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Flash Fixed Income

October 2024

What would Trump do to Treasuries?

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- Both candidates are projected to add trillions to the national debt, though a split Congress could restrict either winner and we don't see fiscal expansion sparking a "bond vigilantes" moment for US Treasuries.
- A bear steepening of the curve is again the consensus "Trump trade", but this didn't play out as expected post-2016 and Trump's policy priorities have shifted in the eight years since.
- As stated, we think Trump's aggressive stances on tariffs and immigration would curtail the Federal Reserve's ability to meet current market expectations for US rate cuts.

As the 2024 US presidential election approaches, indications from both polling and prediction markets are no stronger than a coin toss between Donald Trump and Kamala Harris. Even if one candidate begins to build a lead in the polls between now and November 5, given their vagaries and the closeness of the race so far, markets are not going to be confident of the result until the votes are counted . We will make no prediction about the result, but we will attempt to put some contours around what we think the likely fixed income market reaction will be once the winner is clear.

The market reaction depends on the differences in policy we expect between the candidates, how likely they are to follow through on those policies, and their economic impact. But before comparing a potential Trump presidency to a Harris administration, let's compare Trump's 2024 promises to his 2016 offering.

What is the 2024 "Trump trade"?

Going into the 2016 presidential election Donald Trump was the underdog, trailing in both the polls and betting markets. But for those who wanted to position themselves for a Republican victory, the consensus "Trump trade" was a bear steepening of the US Treasury (UST) curve – both long- and short-term UST yields would rise, with long-term ones rising faster. Having told CNN "I'm the king of debt" in May 2016, Trump was expected to expand fiscal stimulus without raising taxes. This would be financed via UST issuance: "We refinance debt with longer term". Looking at the US yield curve just before and after the 2016 election (see Exhibit 1), this was exactly how the UST market responded.

Curve steepening has therefore been a focal point for commentary on what the 2024 Trump trade might be, and much has been made of price action in 30-year USTs as better or worse polling news for the former president has come in. However, when predicting the ultimate impact on the UST market, we think there are two important caveats investors should keep in mind.

First, Trump tends to confound expectations, and the experience of 2016 showed that initial market reaction may not point to the ultimate direction of travel. While yields were still higher across the curve both 12 and 24 months after the 2016 election, the curve flattened significantly (see Exhibit 2). Equities demonstrated a more immediate reversal in market sentiment; S&P 500 index futures fell by 6% in the hours immediately after the news of Trump's 2016 victory, but they had recovered by the market's open and US equities pushed on to new highs over the years that followed.

Second, eight years later Trump's policy priorities have shifted. While he still wants to extend tax cuts funded with debt, his 2024 campaign has placed far more focus on implementing trade tariffs and curtailing immigration.

Exhibit 1: US Treasury curve before and after 2016 election

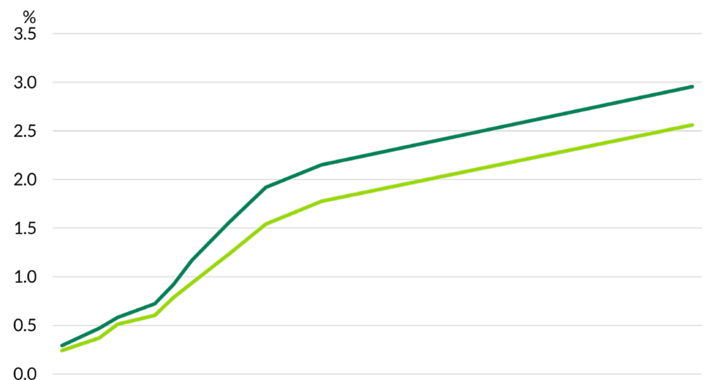

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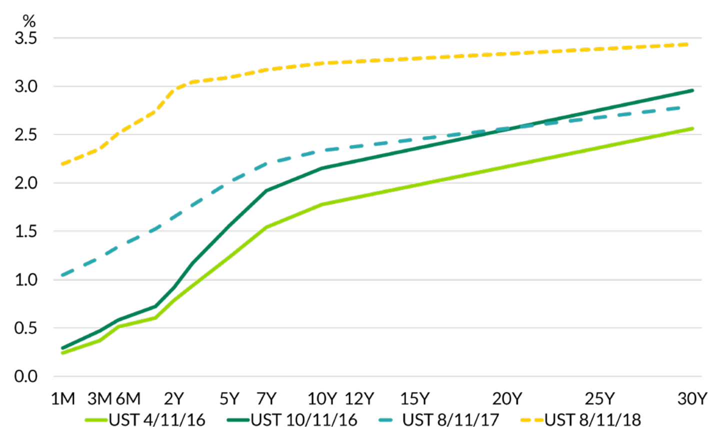
Exhibit 2: Yields rose after Trump's 2016 victory, but the curve flattened



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What is different this time?

To assess the likelihood of a post-election bear steepening, we need to examine how much more fiscal expansion we might expect from a potential second Trump administration than a first Harris administration.

A useful starting point is the very recent analysis undertaken by the non-partisan Committee for a Responsible Federal Budget. It predicts neither candidate will address structural fiscal deficits and rising interest payments – in fact, it predicts both will likely increase deficits and overall US debt levels. Based on the public campaign announcements of both candidates, websites, speeches and social media posts, the Committee projects Trump would add $7.5tr to US national debt over 10 years, while Harris would add $3.5tr. They conclude that Harris's increase to family and education spending is higher than Trump's increase to defence and security spending and although both candidates propose tax cuts, Trump's go further and dwarf the spending difference. A headline $4tr difference in the national debt over 10 years is not insignificant versus the current $35.7tr total, but our expectation is that in practice the difference between the two candidates' plans will be smaller.

The advertised level of fiscal expansion under Trump would require Republicans to win both the House of Representatives and the Senate, a so-called red sweep. Democrat control of either House or Senate would allow them to veto tax cuts and complicate spending bills. Betting markets currently make the Democrats slight favourites to win the House at 55%, though Trump winning the presidency would naturally mean that probability should be lower; although the red sweep cannot be ruled out, there is a much higher hurdle for the Republicans to gain a filibuster-proof majority of 60+ in the Senate, without which some degree of negotiation will be required. The Democrats conversely have a very low chance of retaining both the House and Senate according to the current polls and betting markets, so Harris' advertised plans would likely face the same pressures. On balance we think the most likely outcome is that the difference between Democrat and Republican spending plans is narrowed, and in turn the expected difference in UST issuance is lowered.

Another factor to consider in expectations for a bear steepening is that there could be more of a bias towards short-dated Treasury Bill issuance, which has taken up an increasing share of funding the US fiscal deficit in recent years.

What could tariffs mean for Treasuries?

When it comes to import tariffs, Harris is much more constrained than Trump, with proposals for targeted tariffs only on certain Chinese imports, such as a 100% rate on electric cars and 50% on solar panels. Trump in comparison proposes a 60% tariff on all goods imported from China and a 10%-20% tariff on all other imports.

While tariffs can be introduced by presidential order, we would expect the impact of these changes on US corporate profitability thanks to cost increases, and the impact of potential retaliation, to spark negative backlash from Republican donors and members of Congress. This, along with the knowledge that voters' approval will react negatively to a direct increase in inflation, are likely to temper Trump's final changes somewhat.

As stated, bank analysts have commented that Trump's tariff plans would imply a steep one-off addition to inflation and a dampening of longer-term growth prospects. We can walk back the magnitude of their impact if Trump is more restrained, but in terms of direction of travel, we think higher one-off inflation would push up yield expectations at the front end of the UST curve because it would somewhat curtail the Federal Reserve's (Fed) ability to cut rates. As a one-off inflation contribution we should however see far less impact at the long end of the curve, and can factor in downward pressure on yields from potentially slower economic growth. In our view, tariffs therefore translate to a bear flattening on a Trump victory.

Immigration curbs could curtail rate cuts

Immigration is a key area of policy differentiation between the candidates, and crucially one that can be undertaken unilaterally by the president. Immigration has risen steadily through President Biden's presidency, in contrast to Donald Trump's first term. While Harris has called for a tightening of asylum restrictions, and has shifted from the usual Democrat stance of framing immigration as a matter of legalising undocumented immigrants towards law enforcement at the border, ultimately the expectation is her policy will be one of continuity.

Meanwhile Trump promises to carry out the "largest domestic deportation operation in American history" using the military and the National Guard. He also plans to restore his "remain in Mexico" programme, holding asylum seekers over the border, ending automatic birthright citizenship, detaining all those caught illegally crossing the border, implementing travel bans based on ideology, reducing refugee entry and cutting back on work visas.

The rise in unemployment and drop in wage pressures witnessed in the US this year, part of the mix of economic conditions that has allowed the Fed to begin cutting rates, has predominantly been put down to an increase in labour supply rather than a slowing in demand; prime age participation has increased along with higher rates of immigration. A steep reversal of this trend would make cutting harder for the Fed if wage and price pressures did threaten to rebuild. Unlike tariffs, immigration curtailment wouldn't be a one-off increase to inflation, but would potentially have an ongoing impact on wage growth. We would expect this to put upward pressure on the US neutral rate (the level at which interest rates are considered neither accommodative nor restrictive), so not only slowing the potential pace of Fed cuts but creating a higher floor for the cutting cycle's end point.

Inflation will still dictate any yield curve shift

On balance, the impact of a potential Trump victory we would have the highest conviction around would be a reduction in market expectations for US rate cuts. We are sceptical of Trump's ability to influence monetary policy; it is clear to us the Fed will remain independent. If the election affords a Republican administration the flexibility to increase fiscal expansion, then in isolation this would likely produce a bear steepening of the UST curve. However, we think the inflationary threats presented by tariffs and immigration would override the fiscal expansion in terms of impact on market sentiment, which would see short end yields rise further than those at the long end.

It is worth noting that while neither candidate is going to improve US indebtedness, we don't see fiscal expansion sparking a "bond vigilantes" moment for USTs. To those who worry that the upward trend in the US twin deficits (fiscal and current account) is unsustainable, we would point out this has been the case for many years. We therefore believe it is futile to build an investment philosophy around this without being able to point to a clear catalyst for a change in the market's tolerance for US debt levels.

Ultimately, with anchored inflation expectations, a credible central bank and the world's reserve currency, we think the US will continue to be given plenty of headroom to increase its debt.

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