Updates on US Economy and Interest Rates

November 2024

Whoever is elected in the US, GDP growth, inflation and the fiscal deficit will not be affected much in 2025. The Fed Fund rate is estimated to end at a terminal rate of 3.25%-3.5% at the end of 2026. Both Harris' or Trump's agenda envision a higher deficit which could support economic growth, making it challenging for interest rates to fall sharply. Without the risk of a recession, allocation to Treasury bonds will provide investors with attractive yields in addition to benefits such as reducing volatility of the overall portfolio in an economic expansion with a loose stance of monetary policy.

By Cathay SITE

The market shifted to the side of predicting fewer rate cuts, bringing key benchmark interest rate to 3.25%-3.5% by the end of 2025, which is in line with the Fed's projection. Against the backdrop of a positive economic outlook, we anticipate that the Fed Fund rate will end at a terminal rate of 3.25%-3.5% at the end of 2026 in this rate cut cycle. Without a recession in sight, our estimate for the US 10-year Treasury yield is around 4.0%.

A week before the US election, Donald Trump is leading on internet-betting sites. Having said that, whoever comes to power, GDP growth, inflation and the fiscal deficit in the US will not be affected much in 2025. Whether either candidate could actually enact their proposals should they become president remains in doubt. Their proposals are likely to be watered down, especially under a split Congress.

The effect of the Harris or Trump policies on the deficit will pan out in the medium- to long-term. As a baseline, Congressional Budget Office (CBO) projects federal budget deficits of US$20 trillion over the 2025–2034 period. Whether Harris' or Trump's agenda, the deficit could develop higher than CBO estimate and support economic growth, making it challenging for interest rates to fall sharply.

Bond market volatility has increased significantly, reaching levels seen when the Fed reiterated "higher for longer" in 2023, suggesting that the market has factored in economic expectations if Trump is re-elected, i.e. a stronger economy and slower pace for rate cuts.

The volatility of the U.S. dollar has also increased. A potential Trump victory could be bullish for the US Dollar. On the back of higher real interest rates, capital is likely to flow into the US, forming a buying force for US bonds.

According to statistics, interest income will be the primary contributor to bond total returns in the soft-landing scenario. Recent soaring bond yields may have priced in the strong economy under Trump 2.0, and are likely to remain range-bound in the short-term. In our opinion, without the risk of a recession, allocation to Treasury bonds would provide investors with attractive yields in addition to benefits such as reducing volatility of the overall portfolio in an economic expansion with a loose stance of monetary policy.

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