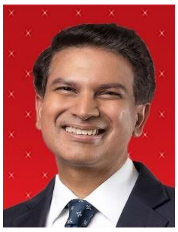
Macro Insights Weekly
The uncertainty trade

Group Research

March 17, 2025



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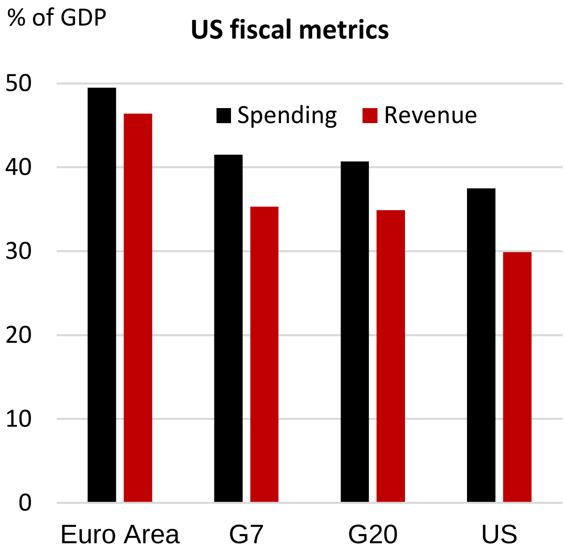
- *There is remarkable macro divergence at play among key economic blocs presently. But the overarching theme is the worsening of growth momentum in the world's largest economy.*
- *Bonds and gold have rallied. So have Chinese and European stocks.*
- *Cryptos have once again proven their beta to risk, selling off with a rise in risk aversion.*
- *We are not convinced if the US fixed income rally sustainable.*
- *Large tax cuts, unmatched by spending cuts, would keep the federal budget deficit under pressure.*
- *Call of the hour: geographical and multi-asset risk diversification.*

Chart of the Week: US fiscal, by comparison

US public sector debt burden, at 121% of GDP, is at an uncomfortable level, as is the fiscal deficit, at 7.5% of GDP. US authorities are keen to tackle this, as seen in the flurry of government worker firings and cancellation of projects. But despite a sharp rise in recent years, US public sector spending as a share of GDP is much smaller than it is in Europe or among the G20 nations. Key issue, in our view, is the sub-30% of GDP revenue ratio in the US. Solving debt and deficit issues in a sustainable manner would entail raising taxes, which unfortunately is not on the cards at all.



Source: IMF, DBS

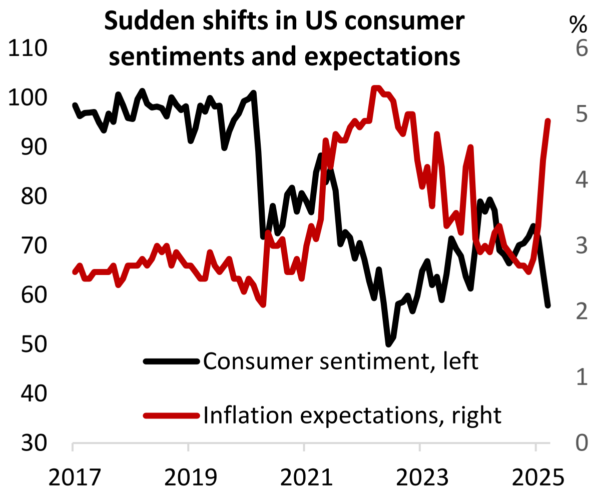
Commentary: The uncertainty trade

There is remarkable macro divergence at play among key economic blocs presently. The US economy is showing signs of slowing amid great policy uncertainty. Europe, faced with an historical weakening of its alliance with the US, is ramping up spending. China, after years of property market distress and external challenges, is finding its feet with a decisively supportive fiscal/monetary/structural policy agenda. But the overarching theme is the worsening of growth momentum in the world's largest economy.

Unsurprisingly, consumption and investment sentiments have faltered. In expectation of a slowdown, US government bonds have rallied. Meanwhile, fears of sticky inflation and lack of clarity about geopolitics have helped gold rally. Volatility traders have had a good month. European and Chinese stocks have rallied, while US stocks have retreated. DM currencies have rallied against the USD, while EM currencies have been steady. Cryptos have once again proven their beta to risk, selling off with a rise in risk aversion.

These trades have worked in 1Q, but there is a good chance a few different ones would be on the table as 2Q gets going. We expect policy uncertainty to persist, especially with announcement by the US on reciprocal tariffs looming. We are however not convinced that the fixed income market rally is sustainable.

Growth slowdown worries are justified, but that does not guarantee substantial Fed rate cuts this year. Two factors complicate that picture. First, inflation is already sticky, and would face mounting upsides as tariffs and immigration tightening measures are combined with tax cut-driven fiscal impulse in 2Q. Second, despite all the DOGE-related headlines, the chance of a meaningful improvement in the fiscal picture is slim. The planned cuts in federal depending barely scratch the surface in bringing the deficit down, with the tax cuts in the pipeline likely to overwhelm any likely savings. As the market comes to terms with ever larger supply of treasuries, the long-end would sell-off. This in turn would risk a substantial steepening of the yield curve if the Fed cuts.



Source: University of Michigan, DBS. Sentiment index set to 100 for 1966 reading. 12-month ahead nflation expectations is survey median reading.

In a scenario in which inflation, deficit, and interest rates remain hight, risk aversion would spike heavily. It would create both economic and political turmoil, primarily in the US, with some attended spillover risk for the global economy. **The portfolio manager's imperative for geographical and multi-asset risk diversification has never been greater**.

Taimur Baig

FX: EUR and DXY at a pivotal juncture

EUR/USD should continue to be pulled in both directions, as it was between 1.08 and 1.0950 last week. The hope of a spending boost for the German economy is offset by recession fears driven by the escalating trade tensions between the EU and the US.

The **CDU/CSU and Social Democrats (SPD) have reached an agreement with the Greens to reform Germany's debt brake,** which will significantly boost spending on defence and infrastructure over the next decade. This would require a two-thirds majority vote at the special sessions of the outgoing Bundestag on March 18th and the Bundesrat on March 21st. **While these parties hold the required majority, they need to address internal disputes and prevent defections to ensure the needed majority.** Fitch warned that the "ReArm Europe" plan would lower the EU's debt rating headroom due to additional debt at the EU level.

However, the EU and US are engaged in a tit-for-tat tariff war, which the Bundesbank alerted could tip the externally dependent German economy into recession. The European Central Bank also warned that maintaining stability would be a formidable task because of the exceptionally high level of uncertainties driven by Trump's policies.

Investors remain wary of "Trumpcession" risks from the Trump administration's aggressive stance on trade and implementation of tariffs and counter-tariffs. US Treasury Secretary Scott Bessent dismissed the correction in US equities as healthy. Bessent did not rule out a US recession, adding that the administration was focused on an optimistic outlook in the long term based on major policies such as extending tax cuts, deregulation, anti-immigration, and energy security. The futures market is looking for US stocks to open weaker on Monday after Bessent's comments.

On a positive note, the **US averted a government shutdown with a six-month continuing resolution** that funds federal operations through the end of September. According to estimates, Republican lawmakers still need to resolve their differences in the decision to suspend or raise the debt limit to prevent the US government from defaulting on its debt obligations by summer.

At the **FOMC meeting** on March 18-19, the market will not buck the Fed's guidance for the Fed Funds Rate to stay unchanged at 4.25-4.50%. The **focus will fall on the Summary of Economic Projections**. Given that countries have retaliated against Trump's tariffs with their own duties, the **Fed will likely lift its inflation forecast and lower its GDP growth projection**. Before the Fed's blackout period, Fed Chair Jerome Powell said the Fed would separate the signal from the noise regarding the net effect of Trump's policies on the US economy. **Powell** reckoned that the Fed was well positioned to wait for greater clarity, **hinting that the Fed need not increase its projection for two rate cuts this year to the three discounted in the futures market**. Today, consensus expects advance US retail sales to rebound by 0.6% MoM in February after its 0.9% decline in January. **Despite its negative tone, we remain cautious about the DXY Index.** Following its 6.3% plunge over the past two months, the DXY appears oversold per its 14-day RSI readings amid signs of stabilizing US bond yield differentials against their counterparts.

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations)

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