Mizuho Macro Themes

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Economics & Macro Strategy | Asia ex-Japan

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Changing Minds?

"When the facts change, I change my mind - what do you do, sir?" - **John Maynard Keynes**

- **From *subtle to seismic, change is rippling*** across *US elections, FOMC/Fed thinking* amid emerging signs of soft spots, *BoJ-JPY dynamics* evolving with JPY squeeze, *China risks* heading into the Politburo and unbridled *AI euphoria* that has ostensibly hit speed bumps, if not a wall.

- **How markets evolve** from here **depends on whether this** is ***merely a blip caused by a pause for breath*** or a **durable change of minds** that *undermines assumptions, challenges the status quo, decouples correlations, upends trends* and *upping volatility.*

- **Bracing for volatility** appears to be the bare minimum ahead of; i) ***FOMC***, where a change in rhetoric) will be key in the absence of rate action and 'Dot Plot'; ii) ***BoJ*** where the bar for meeting hawkish expectations is a tad too high, and; iii) the ***Politburo meet in China***, where hopes for emphatic stimulus is almost surely likely to be disappointed in the details.

- Against this backdrop, **risk appetite** may be **appreciably more restrained**.

- And so, **despite the rebound in US equities** end of last week, **concerns about stretched valuations** led by *effusive AI exuberance,* are **justifiably not entirely negated**. Which is to say, last week's *AI stocks sell-off may continue to cast a shadow.*

US Election: The 'Kamala Effect'

- **Kamala Harris** displacing Biden as the Democrat Presidential candidate has **prompted** quite the **change in US elections calculus**.

- To be sure, **Trump is still leading polls** and is widely viewed as the favourite to win, which ***keeps Trump 2.0 bets mostly intact***.

- ***But*** the pace at which **Kamala Harris** has closed the gap **warrants attention**. Not the least because polls have proven to be unreliable in the past. But crucially because, ***previously untapped voting momentum appears to have been kindled***.

- This has, **unsettled received wisdom about Trump 2.0 bets.** ***But alternative "Kamala hedge" is not so clear-cut.***

- USD is not relegated **as macro/geo-political triggers won't flip** completely. For one, the **Fed is still the main game**. That said, volatility from Ukraine risks and global trade uncertainties

(outside of China) may be more subdued.

- Underlying impetus for UST yield curve steepening ***on fiscal/debt woes is unlikely to be materially assuaged*** (much less reversed) y a Democrat victory. *Albeit* with **softer yields into H1 2025**, which is **underpinned by** the **sheer reversal from Fed pivot** (that remains intact).

- Risk assets may have mixed performance on the **"Kamala hedge"**. At first blush, the *energy sector appears compromised.* Notably, ***Bitcoin's "Trump boost" is liable for more emphatic unwind*** if "Trump 2.0" is not realized.

- Not because Harris, is expressly opposed to the Bitcoin ecosystem per se, but simply because she is not as fervent as Trump in endowing crypto/mining with unequivocal advantage.

'AI' Exuberance: Reset, Rotate or Retrench

- Adding to the haze is an *abrupt change in attitudes,* that has prompted a **capitulation of AI mania** on the **purported expectations gap between hype** (priced to perfection) **and realizable gains**.

- The jury is out on whether this is ***merely a reset*** **from earlier unabated gains in the "Magnificent-7"** *that may fire up another bullish leg,* or more durable **rotation** for *value catch-up* (**benefitting smaller caps** that gave lagged), or a warning shot about sustained **risk retrenchment** that *inflicts broad-based liquidation,* with **potential for wider "risk off"**.

- **Alarm** at this point is admittedly **unwarranted** overreaction. ***But*** equally, **unfettered extension of "risk on" trades** are likely to be **impeded**. Especially *if "Goldilocks" assumptions are further stress-tested.*

Fed's Pivot Latency

- On that note, this week's **July FOMC**, *despite being pegged as a non-event,* **could still be a significant driver** of (possibly even dominate) *UST, USD* and *"risk" triggers.*

- Especially as **latency for a change in policy calculus/response grows**; as **obsession over sticky inflation** (from the baggage of being wrong-footed by "transitory") **is confronted by** the ***growing***, and ***non-linear, downside risks*** **to jobs/consumption**.

- Admittedly, **overt concerns about *softening jobs*** **and *strained consumer resilience***, led by *Fed's Dudley declaring "I have changed my mind* (from higher for longer) … the *Fed should cut now", are not mainstream yet.*

- Nonetheless, there is **scope for Fed rhetoric to temper "higher for longer" more distinctly**. To that end, Fed Chair Powell's *press conference is key to watch* as a potential trigger for July.

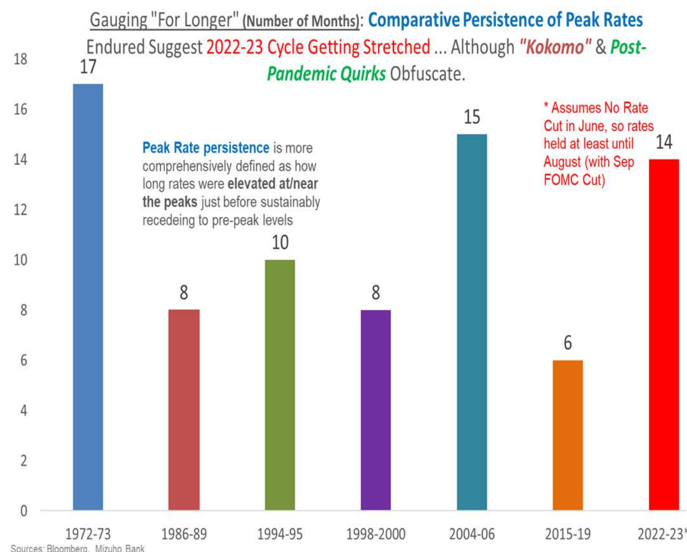
- The **absence of dovish concessions at the July FOMC** though is **not a denial** of change latency, ***but merely deferment*** to such shift in policy calculus ***to*** a more informed (by data) ***'Jackson Hole" **** in August.

  Admittedly, the 2024 Jackson Hole Symposium topic (to be held 22-24 Aug), "***Reassessing the Effectiveness and Transmission of Monetary Policy***", appears to be poised for "higher for longer" arguments.

July FOMC: Surfacing 'Icarus Risks'

- *On balance,* **July FOMC** may be the meeting where **tweaks in the policy language** may **begin to concede 'Icarus risk'**. That is, *"too "high for too long" rates,* which inadvertently **jeopardize**

the desired soft landing.



- To be sure, the **Fed is already on the cusp of cuts**. ***But*** it has **stopped short of guaranteeing a September cut** until it gains "confidence" about "last mile" dis-inflation.

- Trouble is, the **optics of steadfast inflation targeting**, while understandable on account of earlier "transitory" misjudgment, **risks being a case of looking over the shoulder *at the expense of missing approaching threats*** from the opposite direction (jobs slowdown).

- Whereas **a July hold is** more because it is the **path of least (expectations) resistance** given markets have fully baked in a September cut.

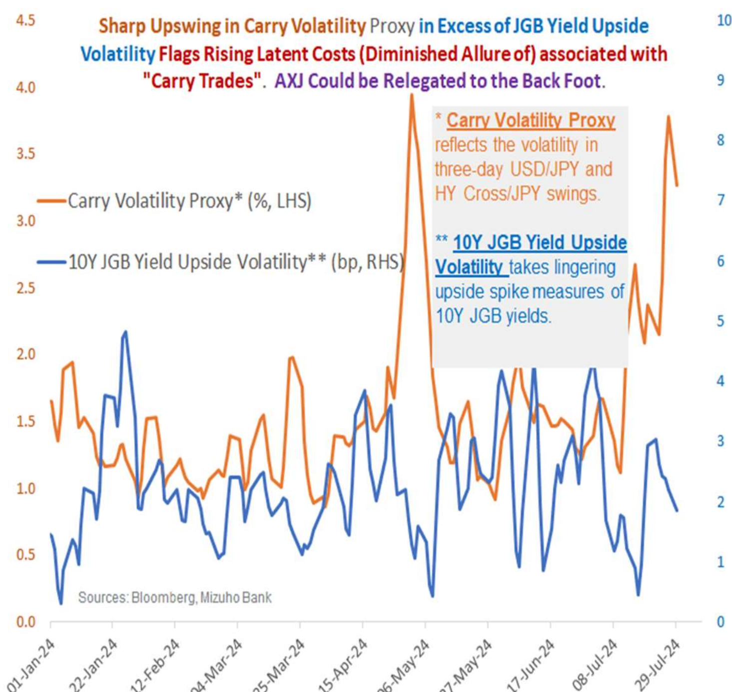
- What's more, a **September** move conveniently provides **the requisite data runway to affirm confidence about sufficient dis-inflation**. So, not many will unequivocally switch to Dudley's abrupt dovish turn (advocating imminent cuts).

- Nonetheless, ***some consensus about avoiding Icarus-type self-sabotage*** of excessive altitudes (with rates) **ought to emerge**.

- All said, admission of, and concession to, *'Icarus risks' merely emerging, not supplanting "higher for longer"*, any **bullish UST response** (drop in yields) **may be measured**. Accordingly, **USD bears may also be on a fairly short leash**.

BoJ-JPY Volatility Spiral?

- Elsewhere, **potential for spikes in JPY, JGB and Nikkei volatility** is *accentuated by the sharp pre-BoJ JPY rebound,* which ironically amplifies the dispersion of views.



- This as **arguments for a hold**, given JPY traction in theory diminishes pressures to hike unnecessarily, are **matched by the strategic case for a hike**, which arguably help dissociate BoJ hikes from JPY/FX triggers.

- But one way or another, this **sets the stage for heightened volatility** amid *complex JPY-BoJ/JGB-Nikkei feed-back loops;* with **unrealistically high bar to satisfy die-hard hawkish bets** conspire with the likelihood for **vague BoJ messaging** that soften the impending rinban reduction.

BoJ: Easy Does It

- Despite heated debate about record wage gains and **scale and urgency of BoJ hikes** required to

address inflation risks are **exaggerated**.

- Point being, the **BoJ has more to lose from haste and aggression** than from being slow and cautious. So, a July hike is far from a done deal ***as consumer and household confidence remains fragile*** and external demand tentative.

- And even if there is a hike it is **likely to be a very graduated 15-40bp into year-end**. Especially as decades of ZIRP/NIRP have left households and businesses unusually ***exposed to amplified adverse shocks from rate increases***.

- **Rinban reduction** (taper) will also be similarly a gradual approach. Even if headline JPY1trln reduction is floated, the execution will be calibrated so as not upset markets; keeping JGB yield volatility in check.

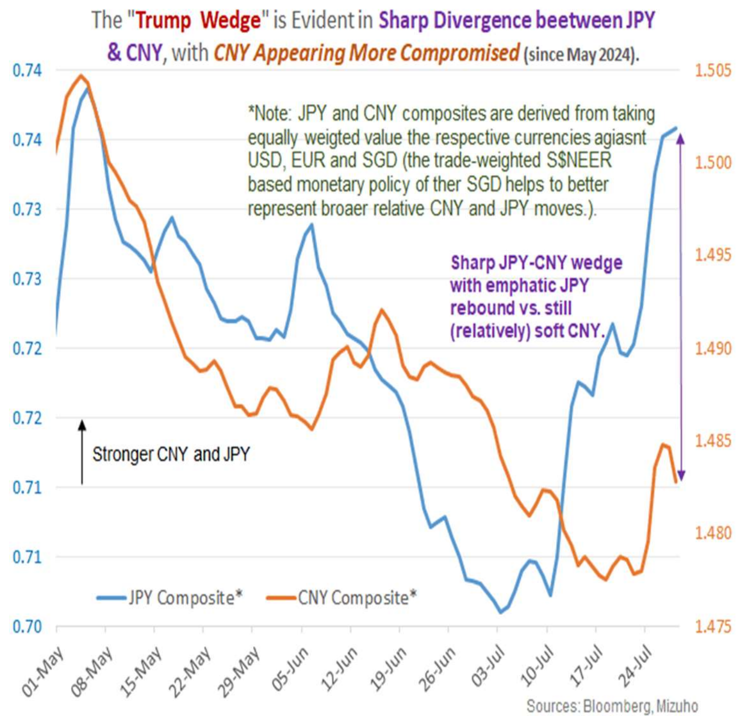
China Politburo

- **China Politburo** this week may also **not quite be cause for champagne popping on tectonic policy change**. In fact, it **may not be much more than familiar wine is a spruced-up bottle** . with new labels.

- Fact is, ***while*** there appears to be a **concerted effort not to cause undue pain** for the economy, the **broader theme of keeping to necessary structural changes** ("Common Prosperity", Industrial Innovation, etc.).

- Specifically, **an economic paradigm** that ***accepts slower underlying growth, as the necessary cost of*** **diminishes the odds of property market rescue of consequence**.

- Whereas a ***convenient calibration*** of monetary policy, entailing unexpected rate cuts should not be mistaken for a catalyst for unqualified economic rescue.



- Against this backdrop**, CNY rebound to catch up on relative underperformance vs. JPY may prove hard to extend**. And so, our view of geo-political and policy factors conspiring to instill ***JPY-CNY wedge appears to be justified****. And could in fact have further to run.*

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