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Macro Insights Weekly

Coming US economic noise and Fed

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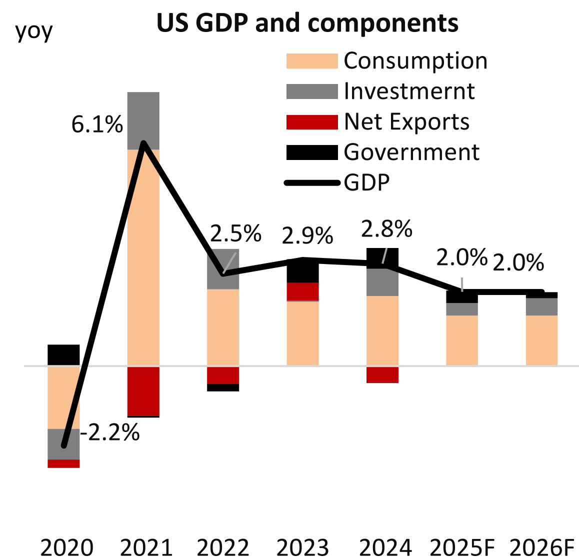
- *Game of tariffs has begun. Which tariffs stay and which are bluffs will be the hallmark of things to come. Trade, immigration, and fiscal noise will constrain the Fed's policy easing space.*
- *Growth rates in Mexico and Canada are bound to get hit. China's exporters will feel the pain too.*
- *In the US, we see near-term downside to growth and upside to inflation.*
- *We forecast 2% growth in 2025-26 and inflation in the 2.5-3% range.*
- *The Fed will find it hard to cut rates substantially in this context.*
- *A terminal rate of 4% is in store, in our view.*

Chart of the Week: US economy marches on

The Biden administration has handed over a US economy on the march to the Trump team. GDP grew by a robust 2.8% in 2024, with consumption, investment, and public spending firing on all cylinders. Strong demand fuelled imports, pushing up the trade deficit and making net exports a negative contributor to growth. A mix of protectionism, deregulation, tax/spending cuts, and immigration restrictions would influence the economy in the coming years; we think around 2% growth await.



Source: CEIC, DBS

Commentary: Coming US economic noise

The game of tariffs, as expected, has intensified. The US government is set to impose substantial tariffs on imports from Canada, Mexico, and China. Many more such measures are forthcoming, we're sure. We are also sure that there will be an element of brinkmanship, some tariff threats on certain products and countries will be issued and then withdrawn after extracting some concessions. We also expect retaliatory measures by trading partners, especially toward products with their origins in republican-run "red" states. Noise and lobbying over trade policy are about to spike.

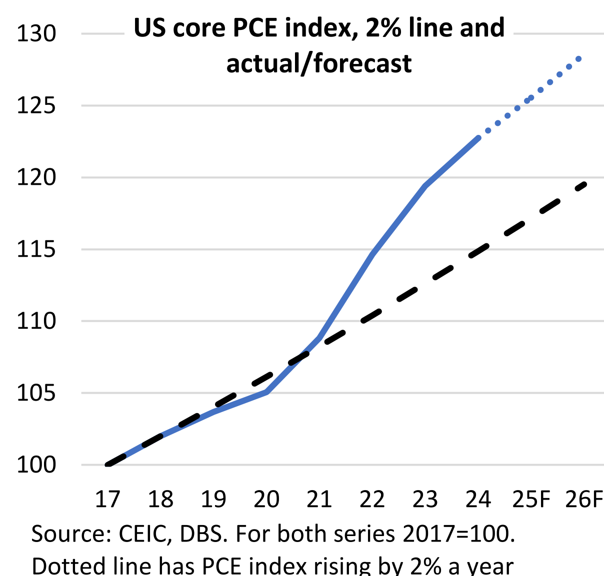
In thinking through the ramification of tariffs, threatened or actual, we should begin with the premise that time for price cuts or passing on savings to customers from productivity gains is over for the time being. Businesses, facing a tight labour market and still-strong demand environment, would pass on tariff-induced costs readily. Given the types of goods heavily traded between US, Canada, and Mexico, we see immediate upside to autos and gasoline. Also, demand for US exports would be affected as retaliatory measures are implemented.

Mexico's export sector, currency, and price level could be destabilised severely; Canada will also likely face considerable damage. Chinese exports, particularly those that have done well lately through the direct-to-consumer delivery model, would likely suffer the most.

The myriad goals of Trump, which include scaling back multilateralism, downsizing the government, reducing the oversight of tech and financial sectors, scaling back immigration, pushing through tax cuts, encouraging fossil fuel production, among others, do not lend themselves to macro stability in the near term. **This in turn could have the effect of paralysing the Fed from acting, as forecasts become harder in the cacophony of policy noise**.

Given the strong momentum in the US economy seen through end-2024, we ought to forecast 2.5%+ growth for 2025 and 2026, but would be pegging our forecast to around 2% instead, incorporating the heightened policy noise. Beyond tariffs, immigration tightening measures, along with consolidation of public sector payrolls and spending would be growth negative, offsetting supportive measures like deregulation and tax cuts, in our view.

Inflation has already been stalling long before settling at the Fed's target of 2%. With tariffs and tax cuts in play, we see headline and core inflation more in the 2.5-3% range the next two years. Unless there are major financial stability related concerns, the Fed would find it hard to carry out substantial accommodation; **we see 4% as the terminal rate in this cycle**, putting aside the scenario of Trump finding ways to force the Fed into cutting rates.



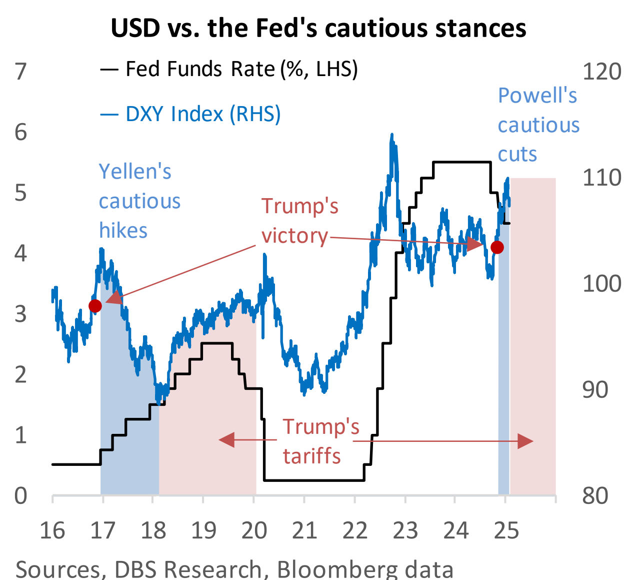
Source: CEIC, DBS. For both series 2017=100. Dotted line has PCE index rising by 2% a year

Taimur Baig

FX: Knives out – Trump's tariffs enhance the USD's haven appeal

Our belief in US President Donald Trump's tariffs driving the USD's haven appeal paid off. US President Donald Trump announced 25% tariffs on imports from Canada and Mexico and an additional 10% tariff on Chinese imports taking effect from February 4. During Trump 1.0, the US-China tit-for-tat tariff war that started in 2018 maintained the USD's haven status until it became clear that the Phase One Trade deal was coming in January 2020. Due to the retaliatory nature of the trade war, the USD's uptrend also ended up choppy after its initial surge in 2Q18.

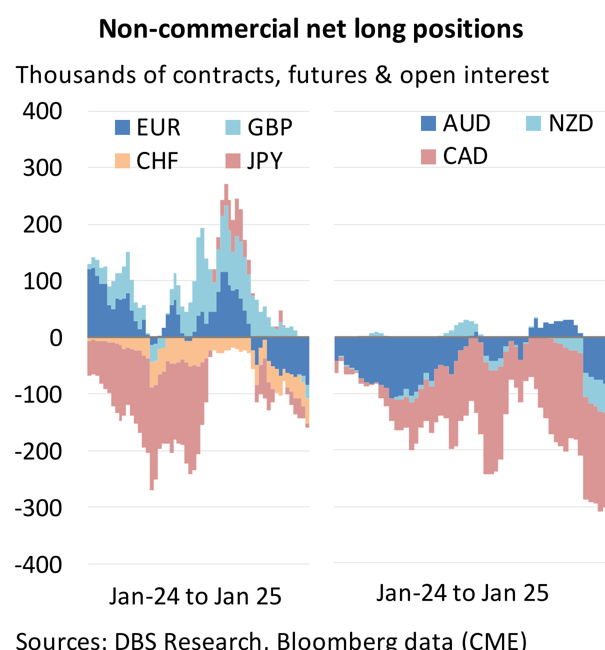
USD vs. the Fed's cautious stances



Sources, DBS Research, Bloomberg data

US-led trade tensions today will likely be worse than Trump 1.0. Trump is imposing tariffs faster, at higher rates, and with a broader scope, targeting most goods from both rivals and allies alike. **The universal tariff policy under Trump 2.0 extends beyond its previous role as a leverage tool for negotiation in Trump 1.0.** First, Trump has adopted a more protectionist stance that aims to boost domestic production apart from reducing the trade deficit. Second, the tariffs are positioned as a revenue source to offset the extension of tax cuts set to expire at the end of 2025. Third, Trump's tariff threat against the Eurozone aligns with his objective of boosting US oil and gas exports.

Non-commercial net long positions



Sources: DBS Research, Bloomberg data (CME)

Speculators held on to their net short currency positions, underscoring the USD's fall in January as a correction in the uptrend established during the Trump Trades in 4Q24. Last week's FOMC decision to keep rates unchanged affirmed the Fed's concerns over inflation's slow progress towards the 2% target due to Trump's policy mix of tariffs, tax cuts, and mass deportation of illegal migrants. Hence, the **Fed's congressional semi-annual testimonies on monetary policy on February 12 could be a significant event rolling back Fed cut expectations**. Conversely, many central banks continued to ease monetary policy to support their less resilient economies in anticipation of heightening global trade tensions. Markets have also increased their bets for 25 bps cuts in the UK on February 6, Australia on February 18, and a 50bps cut in New Zealand on February 19.

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