Macro Strategy

Playing the Trump trade right…

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Economics ▸ **Global Macro Policy** ▸ **October 31, 2024**

Despite a rapid rise in Republican/Red sweep betting odds ahead of the upcoming US election, we think there is more steam to the volatility and Trump trade. With the election still being a binary event, it is important to understand what this could portend for economic policy ahead — and potential impact on asset classes. While a Trump presidency will be more noisy and volatile, we assess that a Harris presidency will not differ too widely in certain key areas. Medium term — watch out for structurally higher volatility in global inflation and growth ahead, implying the conventional playbook of 'buy the dip' or 'time rallies', during the sustained equity bull markets of the 'Great Moderation', need a re-watch. Rising term premium will likely be the next driver of higher yields, whereas FX wars would be the biggest asset class risk that could unfold over the coming years. For India, FX and rates will be the first casualty with equities only temporarily rejoicing the Red sweep. There will be natural weakening bias for INR, led by CNY, while mild bear flattening may make a comeback.

Madhavi Arora
madhavi.arora@emkayglobal.com
+91 22 6612 1341

Harshal Patel
harshal.patel@emkayglobal.com
+91 22 6624 2434

Seshadri Sen
seshadri.sen@emkayglobal.com
+91 22 6612 1226

Arthkumar Gandhi
arthkumar.gandhi@emkayglobal.com
+91 22 6612 1429

Trump trade sweeping the markets?

US betting markets have meaningfully repriced in former President Trump's favor in recent weeks, alongside some notable shifts in swing state polling. Corroborating trending US Presidential poll momentum, Senate polls have also narrowed in favor of Republicans, implying higher odds of a Republican sweep (vs split Congress). Consequently, global investors are starting to position and/or hedge election risk with 'Trump trade' leading to: i) higher UST yields (and DM/EM yields) and, in particular, a higher-medium term Fed terminal rate, ii) stronger dollar as an offset to tariffs, iii) outperformance of US vs non-US (DM) equities, iv) tighter US credit spreads as tax cuts make it even easier for corporates to service their debt, etc. That said, elections are still a binary event and we do not rule out more volatility for asset classes ahead. Thus, it is pertinent to understand potential US policy shifts in key economic areas, including fiscal, trade, immigration, and regulatory policy — to assess the near- and medium-term macro and global market implications post-elections (Exh 1, 2).

Trump vs Harris – Two peas of the same pod?

We focus on the two key areas where differences in approach of Trump and Harris — and the economic implications — could be the sharpest: trade and fiscal policy.

(i) Fiscal: Fiscal restraint may not be exercised by either; however, fiscal thrust from the Republican would come predominantly in the form of tax cuts, whereas Democrats would lead with more spending. Trump argues for full extension of the 2017 tax cuts expiring in end-2025, with spending focus on infra, tech, and defense. Meanwhile, Democrats oppose extending these lower marginal rates (implying corporate taxes back to 28%) and increasing the tax burden on the wealthy to fund the extension of health insurance subsidies and child tax credits. Broad extension of tax cuts was estimated to increase the cumulative deficit by USD4.6trn over a decade, with Trump-led policies being more extravagant at over USD7.5trn, sans any taxes/tariff hikes. **A full Trump sweep would likely be the most equity-positive outcome** with a favorable corporate tax regime alongside low regulatory burden, while any gridlock is technically equity market-negative. However, **the gridlock would be the most bearish outcome for spending, implying good news for bonds**. **Expect bearish steepening on full sweep,** with higher pressure on term premium in a Red sweep. However, 'fiscal cliff' chances on debt ceiling or government funding also increase with Harris-led split Congress.

(ii) Trade: Trade would likely take a front seat in a Trump regime even as both regimes would remain firm on China levies, and protect sensitive industries such as solar and semis. Trump has floated a variety of proposals, from 60% tariff on all Chinese imports, 100% tariffs on EV imports from Mexico, to a universal 10% tariff on all imports. That said, **broad tariffs imply downside risks to US/global growth**, higher cost, and push firms to account for greater risk of frictions for supply chains and end-market access among other factors. We think the US election premium is not yet fully baked into the USD, and the bulk of the rebound owes to a re-pricing higher of UST yields. While Trump has vocally supported a weaker USD, we think his policies would lead to **stronger USD in the near-term** (also helped by higher fiscal-led US growth vs DM peers) amid USD's anticyclical character. Democrat victory should see temporary USD weakening. But regardless of the election outcome, we expect **heightened FX volatility and disrupted supply chains. We will watch for CNY-led Asian EM FX weakness, and INR following suit, even as it may stay in middle of the EMFX pack.** We fear **FX wars would be the biggest asset class risk that could unfold over the coming years**, as China strives to survive its new export model of high-end manufacturing, amid growing Western resistance.

Key highlights:

- **Trump trade has yet not fully priced in FX and rates markets; equities to rejoice trump win, albeit temporarily**
- **Expect more bear steepening of the curve with Trump win; but term premia set to rise irrespective of party lines**
- **FX wars would be the next biggest noise, and geopolitics will stay volatile**

Exhibit 1: Broad policy narratives of Republicans and Democrats

Trump vs Harris - Broad Policy Differences		
	Trump	**Harris**
Fiscal	(1) Fiscal impact of lower taxes will be only marginally offset by higher tariffs (2) Will cost USD7.5trn over next decade; (3) Republican setup would favor heavy industry. Infrastructure and military spending are likely to inflect higher in either case **Our view: Trump's policies are more fiscally profligate, while gridlock in Congress will raise likelihood of debt ceiling impasse**	(1) Higher taxes could weigh on growth (2) Will cost USD3.5trn over next decade; (3) A Democratic setup would favor higher levels of discretionary spending, especially geared towards youth and low-income individuals, which would boost Staples and Discretionary **Our view: The growth implications are probably worse, while focus will be on redistribution of income. Congress gridlock increases odds of debt ceiling impasse**
Taxation	(1) Extension of TJCA cuts on both corporate and personal taxes (2) further reduction in corporate taxes (15%) **Our view: Will depend on Congress control; Republican control will allow full slate of measures, gridlock will mean fewer tax breaks**	(1) Extension of TJCA cuts for individuals earning < USD400k/year (2) reversion to higher tax rate for others (3) more tax credits for low and mid-income (4)higher corporate taxes (28%) **Our view: Will depend on Congress control; Democratic control will entail higher corporate taxes, gridlock will mean fewer tax breaks**
Trade	(1) 20% tariff on all US imports (2) 60% tariff on Chinese imports (3) China's MFN status revoked **Our view: Higher tariffs on China are fairly likely, more difficult to enact tariffs on all imports**	(1) Targeted subsidies and protectionism (semis, green energy) (2) continuation of Trump and Biden-era tariffs on China **Our view: Harris will continue soft protectionism while maintaining existing tariffs on China**
Energy and Climate	(1) Lower environmental regulations (via gutting of the EPA) (2) rollback of some IRA tax breaks for clean energy (3) lower investment in energy transition (4) more support for Big Oil **Our view: EPA will likely see its powers significantly reduced, but mass reversal of IRA tax breaks is unlikely as ~80% of tax credits are flowing to Republican districts**	(1) Continuation of Biden-era support for green energy (2) support for higher domestic O&G production and nuclear power **Our view: Will likely continue support for green energy while also supporting fossil fuels**
Immigration	(1) Tougher stance on both legal and illegal immigration (2) possible mass deportation of illegal migrants (3) tougher asylum requirements. **Our view: Very difficult to enact mass deportation scheme, but both legal and illegal immigration will likely become more difficult**	(1) Continuation of Biden policy of more legal pathways for migration while cracking down on border crossings via Mexico. **Our view: Likely to be tougher on immigration via Mexico than Biden, while protecting illegal immigrants already present for years in the US**
Foreign policy	(1) More hawkish on China, but with some potential for transactional bargains with Xi Jingping (possibly on Taiwan) (2) Quicker resolution of Russia-Ukraine war (esp. if Republicans control Congress as well), with Ukraine likely to be weakened heavily (3) Near-universal support for Israel, some form of conflict with Iran likely	(1) Remain hawkish on China whle managing the relationship (2) Continued support for Ukraine (esp. if Democrats control Congress as well), albeit moving towards negotiated end to conflict in 12-18 months (3) Support for Israel while trying to mitigate humanitarian impact in Gaza and Lebanon, backing for some action against Iran

Source: Emkay Research

Exhibit 2: Assessing the possible asset class impact of US election outcome

US Election Scenarios and Asset Classes				
	Republican Sweep	**Trump with split Congress**	**Harris with split Congress**	**Democrat Sweep**
Broad policy regime	Fiscal-led US exceptionalism; Amplified tariff regime; Lower corporate and income taxes as well as regulation; Possible action on immigration; Universal + targeted tarrifs	Fiscal expansion but with higher odds of debt ceiling gridlock; Amplified tariff regime; Lower regulation; Negotiated tax cuts ; Possible action on immigration; Select tarrifs on universal + China targeted	Fiscal expansion but with higher odds of debt ceiling gridlock; negotiated tax increases and cuts; higher regulatory burden; hawkish on China along with targeted protectionism	Fiscal expansion; higher taxes on corporates and high-income individuals with lower taxes for lower-income; higher regulatory burden; hawkish on China along with targeted protectionism
FX	Tariffs+ Fiscal led US growth exceptionalism = Broad dollar-positive; Asian FX weakness led by CNY and commodity FX **India:** Expect INR to follow CNY's suit; weakening bias but stay in the middle of EM pack	Some near-term payback in recent USD strength, but USD/FX volatility to continue with USD upward bias **India:** Expect INR to follow CNY's suit; weakening bias but stay in the middle of EM pack	Sharper near-term payback in USD strength, but USD/FX volatility to continue with USD upward bias **India:** Expect INR to follow CNY's suit; weakening bias but stay in the middle of EM pack	Immediate USD negative, but USD/FX volatility to continue with USD upward bias in medium term **India:** Expect INR to follow CNY's suit; weakening bias but stay in middle of EM pack
Rates	**Bearish steepening**: Upside bias due to dollar strength, fiscal expansion and the inflationary impact of tariffs **India:** Possible delay in deep Fed cuts to spill on USTs and could stall India rally; **bear flattening** may make a comeback	Gridlock to provide some relief on bonds, but upside bias stays **India:** USTs may rally on split congress and could help India bonds rally on global factors	Best case for bonds: Gridlock to provide some relief on bonds, but upside bias stays **India:** USTs may rally on split congress and could help India bonds rally on global factors	Upside bias due to fiscal expansion **India:** Possible delay in deep Fed cuts to spill on USTs and could stall India rally; **bear flattening** may make a comeback
Equities	**Net Near term Positive** via lower corporate taxes and looser regulations; headwinds from tariffs, FTA negotiation and possible immigration control; But growth and inflation variability to keep equities wobbly over the medium term. **India:** Red sweep may trigger a short-term rally for Indian equities, but sustenance will depend on valuations and earnings momentum. We think it'll quickly fizzle out and our base thesis of market consolidation for 2HFY25 stays unchanged. IT (lower corporate tax rates = higher budgets and BFSI (higher for longer rates) are possible beneficiaries, but these would also be transient.	**Near term Negative** as tax concessions will be fewer; headwinds from tariffs, FTA negotiation and possible immigration control; But growth and inflation variability to keep equities wobbly over the medium term	**Negative** as tax concessions will be fewer and regulatory burden will be higher; some positive offset from higher spending and tax breaks for low-income categories; But growth and inflation variability to keep equities wobbly over the medium term	**Net Negative** due to higher corporate and high-income taxes and more regulation; some positive offset from higher spending and tax breaks for low-income categories; Overall growth and inflation variability to keep equities wobbly over the medium term. **India:** A Dem sweep could trigger nervousness in global equities and leave India somewhat vulnerable. Any major dip should, however, be bought as the core fundamentals for India are likely to be unchanged. IT could be vulnerable in the short term (high valuations, worries over corporate tax hikes) but there is little else from a sectoral perspective.

Source: Emkay Research estimates

Global medium-term macro and market implications

Regardless of the election outcome, three key push-and-pull factors are going to impact the global macro and market structure in the medium term:

(i) Fiscal profligacy + higher expected inflation and growth volatility = higher rates and equity volatility

We've long said that higher interest rates are a key part of the new global regime change. A multitude of shocks have to be confronted concurrently and need to be dealt with agility. Watch out for structurally higher volatility in inflation and growth, such as from trade, tariff and tech wars, geopolitical flare-ups, rate spikes, climate-related supply disruptions, greenflation, AI, ageing population etc. There will likely be less certainty around long-term rates, which deserve more of a term premium. Thus, rising term premium will likely be the next driver of higher yields, led by a greater macro volatility, persistent inflation plus large fiscal deficits, and higher debt issuances. This will keep a trough on yields amid much higher expected terminal Fed funds rate and higher term premia. Besides, surge of US debt could see fewer buyers ahead. With deficit sustainability remaining an issue, the price of fiscal money likely stays elevated *(See, Bond Rout: Something's Gotta Give).* This is likely to spillover to the rest of the world as well, with relatively higher term and risk premia in EMs.

Additionally**,** as we seem to be entering a period of higher growth and inflation variability in the world, **and the conventional playbook of '*buy the dip' or 'time rallies*',** which worked during the sustained equity bull markets of the '*Great Moderation*', **need a re-watch ahead**.

(ii) Prep for dirty FX wars ahead

As we mentioned earlier, 'Trump trade' has been the dominant market narrative, but we think a 'red sweep' outcome is not yet fully priced in, specifically in the FX space. While it might seem that the USD rebound is primarily a function of increased focus on elections, the dollar has gotten a significant boost from a tactical rethink of Fed policy after a massive 50bps cut in September and the near-term trajectory of US data. The US terminal rate has now been repriced by 50bps off the lows, driving a significant widening in rate differentials vs peers.

While this makes the case for broad USD strength post-US elections (assuming a red sweep), it is also helped by fiscal-led US growth exceptionalism; we reckon the China trade and tariff policy stance of Democrats in the medium term may not be entirely different in spirit from that of Republicans. Additionally, China's new growth model evolution, and its survival strategy amid De-Sinicization in the coming decade will be important to watch. China may have to keep competitive export prices and devalued/managed FX, to counter tariffs, minimize growth losses, and maximize employment, while also ensuring limited foreign capital outflows. **An FX-led survival route of China will not go down well with the West,** with both US and EU wanting weaker USD/Euro as a policy prerogative to support domestic industry and exports.

This, in turn, could make the FX space messy with a consequent hit on Asian FX/INR, making it harder for Asian central banks to ease and could lead to downward pressure on EM Asian FX in general. Countries with higher export linkages with China (Korea, Taiwan) will be most exposed. EM Asian members with similar trade structures (ie Thailand, Vietnam) + sizable commodity sectors (Indonesia, Malaysia) will also be hit.

India is relatively better placed on China trade linkages vs EM Asian peers, having both the smallest exports/GDP ratio and the smallest share of exports going to China (Exh 15). That said, India's trade linkages with China and Asia in general have increased substantially over the last decade. To that extent, India would not be insulated from the second round impact of the region's deceleration owing to China's slowdown or owing to weaker Asian FX. We reckon that the RBI has been softly pegging INR against CNY, amid 40% of bilateral trade deficit with China and is unlikely to let INR float naturally.

India: Near and medium-term macro and market impact

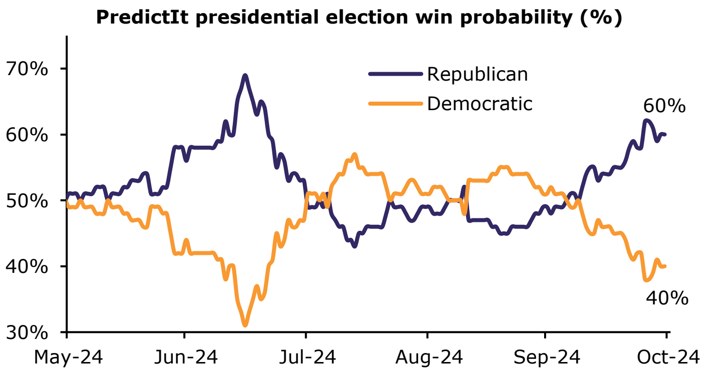
(1) Rates and FX market will be the first casualty. The spillover of bond and FX volatility via global financial markets route would mean the aim of financial stability may precede inflation management and thus merits why some EM central banks, including the RBI, would want to see these uncertainties resolved before acting. This makes the December rate cut call tricky and possibly a shallower rate-cut cycle, following the Fed. Of course, the implications of higher US term premia would possibly lead to higher global rates in the medium term. Given lower FPI exposure of India vs peers on sovereign debt funding (~3% FPI share currently), structurally better demand from domestic players, and better fiscal profile in general could keep India's bond risk premia relatively lower than peers. However, we will watch for evolution of FX and how the RBI chooses to manage the FX play amid global volatility, which could inversely impact the FI market. But as we mentioned earlier, it is difficult to assume India charting an appreciating bias in the medium term, when most of Asia would be having a weaker FX bias, led by CNY.

Equity markets may temporarily rejoice the spillover of US equities rebound in case of a Red sweep. Not to mention, China equities would bleed due to increased market uncertainty and it could also be tactically positive for India on the FPI positioning and flows front. However, there will be challenges sustaining that rally globally, and domestically as well. Our equity strategy team believes that a **Red Sweep would probably trigger a short-term rally but its sustenance depends on earnings momentum and valuations, both of which are weak** *(See, India Strategy: Choppy markets).* A Dem Sweep could trigger a fresh wave of selling, and a significant correction from here (5%+) should be bought into - the impact on the Indian economy and markets is marginal. The medium term play for India may not differ in either Democrat or Republican regime.

We believe as the world navigates the imminent period of higher growth and inflation variability in the world, and probably redefine the conventional investing playbook, the India investing strategy may be no different, even as she enjoys some structural growth levers vs EM peers.

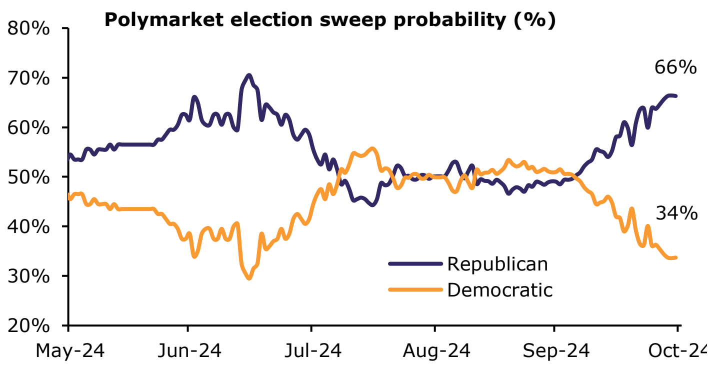
(2) Geopolitically, India faces a tricky period in its US relationship. The nature of challenges depends on which candidate wins. A Harris presidency would likely be a continuation of the Biden doctrine, though she is an unknown quantity at this time, the long-term strategic partnership would continue. There would be, however, some immediate issues surrounding the recent incident involving Khalistani extremists. The big challenge of a Trump presidency would be the tariffs – though China is the main target, India will also feel the effects. Also, the impact of Trump's domestic-oriented policy is a key imponderable at this point. (*See, Expert call with Ashok Malik: Expert – India navigating troubled geopolitical waters*)

Exhibit 3: Betting markets are increasingly predicting a Trump win…



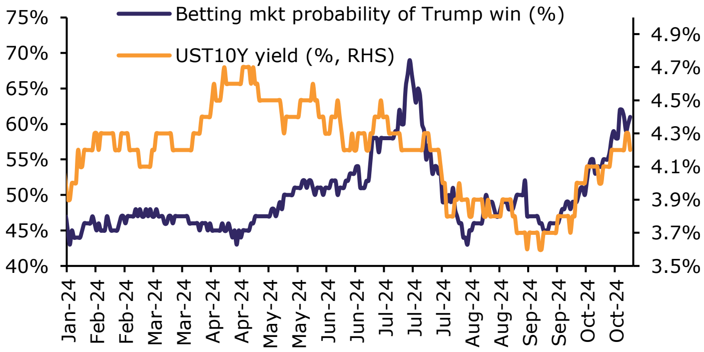
Source: Bloomberg, Emkay Research

Exhibit 4: …as well as a Republican sweep of the White House, Senate, and House elections



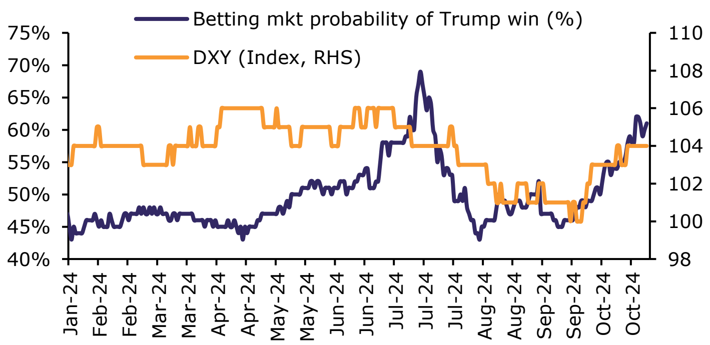
Source: Bloomberg, Emkay Research

Exhibit 5: Rising odds of a Trump win have led to a sharp repricing of the UST10Y…



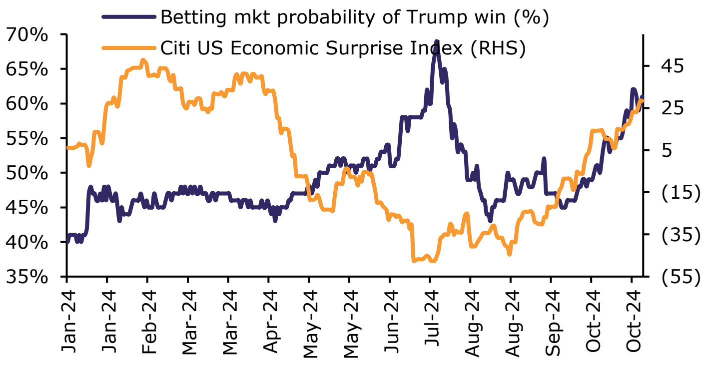
Source: Bloomberg, Emkay Research

Exhibit 6: …with the DXY also strengthening, especially in recent weeks



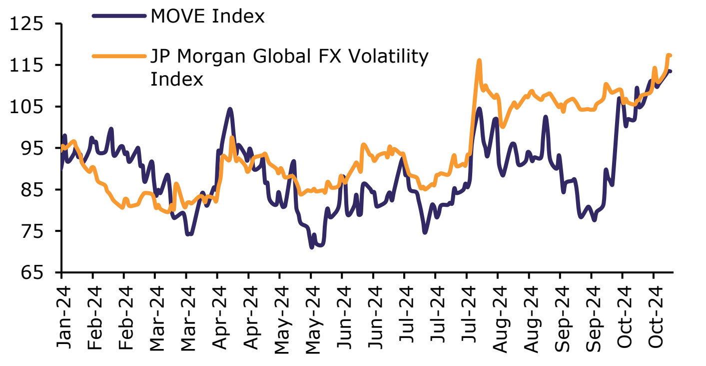
Source: Bloomberg, Emkay Research

Exhibit 7: But higher expectations of a Trump win have coincided with economic data surprises, helping rising yields and USD…



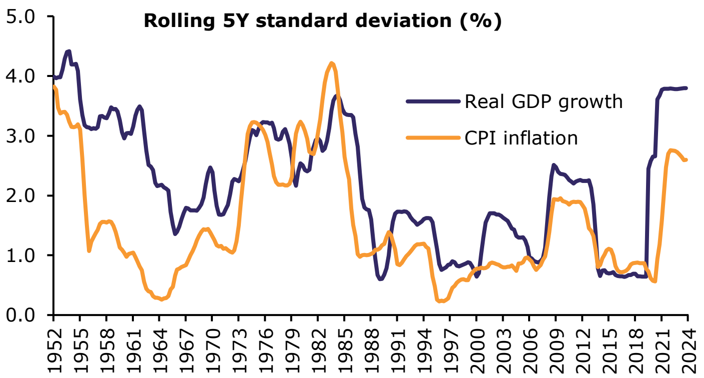
Source: Bloomberg, Emkay Research

Exhibit 8: …but the 'Trump trade' has also led to near-YTD highs for bond and FX volatility, which we think may not be over yet



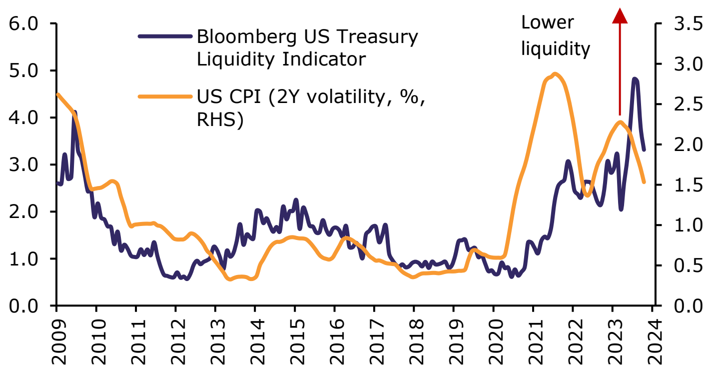
Source: Bloomberg, Emkay Research; Note: Indices indexed to 100 as on 1-Jan-24

Exhibit 9: Higher inflation and growth variance implies higher-term premia



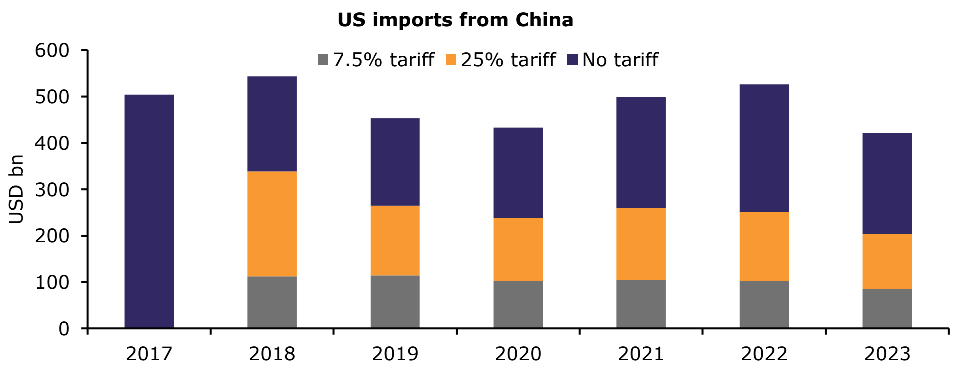
Source: Bloomberg, Emkay Research

Exhibit 10: UST liquidity has improved recently with lower inflation volatility, but it remains relatively tight



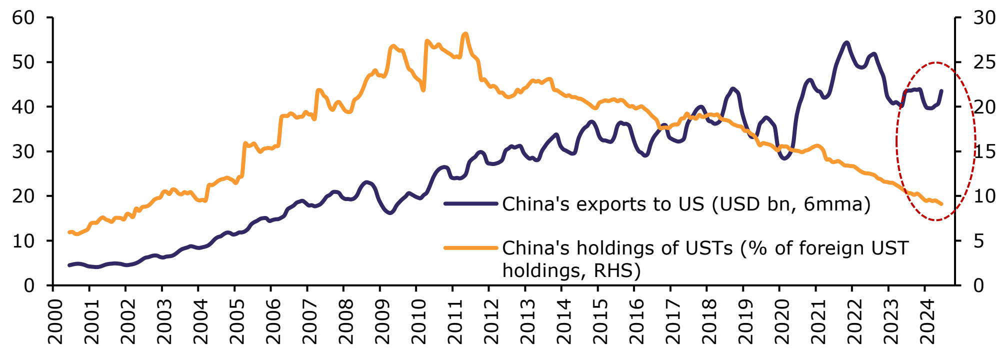
Source: Bloomberg, Emkay Research

Exhibit 11: US imports from China subject to tariffs are now below pre-trade war levels



Source: USITC DataWeb, Emkay Research

Exhibit 12: US-China's co-dependence is likely to worsen ahead

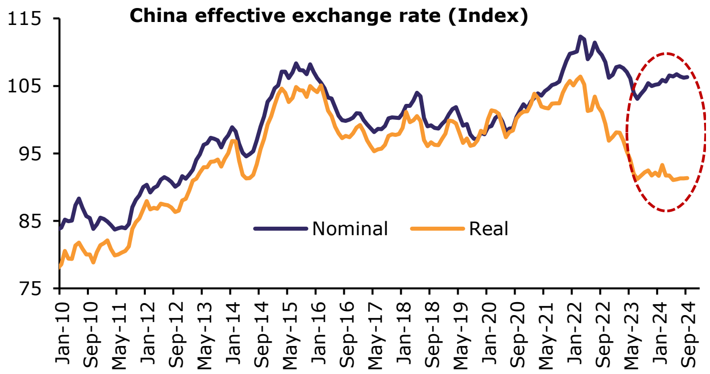


Source: Bloomberg, US Treasury Department, Emkay Research

Exhibit 13: CNY in Trump trade war 1.0 saw effective weakness

Source: BIS, Emkay Research

Exhibit 14: Nominal CNY needs to weaken ahead



Source: BIS, Emkay Research

Exhibit 15: While most of Asia has reduced its exports to China over the past decade, exposure remains heavy

Country	Exports to China + HK (% of total exports)		Exports to GDP (%)		Copper		Iron & steel	
	2022	2022 - 10Y avg	2022	2022 - 10Y avg	Exports to China (% of total copper exports, 2022)	Exports to world (% of global copper exports, 2022)	Exports to China (% of total iron & steel exports, 2022)	Exports to world (% of global iron & steel exports, 2022)
Taiwan	42.7	2.2	62.8	6.8	66%	3%	13%	3%
South Korea	26.8	-4.8	40.8	4.9	49%	4%	11%	4%
Indonesia	21.7	5.7	22.1	4.3	35%	3%	54%	1%
Vietnam	19.0	1.6	91.3	14.7	17%	2%	14%	1%
Philippines	19.6	-6.8	19.5	0.2	43%	0%	3%	1%
Malaysia	16.4	-3.1	86.6	16.0	38%	1%	28%	2%
Thailand	15.2	-1.8	57.9	5.9	8%	0%	1%	1%
Singapore	23.2	-3.1	110.5	-2.3	21%	0%	3%	0%
India	5.5	-3.5	13.4	0.6	44%	3%	3%	1%

Source: UNCTAD, IMF, Emkay Research

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Emkay Global Financial Services Ltd.

CIN - L67120MH1995PLC084899

7th Floor, The Ruby, Senapati Bapat Marg, Dadar - West, Mumbai - 400028. India
Tel: +91 22 66121212 Fax: +91 22 66121299 Web: www.emkayglobal.com

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SESHADRI KUMAR SEN

Digitally signed by SESHADRI KUMAR SEN
DN: c=IN, o=Personal,
pseudonym=133421651129256467AME3LY655Z5MEZ,
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