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MACRO MORNING BRIEFING

November 25, 2024

Three Themes for the Week

- Global trade is obviously vulnerable to increased trade tensions – what about global growth?
- Steepeners seen ahead, watch cross-border UST demand
- CAD bearishness prevails; we see BoC cutting 50bp in December

Global Trade Vulnerable

Global trade is likely to slow starting at some point next year, given that a cornerstone of the incoming administration's economic policy is tariffs. While we still don't know the parameters of any trade restrictions to be proposed, we do have the experience of the first few years (pre-pandemic) of the first Trump administration.

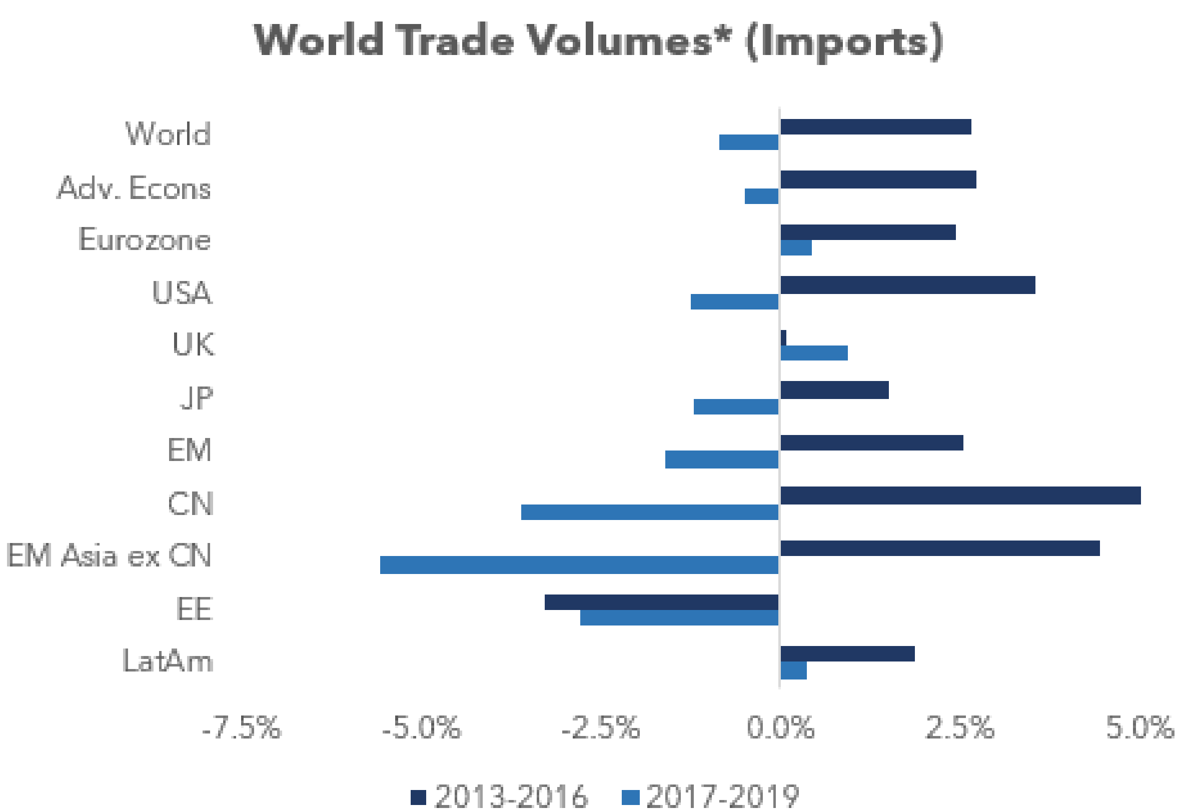
The Dutch research group CPB compiles a valuable dataset on trade volumes among the major economic regions of the world. We looked at the growth in global trade between 2013 and 2016 and compared it to the period from 2017 to 2019. The results for selected regions are shown in Exhibit #1. We use import volumes for our analysis. Data on export volumes are also available – the results look quite similar.

Note that from 2013 to 2016, import volumes rose by an annualized 2.7%, and were much higher for the US (3.5%), China (5.0%), and emerging Asia outside of China (4.4%). Global growth in those years averaged just over 3% per year during that time, according to the World Bank. In the first three years of the previous administration, import volumes fell by -0.8% (annualized), with – unsurprisingly – China (-3.6%) leading the way lower. Emerging Asia ex-China (-5.5%) fared even worse. The chart makes clear that there was a significant retreat across the world in international trade, even though global growth was roughly the same 3% per year witnessed in 2013–2016. For comparison, global trade grew by an average of 0.8% since the end of 2020, a modest comeback from the implosion of supply chains in 2020 during the pandemic.

Does this mean that any future slowdown in global commerce due to any trade restrictions will be similarly met with no deceleration of global economic performance? We're not so sure. As advertised during the campaign, the breadth and scale of the upcoming tariff regime looks to be much wider and more severe. Furthermore, a trade slowdown would be occurring at a time of precarious economic growth. The IMF's October World Economic Outlook sees global growth holding steady at just above 3% for the next three years, although much slower in advanced economies, well below 2% over the same period.

The IMF does warn, however, in the same report, that "an intensification of protectionist policies would exacerbate trade tensions, reduce market efficiency, and further disrupt supply chains." So, their rosy forecast is conditional on keeping trade tensions dampened, a prospect that seems to us highly unlikely. Even if growth doesn't take a major hit across the world, disrupted supply chains and higher import prices due to tariff levies would be inflationary, complicating the current disinflation process.

Exhibit #1: Two Different Trade Regimes



Source: BNY Markets, CPB Economic Policy Analysis; *annualized values

Steepeners and a Potential Buyers' Exit?

Right after the election, we were on the road seeing multiple counterparties in several different countries. We found the mood generally tense, anticipatory but not yet active, and broadly US dollar bullish. Our message was that bearish curve steepeners were quite likely, and not in the too distant future. We see 10y yields close to 5% by the end of the first quarter of 2025, and wonder if the markets, especially leveraged financial strategies, private assets, and consumer credit can be supported in such a high-interest rate environment.

Our ingredients for steepeners includes four fundamental drivers, two inflationary and one related to fiscal issues, and one political economy concern. We'll delve deeper into these drivers in future notes, but will summarize them here:

• Fiscal expansion: The Committee for a Responsible Federal Budget estimates that merely extending the 2017 tax cuts could add $7.75trn to the deficit by 2035 in its central scenario, or as much as $15.5trn in a "high" scenario.

• Immigration policy: Can the new administration really pull off mass deportations? If so, how quickly, and at what cost? Some numbers: Labor force in the US is approximately 150m. 10m immigrants forced to leave the country would be ~6% of labor force. That would be stagflationary, as it is a supply shock.

• Tariffs: Obviously inflationary, but until details emerge it is impossible to estimate just how much. A full percentage point on y/y inflation doesn't seem out of the realms of possibility.

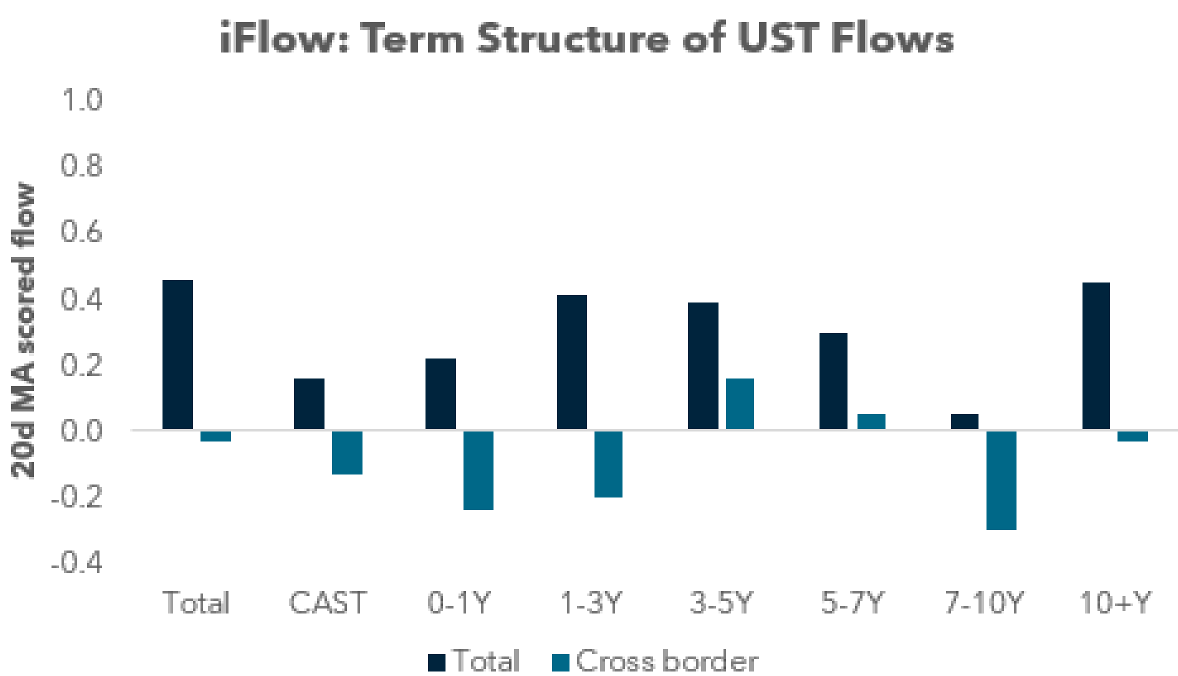
• Relationship with the Fed: We wrote about this already last week in our weekly *Short Thoughts* publication (see here). To put it briefly, we fear that tensions could arise between the White House and the central bank should rates not come down as swiftly or as far as the administration would like, which would raise risk premia across the curve and potentially destabilize inflation expectations.

Of course, we still don't know the details, timing or scope of many of the concerns raised above. This is why, we believe, yields have stalled at around 4.4% in the weeks after the election. However, we are seeing some signs of retreat from the UST market by cross-border investors.

iFlow allows us to examine client custody flows across the US Treasury curve, looking both at total demand (domestic plus cross-border) as well as solely from offshore investors. Exhibit #2 shows the term structure of our UST (scored) flows for both the total sample and just those from cross-border investors. We plot the average daily flow over the past month for each instrument indicated on the horizontal axis of the chart.

Note that at best, cross-border flows have been paltry and at worst, outright negative, while the total flows – like those cross-border flows – into the 7-10y bucket on the curve are quite modest. Cross-border flows into that segment are quite negative. We worry, if given the ingredients listed above, if this is the beginning of a general reluctance on behalf of real money investors to keep financing an ever-growing debt pile. This metric is something we have been keeping an eye on almost daily. Signs of a cross-border buyers' strike would be further fuel to our steepener call.

Exhibit #2: Cross-Border Flows Moribund



Source: BNY Markets, iFlow

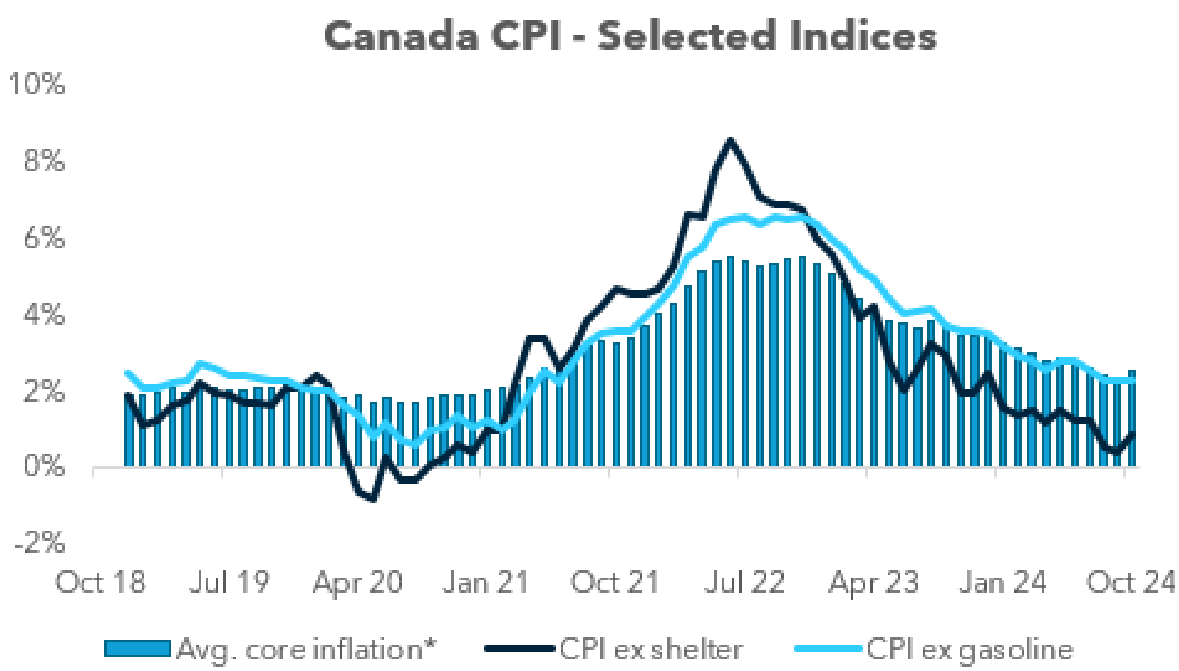
CAD Bearishness

We don't expect last week's inflation data to preclude the Bank of Canada from cutting rates by 50bp. While the headline and core numbers came in above expectations, much of this was due to unfavorable base effects and higher gasoline prices over the year. Ex-gasoline, the CPI was mere 2.2% y/y, the same rate that it has printed for the previous three months. Ex-shelter, inflation was below 1%, as it has been for the previous two months as well. Furthermore, nothing in recent data – including a promising retail sales figure last Friday – suggests that the economy is operating without significant slack.

With the Federal Reserve likely to be much more gradual in the near term in lowering rates, a 50bp cut from Ottawa would increase the rate differential, and we expect to see a terminal rate close to 3% or even slightly lower in Canada, and one much higher, perhaps as high as 3.75% in the United States. We also know that during the easing cycle, Governor Macklem has argued that the rate differential between the US and Canada is not excessive and could even widen slightly from its current 100bp.

This, plus the USD's torrid post-election run (up 4% since November 5) has pushed USD/CAD to its weakest level (spending some time above 1.40) since the pandemic. We see the mid-140s as not out of the question. We were struck by our visits with Canadian clients at the widespread bearishness on the CAD and can only concur with them.

Exhibit #3: Canadian Inflation Still in a Good Place



Source: BNY Markets, Statistics Canada, Bloomberg; *Average of CPI Core Median and CPI Core Trimmed

Please direct questions or comments to: iFlow@bny.com

Disclaimer & Disclosures

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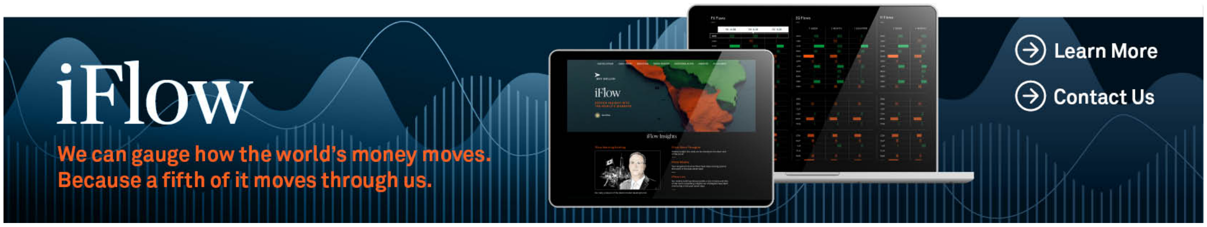

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