

# *Acrophobia - Fear of Heights*

*Of Rates, Geo-politics, Restraints & Risks*



*~Fear of heights is often not about how high the climb is, but how far down the drop will be*

**“It was one of those March days when the sun shines hot and the wind blows cold; when it is summer in the light, and winter in the shade” - Charles Dickens, Great Expectations**

**MIZUHO**

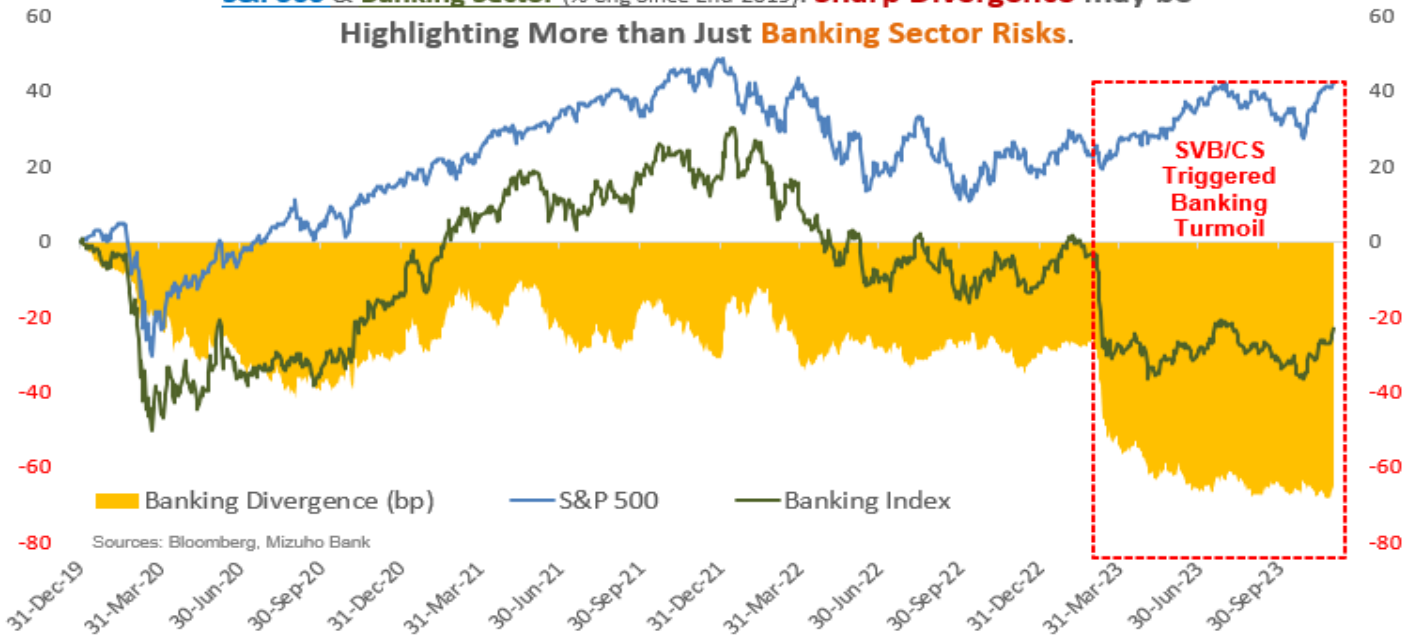
Private and confidential

Photo Credits: Financial Times

December 2023

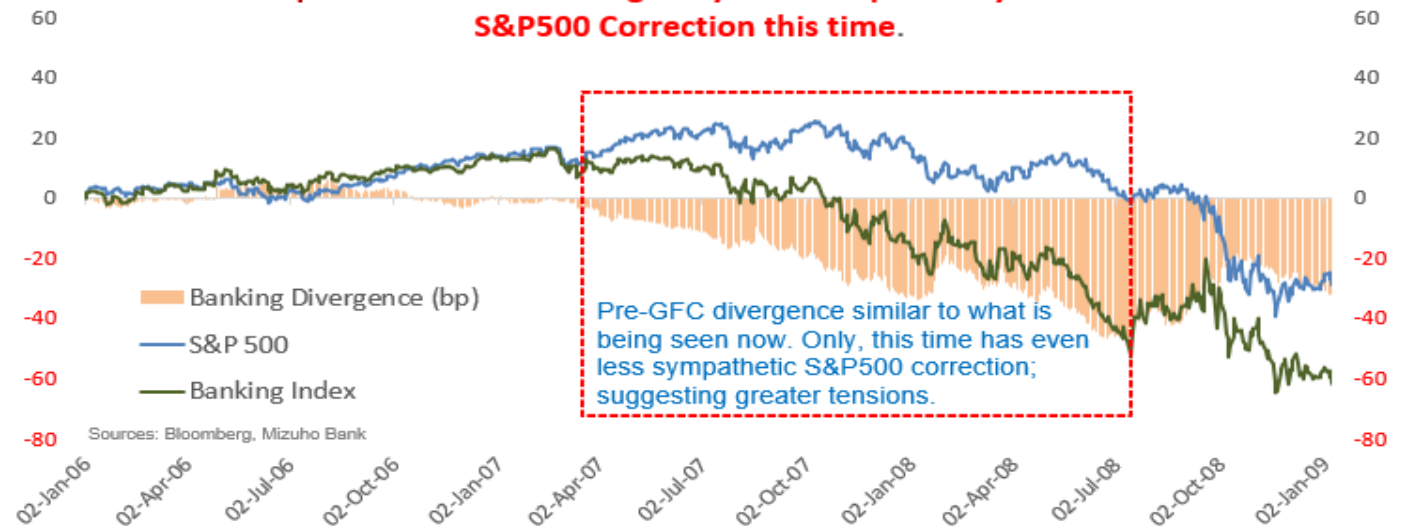
# High Valuations & “Highs” of Pivot?

**S&P500 & Banking Sector (% Chg Since End-2019): Sharp Divergence may be Highlighting More than Just Banking Sector Risks.**



	S&P500	Banking
Since End-2019	41%	-26%
Since Q3 2021	3%	-33%
Since Q1 2022	7%	-33%

**S&P500 & Banking Sector (% Chg Since End-2015): Not Just Echoes Pre-GFC Banking Under-performance ... but Arguably Risks Amplified by Less Severe S&P500 Correction this time.**

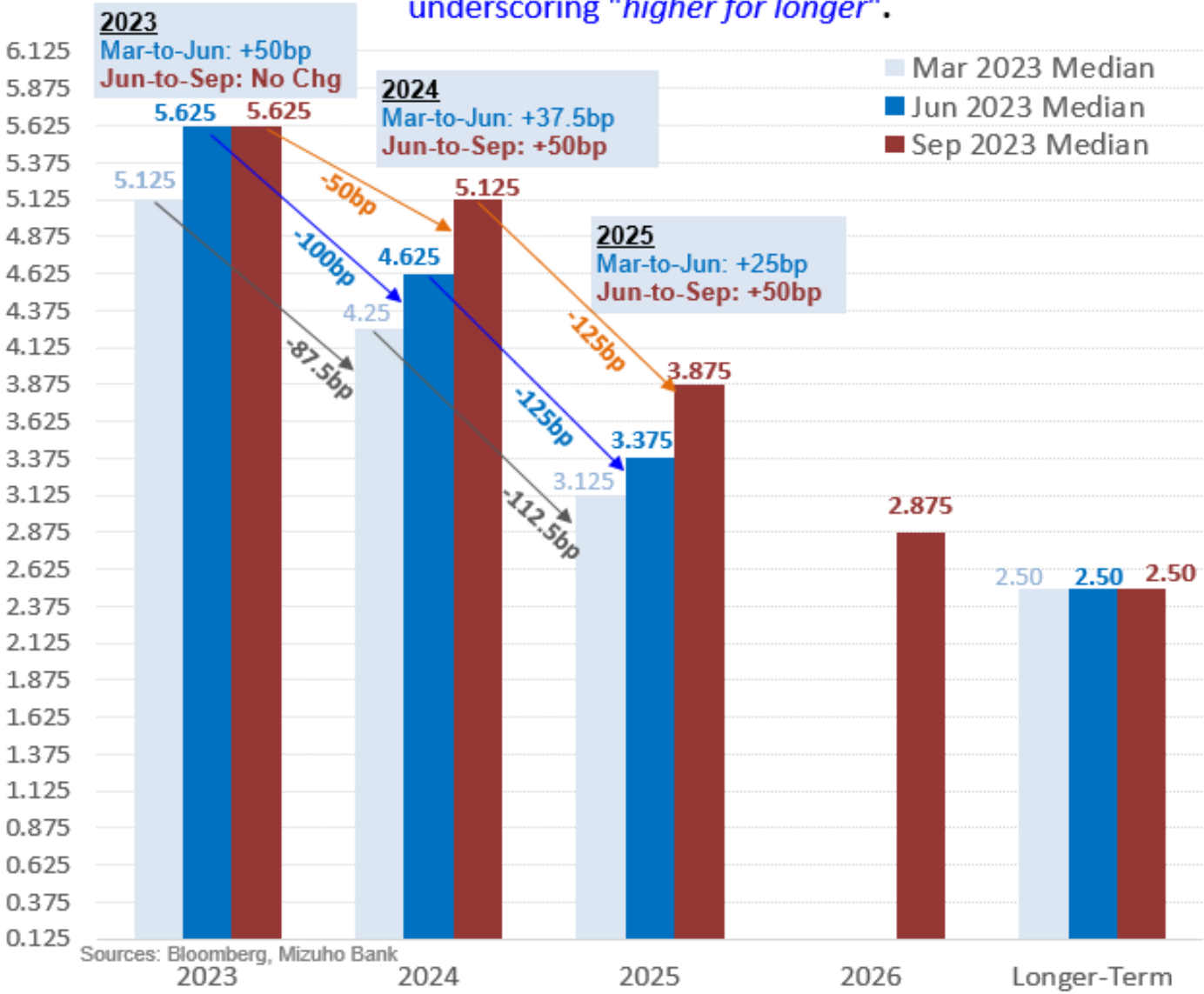


# High Stakes & Elevated Euphoria

1. **High Rates: Why 'Peak Fed' Flags Incoming Pain, Not Imminent Panacea**
  - a. “Higher for Longer” in Real Terms
  - b. Exacerbated by Lagged, & Variable Transmissions
2. **Highs of Re-opening: Global Demand Twists, Turns & Tumbles?**
  - a. Fading Goods-to-Services Transition with Limited Manufacturing Inflection?
  - b. Inconveniently High Cost Shocks both a Policy Risk & Demand Drag
3. **Heightened Geo-political Risk: Conflict & Casualties**
  - a. Oil Compounds Pain & Cost Shocks
  - b. Uncertainty & “Crowding Out” Risk
4. **High Bar for China: Landing, Not Launching**
  - a. Stimulus is Pain Relief, Not Structural Panacea
  - b. Property Dent & Confidence Deficit
  - c. CNY Risks
5. **High USD & Asia FX: Bracing for Outflows & Volatility**
  - a. “Real Risks” Favour USD
  - b. EUR Navigating Risks & JPY Ready for Rebound
  - c. Confluence of “Real” Risks restrain AXJ

# 1a. Hawkish (Dot) Plot Doubling Down on “Higher for Longer”?

**Hawkish 'Dot Plot' Shift: +50bp Revisions to 2024 & 2025**  
underscoring "higher for longer".



**Q:** What is it saying ... of the inflation dynamic ... (that to) achieve the same inflation forecast ... but need another half-a-point of (higher) Funds rate?

**Powell:**  
Wouldn't say that's (inflation persistence) something that has appeared in recent data ... **more about stronger economic activity** ... if I had to attribute one thing ...

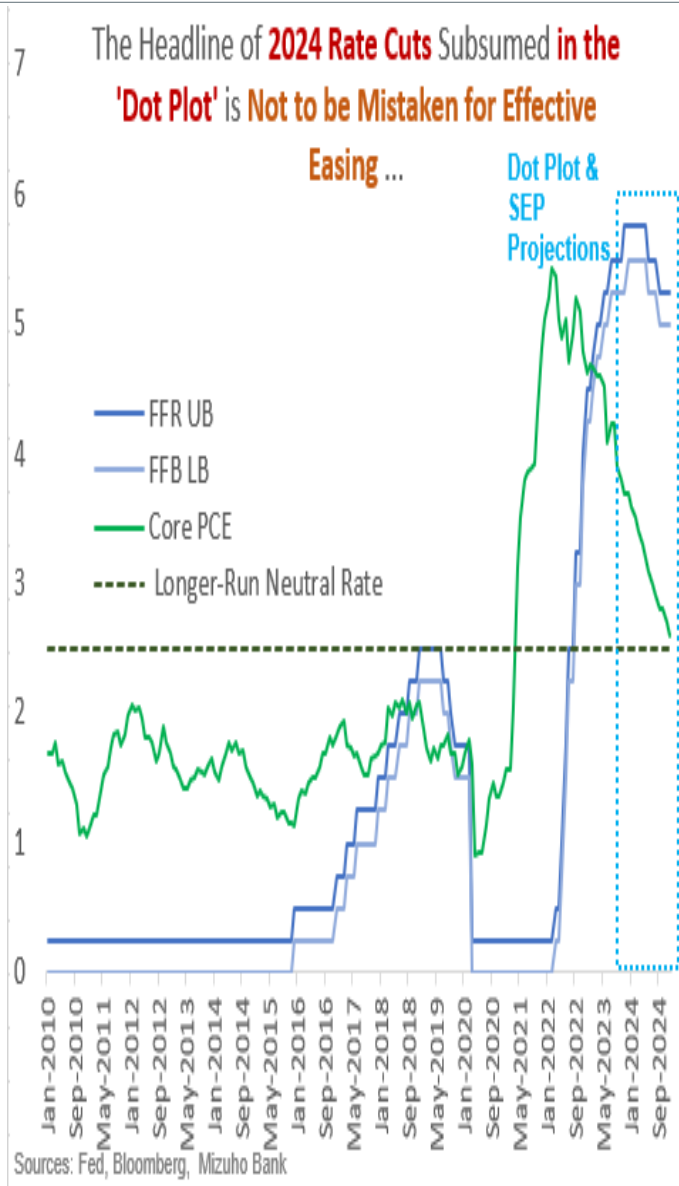
# 1a. Real(-ity) of Restrictive Rates ...

The Headline of **2024 Rate Cuts** Subsumed in the 'Dot Plot' is **Not to be Mistaken for Effective**

Easing ...

Dot Plot & SEP Projections

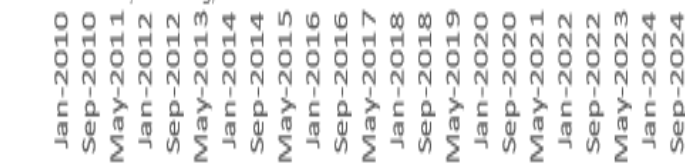
FFR UB  
FFB LB  
Core PCE  
Longer-Run Neutral Rate



Whereas **on Real Rates Measure**, Continued Tightening into 2024 is Implied (on a Smoothed Projection of Dot Plot & SEP) ... Suggests **Euphoria on "Peak Rates"** is Premature if Not Misguided

Implied Real FFR (UB)  
Implied Real FFR (LB)  
Longer-Run Real Neutral Rate

Sources: Fed, Bloomberg, Mizuho Bank



**Q:** You have indicated *sufficiently restrictive* will be **judged on a real** rather than nominal basis ... implying some scope for nominal cuts next year (on softer inflation) ... is the FOMC targeting a real ... policy restriction?

**Powell:**

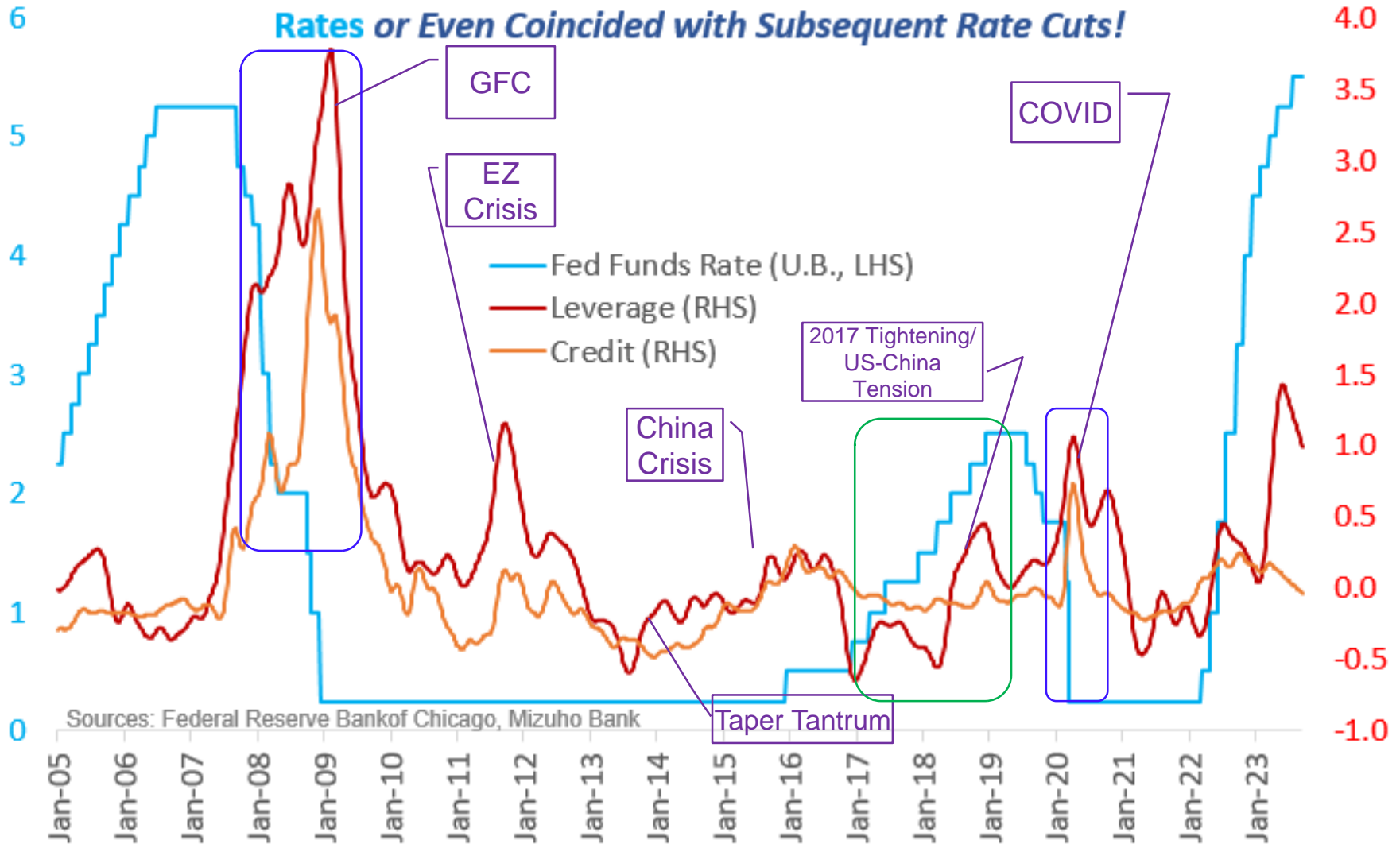
(will) **know sufficiently restrictive only when you see it**

... combination of an unwinding of pandemic-related demand-supply distortions and **monetary policy's work in suppressing demand** ... is actually working ...

want (to be) confident ... **this is the right level and for now stay here ... haven't got ... confidence about that** (high enough rate) yet.

# 1b. The Long & Variable Lags of Policy

**Tightening Credit** Conditions that are **Associated with Recession Risks** and **Follow Tightening Leverage**. have **Often Lagged Peak Rates or Even Coincided with Subsequent Rate Cuts!**

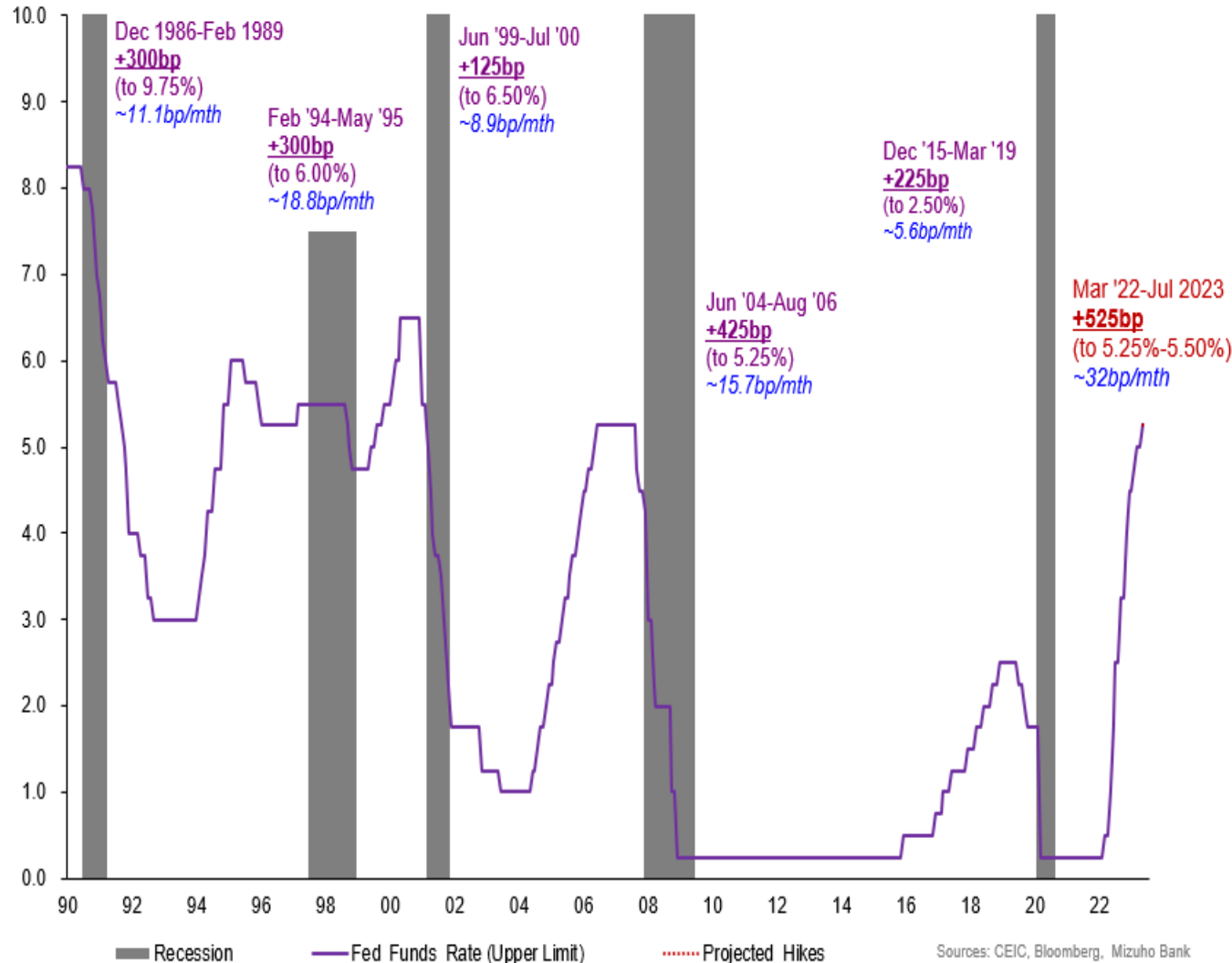


Sources: Federal Reserve Bank of Chicago, Mizuho Bank



# 1b. In any Case, Recessions Have Followed Sharp Rate Hikes, *With Considerable Lag*

**Fed Tightening Cycles & Global Recessions:** Few Tightening Cycles by the Fed Have Resulted in "Goldilocks" Outcomes that **Avert a Recession**. And the Fed has assumed the **fasted pace of hikes in four decades**; since the Volcker era (1980s).



Sources: CEIC, Bloomberg, Mizuho Bank

**Q:** Would you call a **soft landing** now a **base line expectation**?

**Powell:**

**No**, I would not say that ... always thought **soft landing** was a **plausible outcome** ... there was a path to a soft-landing ... *path narrowed and widened ... ultimately decided by factors outside of our control*

**Soft landing is a primary objective** ... *trying to achieve* ...

[**but subordinated to price stability**] though ... **worst thing** ... is to **fail to restore price stability** ... best thing ... for everyone ... restore price stability

**ability to ... move carefully ... planning to ...**

## Our Fed & Yield Outlook: Cold Feet May Over-take Careful Tightening Bias in H1 2024

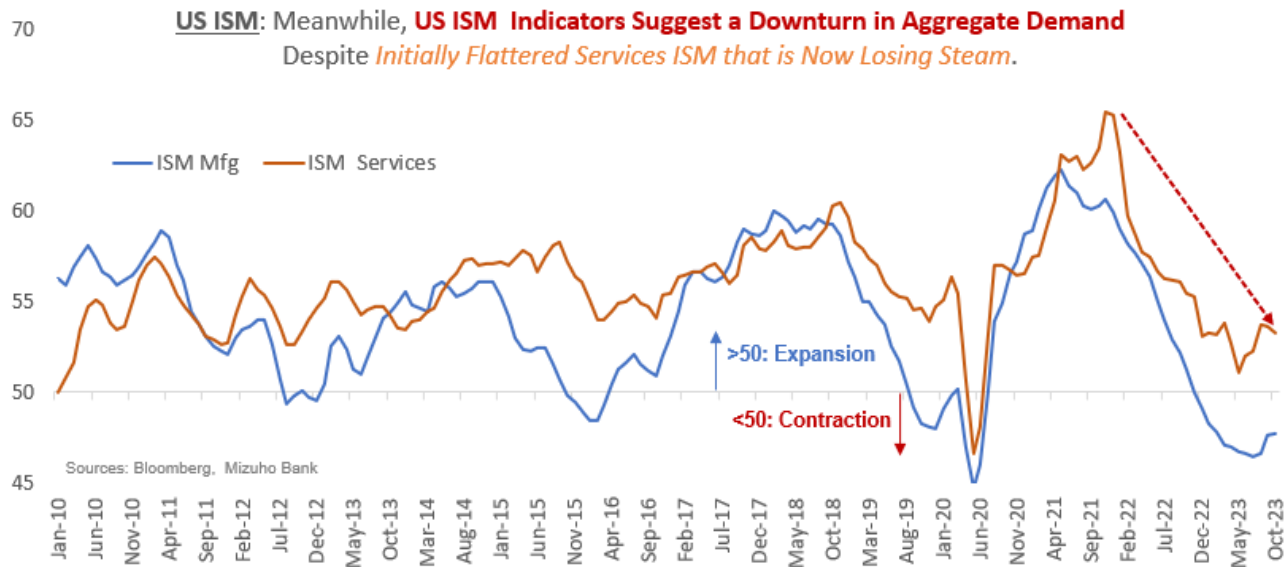
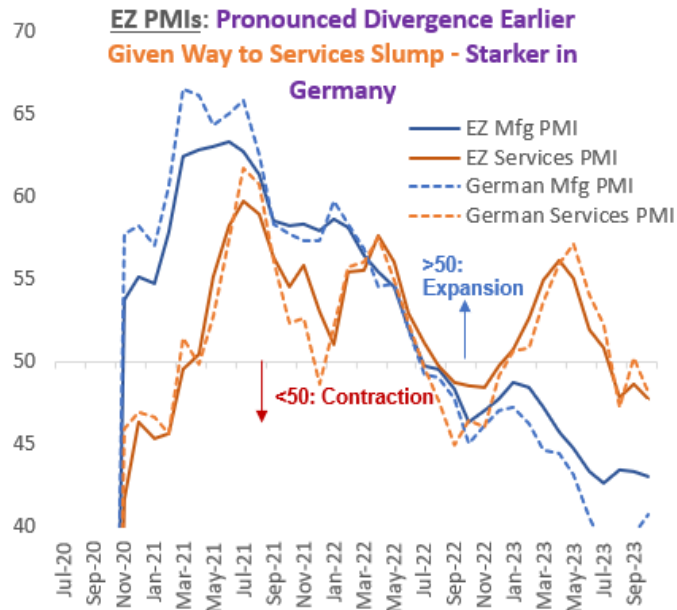
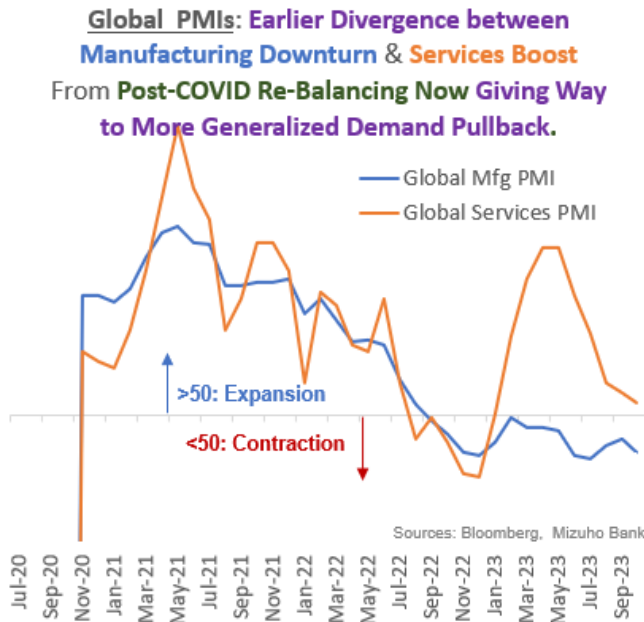
	End-2021	2022				2023				2024			
	Q4 21	Q1 22	Q2 22	Q3 22	Q4 22	Q1 23	Q2 23	Q3 23	Q4 23	Q1 24	Q2 24	Q3 24	Q4 24
Fed Funds Target Rate Ceiling	0.25	0.50	1.75	3.25	4.50	5.00	5.25	5.50	5.50	5.25	4.50	3.75	3.75
Fed Funds Target Rate floor	0.00	0.25	1.50	3.00	4.25	4.75	5.00	5.25	5.25	5.00	4.25	3.50	3.50
UST 2Y Yields	0.73	2.32	2.95	4.28	4.43	4.03	4.90	5.04	4.91	4.00	3.23	2.93	2.80
UST 10Y Yields	1.51	2.36	3.01	3.83	3.87	3.47	3.84	4.57	4.72	4.12	3.56	3.28	3.22

Sources: Bloomberg, Mizuho Forecasts

- **“Live” Dec FOMC, but Hawks Not Living it Up:** *Realized peak rates may be 5.25-5.50%.*
- **But Tightening Bias Not Shed in 2023:** Nonetheless, latent/dormant tightening bias may be hard to fully shed. Fed’s emphasis on “higher for longer” rates may linger till Q1 2024.
- **Volatility:** **Upside yield bias from “high for longer”** may be **sensitive to infection on soft data points;** especially on signs of consumer pull-back. *Oil* is as such as **two-way risk**.
  - ❖ **“Careful” Fed may limit Yield upside:** Although measured tightening calibration bias **could limit scope for strong surge in yields;** 2Y amid 5.0-5.4% and 10Y 4.5-5.3%.
  - ❖ **Counter-intuitive Bear Steepening on Geopolitics** will **hasten reversion to a normal sloping yield curve;** *as US debt woes on military spending drive long-end yields higher eclipsing haven demand (for now) that ought to drags yields lower instead.* But will be non-linear.
- **Giving way to Sharply Softer Yields:** But with Fed easing likely by H1 2024 **UST yields head sharply, albeit bumpily, lower in early-2024, picking up pace into mid-2024.**

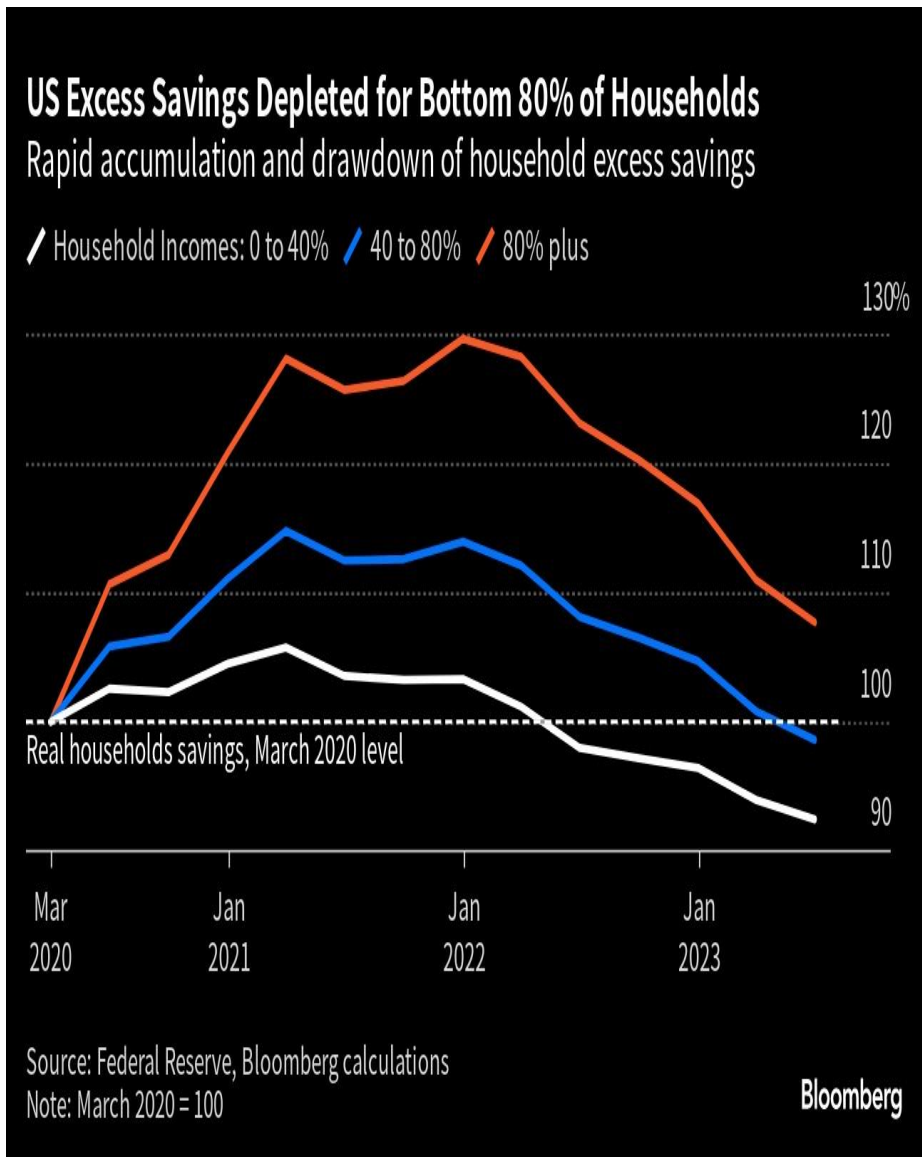


## 2a. Demand Re-balancing More *Red Herring* than *Silver Lining*?

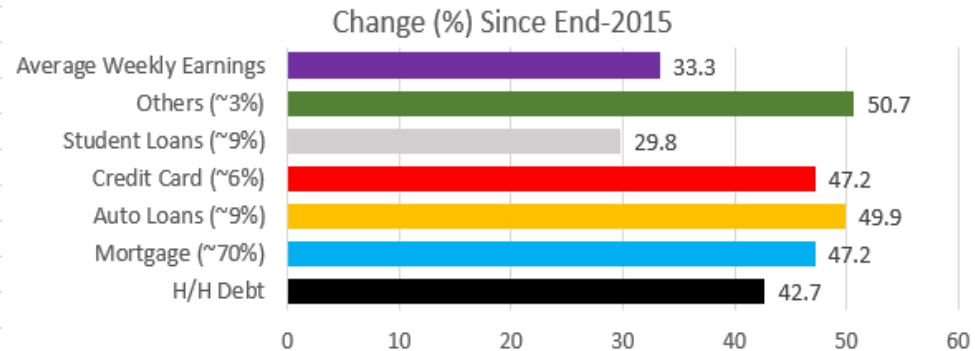
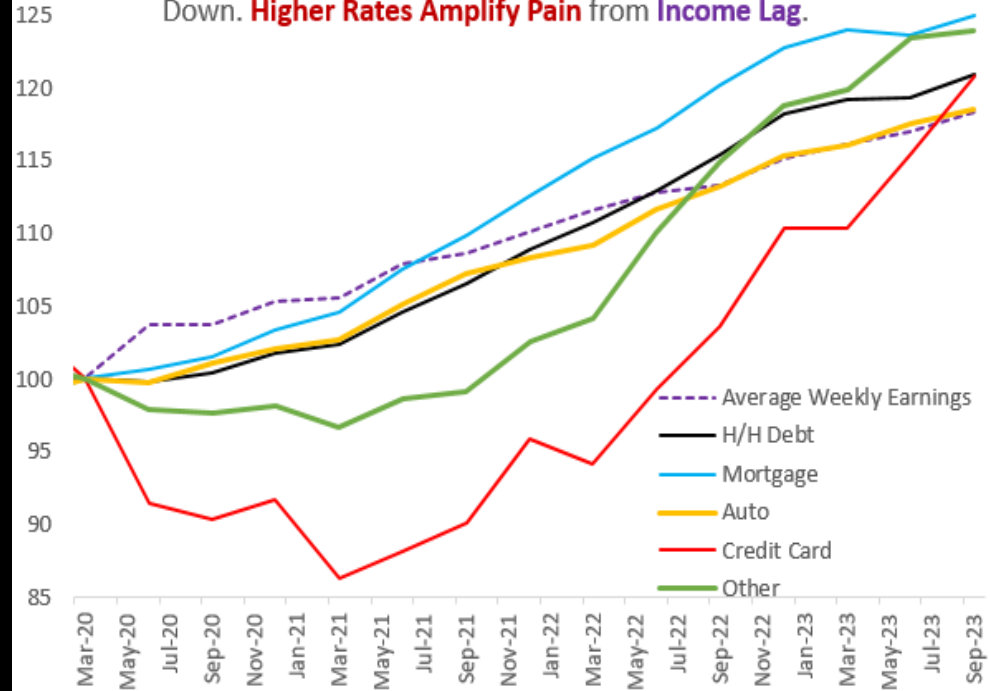


- Stark divergence in Mfg & Svcs PMI →
- Global goods-to-services demand re-balancing “silver lining” that buffer and buys time?
- *But* the risk is that stellar services hides recession risks in plain sight.
- Especially as *eroding savings, high inflation, fiscal consolidation, higher rates & heightened geo-economic uncertainties* warn of fading consumption boost.
- Critically, setting off far more pernicious demand shocks from confidence deficit spiral.
- Despite partial tourism offset, EM Asia’s goods exports reliance hobble unchecked bullishness.

## 2a. To Hit Depleted Savings?



Household Debt Since COVID (Mar 2020): **Sharper Surge in Unsecured Debt** (CC & Others) as Pandemic Savings Drawn Down. **Higher Rates Amplify Pain** from **Income Lag**.



## 2b. Inflation: Irascible on Shocks ... Compound Policy Dilemma & Hits Demand

2021-22 Cost-Push Has Subsided, suggesting **Peak Inflation** (Inferred from Freight & Upstream Cost-Push Pressures). **But** Risks of **Fresh Geo-Political Shocks, Stickiness & Second-Round Effects** Persist.

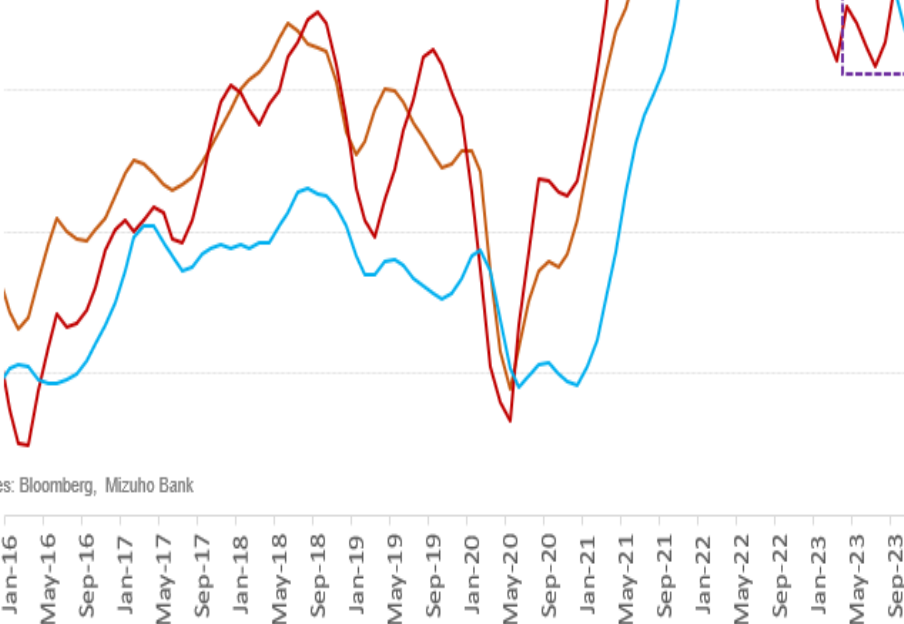
\* This **global cost-push proxy** entails a composite of:

- i) Baltic Dry Index (30%);
- ii) Brent Crude (40%);
- iii) In-bound Air-freight from Asia (10%);
- iv) CRB - Food (10%);
- v) CRB - Metals (5%), and;
- vi) CRB - Input Prices (5%)

\* This **global ex-Freight cost-push proxy** entails a composite of:

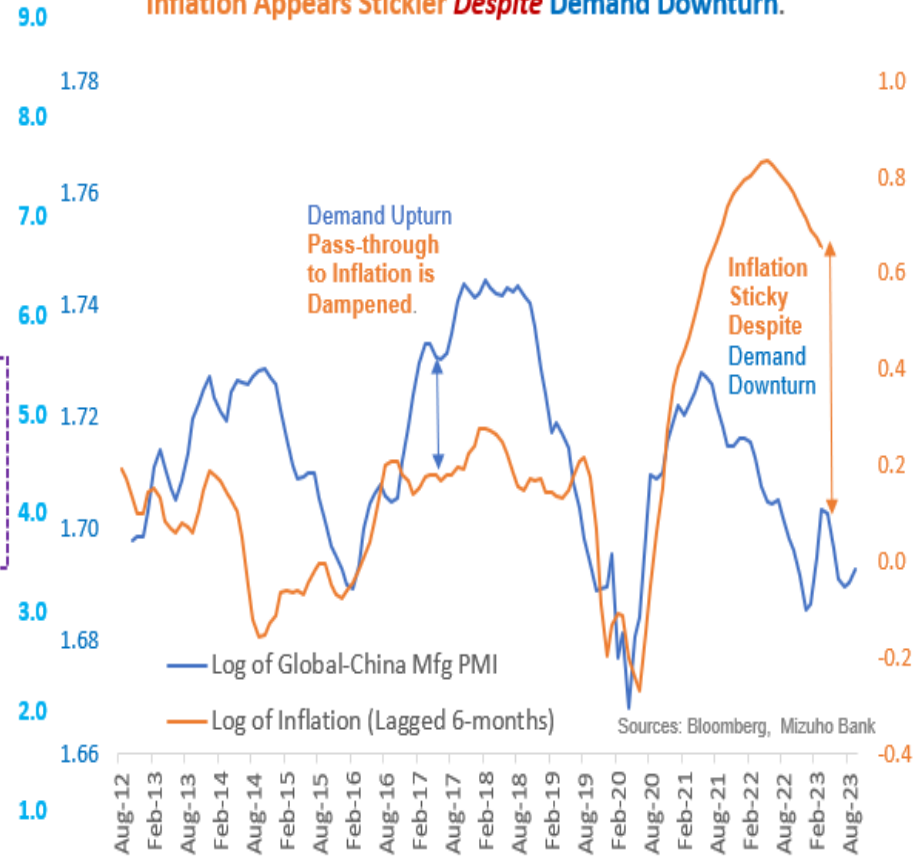
- i) Brent Crude (50%);
- ii) CRB - Food (20%);
- iii) CRB - Metals (15%), and;
- iv) CRB - Input Prices (15%)

— Ex-Freight Cost-Push Proxy\* (Indexed, end-2017=100)  
 — Cost-Push Proxy\* (Indexed, end-2017=100)  
 — G4 Composite Inflation (RHS; % YoY)



Sources: Bloomberg, Mizuho Bank

**Chg in Inflation (Log CPI) VS. Chg in Demand (Log Mfg PMIs):**  
**Inflation Appears Stickier *Despite* Demand Downturn.**



Sources: Bloomberg, Mizuho Bank

- **Stagflation-type outcomes of elevated inflation despite soft demand** → Cost shocks hurting demand rather than softer demand taming inflation?
- **Policy dilemma inherited from pandemic-related series of high inflation amplifies hard-landing risks?**

### 3a. Oil Price Shocks ... Geo-politics Complicates the Descend

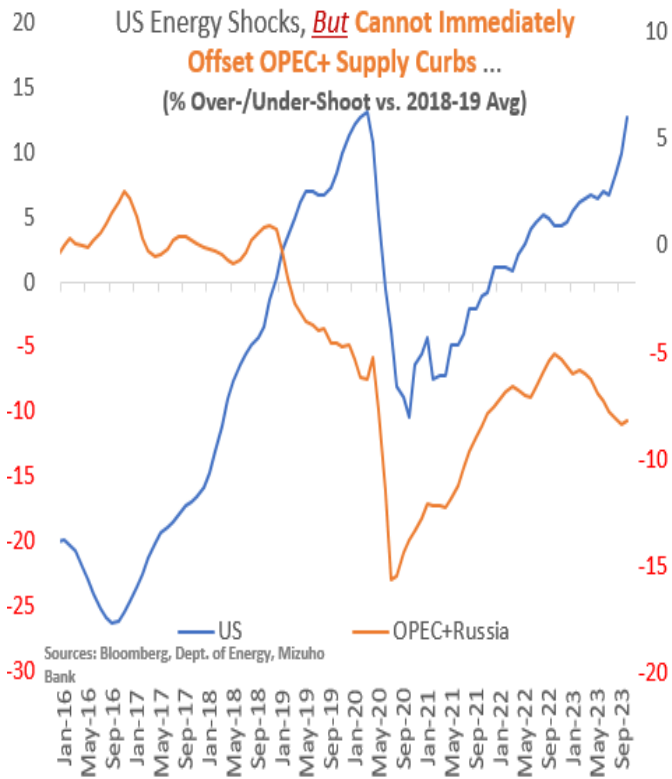
Geopolitically-charged \$100-120 surge neither imminent nor unavoidable. In fact, **downside risks to Oil grows** on Non-OPEC supply. *But* equally, **dangers of a geo-political flare-up in Oil** is masked by *illusions of controlled war*.

Nuanced point on Geopolitics: It would take *identifiable, proximate, threats of supply disruption* of a significant magnitude **to catalyze** such a large order of Oil price agitation.

Upshot: \$100-120 crude is not the prevailing base case. *But* it is a **“fat tail” risk**. Meanwhile, **OPEC-engineered supply tightness** and **Saudi’s Budget preference/incentives for \$100+ oil** **at least backstop Oil**, if not, **amplify Crude price sensitivities** alongside **geo-political supply shocks**.

Record US Crude Production to Partially Hedge

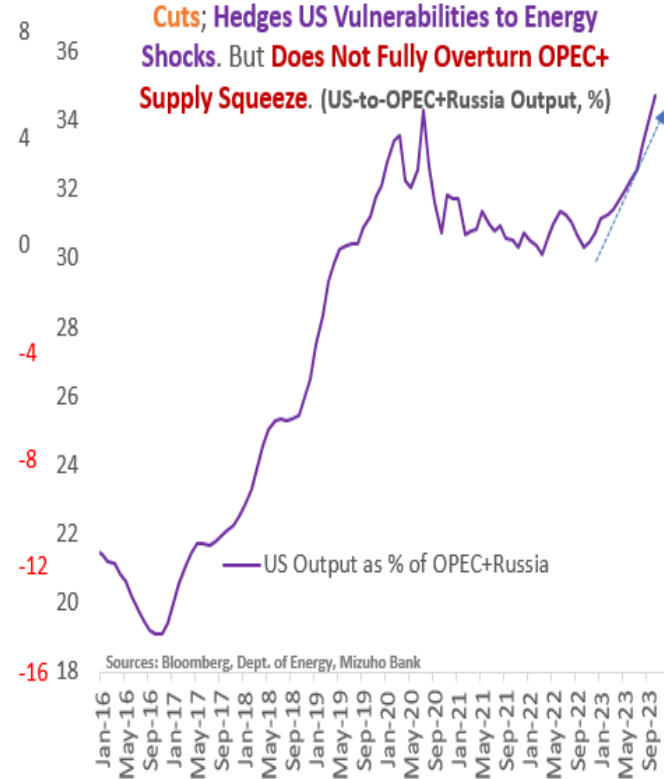
US Energy Shocks, *But Cannot Immediately Offset OPEC+ Supply Curbs ...*  
(% Over-/Under-Shoot vs. 2018-19 Avg)



Especially as **Aggressive Saudi-led Output Curbs** Purposefully Inflict Tight Supply & Inventory Run-down (% Over-/Under-Shoot vs. 2018-19 Avg)



Surge in US Output, in Response to OPEC+ Cuts; Hedges US Vulnerabilities to Energy Shocks. But **Does Not Fully Overturn OPEC+ Supply Squeeze.** (US-to-OPEC+Russia Output, %)



## 3b. Heightened Uncertainty & “Crowding Out” Risks

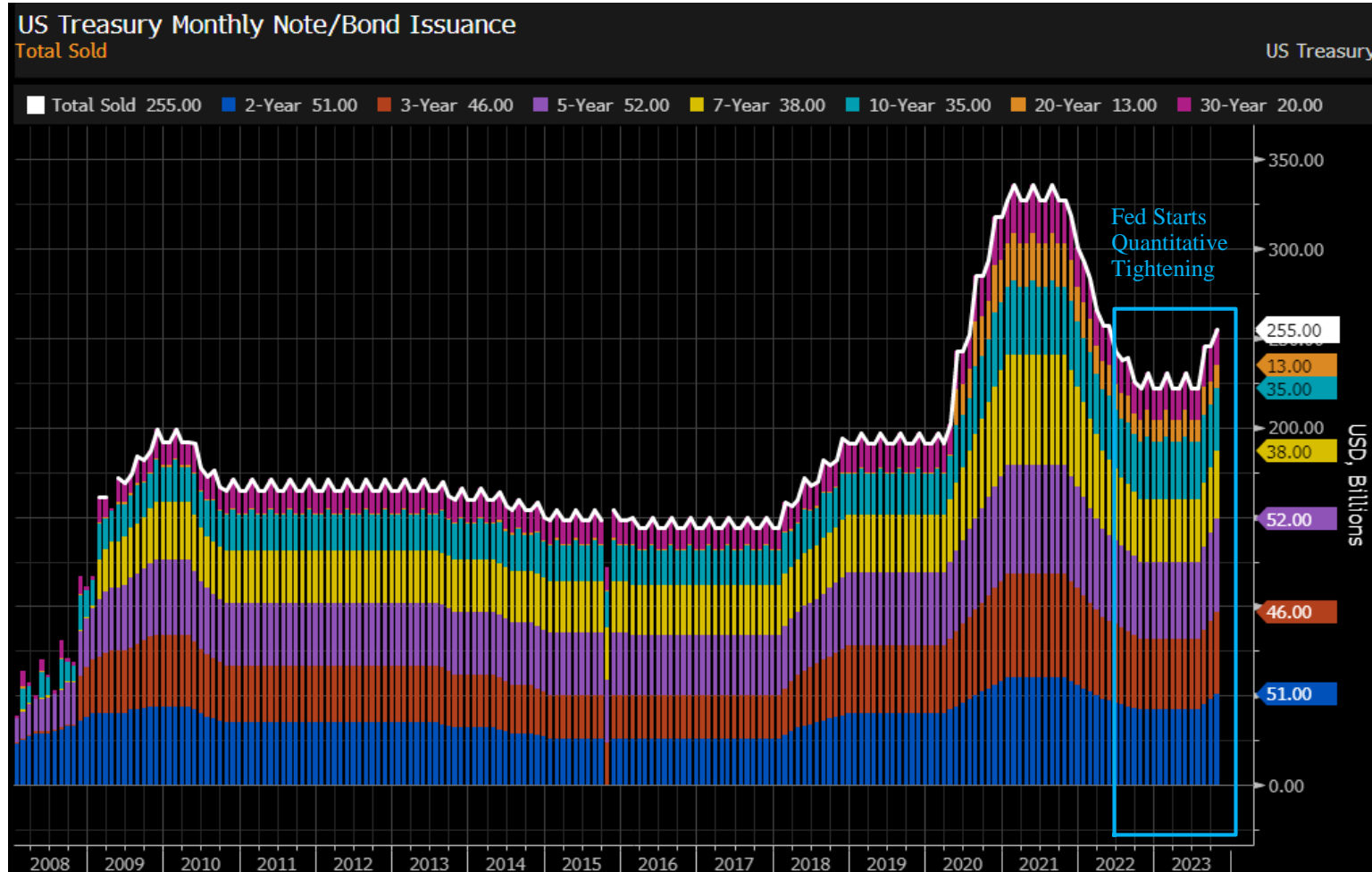
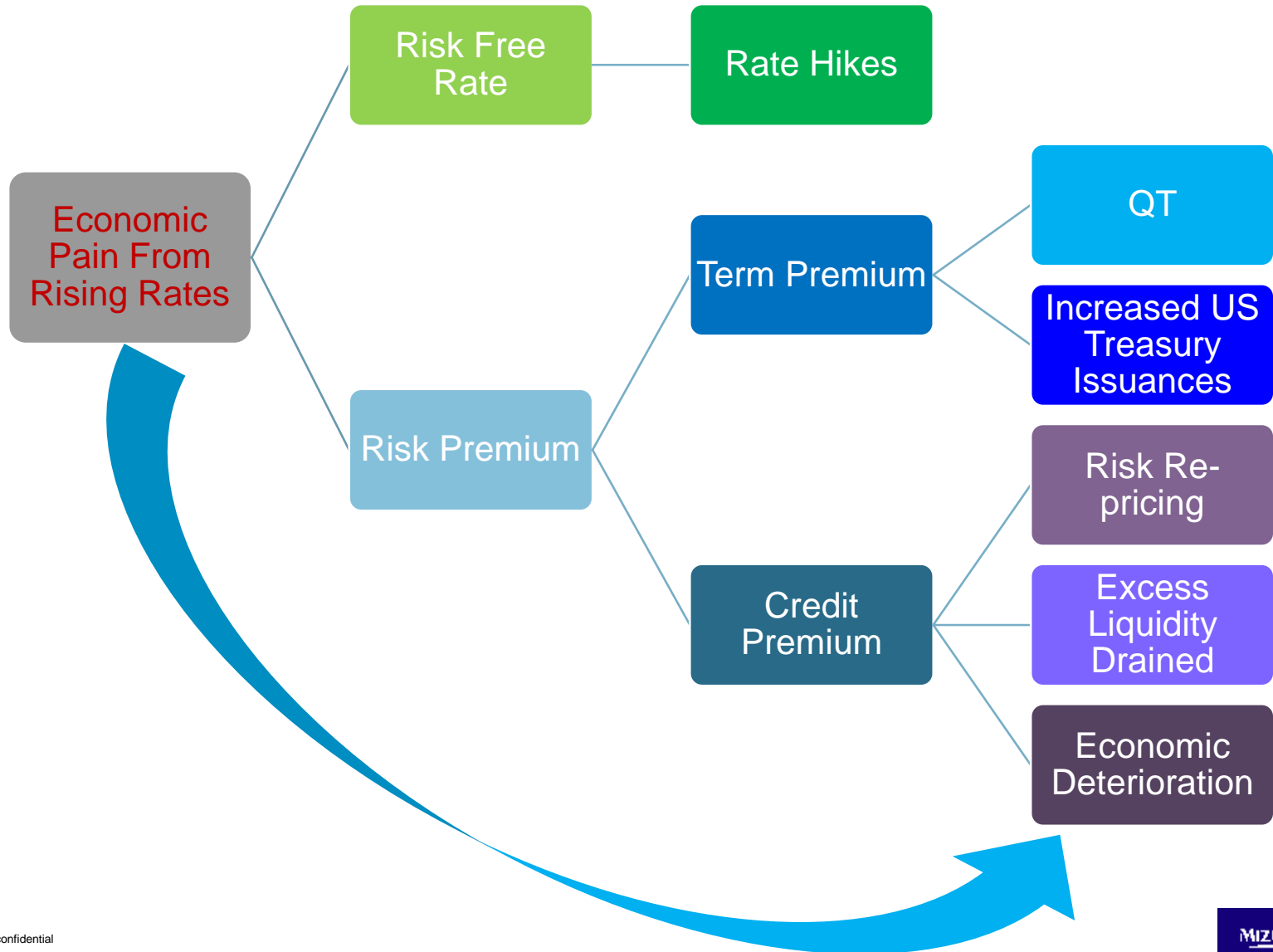


Chart from Bloomberg

- Insofar that fears of US debt/unsustainable fiscal trajectory dominate, yields may ironically go higher;
- as heightened (but not acute) **geo-political risks** is **associated with increased debt issuance** on defense (Ukraine/Gaza) to a greater degree than (yield suppressing) haven demand.
- Conspires with **QT** & “**higher for longer rates**” inflation to **amplify “crowding out” risks**.

### 3b. Visualizing Pain from Higher Rates

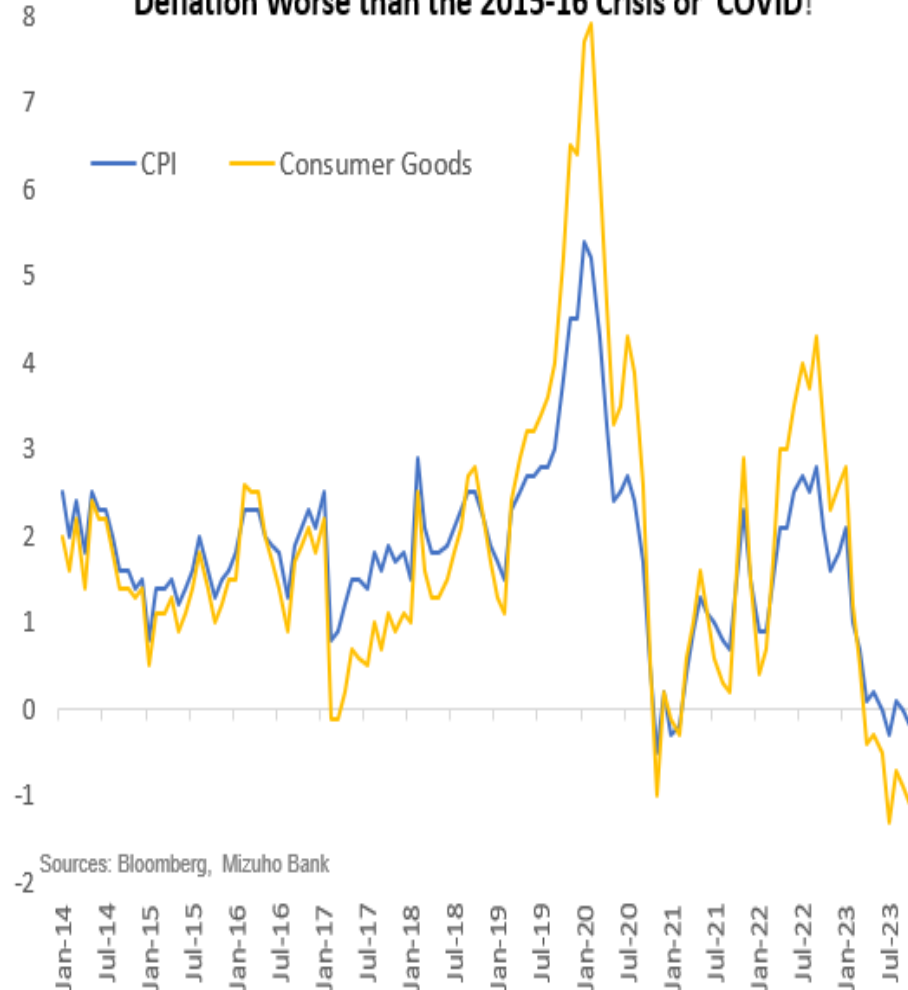




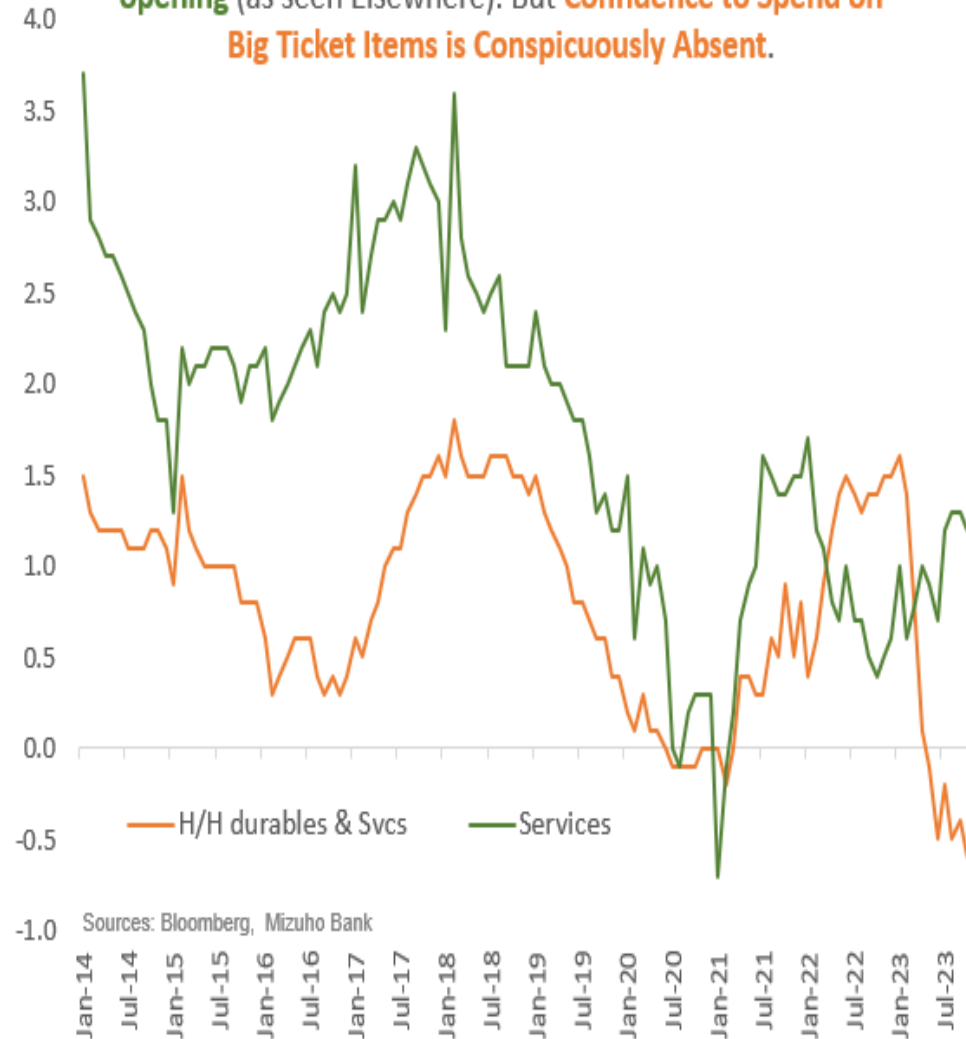
## 4a. A Structural Confidence Deficit, if Not, Crisis

**China's Deflation: An Odd Story of Confidence Deficit at Odds with the World; with Consumer Goods Deflation Worse than the 2015-16 Crisis or COVID!**

— CPI — Consumer Goods



**China's Deflation: Services Inflation Has Picked up on Re-opening (as seen Elsewhere). But Confidence to Spend on Big Ticket Items is Conspicuously Absent.**



## 4a. China: Structural Headwinds Not Offset by Cyclical Re-opening

### Underlying (Real) Momentum in Industrial Profits remains Pressured

(3Y, Annual %); consistent with **2015-16 China Turbulence** & **2018-19 "Trade Wars"**. Amid Confidence Deficit, **Stress Factors May Not**

**Dissipate so Rapidly; Might Even Intensify.**

**Dissipate so Rapidly; Might Even Intensify.**

Note: All data are annual (for full year) except for 2023, which is based on YTD growth up till September 2023.

— 3Y Running Ind. Profit Growth  
 - - - 3Y Ind. Profit Growth Adjusted for PPI

Sources: Bloomberg, Mizuho Bank



### Binding Structural Impediments

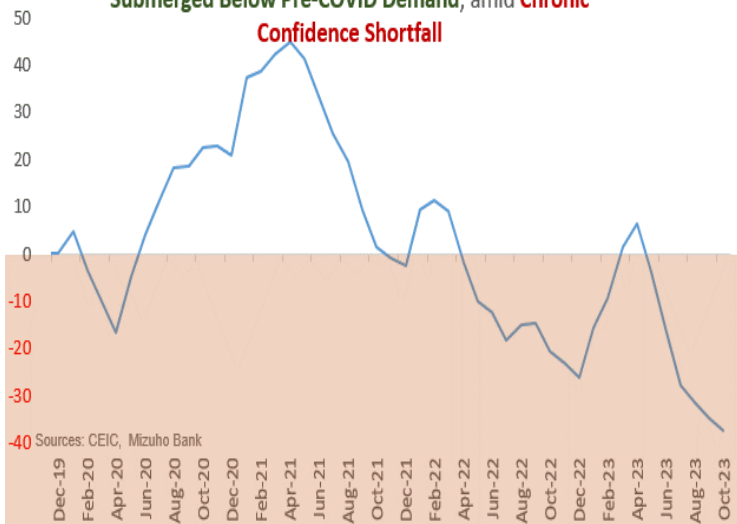
- i) **Elevated Leverage:** Structurally higher credit intensity conspires with financial stability risks (“Minsky moment”), resulting in subdued, if not sub-par growth outcomes.
- ii) **Geo-politics:** Sanctions challenge China’s high-tech sector ambitions, posing the **most binding threat**. Limited policy/diplomatic options mean unforgiving margins for miscalculation; with far-reaching, adverse consequences.
- iii) **Confidence Deficit:** By-product of uncertainty on “**Common Prosperity**” campaign (motivated by *complex socio-political agenda that sometimes supplant economic aims*).  
 → Confidence overhang hampers big-ticket spend and investments, *compromising growth multipliers*.

## 4b. As the Restrained, but Unresolved, Property Crisis Hits Confidence Hard

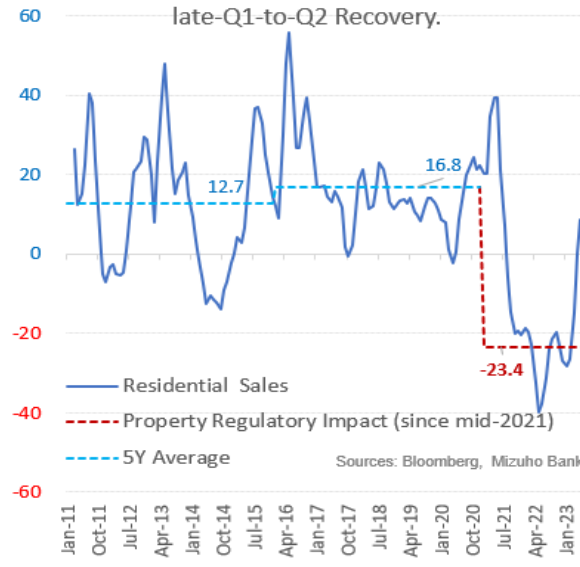
**2Y Annualized Home Sales: Demand, Unshakeable Through Financial Crises, Battered by "Common Prosperity".**



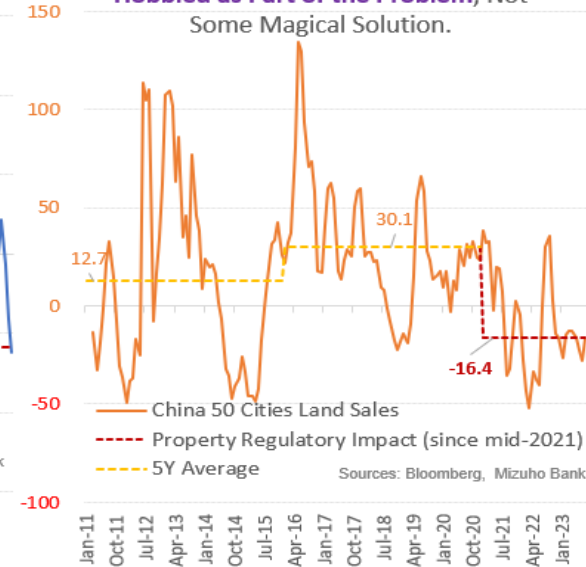
**China Property Sales (% of 2018-19 Avg, smoothed): Remains Submerged Below Pre-COVID Demand; amid Chronic Confidence Shortfall**



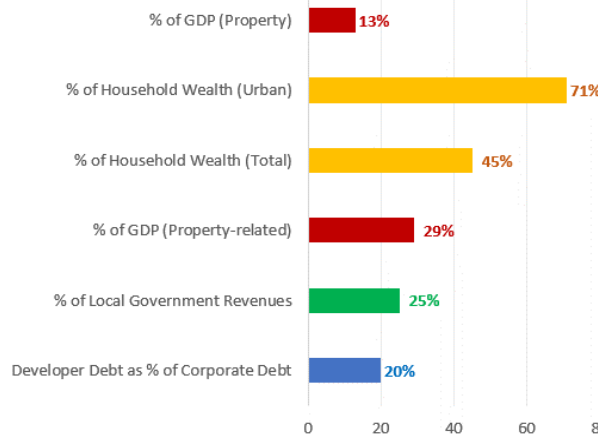
**China Property Sales: Hounded by Confidence Issues.** Base effects flatter late-Q1-to-Q2 Recovery.



**China Land Sales: Local Government Hobbled as Part of the Problem; Not Some Magical Solution.**



**Property Sector Liabilities Will Ripple Far** Given High-Multipliers via; i) related Industries/Services; ii) Significant Local Government Financing Reliance, &; iii) Massive H/H Wealth Effects

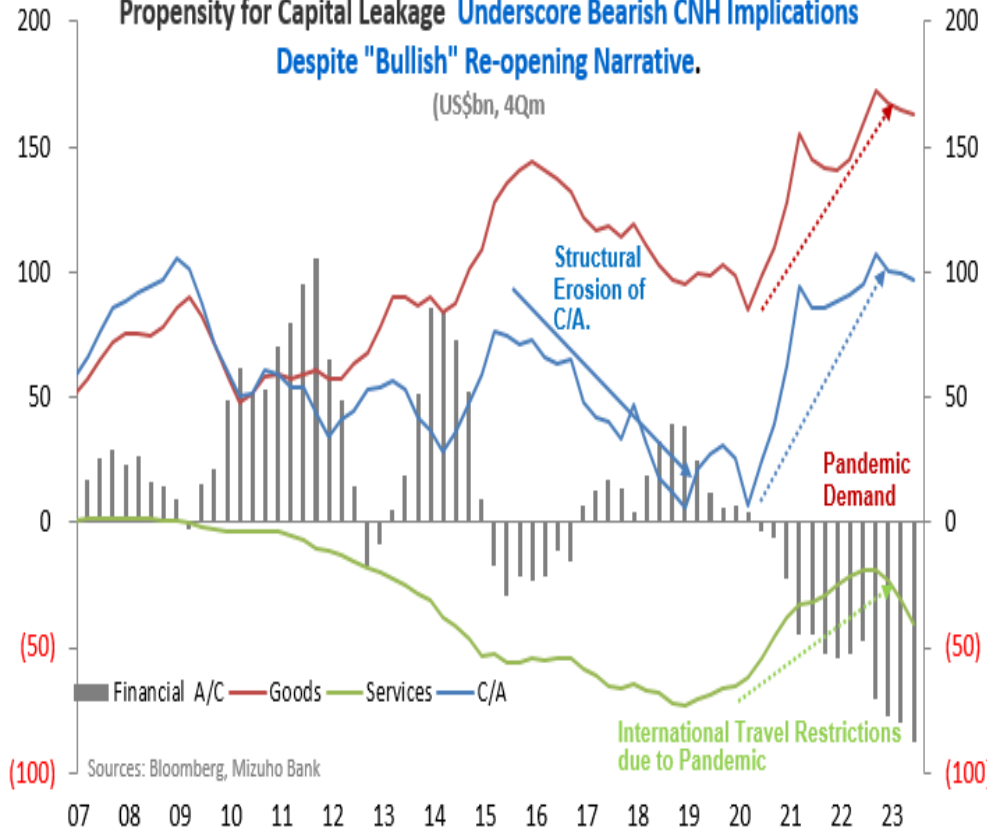


### Property Overhang

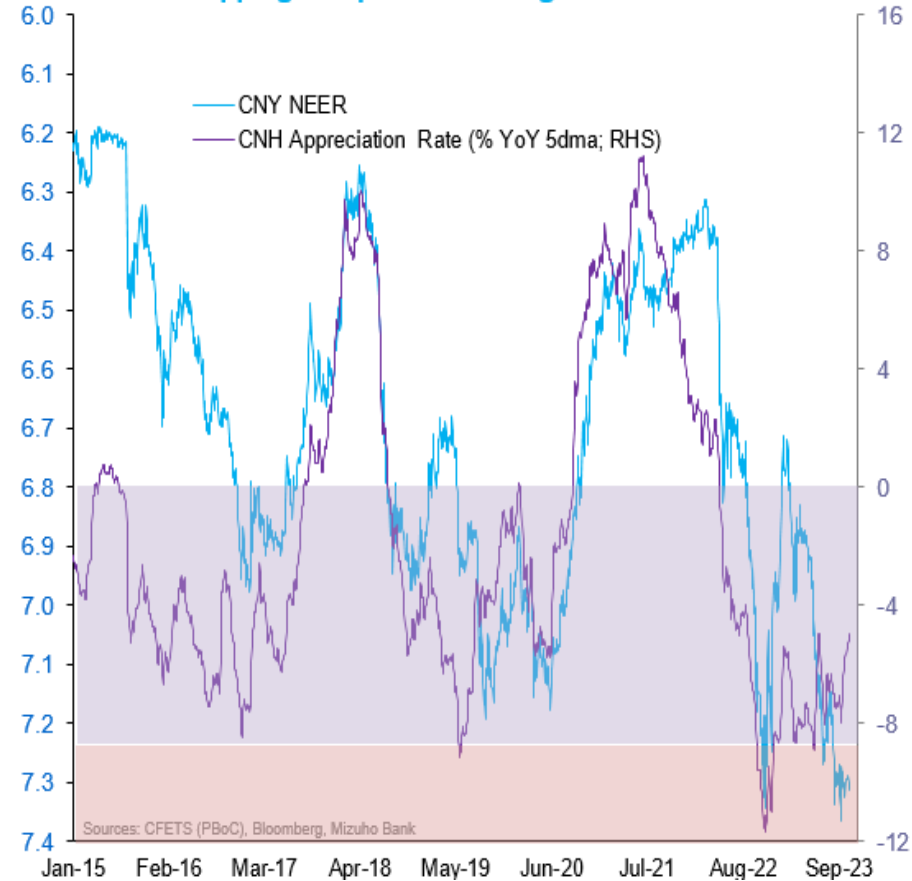
- Backstop critical but Falls Short!
- Financing cashflow is welcome
- But Not Sustainable Without Sales (Operating Cashflow) Recovery Requiring Confidence.
- Psyche of "sure win" property has changed.
- POEs defaulting amid "Common Prosperity" leaves Confidence Shaky.
- Compromises growth multipliers & credit.

## 4c. Re-opening “Cash-Flow” Shifts Undermine CNY

China's Re-opening Reversal of; i): Goods Surplus Surge from Pandemic Demand, and; ii) Diminished Net Tourism Outflows; Accentuated by Propensity for Capital Leakage Underscore Bearish CNH Implications Despite "Bullish" Re-opening Narrative.



CNH Depreciation Validates PBoC Intervention; Backstopping Sharper Trade-Weighted Weakness.



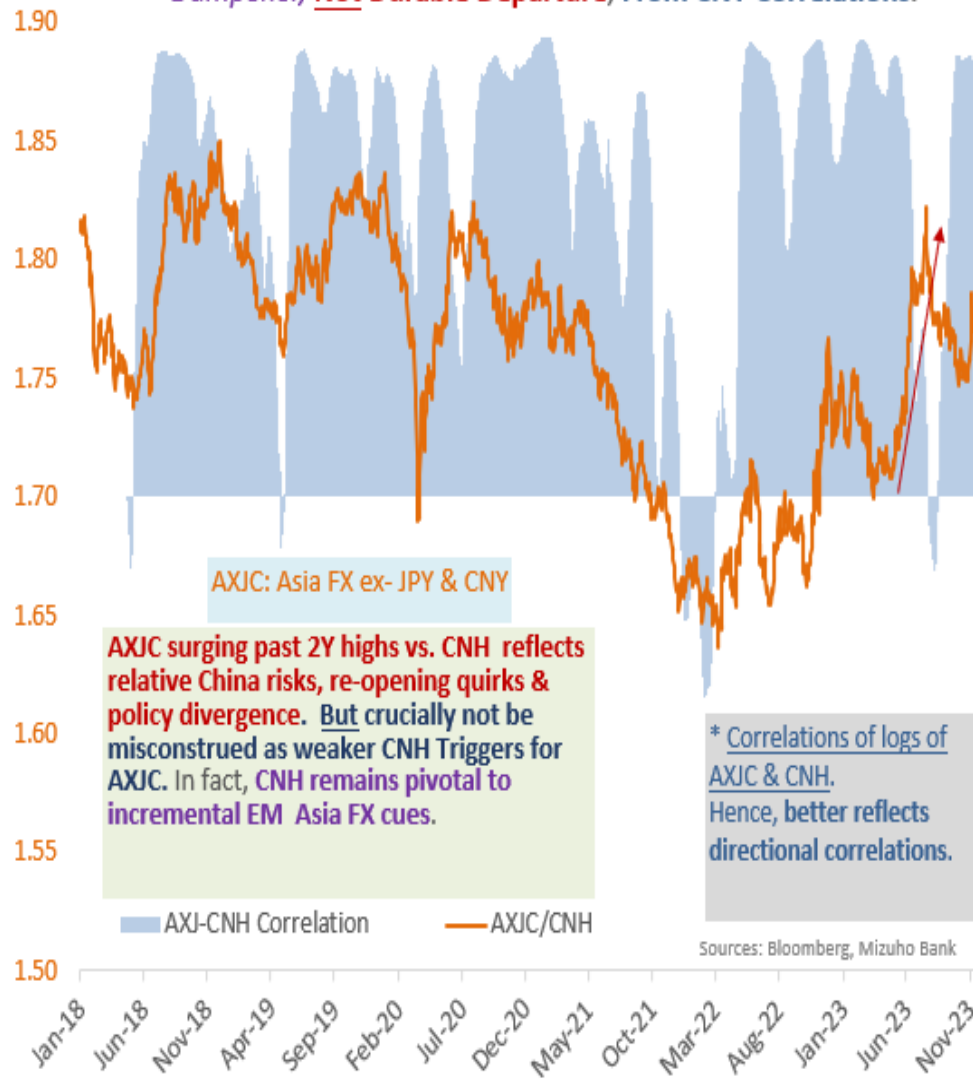
- i) **Goods Account:** Global goods-to-services consumption shift diminishes exceptional COVID boost to Good Surplus.
- ii) **Services (Tourism):** Outbound Tourists to re-widen services deficit – much of it being Chinese tourists spending overseas. Chinese tourists spending overseas in 2019 accounted for 1.7% of China’s GDP in net terms.
- iii) **Capital Account:** Capital flight becomes an enlarged risks as political uncertainty and policy shifts (including confiscations risks amid ‘Common Prosperity’ induce shift of funds out.

“It is stupidity rather than courage to refuse to recognize danger when it is close upon you”

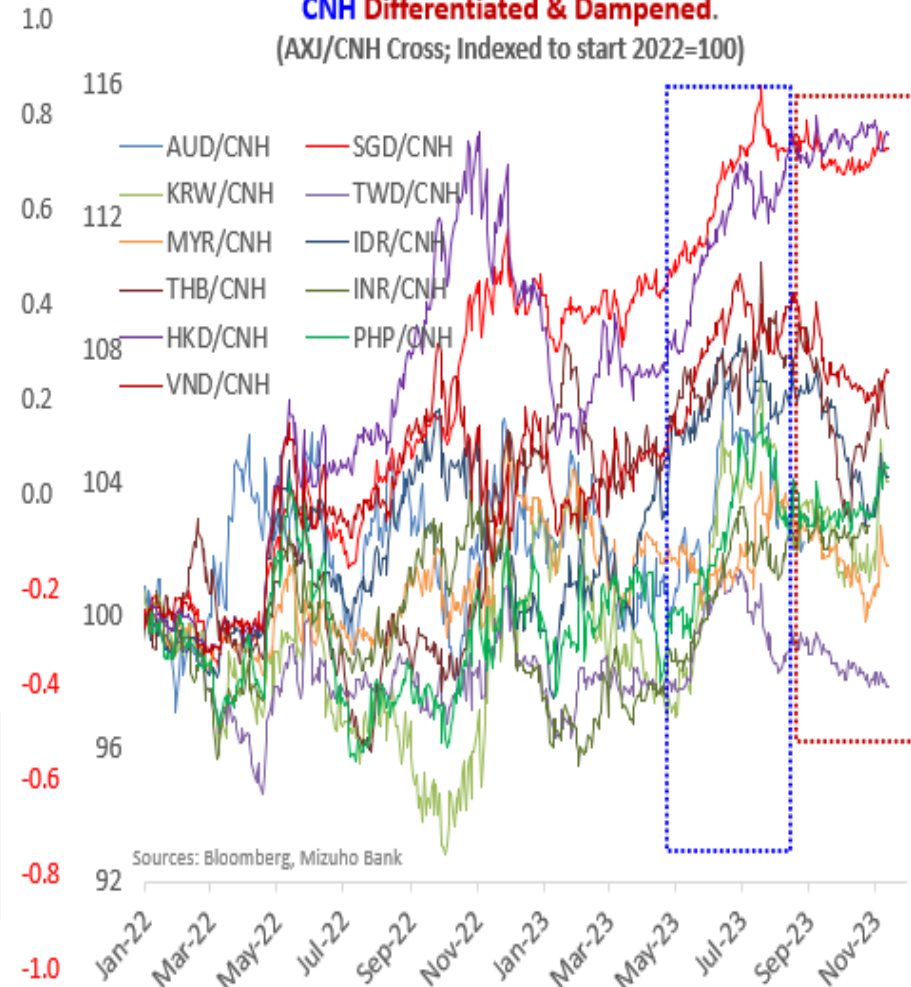
- Sherlock Holmes

## 4c. Remembering CNY Correlations

**Sharp Surge in AXJC vs. CNH** Corresponds to *Temporary & Partial Dampener*, **Not Durable Departure**, From CNY Correlations.



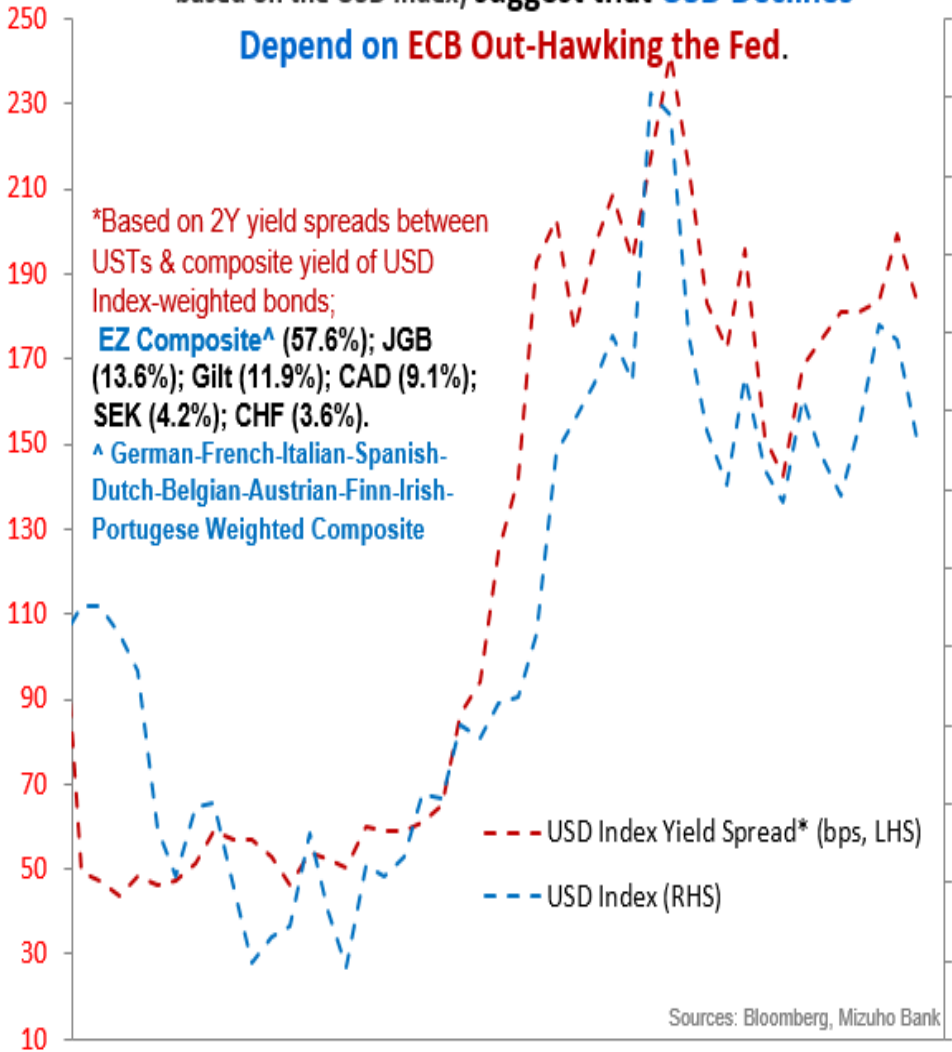
**Strong out-performance of other EM Asia FX (AXI) vs. CNH Differentiated & Dampened.**  
(AXI/CNH Cross; Indexed to start 2022=100)



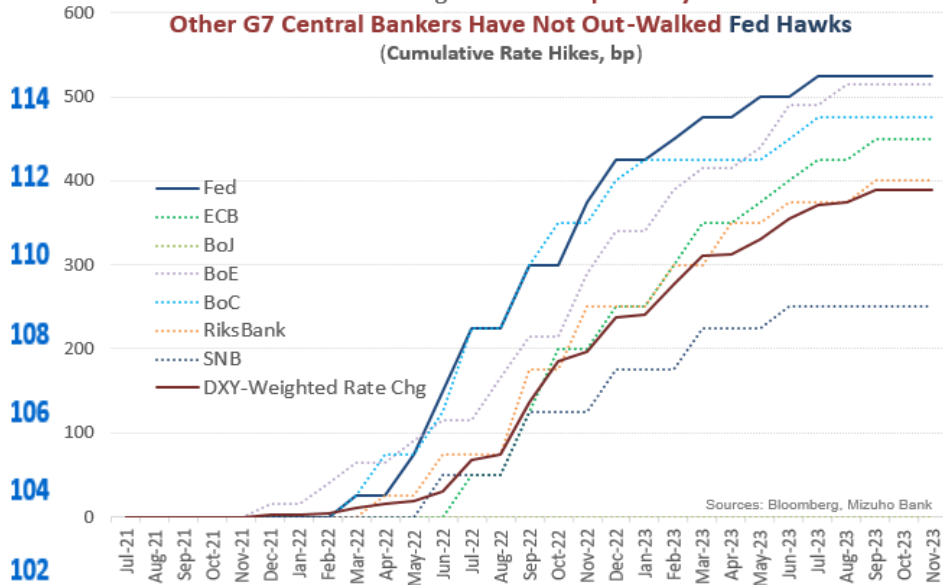


# 5a. USD Bears Counting on Erosion of Spreads ... A Gambit, Not a Guarantee!

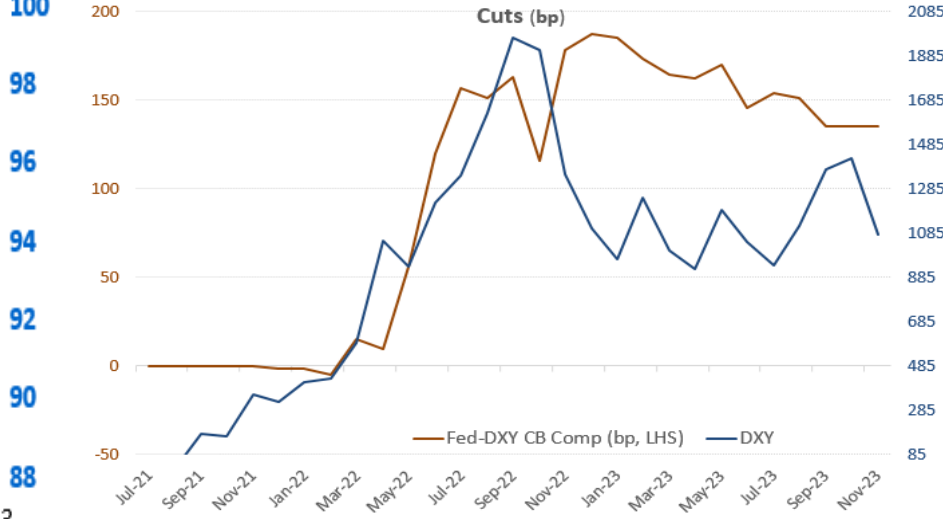
**Fed & USD: 2Y UST yield spreads** (vs. a composite of Yields based on the USD Index) suggest that **USD Declines** Depend on **ECB Out-Hawking the Fed.**



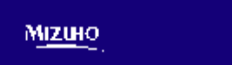
**Peak Fed Rate Bets** Ought to be **Tempered by the Fact that Other G7 Central Bankers Have Not Out-Walked Fed Hawks** (Cumulative Rate Hikes, bp)



**Current USD Valuation** Ostensibly **Based on Narrowing Policy Spreads**; Either **Larger Rate Hikes Elsewhere** or **Quicker Fed**

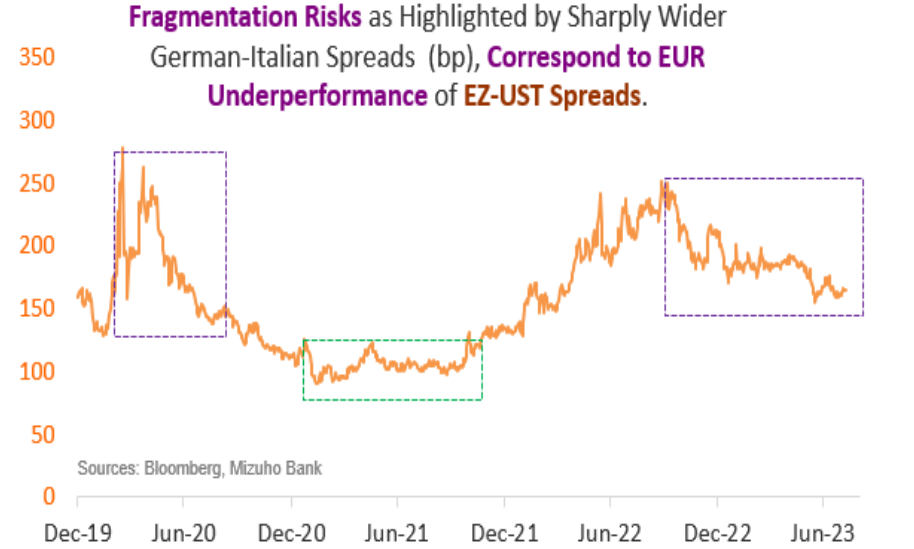
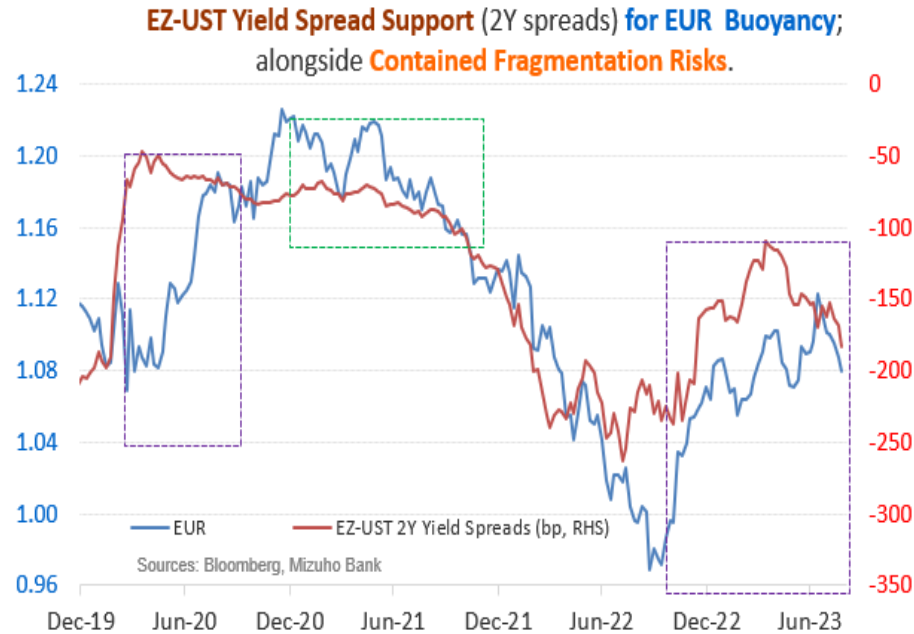
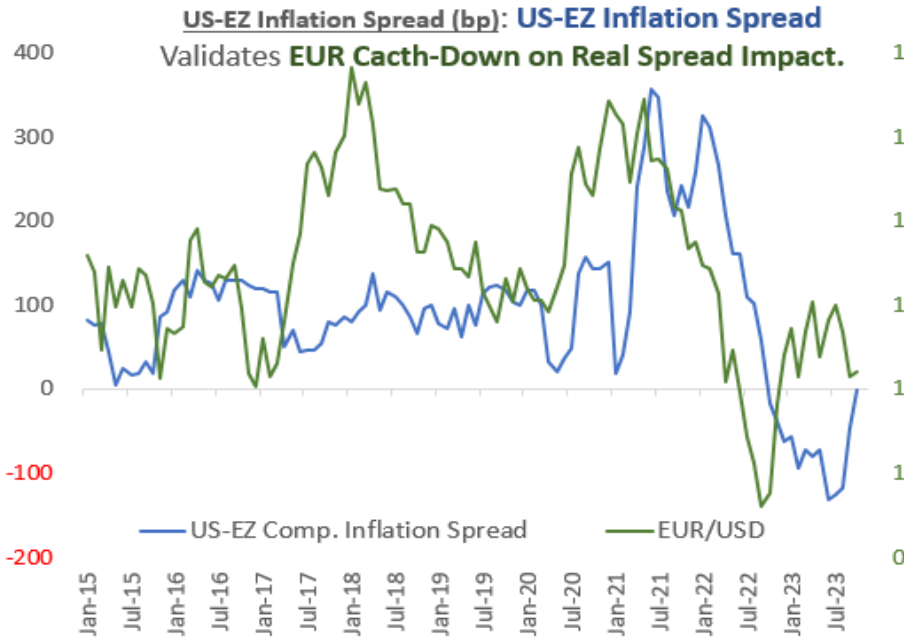
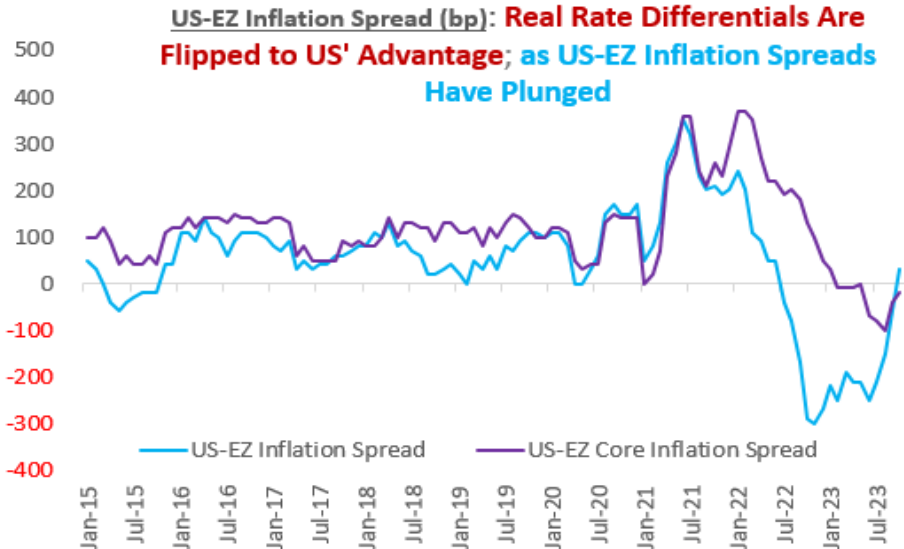


Mar-20 Aug-20 Jan-21 Jun-21 Nov-21 Apr-22 Sep-22 Feb-23 Jul-23 Dec-23

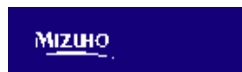
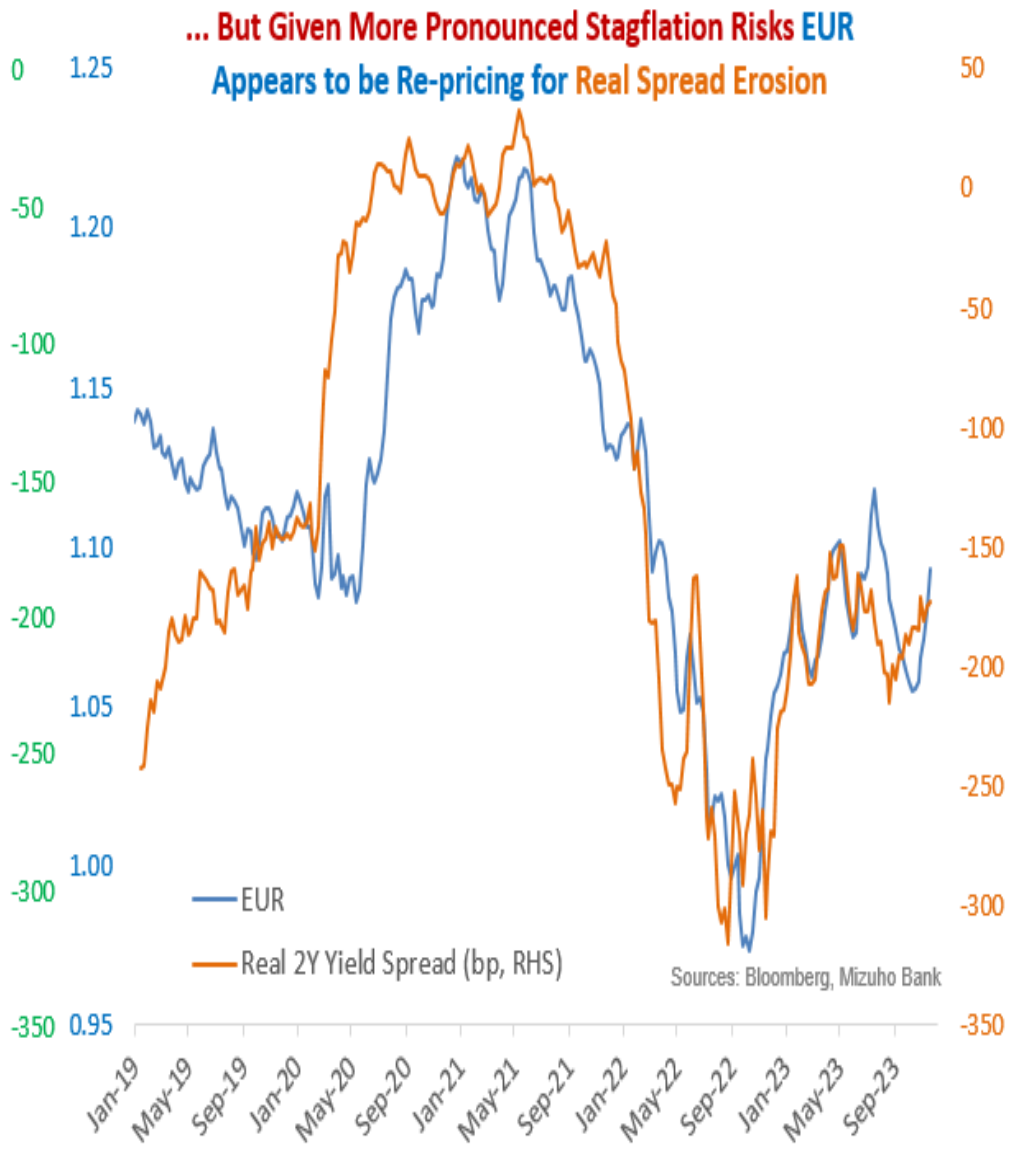
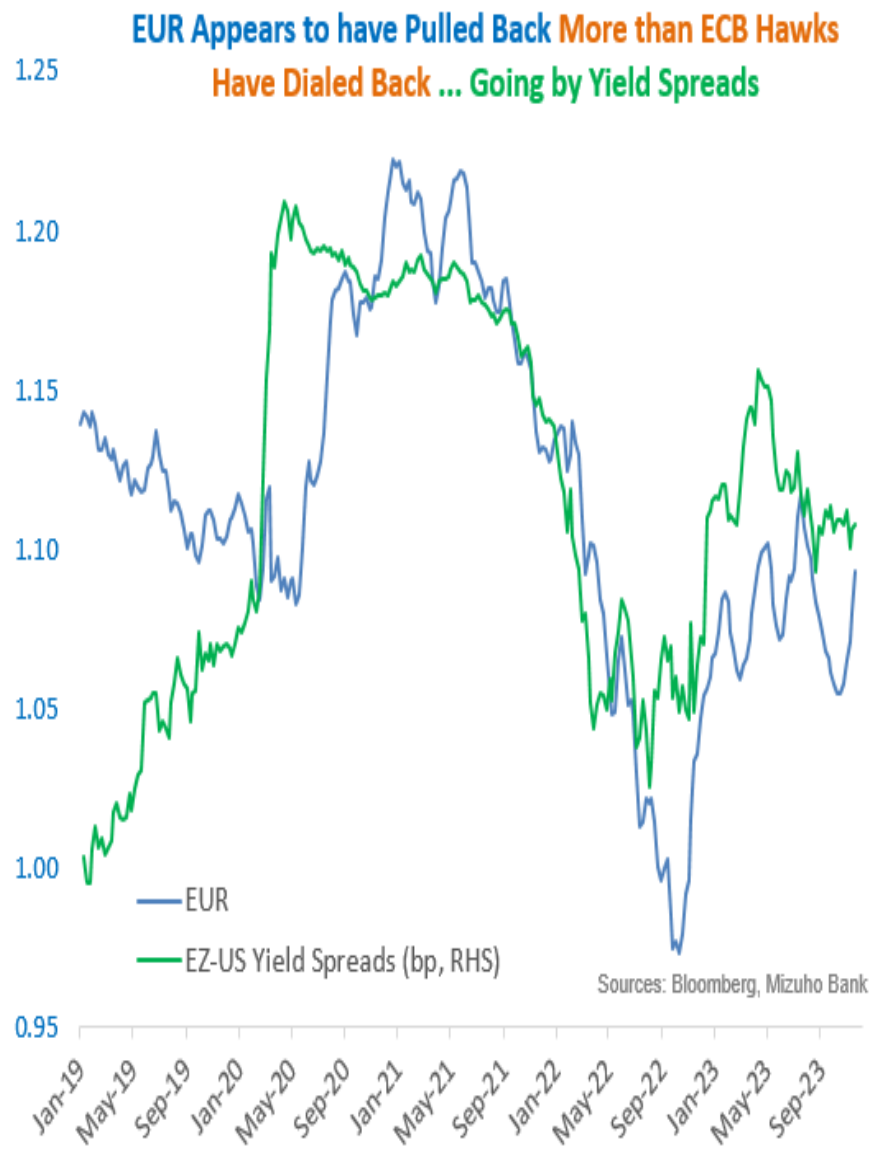




# 5b. EUR: Hawkish ECB Flex May Not Persist & "Real" Challenges Remain!



# 5b. EUR: More So if ECB Hawks Can't Out-Walk the Fed

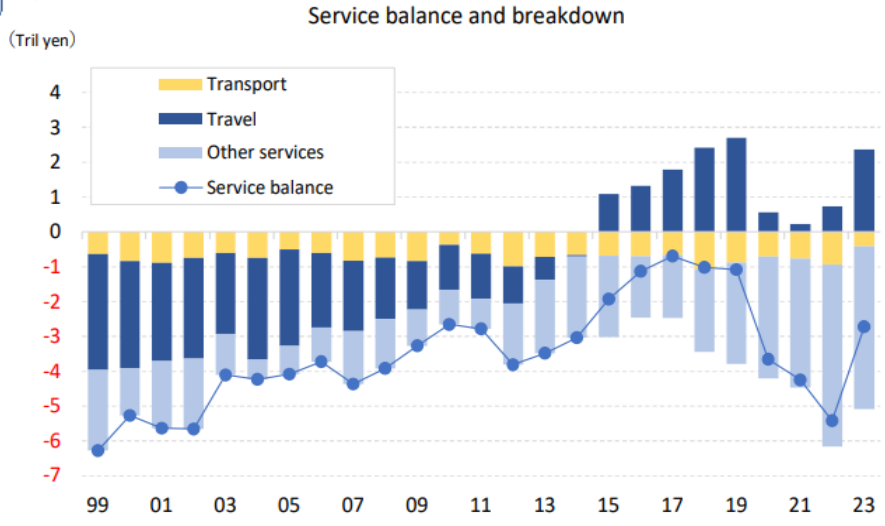
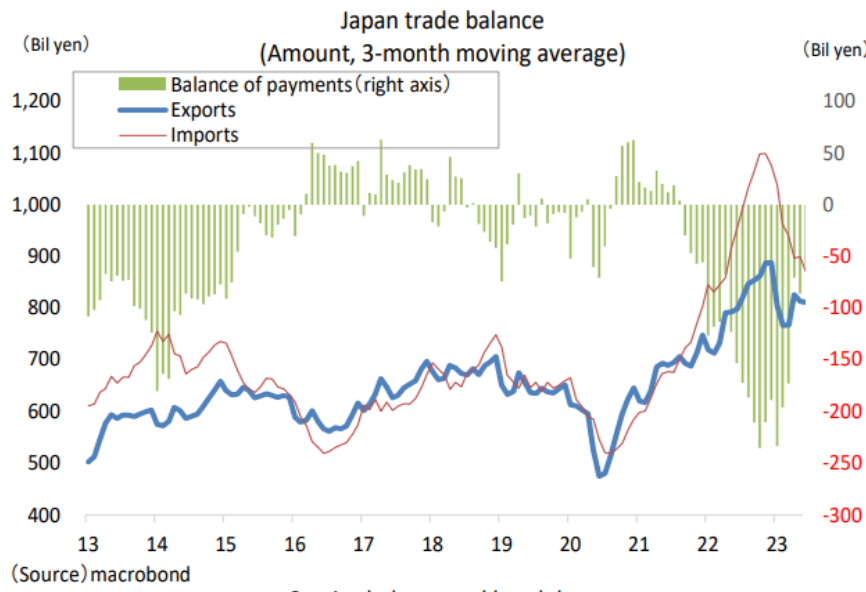


# 5b. FX: JPY - A *BoJ Problem* with a *Fed Solution* ... BoJ Ought to Avoid "Over-correction" Risks

**Peak Fed May be the Durable Panacea to take some Edge off USD/JPY Upside Pressures from Relative Dovish BoJ Impact via UST-JGB spreads (bp). Meanwhile, YCC tweak may Buy Time & Dampen Excessive Volatility.**

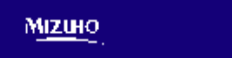


If we are right, and downturn risks trigger a sharp 80-160bp pullback in UST yields/(UST-JGB spreads) in the next 6-9 months, corresponding JPY rebound to 122-138 levels is not unimaginable. At which point upside volatility in JPY needs tempering as well!



— USD/JPY (2wkma, LHS)  
 — UST-JGB spreads (2wkma; bps; RHS)  
 Sources: Bloomberg, Mizuho Bank

(Source) Bank of Japan (Note) The data for 2023 is through August.



# 5c. FX: EM Asia - Real Challenges as Relatively Higher Real US Rates Impact

**Inflation Spreads (vs. US): Even as Energy & Food**

**Shocks Dismount Reversion from Current**

**"Inversion" Gathers Pace;** from late-stage Services

Migration (Tourism) & Fiscal (Buffer) Fade.

(EM Asia CPI - US CPI Spreads, %-Pts YoY)

**"Extra" real pick-up in EM Asia returns from US inflation surge is eroding rapidly.**

Higher EM Asia Inflation

==> **Diminishes** relative real returns in EM Asia

Higher US Inflation ==> **Enhances** relative real returns in EM Asia

— ASEAN-6 & US Inflation Spread

— ASEAN-6+2 vs. US Inflation Spread

**ASEAN-6:** Indonesia, Malaysia, Philippines, Singapore, Thailand, Vietnam

**ASEAN-6+2:** ASEAN-6, India & Korea

Sources: Bloomberg, Mizuho Bank

Jan-12 Jul-12 Jan-13 Jul-13 Jan-14 Jul-14 Jan-15 Jul-15 Jan-16 Jul-16 Jan-17 Jul-17 Jan-18 Jul-18 Jan-19 Jul-19 Jan-20 Jul-20 Jan-21 Jul-21 Jan-22 Jul-22 Jan-23 Jul-23

**Inflation Spread (vs. US; bp): "Inflection" since mid-2022, from which point US dis-inflation has out-paced EM Asia's dis-inflation.**

600

400

200

0

-200

-400

-600

-800

US inflation lower... But rising faster or falling slower than Asia's.

US inflation lower... with Asia's inflation rising faster or falling slower than US'.

US inflation higher, and out-pacing (rising faster or falling slower) than Asia's.

US inflation higher. But dis-inflating faster.

Jan-21 Mar-21 May-21 Jul-21 Sep-21 Nov-21 Jan-22 Mar-22 May-22 Jul-22 Sep-22 Nov-22 Jan-23 Mar-23 May-23 Jul-23 Sep-23

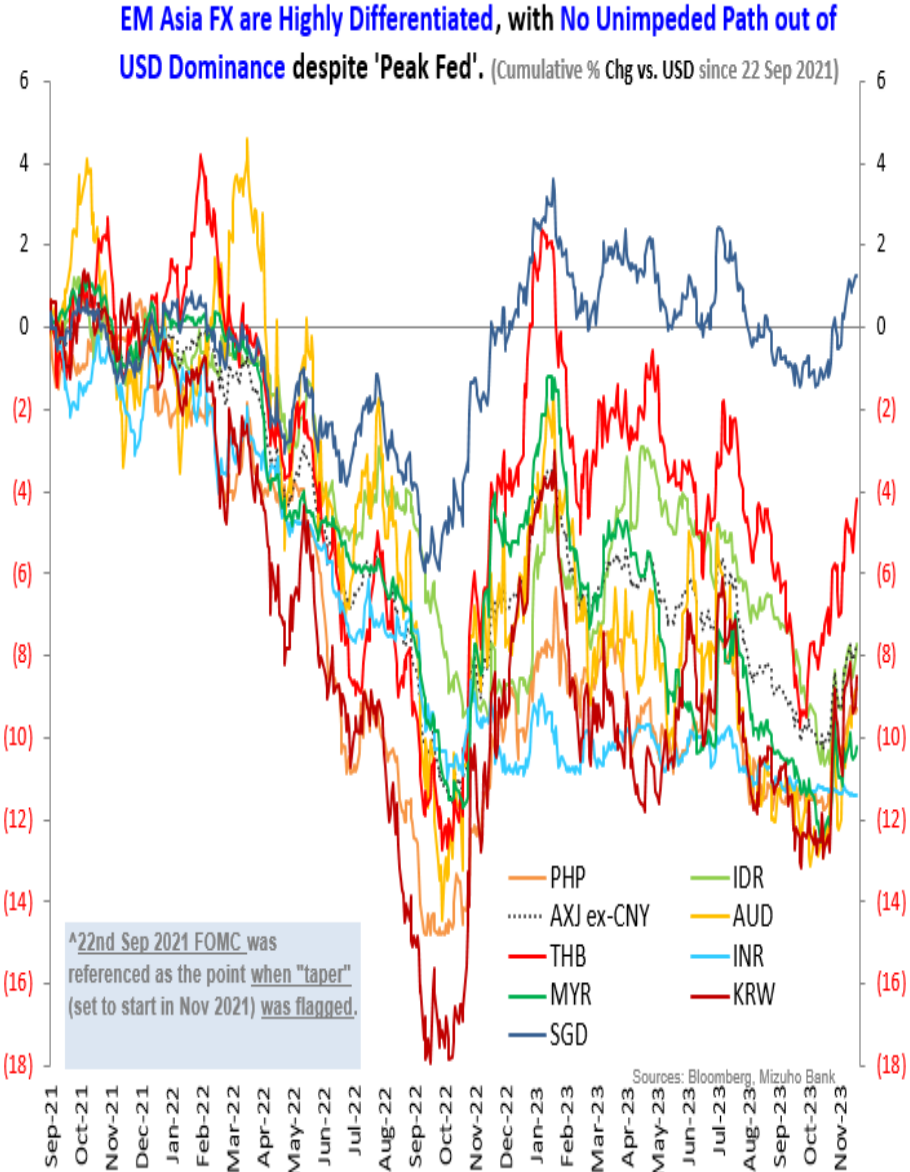
— RBA — PBoC — RBI — BI  
 — BoK — BNM — BSP — BoT  
 — SBV-Refi — CBC

Sources: CEIC, Bloomberg, Mizuho Bank



# 5c. AXJ: A Bumpy Path Out of USD Dominance

FX Forecasts	Dec 23	Mar 24	Jun 24	Sep 24	Dec 24	Mar 25
USD/CNY	7.04 - 7.41 (7.22)	7.08 - 7.48 (7.35)	7.17 - 7.57 (7.42)	6.87 - 7.50 (7.18)	6.83 - 7.34 (7.06)	6.76 - 7.13 (6.95)
USD/INR	80.6 - 85.2 (82.9)	80.6 - 85.5 (83.5)	82.2 - 86.2 (84.5)	79.2 - 86.4 (83.5)	78.2 - 84.7 (82.0)	78.0 - 83.6 (80.8)
USD/KRW	1260 - 1430 (1330)	1280 - 1410 (1320)	1230 - 1420 (1335)	1190 - 1360 (1290)	1190 - 1320 (1250)	1190 - 1340 (1240)
USD/SGD	1.320 - 1.379 (1.344)	1.316 - 1.380 (1.350)	1.332 - 1.403 (1.380)	1.310 - 1.395 (1.353)	1.292 - 1.366 (1.328)	1.286 - 1.345 (1.322)
USD/TWD	30.7 - 32.6 (32.0)	31.4 - 33.5 (32.1)	31.2 - 33.8 (32.2)	29.6 - 32.5 (31.5)	29.1 - 31.6 (30.0)	28.6 - 30.7 (29.5)
USD/IDR	15170 - 16020 (15400)	14900 - 15960 (15250)	14960 - 16160 (15580)	14750 - 16350 (15710)	15320 - 16160 (15670)	15190 - 16000 (15380)
USD/MYR	4.54 - 4.89 (4.75)	4.60 - 4.86 (4.66)	4.48 - 4.88 (4.72)	4.42 - 4.77 (4.68)	4.42 - 4.80 (4.61)	4.39 - 4.77 (4.58)
USD/PHP	55.3 - 57.4 (57.0)	54.4 - 59.4 (55.9)	53.8 - 58.8 (55.5)	54.7 - 59.5 (57.2)	53.3 - 58.3 (56.0)	52.9 - 57.7 (55.0)
USD/THB	34.3 - 37.3 (35.5)	34.8 - 37.3 (35.8)	35.6 - 37.8 (36.3)	33.8 - 36.6 (35.2)	33.3 - 36.0 (34.2)	33.1 - 35.4 (34.0)
USD/VND	23700 - 24800 (24400)	23600 - 24900 (24300)	24000 - 24800 (24500)	24000 - 24600 (24100)	23900 - 24400 (24000)	23700 - 24300 (23900)
AUD/USD	0.637 - 0.671 (0.645)	0.619 - 0.695 (0.655)	0.595 - 0.658 (0.631)	0.626 - 0.701 (0.653)	0.643 - 0.698 (0.673)	0.638 - 0.719 (0.685)



# FX Views: A Narrative of US Exceptionalism to Fed Cold Feet amid Recession Risks

## Q4 2023: US Exceptionalism & USD Bulls ... Triggered & Tempered

A hawkish skip at the Sep FOMC set the stage for “**higher for longer**” Fed to leverage on spots data out-run to pushing UST yields higher despite moderating inflation. The resultant **surge in real UST yields** is a reflection of **‘US exceptionalism’ narrative triggered**; in contrast to concerns of economic slowdown that is accompanying, if not overshadowing, less unimpeded dis-inflation in Europe/UK. Consequently, “*higher for longer Fed backed by US exceptionalism buoys the USD*”; possibly even triggering bouts of appreciation.

But **‘US exceptionalism boost’**, expressed via *real rate differentials favouring USD* (see USD: Keeping it Real, 25 July 2023)\* while mostly retained into Q4, **may not endure in a linear fashion**. Especially if the Fed dials back hawkish bias (with or without a hike in Q4). This is a risk if activity slows from *lagged credit tightening* colliding with US *government shutdown risks* as well as the *auto union strikes*. Diminished hawkish inclination could in turn temper any outrun in USD strength in the first half of Q4; leading to some moderation of USD gains.

**CNH is a key swing factor** hinging on the strength of policy stimulus to prop up the economy (and confidence) and or direct measures taken to stem capital outflows. Unassuaged China fears may dampen the extent to which EM Asia FX may regain traction even as USD gains moderate later in Q4; especially if year-end USD demand is accentuated. Whereas, manufactured China cheer and CNH rebound may lean into ‘Santa rallies’ to amplify scope for some rebound in AXJ.

## Q1 2024: Fed Pivot Bets & Goldilocks

Where earlier we had anticipated pronounced recession risks precipitating from lagged policy tightening to hit in Q1, we have now **pushed out the worst of US recession risks out to Q2-Q3**. *Nonetheless*, measured *softening in US data* coinciding with *conspicuous absence hawkish references to more hikes by Fed speakers* for could prompt **further softening in the Greenback**, insofar as “**pivot**” bets start seeping into the Fed calculus; especially *as the ‘US exceptionalism’ premium baked into the USD erodes further*.

It is worth noting that the notion of a controlled landing, rather than an unavoidable crash, may help with a **“Goldilocks”-like scenario**; in which, relief from bets on/signs of Fed pivot are not overwhelmed by acute demand for precautionary/haven demand for USD. To be clear, two-way FX volatile will remain a feature amid headline driven triggers; some involving fresh buckles in EM Asia FX. But that said, the wider Fed pivot relief could lend some traction for EM Asia FX in early Q1.

## Q2-Q3 2024: Recession Risks!

Although, that support could be brutally reversed into (either side of) mid-2024 as recession risks from lagged policy tightening hits more jarringly via credit channels; and potentially via financial shocks. The reflex here will be for the refuge of the Greenback regardless of expectations for the Fed to cut rates aggressively. Simply because safety takes precedence over meagre returns. Especially as recession risks cast a long shadow on exports-dependent, economies hobbled further by stagflation-type headwinds crimping domestic buffer. This could further dim economic outlook, hence support for FX via growth-based returns allure. Depending on the degree of financial shocks involved, the flight to safety can vary across EM Asia FX. Higher inflation, debt exposures and “twin deficit risks may be amplified.

What’s more, a sharp appreciation in the JPY, in accordance with “risk off” triggers also means that funding currency squeeze accentuates downside pressures in EM Asia FX. Interrupted FDI inflows, exacerbated by capital flight underscore the risks of disorderly correction in AXJ (may not be adequately offset by higher FX reserves).

And so, we expect AXJ on the whole to slip back further amid recession risks; albeit prone to two-way volatility and differentiated outcomes. Modest recovery off extreme sell-off levels in EM Asia FX as aggressive Fed rates cuts starts to coincide with worst-case recession/markets outcome later into Q3 is reasonable; with Fed pulling stops on QE-type stimulus being a decisive turnaround factor for AXJ (mainly on USD slide).

## Q4 2024: Chasing Rainbows

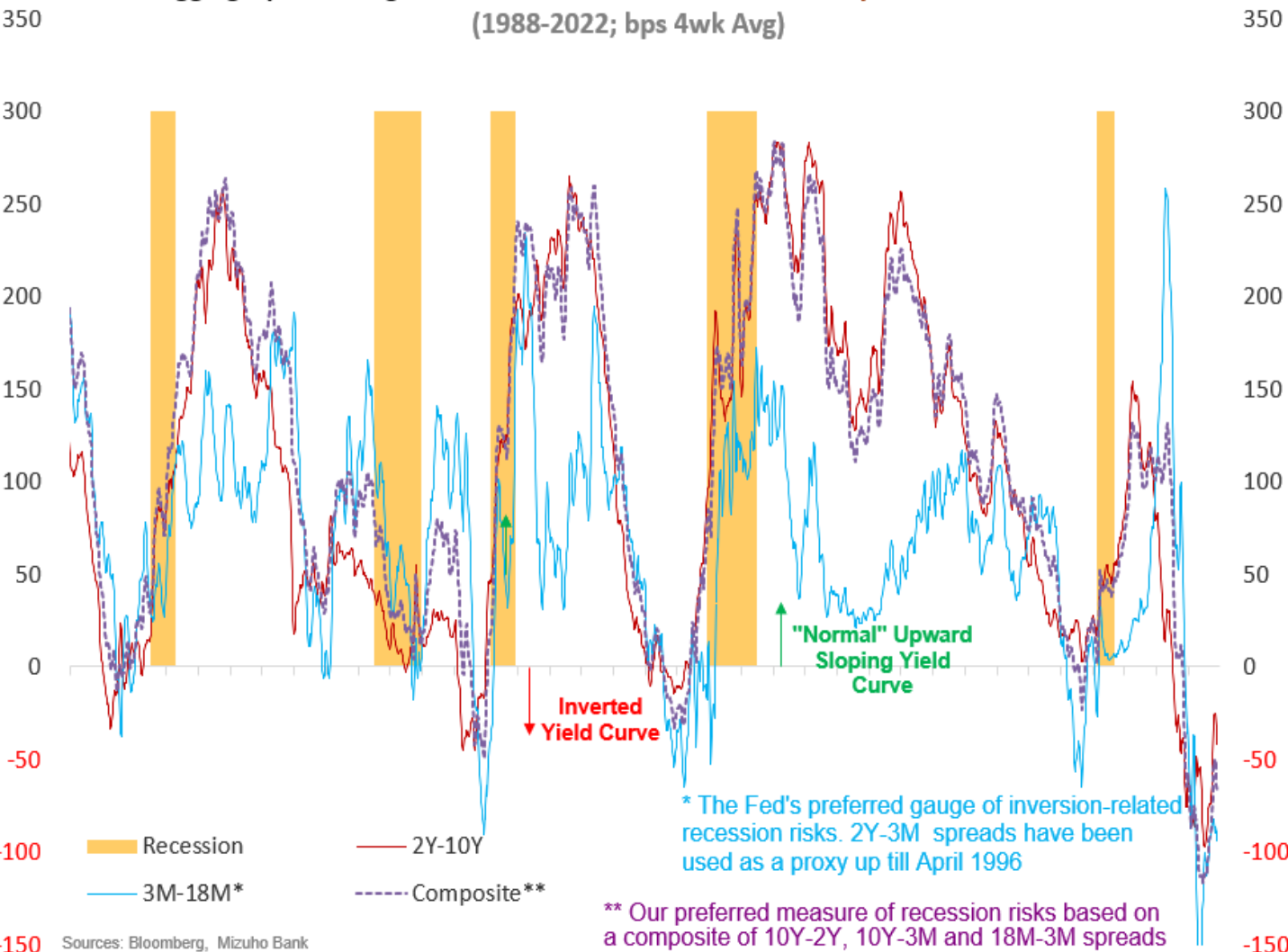
Heading into late 2024 is when the narrative of sustained EM Asia FX gains currency (no pun intended). This will be mostly premised on dovish Fed and bottoming global economy conspiring to lift optimism and a flood back into “growth” bets that favour EM assets. And to be sure, the rain need not be decisively over for forward-looking markets to chase rainbows. Just signs of bottoming may be seized upon.

What’s worth mentioning though is that CNH remains a key factor in determining relative levels. Crucially, given lingering economic and geo-political drag, the ability of CNH to regain ground could set the relative marker for various EM Asia FX. This could be an evolving equilibrium with regards to CNH.



# Appendix: Reversion from "Inversion" Often Because of Recession

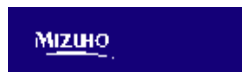
All Indicators, including the Fed's preferred "near-term forward spread" (3M-18M) **Flagging Up Growing Recession Risks; 73 weeks of 10Y-2Y yield curve inversion.** (1988-2022; bps 4wk Avg)



Yield Curve Inversion & Recession		
	Average Depth (bp)	Average Lag (Wks)
1981-82	75.6	40
1990-91	10.4	78
2000-02	27.4	54
2007-08	7.2	76
2022-23?	58	73

Sources: Bloomberg, Mizuho Bank  
 88 89 90 91 92 93 94 95 96 97 98 99 00 01 02 03 04 05 06 07 08 09 10 11 12 13 14 15 16 17 18 19 20 21 22 23

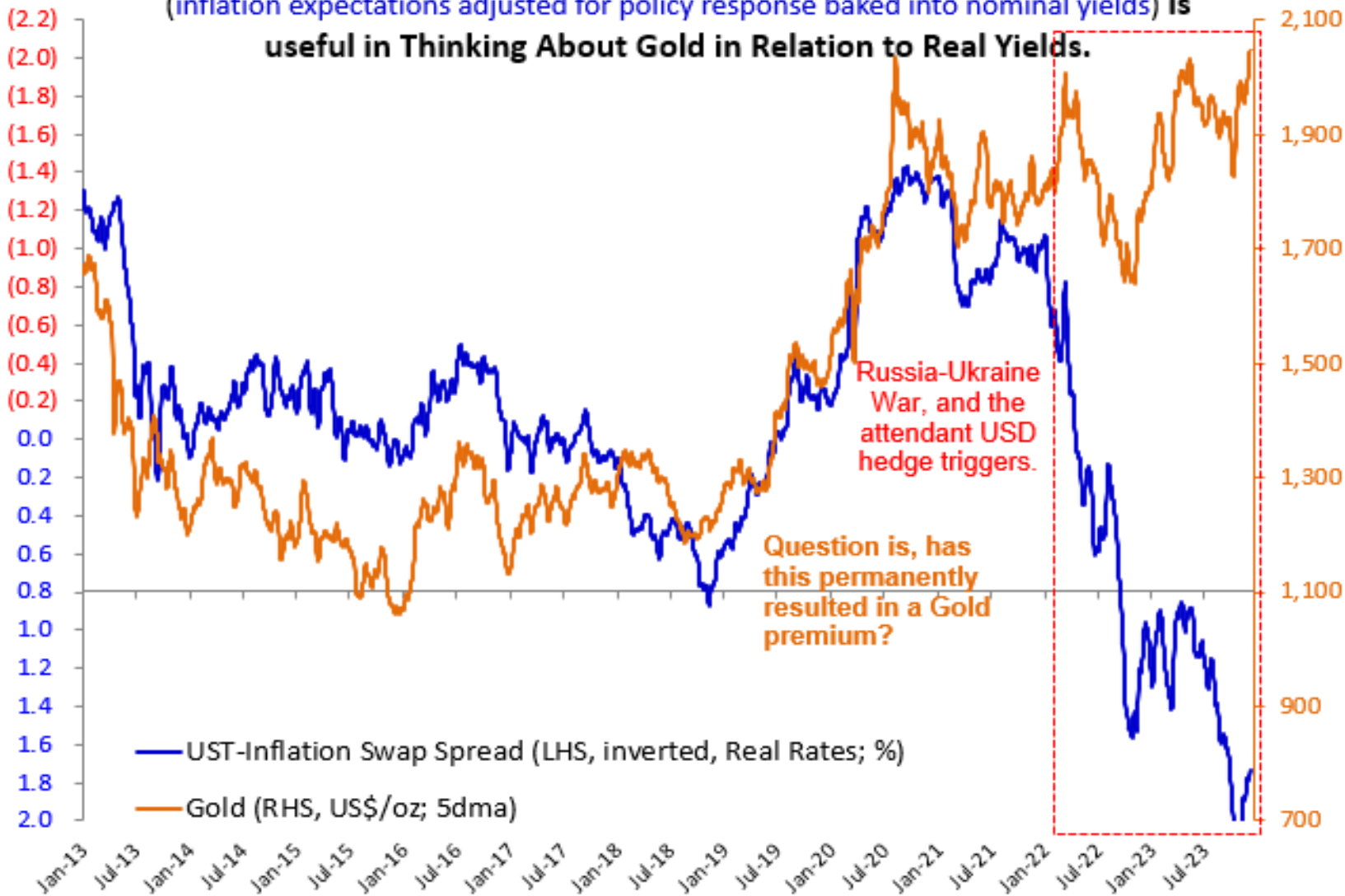
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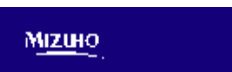
# Appendix: Cracks in Correlations – Gold’s Glitter

## Negative Co-Movement/Correlation between Gold & Real Rates

(inflation expectations adjusted for policy response baked into nominal yields) is useful in Thinking About Gold in Relation to Real Yields.



Sources: Bloomberg, Mizuho Bank



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