FX SALES, STRATEGY AND TRADING

RBC Capital Markets

03 October 2024

Global FX Strategy

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CAD: US Election Soundbites

1. What are the main proposals of Trump vs Harris?

	Trump	Harris
Fiscal policy & other economic policies	Lower the **corporate tax** from 21% to 20%; lower to 15% if company produces in the US Make the expiring **2017 TCJA permanent** Replace individual income tax w/ tariffs **No taxes on tips** for restaurant/hospitality workers, overtime pay, Social Security benefits Create sovereign wealth fund Help new homebuyers (e.g. use federal land for large-scale housing construction) **Cancel unspent funds** from the Inflation Reduction Act	Raise **corporate tax** from 21% to 28%, ensure those with <400k in annual earnings do not pay more in taxes, enact billionaire minimum tax, quadruple stock buybacks tax, raise LT capital gains tax to 28% (from 20%) if earn >= $1mn **No taxes on** service/hospitality workers' **tips** Restore/expand the **Child Tax Credit** and expand the **Earned Income Tax Credit** Federal ban on price gouging Build new homes, provide $25k downpayment support to first time homebuyers
Monetary Policy	**Trump stated** that he would let Powell serve out his term in an interview Wants lower interest rates but said **focus will be on bringing down costs** through lower energy prices "*A president can certainly be talking about interest rates […] doesn't mean I'm calling the shot*" (*Bloomberg*, 19 Aug 2024)	**Harris stated** "*The Fed is an independent entity and as president I would never interfere in the decisions that the Fed makes*" (Reuters, 11 Aug 2024)
Immigration	**End undocumented immigration**: close borders/finish wall/**deportation**	The **immigration system** needs "*comprehensive reform that includes strong border security and an earned pathway to citizenship*" (here) Plans to bring back the border security bill
Trade / FX	**Trade: 10% universal tariff** (in August NC rally suggested **could be between 10-20%**); proposal for Trump Reciprocal Trade Act 50% **tariffs on Chinese good imports** (denied in BBG interview that considering 60%); tariffs on Chinese cars coming through Mexico; revoke China's Most Favored Nation status **FX: keep USD as world reserve currency & punish de-dollarization through 100% tariffs** "*We have a big currency problem*" – this was in the context of JPY & CNY (Bloomberg Businessweek, 19 Jul 2024)	In an interview, Harris stated about Trump's tariffs idea that, "*It would be a sales tax on the American people*". **In response to a question about her views on tariffs** ("*Where do you come out on, is there a good tariff, a bad tariff?*"), **she answered that,** "*Well, part of it is, you don't just throw around the idea of just tariffs across the board*" (MSNBC, 25 Sep 2024)
Foreign Policy	Wants to end the **Russia/Ukraine** war within months of being elected "*I think, Taiwan should pay us for defense […] Taiwan doesn't give us anything*" (Bloomberg Businessweek, 19 Jul 2024) Thinks **sanctions** "*kills your dollar and it kills everything the dollar represents*" and "*I don't love sanctions*" (FT, 09 Sep 2024) **NATO**: He has been critical of countries not meeting the 2% of GDP defense spending commitment in the past	**US-China relations:** "*We, as the United States, in our policy, it is not about decoupling, it is about de-risking*" (CBS News, 10 Sep 2023) **NATO/Ukraine**: "*I will stand strong with Ukraine and our NATO Allies*" (The White House, 22 Aug 2024) **Taiwan**: "*We will continue to oppose any unilateral change to the status quo*" and "*And we will continue to support Taiwan's self-defence*" (Reuters, 28 Sep 2022)
Tech companies	"*They have become too big, too powerful*" (Bloomberg Businessweek, 19 July 2024)	

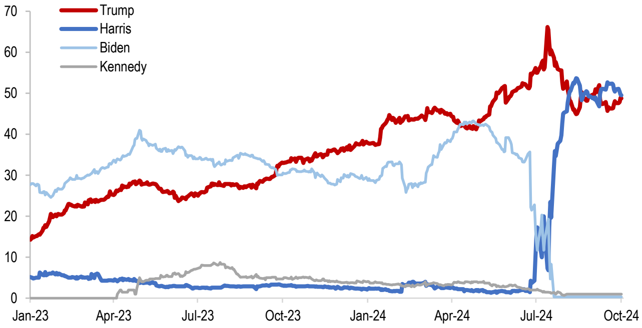
Source: Bloomberg, CNBC, Donald J Trump campaign website, FT, Kamala Harris campaign website, MSNBC, NY Times, Reuters, Tax Foundation, The Japan Times, The White House, RBC Capital Markets.

2. What is the market pricing for the US election?

We use **prediction markets as a proxy** for the probability the market attaches to the likelihood of each presidential candidate winning the November election, with Real Clear Politics' readings showing Trump and Harris at ~49% and ~50%, respectively. The **latest 3m rolling correlation** of the daily changes in USD vs the daily changes in Trump's odds (and vs the spread between Trump's odds and Harris) **is statistically insignificant** (<=**0.10)**, and **it is hard to find evidence that the election has been a big driver of USD**. Markets have been more focused on the US economic outlook and the Fed's rate cutting cycle.

For most pairs, a similar picture shows up in **vol**. The table below looks at the difference between the 1M ATM forward implied vol covering the US election and the 1M historical vol for each pair to figure out the amount of risk premium in FX vol curves. The first column shows the results for this year's election, and the other two columns look at the premium for the 2020 and 2016 elections, with the same number of remaining days into each respective election. **For many of the pairs in the table, vol is carrying a smaller 'risk premium' for the upcoming US election than in the prior two cycles** (CNH is a bit of an exception here). The caveat is that historical vol captures the recent FOMC meeting & the August NFP, and 1M implied vol figures capture not only the US election, but also the October NFP and the Fed's next decision (and for CNH, it captures China's Golden Week).

Real Clear Politics: US Presidential Election betting average odds (%)



Source: RBC Capital Markets, Bloomberg

Election Risk Premias* in FX Vol Curves

	01-Oct-24	29-Sep-20	04-Oct-16
USDCAD	1.16	2.22	1.62
EURUSD	1.45	2.13	1.89
USDMXN	3.84	4.23	7.59
USDCNH	2.88	2.04	2.30
AUDUSD	1.74	3.02	2.44

Source: RBC Capital Markets, Bloomberg; *Calculated as the difference between 1m atm fwd implied vol (covering the US election) and the 1m historical vol; for CNH, the current 1m implied vol covers the US election period

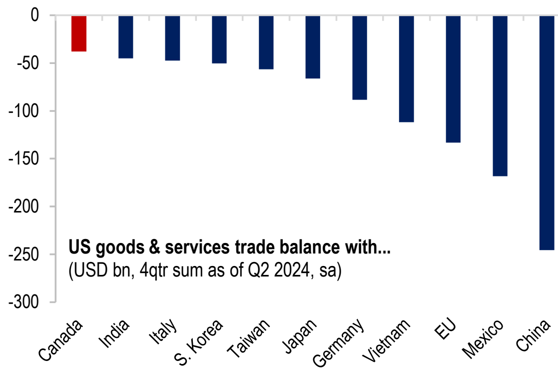
3. What may be the impact of the US election on CAD?

Direct impact for Canada: The main domestic development to watch will be the **first joint review of the USMCA on July 1, 2026**, as it can impact not only Canada's trade with the US but also potentially business confidence/investment. **Article 34.7** of the agreement allows each party to confirm in writing whether they want to extend the USMCA for another 16 years, and to present any recommendations for action at this review meeting. If one or more of the parties decide to not extend the agreement, then the USMCA would be terminated on July 1, 2036. Additionally, a joint review will be held each year (rather than every six years) for the remainder of the USMCA's term, unless the decision to not extend the USMCA is reversed at one of the subsequent annual reviews (after which a joint review would be held every six years). **Effectively**, Article 34.7 makes it possible for a party to backtrack on one's decision to not extend the term of the USMCA. It is also worth flagging that **Article 34.6** allows a party to withdraw from the USMCA and it goes into effect in six months (but it is not clear if a party can renege on that decision during those six months).

Given how the NAFTA re-negotiations played out and Trump's history of using tariffs as a negotiating tactic, the process is likely to be much less predictable under Trump than Harris. Harris was one of ten senators that voted against the USMCA due to it "not addressing climate change", but would be unlikely to turn it into a political flashpoint now. **Any threats about terminating the USMCA and/or using tariffs for leverage during the review process are likely to be CAD-negative, but this is more a story to watch for late 2025 and more so into 2026 under a Trump presidency.**

On tariffs, the US-CA side letter for the **USMCA provides space for the Canadian auto sector to be exempt from potential US tariffs** through section 232 of the Trade Expansion Act of 1062. The following imports from Canada are excluded from section 232: light trucks, 2.6mn passenger vehicles per year, and a USD 32.4bn customs value of auto parts per year. **If there were to be a reversal of this agreement**, then any tariffs levied on the Canadian auto sector would carry negative implications for the Canadian economy. In 2023, almost 80% of Canadian goods exports went to the US, and "Transportation equipment" was the second largest category at ~16% of exports to the US.

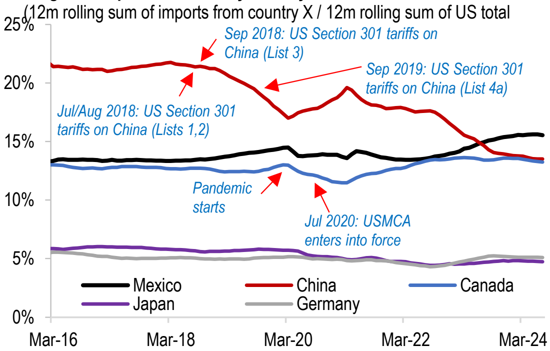
Having said that, any potential auto tariffs would also negatively impact the US economy, given the tight integration of the US & Canadian auto sectors (see here). Thus, although threats to remove that exception may be plausible, the probability that Trump ultimately backtracks on that exception should be low. **More importantly, there are other economies with which the US has a larger goods & services trade deficit**, making them the more likely targets of anti-trade rhetoric under a Trump win (below Figure on LHS).



Source: Haver Analytics, RBCCM

US goods imports: % share by country of source

(12m rolling sum of imports from country X / 12m rolling sum of US total



<u>Indirect impact for Canada</u>: In 2025, the impact of the US election through the external backdrop (USD direction & risk backdrop) **will likely matter more than the direct channel for CAD**. **<u>In short</u>**, although there is uncertainty about implementation, we still lean towards expecting a **Harris presidency** to extend the status quo. While some of her policies are perceived to be very market-negative, the chances of getting those through a divided Congress are infinitesimal. Our base case profile is a range-bound USD in the near-term and then a drift lower in the medium-term. Meanwhile, a **Trump presidency** would be a USD-wildcard, but net-net, we lean more USD-bullish than USD-bearish.

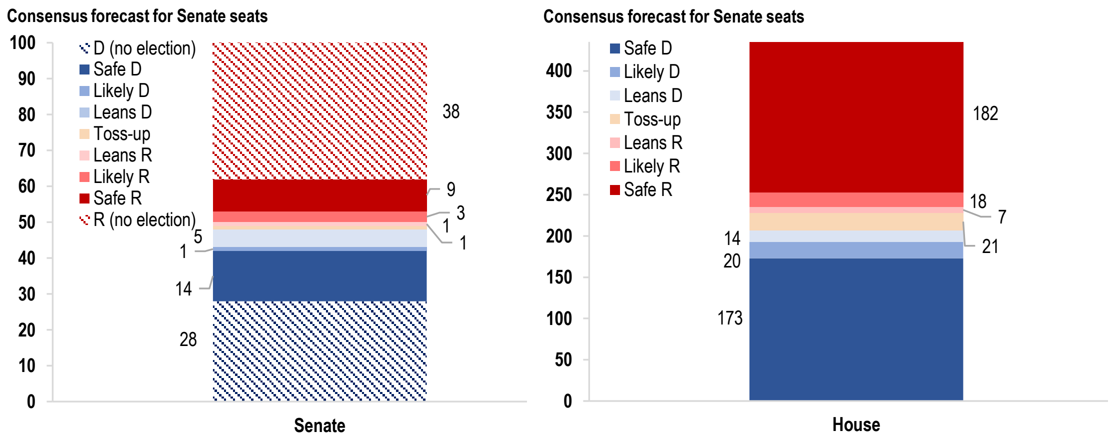
- ***Monetary policy*** – **Trump is likely to be more aggressive in using tariffs and reversing prior immigration/cracking down on further immigration than Harris**, and our US rates team thinks that such an outcome "*should be priced in like a hawkish policy error – with the Fed forced to hold rates higher in 2025 due to inflationary pressure, but deeper cuts further out the curve and a longer-run drag on growth expectations*" (see here & here for more thoughts from our US rates/economics team). At least initially, **this should be USD-positive**, posing an upside risk to USD/CAD and CAD on the crosses. **This is the main driver of our bias** for a Trump presidency to lean USD-bullish, as a president has more unilateral authority to take action on immigration and impose tariffs compared to implementing fiscal policy.

  If the US imposes more aggressive tariffs on China, the extent of China's response may add to the USD upside risk (e.g. tit-for-tar tariffs or PBoC weakening the local currency).

- ***Fiscal policy*** – The consensus forecasts collated by 270toWin from various forecasters suggest that it will be a tight race in Congress, and it is not clear that the Republicans or the Democrats will experience a Red or Blue Sweep. **This would make it difficult for either presidential candidate to pass their fiscal agenda**.

  As of writing, both candidates' policies carry elements that would be fiscally expansionary and contractionary. Having said that, **neither the Republicans or the Democrats have been parties of fiscal responsibility under the Trump and Biden administrations** – until further information, we think it is fair to assume that this likely will not change whether Harris or Trump wins.

  Is the US fiscal deficit a concern? We continue to think that the large US fiscal deficit should not be a USD-negative story unless the private domestic sector shifts from a surplus to a deficit, as that would imply the US will need a weaker currency to attract foreign flows to fund its deficits (see chart here).



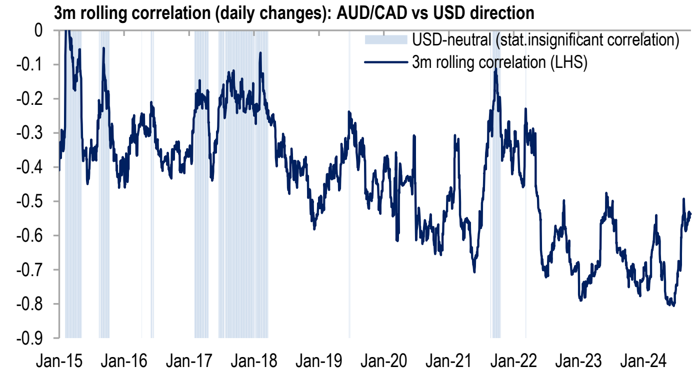
Source: 270towin.com, RBC Capital Markets

- ***FX*** – Earlier this year, news reports citing Trump's advisers suggested Trump would potentially pursue a weaker USD policy. But Trump's reliance on tariffs would only push USD higher and it is unlikely that the Fed would give into political pressure for lower interest rates. Direct FX intervention can't be ruled out by Trump v.2. Traditionally FX intervention would be executed by the NY Fed's Open Market Trading Desk through the System Open Market Account (SOMA) under the direction of the FOMC or the Exchange Stabilization Fund (ESF) under the direction of the US Treasury – the last intervention took place in March 2011 (selling JPY due to the earthquake in Japan) and the operation was evenly split between the SOMA and ESF accounts. **The optics of whether the FOMC works with the Treasury** on any FX intervention matters. If the Treasury is unilaterally intervening but monetary policy is tightening in response to inflationary pressures, we think the impact of intervention would be limited.

4. If a Harris win represents status quo, how do we trade CAD under a Trump win?

We think the answer is **short AUD/CAD** – this is an idea that we initially flagged in our August 9 edition of *CAD: Weekly Soundbites*. This thematic trade is **conditional on the following factors**: **(1)** a combination of Trump imposing tariffs and taking action on prior and future immigration (this would lend support to USD and subsequently CAD should gain vs AUD due to its 'mini-dollar' status), **(2)** China is likely to be the main target of Trump's tariffs (AUD likely to get hit more than CAD due to Australia's strong linkages with China's economic outlook and despite both currencies being vulnerable to broader risk sentiment), and **(3)** although CAD may potentially face headwinds on the back of the first joint USMCA review, we think this will be more a story for late 2025 and even more for 2026.

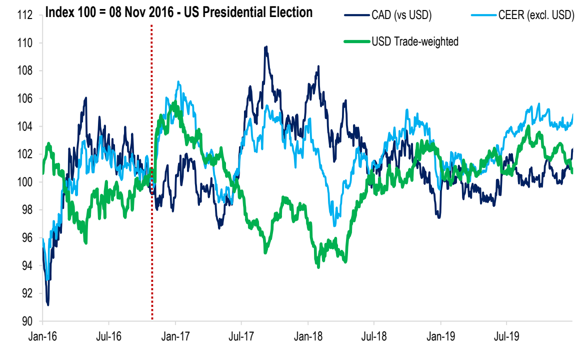
The **main risk** would be China unleashing additional and significant fiscal stimulus post the US election.



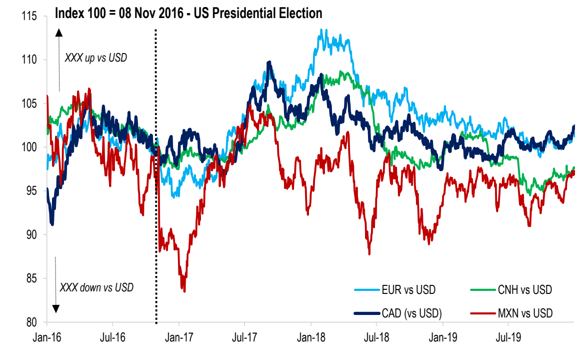
Source: RBC Capital Markets, Bloomberg

5. How did FX behave post the 2016 US election?

The below charts show the price action pre- and post the 2016 US election, with the LHS figure showing CAD vs USD, CAD on a trade-weighted basis (CEER-ex USD), and our USD trade-weighted index, and the RHS chart showing EUR, CNH, MXN, and CAD vs USD. The dotted line represents the day of the 2016 election. For comparison, all currency returns have been rebased to an index (08 Nov 2016 = 100).



Source: RBC Capital Markets, Bloomberg



Source: RBC Capital Markets, Bloomberg

There are several key takeaways:

- Following the November 2016 election, **USD** saw a notable rally into year-end (green line on LHS), as the Trump victory surprised markets and relative rate dynamics moved in favor of USD (*Currency Report Card*, December 2016). Trade-weighted **CAD** (ex-USD) rallied during that time period, likely helped by its mini-dollar status (light blue on LHS), while CAD's price action vs USD (dark blue on RHS) was a lot more muted than MXN's selloff vs USD (red line).
- For most of 2017, **USD** saw a decline. Back then, we pinned it down to a combination of the relative rate dynamics, markets pricing in the risk of the Fed over-tightening and reversing, and the currency carrying a risk premium for wider US policy uncertainty (*Currency Report Card*, July & September 2017). **CAD** saw independent strength in late Q2 & Q3 amid a hawkish BoC.
- **It was not until 2018 that USD began to rally** on the back of Trump's trade war with China and US tariff announcements, with USD holding up well in 2019 despite the Fed cutting rates later in the year. **CAD** experienced **independent weakness in early 2018**, driven by (1) a more cautious BoC amid the softer data narrative and (2) heightened uncertainty around the NAFTA renegotiations (e.g. the US announced its intent to impose tariffs on Canadian steel and aluminum products on March 1 before Canada got a temporary exemption).
- **For the rest of 2018**, **CAD was mainly driven by the external backdrop**. The **CAD** index (ex USD) and USD/CAD rallied in Q2/Q3 as the US-China trade war pushed USD higher, and this overshadowed the negative reaction in CAD to Canada losing its temporary exemption to US tariffs on its steel and aluminum products on May 31. Then in Q4, **CAD** experienced weakness amid a collapse in crude oil prices and US equities.

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