# *Pulling Rabbits & Slaying Dragons*
## *Pivot Pitfalls: Of Constraints & Competition*

As *Year of the Rabbit* gives was to the *“Dragon”*, we review;
i) soft-landing hopes/fantasies (rabbits), and;
ii) **simultaneously** *taming inflation* (dragons)

Also **volatile geo-politics** *as the threat of a "live dragon"* amid risks of cavalier *mis-calculations heading into* ***US elections***

Why "immaculate dis-inflation" may be a fairy tale or illusion.

Making sense of **US exceptionalism & China gloom**


Photo Credits: Vector Stock

*“It does not do to leave a live dragon out of your calculations, if you live near him”*
**- Gandalf, Lord of the Rings**

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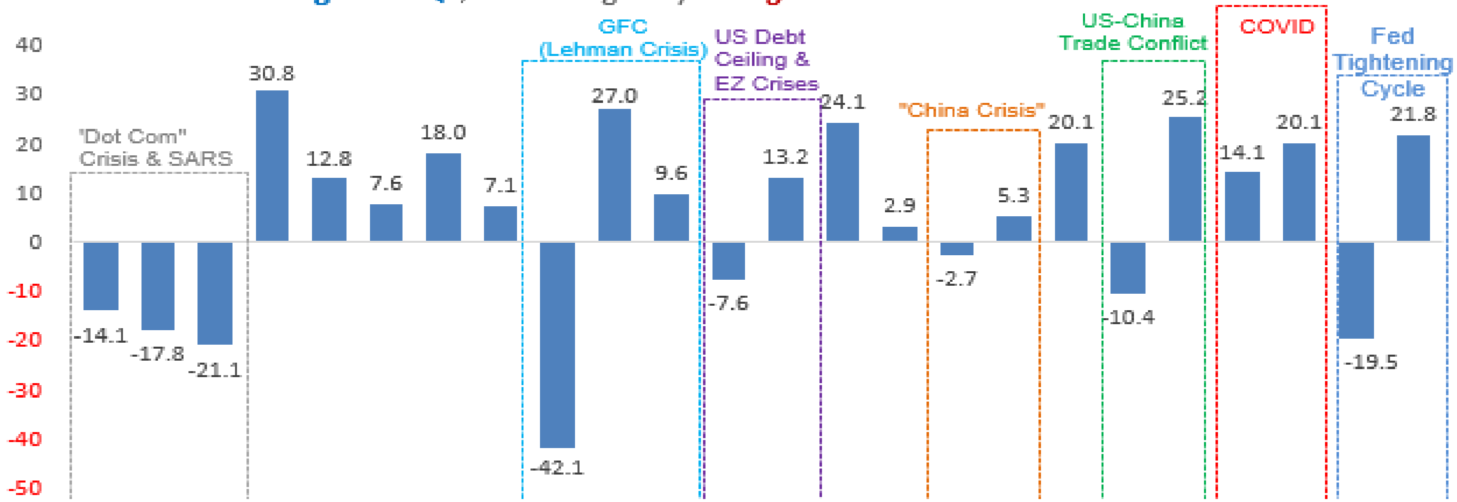
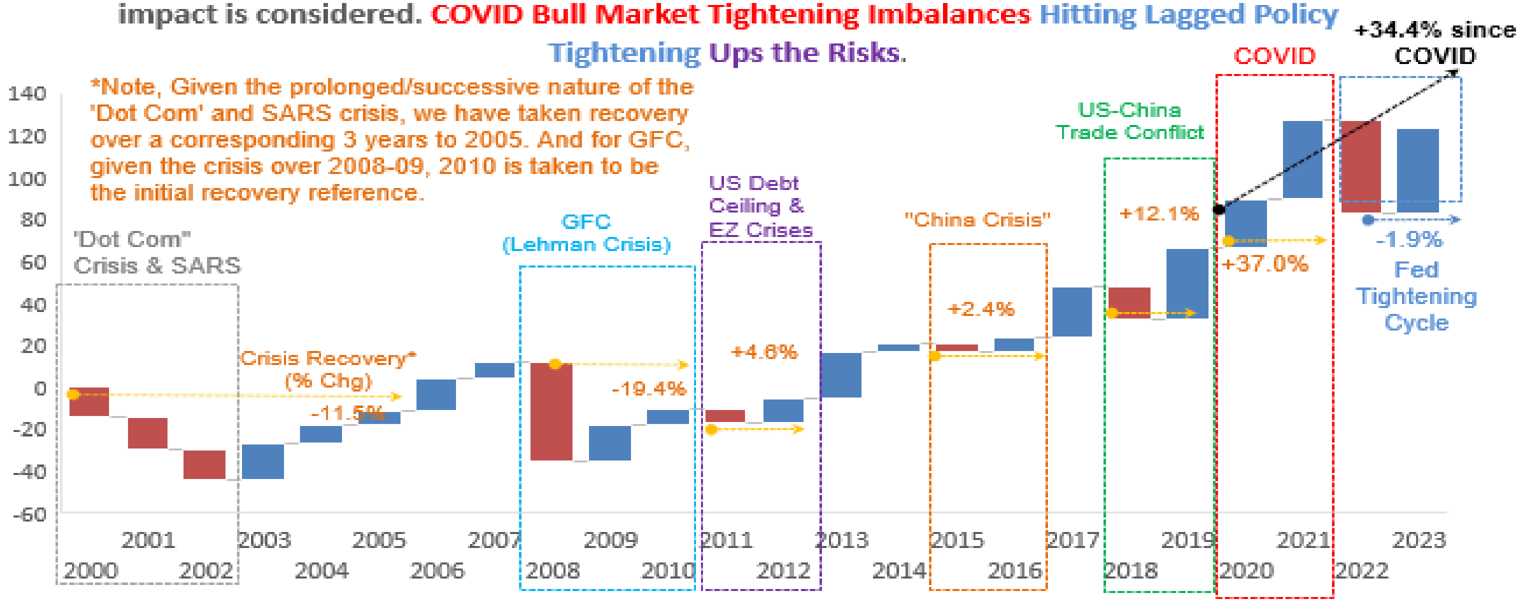
February 2024

# Equities Deflecting Rate Hike Stress Overly Reliant on "Immaculate Dis-inflation" Pivot

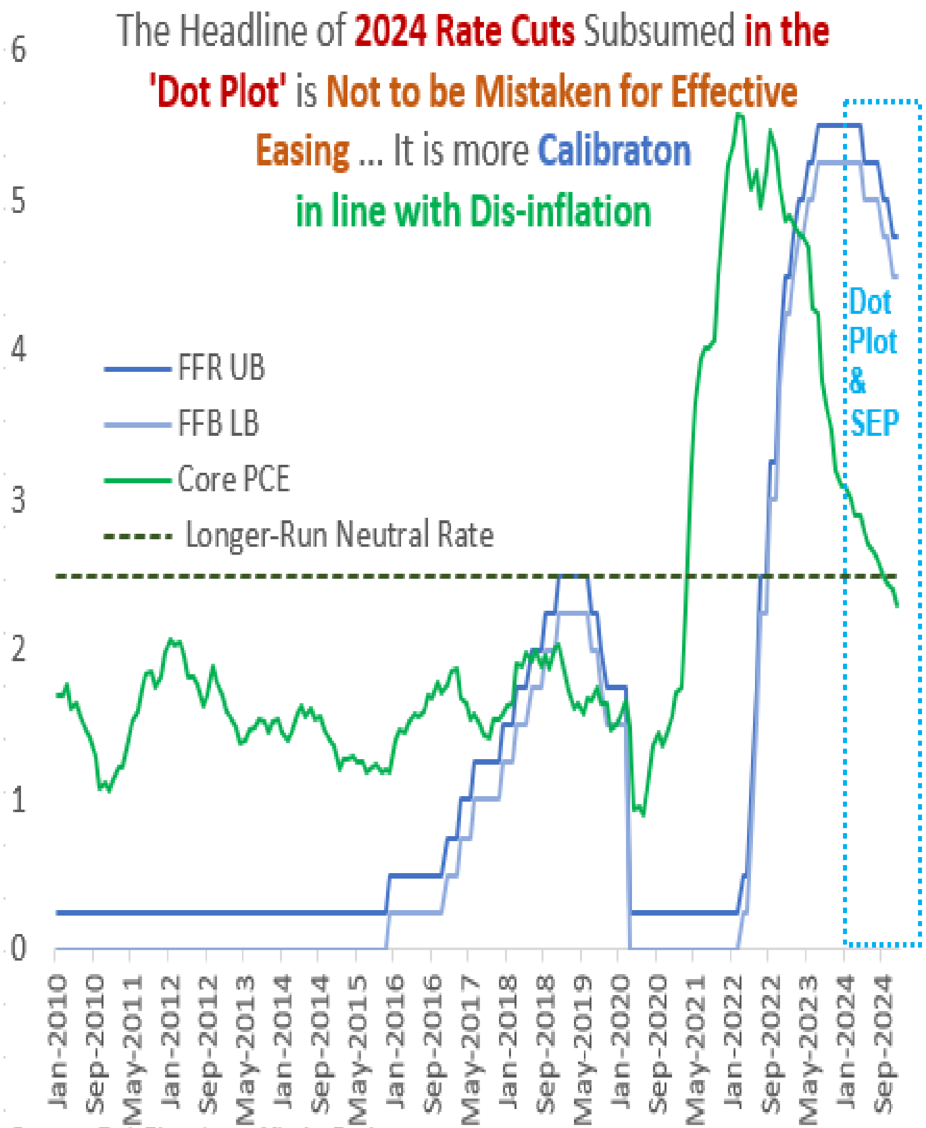
MSCI Global (2000-2021; Annual % Chg): Equity Market Cycles, Which Appear to Have Changed on QE, is Now Arguably Facing the Most Intense Fed Headwinds.



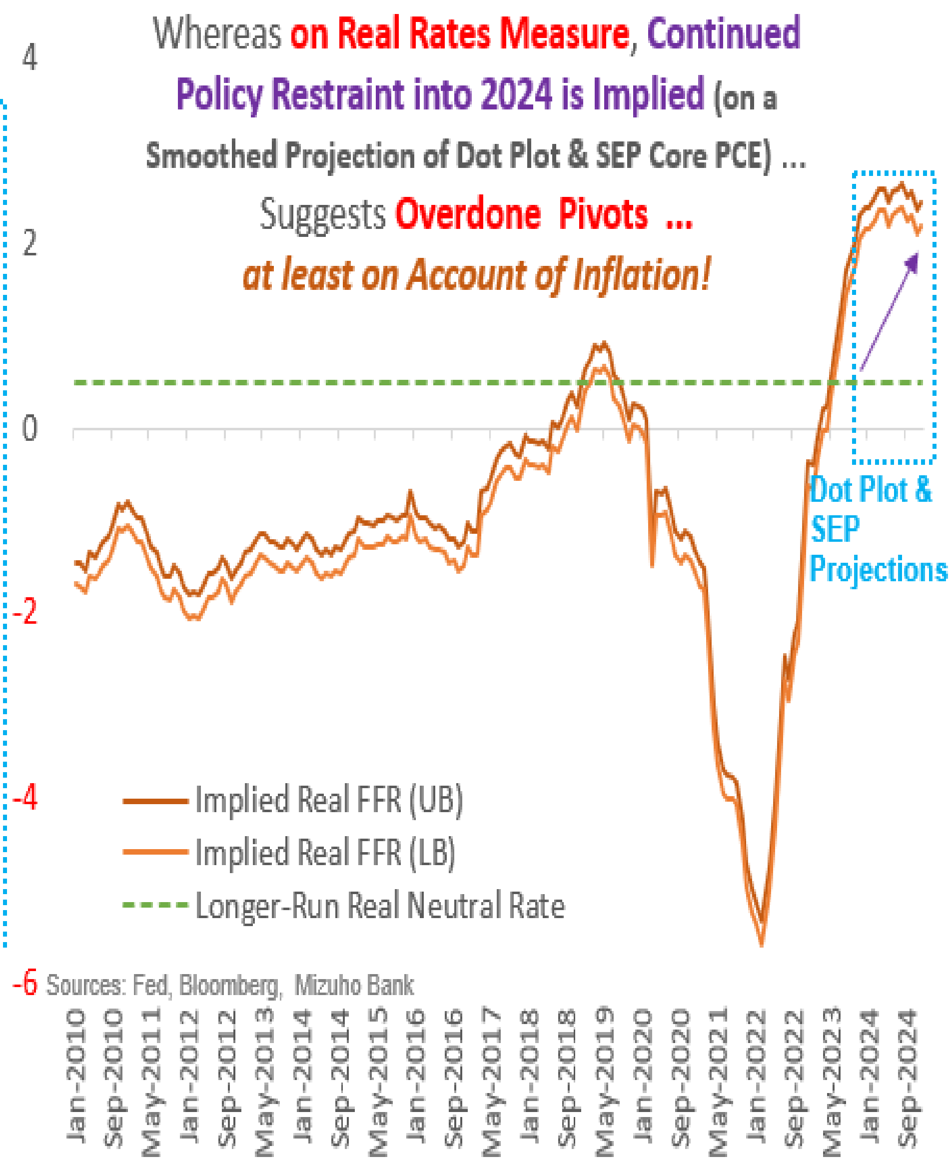

MSCI Global (Annual % Chg; Indexed to End-1999): This Sharpens Dramatically once cumulative impact is considered. COVID Bull Market Tightening Imbalances Hitting Lagged Policy Tightening Ups the Risks.



# *But Elevated* Real Rates Suggest that the Fed Pivot is Cautious, Conditional & Calibrated



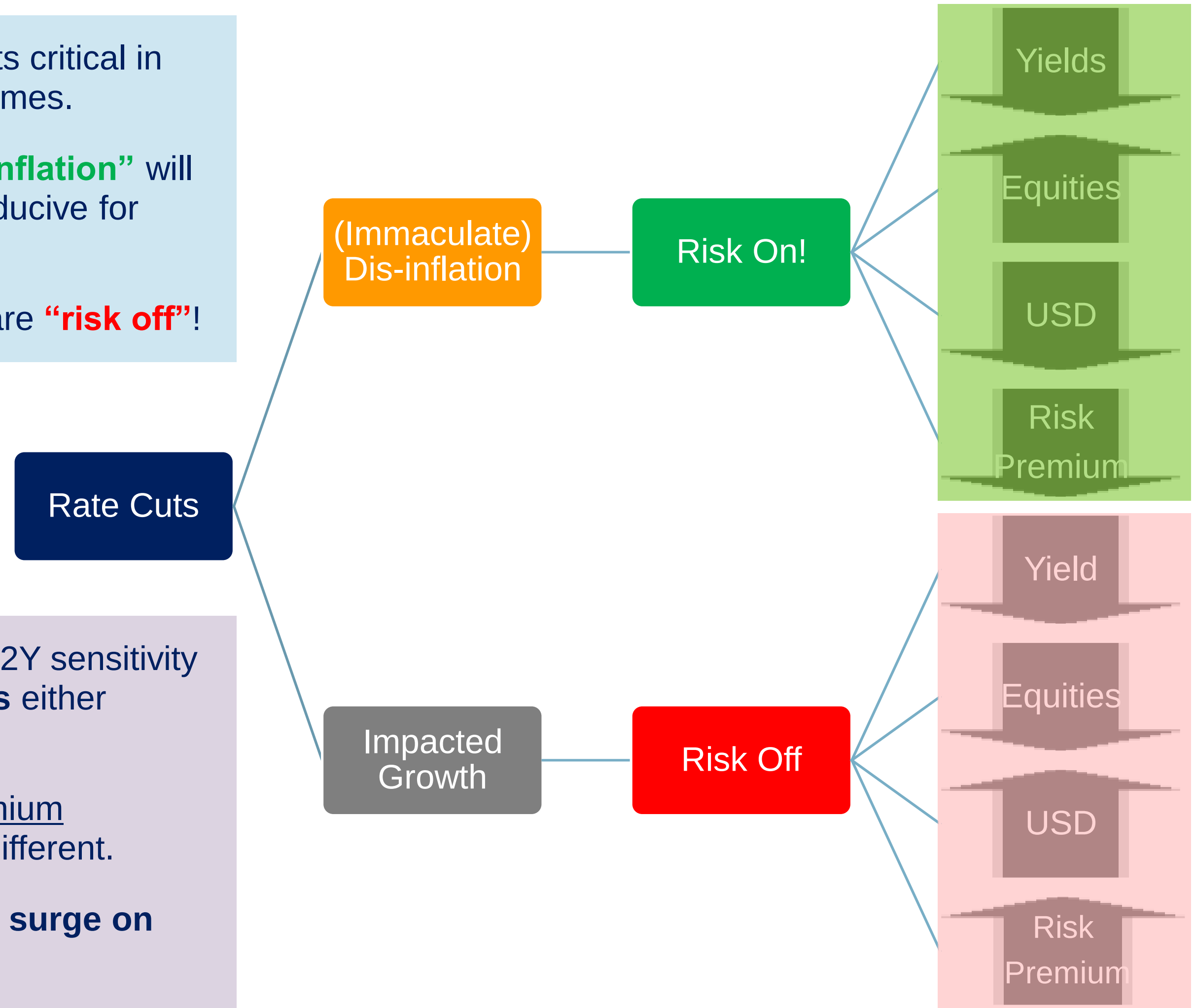

Sources: Fed, Bloomberg, Mizuho Bank




Sources: Fed, Bloomberg, Mizuho Bank

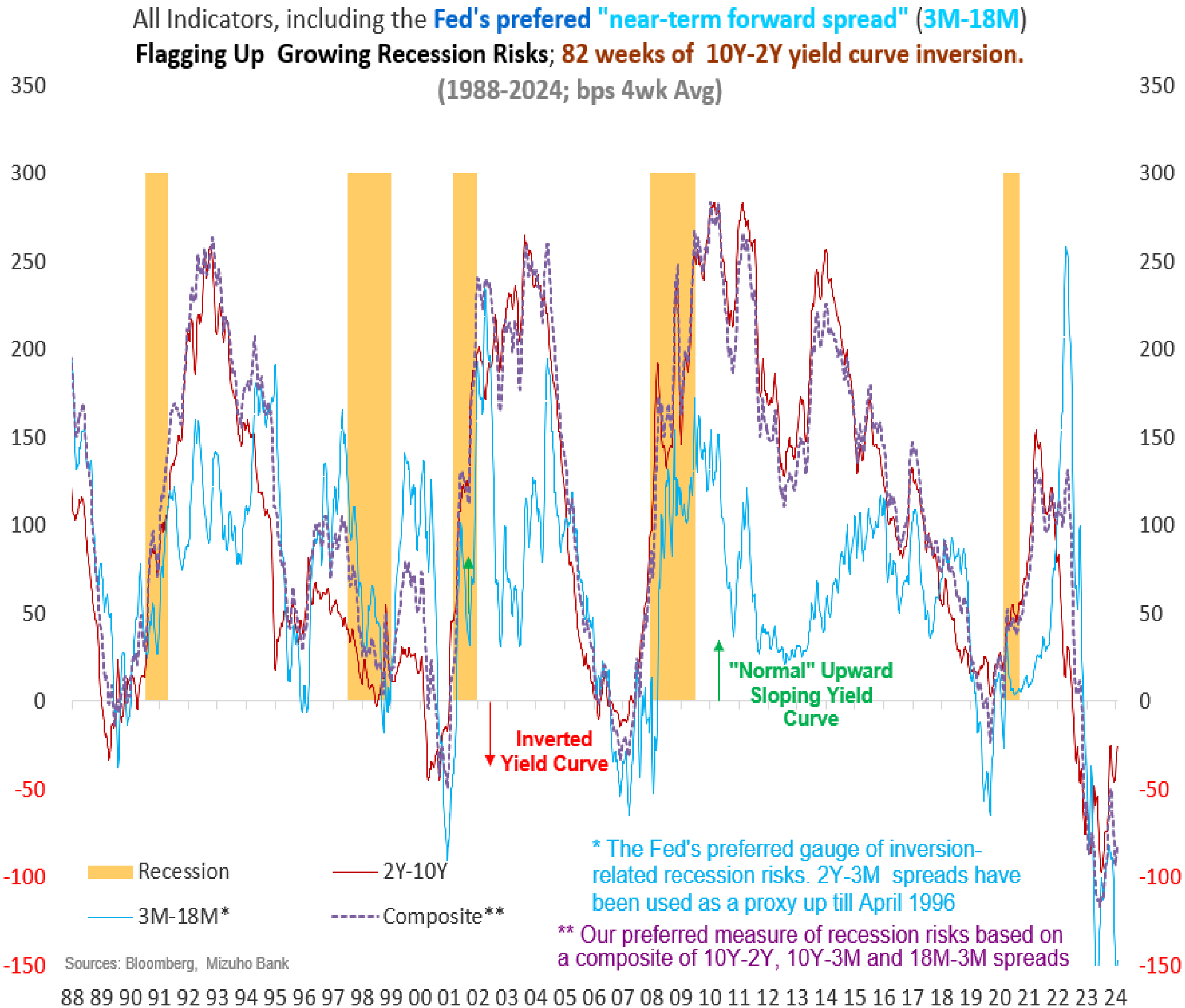
# Distinction with a Difference: Why Being Wrong About “Immaculate Dis-inflation” Matters

- Arguably, motivation for rate cuts critical in determining asset market outcomes.
- Specifically, **“immaculate dis-inflation”** will trigger **“risk on”** response conducive for asset prices.
- But rate cuts on **growth risks** are **“risk off”**!




- **Drop in yields** – initially led by 2Y sensitivity to policy – is **consistent across** either iteration of rate cuts.
- But USD, equities and risk premium consequences may be starkly different.
- **USD**: To **ease on “risk on”** but **surge on “risk off”** amid haven demand.
- **Equities**: “Immaculate dis-inflation” rallies liable to sharp corrections on hard landing.
- **Risk Premium**: To surge (denting EM/risk assets) if economic outcomes sour.

# But Warning of the Recession “Dragon”




**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? | 56 | 82 |



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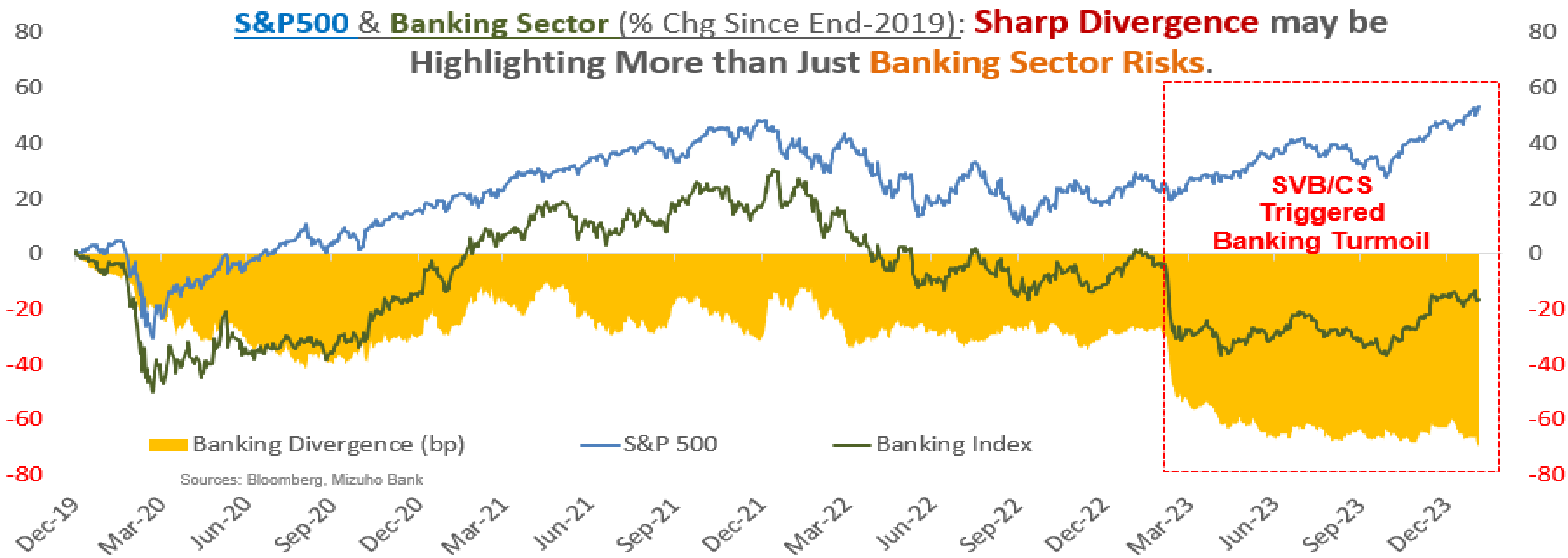
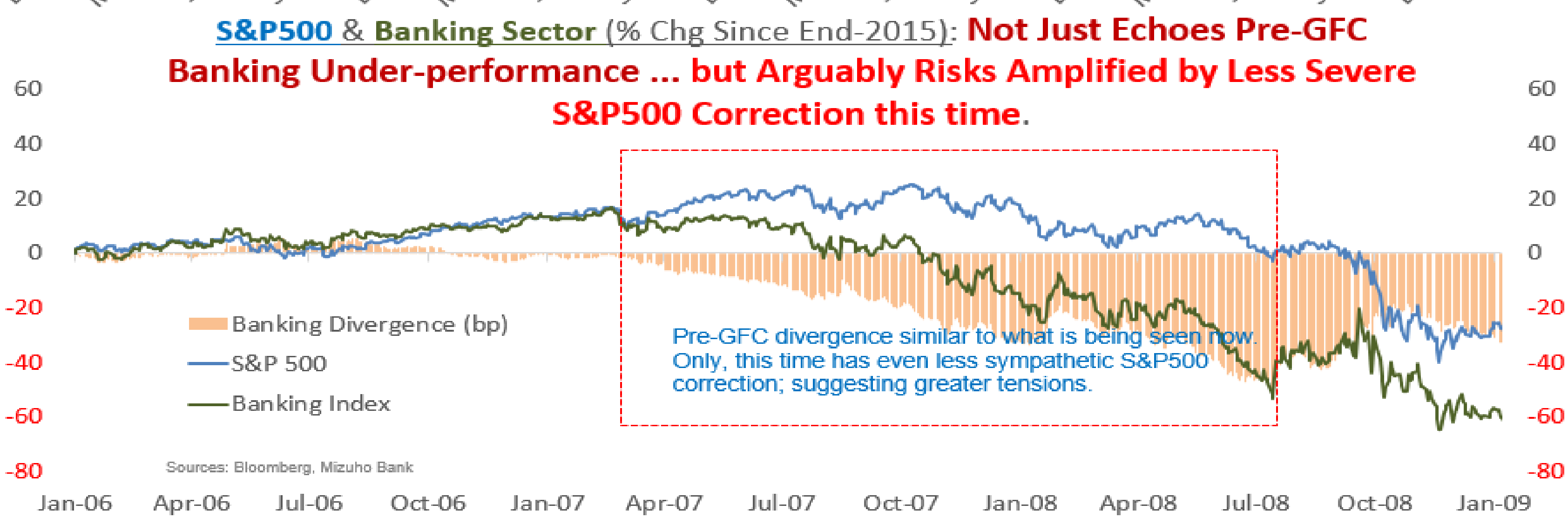
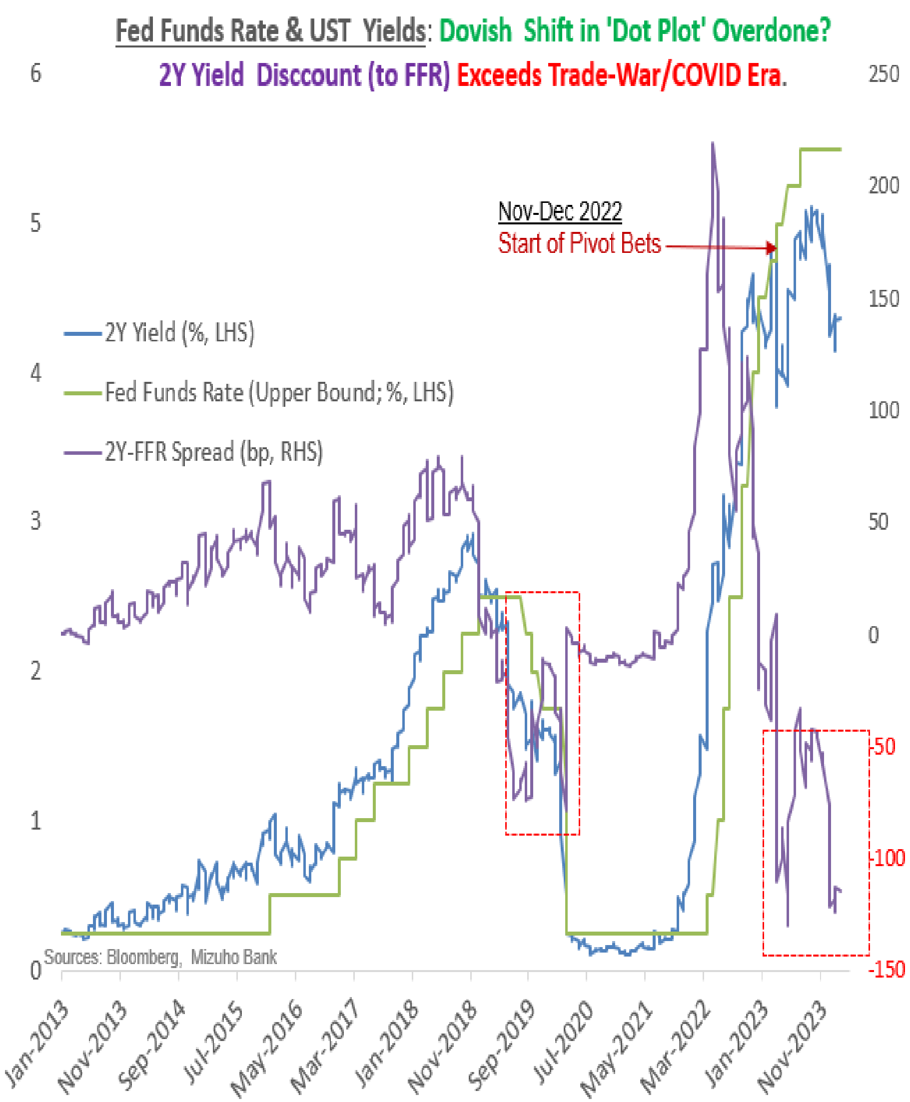
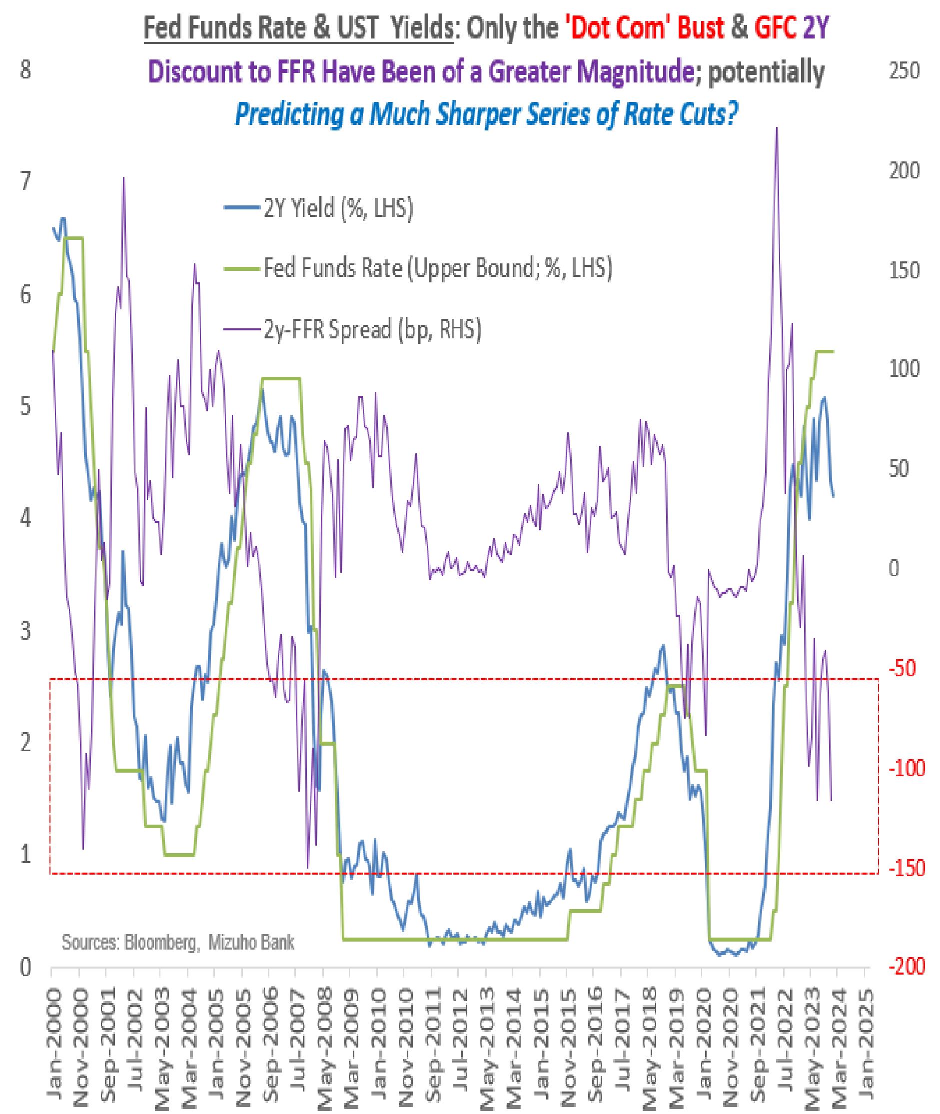
# Equities-Banking Wedge Warns of *Cracks* in the Soft Landing Assumption



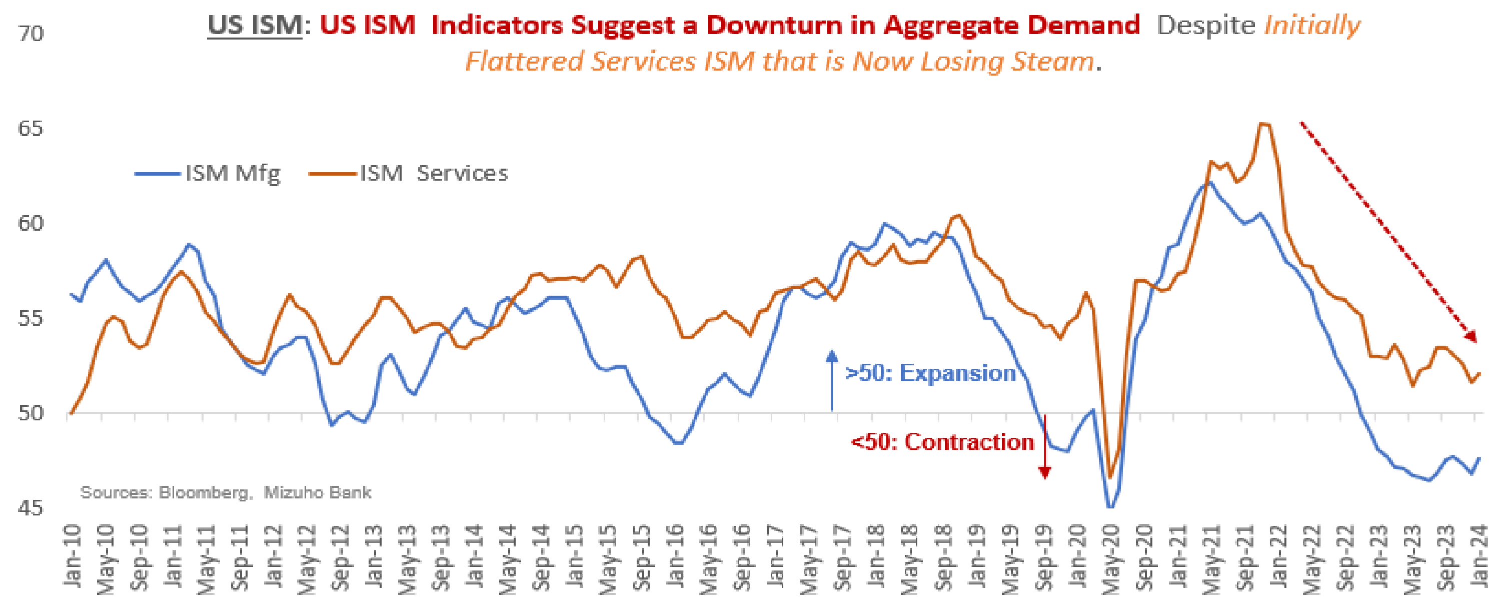



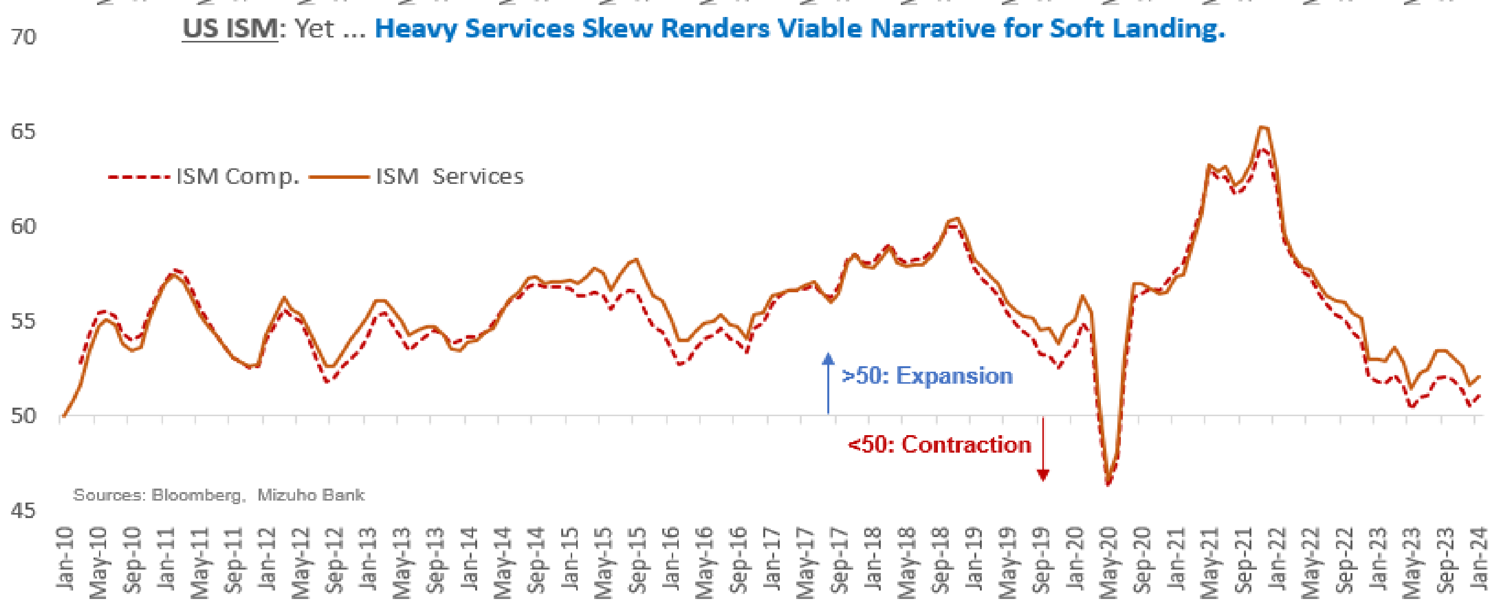
# The 2Y Yield Discount to Fed Funds Rate Suggests Overdone Pivot or Recession Risks



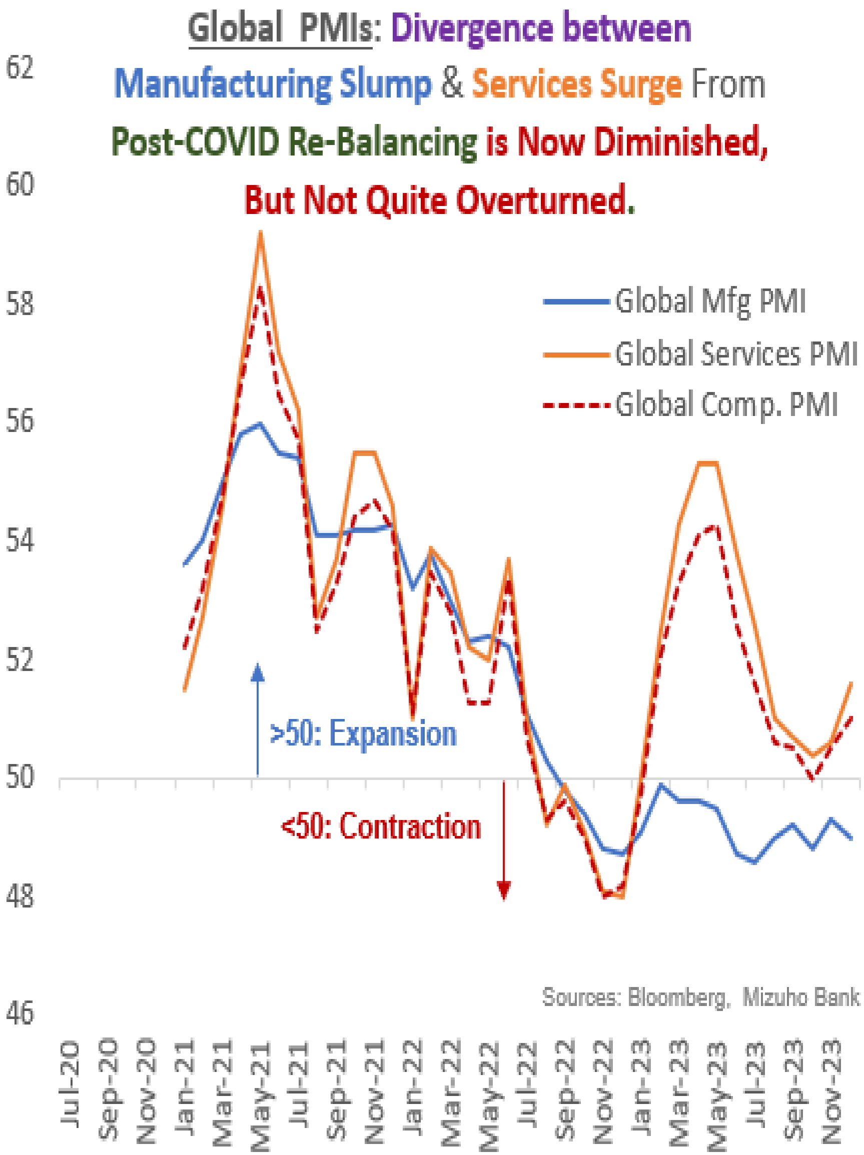



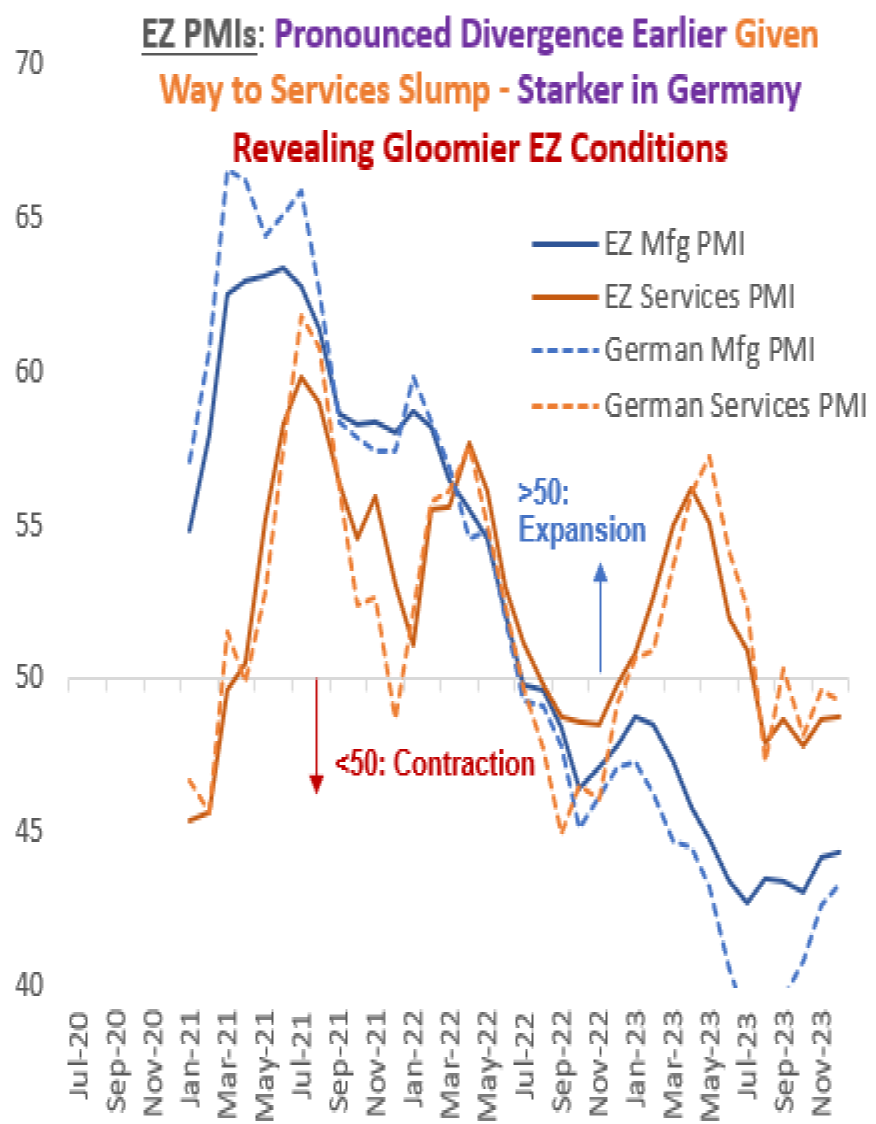
# The Biggest Rabbit Pulled Out of the Hat: Soft Landing



# But US Exceptionalism & *Spill-over Global Cheer* Neither Ubiquitous Nor Contagious



# The Key Question is Whether US Consumer Will Continue to Defy Gravity?

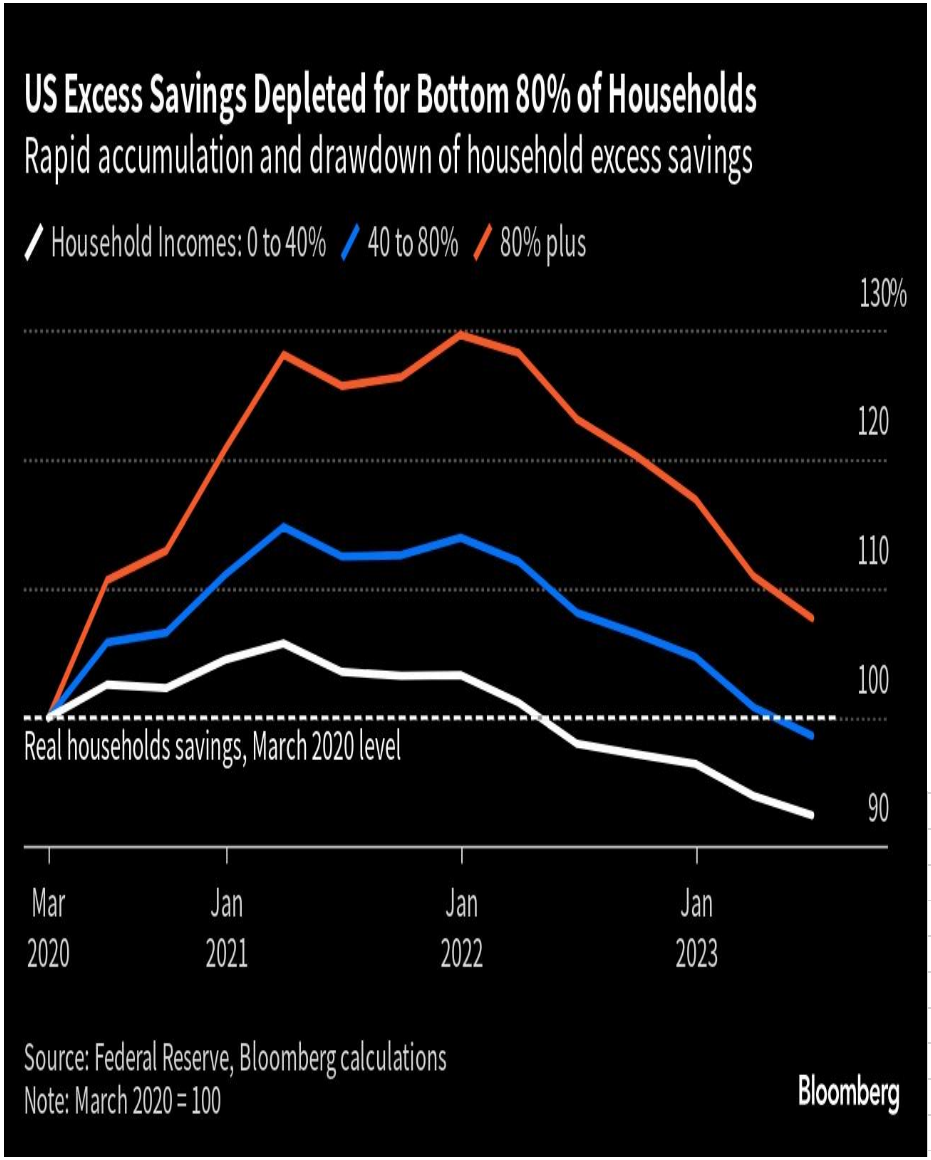
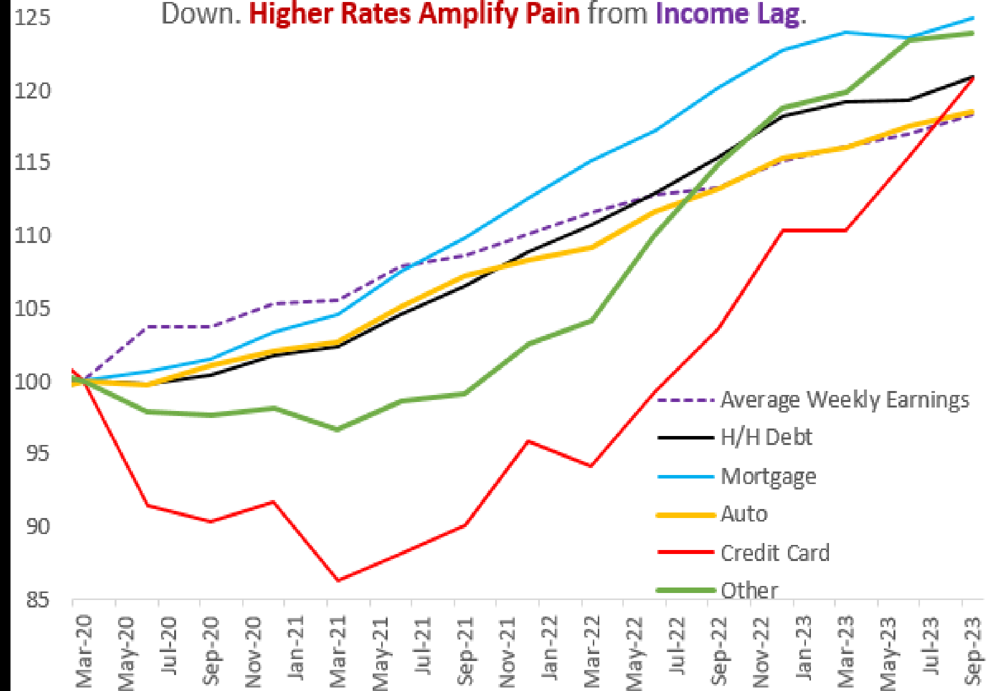
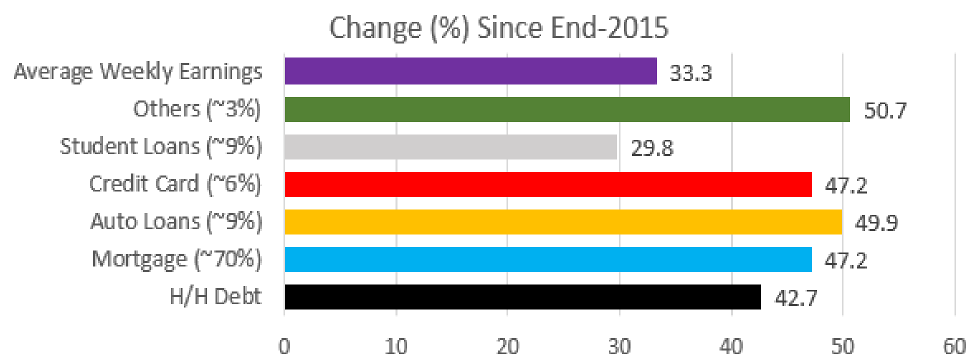



Chart from Bloomberg

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**.



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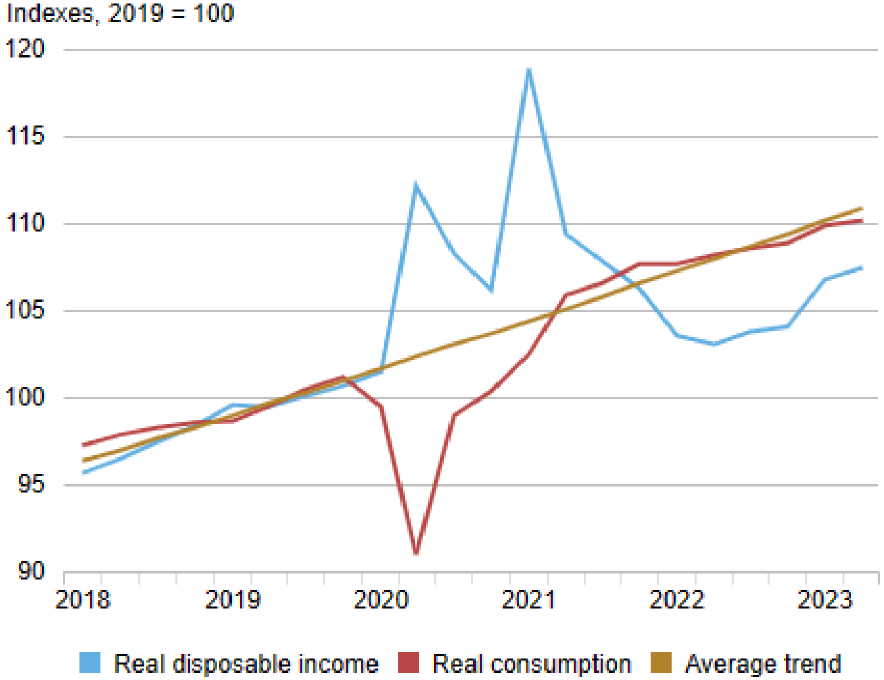
# Especially if the Income Constraints Catch-Up in Conspiracy with Higher Rates

## U.S. Consumption Back to Trend but Income Lags

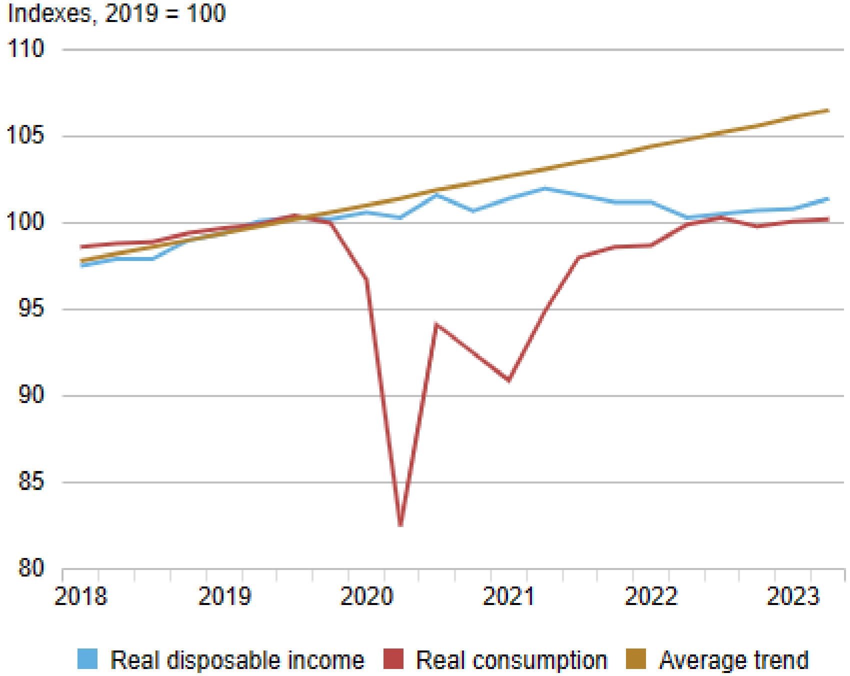
United States: Real Income and Consumption Indexes




Sources: Bureau of Economic Analysis, Integrated Macroeconomic Accounts; authors' calculations.
Note: The average trend for consumption and income is based on growth from the fourth quarter of 2014 to the fourth quarter of 2019.

## Foreign Income and Consumption Tracking Below Trend

Foreign Economies: Real Income and Consumption Indexes

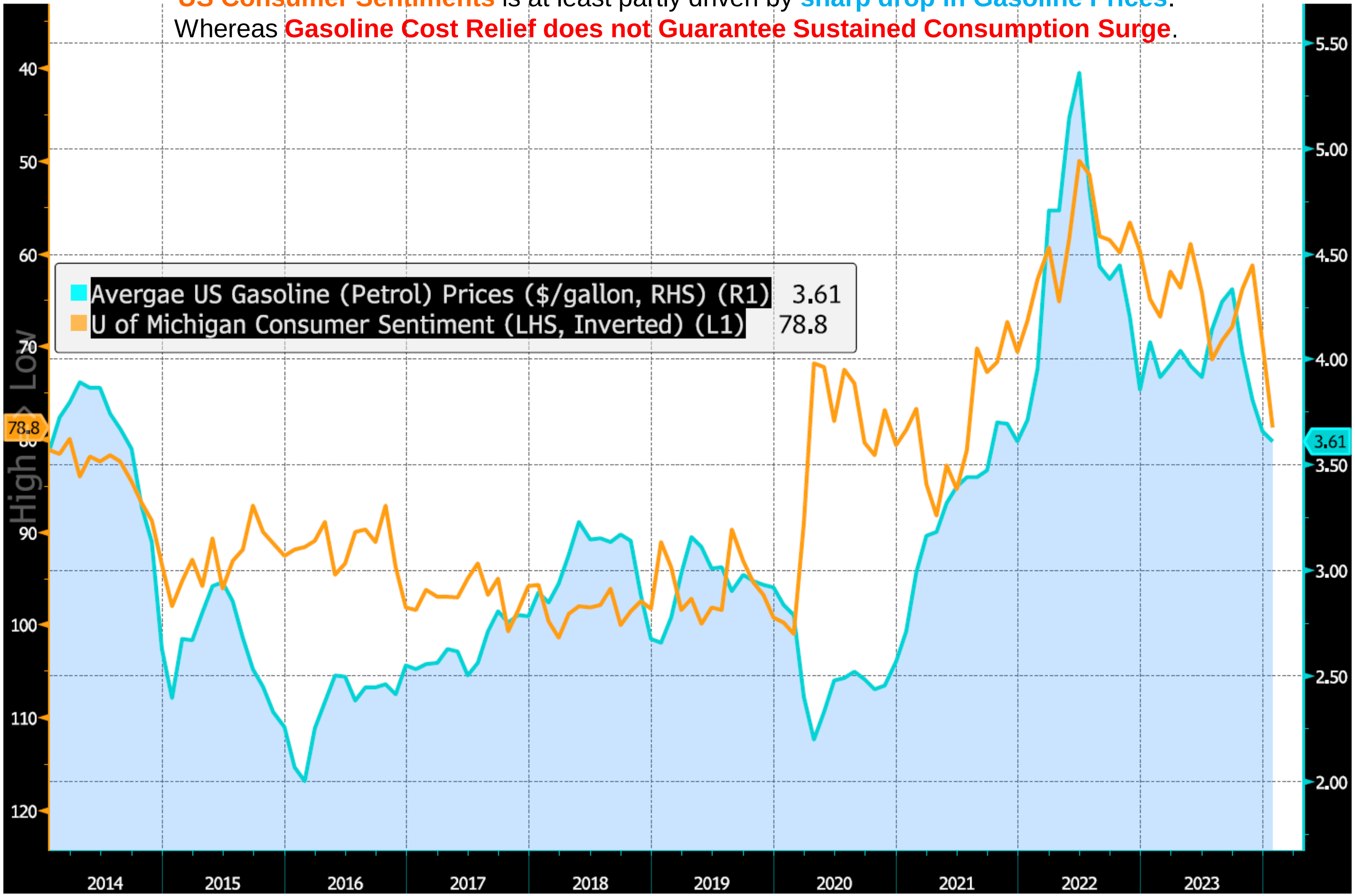



Sources: Eurostat; UK National Statistical Office; Japanese Cabinet Office; Statistics Canada; authors' calculations.
Notes: The foreign high-income series is a GDP-weighted average of the euro area, Japan, the United Kingdom, and Canada. Disposable income data for the second quarter of 2023 in Japan have not yet been released. Income for that quarter is extrapolated from the first quarter of 2023 at the average growth since the first quarter of 2022. Japan represents about 15 percent of the foreign index.

Source: Federal Reserve Bank of New York

# For Now … Gasoline Prices May be Fuelling Sentiments!

**US Consumer Sentiments** is at least partly driven by **sharp drop in Gasoline Prices**.
Whereas **Gasoline Cost Relief does not Guarantee Sustained Consumption Surge**.



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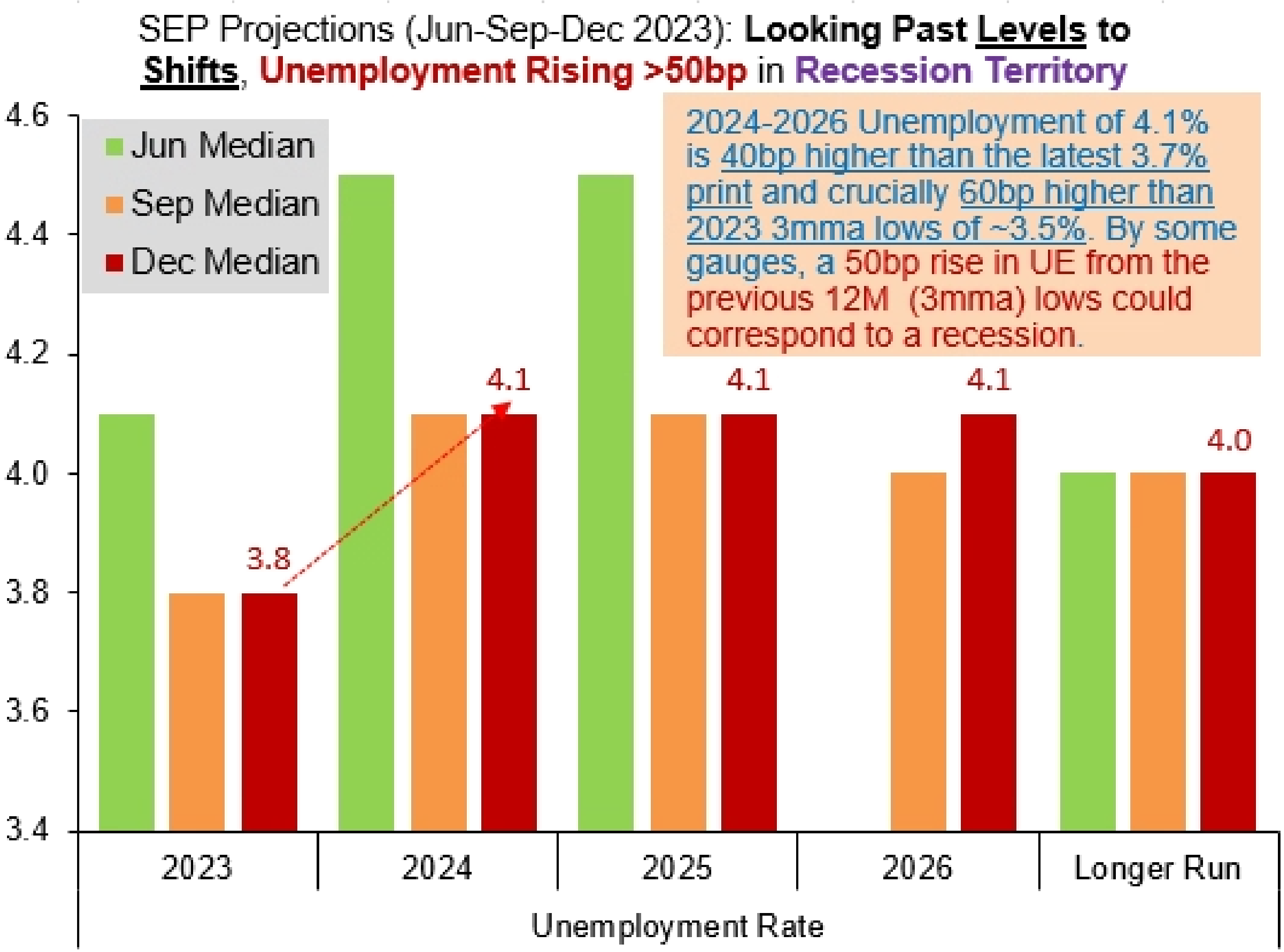
# Recession Risks *Going by a 2nd Order Gauge* is Hidden in Soft-Landing




Source: Fed, Mizuho Bank

# Geo-Politics: Conflict, Production & Passage

**<u>Straits of Hormuz:</u>**
**Conflict risks**
**Most critical Oil choke point – Iran risk**
**20-22MBpD of Oil (~$1.2b worth)**
**Most of Saudi's Oil passage**
**~20-25% od seaborne Oil Passage**
➔ **as Large as a Doubling in Prices!**




**<u>Red Sea:</u>**
**Conflict risks - Houthi Rebels**
**Could disrupt passage of Oil**
**~12% of global shipping (~$1trln)**
**CoGH detour adds 3-4 weeks to Asia routes**
➔ **approximated to 20% of shipping capacity impact**

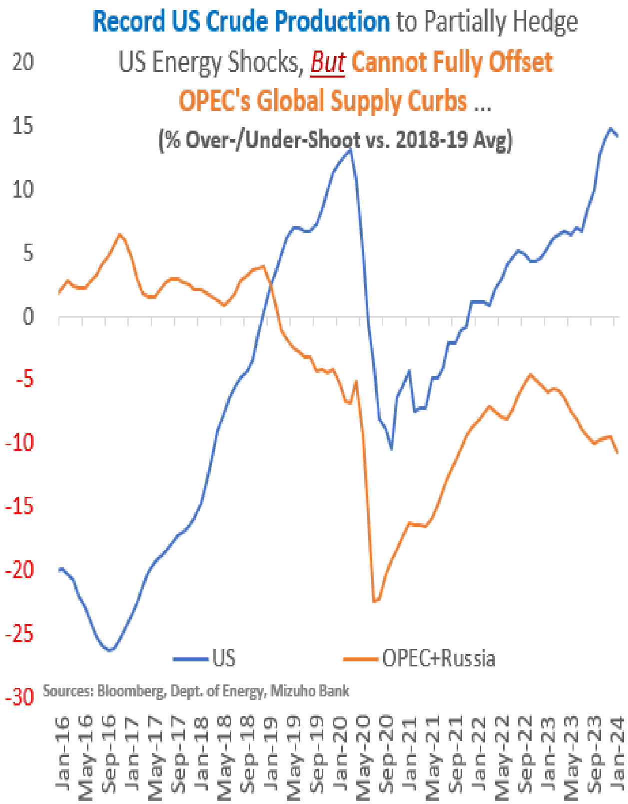
**<u>Panama Canal:</u> Water Crisis**

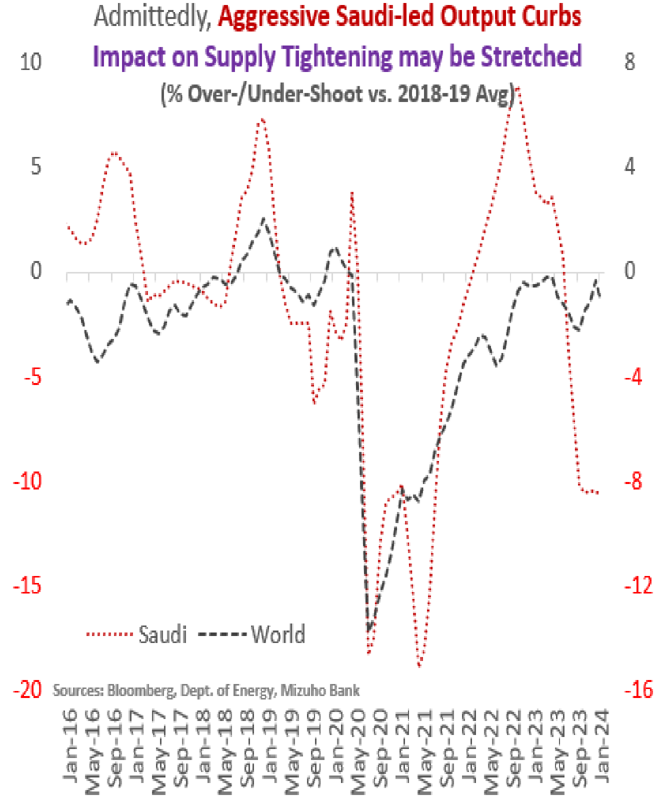
# Geo-Politics: Oil Price Shocks … Geo-politics Complicates the Descend

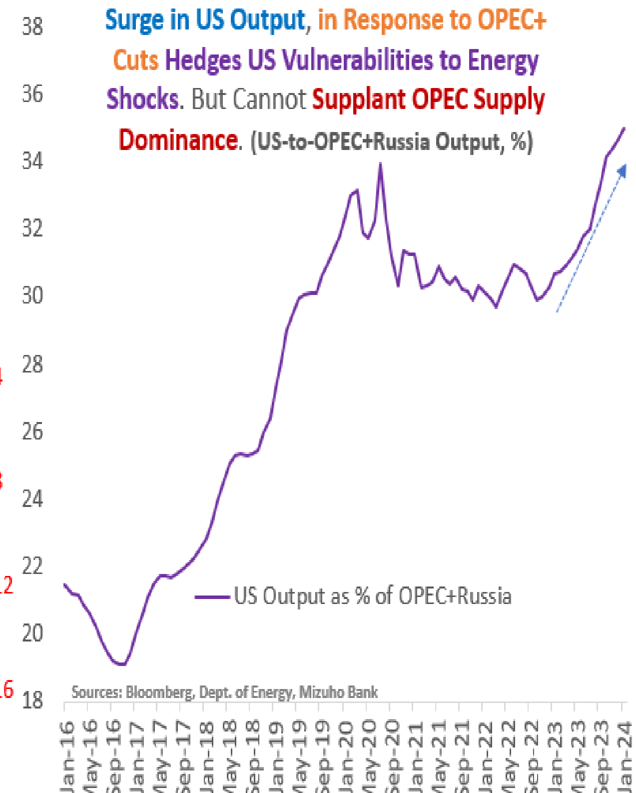
Geopolitically-charged $100-120 surge neither imminent nor unavoidable. In fact, **downside risks to Oil grows** on Non-OPEC supply. *But* equally, ***dangers of a geo-political flare-up in Oil** is masked by illusions of controlled war.*

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.**



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# Geo-Politics: Heightened Uncertainty & “Crowding Out” Risks

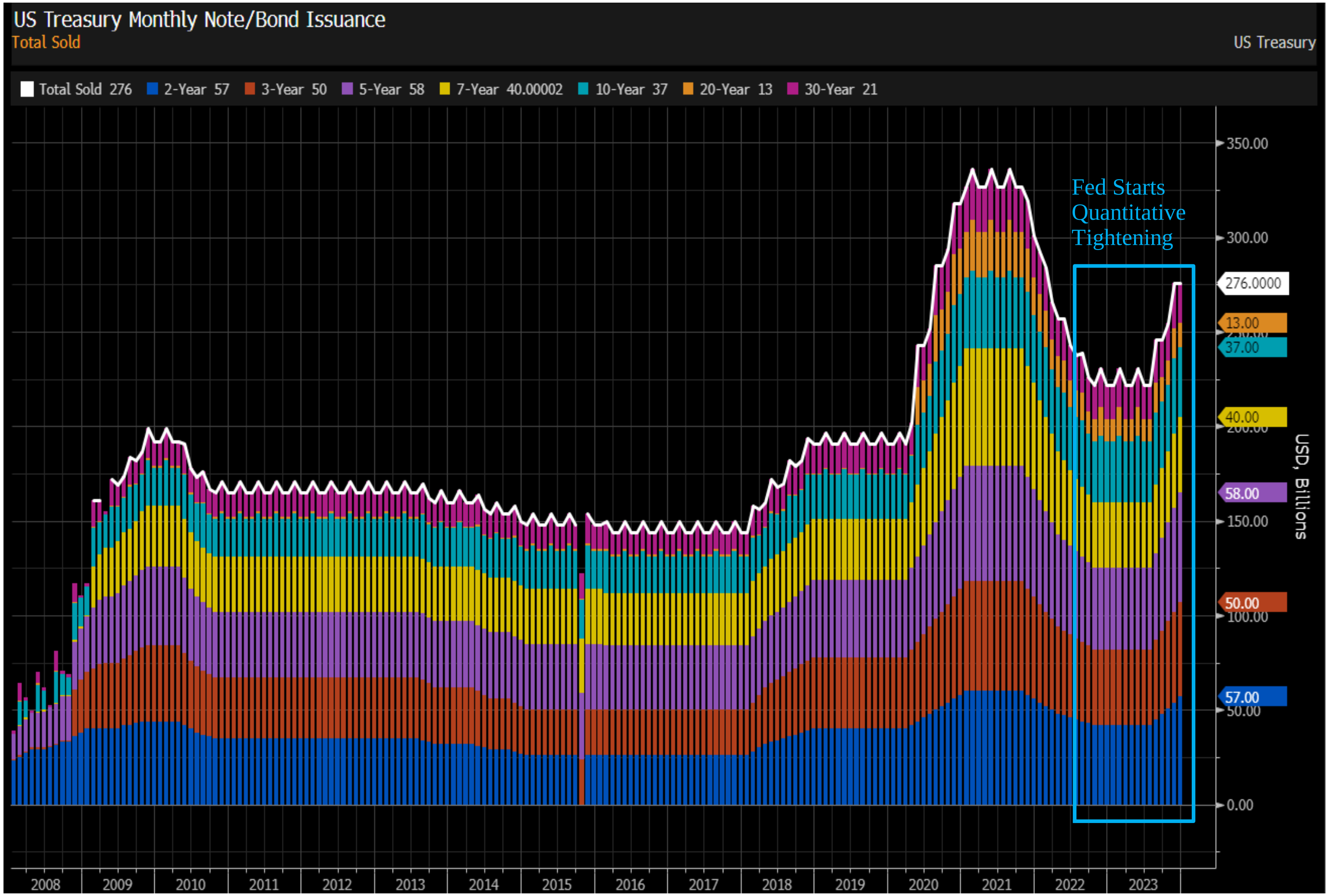


Chart from Bloomberg

- **Insofar that fears of US debt/unsustainble 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.**



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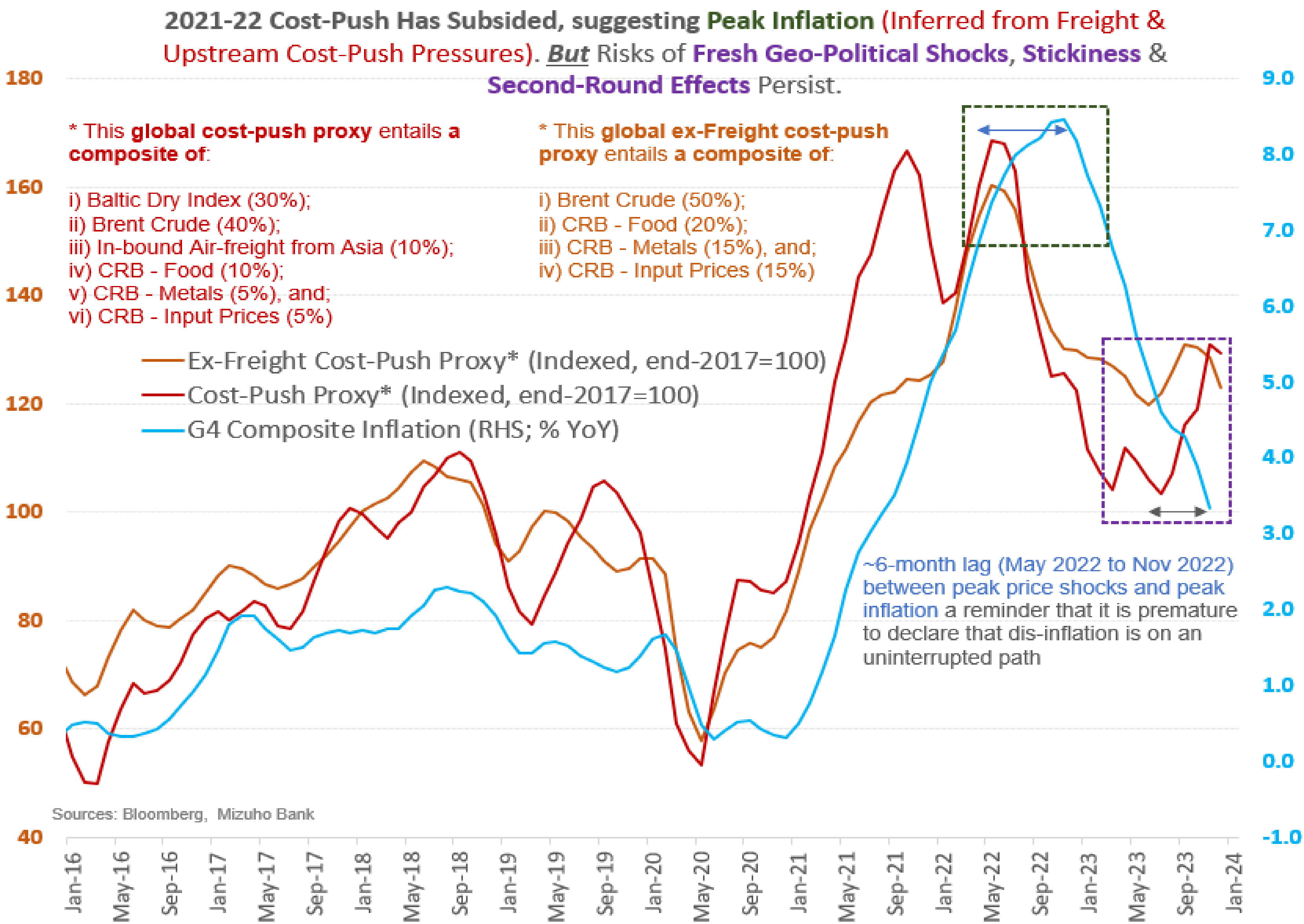
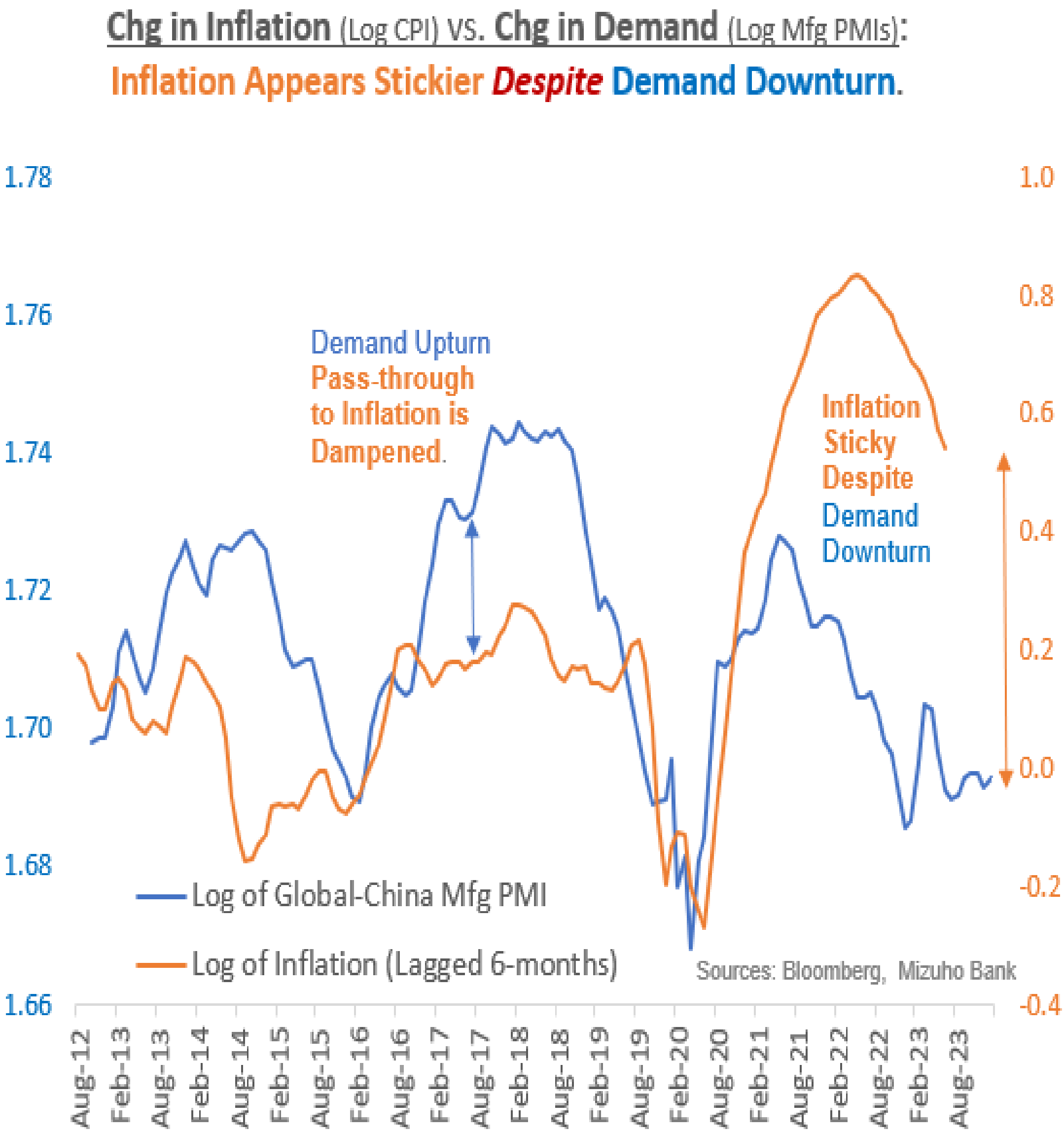
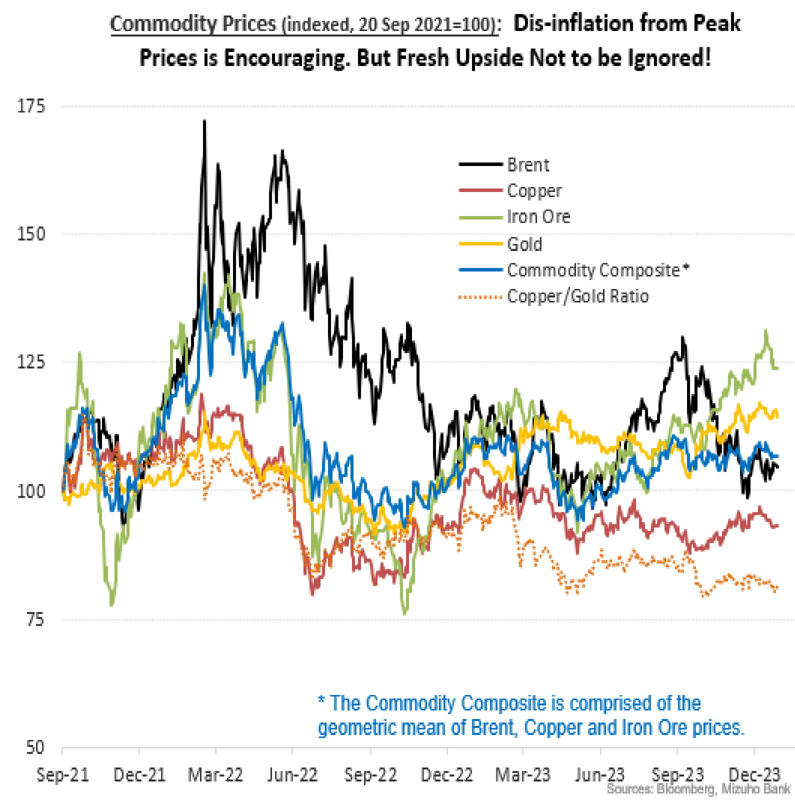
# Inflation: Irascible on Shocks (with a Lag) Underpinning "Last Mile" Worries …



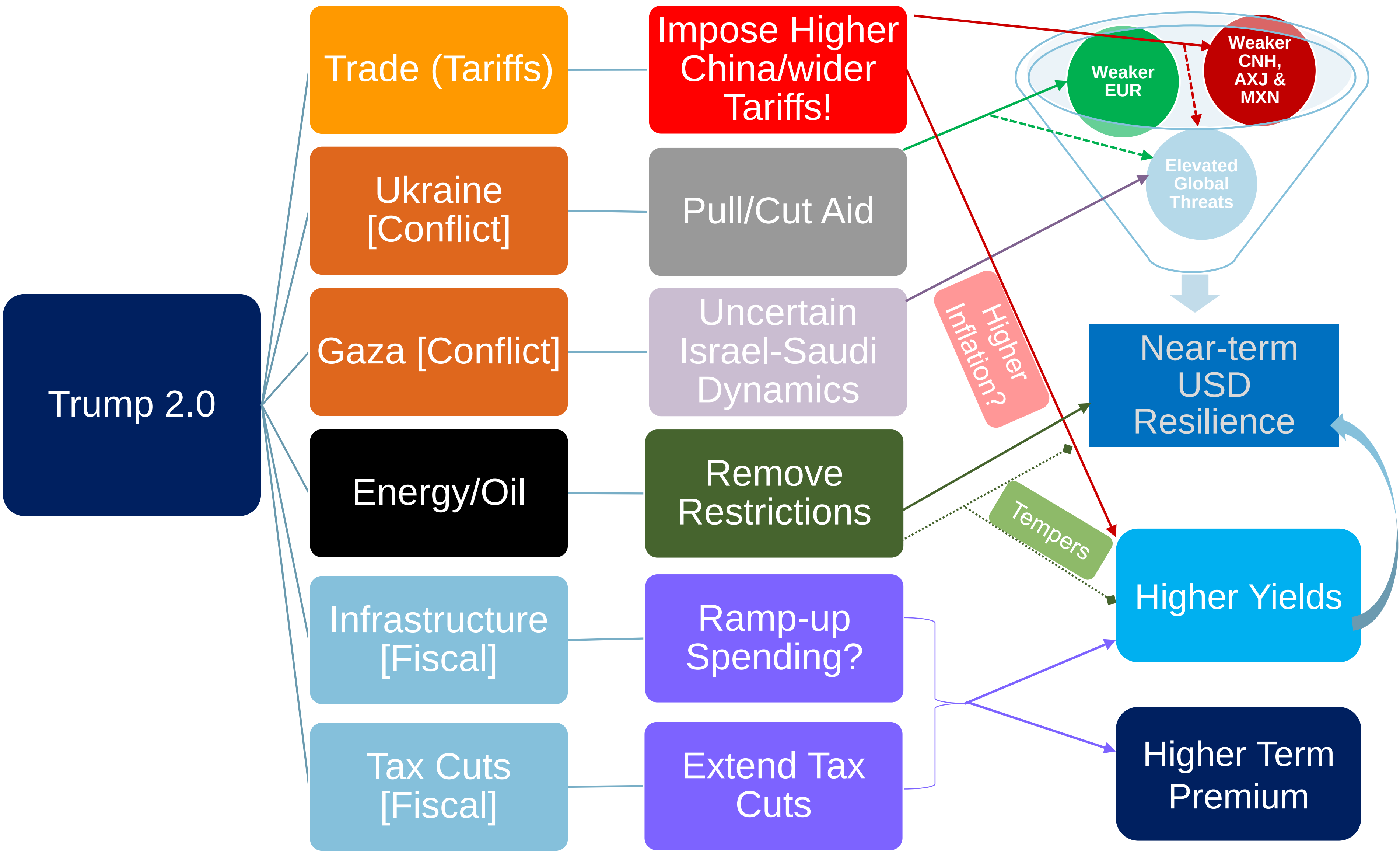
# **Inflation:** … Compound Policy Dilemma & *Hits Demand*



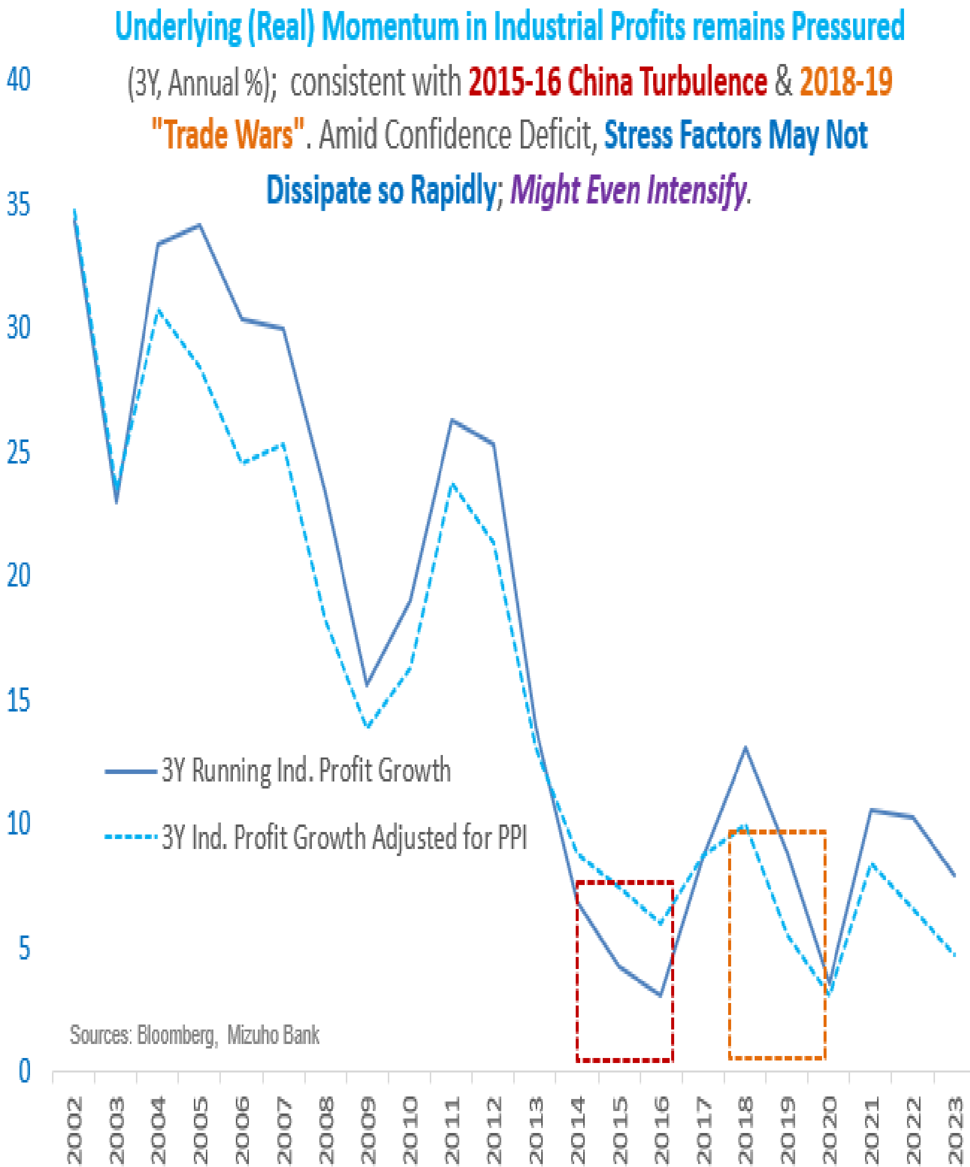

- **Stagflation-type outcomes of** elevated inflation *despite* soft demand ➔ Cost shocks hurting demand rather than softer demand taming inflation?
- **Policy dilemma inherited from pandemic-related series of high inflation amplifies hard-landing risks?**

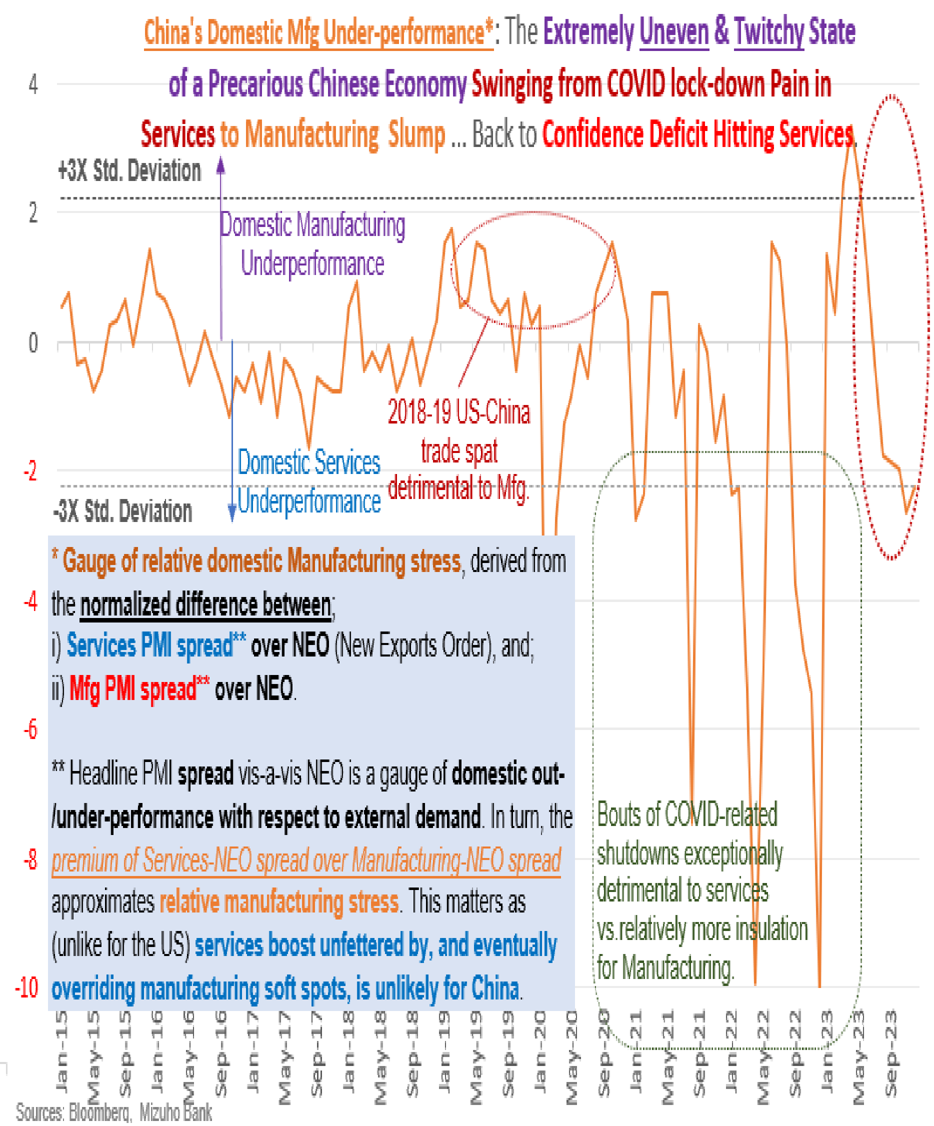


# US Elections: Bracing for Trump 2.0?



# China: Profits Pressured as *Confidence Cracks*



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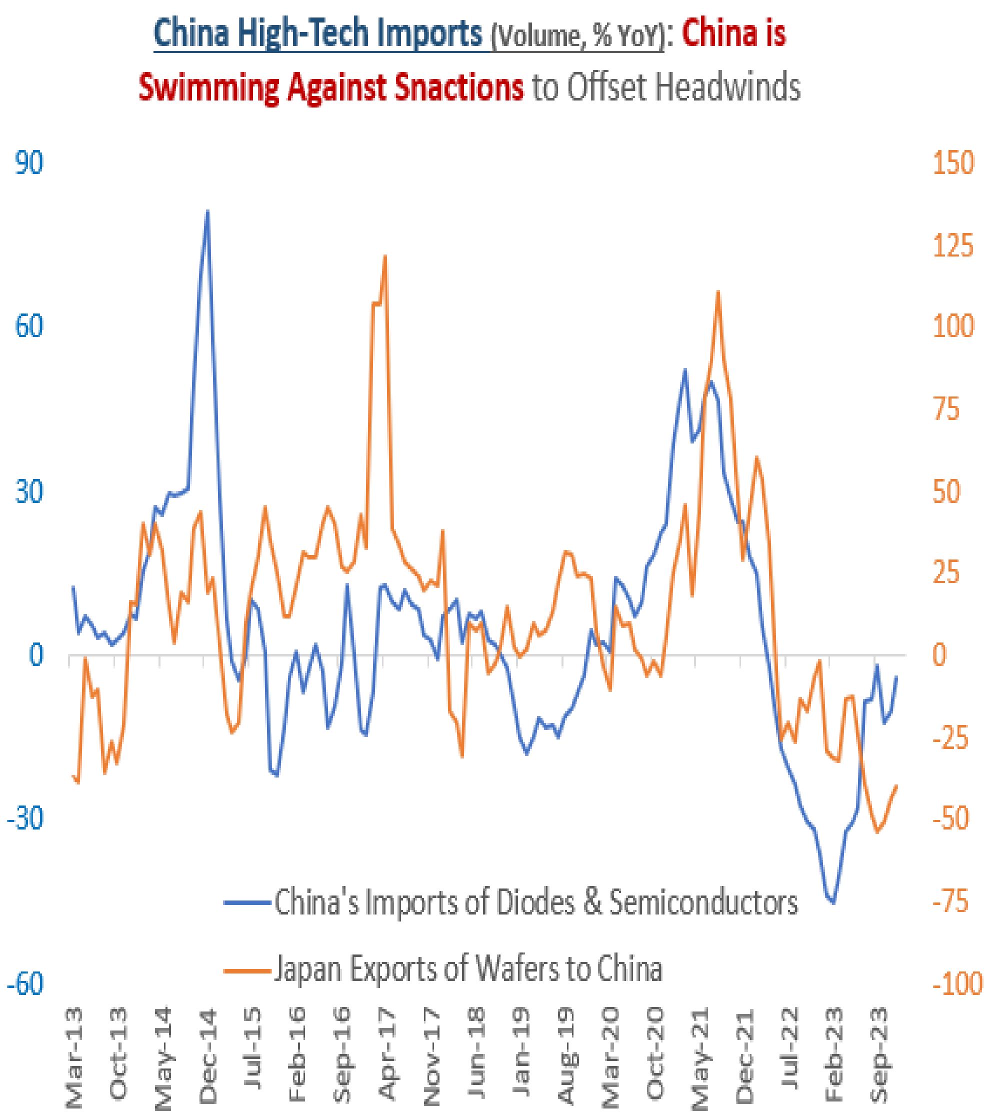
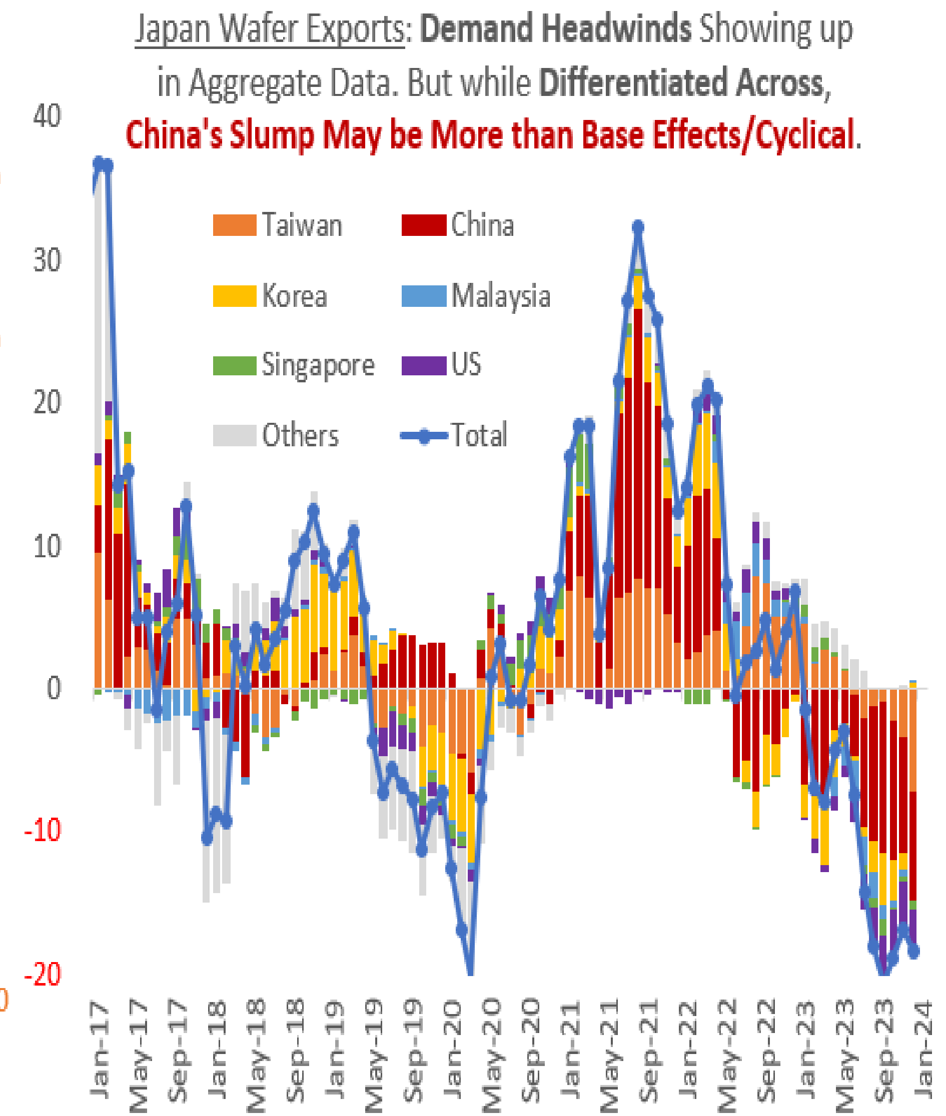
# China: *Confidence* Deficit & Geo-political *Cracks* Accentuate Fragilities




Sources: Bloomberg, Mizuho Bank

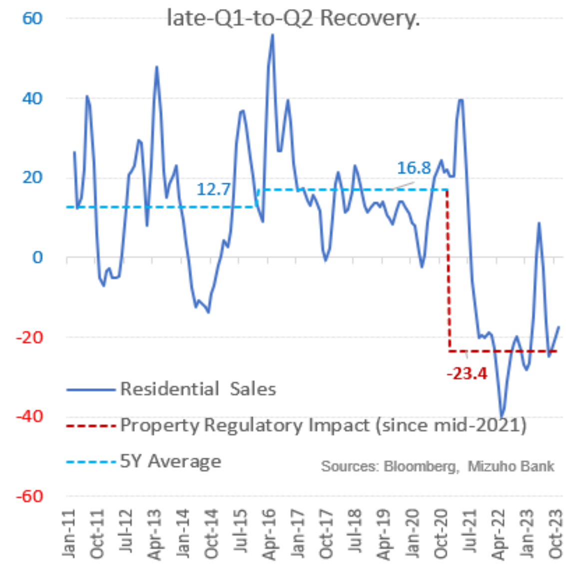



Sources: Bloomberg, Mizuho Bank

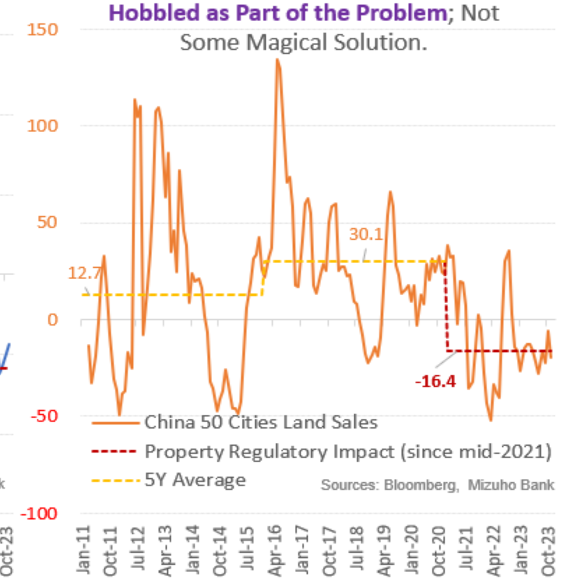
# China: Property Slump Reveals Worst *Confidence* Crisis

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

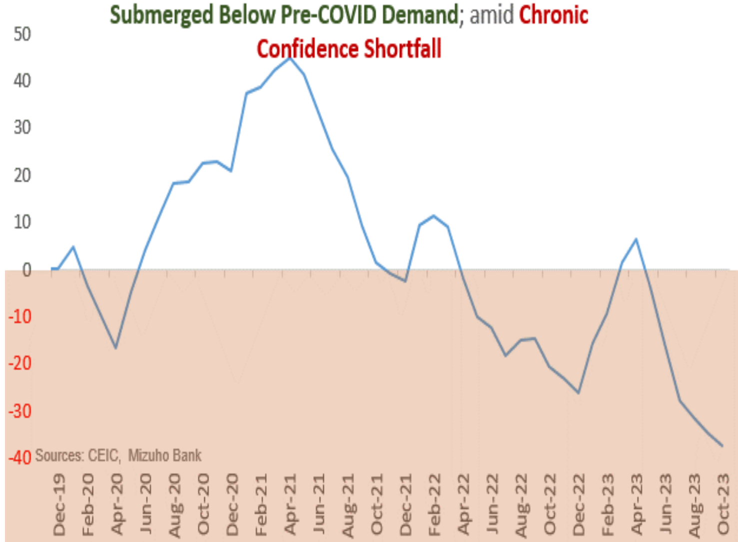

China Property Sales: Hounded by Confidence Issues. Base effects flatter late-Q1-to-Q2 Recovery.



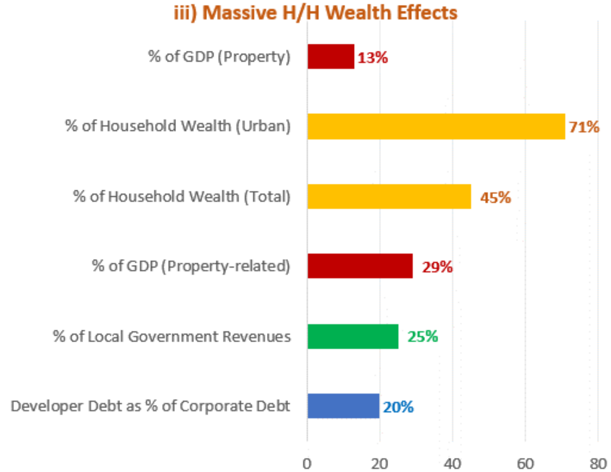

China Land Sales: Local Government Hobbled as Part of the Problem; Not Some Magical Solution.




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



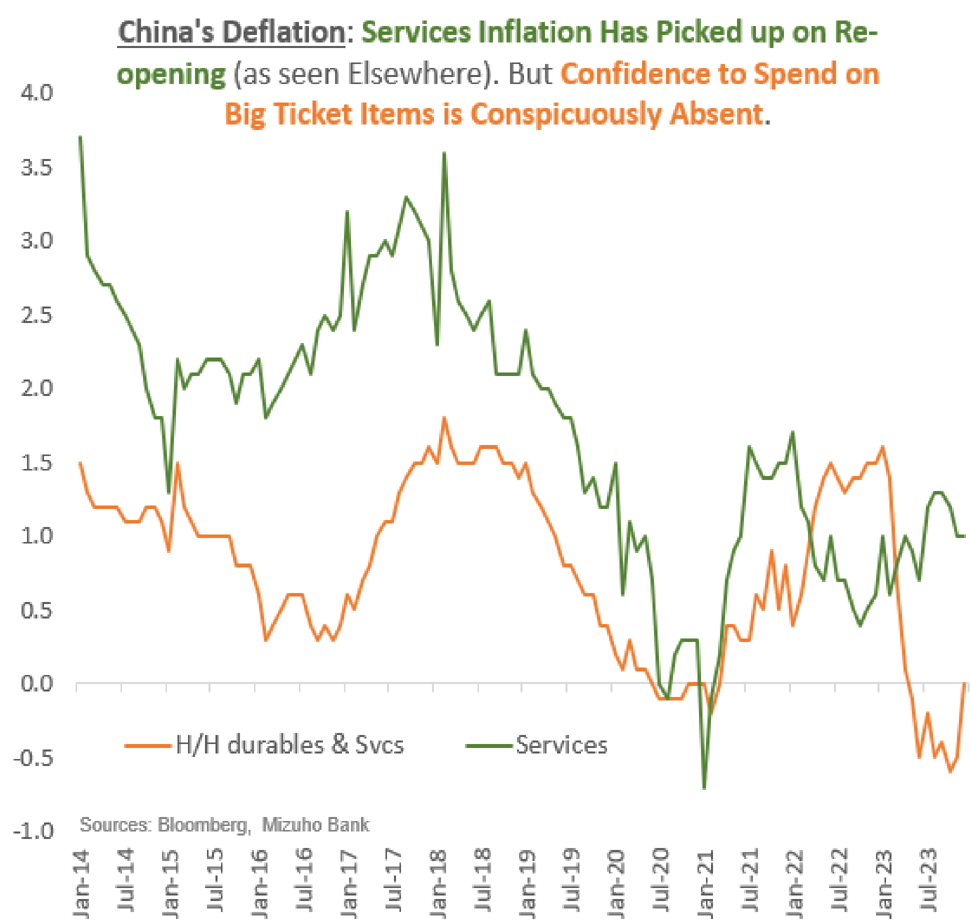

Property Sector Liabilities Will Ripple Far Given High-Multipliers via; i) related Industries/Services; ii) Significant Local Government Financing Reliance, &; iii) Massive H/H Wealth Effects




## 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.

# China: *Cracking* Deflation Details Reveal Compromised Growth Multipliers


## Binding Structural Impediments

**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*.



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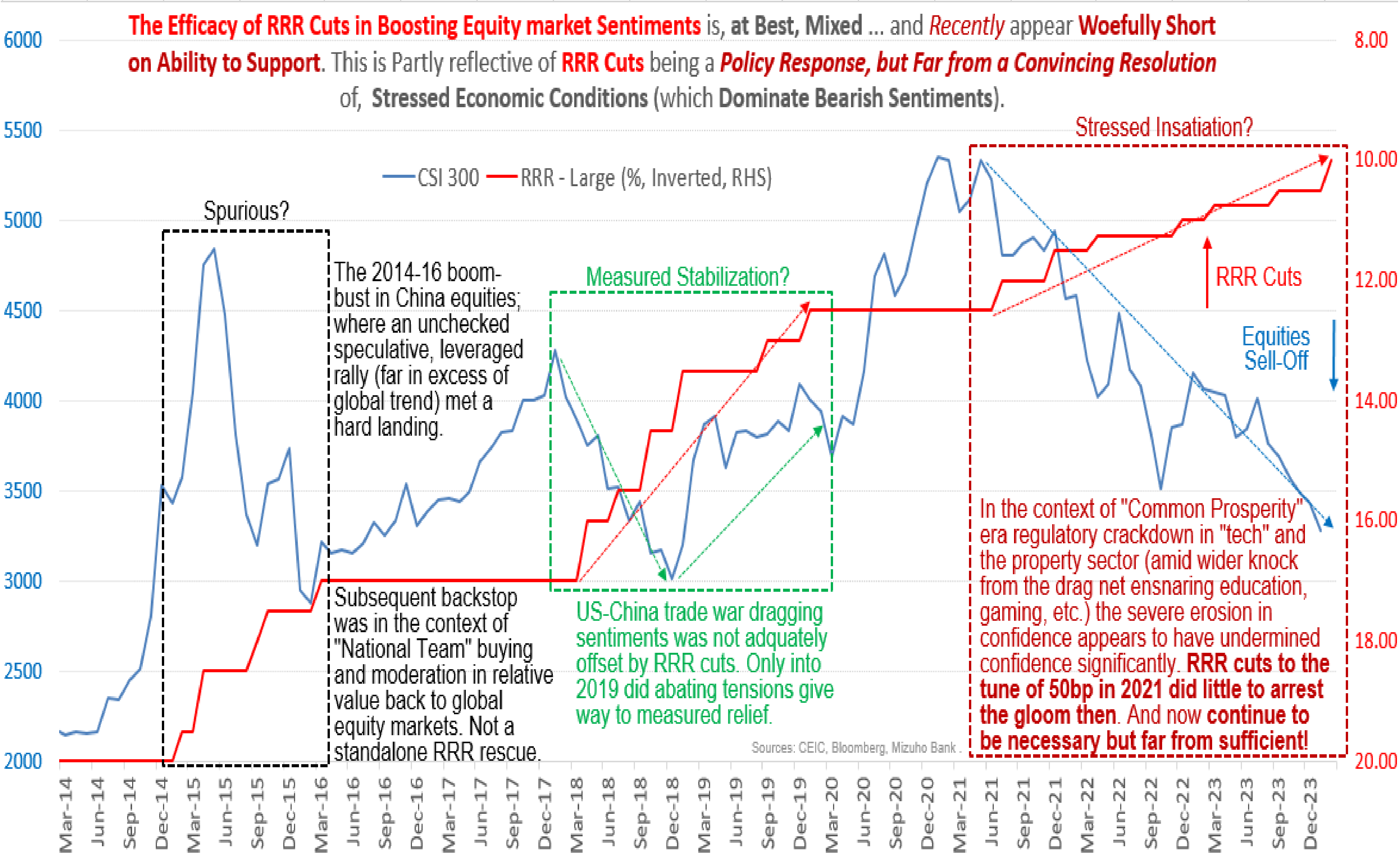
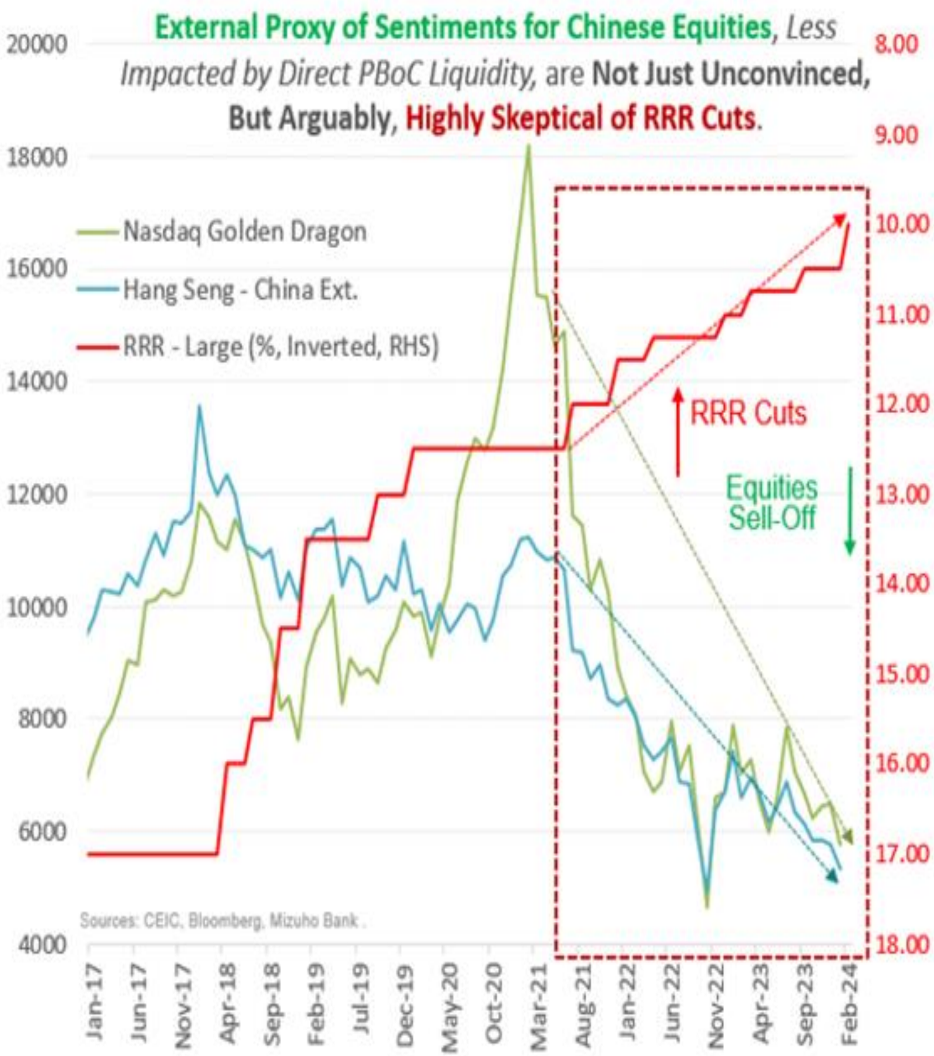
# China Equities: Worse than 2015-16?

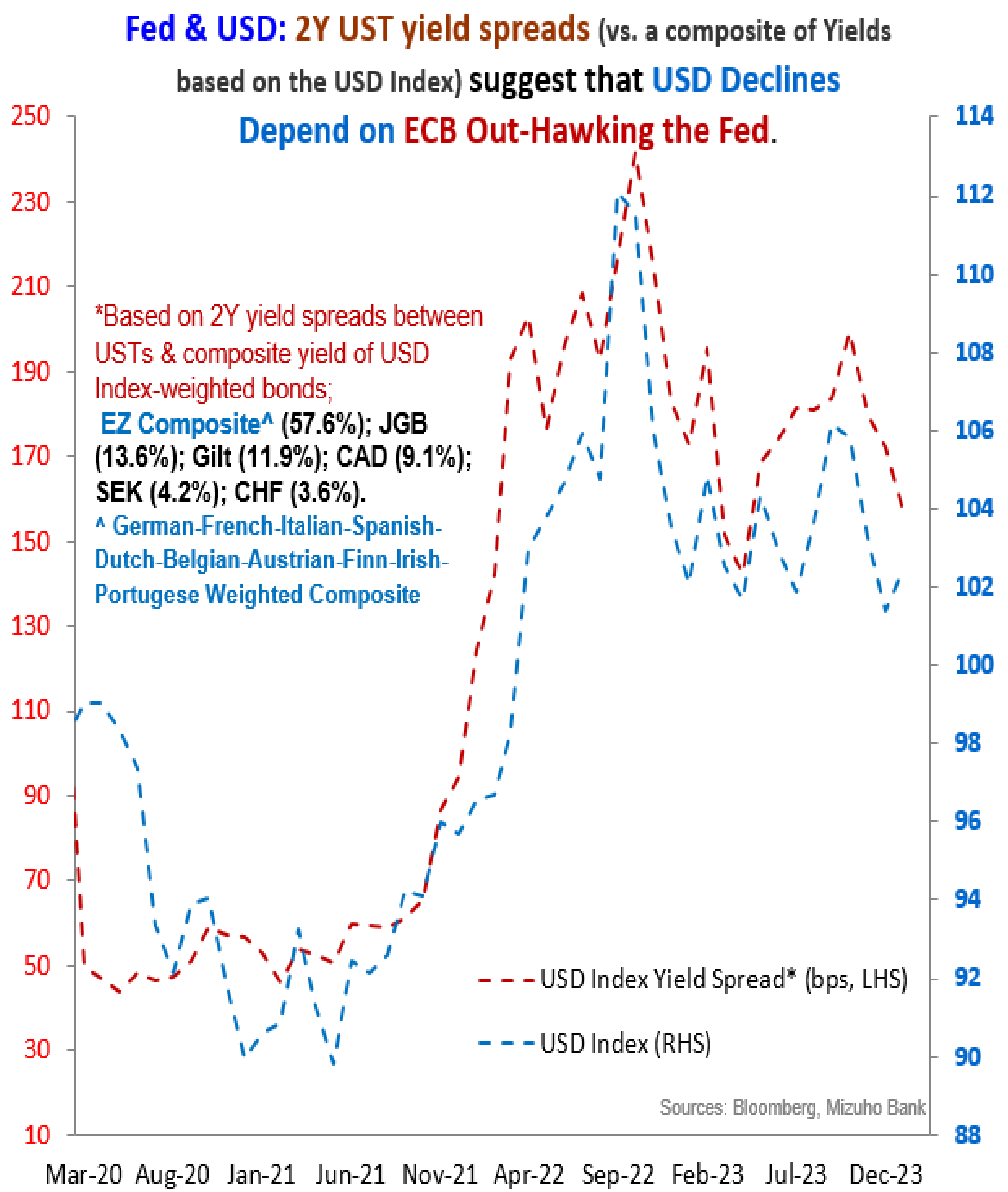

# Why RRR Cuts Alone Don't … Cut It

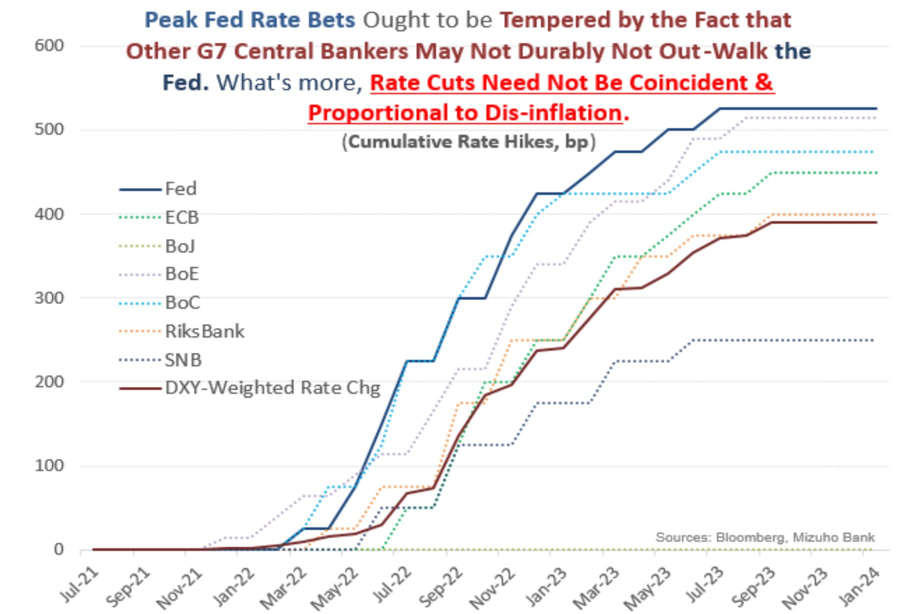


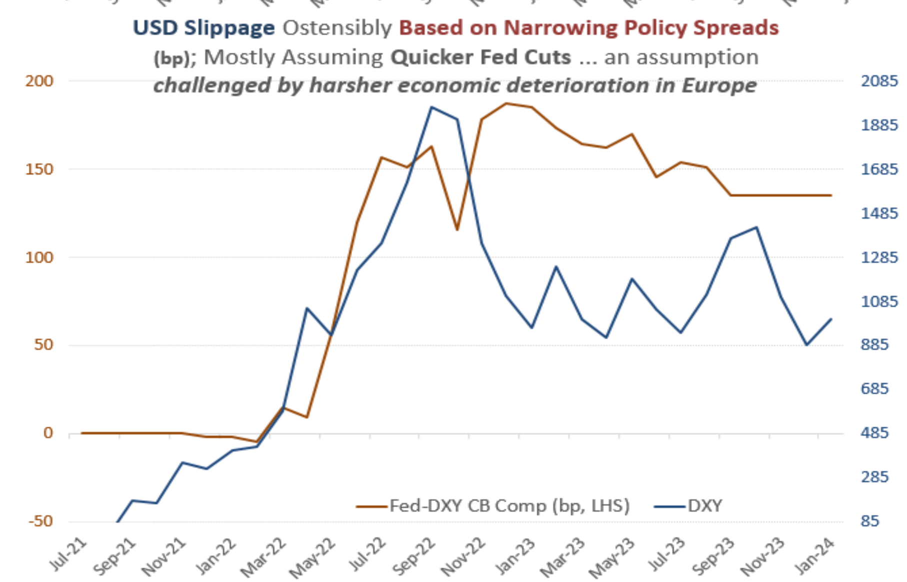
# China Travails Being Addressed, Far from Absolved




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



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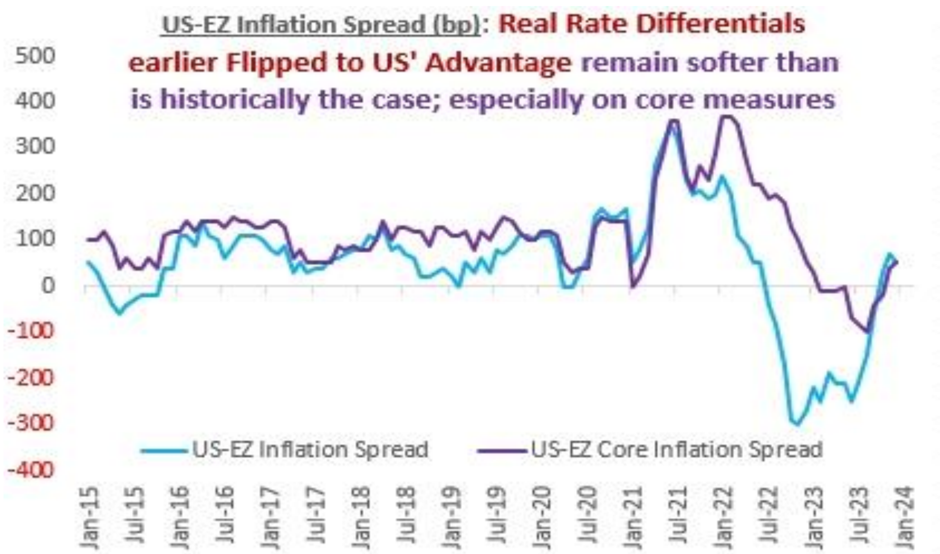
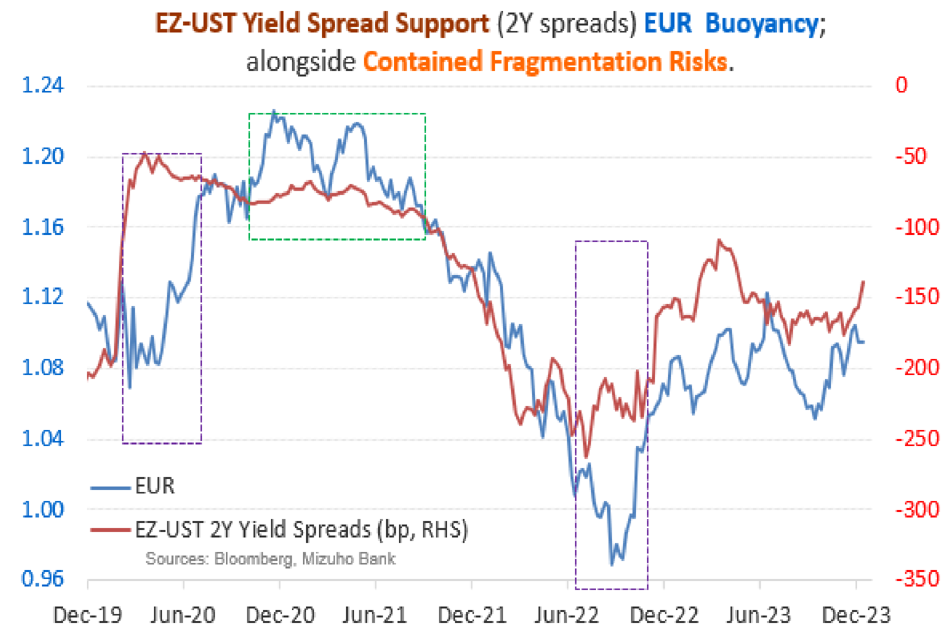
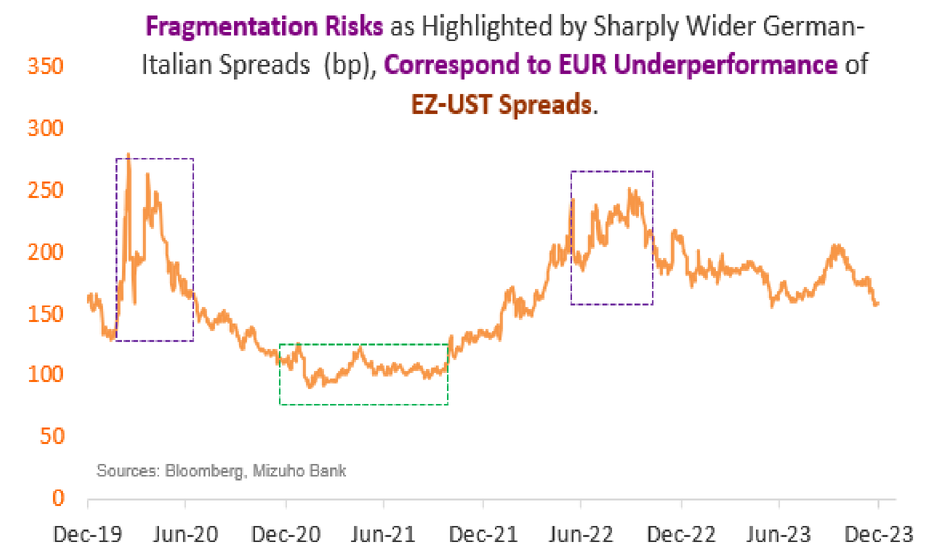
# FX: EUR - Hawkish ECB Flex May Not Persist & "Real" Challenges Remain!

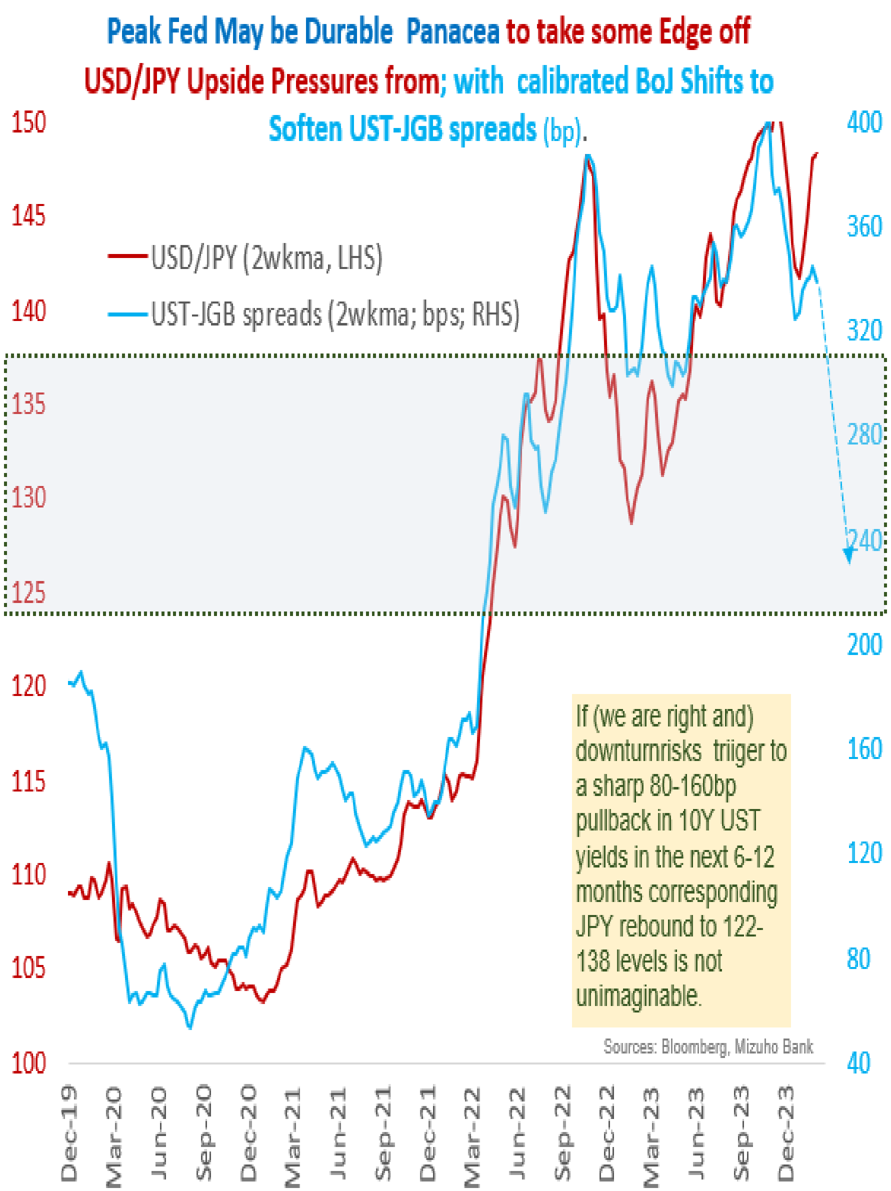


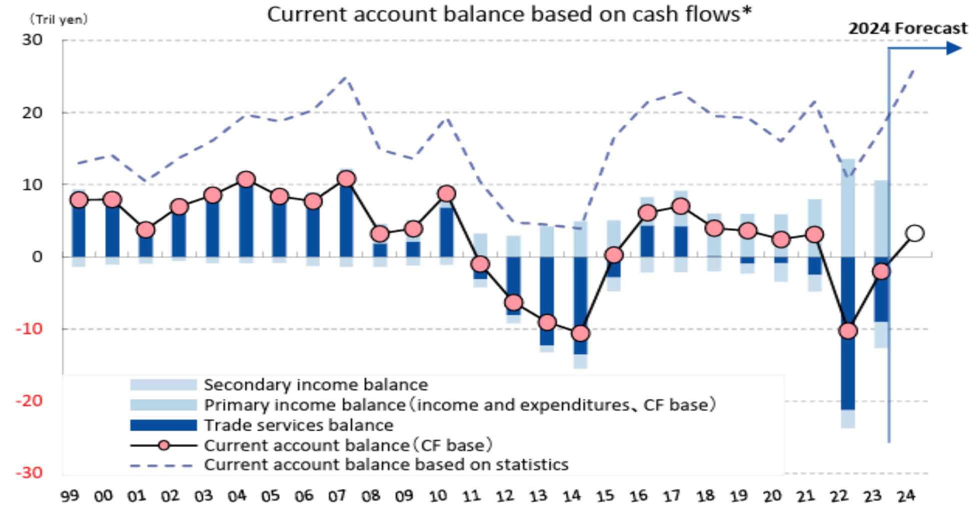







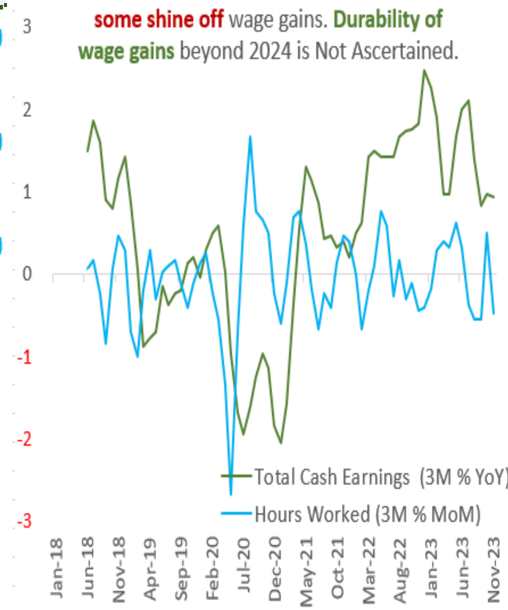
# FX: JPY - A *BoJ Problem* with a *Fed Solution* … BoJ Ought to Avoid "Over-correction" Risks



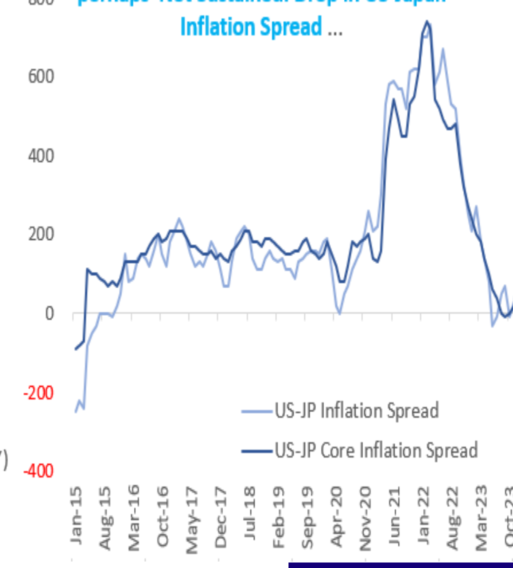




(Source) Bank of Japan (Notes) 2023: Sum from Jan to Oct
*With regard to the receipt and payment of primary income and expenditure, "reinvestment income" of direct investment income, "dividends" of securities investment income and expenditure, and "bond interest, etc." are deducted

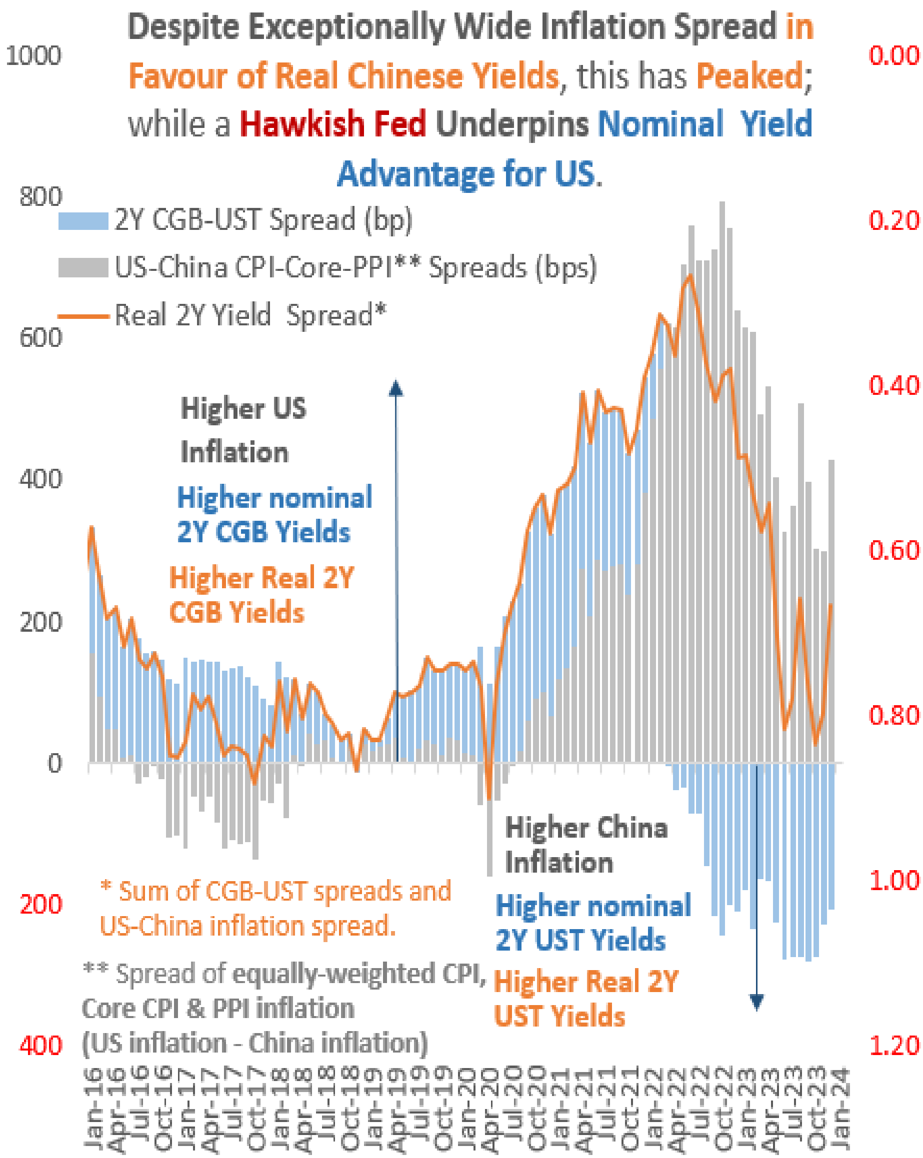
Japan Jobs: **Reduced Hours** worked **takes some shine off** wage gains. **Durability of wage gains** beyond 2024 is Not Ascertained.

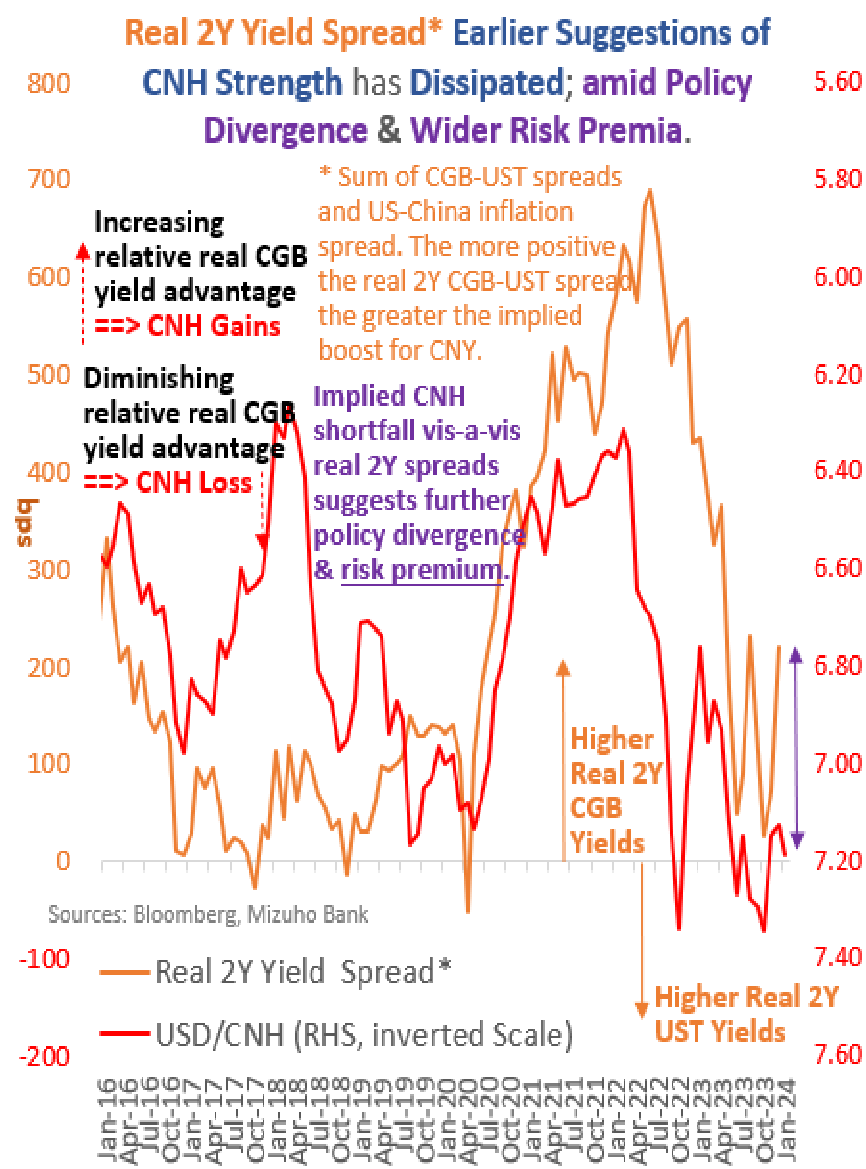



US-Japan Inflation Spread (bp): **Sharp, but perhaps Not Sustained. Drop in US-Japan Inflation Spread** …



# FX: CNH - Impacted by "Fundamental" Yield Support Eroded …



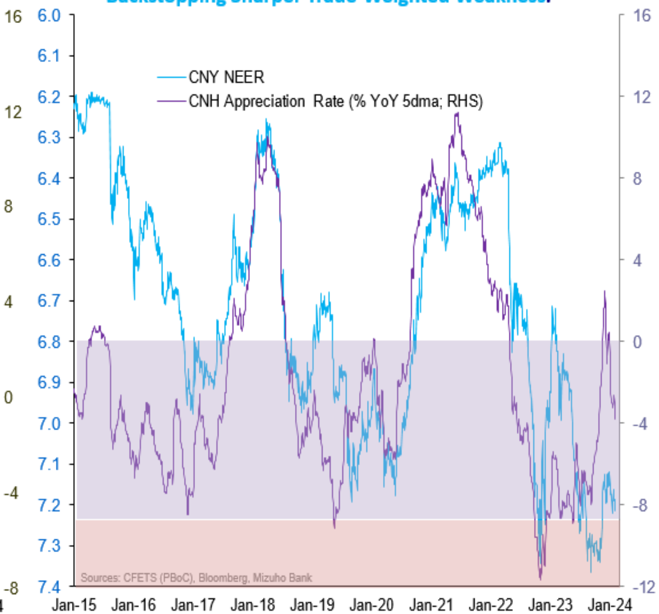



# FX: CNH - … & is Still Not Out of the Woods

Drop in CNY NEER (& Sharper collapse in CNH) reflects Macro, Re-opening & Geo-Economic Vunerabilities Accentuated via China's Financial Conduits

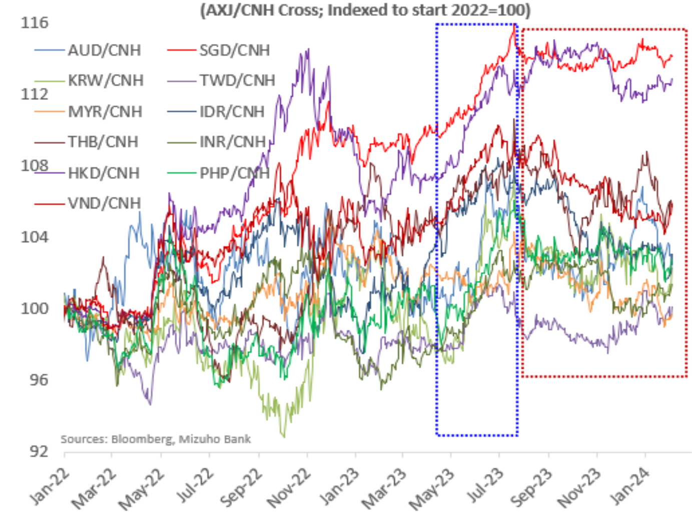

Sharp CNY NEER Depreciation Reflects Economic Disappointment , *Accentuating* Pre-existing Re-opening & Geo-Economic Drag Forces.


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

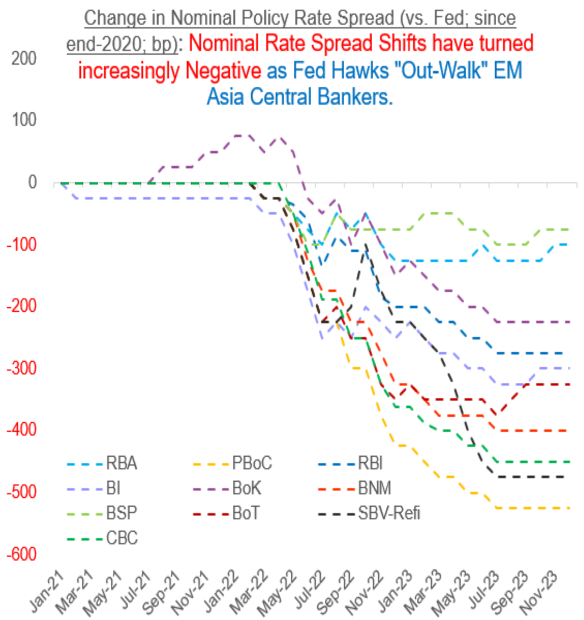


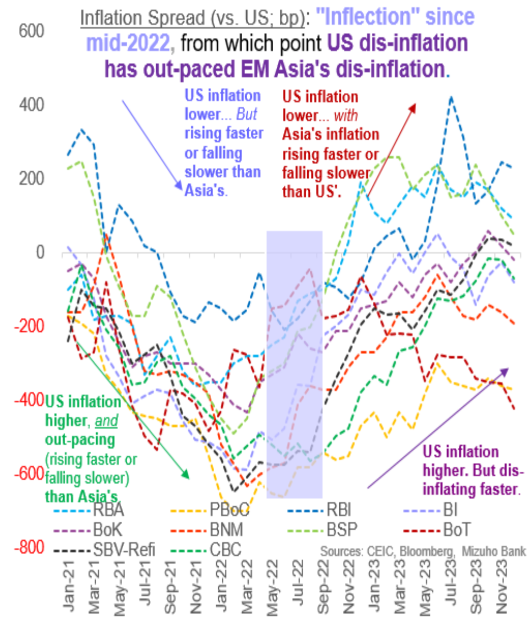

CNY NEER Traction is Undermined by Lingering US-China Risks amid "Unforced" Policy Stumbles. USD trend is instead dictating relative CNY shifts! (Index end-2014=100)

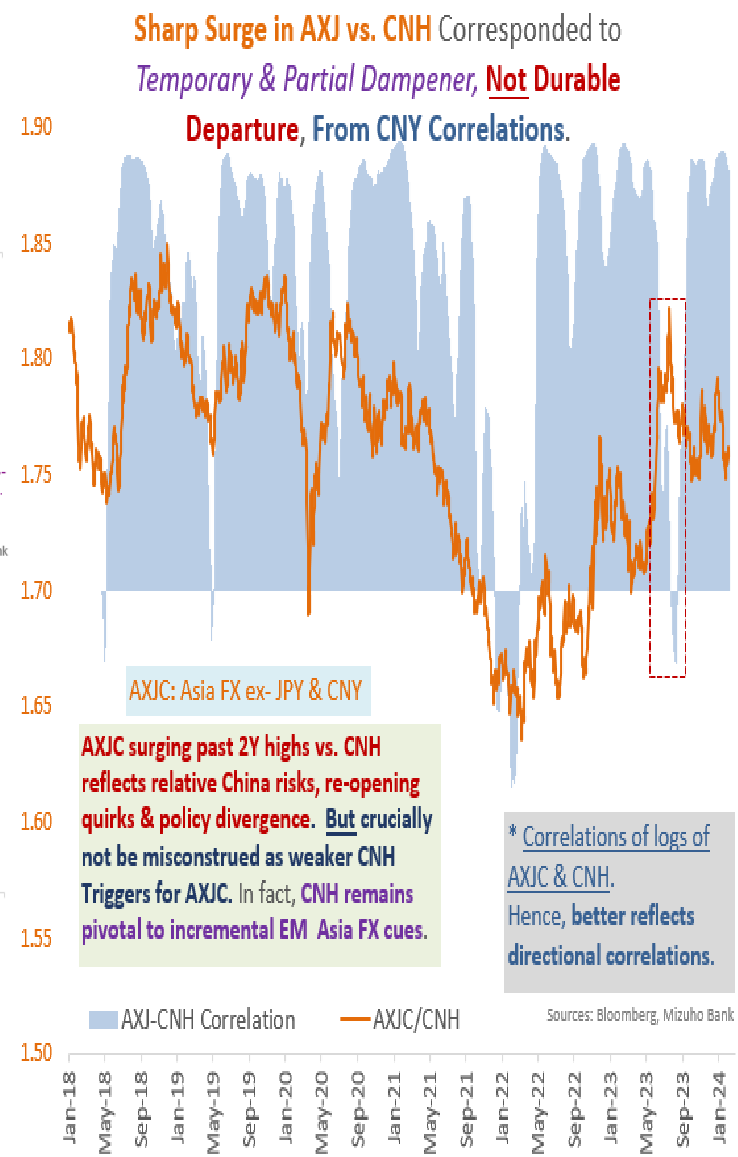

Strong out-performance of other EM Asia FX (AXJ) vs. CNH Differentiated & Dampened.
(AXJ/CNH Cross; Indexed to start 2022=100)

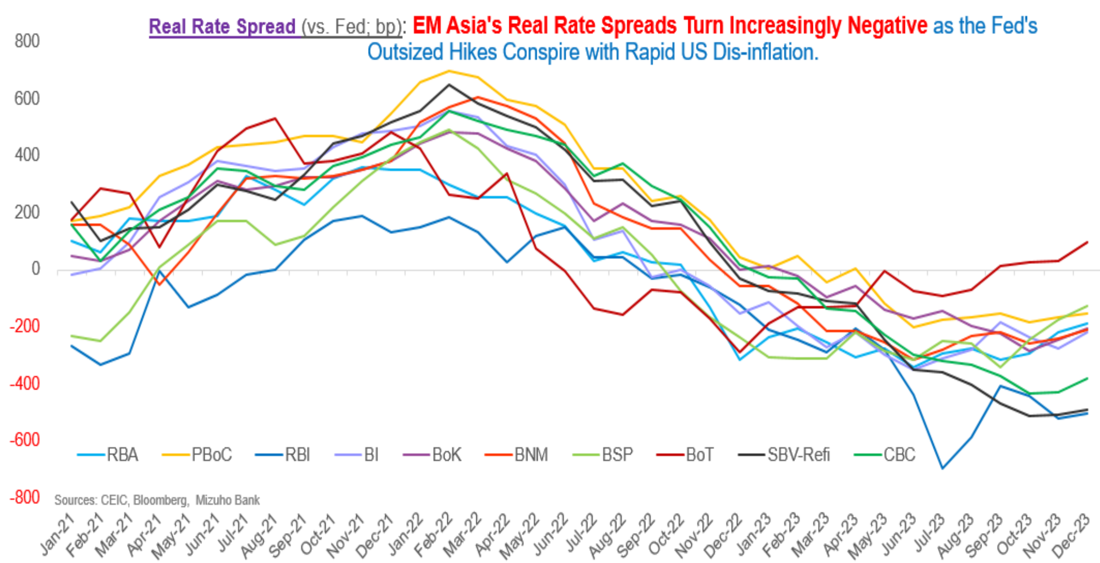


# FX: EM Asia - Relatively Higher Real US Rates Impact alongside CNH Drag



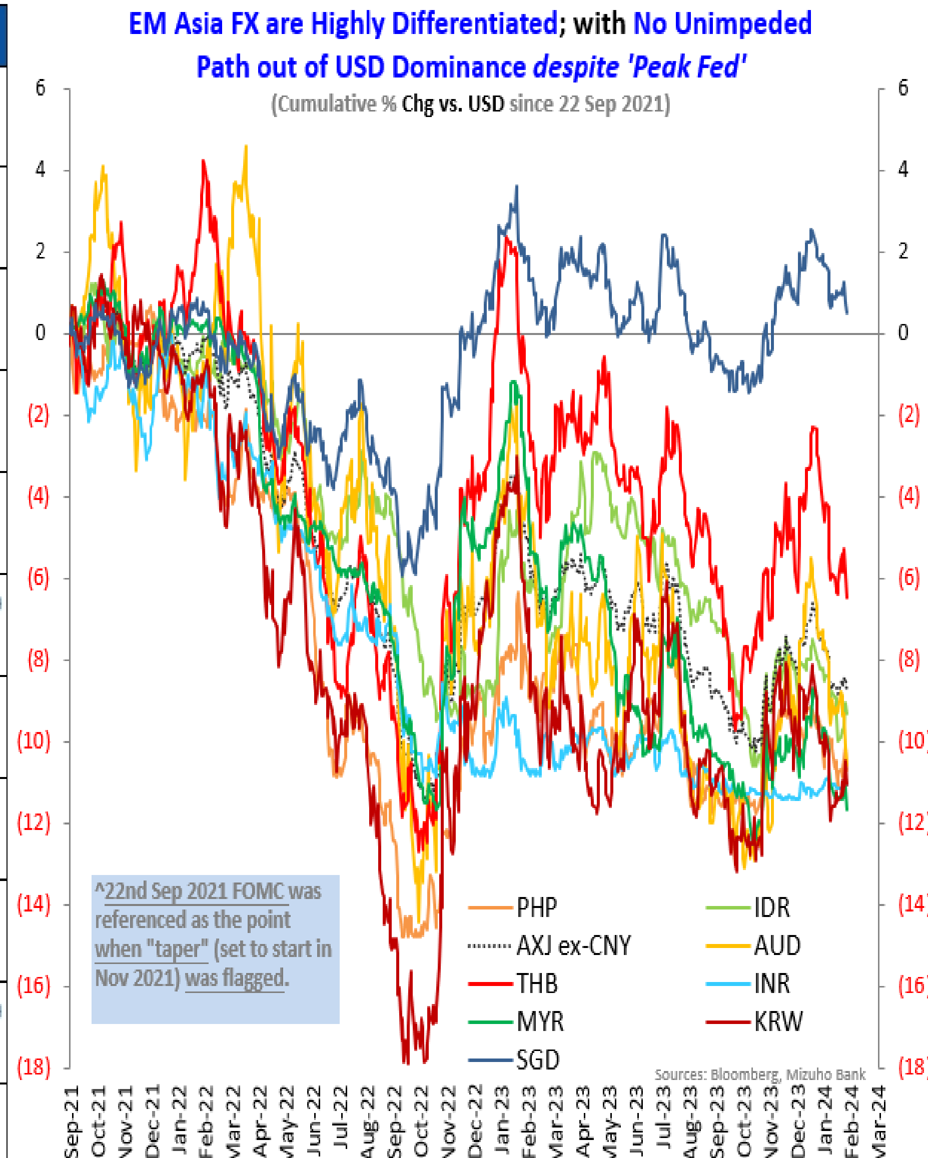



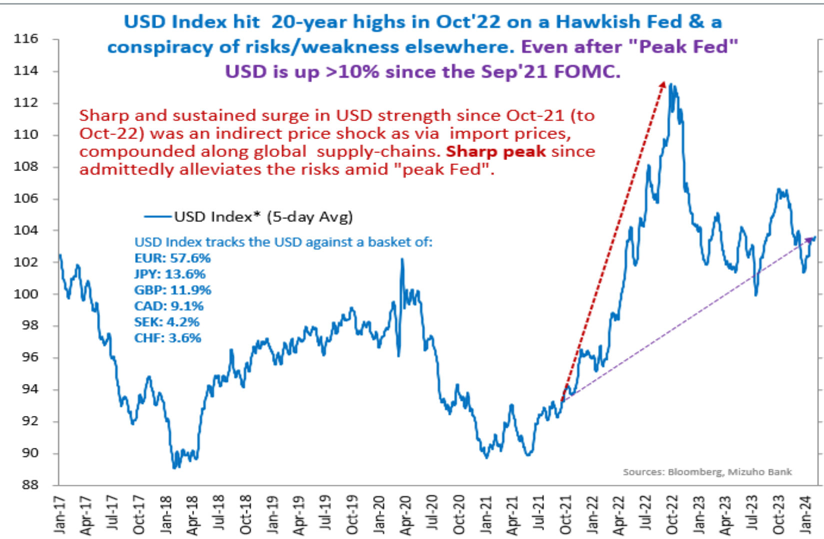



# AXJ Outlook: A Bumpy Path Out of USD Dominance

| FX Forecasts | Mar 24 | Jun 24 | Sep 24 | Dec 24 | Mar 25 | Jun 25 |
|---|---|---|---|---|---|---|
| USD/CNY | 7.04 - 7.46 (7.28) | 7.17 - 7.57 (7.42) | 6.87 - 7.50 (7.18) | 6.83 - 7.34 (7.06) | 6.76 - 7.13 (6.95) | 6.73 - 7.13 (6.95) |
| USD/INR | 81.4 - 85.8 (83.8) | 82.2 - 86.2 (84.5) | 79.2 - 86.4 (83.5) | 78.2 - 84.7 (82.0) | 78.0 - 83.6 (80.8) | 77.2 - 82.3 (79.6) |
| USD/KRW | 1230 - 1360 (1305) | 1220 - 1410 (1325) | 1180 - 1350 (1280) | 1160 - 1290 (1220) | 1150 - 1300 (1200) | 1130 - 1230 (1180) |
| USD/SGD | 1.301 - 1.358 (1.338) | 1.332 - 1.403 (1.380) | 1.310 - 1.395 (1.353) | 1.292 - 1.366 (1.328) | 1.286 - 1.345 (1.322) | 1.304 - 1.370 (1.330) |
| USD/TWD | 30.2 - 32.3 (31.6) | 31.2 - 33.8 (32.2) | 29.6 - 32.5 (31.5) | 29.1 - 31.6 (30.0) | 28.6 - 30.7 (29.5) | 28.5 - 30.6 (29.4) |
| USD/IDR | 15140 - 16250 (15500) | 15080 - 16290 (15710) | 15020 - 16160 (15520) | 15010 - 15830 (15350) | 15010 - 15810 (15200) | 14710 - 15970 (15200) |
| USD/MYR | 4.61 - 4.81 (4.67) | 4.41 - 4.72 (4.64) | 4.42 - 4.77 (4.68) | 4.42 - 4.80 (4.61) | 4.39 - 4.77 (4.58) | 4.37 - 4.72 (4.58) |
| USD/PHP | 54.3 - 57.0 (55.8) | 54.0 - 57.0 (56.2) | 53.7 - 57.0 (56.2) | 52.6 - 56.9 (55.2) | 52.7 - 56.9 (54.8) | 52.2 - 56.9 (54.8) |
| USD/THB | 34.0 - 36.5 (35.5) | 35.0 - 37.6 (36.1) | 33.8 - 36.6 (35.2) | 33.3 - 36.0 (34.2) | 33.1 - 35.4 (34.0) | 32.9 - 35.2 (33.8) |
| USD/VND | 23600 - 24700 (24300) | 24000 - 24800 (24500) | 24000 - 24600 (24100) | 23900 - 24400 (24000) | 23700 - 24300 (23900) | 23700 - 24300 (23900) |
| AUD/USD | 0.627 - 0.706 (0.663) | 0.609 - 0.673 (0.645) | 0.632 - 0.708 (0.660) | 0.643 - 0.698 (0.673) | 0.638 - 0.719 (0.685) | 0.665 - 0.725 (0.690) |



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




[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 mid-/late-2024**. *Nonetheless,* measured *softening in US data* coinciding with *conspicuous absence hawkish references to more hikes by Fed speakers* for could prompt **softening in the Greenback**. In fact, this iteration **of USD pullback that is accompanied by "risk on"** as **"pivot" bets** start seeping into the Fed calculus; especially *as a* **"Goldilocks" balance** *of diminished 'US exceptionalism' premium* baked into the USD; but without compromising soft-landing hopes!

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.

But to be clear, **two-way FX volatile will remain a feature**. This could be either on account of;

i) *Fed push-back that unwinds overdone "pivot" bets* with controlled "risk off" on straight pivot unwind, or;

ii) *"competitive pivot",* recognizing the odds of ECB/BoE (and other Major central bank) catch down with Fed pivot; which results in USD pick-up (at the expense or EUR or other Majors).

In essence this recognizes the tensions between aggressive USD shorts and relative US exceptionalism. But that said, the wider Fed pivot relief could lend some traction for EM Asia FX in 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. This marks the **critical distinction between**;

i) **Fed pivot amid a soft-landing** *engineered by "immaculate dis-inflation"* that **spurs "risk on"** and;

ii) **Un-Goldilocks** outcome of sharp(er) **rate cuts because of mounting hard-landing risks**; in which case, **"risk off"** is triggered, and *USD-UST yield correlations flip to negative.*

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 the 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, which 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.

# Growth Outlook:

Growth:

As 2024 begins in earnest, **'soft landing' hopes remain high**. Especially as markets converge *on* the view of *peak rates transitioning to rate cuts* fairly quickly, *fuelled by an ardent belief of "immaculate dis-inflation"*. That this is **in defiance of central banks/Fed pushing back** on the *timing* and *depth* of cuts to be expected is one thing. **But trouble is, completely averting a global downturn**, constituting a not-so-soft landing, looks like **a rather high bar**.

Point being, **global growth remains liable for a bumpy ride and air-pockets** given a conspiracy of;

i) lagged policy tightening (and a post-Volcker record at that!);
ii) moderation in post-pandemic services consumption surge as excess savings are depleted;
iii) lingering geo-political risks and;
iv) higher risks of "crowding out" (amid government spending, including military);

Moreover, **global economic prospects are highly uneven** – *both across sectors and geographies.* For one, the macro narrative of **US exceptionalism** *seemingly unfettered by policy tightening* is **in sharp contrast to China's precarious policy backstop**; as Beijing's **belated stimulus**, *hobbled by conflicted objectives,* **falls short of restoring confidence** (that is in woefully short supply). Meanwhile **US Presidential elections may amplify rather than supplant geo-political** (US-China as well as Russia/Gaza conflict) **risks**.

In Europe and UK, **remnant hawkish flex** is **at odds with recessionary risks** amplified by geo-political vulnerabilities. And that spells accentuated odds of global policy mistake a priori and heightened volatility from uncertainty and/or "competitive pivot" ex-post (on catch down rate cuts). Across global commerce, the **AI-boost provides a stronger basis of semiconductor rebound**, that may lift manufacturing generally. ***But*** this is **from a very low base**. And **in narrow terms** that is **unlikely to overturn headwinds elsewhere**.

The upshot is that Fed-led global central bankers' ***abilities to achieve a "soft landing" are overstated*** as exceptionally **lagged impact from credit tightening underappreciated**; especially as **fizzling post-pandemic consumer boost may be under-accounted for**. Meanwhile **geo-political** and **fiscal risks loom large** in a world grappling with the dangers of fragmentation that necessarily loses gains from comparative advantages.

# Inflation Outlook:

Inflation:

The **silver lining** is that **dis-inflation** dynamics, *if sustained,* appear to be **on track to reach global central bank targets, and/or within comfort threshold in the next 12-18 months**. Crucially, and **exceptionally high peak inflation well behind** us; with headline peaking in 2022 and the sticky core relenting in 2023.

But the danger is that it goes relatively unnoticed that the **outlook on inflation risks is obscured**; with visibility far lower than backward-looking inflation trajectory would suggest. Point being, *neither* the risk of *volatile inflation dynamics, with potential for '70s-style resurgence, nor much sharper than expected dis-inflation* may be confidently ruled out. And being lulled into premature comfort about dis-inflation that amplifies susceptibility **to pitfalls of central bank policy being caught lamentably wrong-footed**.

The key points to note are that **cyclically, two-way inflation risks are accentuated**. On one hand, in the very near-term, *sudden geo-political flares* could unleash *convulsions of cost shocks* via **energy prices/shipping costs**. Especially if a wider spill-over from Gaza to Iran/Lebanon/Red Sea/Straits of Hormuz collide with other aspects of supply side shocks – including **food**. Yet on the other, heading further out into 2024, *adverse demand shocks* from sudden, lagged downturn may set off *dis-inflationary, if not deflationary price forces*.

Interestingly, consequent **inflation risks have the propensity to play out unevenly** across economies. US notably being better buffered against energy shocks given its record crude output, while Europe bears the brunt. **EM Asia's inflation also rendered stickier and more volatile** given generally higher energy and food imports/exposures amid follow-through tourism-induced services inflation pick-up. In addition, **inflation risks/outcomes within EM Asia** are also set to be **far more differentiated**; given as currency impact amid "twin deficit" risks and capacity for fiscal buffer vary considerably across Asian economies.

Insofar that this volatile and variable inflation risk has implications on abrupt shifts in real spreads and associated capital outflow/currency stability risks that feedback into imported inflation, this means that there is a certain **risk premium associated with second-guessing and/or leap-frogging the Fed on rate cuts**.

Looking ahead, **geo-political risks add a structural element of inflation** from *supply-chain fragmentation* (if not fracture), over and above security costs entailing *inefficiencies from hoarding* strategic stockpiles as well as circumventing sanctions/restrictions. And so, beyond near-term dis-inflation, the **more durable question is about underlying inflation trends** and **sustainable/viable central bank inflation targets**.

# Appendix: Fed & Yield Outlook – *Growth Risks Rather than Dis-inflation to Drive Deeper Cuts*

| | End-2021 | End-2022 | 2023 | | | | 2024 | | | | 2025 | | | | 2026 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Q1 23 | Q2 23 | Q3 23 | Q4 23 | Q1 24 | Q2 24 | Q3 24 | Q4 24 | Q1 25 | Q2 25 | Q3 25 | Q4 25 | H1 26 | H2 26 |
| Fed Funds Target Rate Ceiling | 0.25 | 4.50 | 5.00 | 5.25 | 5.50 | 5.50 | 5.25 | 4.50 | 3.75 | 3.25 | 3.25 | 3.00 | 2.75 | 2.75 | 2.50 | 2.50 |
| Fed Funds Target Rate floor | 0.00 | 4.25 | 4.75 | 5.00 | 5.25 | 5.25 | 5.00 | 4.25 | 3.50 | 3.00 | 3.00 | 2.75 | 2.50 | 2.50 | 2.25 | 2.25 |
| UST 2Y Yields | 0.73 | 4.43 | 4.03 | 4.90 | 5.04 | 4.25 | 4.16 | 3.29 | 2.97 | 2.66 | 2.60 | 2.69 | 2.80 | 2.53 | 2.50 | 2.30 |
| UST 10Y Yields | 1.51 | 3.87 | 3.47 | 3.84 | 4.57 | 3.88 | 4.02 | 3.62 | 3.32 | 3.08 | 3.12 | 3.35 | 3.42 | 3.28 | 3.33 | 3.18 |

Sources: Bloomberg, Mizuho Forecasts

**Growth Impact, Not "Immaculate Dis-inflation":**

- Fed cuts more aggressively as growth shocks overtake dis-inflation
- Most of the cuts are likely to be concentrated mid-/Q3-2024
- Admittedly Presidential elections risks obscure
- But in any case, the drop in 2Y rates will speed up sharply late-Q1/early-Q2 2024
- This will reverse the "inversion" more durably.
- In fact, in 2025 heading into 2026, there could be a more emphatic pick-up in (10Y-2Y) term premium.
- This is likely to be based on structurally higher inflation, once growth risks are checked
- Compounded further by worries of more bloated UST issuances at the longer end from widening fiscal deficit.



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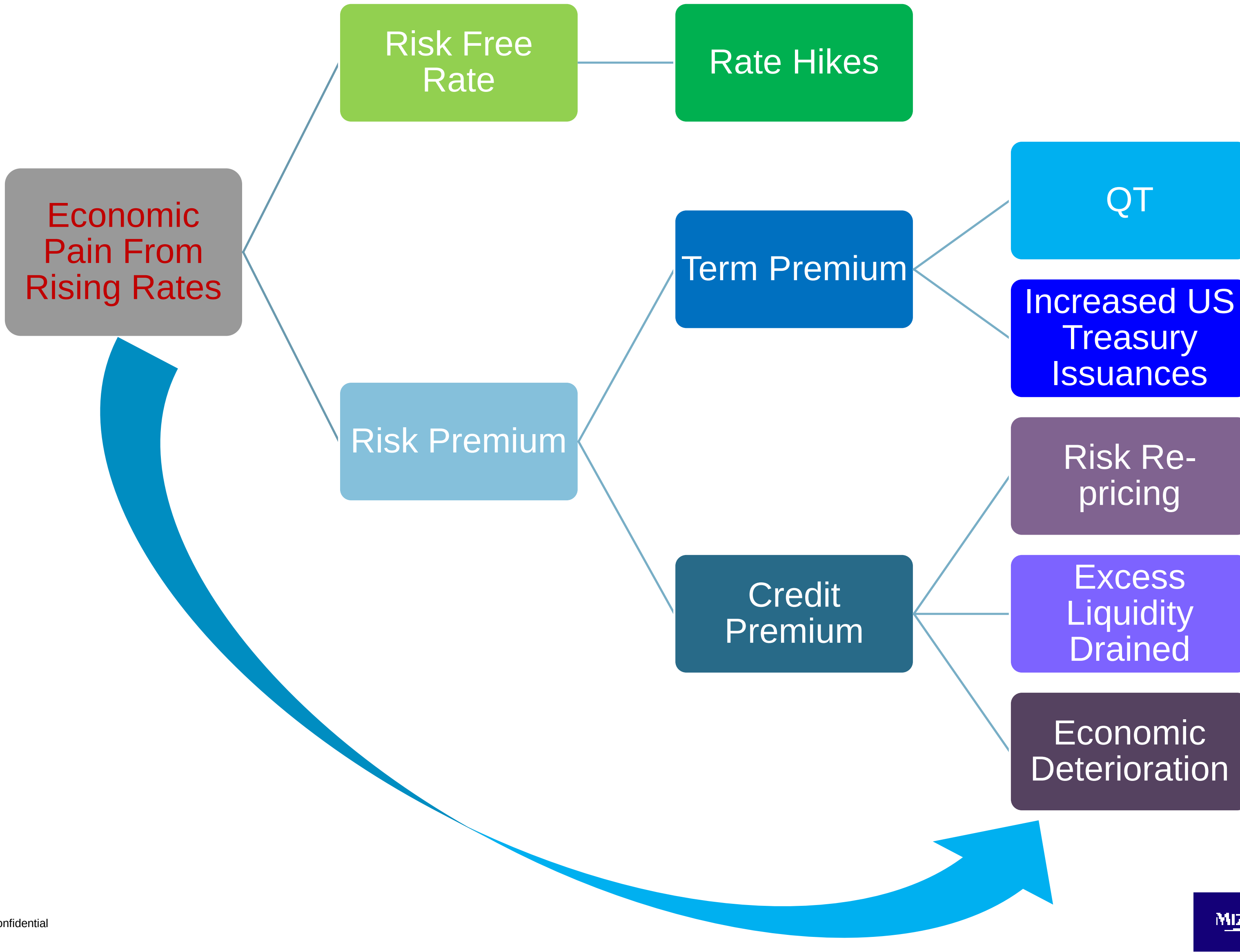
# Appendix: Visualizing Pain from  Higher Rates



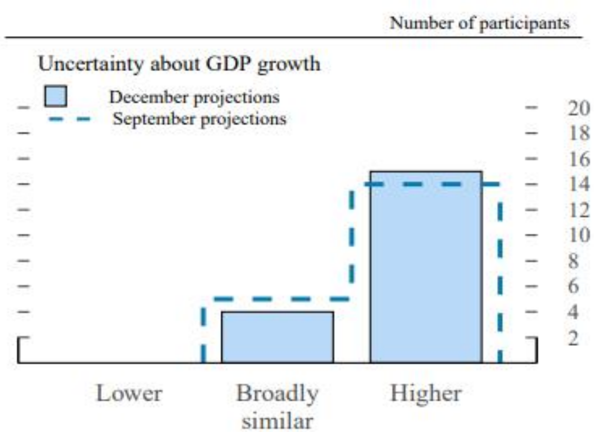
# Appendix: SEP for December FOMC

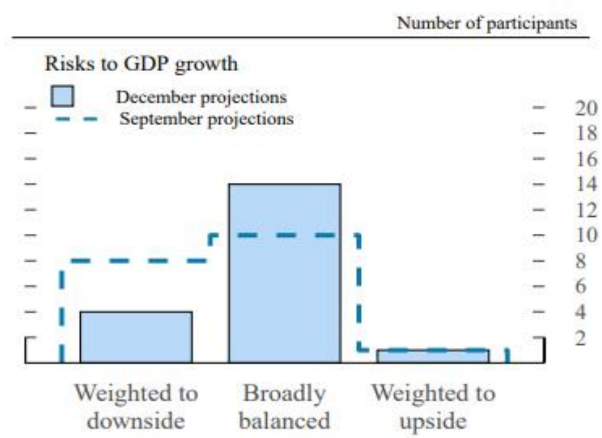
**Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, December 2023**

Percent

| Variable | Median[1] | | | | | Central Tendency[2] | | | | | Range[3] | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2023 | 2024 | 2025 | 2026 | Longer run | 2023 | 2024 | 2025 | 2026 | Longer run | 2023 | 2024 | 2025 | 2026 | Longer run |
| Change in real GDP | 2.6 | 1.4 | 1.8 | 1.9 | 1.8 | 2.5–2.7 | 1.2–1.7 | 1.5–2.0 | 1.8–2.0 | 1.7–2.0 | 2.5–2.7 | 0.8–2.5 | 1.4–2.5 | 1.6–2.5 | 1.6–2.5 |
| September projection | 2.1 | 1.5 | 1.8 | 1.8 | 1.8 | 1.9–2.2 | 1.2–1.8 | 1.6–2.0 | 1.7–2.0 | 1.7–2.0 | 1.8–2.6 | 0.4–2.5 | 1.4–2.5 | 1.6–2.5 | 1.6–2.5 |
| Unemployment rate | 3.8 | 4.1 | 4.1 | 4.1 | 4.1 | 3.8 | 4.0–4.2 | 4.0–4.2 | 3.9–4.3 | 3.8–4.3 | 3.7–4.0 | 3.9–4.5 | 3.8–4.7 | 3.8–4.7 | 3.5–4.3 |
| September projection | 3.8 | 4.1 | 4.1 | 4.0 | 4.0 | 3.7–3.9 | 3.9–4.4 | 3.9–4.3 | 3.8–4.3 | 3.8–4.3 | 3.7–4.0 | 3.7–4.5 | 3.7–4.7 | 3.7–4.5 | 3.5–4.3 |
| PCE inflation | 2.8 | 2.4 | 2.1 | 2.0 | 2.0 | 2.7–2.9 | 2.2–2.5 | 2.0–2.2 | 2.0 | 2.0 | 2.7–3.2 | 2.1–2.7 | 2.0–2.5 | 2.0–2.3 | 2.0 |
| September projection | 3.3 | 2.5 | 2.2 | 2.0 | 2.0 | 3.2–3.4 | 2.3–2.7 | 2.0–2.3 | 2.0–2.2 | 2.0 | 3.1–3.8 | 2.1–3.5 | 2.0–2.9 | 2.0–2.7 | 2.0 |
| Core PCE inflation[4] | 3.2 | 2.4 | 2.2 | 2.0 | | 3.2–3.3 | 2.4–2.7 | 2.0–2.2 | 2.0–2.1 | | 3.2–3.7 | 2.3–3.0 | 2.0–2.6 | 2.0–2.3 | |
| September projection | 3.7 | 2.6 | 2.3 | 2.0 | | 3.6–3.9 | 2.5–2.8 | 2.0–2.4 | 2.0–2.3 | | 3.5–4.2 | 2.3–3.6 | 2.0–3.0 | 2.0–2.9 | |
| Memo: Projected appropriate policy path | | | | | | | | | | | | | | | |
| Federal funds rate | 5.4 | 4.6 | 3.6 | 2.9 | 2.5 | 5.4 | 4.4–4.9 | 3.1–3.9 | 2.5–3.1 | 2.5–3.0 | 5.4 | 3.9–5.4 | 2.4–5.4 | 2.4–4.9 | 2.4–3.8 |
| September projection | 5.6 | 5.1 | 3.9 | 2.9 | 2.5 | 5.4–5.6 | 4.6–5.4 | 3.4–4.9 | 2.5–4.1 | 2.5–3.3 | 5.4–5.6 | 4.4–6.1 | 2.6–5.6 | 2.4–4.9 | 2.4–3.8 |

FOMC participants' assessments of uncertainty and risks around their economic projections



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