

Trump 2.0 – New World Order

Overdue or Overblown?



“Known must be your fear before banish it you can.”

- Master Yoda, Star Wars

Private and confidential

Photo Credit: FT

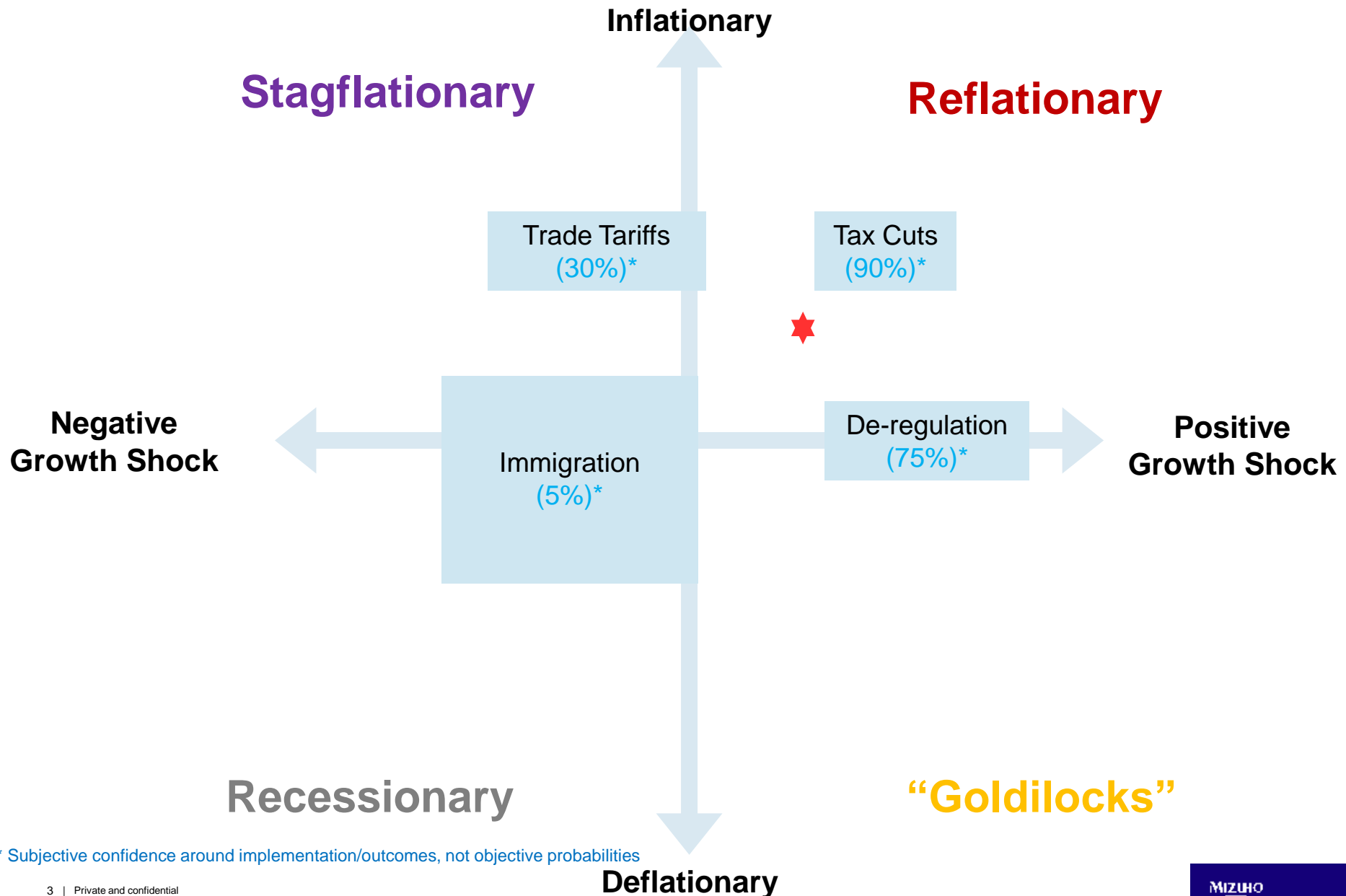
MIZUHO

January 2025

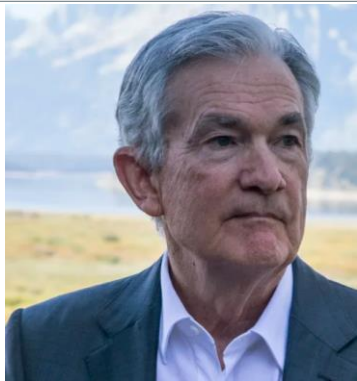
“Known Unknowns” of Trump 2.0

1. Trump 2.0: Is Trump-flation Necessarily Reflationary?
2. Fed Flip: Will the Fed (Easing Cycle) be Trumped?
3. Trump Trades: Will the Fed (Easing Cycle) be Trumped?
4. The Fiscal “Curveball”? The Bessent-DOGE Effect
5. Lower Interest Rates: The One Ring to Rule them All?
6. USD Dominance, Not Unfettered Surge: Tempering on Fed & (Partial) Relief
7. Trade Risks: Code Orange - Navigating Disruption Risks & Collateral Damage
8. China Risks: Does China Have the Trump Card?
9. AXJ Risks: Compromised

1. In Aggregate, **Trump-flation** is Assumed to be **Reflationary** ...



1. ... But that is Neither the Experience Nor the Guarantee



We don't guess ...
...we don't speculate ...
... and we don't assume.

“We don't know what the timing or substance of economic policy changes going forward. The **Fed is not going to assume or guess** what's going to happen. In the near term, the election will have no effect.”

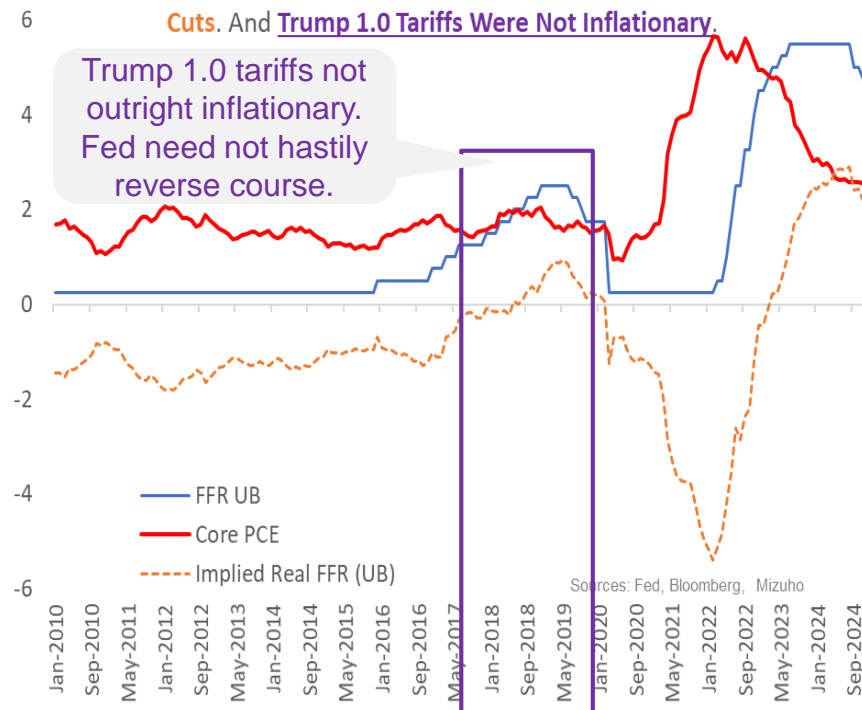


Core PCE: Easing to 2.6% is Encouraging, Not Exculpatory.

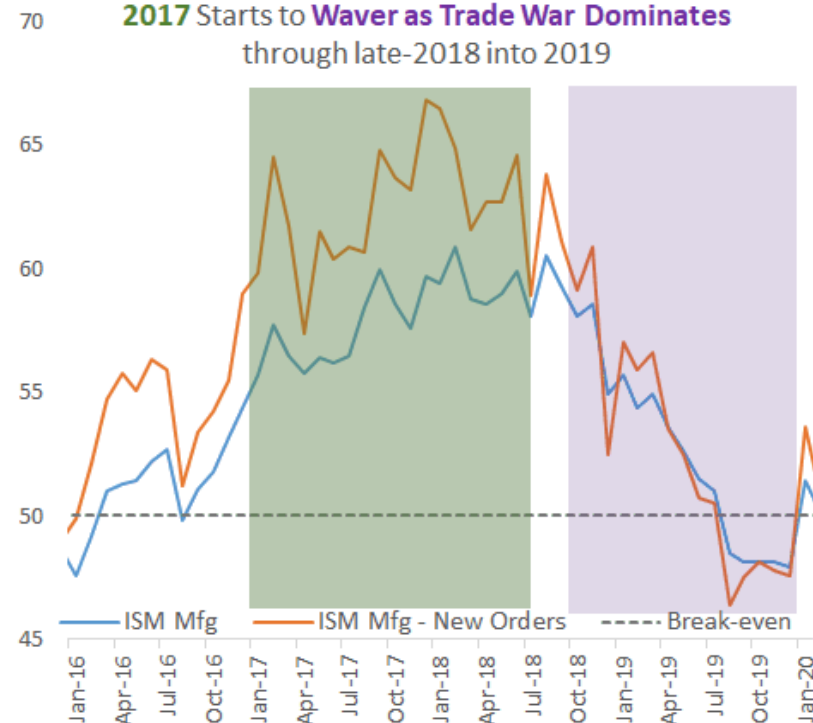
Moreover, Tighter Real Rates is the Interim Reality Even with

Cuts. And Trump 1.0 Tariffs Were Not Inflationary.

Trump 1.0 tariffs not outright inflationary. Fed need not hastily reverse course.



US ISM: Trump's **Reflationary Policies** through 2017 Starts to **Waver** as Trade War Dominates through late-2018 into 2019

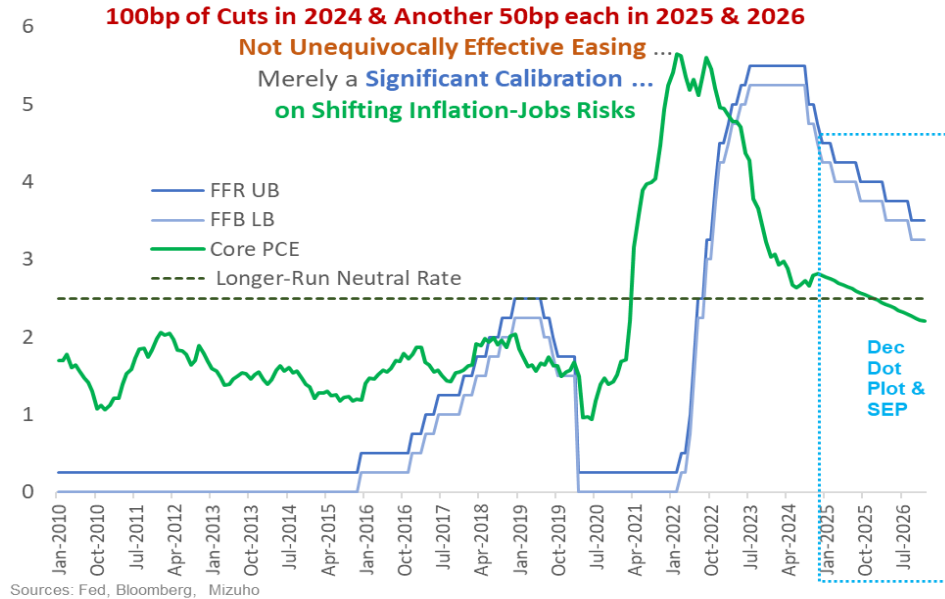


2a. Fed's Restrictive Stance Leaves Scope for More Easing than the "Dot Plot" Suggests

100bp of Cuts in 2024 & Another 50bp each in 2025 & 2026

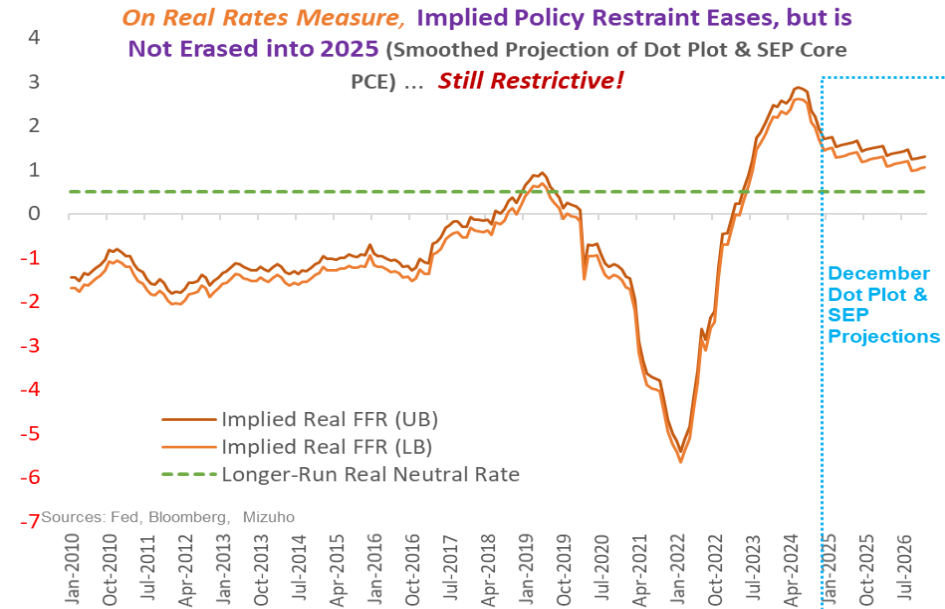
Not Unequivocally Effective Easing ...

Merely a **Significant Calibration ...**
on Shifting Inflation-Jobs Risks



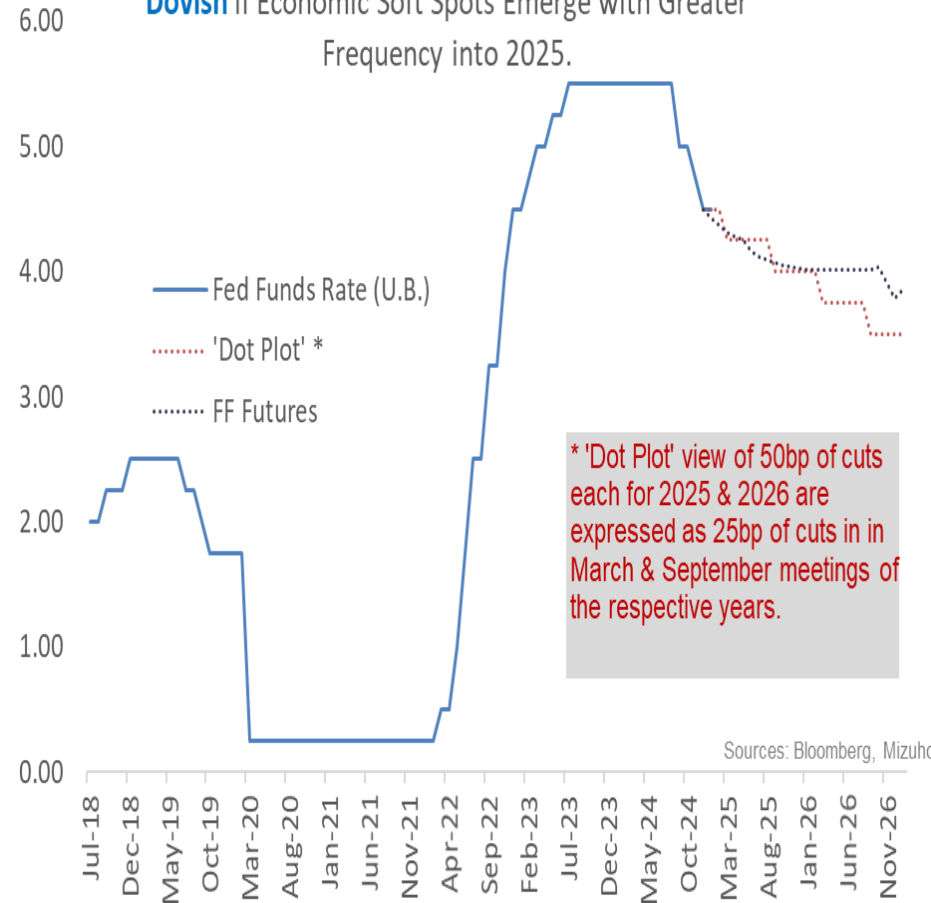
On Real Rates Measure, Implied Policy Restraint Eases, but is

Not Erased into 2025 (Smoothed Projection of Dot Plot & SEP Core PCE) ... **Still Restrictive!**



Markets Assume a More Hawkish Restraint than is Suggested by the 'Dot Plot'. Whereas the **Surprise may be**

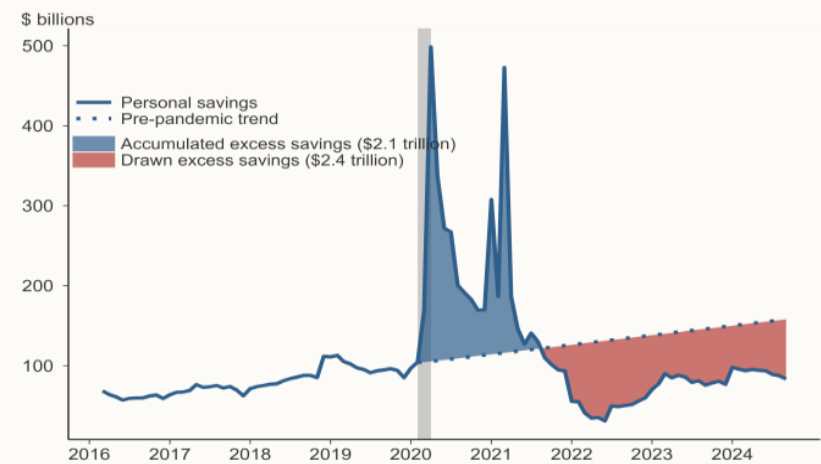
Dovish if Economic Soft Spots Emerge with Greater Frequency into 2025.



*** 'Dot Plot' view of 50bp of cuts each for 2025 & 2026 are expressed as 25bp of cuts in in March & September meetings of the respective years.**

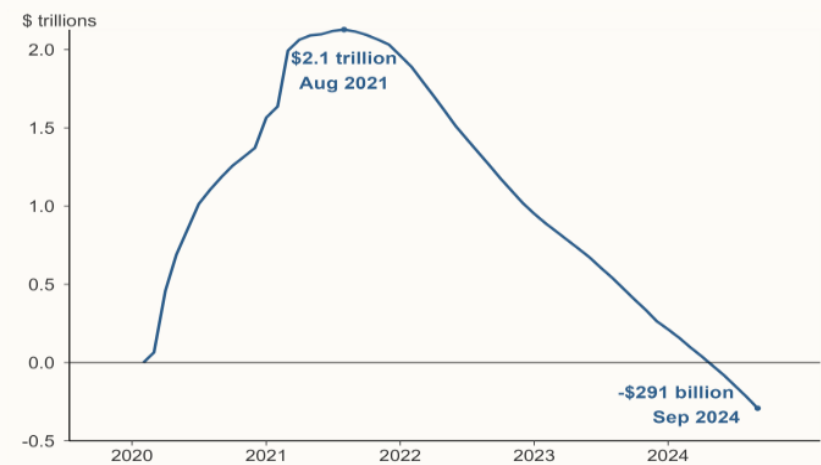
2b. Whereas US Household Cash-flow Constraints Threaten Demand Resilience

Chart 1: Aggregate personal savings compared with the pre-pandemic trend



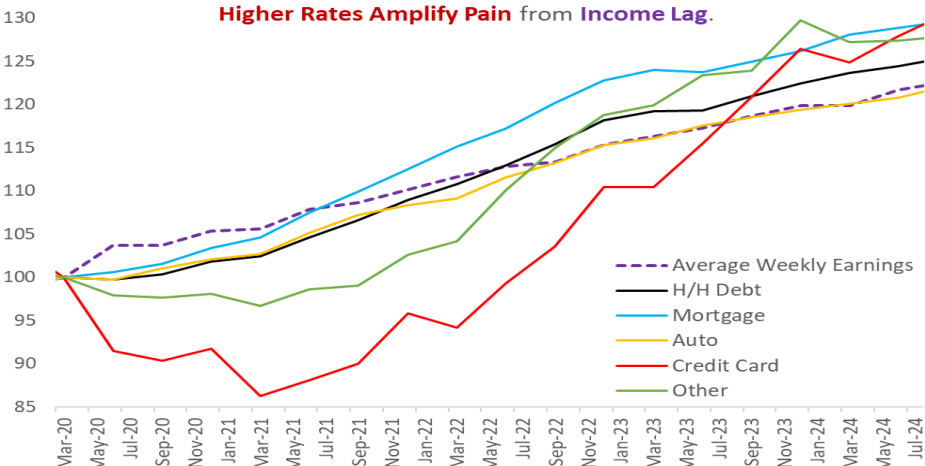
Note: Gray shaded area represents NBER recession dates. Source: Bureau of Economic Analysis and authors' calculations.

Chart 2: Cumulative aggregate pandemic-era excess savings

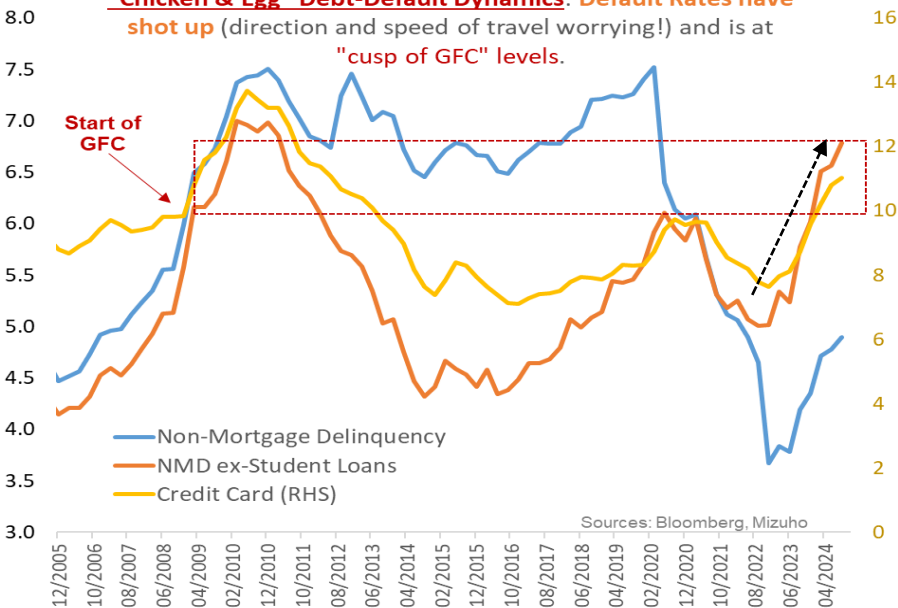


Source: Bureau of Economic Analysis and authors' calculations.

Household Debt Since COVID (Mar 2020): **Sharper Surge in Unsecured Debt** (CC & Others) as Pandemic Savings Drawn Down. **Higher Rates Amplify Pain** from **Income Lag**.



"Chicken & Egg" Debt-Default Dynamics: Default Rates have shot up (direction and speed of travel worrying!) and is at **"cusp of GFC" levels.**



Sources: Bloomberg, Mizuho

2c. 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	4.25	3.75	3.25	3.00	3.00	3.00
Fed Funds Target Rate floor	0.00	4.25	5.25	5.25	4.75	4.25	4.00	3.50	3.00	2.75	2.75	2.75
UST 2Y Yields	0.73	4.43	4.62	4.75	3.64	4.24	3.90	3.34	3.04	2.87	2.77	2.81
UST 10Y Yields	1.51	3.87	4.25	4.40	3.78	4.57	4.28	3.96	3.77	3.68	3.60	3.65
UST 10Y-2Y Spread (bp)	77.8	-55.1	-36.8	-35.7	14.0	32.9	38.0	62.3	72.8	81.5	82.8	84.0

Sources: Bloomberg, Mizuho Forecasts

Conditional

Pronounced Steepening

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 mid-2025**, with some 75-100bp on the cards, to lower rates to ~3.50%.
- 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 Fed in 2025** *if jobs/demand deteriorate sharper than SEP** “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.

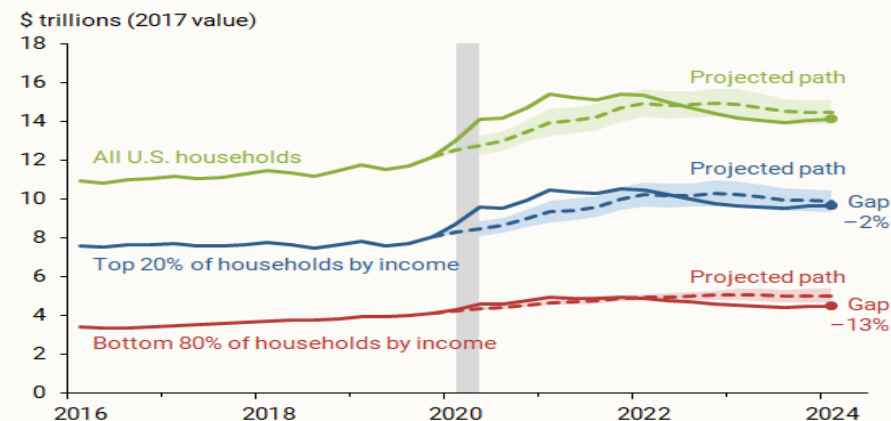
Outcomes: Lower Yields + Distinctly **Steeper Curve** + Long-end Fiscal Volatility

2d. Especially as Distributional hereas US Strains from Erosion of “Liquid” Wealth

US Consumer - Tightening Cash-flows

- Drawdown of savings, increased credit (and attendant servicing burden) and softening wage gains translate into tighter consumer cash-flows.
- In turn the hit on demand will have negative multiplier effects at the margin, which **significantly dampen growth** outcomes; *even if an outright recession is averted.*
- For a Fed that is decidedly not setting out to break something, this will be a jolt out of the Type 2 error resulting from the earlier Type-1 error.

Real household liquid wealth vs. “no-pandemic” estimates



Note: Quarterly data adjusted for inflation using the overall personal consumption expenditures price index. Gaps show the changes between the pre-pandemic projection and the latest data as of end of 2024:Q1. Shaded areas around dashed line projections represent 90% confidence bands. Gray bar marks pandemic recession as defined by the NBER.

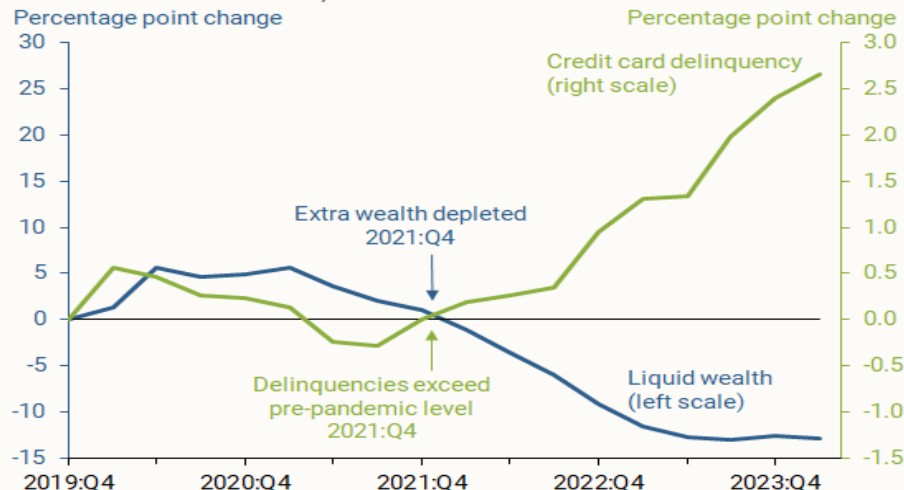
Source: Federal Reserve Board of Governors and authors' calculations.

8 | Private and confidential “Type-1” Error: Wrongly rejecting null hypothesis of inflation risks.

“Type-2 Error: Wrongly failing to reject null hypothesis of persistent inflation risks

Credit card delinquencies and pandemic-era liquid assets

A. Bottom households by income



B. Top households by income

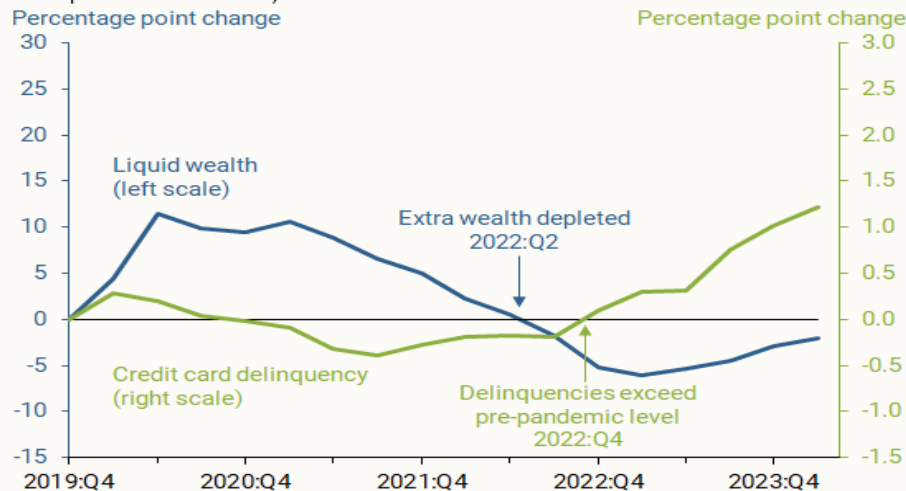
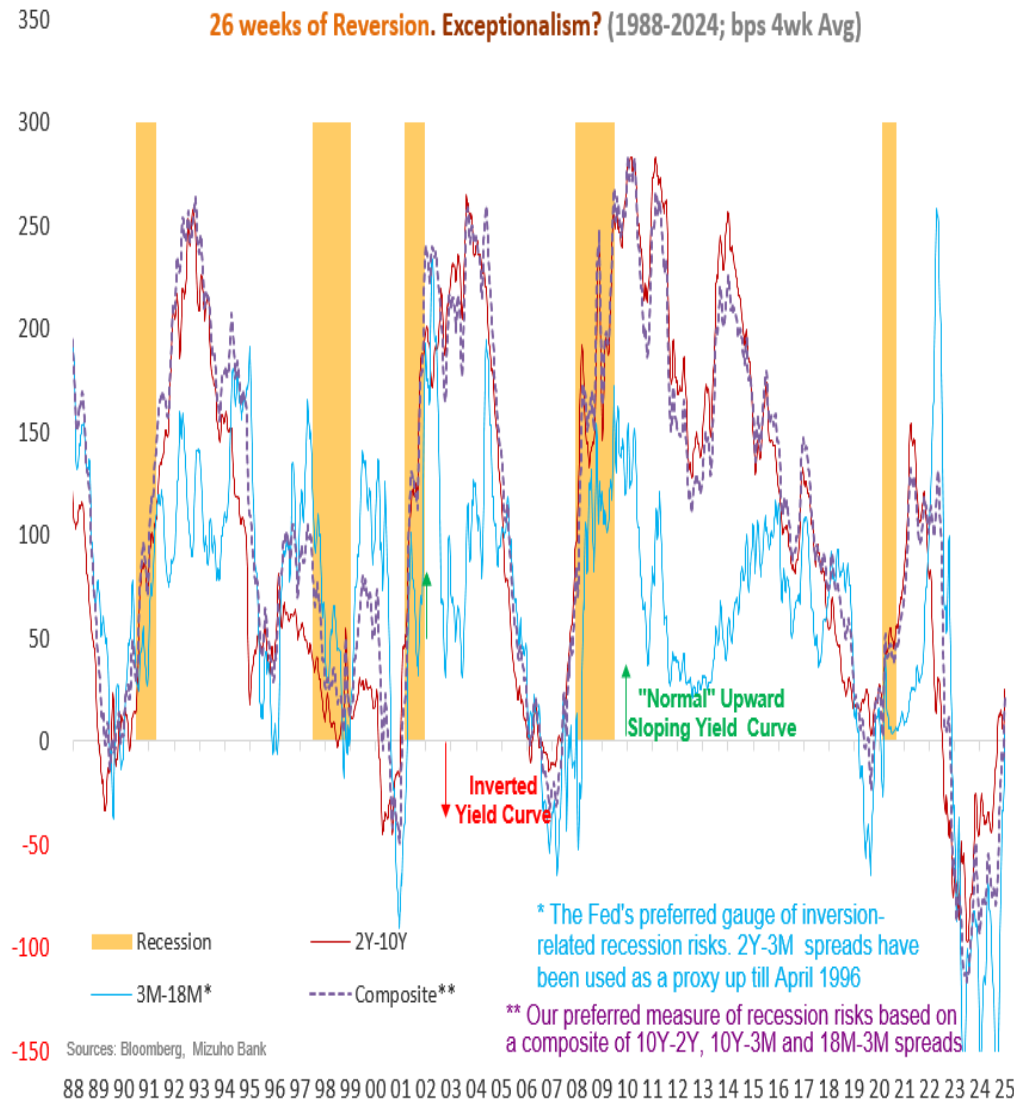


Chart from Bloomberg, San Francisco Fed.

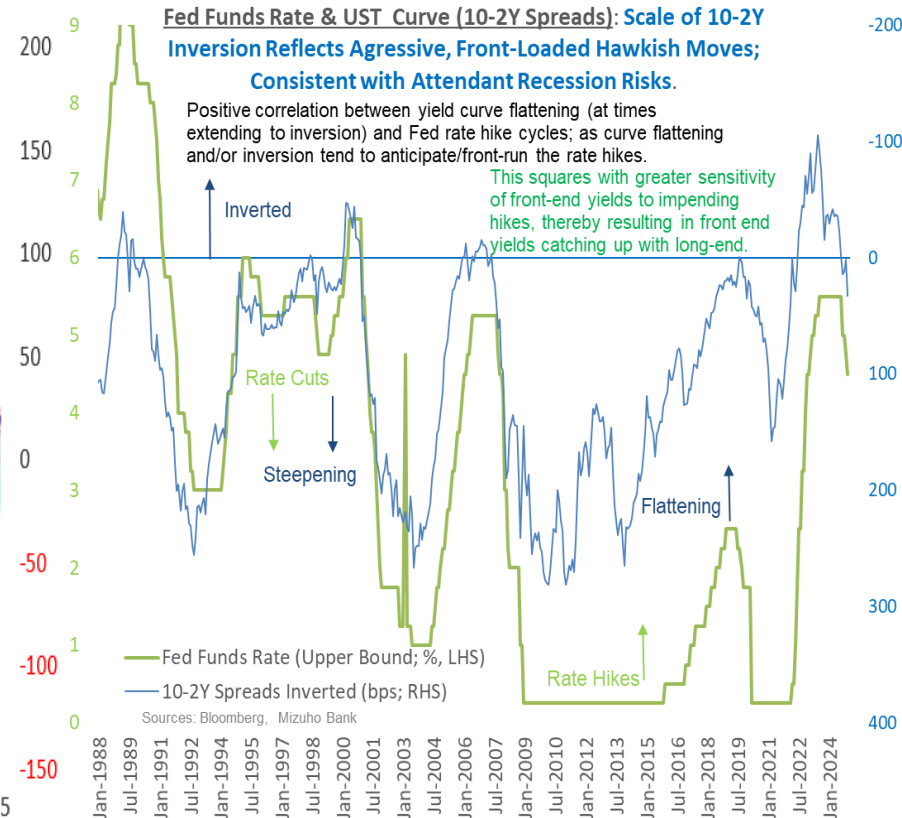
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2e. Fed's Hawkish Tilt is Perhaps Not the Last Word ... as Risks Lag & Linger

"Traditional (10-2Y) & Fed's preferred "near-term forward spread" (3M-18M) Have Flashed Red, but Reverted. 113 weeks of 10Y-2Y yield curve inversion followed by 26 weeks of Reversion. Exceptionalism? (1988-2024; bps 4wk Avg)



10-2Y Inversion, Reversion & Recession			
	Average Depth (bp)	Inversion Lag (Wks)	Reversion Lag (Wks)
1981-82	75.6	40	0
1990-91	10.4	78	37
2000-02	27.4	54	8
2007-08	7.2	76	26
2022-24	49	113	17



3a. Trump Trades: Details Matter, Execution will Nuance & Fed Still in the Game!

"Trump Trades"	Higher Equities ↑	Higher USD ↑	Higher Yields ↑	Steeper Curve ↑
Since end-Sep (amid rising Trump 2.0 bets)	+2.1%	+7.6%	+79bp	+19bp
Tax Cuts → Fiscal Slippage → Higher Growth	↑	↑	↑	↑
Deregulation → Higher Growth	↑	↑	↑	↑
Trade Tariffs	Greater Differentiation	↑		

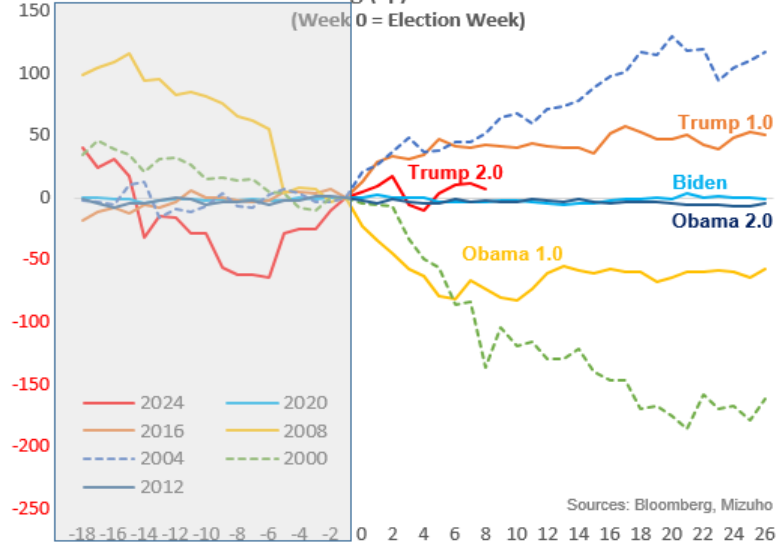
		USD	Long-end Yields	Curve
US Elections	Trump	Stronger ++++ (2-6%) ↑	Higher +++ (20-40bp) ↑	Steeper ++++ (30-60bp) ↑
	Split	Stronger +++ (1-4%) ↑	Higher ++ (10-20bp) ↑	Steeper +++ (15-40bp) ↑
	Split	Neutral	Lower -- (5-15bp) ↓	Flatter - (5-10bp) ↓
	Harris	Weaker - (1-2%) ↓	Higher + (5-10bp) ↑	Steeper ++ (10-30bp) ↑

Note: These outcomes are expected to last 4-8 weeks, reflecting perceptions and "announcement effects". Whereas our view is that Trump 2.0 may be less adverse for China than feared given Trump's transactional tendencies, inclined to water down trade actions.

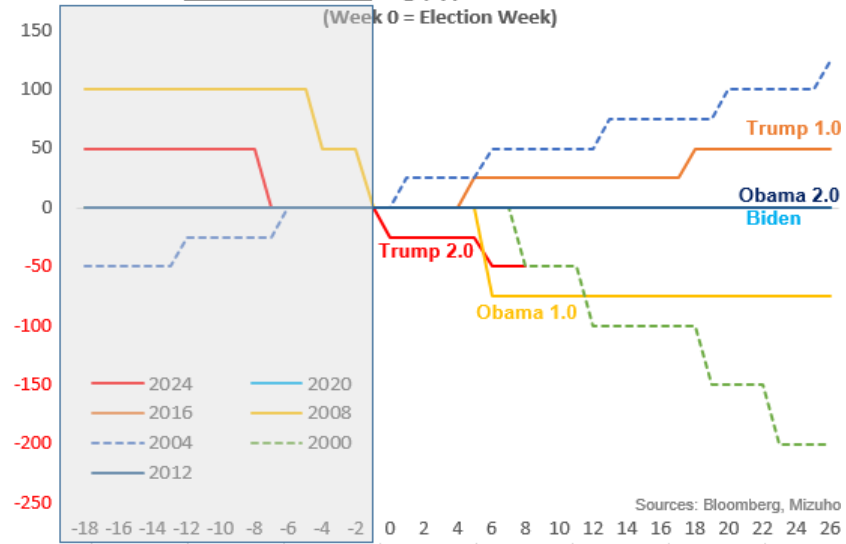
3b. Fed & Rates: Fed Cycle, Inflation Expectations & Trump

1. **Front-end (2Y) Yields are Tightly Tied to the Fed Cycle, Not the Elections → Trump-Effect Overstated?**
2. **Long-end (10Y) Yields admittedly more affected by inflation expectations and fiscal path.**

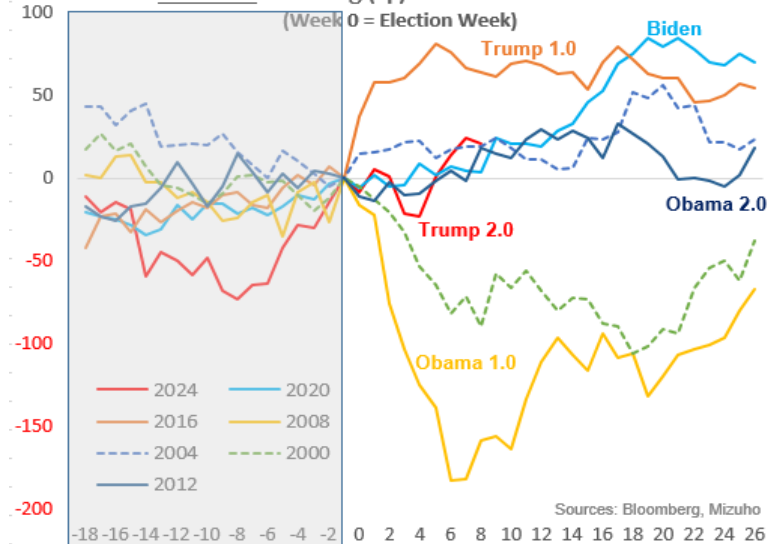
2Y UST Yield Chg (bp) Around US Elections



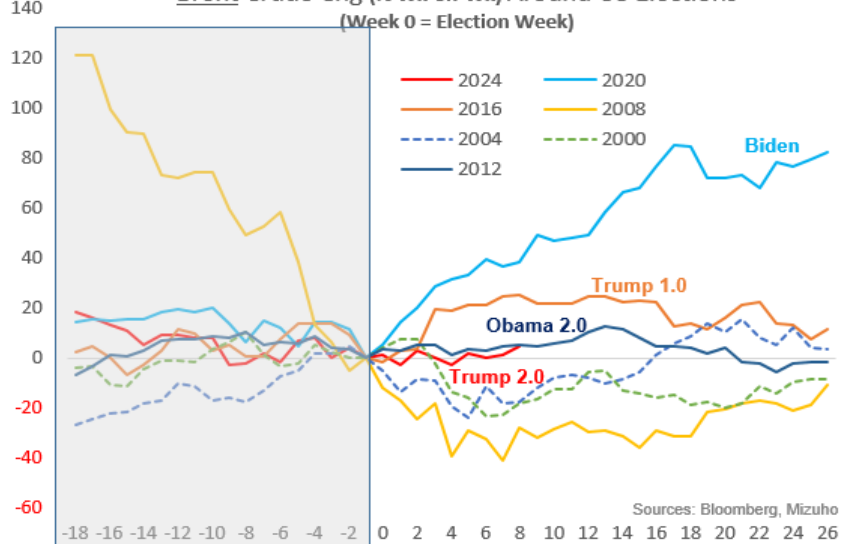
FFR Upper Limit Chg (bp) Around US Elections



10Y UST Yield Chg (bp) Around US Elections

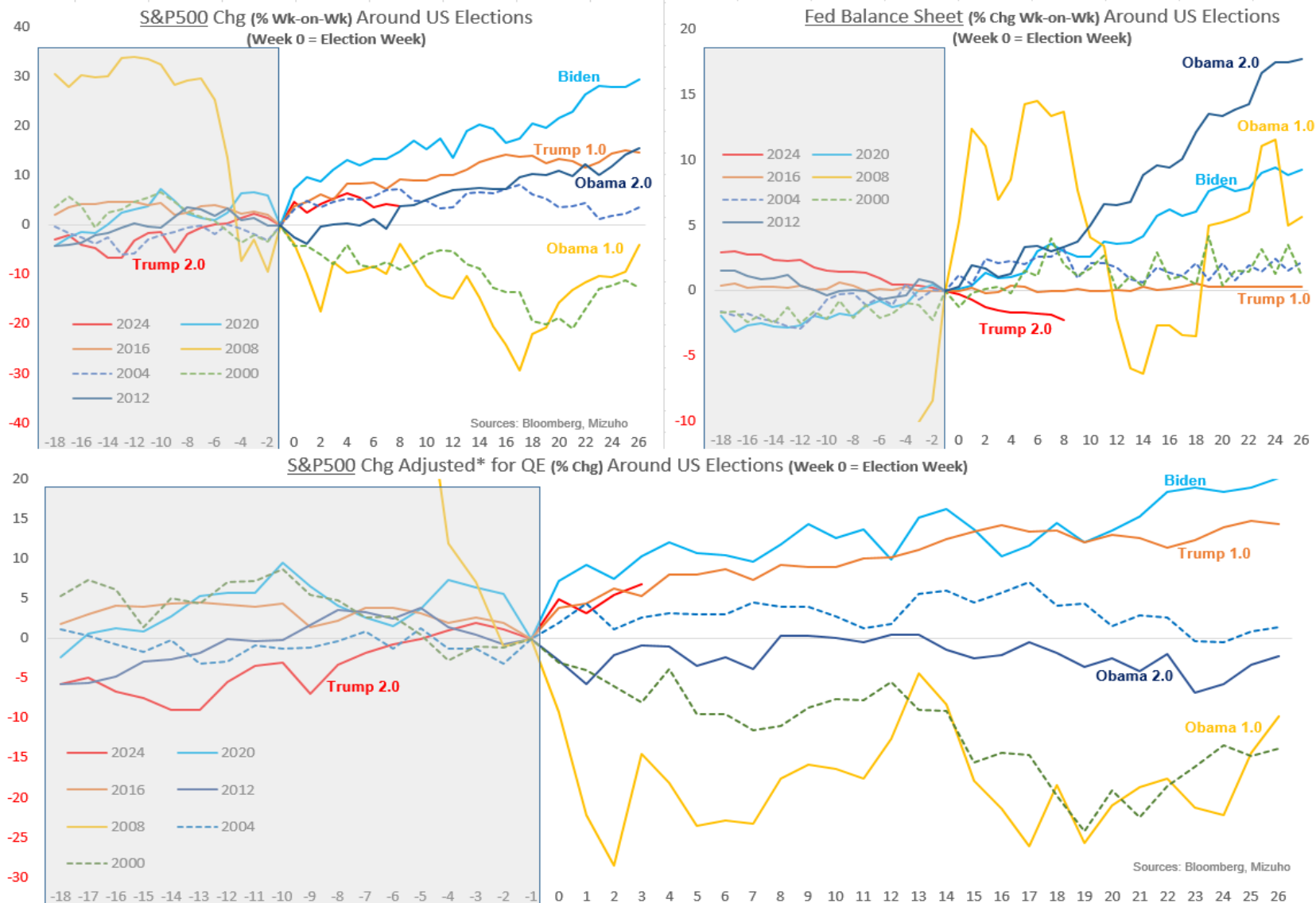


Brent Crude Chg (% Wk-on-Wk) Around US Elections



3c. Fed & Equities: Trump Effect Validated, but Equities Highly Sensitive to Fed Policy

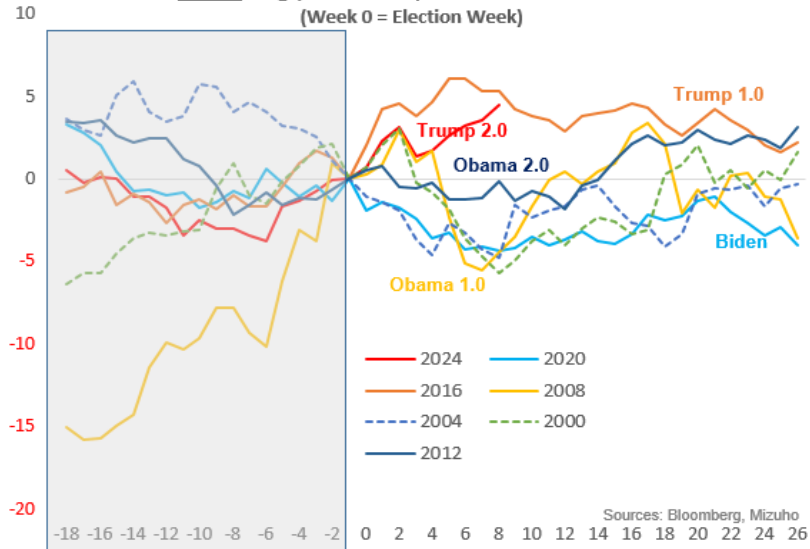
1. Fed QE (Balance Sheet) has Significant Sway on Equities (via cheap Liquidity)
2. Adjusting for Fed QE Effects, Trump Premium is Validated, (albeit Not Nuanced?)



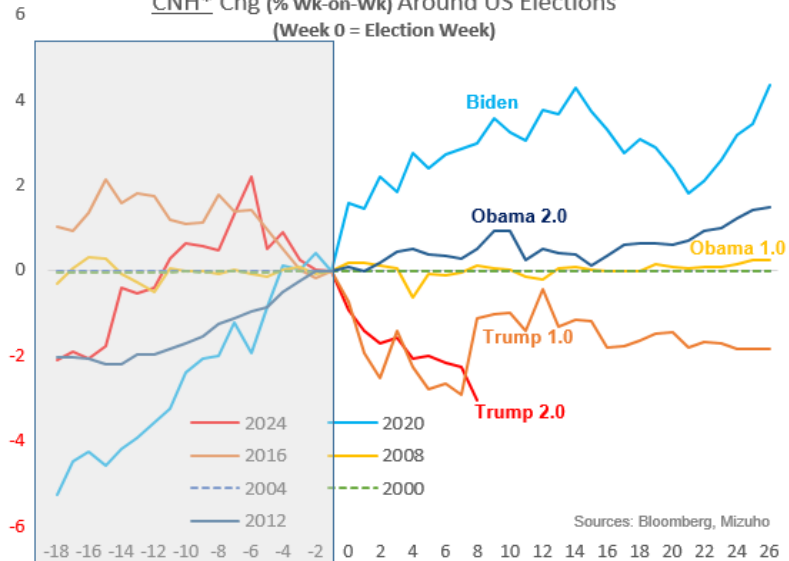
3d. Fed & USD: Trump's Incongruence (Effects vs. Intent) & the Fed's Influence

1. USD Strength is Not Typical Post-Elections, but Some Currency to Inadvertent Trump Boost for Greenback.
2. But again, the **Fed's Cycle** is Not Only **Highly Relevant**, but *Could Even Override*.

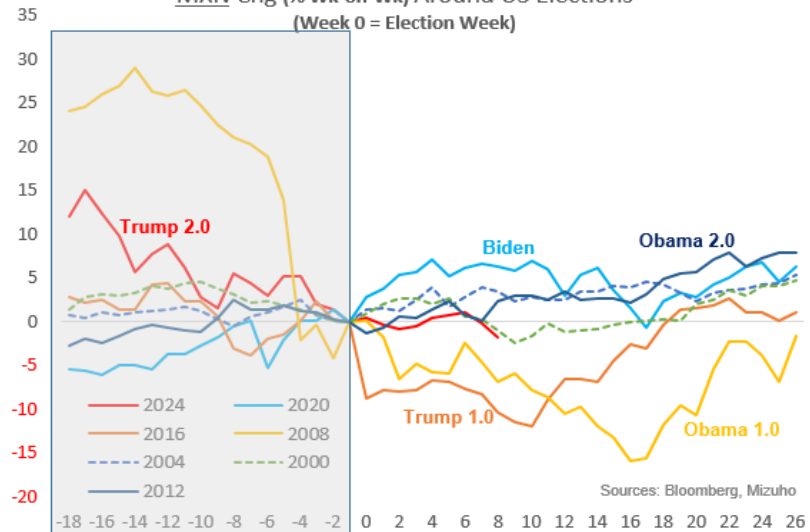
Dollar Chg (% Wk-on-Wk) Around US Elections
(Week 0 = Election Week)



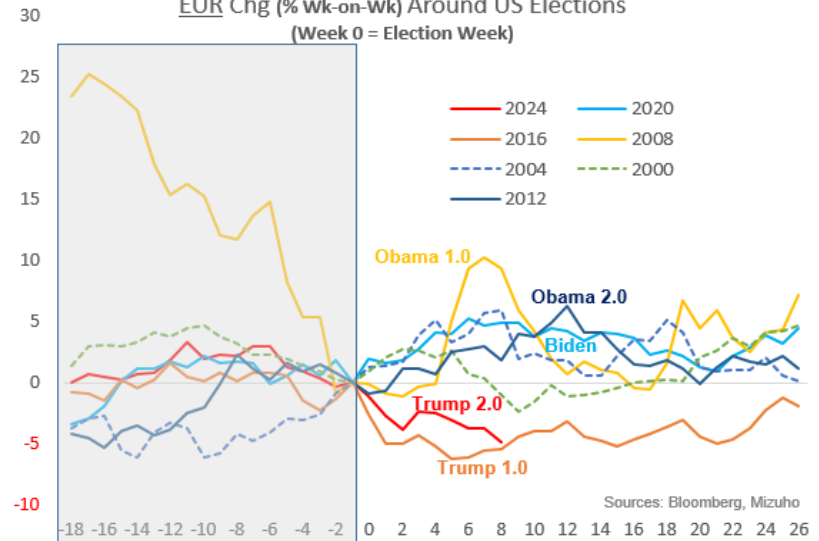
CNH* Chg (% Wk-on-Wk) Around US Elections
(Week 0 = Election Week)



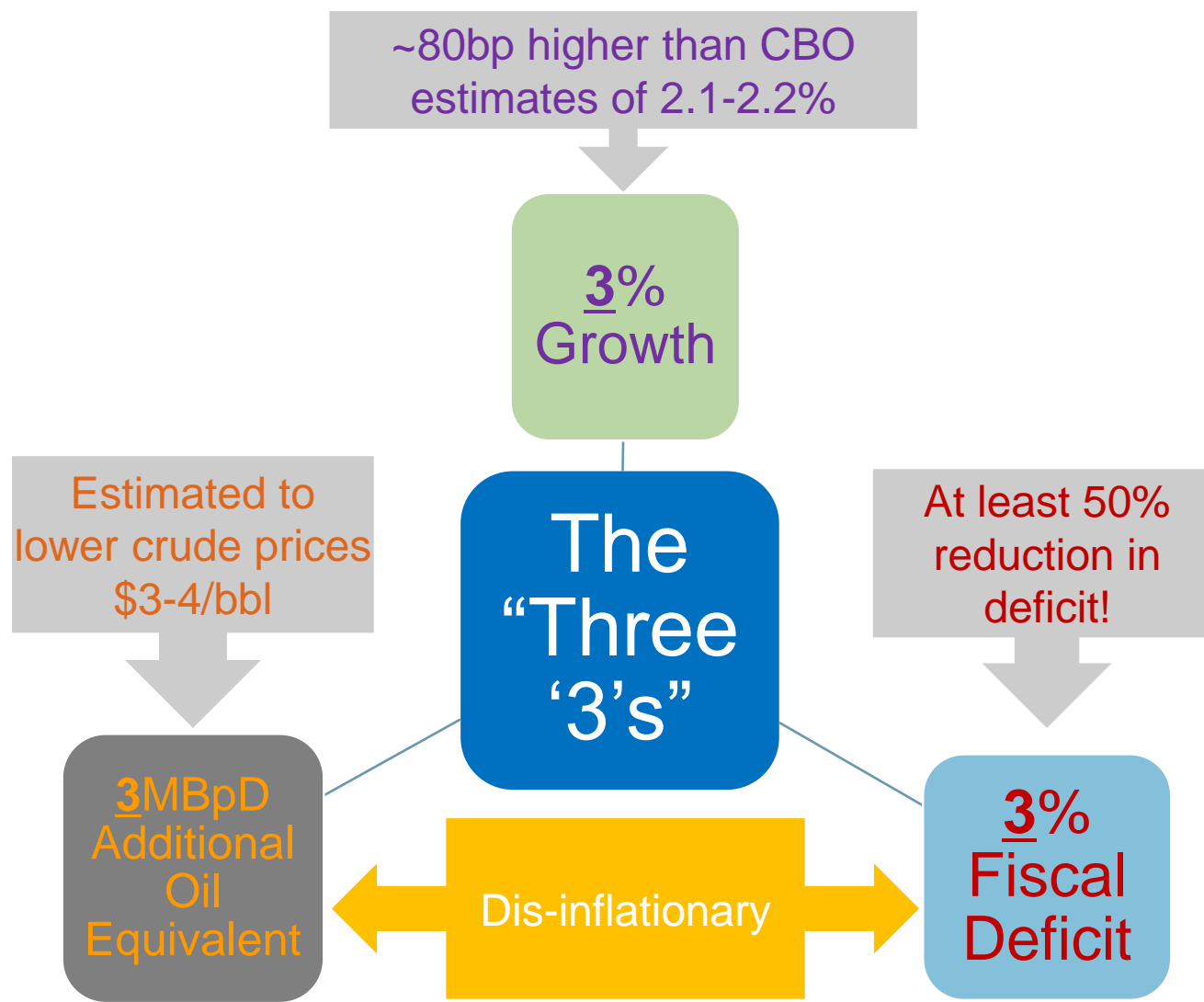
MXN Chg (% Wk-on-Wk) Around US Elections
(Week 0 = Election Week)



EUR Chg (% Wk-on-Wk) Around US Elections
(Week 0 = Election Week)

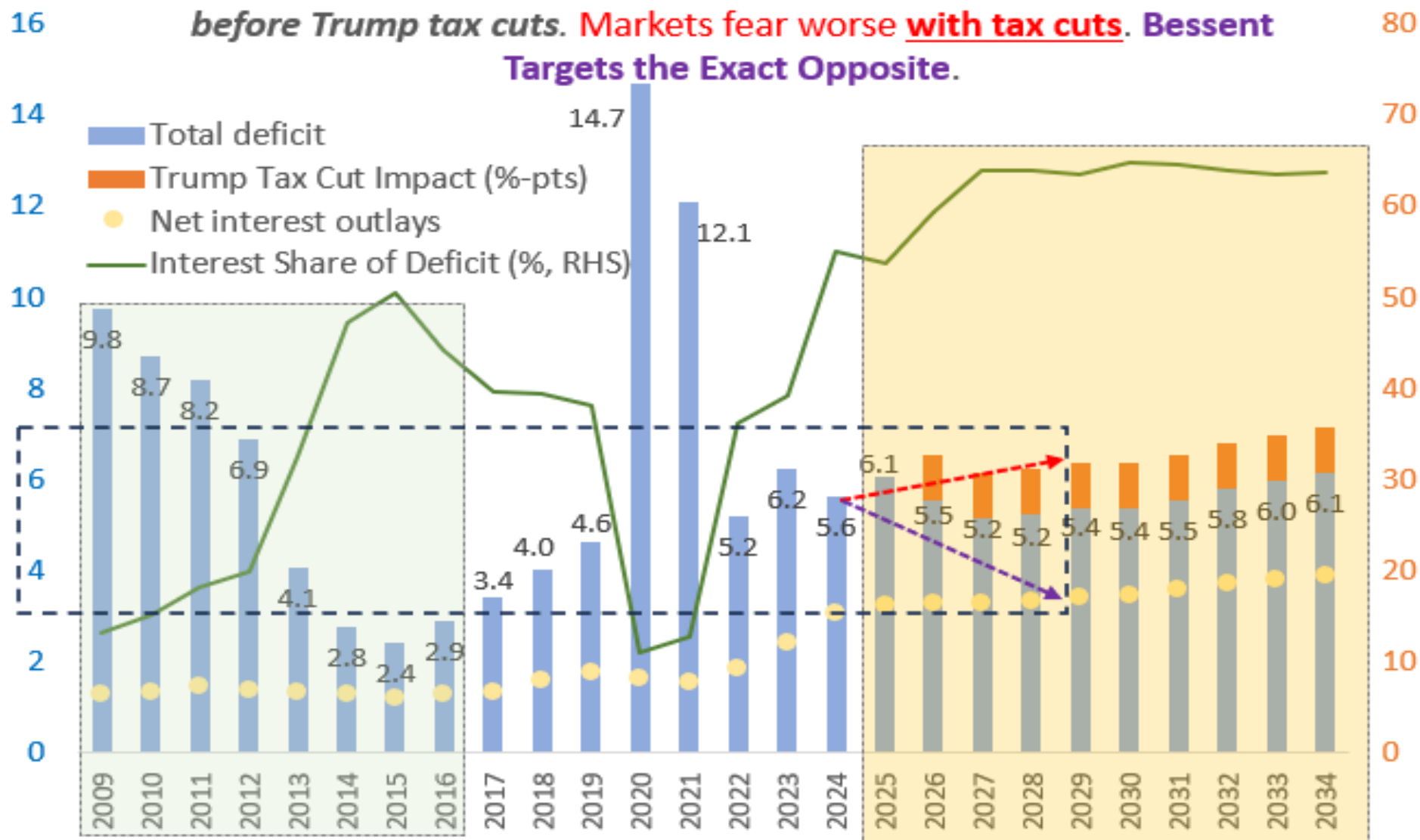


4a. The “Bessent Effect”: What to Make of the “Three 3s”



4b. Enough for Direction of Travel to Surprise!

US Post-GFC Fiscal Deficit: CBO Projects deficit hitting ~6% even **before Trump tax cuts**. **Markets fear worse with tax cuts**. **Bessent Targets the Exact Opposite.**



4c. Interest Rates Must Be Part of the Answer!

US Post-GFC Fiscal Deficit: CBO Projects deficit hitting ~6% even before Trump tax cuts. Markets fear worse with tax cuts. Bessent Targets the Exact Opposite.

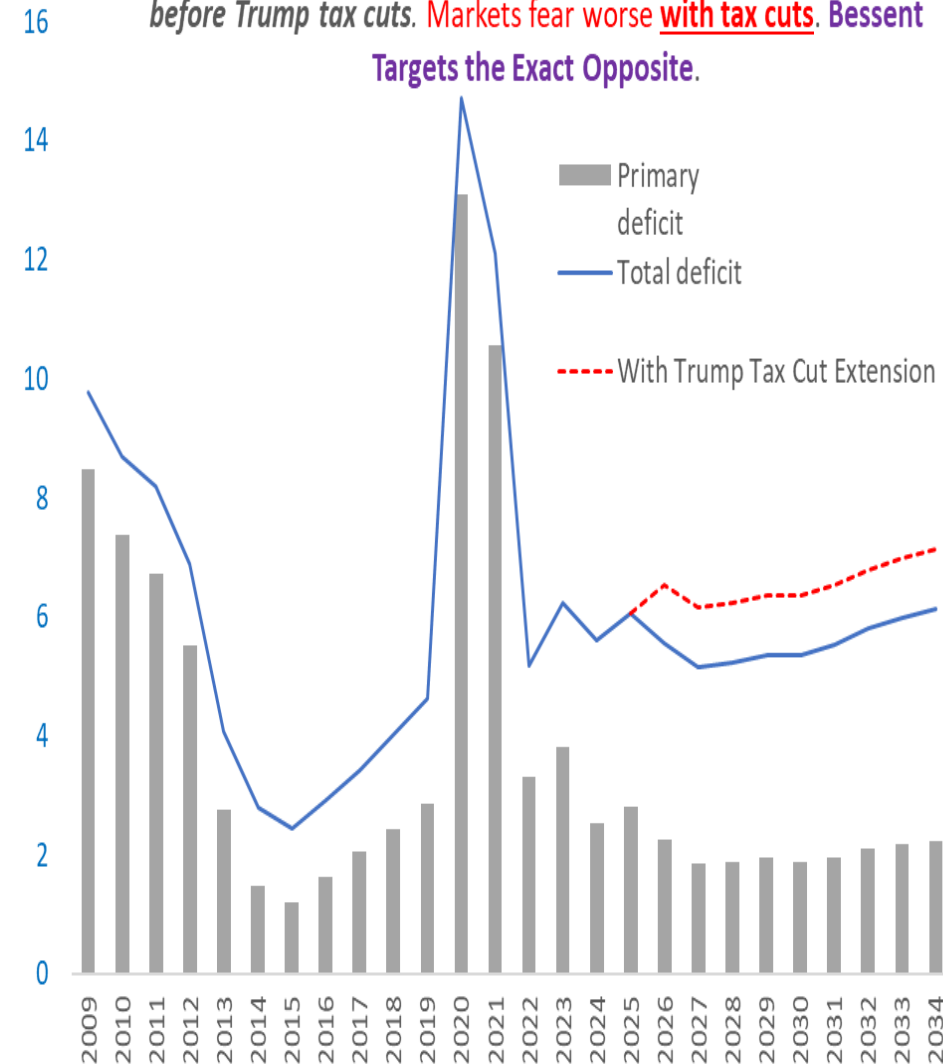
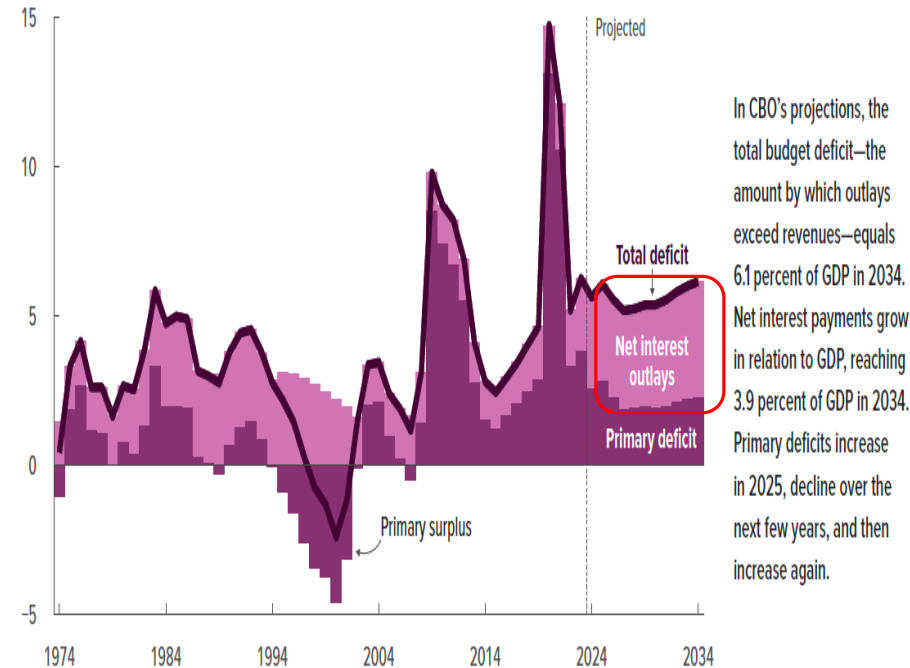


Figure 1-1.

Total Deficit, Net Interest Outlays, and Primary Deficit

Percentage of GDP



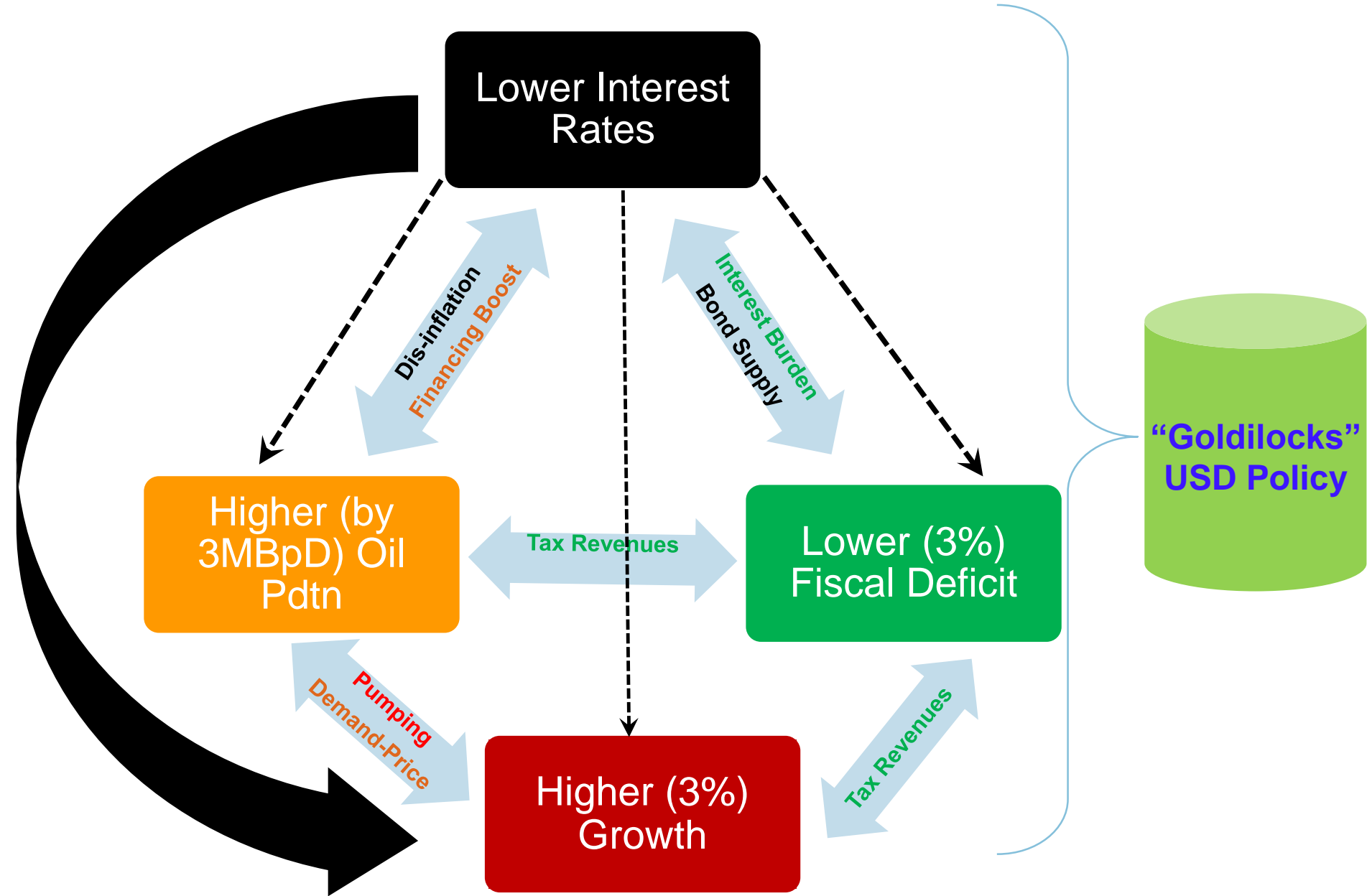
Data source: Congressional Budget Office. See www.cbo.gov/publication/59710#data.

When October 1 (the first day of the fiscal year) falls on a weekend, certain payments that would have ordinarily been made on that day are instead made at the end of September and thus are shifted into the previous fiscal year. All projections presented here have been adjusted to exclude the effects of those timing shifts. Historical amounts have been adjusted as far back as the available data will allow.

Primary deficits or surpluses exclude net outlays for interest. When outlays exceed revenues, the result is a deficit. In this figure, deficits and surpluses were calculated by subtracting revenues from outlays; thus, positive values indicate deficits, and negative values indicate surpluses. When outlays are subtracted from revenues, as recorded in the federal budget and in the tables in this chapter, negative values indicate deficits, and positive values indicate surpluses.

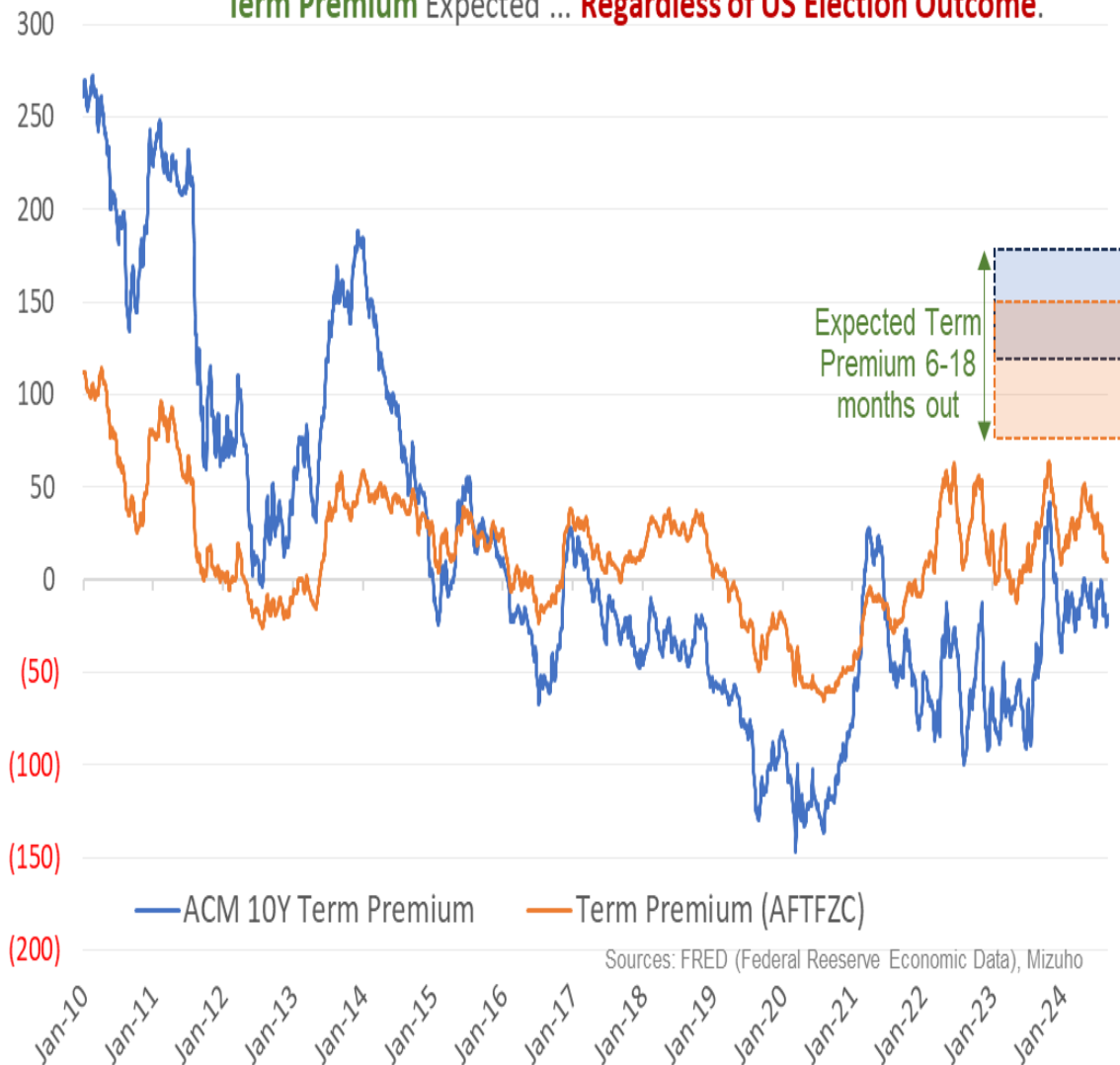
GDP = gross domestic product.

5a. Lower Rates as the “Bridge” to (& From) Three-3s ➔ The One Ring!



5b. Caveat is that the Structural View is for Higher Term Premium Beyond Cyclical Forces

Modelled 10Y UST Term Premia (bp): A **Sustained & Structural Pick-up in Term Premium** Expected ... **Regardless of US Election Outcome.**



Significant & Structural lift in term premium, accentuating the policy cycle buoyancy expected in longer-end yields (in re-steepening), a key macro risk

i) Inflation Expectations: Up & Uncertain?

- First, **structurally higher inflation**, associated with *de-globalization threats that feature antagonistic US-China geo-politics**** colliding with “green-flation”.

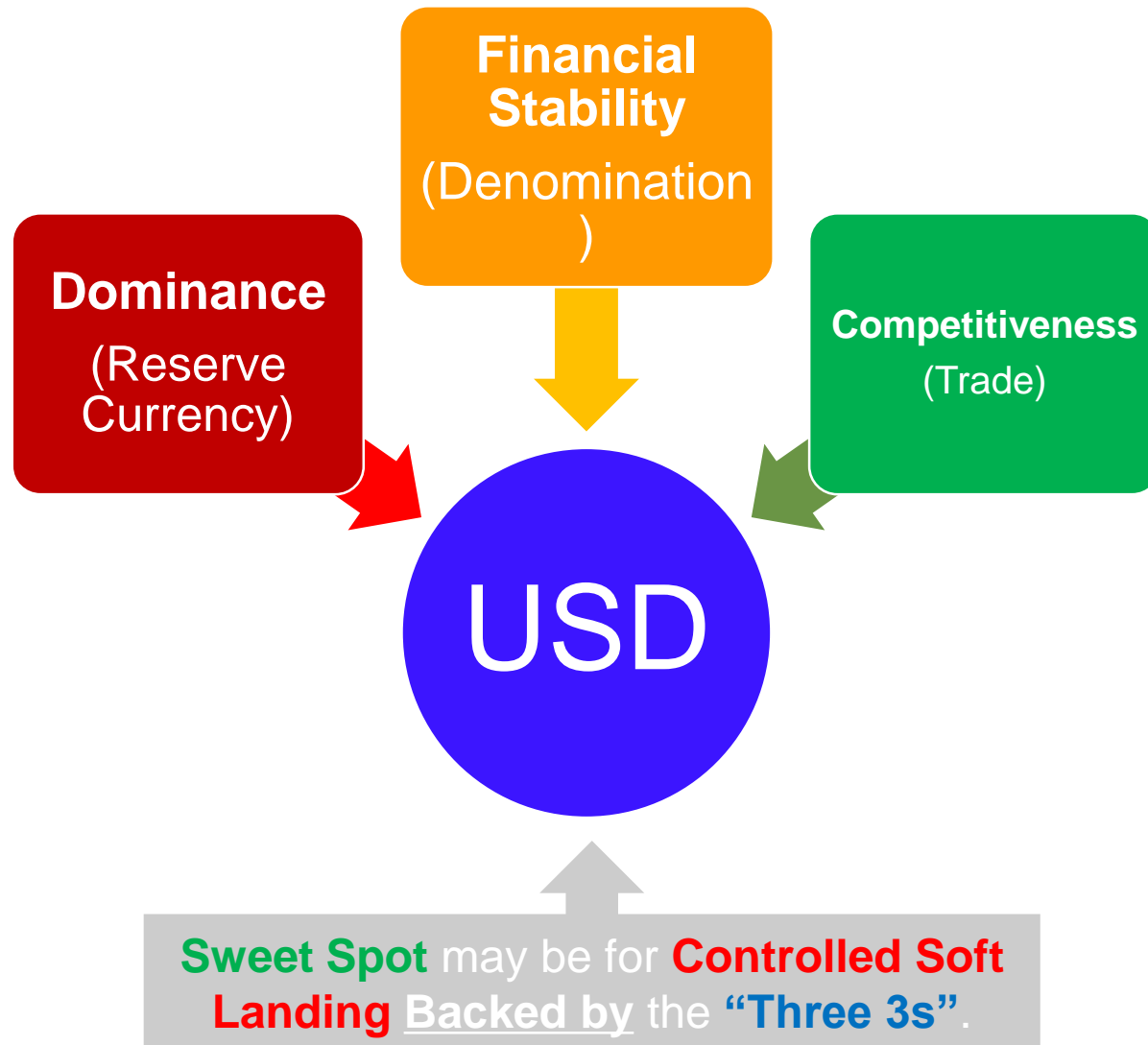
ii) Geo-Political/Social Costs Termed Out

- Moreover, **conflict/geo-political tensions raising longer-end bond supply globally**, exacerbated by a *more isolationist and less predictable US*, feature in the term structure via **higher volatility expectations**.

iii) Debt, Debasement & Dollar

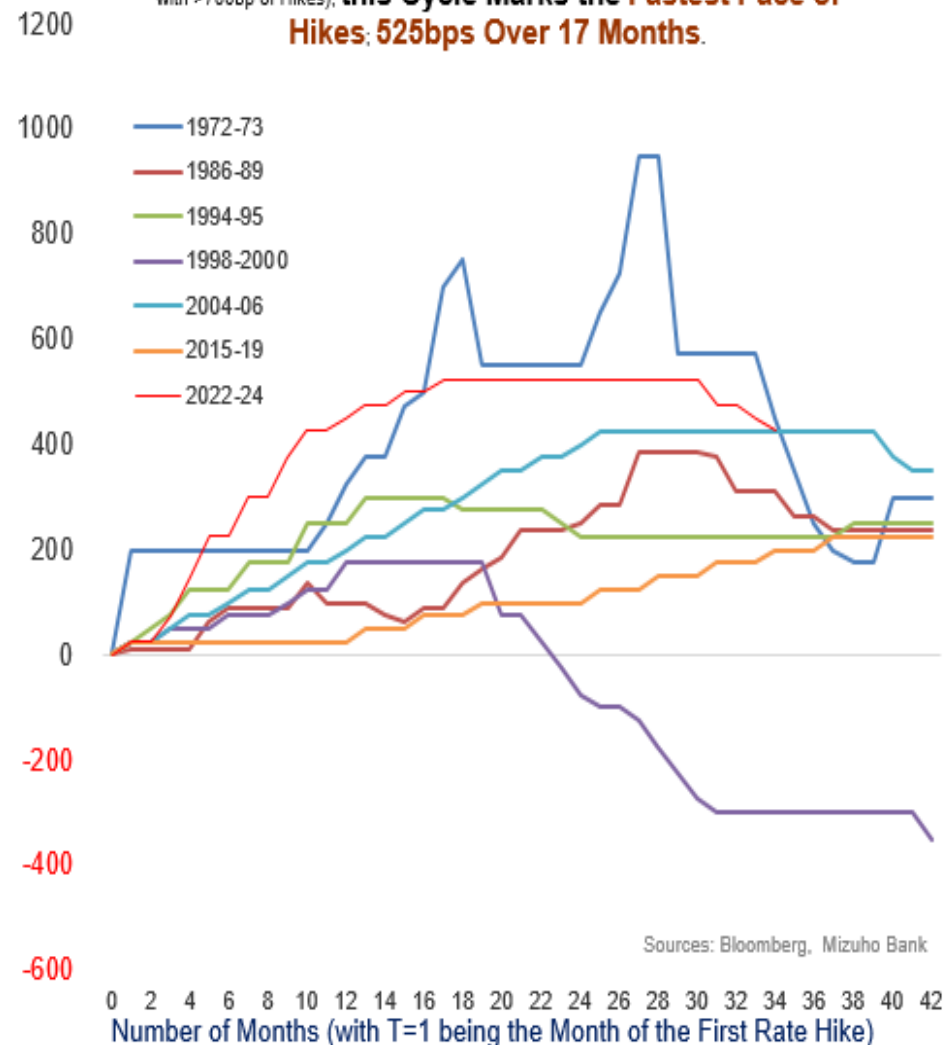
- Crucially**, **dramatically increased**, but **harder-to-time**, **USD debasement risks** from *burgeoning debt*, may emerge as **pronounced UST term premium**.

6a. USD Policy Tensions → **Soft-Landing for USD?** → **Cool, Not Crash**



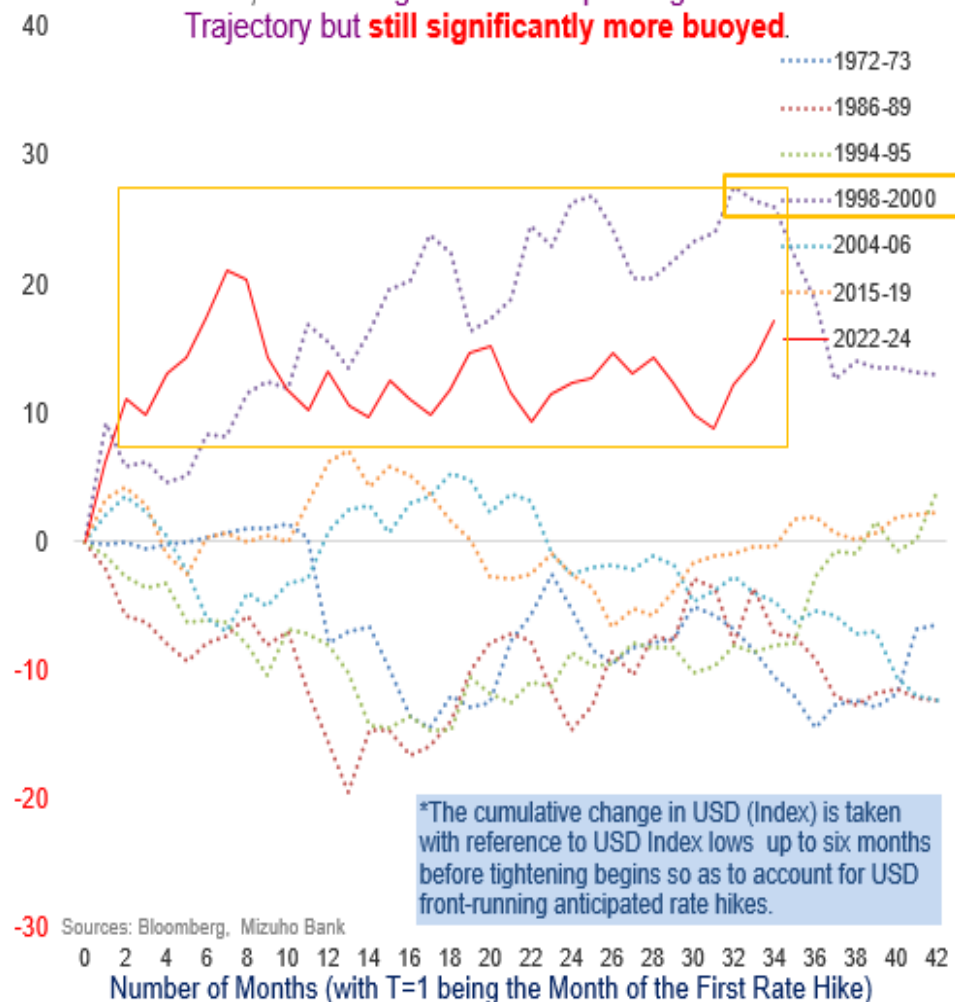
6b. USD: Atypical Late-Stage USD Strength

Fed Hiking Cycle (Cumulative Rate Hikes; bp): Although not the Greatest Amplitude of Rate Hikes (1970s More Brutal, with >700bp of Hikes), this Cycle Marks the Fastest Pace of Hikes; 525bps Over 17 Months.

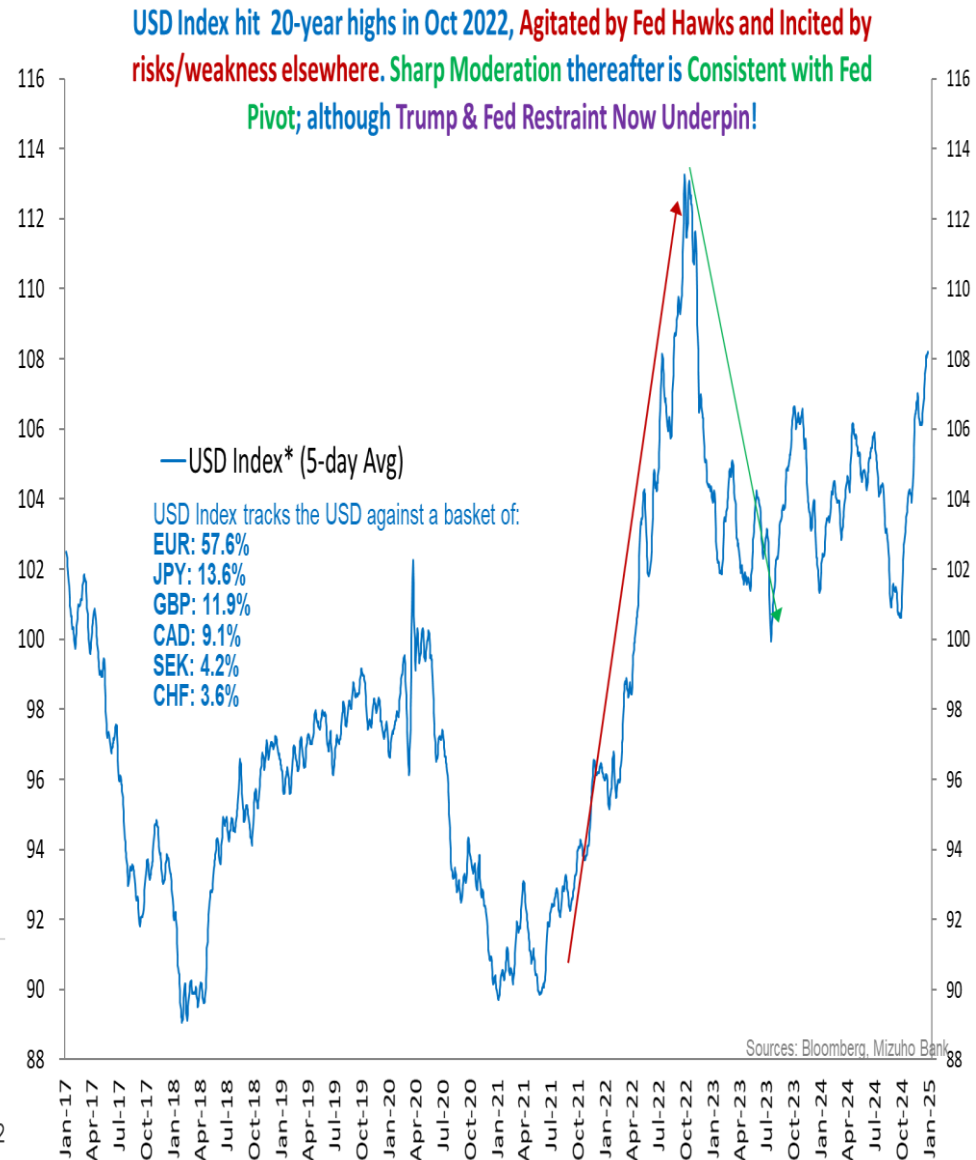
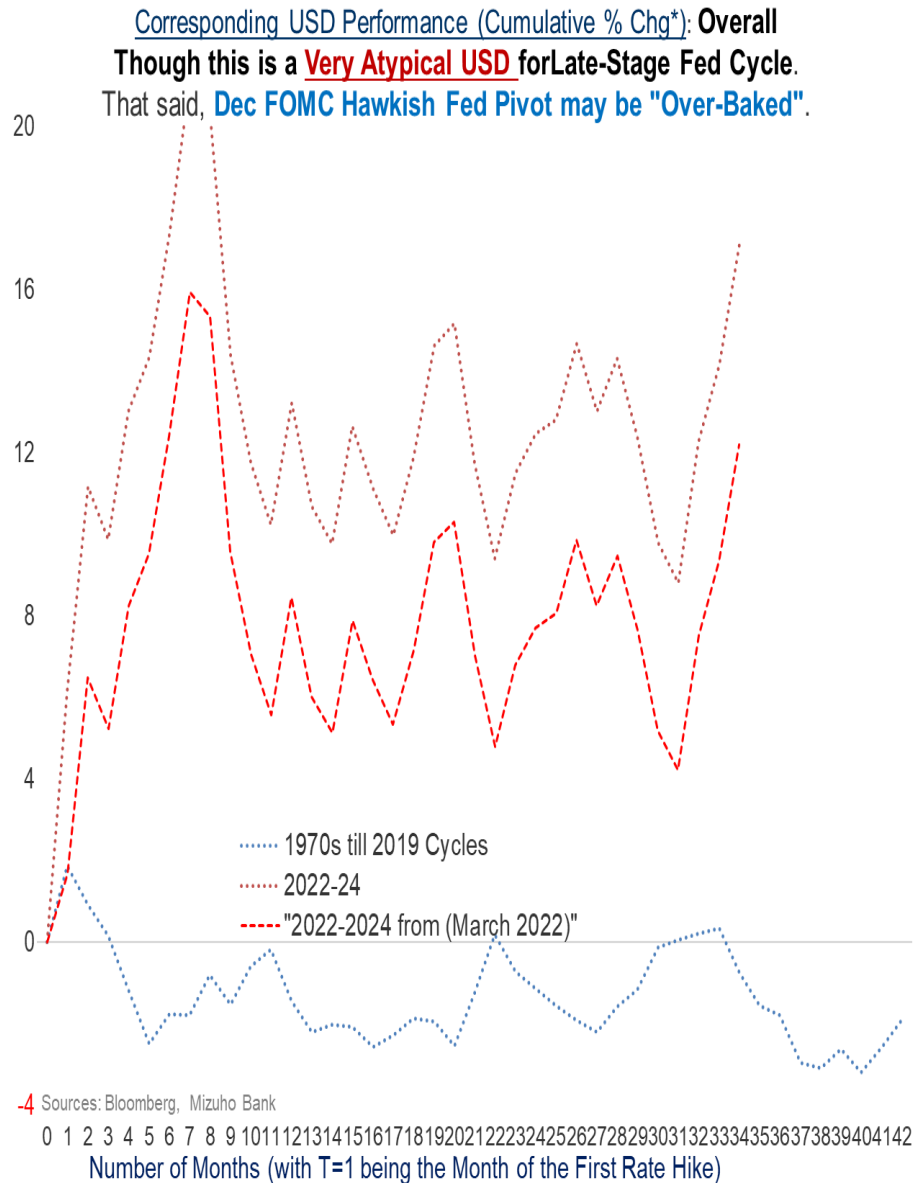


Corresponding USD Performance (Cumulative % Chg*):

Notably, the **Current Rate Hike Cycle** Has Resulted in the Sharpest Phase of USD Strength in the First 8-9 months; moderating below corresponding 1998-2000 Trajectory but **still significantly more buoyed**.

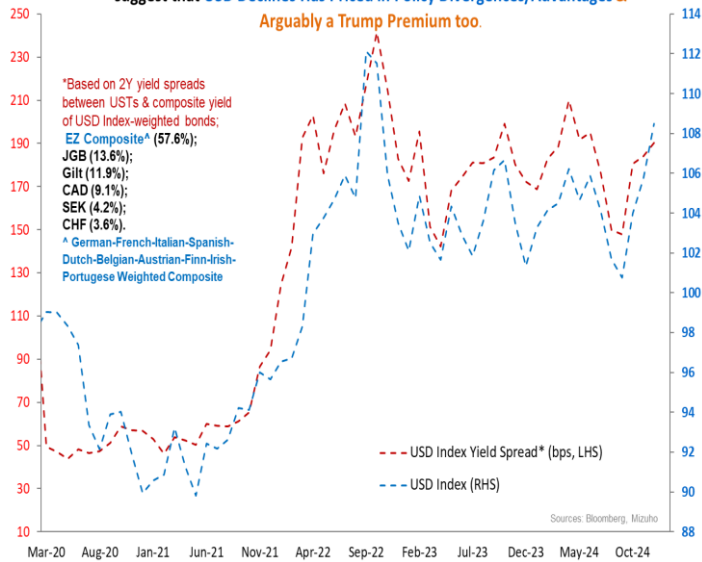


6c. USD Appears to be Priced to Peak Trump & Hawkish Fed Pivot

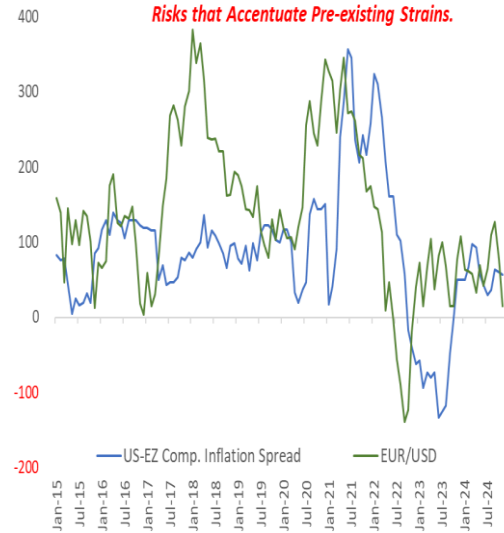


6d. Whereas, EUR & GBP are Compromised. So USD May be Tempered

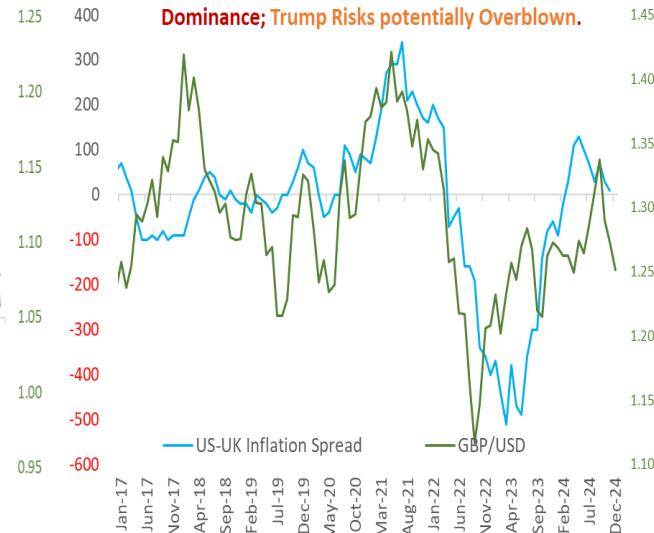
Fed & USD: 2Y UST yield spreads (vs. a composite of Yields based on the USD Index)
 suggest that **USD Declines Has Priced in Policy Divergences/Advantages & Arguably a Trump Premium too.**



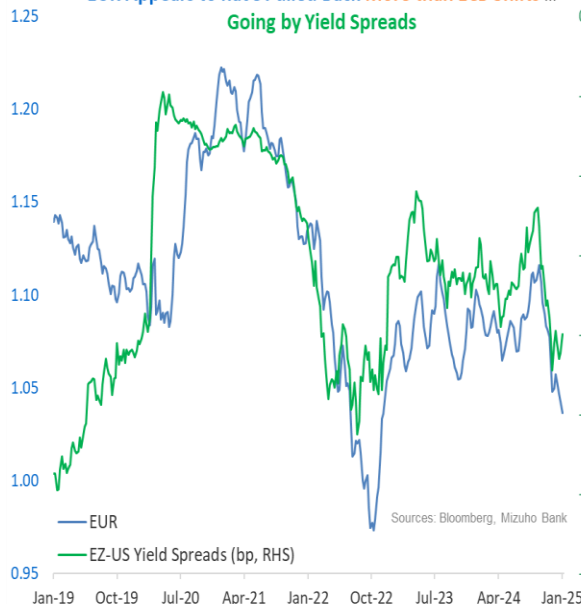
US-EZ Inflation Spread (bp): US-EZ Inflation Underscore
 Limitations on **EUR Buoyancy. Especially amid Trump 2.0**
Risks that Accentuate Pre-existing Strains.



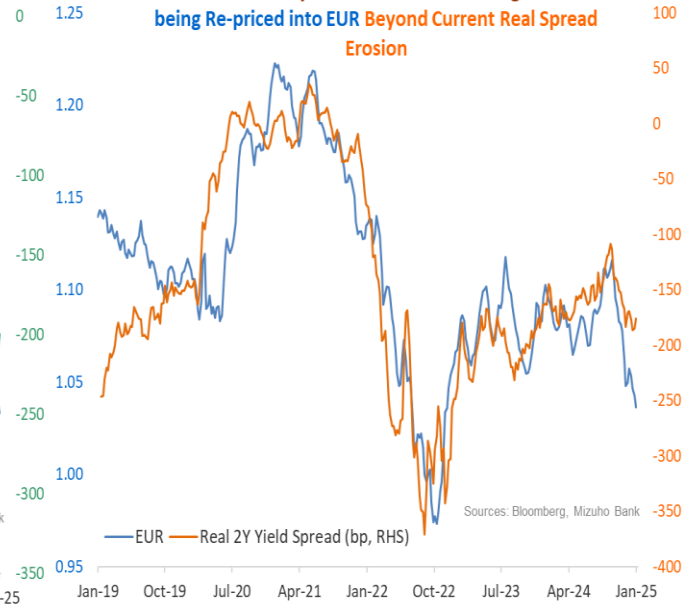
US-UK Inflation Spread (bp): GBP at a Discount as
Relative Stagflation Risks Amplify the case for USD
Dominance; Trump Risks potentially Overblown.



EUR Appears to have Pulled Back More than ECB Shifts ...
Going by Yield Spreads



... But One Possibility is More Pronounced Stagflation Risks
being Re-priced into EUR Beyond Current Real Spread
Erosion

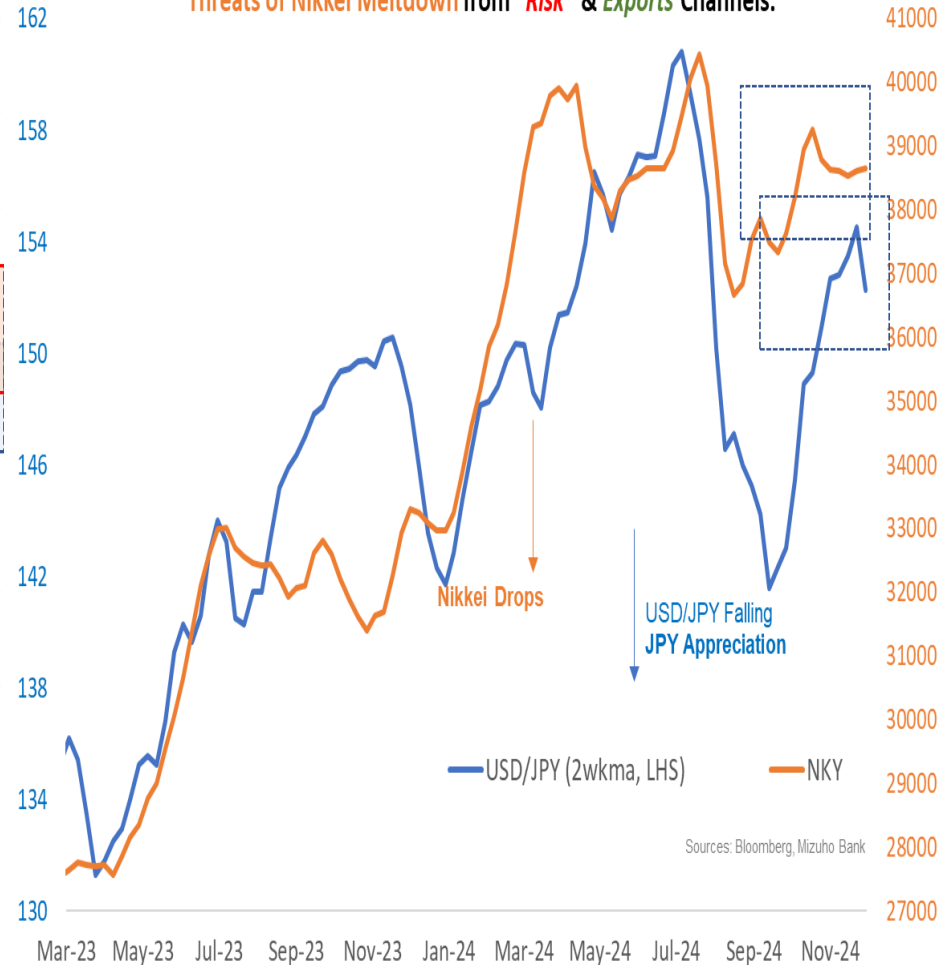
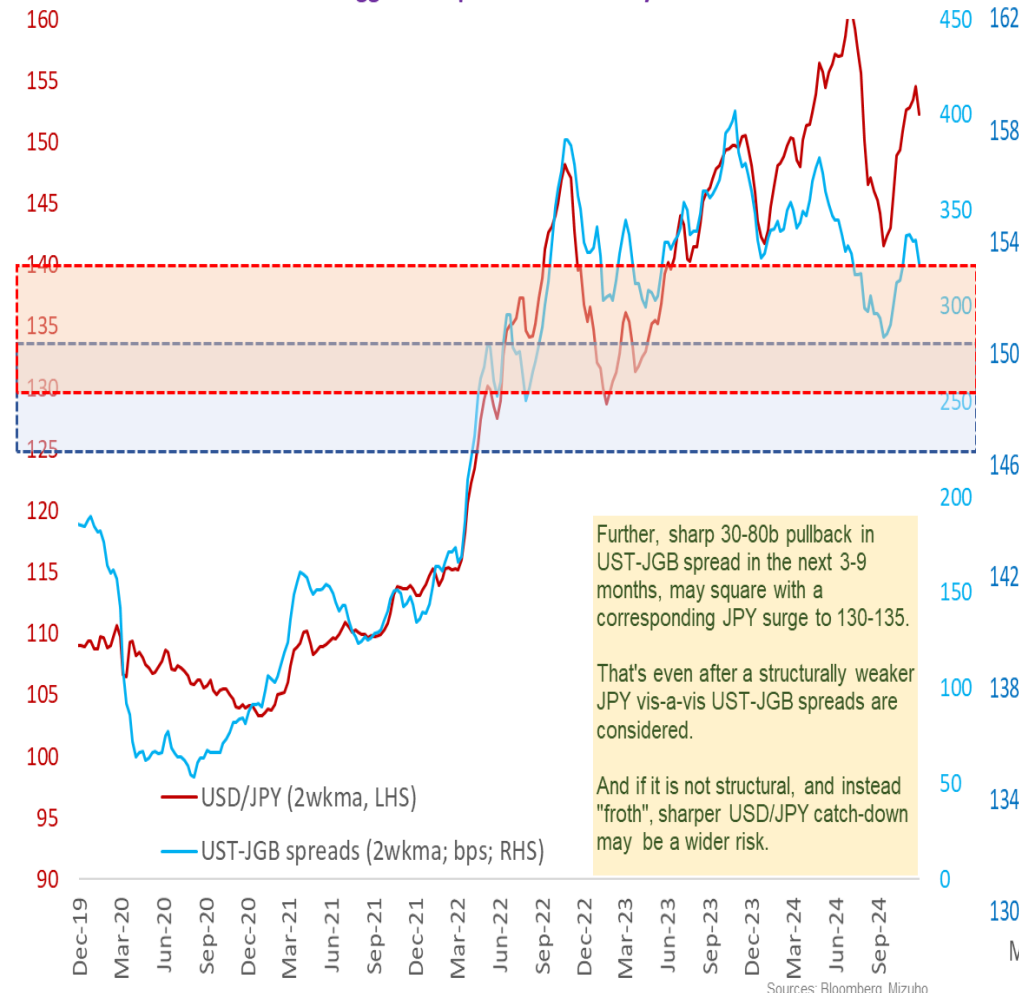


6e. FX - JPY-BoJ Risks: Trump 2.0 Heightens Inherent

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 Accentuate **JPY Rebound (USD/JPY Pullback)** From 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.



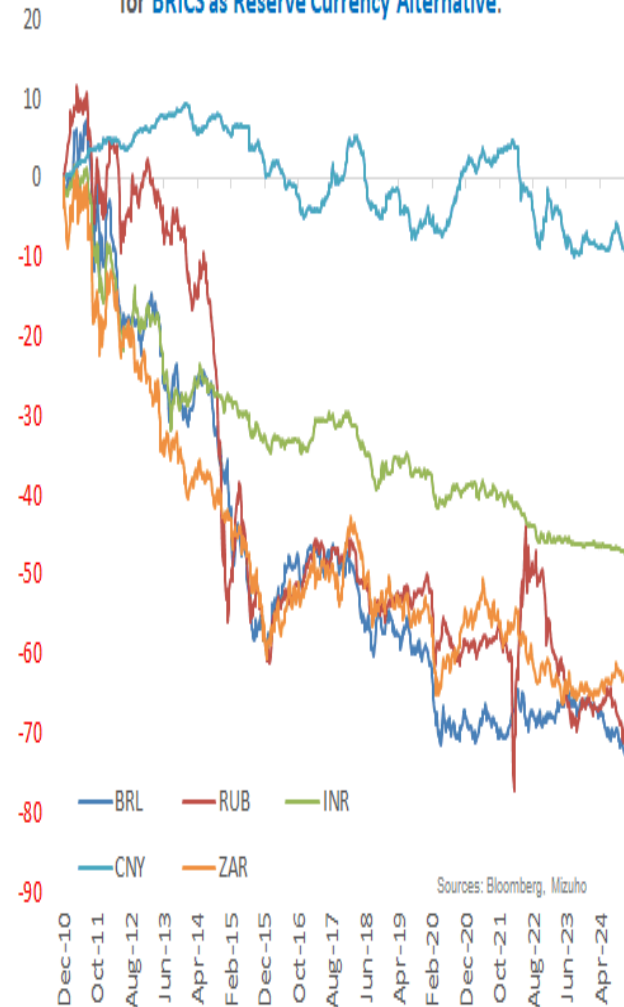
USD Narrative: Trump USD Front-Loaded, Not Unfettered

The USD Backdrop

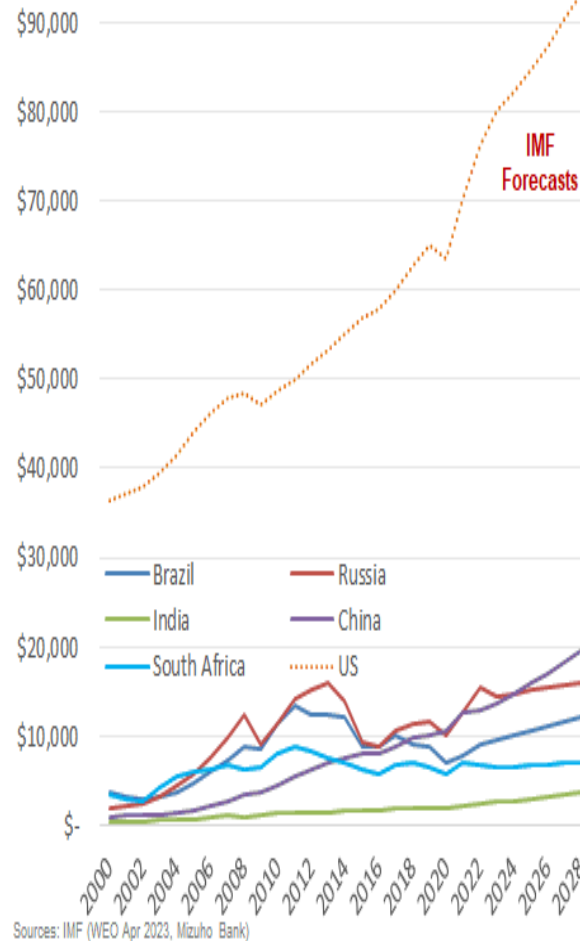
- 1) **The Trump USD:** **Trump 2.0 provides a significant level boost to USD dynamics** that is expected to be pronounced through most of H1 2025 at least, **but perhaps not unremittably so**. Fact is, **Trump's** (loudly) **articulated posture** (be it policy and diplomatic), and associated bombast are mostly **inclined to boost the USD** through one of **two channels**. The **first** is via **'USD exceptionalism'** and **corresponding USD boost**. The **other** is from mechanisms of **US antagonism**, which in turn, **undermines the currencies at the receiving end**. In any case, and more comprehensively, **geo-politics, energy policies** and **relative monetary policy shifts** are all **also positioned to align with a stronger USD**.
- 2) **But Not Spared Some Doubt/Decay:** Nonetheless, **even for the "Trump USD"**, **unchallenged one-way ascendancy without any signs of decay** is **highly unlikely**. Broadly speaking, **some shine could "USD Trump"** on account of disappointment on the economic front. Especially multiple dimensions of a strong USD (on US exceptionalism and antagonism priced in). This means susceptibility to "disappointments may be under-accounted for. What's more, USD may not be unscathed by retaliation on the trade front. Finally, the Fed easing cycle is not necessarily blown off by, and certainly not mutually exclusive to, by Trump 2.0.
- 3) **Meaningful Back-end Moderation:** In fact, all said, under a confluence of conditions, **USD could mellow meaningfully at the backend of 2025**; as the **worst of risk scenarios are alleviated** (diminished have demand) and at the same time **US exceptionalism is appropriately tempered, such that Fed policy restraint is dialed back**. In other words, a **conspiracy of "fear" and Fed (restraint) firing up the Greenback could unwind**; thereby **moderating the intensity of USD bulls**. Especially if three conditions are fulfilled. Specifically these are:
 - 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.
- 4) **But Controlled Landing, Not Crash:** But even with these conditions, **USD is likely to have a controlled landing, not an unmitigated crash**. Not by a long shot. First off, the early path to a softer USD may be **exceptionally bumpy with bullish detours likely into early-2025**. What's more, given that **softening of US data is unlikely to take a linear path, corresponding** (initial) **stickiness of Fed rates could impede a softer USD**. Furthermore even if US suffered headwinds, sufficiently **acute US recessions may** (initially) **trigger USD strength v(from haven demand)** before USD softens on rate cuts and bottoming. All said, the stage may be set for a **cushioned decline not an uncontrolled downward spiral** (in coming months) tied purely to Fed rate cuts/expectations.
- 5) **Non-Reversion "USD Smile" Slope:** Crucially, the **depth of decline is likely to be far more limited, stopping well short of a "full reversion" to pre-Fed normalization (to ~90 DXY index levels)**. Instead, the **Fed's direction of policy travel** (down in rates) alongside more elevated uncertainty **corresponds to a gently softer USD tracing the slope down the "USD Smile"**.
- 6) **Less Compelling Fiat Alternatives:** More so, as the most liquid **fiat alternatives to the Greenback (such as the EUR, JPY and GBP) are structurally less compelling compared to previous cycles**. This partly explains exceptional support in Gold (that has defied elevated real rates), cryptocurrencies and other real assets. The upshot though is that in relative fiat terms, the **Greenback could appear stronger relative to the past through Fed cuts**. More so, as geo-politics tilts the scale to the advantage of the Greenback.
- 7) **No Real Divergence:** What's more, **in real rate terms, enduring and profound policy divergence, corresponding with a sharp and sustained USD drop, is unlikely**. Point being, the US is unlikely to go it alone with large and fast rate cuts, checking nominal divergence. And US dis-inflation is not particularly vulnerable to falling significantly short. Especially **given superior domestic buffer to energy shocks** (from geo-politics) in Europe and Japan. Again, this **checks the extent of USD pullback**.

6e. Bessent Stresses on Reserve Currency Dominance → Trump Has Fired the Warning Shot

Cumulative FX Chg (% since end-2010): **Steep Losses & Bouts of Heightened Volatility Undermines the Case for BRICS as Reserve Currency Alternative.**



GDP per Capita (US\$): With **US per capita income at more than four times** that of any of the BRIC economies, the **disparity in end-demand is stark.**

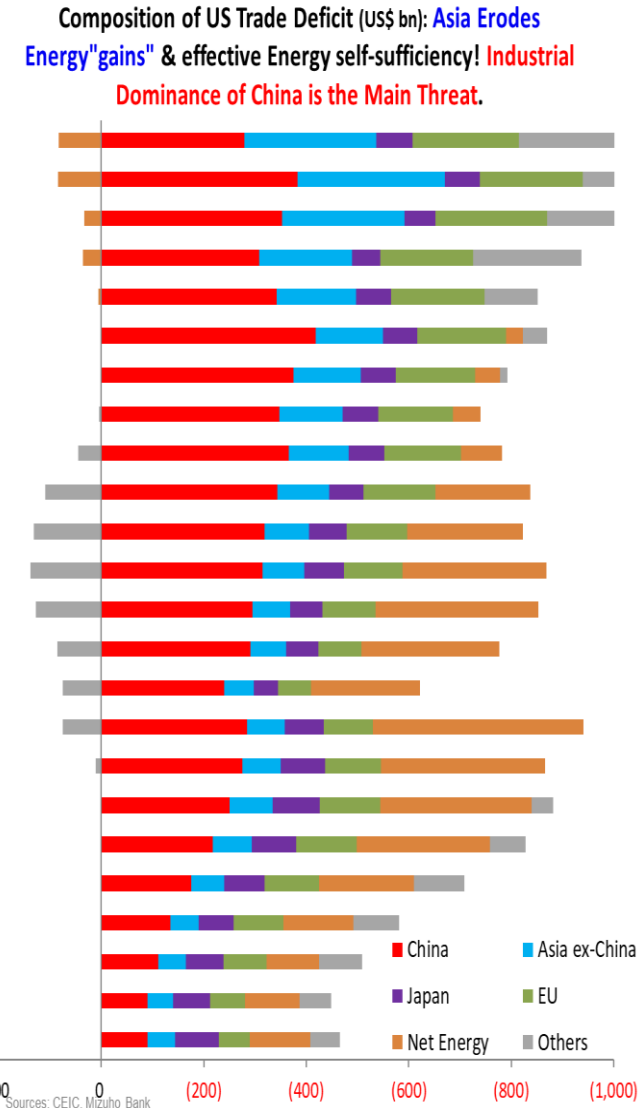
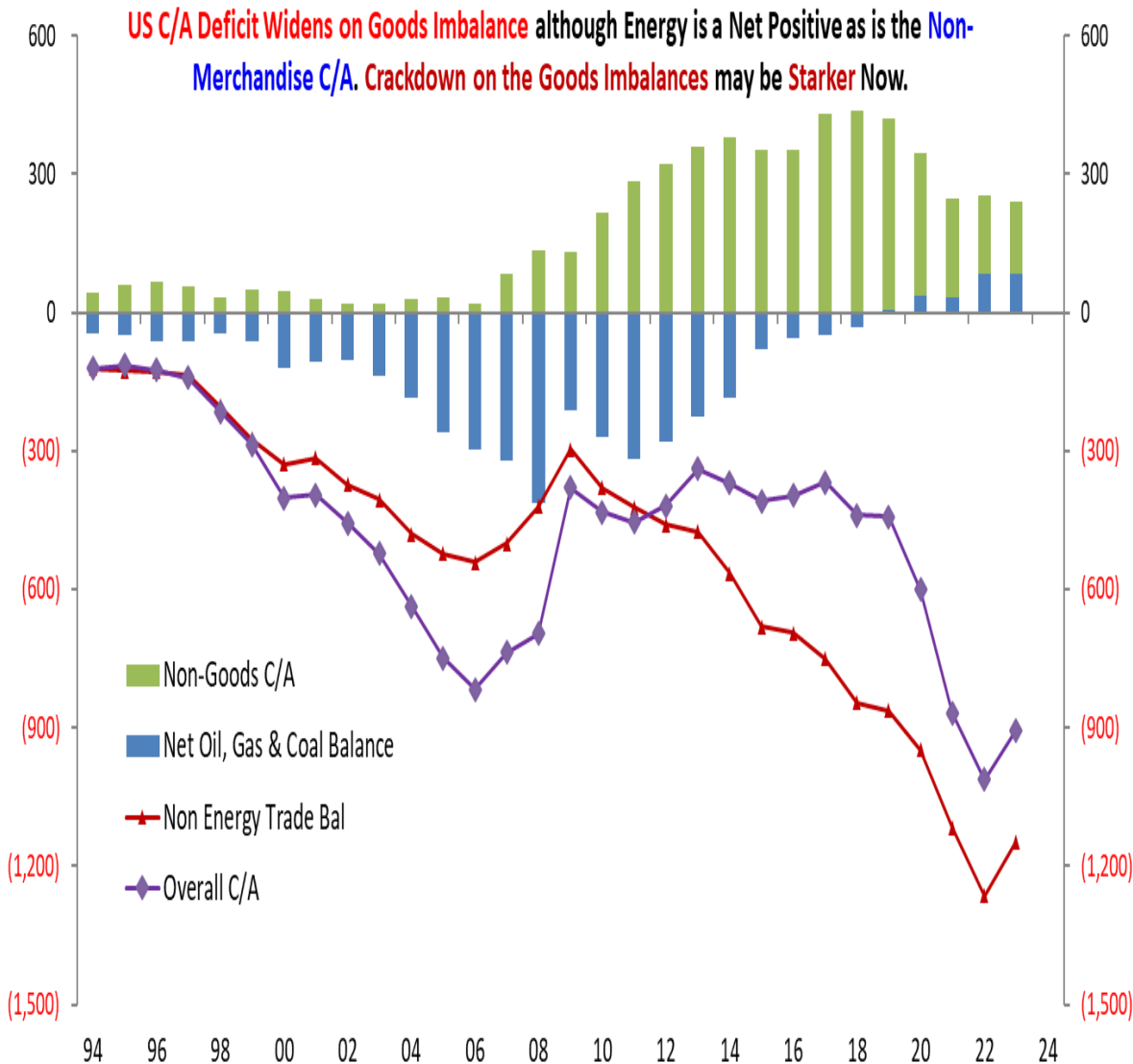


Donald J. Trump
@realDonaldTrump

The idea that the BRICS Countries are trying to move away from the Dollar while we stand by and watch is OVER. We require a commitment from these Countries that they will neither create a new BRICS Currency, nor back any other Currency to replace the mighty U.S. Dollar or, they will face 100% Tariffs, and should expect to say goodbye to selling into the wonderful U.S. Economy. They can go find another "sucker!" There is no chance that the BRICS will replace the U.S. Dollar in International Trade, and any Country that tries should wave goodbye to America.

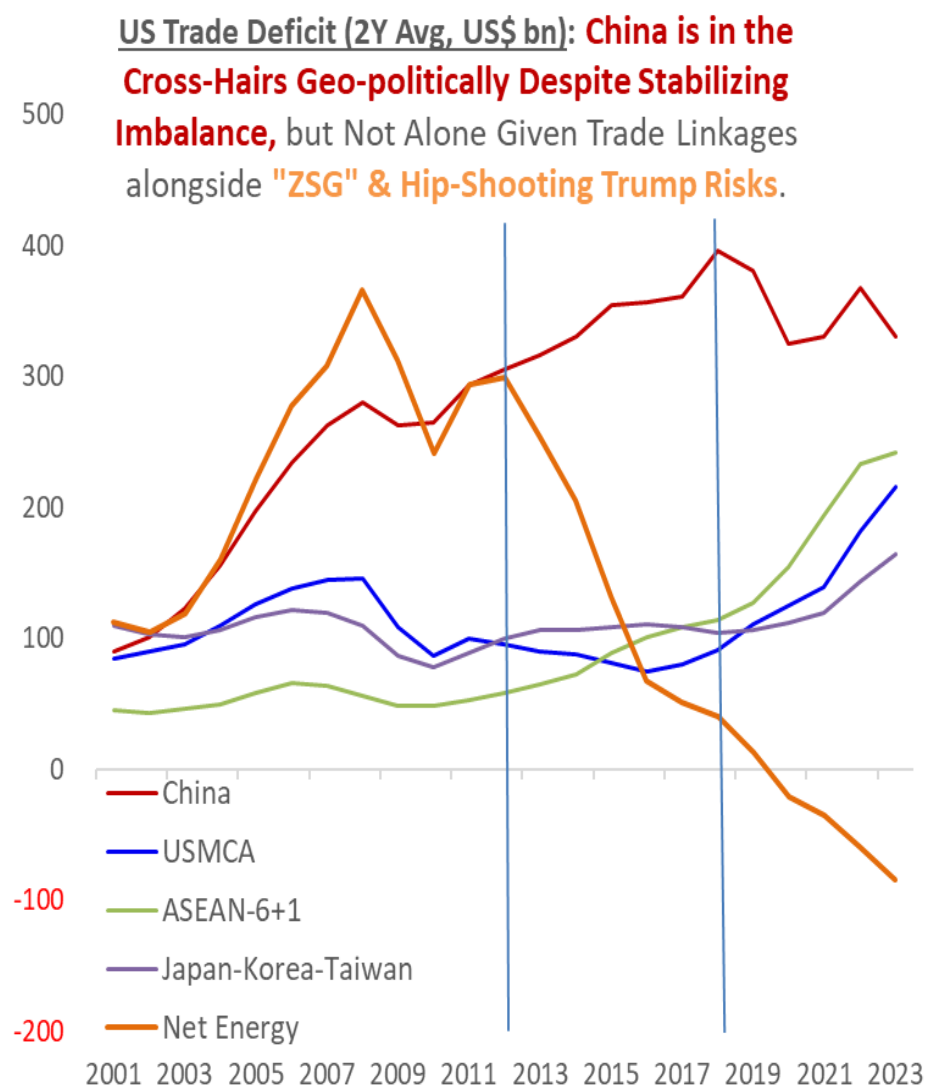


7a. Trade Risks: Risks Go Well Beyond China

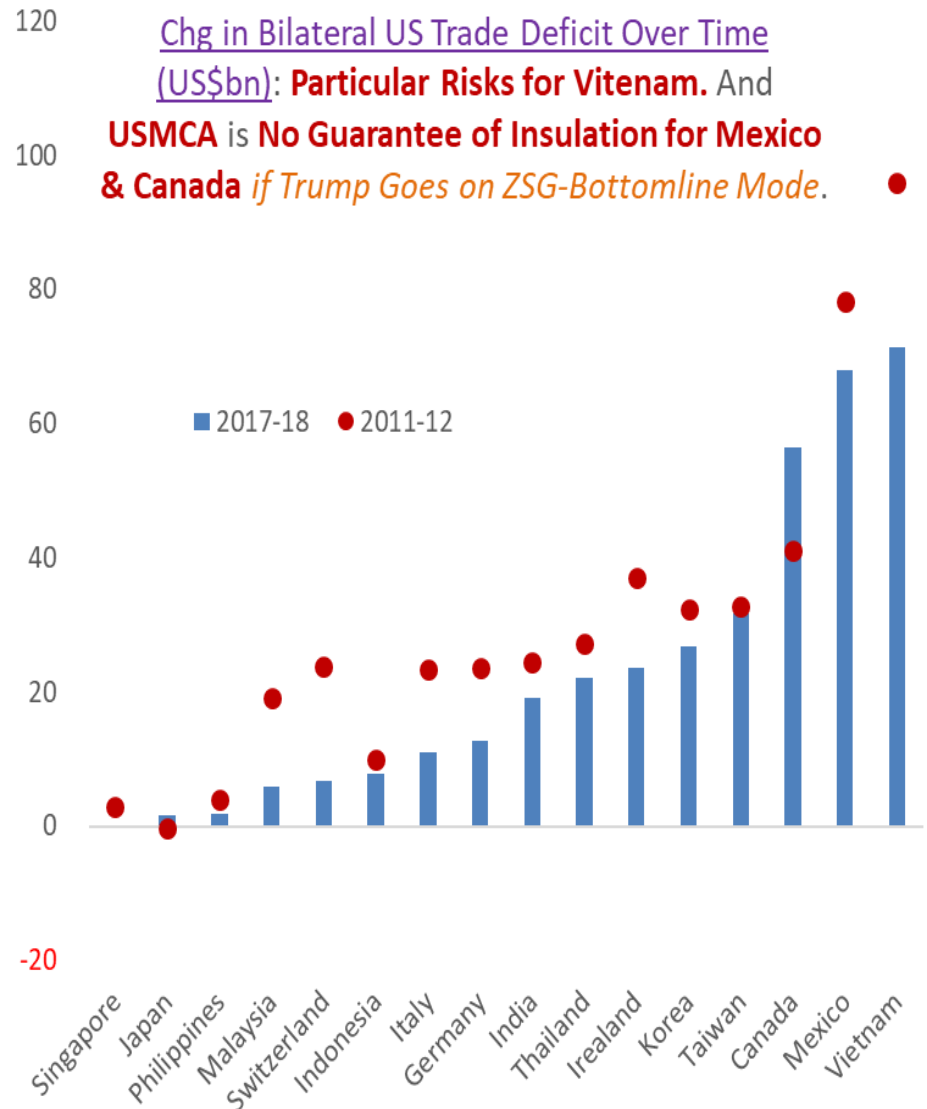


7b. Trade Risks: Excluding China, a Few Key Economies Led by Mexico & Vietnam at Risk

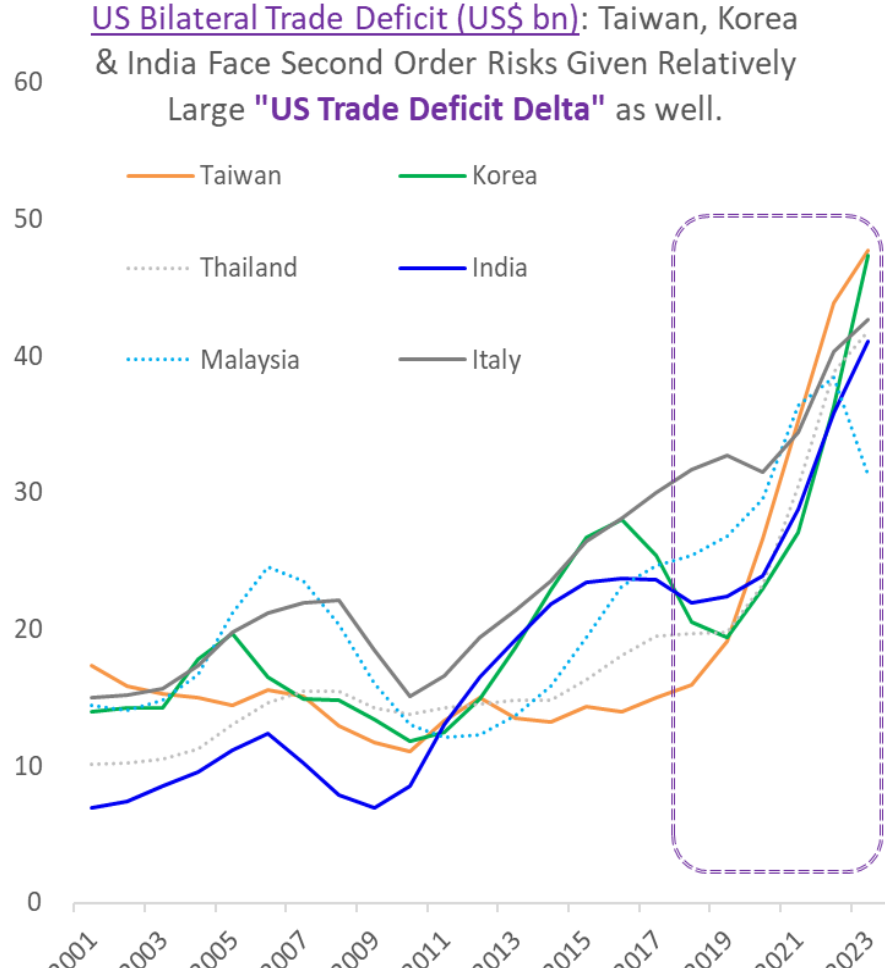
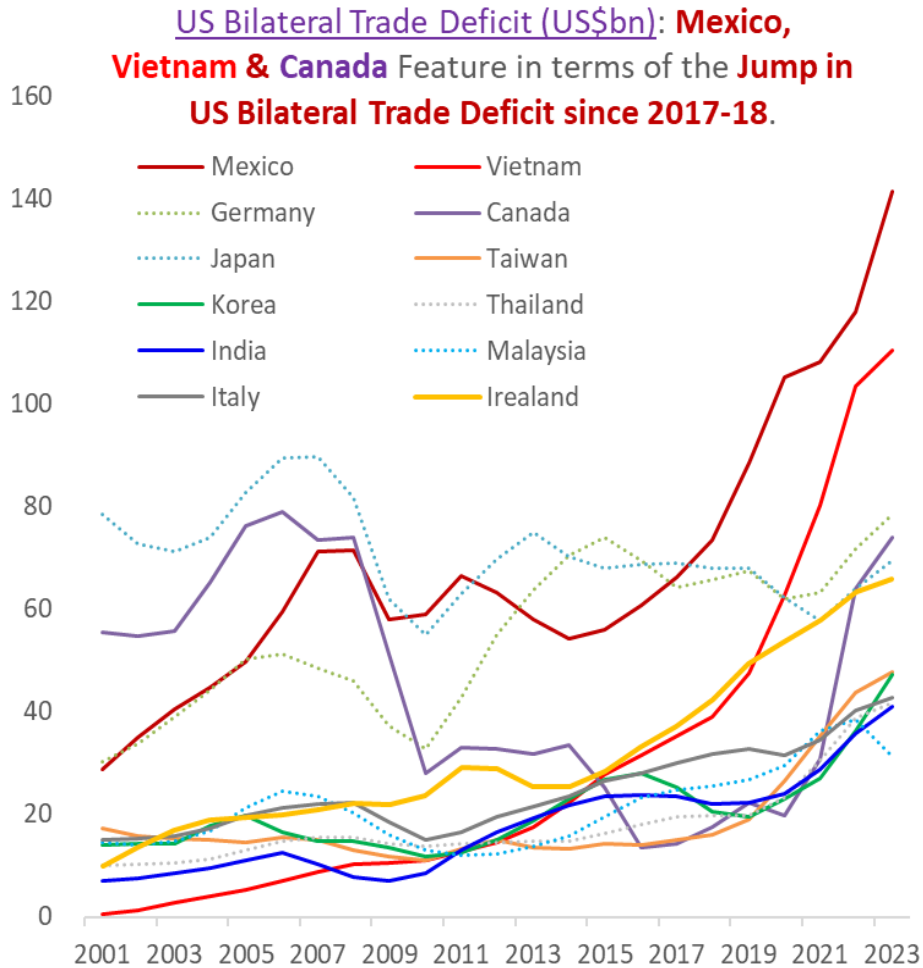
US Trade Deficit (2Y Avg, US\$ bn): China is in the Cross-Hairs Geo-politically Despite Stabilizing Imbalance, but Not Alone Given Trade Linkages alongside **"ZSG" & Hip-Shooting Trump Risks.**



Chg in Bilateral US Trade Deficit Over Time (US\$bn): Particular Risks for Vitenam. And **USMCA is No Guarantee of Insulation for Mexico & Canada** if Trump Goes on ZSG-Bottomline Mode.



7c. Winners & Losers: Vietnam is in a Precarious Position amid Trump 2.0 Uncertainties



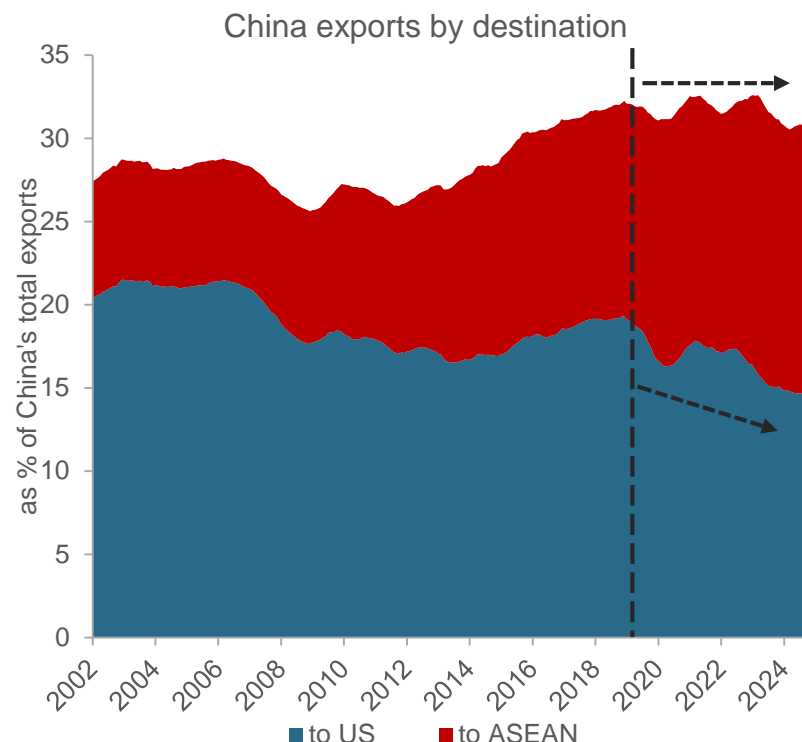
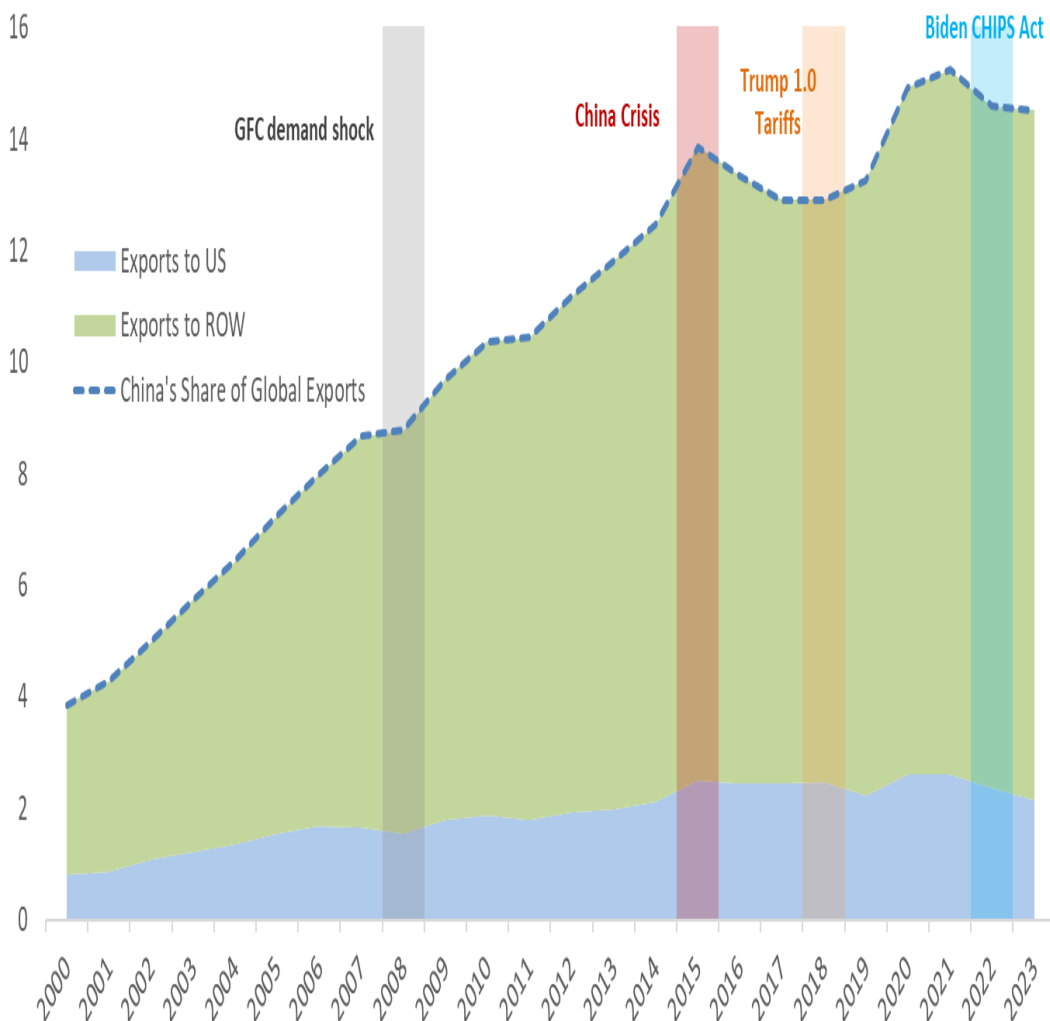
US Bi-lateral Trade Deficit

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

8a. Does China Have a Trump Card? → Unfettered Global Exports Share

China's Share of Global Exports Not Adversely Affected by Trump 1.0 Tariffs. In fact Trade

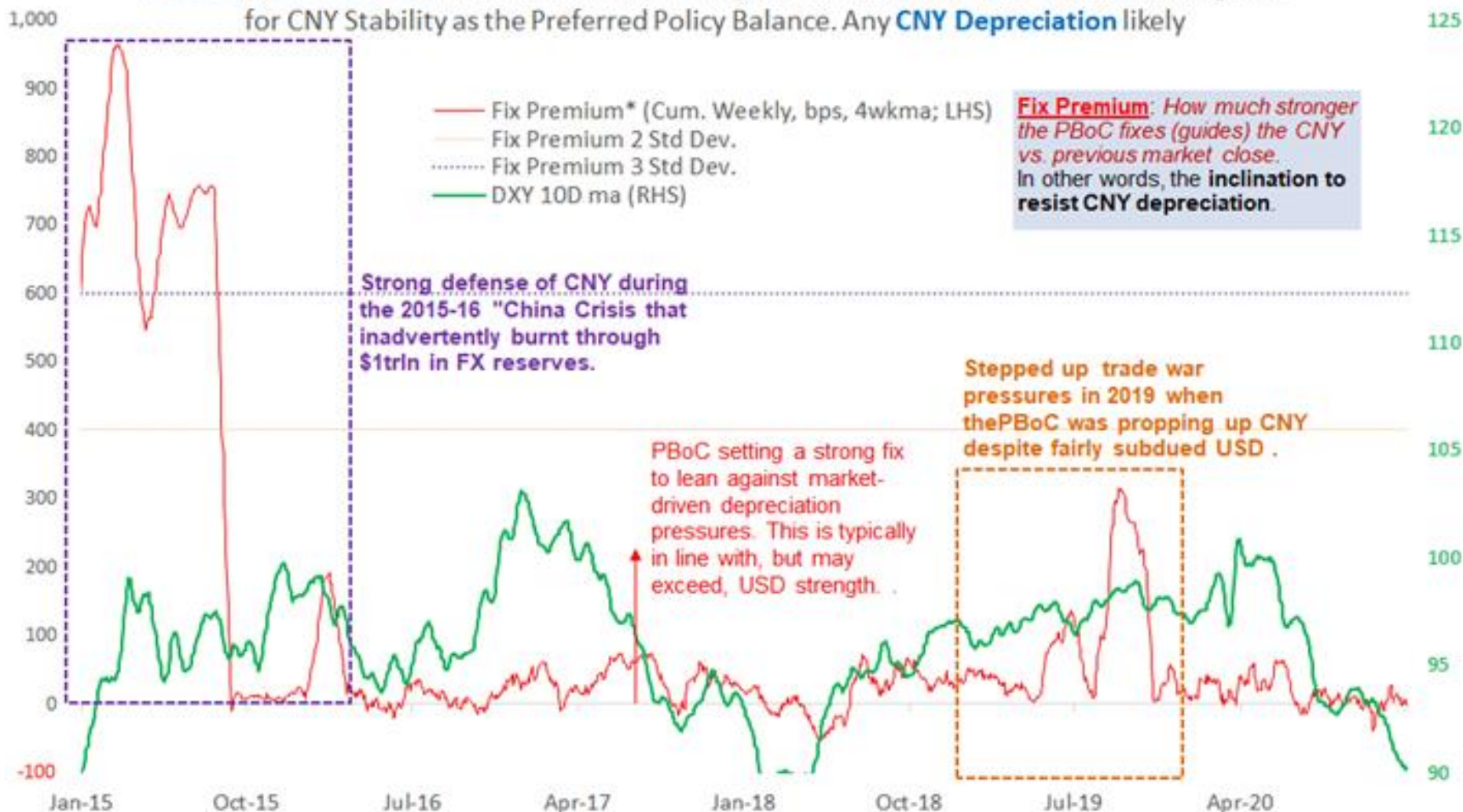
Biden's Targeted CHIPS Act might have had some Dampening Impact.



- China's trade sector has demonstrated greater resilience than many had expected:
 - Despite a decline in China's share of exports to the US, its share to ASEAN has steadily increased during the same period.
 - Current export levels to the US remain higher than those recorded in 2019, when most additional tariffs were implemented.

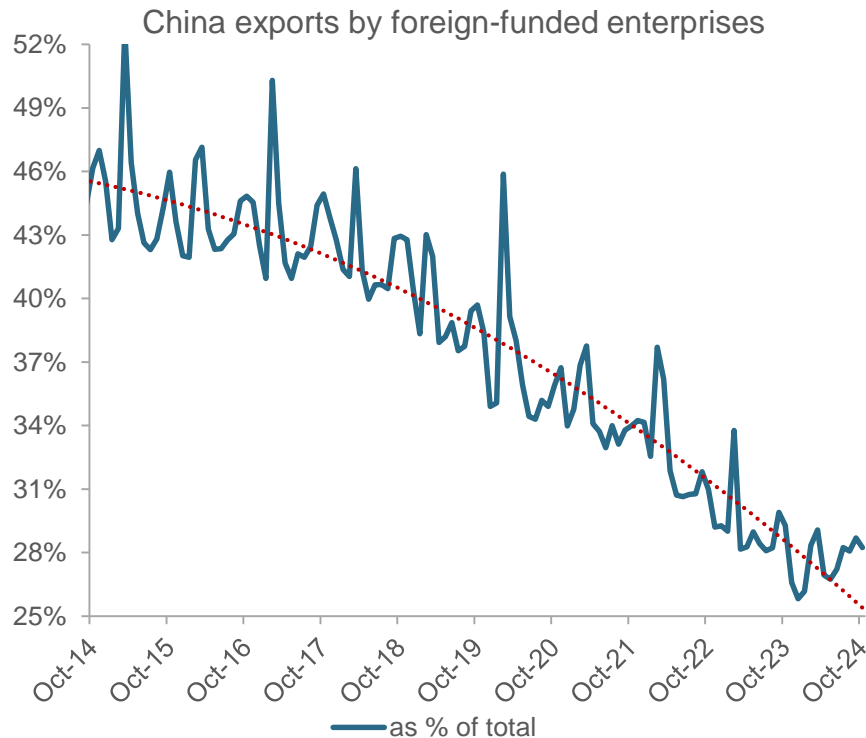
8b. Beijing Cannot Afford Cheap RMB, But Nor Can it Side-Step Turbulence

PBoC-Driven Appreciation/Depreciation Bias: Through the **Trump 1.0 Trade Conflict**, the PBoC supported the CNY rather than suppressing it. This underscores the overwhelming case for CNY Stability as the Preferred Policy Balance. Any **CNY Depreciation** likely

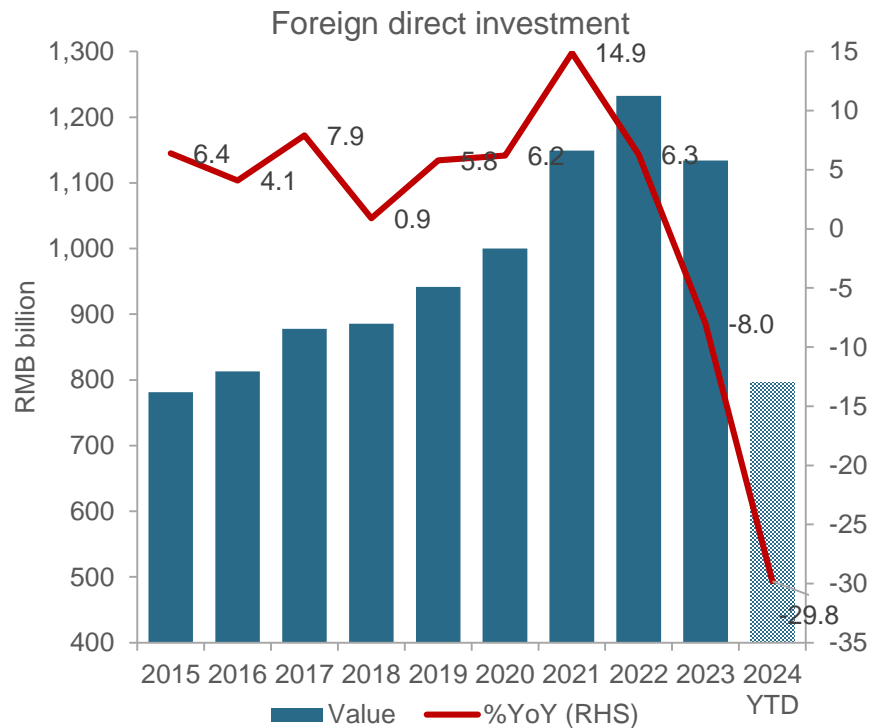


8c. Geo-economic Realities Accentuate “China+1” & Overcapacity Feedback Loops

- With the relocation of export-oriented factories away from China, there will be a steady rise in overcapacity along the manufacturing supply chains.
- Foreign direct investment is poised to see a YoY decrease for the second consecutive year, with its level likely reaching a new low since 2015.

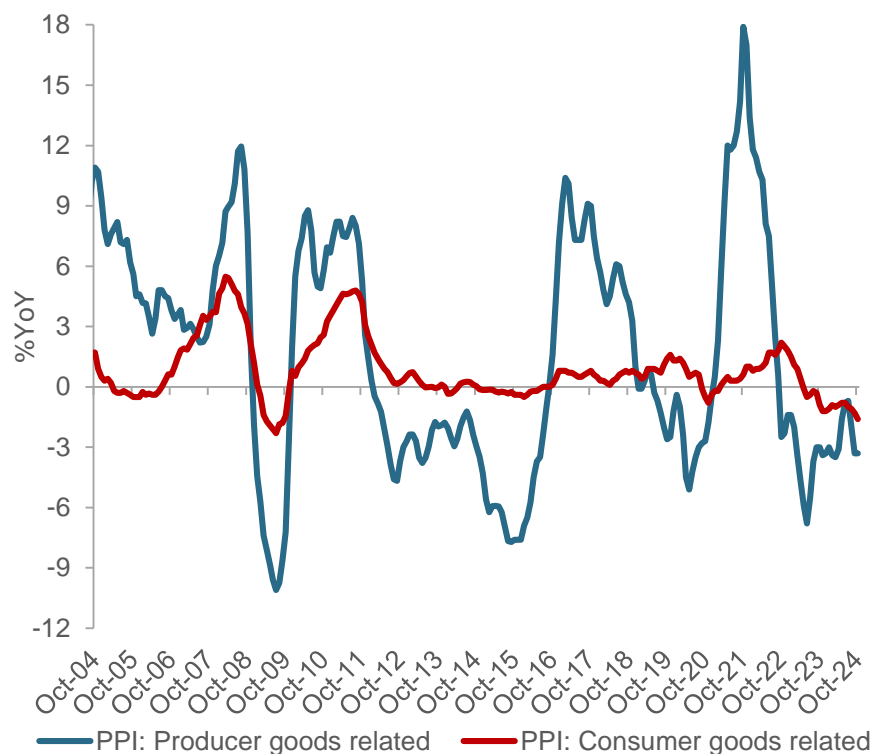


Source: CEIC, Wind, Mizuho

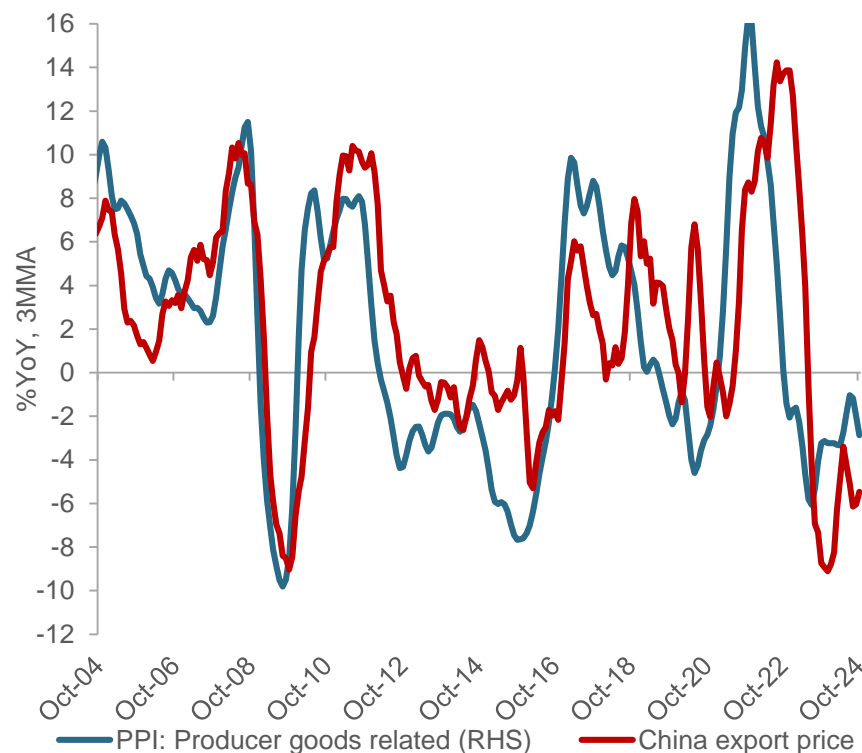


8d. Overcapacity is Ultimately Deflationary for China amid Profits Shake-down

- Over the past two decades, China has typically transferred deflation or inflation pressures on producer prices to export prices rather than its domestic consumer prices.
- However, this pattern may shift in the coming years, leading to an easier monetary policy in the long run.
- China's rapidly aging population and declining birth rates pose challenges for China to absorb this overcapacity with merely domestic demand.



Source: CEIC, Mizuho



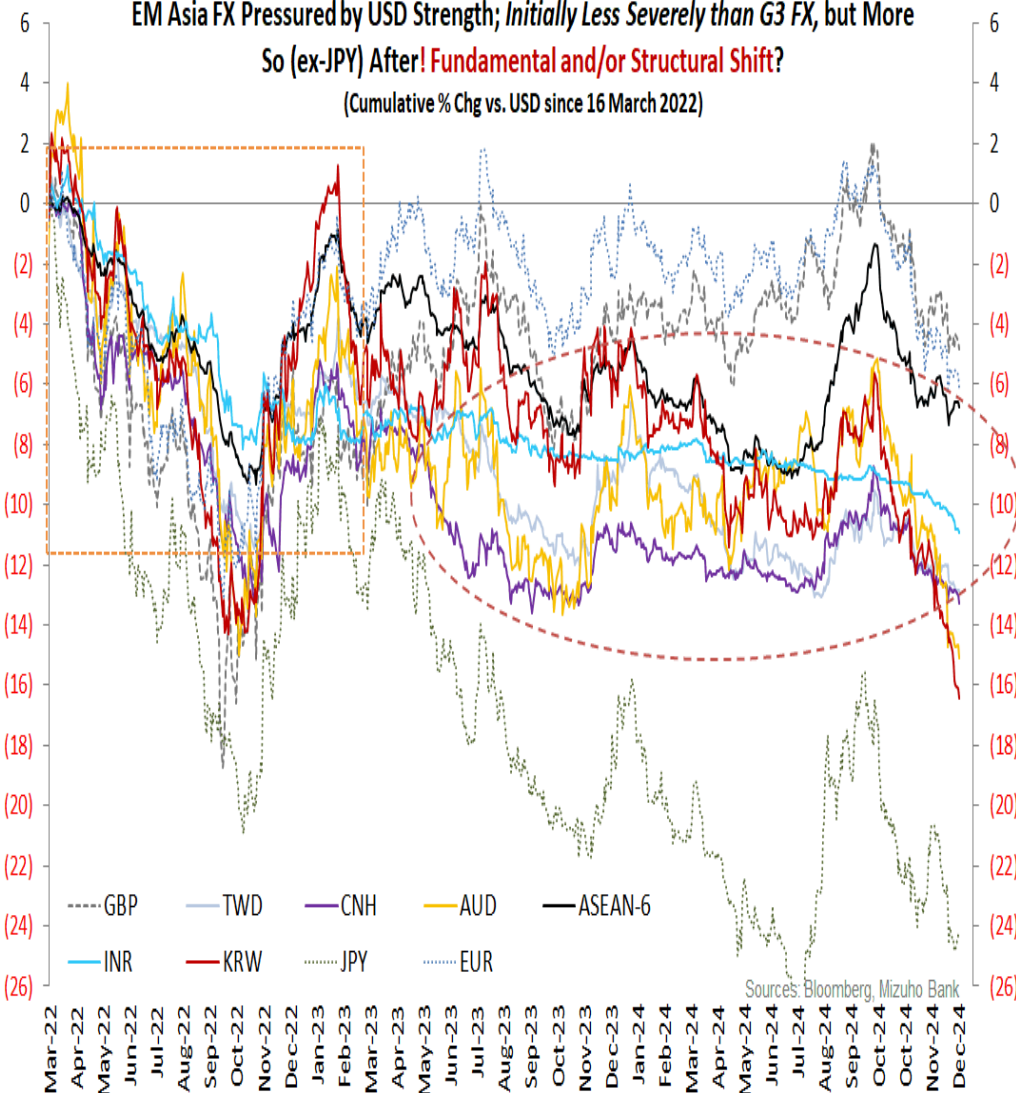
9a. AXJ: Full Reversion of AXJ may be Challenged

Sweeping, USD Strength with Trump & Fed's Impact

EM Asia FX Pressured by USD Strength; Initially Less Severely than G3 FX, but More

So (ex-JPY) After! Fundamental and/or Structural Shift?

(Cumulative % Chg vs. USD since 16 March 2022)

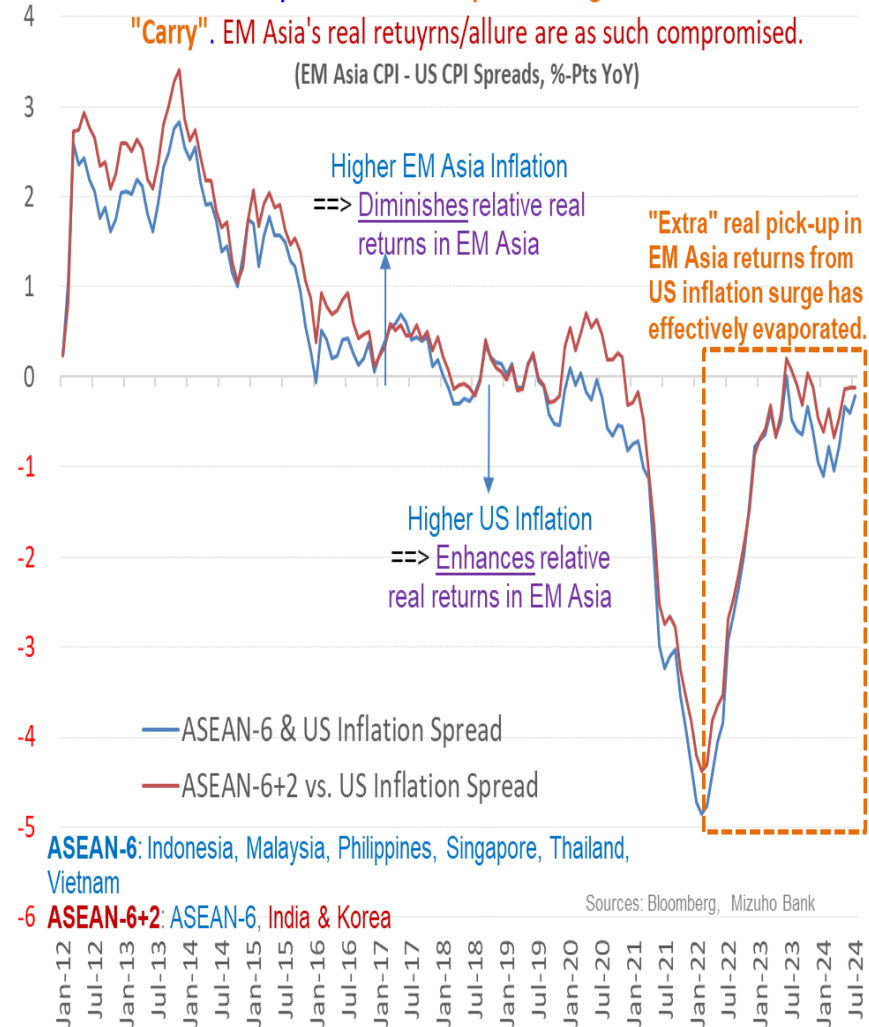


Inflation Spreads (vs. US): Reversion of US inflation back towards

2% from ~9% peaks Erodes Exceptional Surge in EM Asia's Real

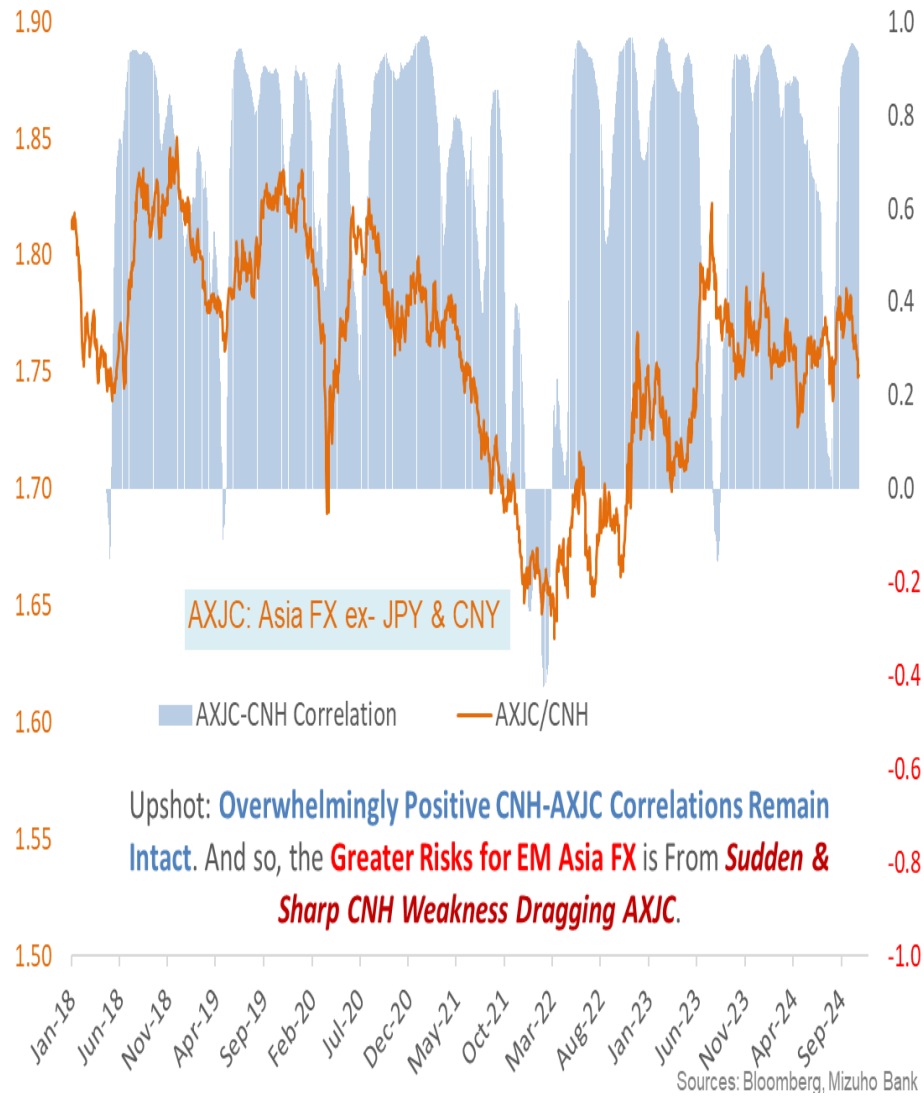
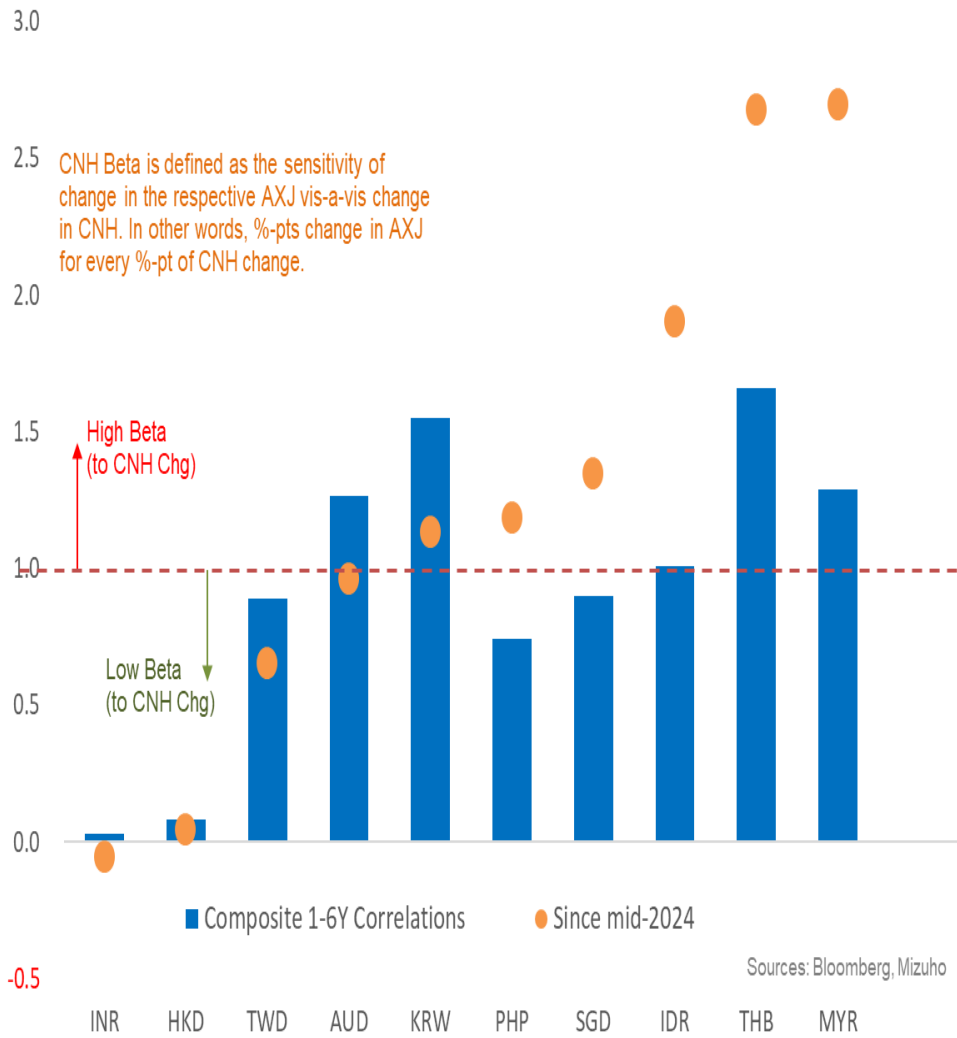
"Carry". EM Asia's real returns/allure are as such compromised.

(EM Asia CPI - US CPI Spreads, %-Pts YoY)



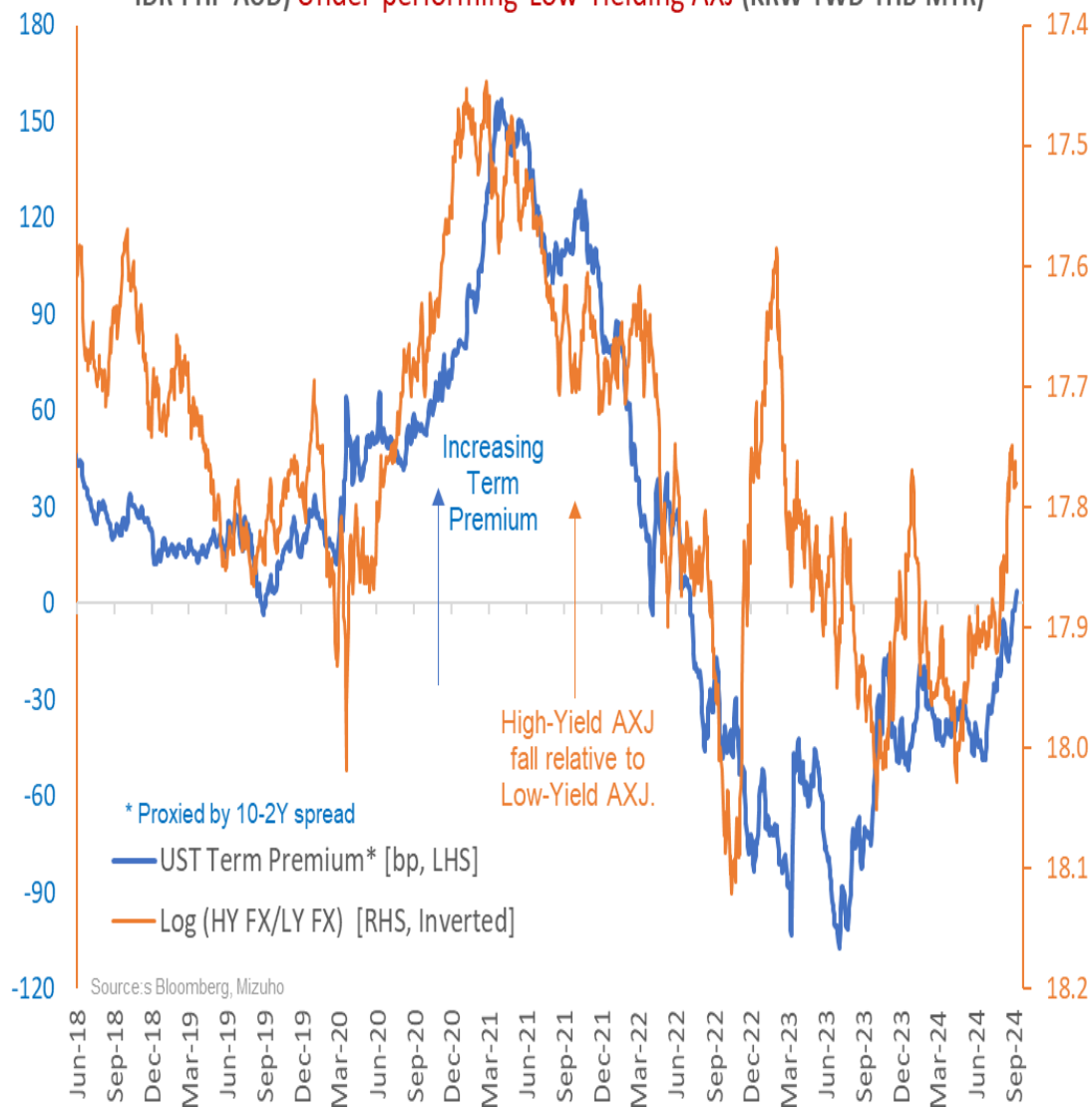
9bb. FX - CNH Beta: Expect AXJ Volatilities to be Heightened & Fluid

CNH Beta*: There is Notable Variation in CNH-Beta of AXJ, which are are both Differentiated & Time-Varying.



9c. FX - AXJ: Steeper UST Curve an Additional Interim Risk (Especially for HY AXJ)

Rising UST Term Premium is Consistent with High-Yielding AXJ (INR-IDR-PHP-AUD) Under-performing Low-Yielding AXJ (KRW-TWD-THB-MYR)



At the Cost of Risk Re-pricing in EM Asia ...

- But **path to a steeper UST yield curve** may be **bumpy for EM Asia** assets and FX too.
- Possibly even **entailing risk re-pricing** that involves spot of capital outflows.
- This is particularly in the context with a steeper UST yield curve typically diminishing the attractiveness of EM Asia yields.
- Especially given starting point of substantially eroded EM Asia spread over USTs.

... Harsher on High-Yield AXJ

- Specifically, the **ability to swap credit risk (in EM Asia) for more pronounced comparative term premium pick-up in USTs**. → *going out the “risk-free” curve rather than going down the credit curve.*
- Attendant pressure on EM Asia currencies is par for the course.
- And **given the credit risk-to-term premium swap involved, higher-yielding EM Asia currencies are left at a relatively greater disadvantage** (vis-à-vis lower-yielding EM Asia FX).

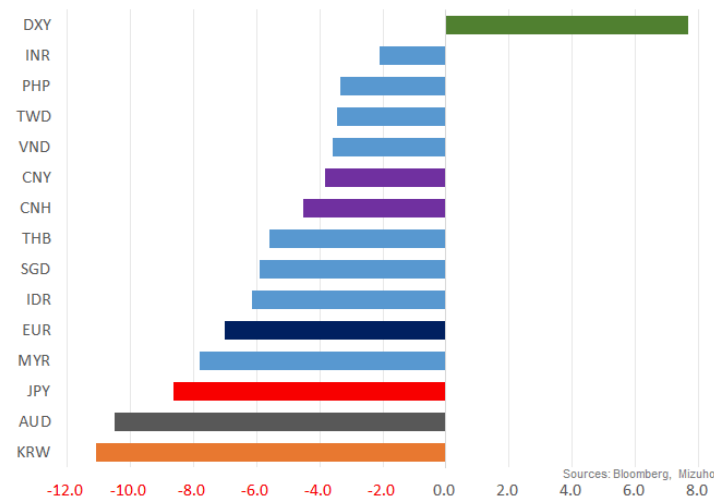
FX Outlook

Currency Forecast

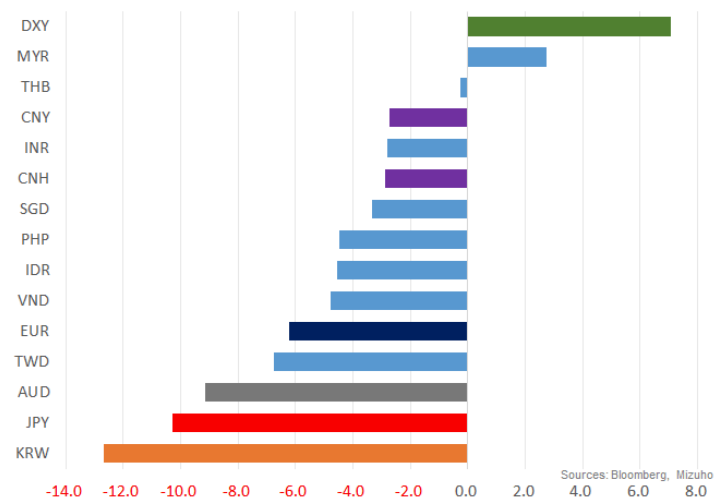
FX Forecasts	Q4 24	Q1 25	Q2 25	Q3 25	Q4 25
USD/CNY	7.04-7.38	7.10-7.55	7.15-7.60	7.05-7.45	6.98-7.37
	7.28	7.32	7.38	7.23	7.12
USD/HKD	7.76-7.80	7.75-7.79	7.75-7.79	7.75-7.79	7.76-7.80
	7.77	7.76	7.76	7.75	7.76
USD/INR	83.8 – 86.3	83.9 - 87.8	83.5 - 87.8	83.0 - 86.5	82.6 – 86.1
	85.2	85.8	86.0	84.8	84.3
USD/KRW	1317-1490	1320-1500	1370-1540	1330-1480	1290-1400
	1455	1438	1442	1385	1345
USD/SGD	1.283-1.368	1.327-1.376	1.330-1.388	1.315-1.375	1.292-1.344
	1.359	1.363	1.371	1.335	1.318
USD/TWD	31.6-33.1	31.8-34.5	32.1-34.5	31.5-33.9	31.2-33.5
	32.4	32.8	33.1	32.5	32.2
USD/IDR	15170 - 16350	15690 - 16380	15900 - 16480	15100 - 16380	14710 - 15810
	16150	16250	16300	15650	15200
USD/MYR	4.12 - 4.58	4.29 - 4.65	4.27 - 4.67	4.13 - 4.55	3.99 - 4.36
	4.51	4.53	4.53	4.30	4.12
USD/PHP	56.0 - 59.6	56.6 – 60.2	57.1 – 60.5	55.9 – 59.8	54.7 - 58.2
	58.9	59.5	59.6	57.2	56.5
USD/THB	32.3 - 35.3	32.9 - 35.9	33.8 - 36.2	33.4 - 35.7	32.7 - 34.9
	34.5	34.8	35.2	34.3	33.6
USD/VND	24560-25900	25300-26100	25200-26200	24600-25800	24500-25600
	25500	25850	25750	25100	24700
AUD/USD	0.616-0.694	0.610-0.660	0.608-0.668	0.610-0.673	0.645-0.700
	0.624	0.615	0.613	0.655	0.680

Note: For FX forecasts, level in parentheses pertains to period end forecasts; and the period's range precedes this.

AXJ (% Chg, Q4 2024): Admittedly, **KRW Slump Exacerbated by Political Turmoil**. But **'Trump USD' asserts Dominance**. **China Risks Ripple Through as well.**



AXJ (% Chg, 2024): Admittedly, **KRW Slump Exacerbated by Political Turmoil**. But **'Trump USD' asserts Dominance**. **China Risks Ripple Through as well.**



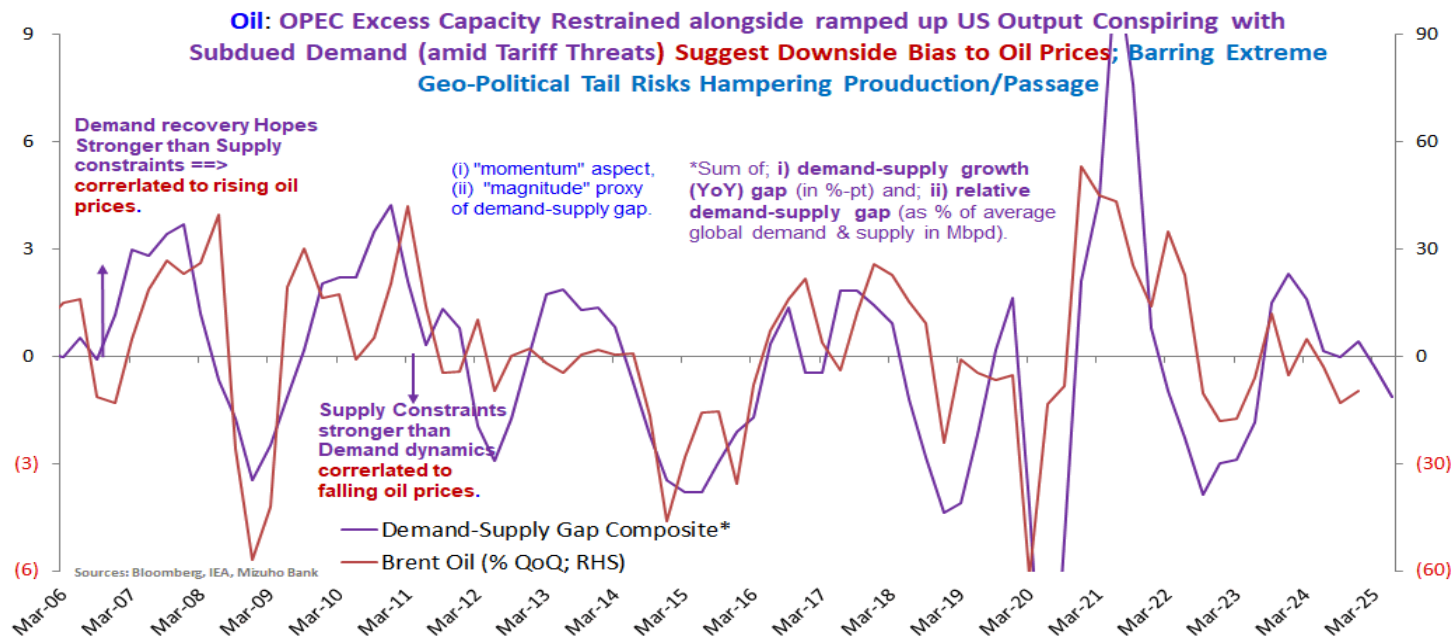
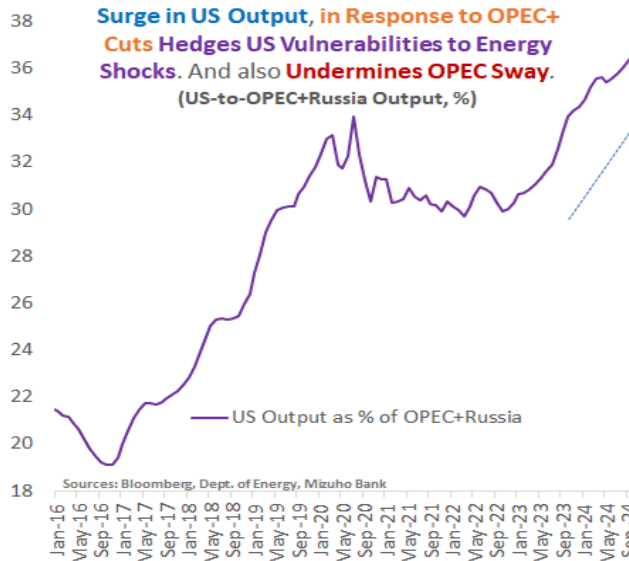
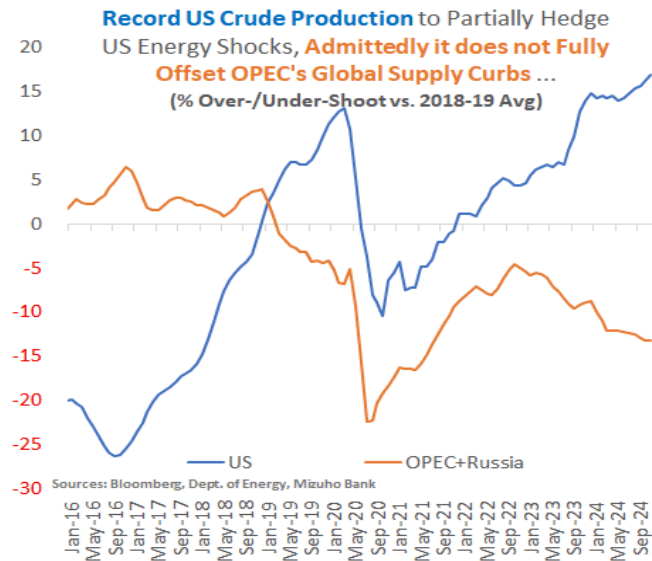
AXJ Outlook

- Defiant & Dominant “Trump Effect”: *Despite 100bp of Fed rate cuts, AXJ are down nearly 6%** since end-September. Such **defiant** and emphatic **USD strength**, *unencumbered by Fed cuts*, may be **attributed to a dominant “Trump effect”** – assumed to be *reflationary for the US* and *repressive for the rest* (allies, and adversaries alike) – **more than washing emphatic Fed cuts**. To be sure, the Fed dialing back easing bias (at the Dec FOMC) may accentuate, but not solely drive, USD buoyancy. Trump 2.0 is in the driver’s seat. Nonetheless, **Trumpflation-driven USD surge at the expense of AXJ is neither linear nor unremitting**.
- Headlines (Risks)...: But *initially*, **AXJ may be hijacked by, and sensitive to, headline risks**; and *not necessarily from Trump 2.0 exclusively*. So, **regardless of underlying fundamental allure**, Trump 2.0 risks (led by announcement effects) could trigger sharp bouts of AXJ volatility.
- ...& Headlights Especially as **AXJ are prone to “deer in the headlights” type of acute volatility** form being wrong-footed. After all, **unpredictability is a feature**, not a bug, (for Trump 2.0), and *volatility its companion*.
- Tariff Threats & Transmission: To be sure, **China has inherent** (albeit under-appreciated) **buffer from US trade antagonism** given unmatched industrial heft and unassailable cost/-efficiency advantages. Nevertheless, the **announcement effects of outsized/aggressive tariffs will inevitably trigger bearish CNH reflex**. Consequently, **most other AXJ will invariably suffer collateral damage** – as supply-chain and financial links overwhelm scope for near-term substitution gains.
- Ubiquitous, Uneven & Upsized: **Wider spill-over AXJ pain from tariff risks as** may be **ubiquitous** given the sweeping and inextricable linkages with China. Crucially, the **“beta”** (sensitivity to CNY depreciation drag) will be **uneven**, differentiated for trade/investment and geo-political exposure, across AXJ. *In many cases, AXJ losses may be upsized, exceeding the relative magnitude of CNY depreciation*.

AXJ Outlook – Cont'd

- Differentiated & Dynamic: Specifically, **AXJ “beta”** vis-à-vis CNY pressures/China risks are not just **differentiated**, but also **dynamic**, (see Box 1) varying with the *details of tariff threats/execution, risk of retaliatory miscalculations and willingness/incentive to de-escalate/compromise*. Notably, **commodity FX** (AUD, IDR.) may **far more sensitive to onshore China stimulus triggers**. And even the **trade sensitivities in other supply-chain reliant AXJ** may be further differentiated. **Upstream trade assaults** restricting China's technology access impact KRW, TWD and JPY most vs. downstream impact ASEAN FX.
- Not Just Collateral (Damage): What's more, **AXJ pain may not be exclusively transmitted indirectly from CNY** as **China may not be the only one in the crosshairs** of Trump 2.0 US trade antagonism. *Vietnam, Taiwan* and *Korea* are **at risk of direct trade pressures** (and attendant FX wobbles) if Trump's bilateral, bottom-line, zero-sum game instincts are not tamed.
- Fed Detour: A **bumpy path of Fed cuts**, interrupted by sticky inflation and *US exceptionalism*, contrasting against Asia's growth pressures amid **trade risks** are **set to pressure AXJ**. But by the same token, *the Fed relenting to cut more* (later in 2025) could provide **some relief (and partial recovery) for AXJ**.
- 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**.
- Tentative Two Halves with Back-End Relief: **AXJ are likely to be on the back foot into mid-2025** compromised by Trump 2.0 trade turbulence and a relatively less dovish Fed. But policy and geo-economic factors compromising AXJ (underpinning USD) may relent later. So, **AXJ pain may not be unremitting as relief/ partial restoration tentatively emerges** later in **H2 2025**. All said though, the **vagaries of unpredictable Trump 2.0** will remain hard to call. **Non-linearity** and **bumpiness** will feature.

Geo-Politics & Oil



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