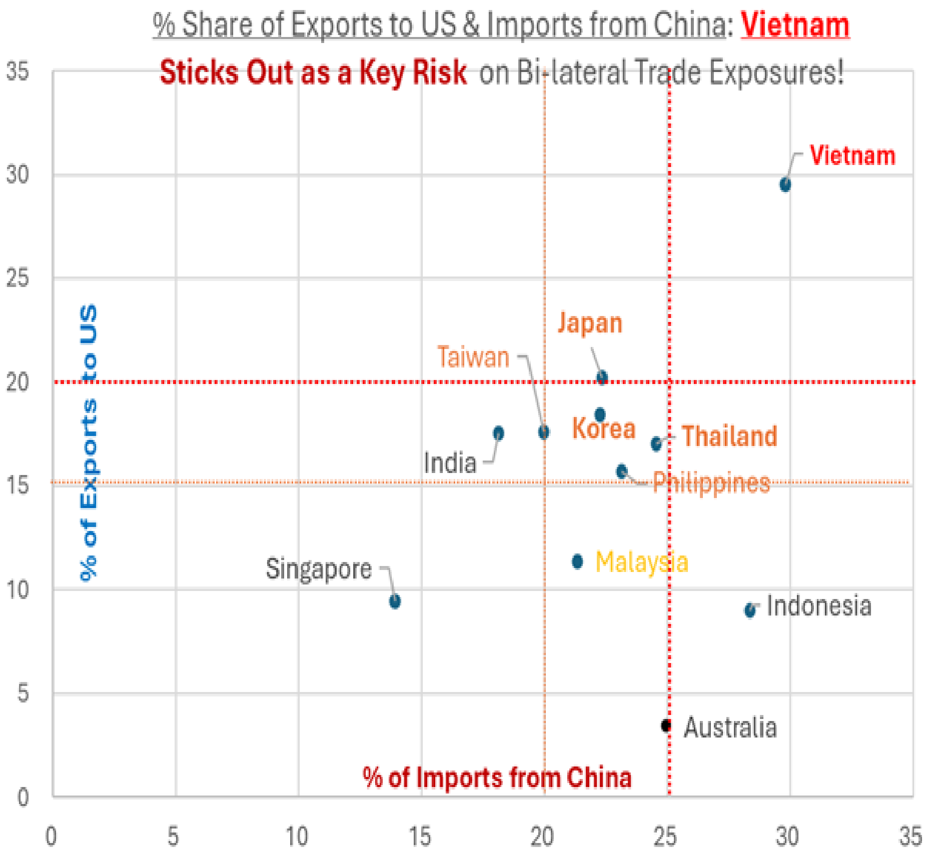
2. & the Asymmetric Inclinations *Tilted Against China+*

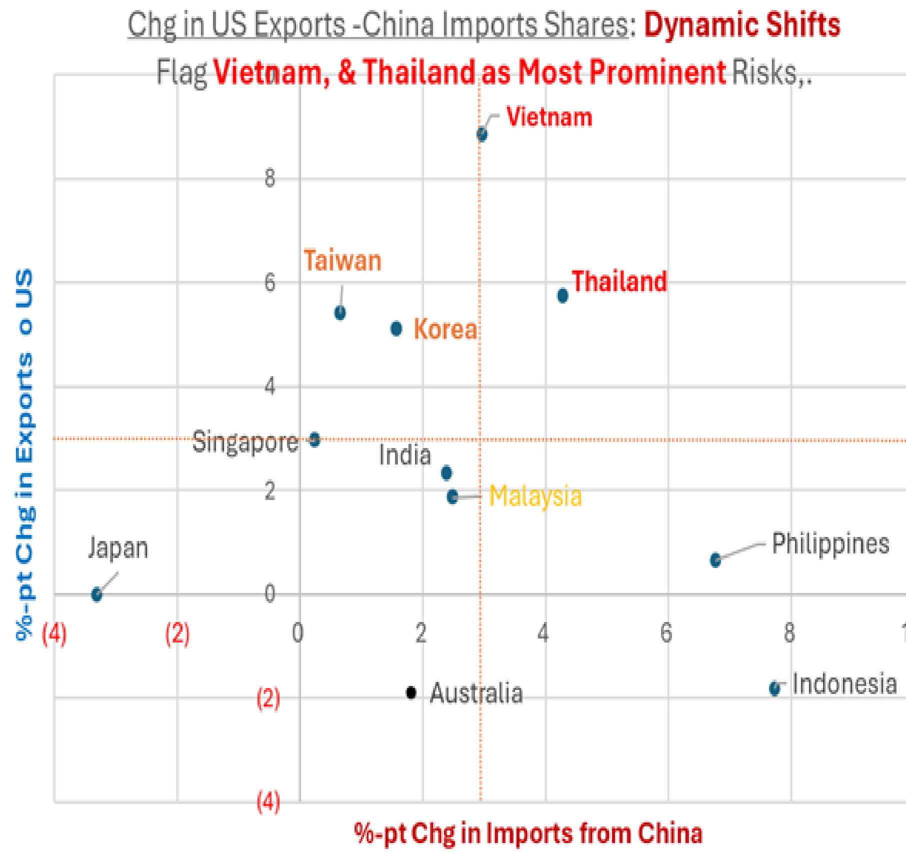
> *"Named must your fear be before banish it you can."*
> – **Master Yoda, Star Wars**



- 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.

2. Tariff Risks: China-Linked Risks Elsewhere Not Eradicated





ASEAN Risk Determination

Enabler of China — Trade Risks Escalate

Substitute for China — Trade Risks Subside

"The probability lies in that direction."
– Sherlock Holmes

3. 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 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.

^ 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***.

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

"When you look at the dark side, careful you must be, for the dark side looks back."
– **Master Yoda, Star Wars**

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]

3. 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.

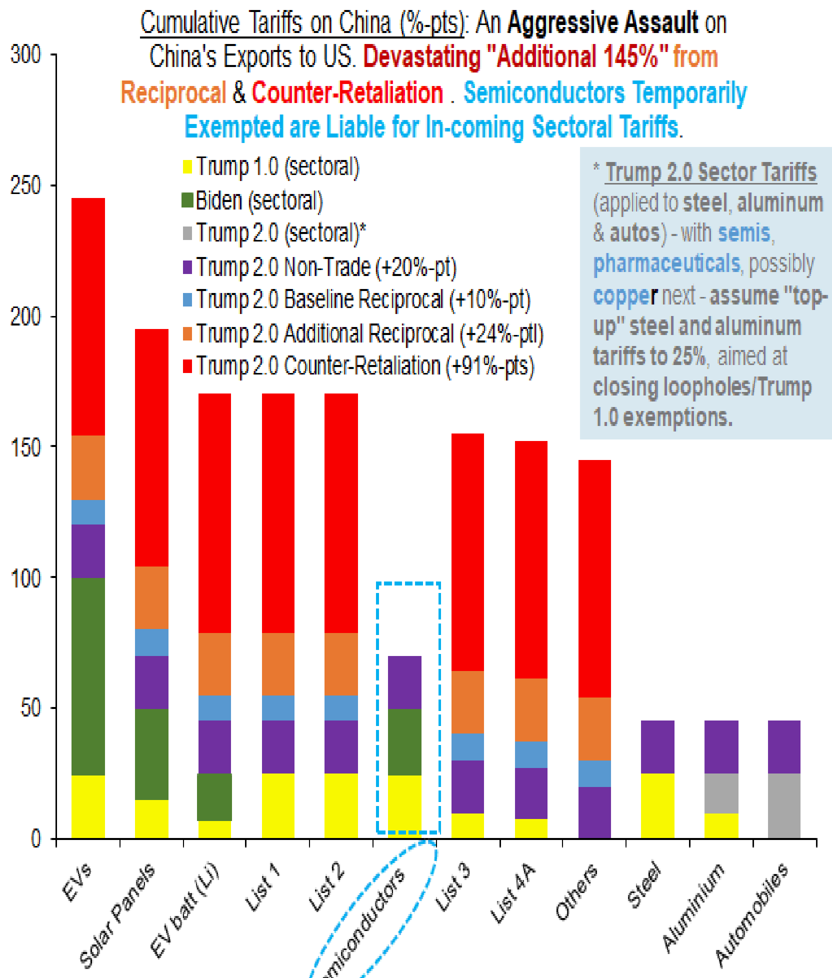
3) Tariffs are a tool for negotiating leverage as much as for revenue and fairness. Tariffs will likely precede any shift to soft dollar policy that requires cooperation from trade partners for implementation, since the terms of any agreement will be more beneficial if the United States has more negotiating 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.

> "The world is indeed full of peril, and in it there are many dark places."
> **– Lord of the Rings**

4. US-China Risks Could Splinter Global Trade



Sources: US Trade Rep; Mizuho estimates

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. And now Note that we did not single out the exceptions, if any, from Lists

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 91% duties on Chinese goods.**

"Move not unless you see an advantage; use not your troops unless there is something to be gained; fight not unless the position is critical." – **Sun Tzu, The Art of War**

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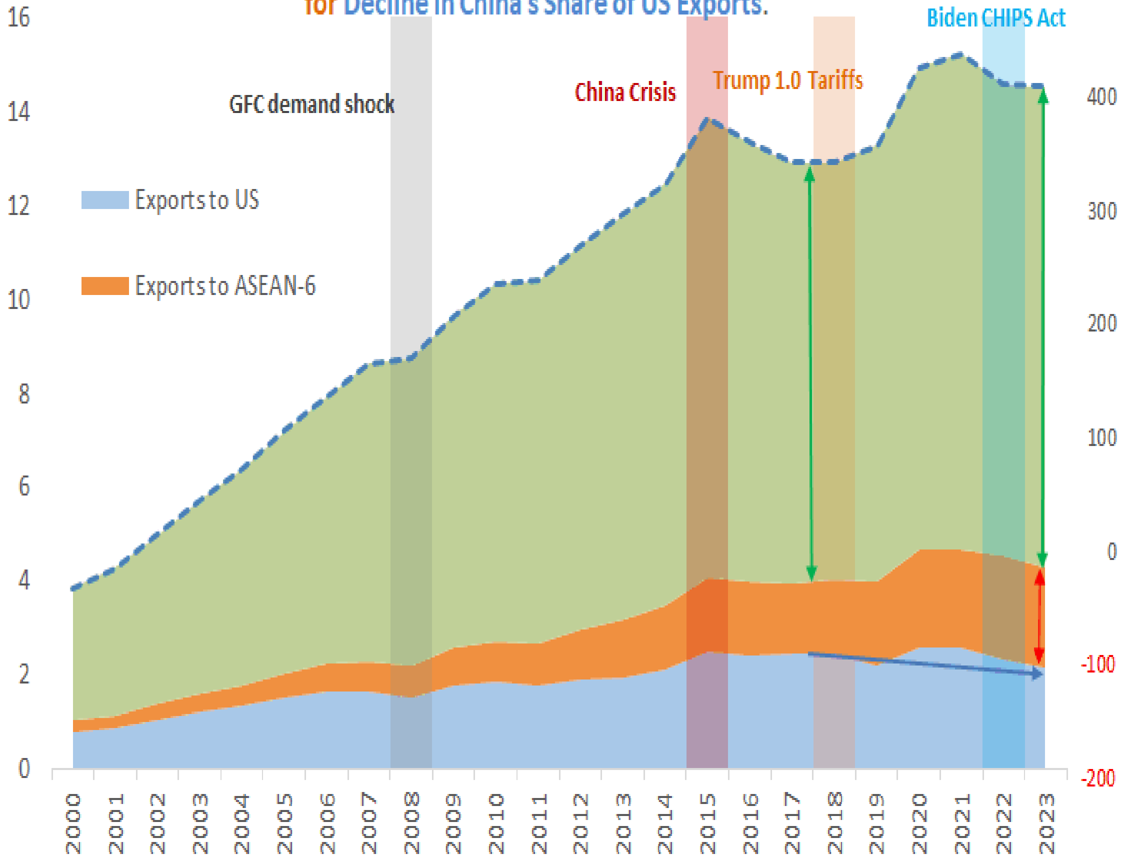
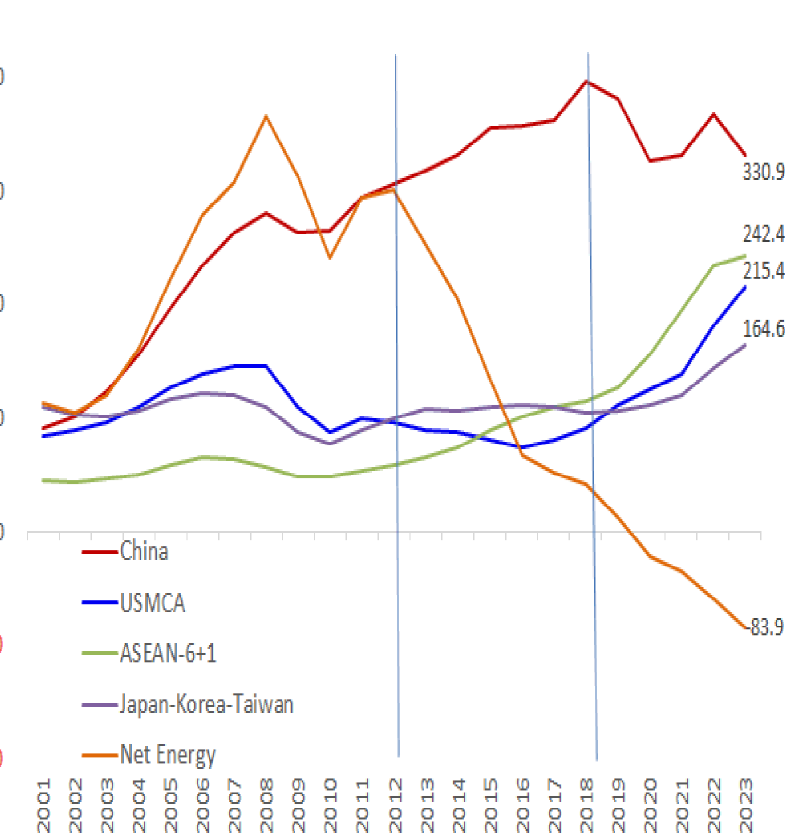
4. US-China Fragmentation Could Force Dislocations

"You will only find what you bring in."
- Master Yoda, Star Wars

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.



US Bi-lateral Trade Deficit

ZSG: Zero Sum Game

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

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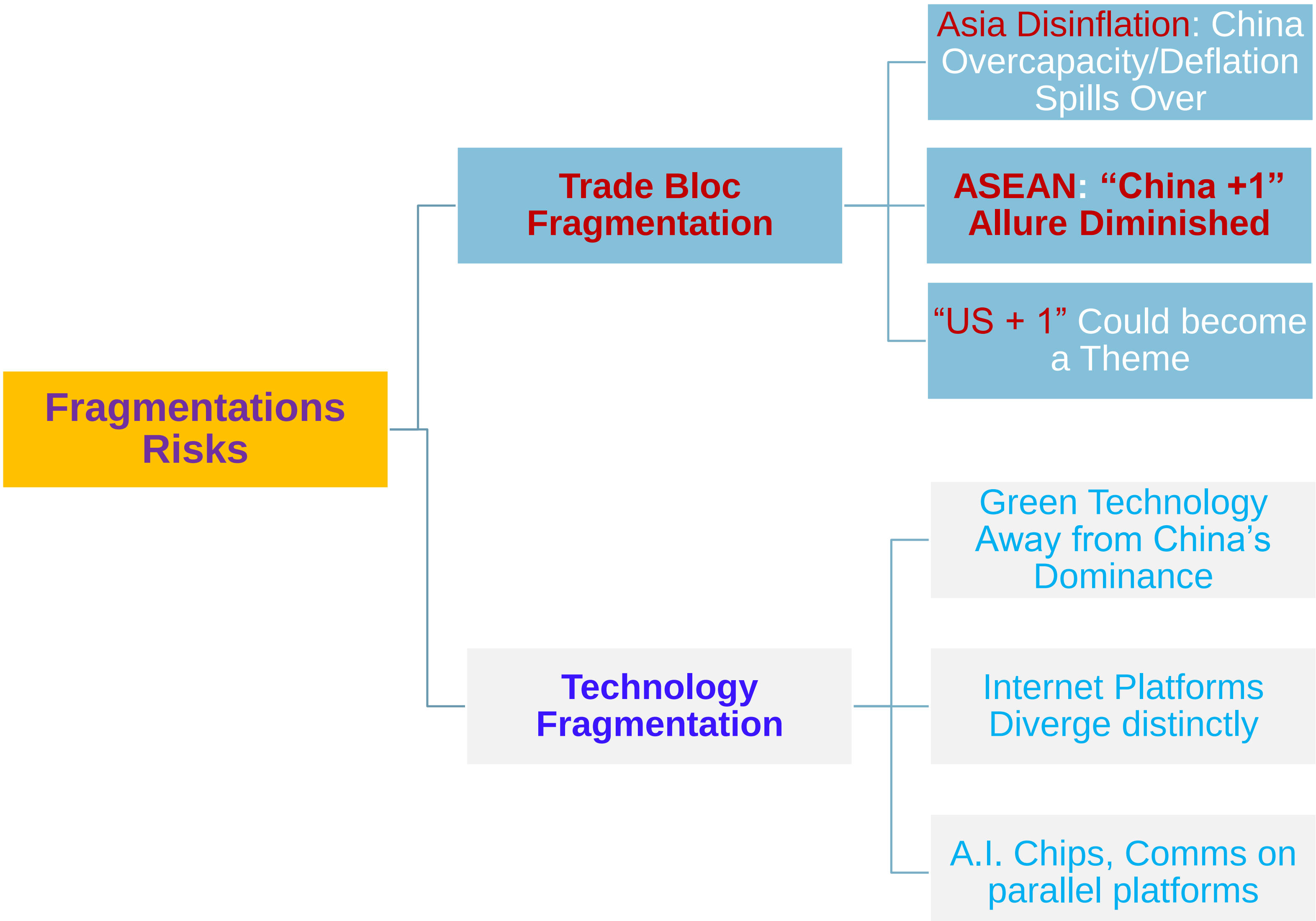
4. Key Fragmentation Outcomes

> *"Once you start down the dark path, forever will it dominate your destiny. Consume you, it will."*
> **- Master Yoda, Star Wars**



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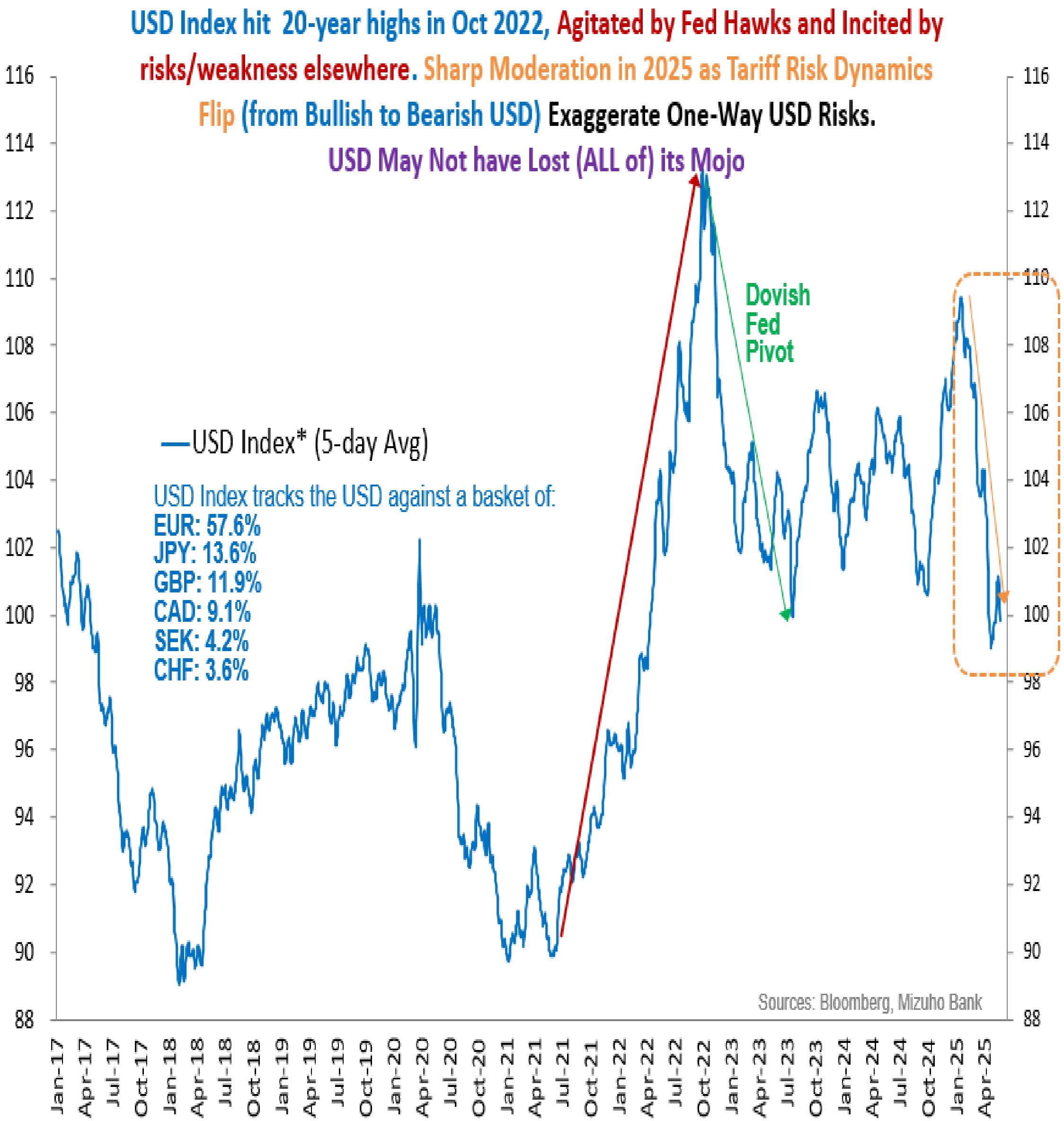
USD: Demise (De-Dollarization) Exaggerated?

> *"Reports of my death are greatly exaggerated."*
> **– Mark Twain**



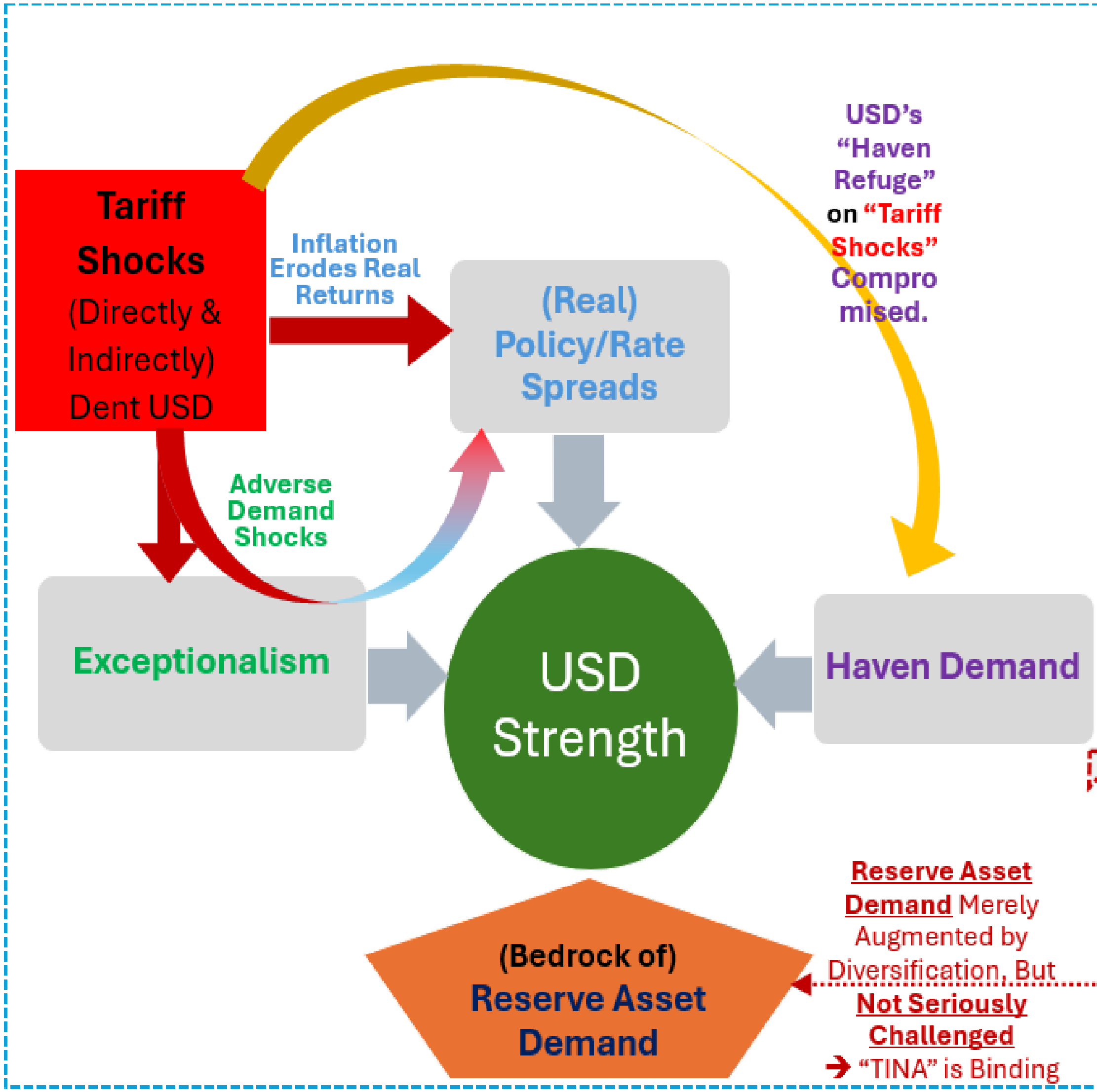
USD: Doubt, Not Demise

- **USD's exceptional plunge** mainly reflects *abrupt & upfront* **macro doubts** on tariff shocks.
- **Not an imminent demise of USD's reserve currency status** that portends a collapse.
- **Stretched bullish USD positioning earlier** had **exaggerated the intensity of USD bearishness**.
- More so given aggressively **front-loaded, tariff blowback shocks** (detrimental to USD) **accentuated by overturned haven allure**.
- But it's **misguided** to **project a linear USD depreciation** based off current pace of travel.
  - Measured DXY Declines: Instead, a measured **USD level shock shifting near-term equilibrium lower** (~96-98 DXY center-of-gravity) is more likely.
  - Lagged, Phased, Incomplete CNH Gains: **Lagged**, **phased** and **incomplete CNH catch-up** ***corresponding to USD declines*** is **likely as US-China "deal" emerges**.
  - Exploiting Convenient Policy Buffer: But for now, **expect the PBoC to exploit** ***cover of a weak USD*** to derive relief via **considerably weaker trade-weighted CNH** amid trade headwinds.
  - Relative CNH & AXJ Underperformance: In other words, **CNH is set to continue under-performing most Major FX** amid a softer USD. And **AXJ are likely to follow suit** as *trade bugbear impacts Asia disproportionately*.

5. USD's "Trump Trade" Reversals Confuse Correlations

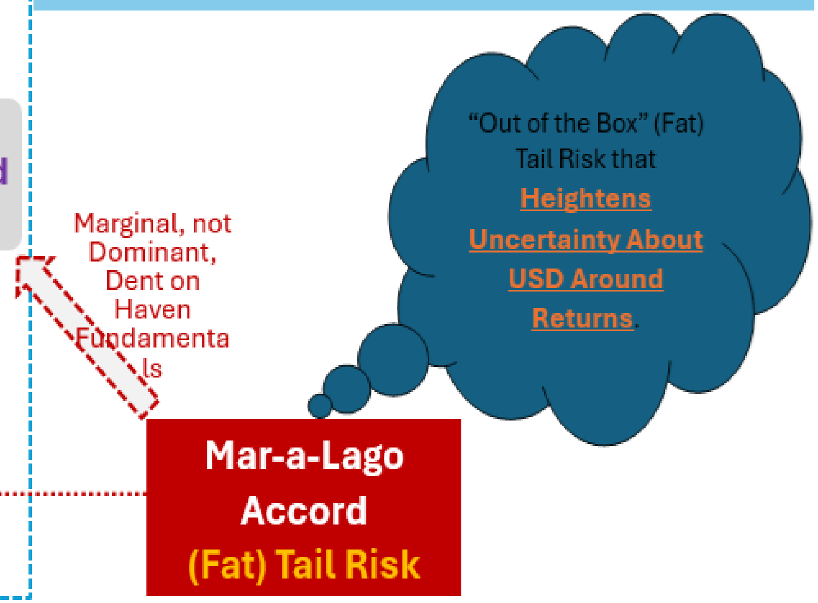
> "I find your lack of faith disturbing."
> - Darth Vader, Star Wars: A New Hope

Figure 1. Tariff Shocks Compromise USD Via Exceptionalism, Policy/Rates Spreads & Haven Demand



Mar-a-Lago Accord in a Nutshell:

- The so-called **Mar-a-Lago Accord (MAL)** refers to US plans (mostly unilateral) **to extract a price** (for military security and provision of reserve assets) **from trading-/security-partners**.
- Specifically, to **share the "exorbitant burden"** of a chronically overvalued USD from reserve asset demand, but without forsaking the "exorbitant privilege" of USD as the global reserve currency.
- **Tariffs subsequently tied back to the US security umbrella** is only the **initial phase of MAL**.
- *Further down the line,* **discriminated haircuts on interest paid on** (returns from) **foreign holdings USD reserve assets** line.



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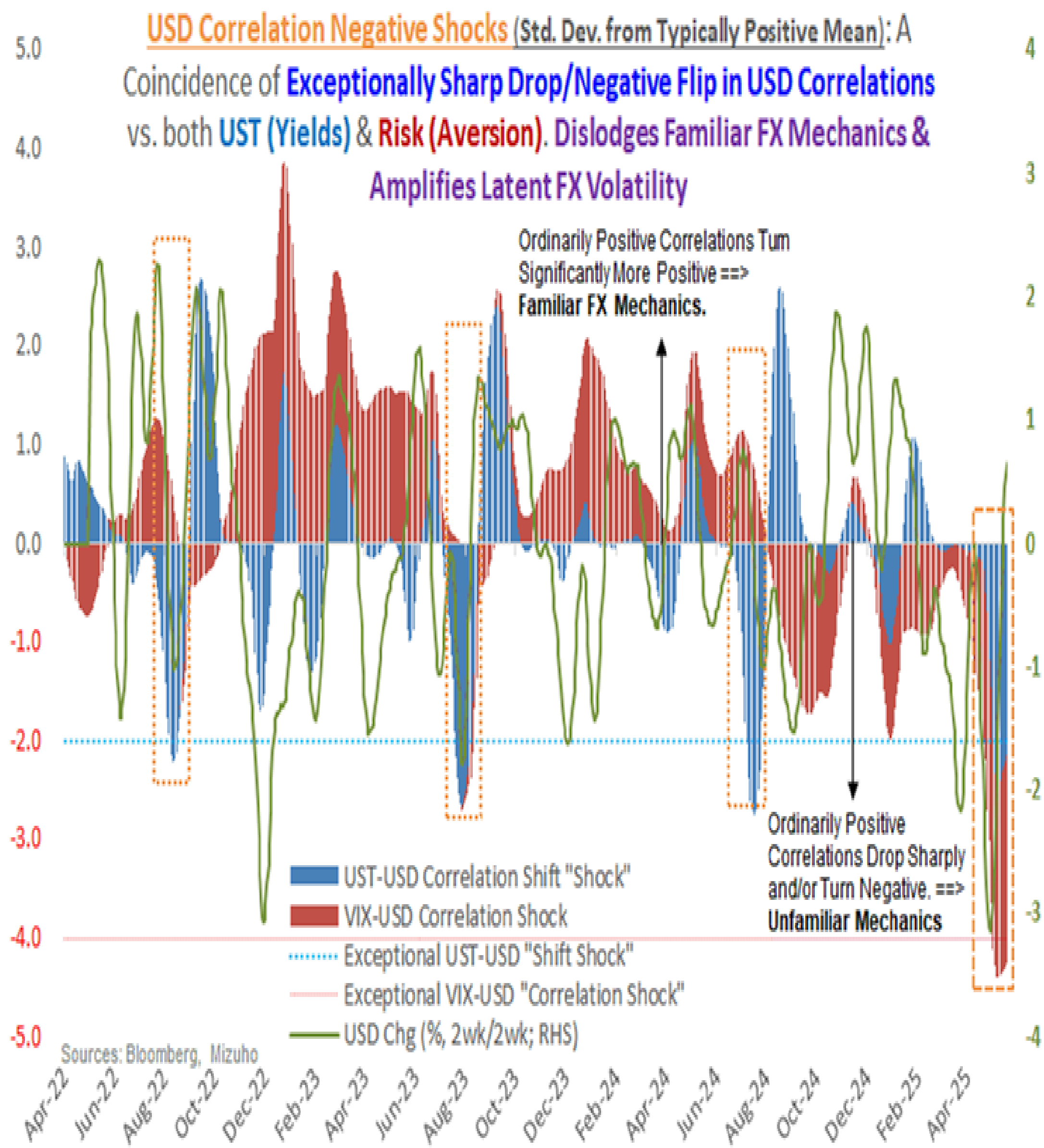
5. USD's "Trump Trade" Reversals Confuse Correlations

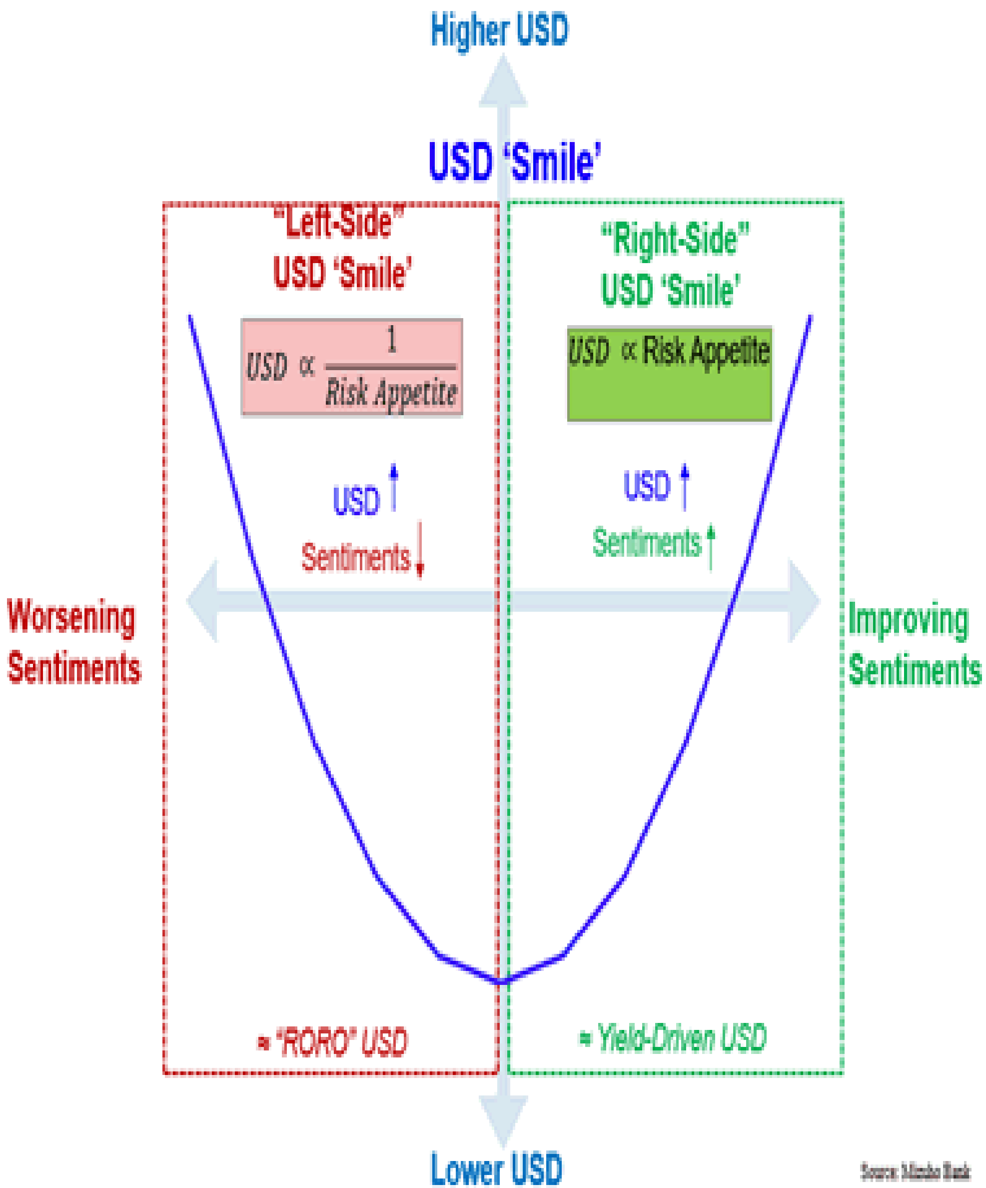
"I'm afraid I can't explain myself, sir. Because I am not myself, you see?"
– Alice in Wonderland

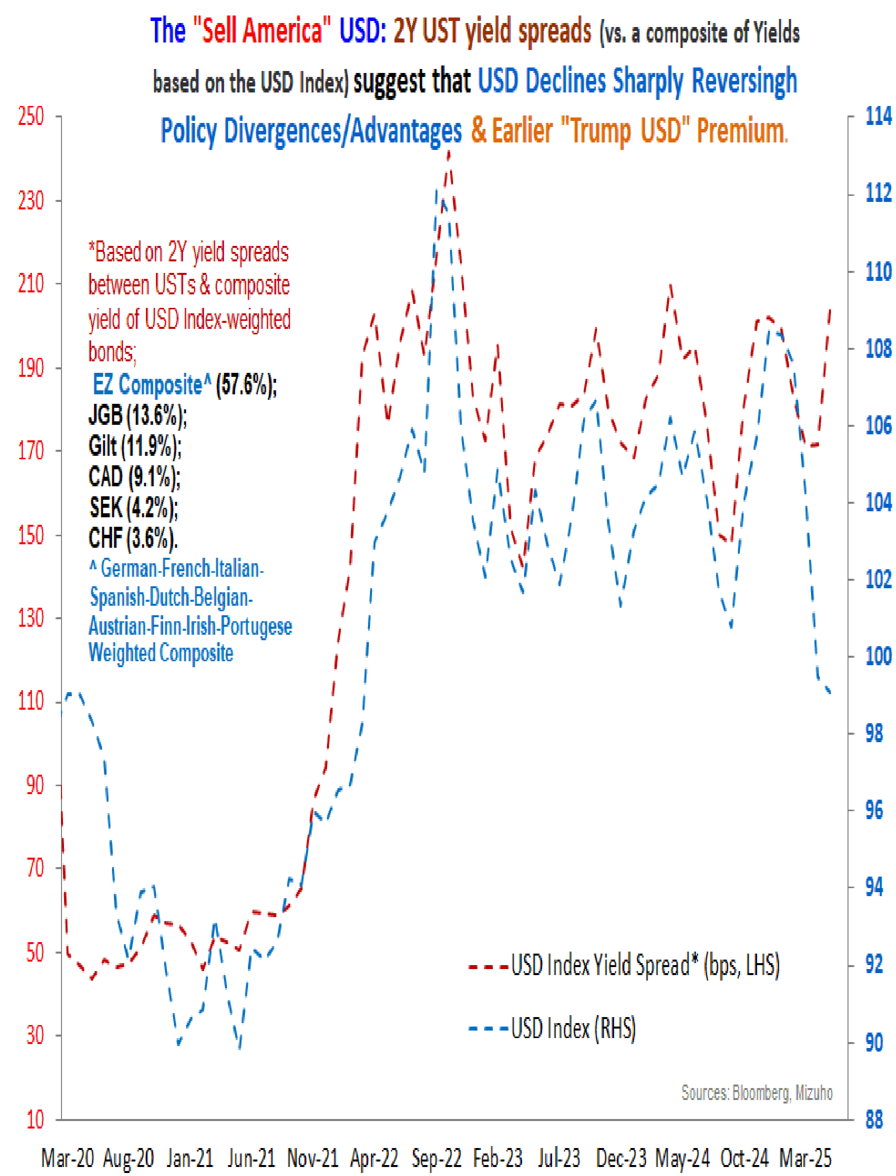


- **Exceptional departures from well-established USD correlation dynamics warn of elevated unpredictability** that has become ***inconspicuously embedded*** **in FX markets**.
- Specifically, **exceptional in the *momentum* and *degree* of correlation shifts**. That reveal **extraordinarily stretched standard deviations** in USD correlations.
- Specifically, **magnitude** and **coincidence** of excessive (>2 standard deviation) decline in both change in UST-USD correlation and VIX-USD correlation.
- implications are that; 1)USD has decoupled, and *unpredictably so*, from (UST) yield-driven moves; 2)USD's haven allure has weakened dramatically, **arresting received wisdom about buying USD (vis-à-vis EM FX) into "risk off" triggers.**
- **Greenback may be less reliably predicted by both rates** (long-end UST yields) **and risk**. Resulting unfamiliarity of FX mechanics inevitably **elevates unpredictability in FX markets**.
- This in turn *sets the stage for outbursts of latent* (currently subdued) *volatility.*
- Notably, what's **at risk is the remarkable (and unexpected) stability of AXJ through turbulent tariff headlines in the cover of a bearish USD *dissociated from haven allure and higher UST yields*.**
- Hence, **risks of sharp downside volatility in AXJ cannot be dismissed prematurely**. Neither on complacency about resilience thus far (which is **distorted by correlation departures**), nor on account of US-China tariff relief that falls woefully short of a durable resolution.

5. Wiping Off the "USD Smile"?

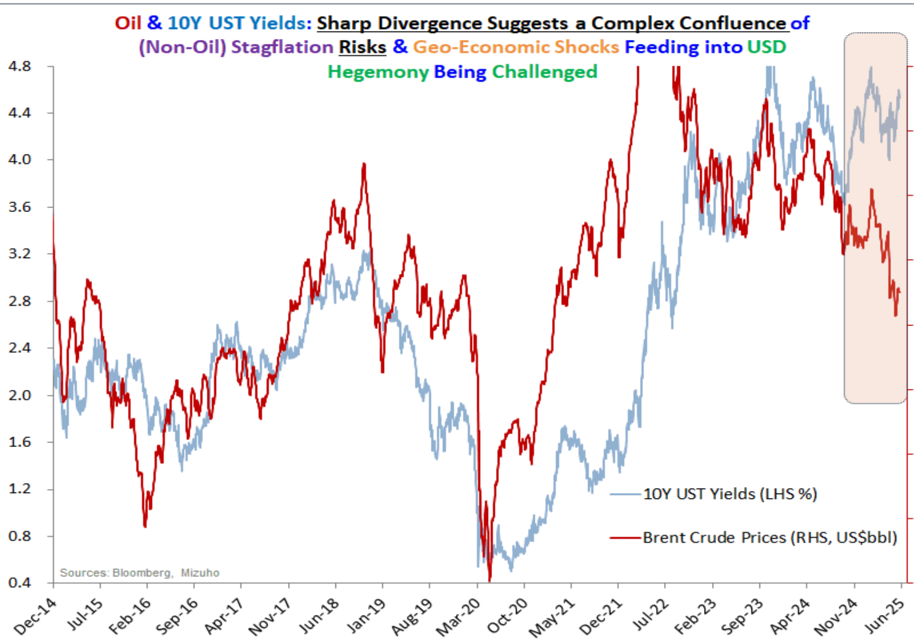
> "I love those who can smile in trouble ..."
> – Leonardo Da Vinci

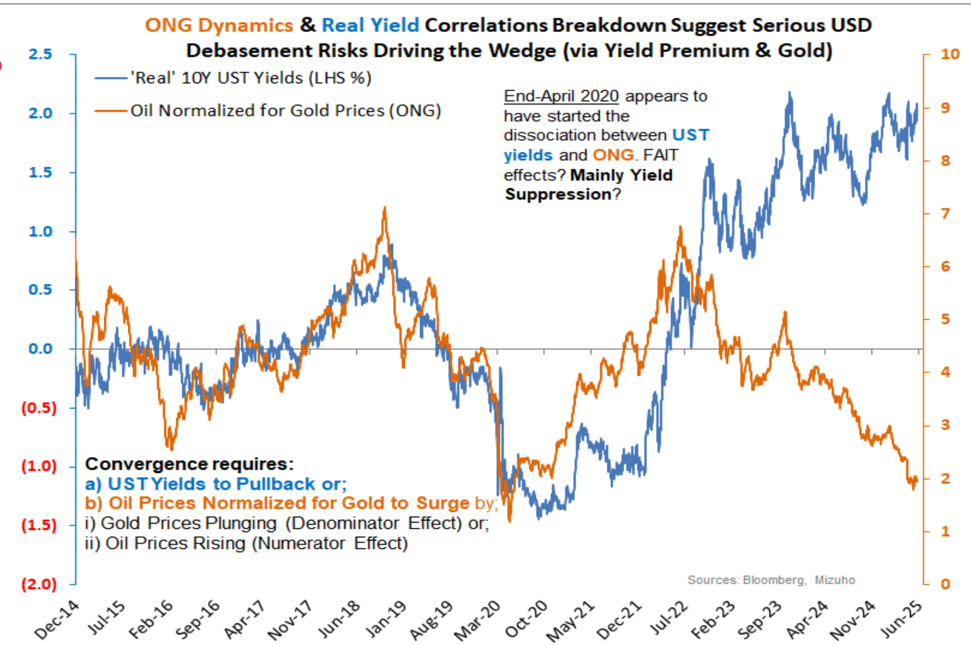


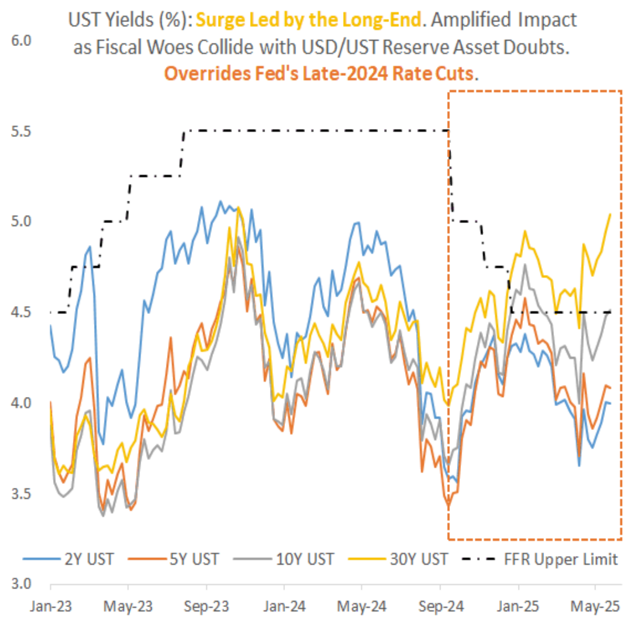


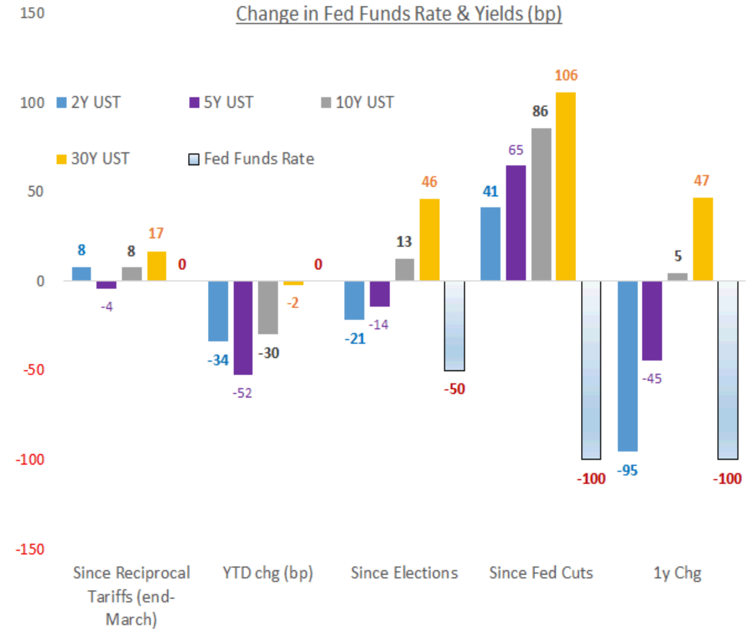
5. UST Yield-Oil/Fed Departure on Debasement Risks?

> "To a dark place this line of thought will carry us. Hmm. Great care we must take."
> – **Master Yoda, Star Wars**









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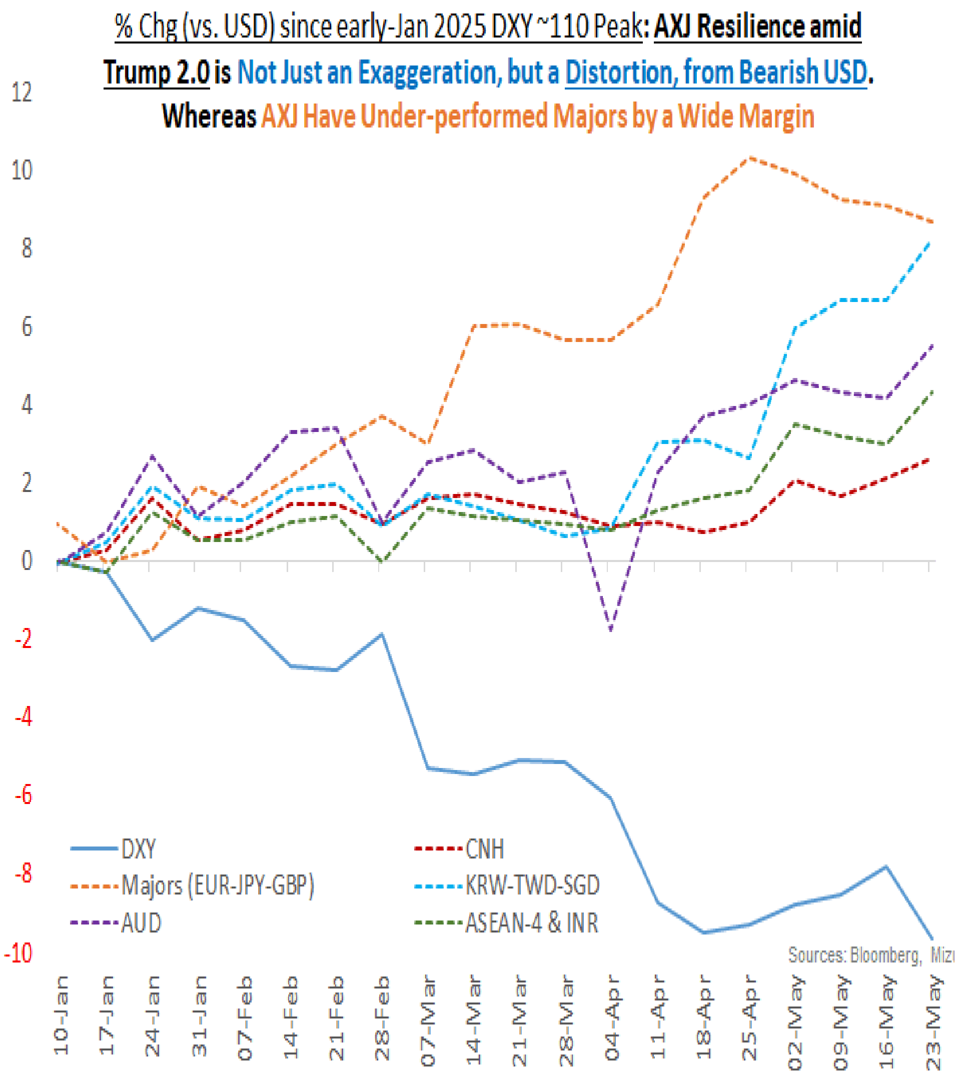
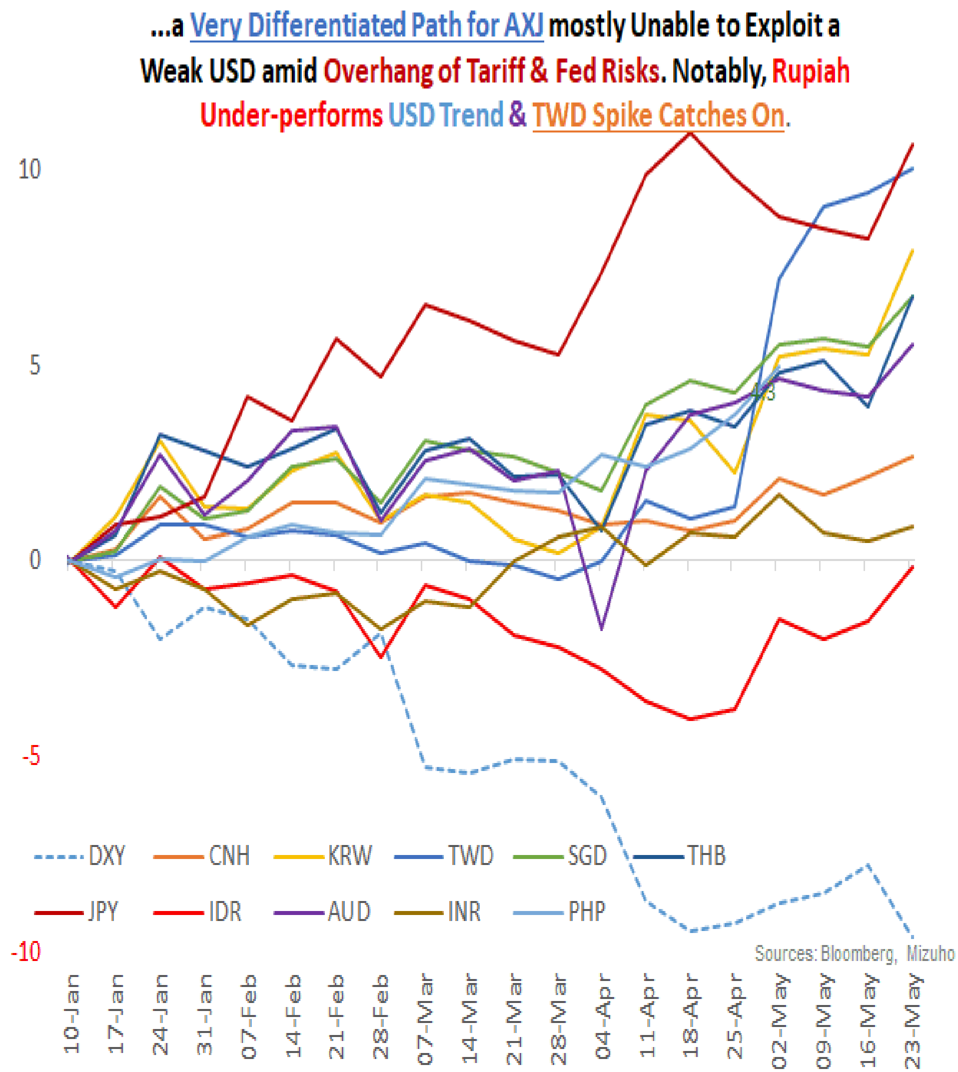
5. USD Bears – AXJ: Obfuscate & Overstate (Resilience)

"Your focus determines your reality."
- Star Wars, Qui-Gon Jinn





The TWD (Bull) Case

Wrong-Footed Exposure

- The sharp, historic (amplitude of) surge in TWD was reportedly amplified by;

I. lapse in anticipated CBC intervention (at key) levels triggering a wave of (self-reinforcing) TWD buying;

II. magnified as under-hedged exporters and insurers (both constituting significant long-USD exposures) inadvertently caused a stampede into panicked hedges.

Historic, Not Necessarily Disproportionate

- Admittedly, the **historic proportions of the intensity/pace of TWD surge** justifiably raises concerns about dislocations.
- But what's notable that in the grander scheme of things, **TWD's move is not disproportionate** per se as it merely catches up with JPY moves.

Sympathetic TWD-JPY Dynamic

- The **TWD-JPY comparison**, and expectations of **convergent dynamics**, is not too stretched given both the "flow" and "stock" similarities.
- **Flow (P&L)**: That is, Taiwan is a huge Current Account surplus country (with massive USD P&L exposed to FX volatility),
- **Stock (Balance Sheet)**: And like Japan, Taiwan is a huge net USD asset owner. Hence, USD exposures on the balance sheet are massive, and under conditions of heightened volatility in FX markets, can invoke massive FX reactions.

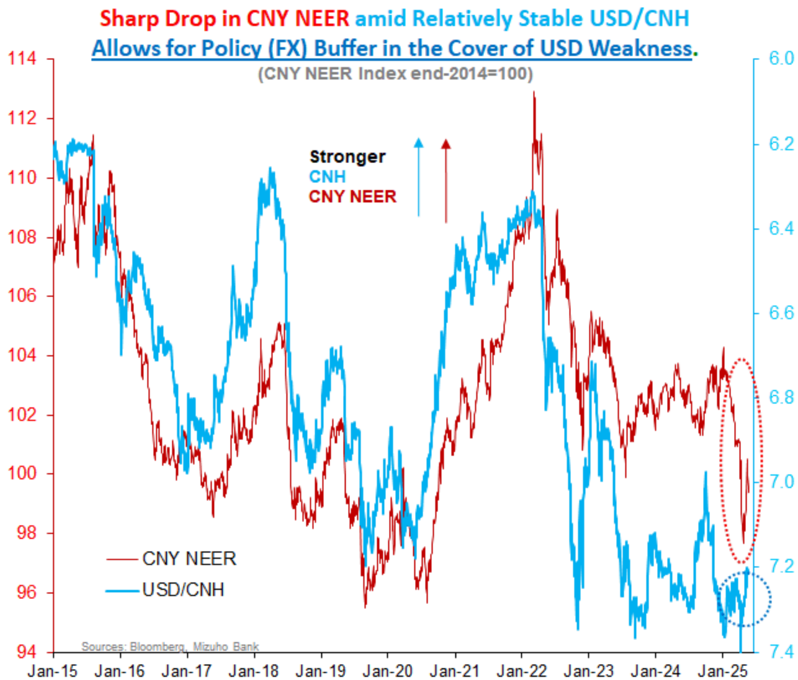
Compressed, Not "Continental Drift"

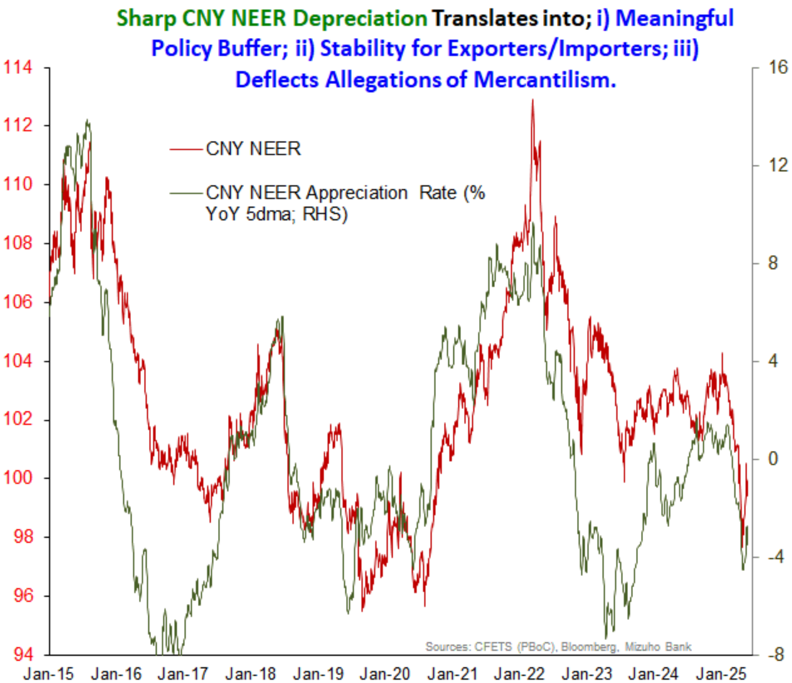
- Admittedly, just how compressed this massive TWD catch-up is raises legitimate concerns about reflexivity - which definition warns of destabilising overshoot.
- But it will be **hasty to declare a tectonic and permanent shift in FX valuations** resulting from sustained, significant, reserve asset/wealth reallocation out of USD assets.
- Instead, this arguably **reflects aggressive compensation for under- hedged exposures**. ***Not a wholesale migration out of US assets to elsewhere.*** This is not **"continental drift" across the Atlantic** (or for that matter, Pacific).

Deal Over De-dollarization

- The elephant in the room is the question of ***whether*** this is the **beginning of a broader de-dollarization** move by massive US asset owners - with Taiwan staging its asset reallocation for strategic reasons
- We think not. Taiwan has very few good options. And while US security guarantees are eroded, and perhaps even ephemeral, it is still the best bet that Taiwan has.
- Hence a **dedollarization strategy by Taiwan is not conceivable as a viable position**. Instead, *allowing some TWD appreciation with further commitment to support US asset markets may be the least unfavourable concession* (for a **deal**/US **security umbrella**).

CNH Stability Trade-Offs (USD & NEER) Amid USD Cover



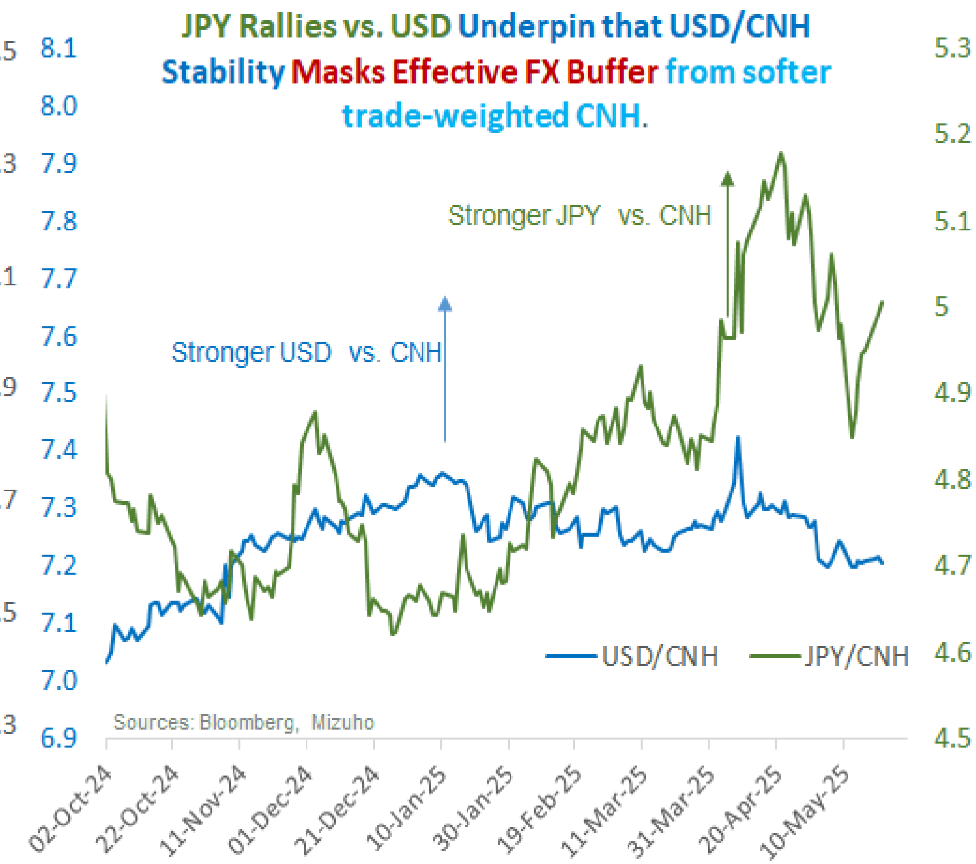


- **CNH stability** (vs. USD) is **an *illusion* enabled by a bearish USD wave**, whereas the ***reality* is sharp drop in effective** (trade-weighted) **CNH exchange rates**.
- Nonetheless, this is a useful "illusion", **providing the PBoC with sufficient geo-political cover**, as a *relatively softer USD helps deflect potential criticisms of mercantilist policies*.
- Not only does the PBoC enjoy *FX policy buffer* against acute trade turbulence, but it also offers *stability for Chinese exporters/importers* and *builds FX reserves*.
- To be sure, this **FX policy sweet spot** courtesy of USD bears is likely to be **fleeting**.
- **Whereas what's *persistent* are acute geo-economic risks**, *and attendant policy trade-offs*, that **feature in the new global order** us being advanced.

"There is nothing more deceptive than an obvious fact."
– Sherlock Holmes, The Bascombe Valley Mystery

CNH's Illusion of Stability Masks Latent Volatility

> *"Reality is an illusion, albeit a persistent one."*
> **– Albert Einstein**



- Associated **CNH vulnerabilities** and **wider two-way volatility** are thus merely masked currently and are **liable to resurface** amid elevated threats of US-China antagonism.
- Inevitably, **AXJC** on the hook for spill-over turbulence**, with potentially amplified pressures, as China- and trade-related risks persist amid uncertainty.
- Especially ***if the absence of emphatic bearish USD*** conspires with AXJC-CNH correlation rebound and exaggerated AXJC gains (vs. CNH).

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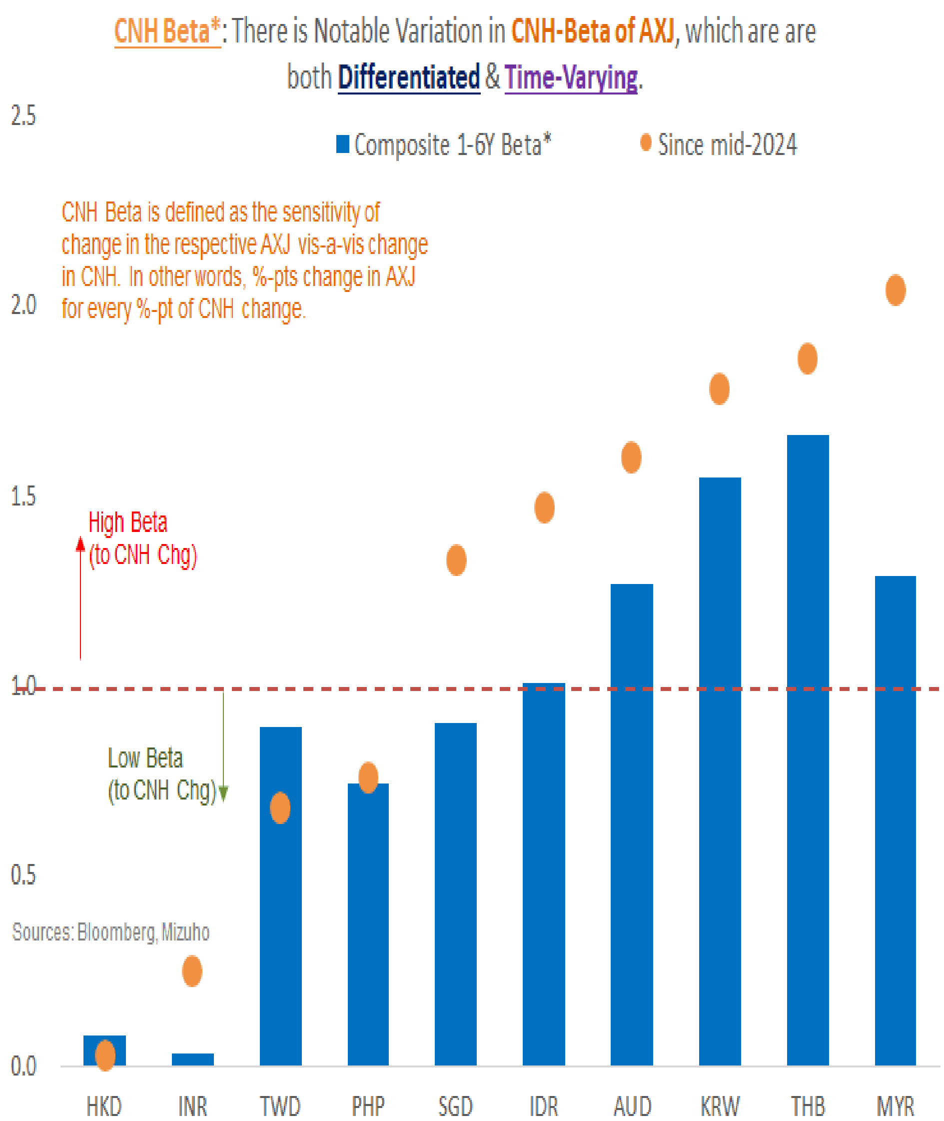
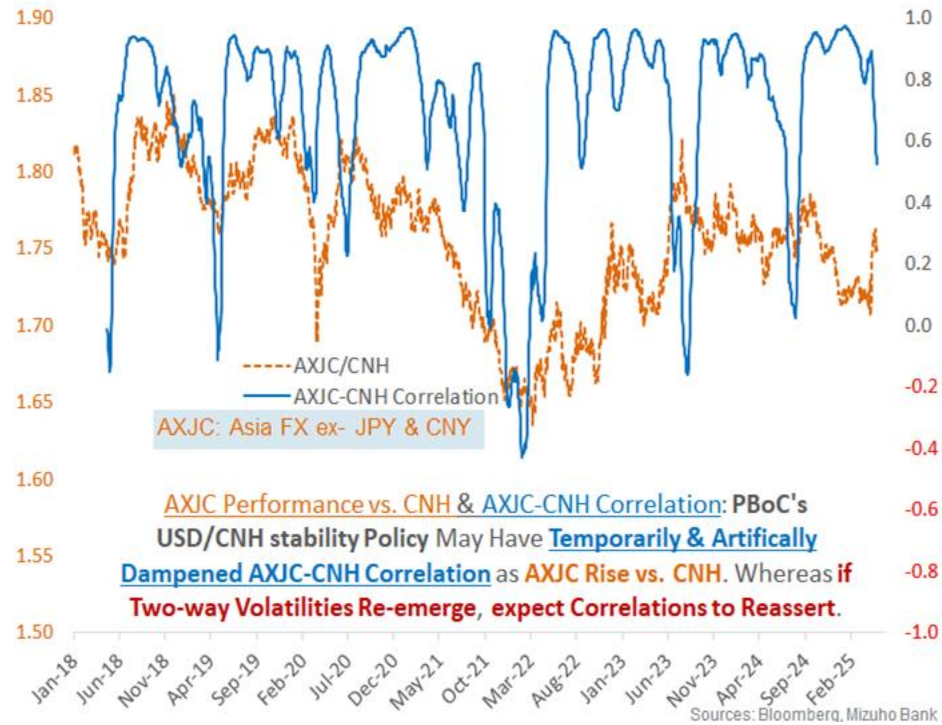
FX - CNH Beta: Expect AXJ Volatilities to be Heightened & Fluid





- 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**.

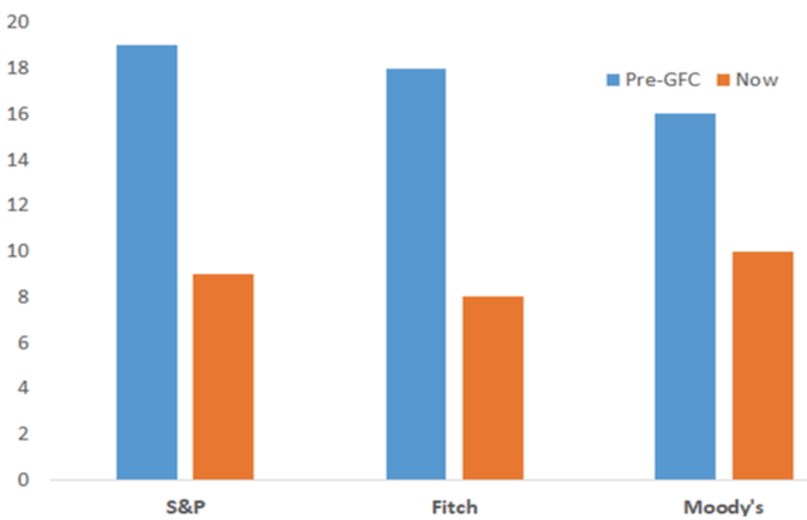
- Devil in the Dynamic Details: Notably, **commodity FX** (AUD, IDR.) may **far more sensitive to onshore China stimulus triggers**. And the **trade sensitivities in other supply-chain reliant AXJ** may be further differentiated. ***Upstream trade assaults***, which restrict China's technology access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

"I presume nothing."
– Sherlock Holmes, The Hounds of Baskerville

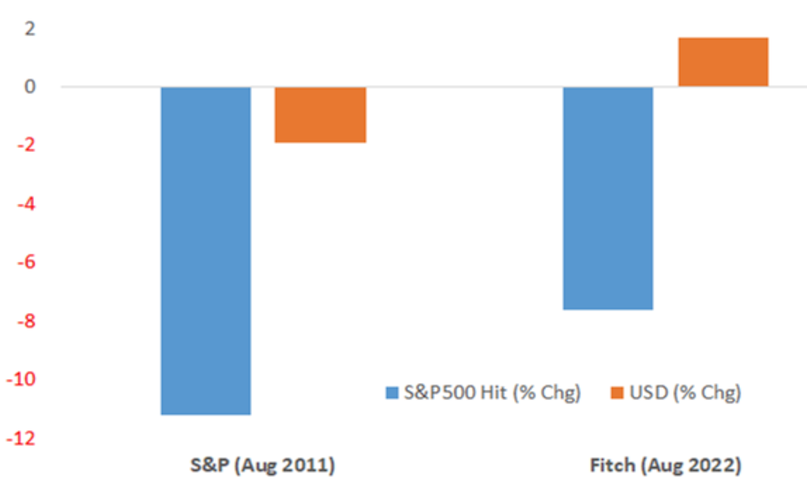
Moody's Downgrade: Profound, Not Prescient

> "It has not yet become obvious to me that there is no real problem."
> – Richard P. Feynman

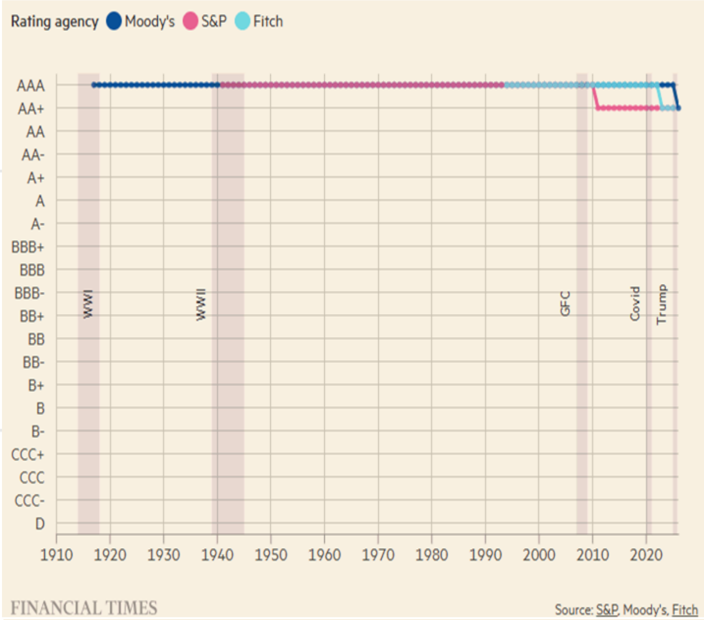
Developed Market Triple-A Ratings: The number of Countries have Essentially **halved since the GFC**



Earlier S&P & Fitch Downgrades: **Differing Equity Response** as **"Unprecedented Shock" factor of S&P** being **Muted for Fitch** (for Equities). **USD has also responded differently due to Opposing Fed Cycles** (2011: Easing vs. 2023: Tightening).



- The **one-notch downgrade of US credit ratings from Aaa to Aa1** is ***ultimately inconsequential*** **for markets**.
- **Unsurprising catch down with S&P and Fitch**, that *does not reveal anything new about mounting US credit/fiscal woes*.
- Crucially, the **downgrade does not adversely impact liquidity/collateral value of USTs**, ➔ No inadvertent & imminent forced liquidation shocks.
- What' more, the **post-GFC relaxation in global fund mandates significantly mitigate forced liquidation** of USTs from ('AAA/Aaa') **ratings lost**.
- Above all, there are **no viable triple-A alternatives** that are **sufficiently deep and liquid** to threaten the reserve asset (currency) status of USTs (USD).
- So, this is will **neither** be **a crisis for USTs and the USD's reserve currency status** nor an **inadvertent shock to global liquidity plumbing**.



- UST Slippage to Benefit AAA Universe: That said, amid **long-end UST volatility on knee-jerk selling** may **at the margin benefit** (lower yield spreads of) **bonds** with **undisputed* triple-A ratings** (Australia, Germany, Netherlands, Switzerland, Sweden, Denmark, Norway and Singapore).
- Attendant FX Gains vs. USD: The **attendant pullback in the USD** is also likely to be accentuated by **corresponding gains in** CHF, AUD, SGD, EUR, SEK, NOK and DKK.
- Gold: Gold, which has already been on a **stellar ascendancy** for a couple of years now could **admittedly be further underpinned**. ***But*** **further and sustained buoyancy** is **checked as a limited hedge rather than a substitute**.
- Credit Spreads: Counter-intuitively, **ring-fenced risks from Moody's ratings downgrade could tactically/temporarily dampen credit spreads** elsewhere. *but wider geo-economic risks warn of wider credit premium as the sustained direction of travel*.

*Defined as triple-A ratings from all three agencies, hence Canada is excluded after Fitch's downgrade in 2020.

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Global Assumptions

Global FX Assumptions: USD – Doubt, Not Demise

		Q1 2025	Q2 2025	Q3 2025	Q4 2025	Q1 2026	Q2 2026
DXY		104.2	98.8	96.8	99.2	98.5	96.5
		103.1-110.2	96.2-104s.5	93.5-100.8	94.8-102.5	94.0-100.5	93.6-99.5
Brent Crude (US$/brrl)		68.5	64.5	61.5	65.5	63.8	63.8
		63.5-78.8	60.5-72.5	57.5-69.6	58.5-72.5	58.5-70.5	58.5-70.5
Fed		4.25-4.50%	4.00-4.25%	3.50-4.00%	3.00-3.50%	2.75-3.00%	2.75-3.00%
ECB		2.50%	2.00%	1.75%	1,50%	1.50%	1.50%
BoJ		0.50%	0.75%	0.75%	0.75%	0.75%	0.75%

G3 Central Banks: Timing (Cuts) is Everything

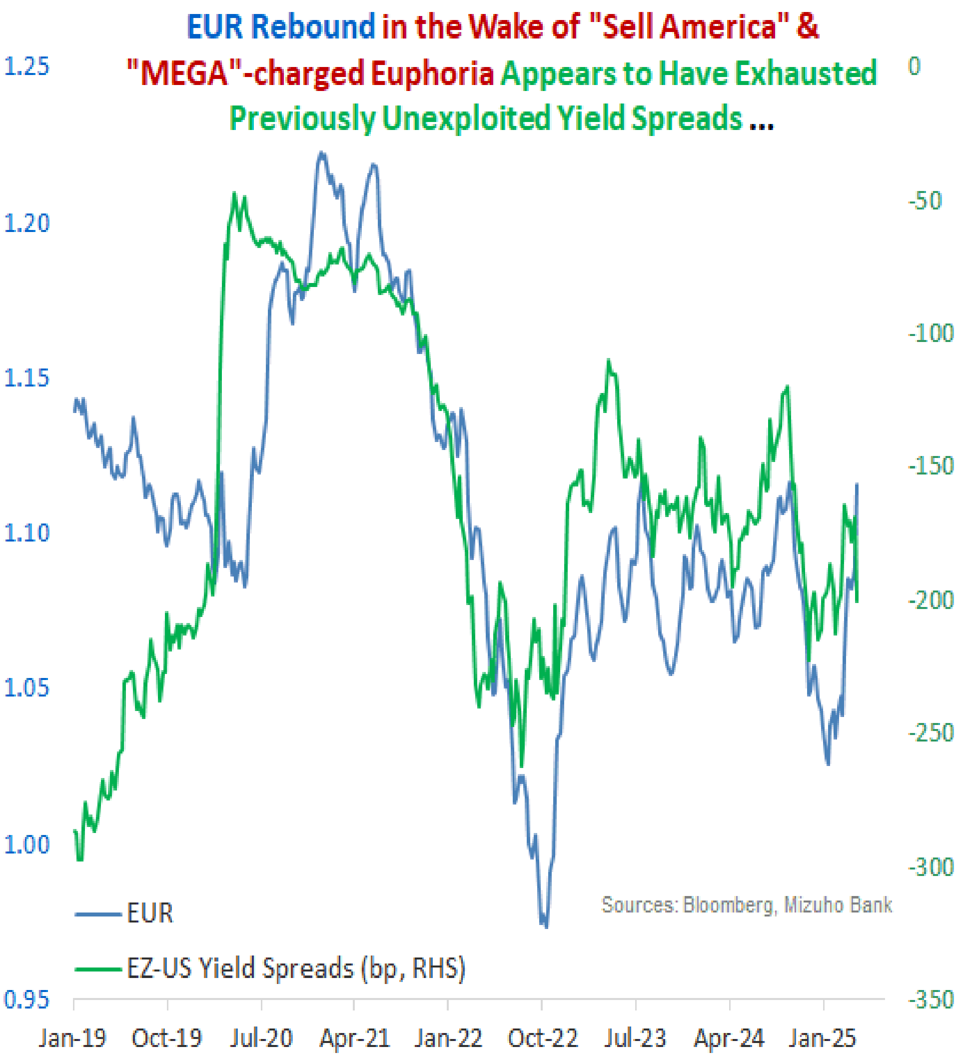
Fed: **Despite an even more hawkish accent to the March 'Dot Plot'**, with just two (50bp) rate cuts for 2025, the stage is set for an **abrupt dovish inflection in H2** – to cut rates by 125bp to about 3.00-3.25%. ***But for now***, **policy is in a state of suspended animation amid rippling Trump 2.0 tariff assaults**, which *threaten to inflict simultaneously price shocks* and *adverse demand hit.* Hence, the **interim Fed playbook** will be to **hold its ground** to better **assess the evolving balance of risks**. But this is merely timing the optimal (and likely sharp) rate cut path. Point being, the **direction of travel (lower) in rates is not in doubt**, much less seriously challenged. That said, the **Fed does not have the luxury of pre-emptive rate cuts** given inherited, post-pandemic "sticky" inflation conspiring with left-over (albeit fading with a lag) job market resilience. US exceptionalism is over. So, **sharp catch-down cuts are a matter of time**. ***But* timing matters!** In fact, it **is everything**.

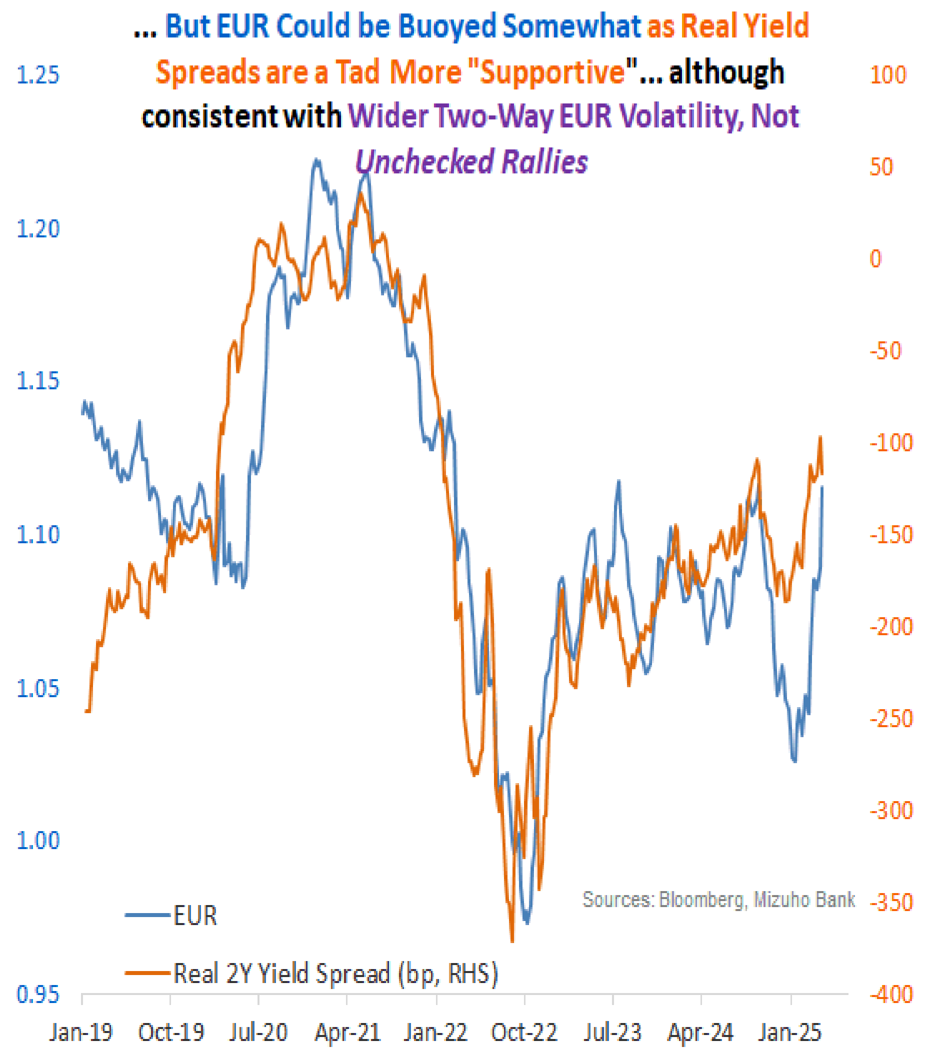
ECB: Revealingly, the **ECB is increasingly alluding to tariff shocks that ultimately prove dis-inflationary** *as adverse income shocks outlast and overwhelm price jumps*. **But the hawkish camps continue to reserve judgment** and **defer to data dependence**. Nonetheless, a **higher degree of economic uncertainty** and **geo-political liabilities**, suggest persistent **fragilities in confidence**.

This in turn is set to be a ***bugbear for growth (multipliers) outside of select industries***. As such, the **ECB will have to cut deeper heading into H2 2025** if pre-existing **economic weakness** and **vulnerabilities** are **exacerbated by trade trades making landfall**. **Inadvertent** (but inevitable) **EUR volatility** through pockets of perceived policy divergence and trade/diplomatic abrasion/relief render policy complex, and trade-offs sharper. But this is a **necessary cost of policy relief**.

BoJ: To be fair, the BoJ is **serious about setting course for rates to go higher. *But*** just **not imminently so**. *Especially given Japan's disproportionate vulnerabilities to* any *global trade shocks unleashed by Trump 2.0 tariffs*. Crucially, the consolation of a bilateral US-Japan deal does not sufficiently mitigate, **dire threats of adverse income/balance sheet shocks from wider global trade upheaval** reverberating via complex, interconnected supply-chain linkages. Hence, **Japan's deep exports dependency** *that ties back to wages* and already *fragile household confidence*, **ought to hobble BoJ hawks**. Point being, the **BoJ's greatest peril is premature tightening into debilitating external headwinds** that amplifies economic pain. What's more, when **the Fed re-hastens its pace of cuts**, the ***consequent*** **ill-timed, sharp JPY strength threatens to aggravate economic pain**. So, hawkish talk on further tightening conditioned on averting trade shocks and securing further wage gains is as far as BoJ hawks may push the envelope. Timing is everything. And **"not right now" is the overarching message for BoJ hawks**. *So, for now, BoJ hikes ought to stop short of 1.00%.*

EUR is Compromised. So, USD May be Tempered





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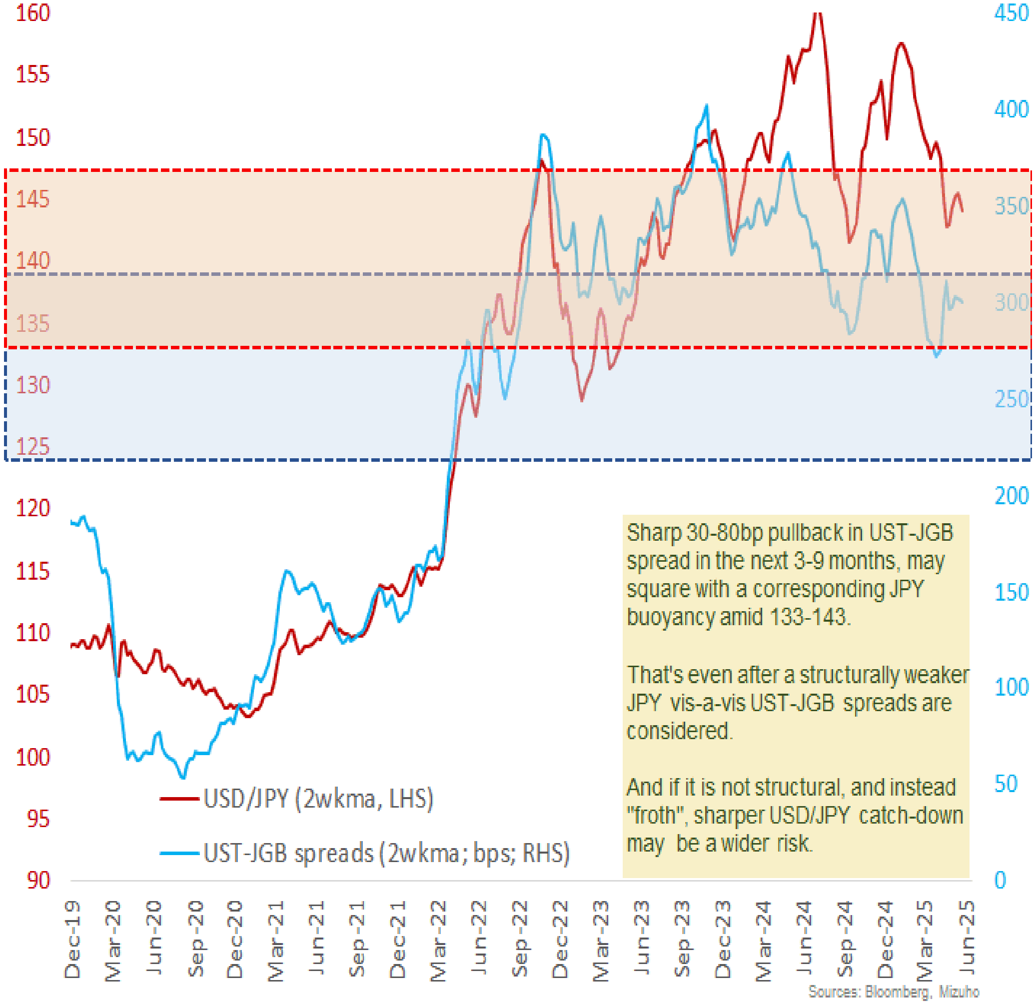
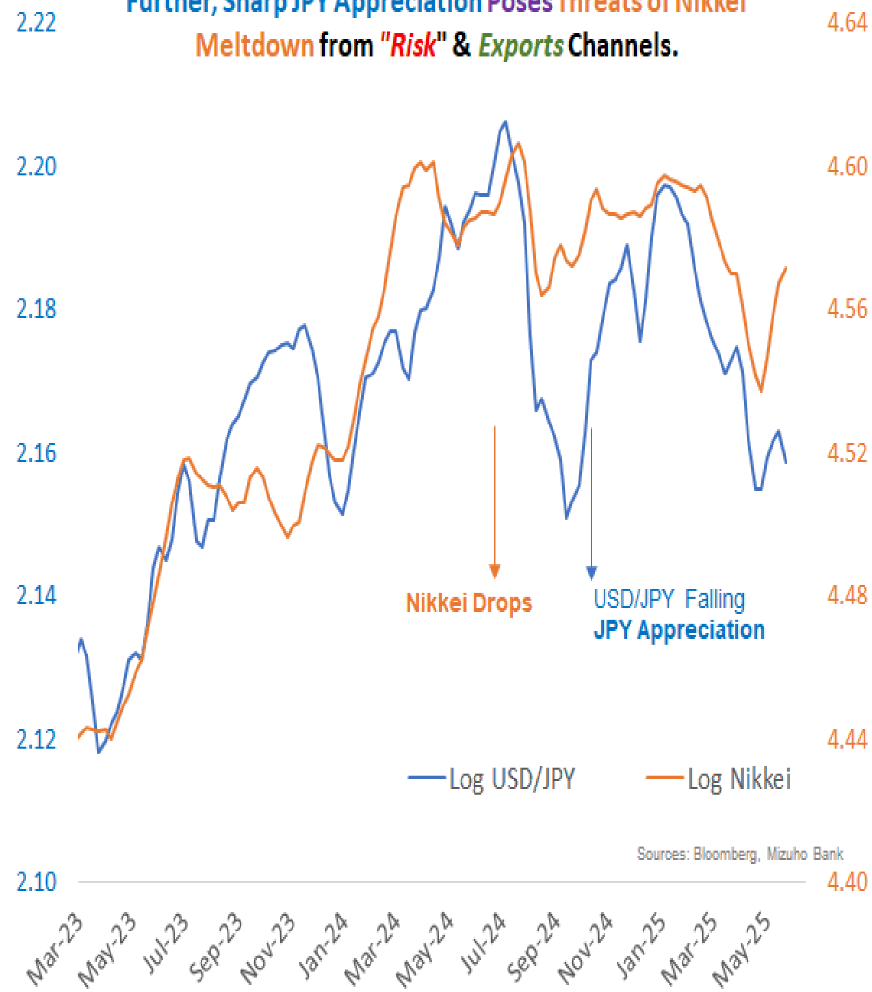
JPY-BoJ Risks: Trump 2.0 Heightens Inherent Volatility

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 Trigger JPY Rebound (USD/JPY Pullback) amid 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.



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AXJ Risks & Outlook

Currency Forecast

FX Forecasts	Q1 25	Q2 25	Q3 25	Q4 25	Q1 26	Q2 26
USD/CNH	7.21-7.38	7.18-7.45	7.10-7.45	7.03-7.38	7.00-7.28	6.98-7.36
	7.266	7.24	7.23	7.12	7.14	7.11
USD/HKD	7.76-7.80	7.75-7.79	7.75-7.79	7.76-7.80	7.76-7.80	7.76-7.81
	7.78	7.76	7.75	7.76	7.76	7.77
USD/INR	85.4-87.9	84.2-87.7	84.2-87.3	84.5-87.9	83.8-86.9	83.2-86.0
	85.4	85.2	85.5	86.2	85.2	84.3
USD/KRW	1424-1477	1350-1488	1380-1470	1400-1480	1380-1450	1360-1440
	1473	1415	1400	1420	1405	1385
USD/SGD	1.327-1.376	1.278-1.355	1.289-1.341	1.299-1.353	1.292-1.344	1.276-1.328
	1.342	1.303	1.315	1.326	1.318	1.302
USD/TWD	32.6-33.2	29.6-32.4	29.8-31.9	30.7-33.0	30.5-32.8	29.8-32.2
	33.2	31.3	31.0	31.8	31.3	30.7
USD/IDR	16130-16595	15910-16930	15810-16980	15920-17080	15760-16740	15360-16480
	16560	16400	16300	16500	16250	16000
USD/MYR	4.38 – 4.51	4.12 – 4.50	4.06 – 4.33	4.12 – 4.41	4.02 – 4.31	3.92 – 4.19
	4.43	4.27	4.18	4.26	4.14	4.07
USD/PHP	57.1 – 58.7	53.6 – 57.5	53.3 – 57.1	54.4 – 57.9	53.5 – 56.9	52.8 – 56.0
	57.2	55.8	55.4	56.1	55.2	54.4
USD/THB	33.3-34.9	32.1-35.4	31.9-33.9	32.7-34.1	32.1-33.5	31.9-33.8
	33.9	33.3	32.6	33.4	32.8	32.5
USD/VND	25038-25651	25400-27000	25600-26900	25700-27000	25600-26900	25300-26600
	25577	26200	26100	26200	26100	25800
AUD/USD	0.608-0.641	0.594-0.663	0.622-0.675	0.626-0.664	0.632-0.678	0.637-0.684
	0.625	0.639	0.655	0.645	0.658	0.664

Note: Values in black are historical whereas those in blue represent forecasts. *Point forecast is for end-period. Ranges are only indicative.

- (Tariff) **Disturbance & Disruption**: **Trump's understatement** about "***a little disturbance***" from tariffs is **self-serving**. But equally, an unintended (albeit admission of economic self-harm from indiscriminate, sweeping tariffs. But as it turns out, "a little disturbance" entailed nerve-wrecking disruption bordering on dislocations.

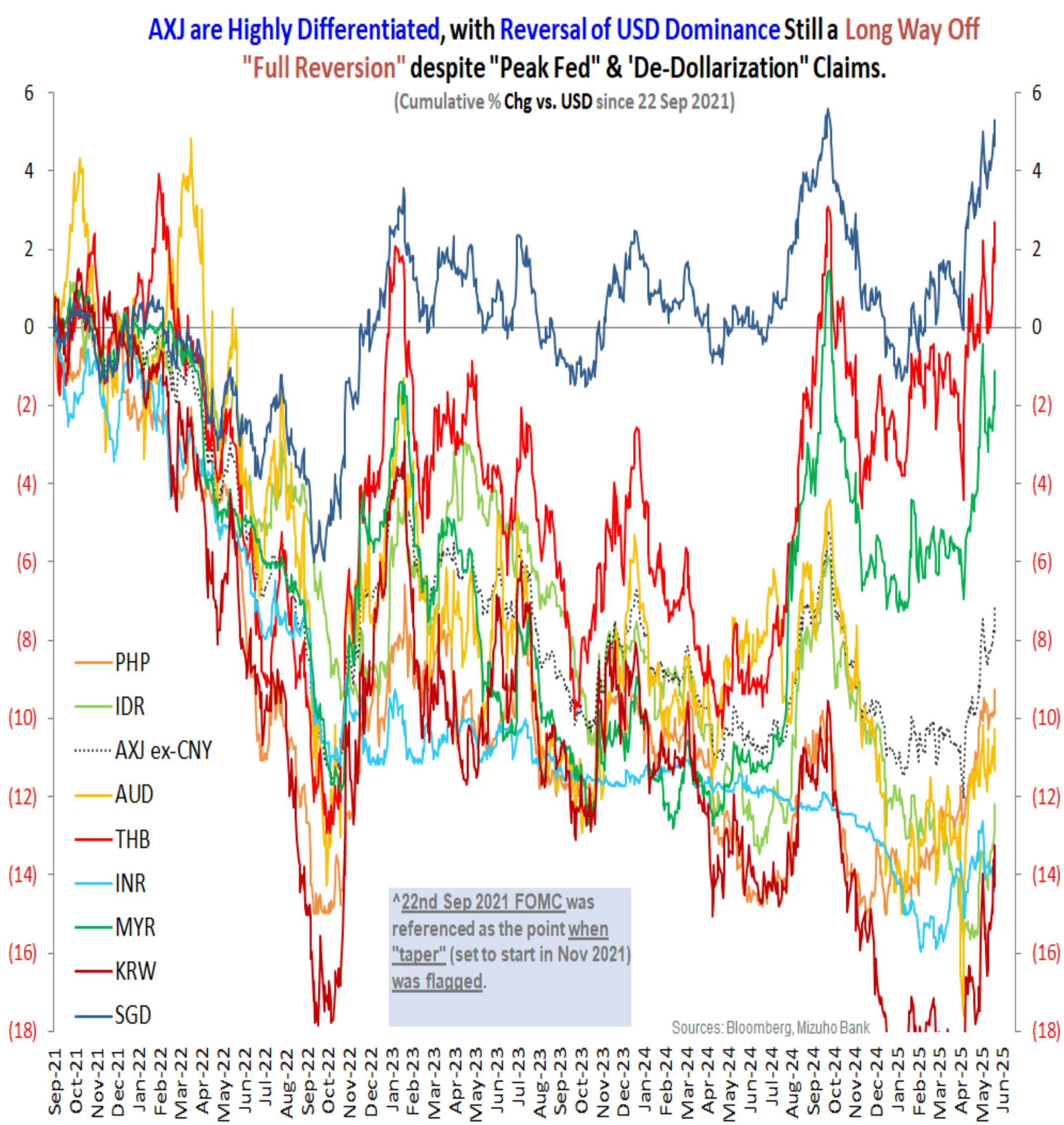
- Manic Depressive (FX) Markets: Wild swings in AXJ alongside wider risk asset as markets lurched from acute fears of economic crash (from global trade shocks) to exuberant relief on suspended tariff step-up accompanied by the prospects for a deal to avert the worst.

- False Dichotomies: Trouble is, with the **extreme fears of outsized tariffs, false dichotomies**, which **amplify volatility**, ***without effectively ameliorating the underlying risks***, have been adopted. Misguided focus on "deal" or "no deal" that is falsely conflated with "risk on"/relief and "risk off"/fear's amplify headline risks and associated swings in sentiments, risk assets and FX (AXJ).

- Flawed Risk Gauges: Whereas, **complex and inextricably linked supply-chains**, especially within Asia, suggest that bilateral **deals with US may only offer superficial relief**. Whereas resolution for Trump 2.0 tariffs may be far more fraught. Accordingly, the "risk on"/"risk off" reflexes are liable to be flawed.

- Dollar-Risk **Departure**: What doesn't help is that there has been a **departure from the usual "left-half USD Smile" (haven allure of USD) dynamics**, which stipulates USD gains during episodes of "risk off". But in sharp contrast, **Trump 2.0 tariffs assaults** have, counter-intuitively**, triggered a broad-based USD sell-off** since March. **overwhelming early(-Q1) AXJ pressur** strength) **from trade uncertainties**.

AXJ Risks & Outlook (Cont'd)



- Confusion & Complacency: The real danger as such is that **markets mistake fortuitous FX dynamics for rightful, guaranteed, AXJ relief**. First, there is **confusion about USD dynamics** amid.0 geoeconomic risks. Whether it is **merely assuming level shocks** *to make adjustments for tariff self-harm*, *attendant dovish Fed calibrations* and some *interim weakening of haven flows*. **Or** in fact, *FX mechanics have durably shifte*d and *USD is irredeemably subordinated to AXJ on tariff-induced risks*. **Persistent trade- and China-linked vulnerabilities in Asia warn against**, **complacency about passing storms is not an option**. Instead, **acute trade uncertainties and geopolitical antagonism flag potential AXJ volatility**.

- CNH Cover & Correlations: More **complex CNH-AXJ dynamics** further obfuscates the AXJ view. This is a result of **intense US-China risks that require extraordinary policy bracing by the PBoC**. Hence, a **relatively steady CNH against a bearish USD** [Box 1] resulted in *AXJ outperforming CNH considerably*. But in the context of *temporarily looser CNH-AXJ correlations*. So, a **reinstatement of CNH-AXJ co-movement could revive more two-way AXJ risks**; **beyond scope for CNH catch-up with AXJ** further down the line.

- Fits & Starts: This **sets AXJ up for fits and starts of rallies and retreats** in response to Trump 2.0 headlines. *Outsized moves*, *exceptionally wide ranges* and *sudden inflections* are all par for the bumpy course. Through all the volatility, **opportunism masquerading as optimism could flatter AXJ upside**. But **trade exposures and fiscal strains**, which could **accentuate latent pressures** from central bank policy dilemmas.

Oil: Bearish Outcome Despite Conflict Risks

Oil: Bears Caution

Softer: **Oil prices could soften further in 2025** on a conspiracy of demand dampeners and supply-push despite lingering volatility (and latent upside risks) from unabating Geo-political risks. The upshot is that the **overwhelming conspiracy of demand (depressing) factors alongside impending supply boost** are likely to keep prices suppressed, and more likely than not, a tad softer amid Trump 2.0 uncertainties.

Demand Dampeners: Signs of **softening demand as global fiscal push becomes more constrained** and post-pandemic consumption bump-up fizzles point towards softening demand growth outside of specific pockets of optimism (in AI, tech, etc.).

China Shortfall: What's more, despite the assurances of more emphatic stimulus, downside risks to China's growth persist. And given the stockpiling of Oil by China, the potential for a large bump-up in oil demand from China is somewhat less promising than is the risk of slippage in demand.

Exacerbated by Trump 2.0 Trade Conflict: What's more, the potential for negative demand shocks from Trump2.0 trade tariffs and threats of a retaliatory spiral, *even if only due to uncertainty*, is more likely than not to suppress demand and consequently keep prices soft.

& US Energy Dominance Goals: More so as **overarching US strategic energy dominance** objectives. Point being, **materially higher oil/energy output under Trump 2.0** (O&G deregulation/incentivization) should, all else equal, accentuate downside in oil prices even if output ramp-up falls short of Bessent's 3MBpD output increase ambitions. So, **softer oil** is an inevitable reality of a by-product, of US exceptionalism.

OPEC+ Shift to Secure Market Share: Finally, the biggest supply hold-back factor, the **OPEC's deliberate and deliberated production curbs could also start to be loosened**, softening oil. Notably, a distinct shift in OPEC+ strategy shifts to regaining market share, rather than underpinning prices (See Box 5). Whilst OPEC+ remains inclined to prefer higher prices, the trade off in market share is overwhelming. What's more, non-compliance (to curbs) is now being punished with a ramp up in production for all, which punishes higher cost producers flouting the quotas.

Conflict –Latent, Not Unleashed, Volatility: Admittedly, **tail risks of oil prices surging on conflict** risks spinning out of control cannot be dismissed. In which case, the potential for prices to spiral past $100/bbl cannot be dismissed. ***But*** **desensitization to war** means that *unless there is imminent and inevitable disruption to production and/or passage of crude*, prices and volatility are more likely to be contained.