China, bonds, Trump – The big talking points from a week in Asia

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A crucial part of understanding the global economy is getting out into it. As well as an opportunity to catch up with old friends, getting on the road and meeting with clients provides important perspective on how global issues are being considered – and how they are affecting local economies and markets – from region to region. It was perhaps unsurprising that the issues that cropped up most often in a series of conversations held throughout Asia last week were around the impact of China's stimulus pledges and the upcoming US election. But investors in the region were fixated too on the outlook for the US Treasury market in the wake of the recent spike in yields.

A REBOUND IN CHINA?

Conversations in the region began and ended with China, and specifically whether recent stimulus moves – and further moves signalled by Beijing – will be enough to revive the economy. Our view is that the near-term outlook has improved as a result of Beijing's announcements, and we've nudged up our growth forecast in response, now expecting the economy to expand by 4.5% in 2025, as measured by our in-house China Activity Proxy. But important details of the package – particularly around support for consumers – are still missing. And the measures that we do know about do nothing to address the structural headwinds facing China's economy. In fact, the piecemeal approach to rolling out this stimulus combined with its emphasis on investment over consumption reinforce our concerns about China's medium-term outlook. Nothing that has been revealed by the Party leadership so far changes our view that Chinese economic growth is heading towards a trend pace of 2% a year by the end of this decade.

WHITHER BONDS?

The sell-off in bond markets in recent weeks continued to come up in discussions, and we made the point that it has to be viewed in the context of the rally of the previous six months. This earlier rally meant that, by mid-September, the magnitude of interest rate cuts priced into markets in the US and euro-zone was looking excessive. Accordingly, the shift over the past month saw the market move closer to our own forecast for the Federal Reserve to cut interest rates to 3.00-3.25% by end-2025 (and the European Central Bank to cut interest rates to 2.5% over the same timeframe). In fact, looking at the short end of the curve, our profile for US rates over the next six months sits a bit below that now priced into markets. Further along the curve, however, we think that the level of "neutral" rates priced into markets is too low, and that fiscal risks are not being adequately priced in. When it comes to yields at the 10-year part of the curve, these two points – the possibility of a renewed shift down in near-term rate expectations alongside inadequate pricing of medium-term risks – probably offset each other. This being the case, while the level of the 10-year Treasury yield will ebb and flow, we expect it to remain around 4%, assuming the current policy path continues. The biggest risk here stems from the outcome of the US election, on which note…

HOW MUCH OF A RISK IS THE US ELECTION?

In what has been a busy year for elections, this one matters most of all for the global economy. While the composition of Congress will have some bearing, a Kamala Harris victory would, for the most part, signal continuity for the US and for the rest of the world after the Joe Biden administration. In contrast, another Donald Trump presidency would have potentially significant consequences, not least:
Higher tariffs, including the possibility of a universal tariff on all imports to the US;
Tighter controls on immigration, including the potential removal of undocumented migrants; and
Tax cuts, particularly for corporates (albeit on a much smaller scale than was the case during the first Trump administration).

While it is reasonable to assume that many of Trump's campaign pledges will be diluted when faced with the reality of government, the common thread running through each of these proposals is that they will end in higher inflation. Accordingly, we think that under a second Trump administration, by mid-2026 the level of US prices would be just over 2.0% higher than our current baseline, while real GDP would be about 0.75%-pts lower and the federal funds rate would be around 50 basis points higher. Taken together this would be negative for both US bonds *and* equities.

The effects would ripple out to the rest of the world and would probably contribute to a (smaller) rise in yields in other countries. Emerging markets with high levels of external debt or central banks that are particularly sensitive to movements in the exchange rate – notably Turkey, Indonesia and, given its recent inflation problems, Brazil – would probably dial back the pace of monetary easing. The threat of higher tariffs, if implemented, could also have a significant effect on countries that trade with the US (Mexico, Korea, Vietnam and, of course, China) — particularly if Trump imposes a universal tariff, which would be much harder to avoid through trans-shipment (our EM team will be publishing analysis on the policy and trade impacts of another Trump presidency this week).

But a Trump victory would also have a profound influence on longer-term global macro trends, notably the evolution of US-China fracturing. America's advantage in a fractured world is the size and economic diversity of its allies compared to China's. If Trump pursues an isolationist agenda it would undermine a key source of US strength, making it harder for America to convince traditional allies to impose punitive measures on China, including restricting its access to critical technologies, and easier for China to pull other countries into its orbit. Clients can follow all of our analysis in the run-up to and aftermath of the vote here.

In case you missed it

I discussed what we know about Trump's trade policy plans and their potential impact on the global economy in this week's podcast episode.

We're holding Drop-Ins to preview the US election in US hours on Tuesday and Asian hours on Wednesday.

Jonas Goltermann, our Deputy Chief Markets Economist, will be taking client questions on both of those online briefings. In Friday's Capital Daily, he explored shifts in the election prediction market and how financial markets could react if Trump wins next month.