Mizuho Macro Themes

Economics & Macro Strategy | Asia ex-Japan

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MIZUHO

Dampened, Not Derailed

- As is the case with most things in life, **moderation** is key. That applies to **global macro forces** as well.
- Even if not always from the outset, and ***especially if overdone earlier***.
- But justifiably **dampened (excessive) momentum** is **not to be mistaken for derailed macro forces**.
- To that end, the **stronger-then-expected September jobs report**, ought to **temper worries of an uncontrolled hard landing**, ***not fuel "lift off" expectations***.
- In turn, this may **check overly aggressive bets on front-loaded rate cuts**. ***But doesn't necessarily overturn a cutting cycle***.
- Jumbo 50bp cut for November may be off the table, ***but a cumulative 50bp more for 2024*** *(25bp each in November and December) are* ***still being priced***.
- Similarly, what appears to be an **unexpected dovish turn by PM Ishiba** merely **reins in unrealistically overdone BoJ rate hike expectations**.
- Whereas it **does not fundamentally absolve the BoJ** (and the JPY) **of swimming against a global easing tide**.
- So, *USD/JPY rebound* (JPY pullback), unduly accentuated by a conspiracy of BoJ-Fed expectations shift, *doesn't actually negate lingering JPY squeeze risks*.
- Finally, **China exuberance** on the back of *monetary "bazookas"* unleashed and *fiscal floodgates* (thrown open), now **hinges on details/execution** of stimulus.
- Expect that **follow-through rallies** may be **less unbridled**. In fact, it may even be dampened if the absence of details, if not doubts about actual execution and efficacy.
- ***But*** equally, it is **unlikely to be derailed** at this juncture. ***Especially for opportunistic China equity bulls*** inclined to "follow the money" and the "National Team" buying.
- That said, **China's economic prospects may not be extricated from binding structural and geo-political dampeners**.
- In turn, this warns of far more **two-way CNH risks** that **derails unfettered appreciation** tied to stimulus cheer.
- Yields: All said, acute *2Y yield squeeze* (+36-37bp on the week) from bullish US jobs is *not to be mistaken for exhausted downside in yields*.
- Yield Curve: What's more, a *resumption of distinct steepening* is likely as Fed cuts extent into 2025, with US elections likely accentuating steepening bias.

- FX: USD underpinned UST yield surge as aggressive rate cut bets reined in. Along with JPY slide on dovish BoJ cues and subdued CNH bulls, AXJ look set to lose some traction.

1) Fed: Dampened, Not Derailed, Cut Cycle

- While ***confidence about another 50bp cut is justifiably dampened*** (by a bout of upside economic/jobs data surprise) the **Fed rate cut cycle is far from derailed**.

- Admittedly, the **all-around blockbuster jobs report*** is justifiable *cause to re-assess overzealous* (and quite overdone) *"pivot bets"* on front-loaded, outsized cuts.

- **Nonetheless**, this **NFP does not distract *from ongoing disinflation*** and **increased** (even if not yet prohibitive) **downside risks**.

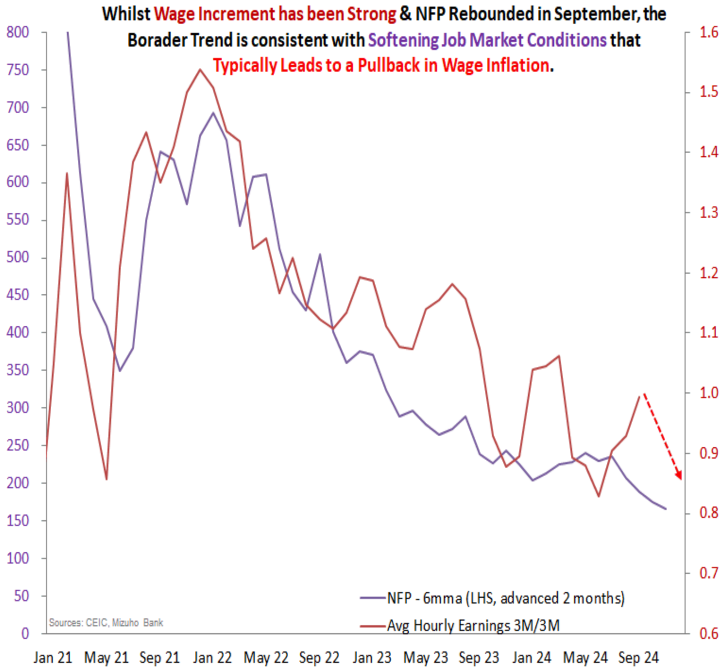
- Both inflation and jobs cues cast the glare on exceptionally and perhaps unnecessarily restrictive rate settings.

- This in turn makes a **compelling case for a continuation** (albeit calibrated for now), *not a premature suspension,* **of rate cuts**.

- And perhaps still ***inclined to easing more and sooner*** (by mid-2025) given ***policy lags*** and propensity for ***non-linear deterioration in the labour market***.

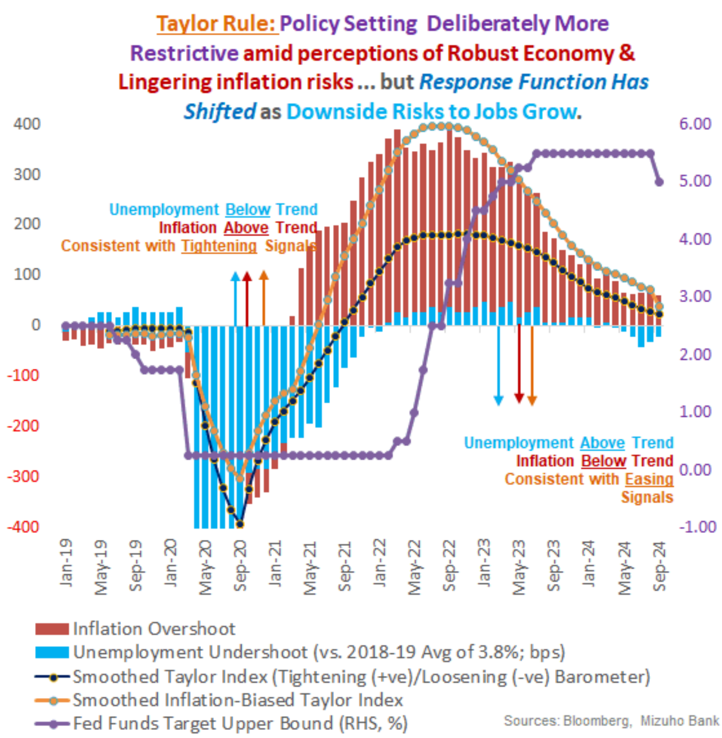
- The upshot is that the Fed's policy calculus tips in favour of sticking with measured cuts to diminish hard-landing risks.

- Afterall, a longer view (6m rolling average) of jobs suggest is consistent with softening. And the experience is that this eventually softens wage inflation as well.



- And so, we suspect that the **question for FOMC meetings** ahead are likely to be a **matter of how, not whether (to cut)**.

- That is, *"how much"* and *"how soon"* **to cut**. And *not "whether to (continue with) cuts"*.

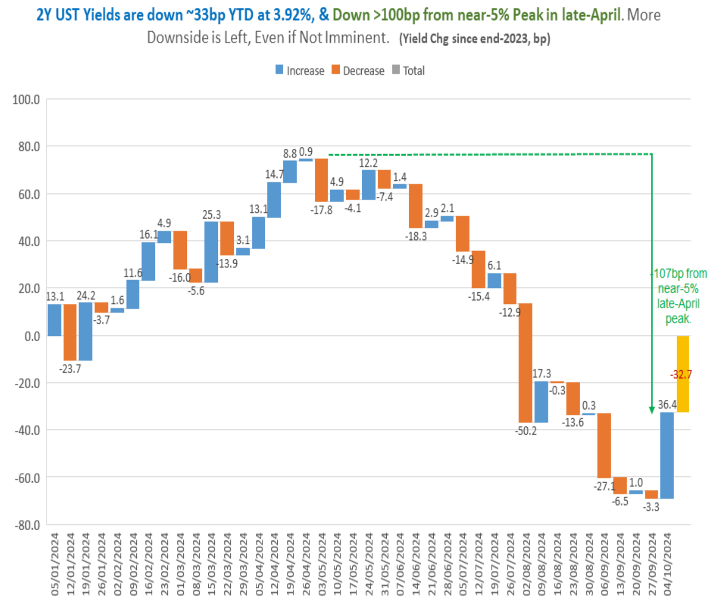


- What that means for market is;

- Front-end Yields: *Moderation* in the earlier overdone plunge in front-end yields is an interim correction but *not a durable and sustained reversal. Front-end downside in yields to resume with sub-3% on the cards into mid-2025.*

- Long-end Yields: Similarly, the *lower-beta resumption of downside in 10Y UST yields* is expected to be reinstated soon. US elections to add two-way volatility, underpinning relatively less pronounced downside in long-end yields.

- Yield Curve: Hence, the reflexive **bear flattening appears overdone**. Whereas *further* (mostly bull) *steepening is likely.* And is typically ***accentuated by US election risks***.



- USD: *USD may toughen more durably* on relative policy shifts (for now) and more durably diminished policy divergence vis-à-vis other Major central banks (i.e. the Fed is unlikely to go it alone with upsized and sped up rate cuts).

*Replete with >100K outrun in Sep jobs, a 72K upward revision to Jul-Aug jobs, a surprise dip in unemployment to 4.1% and wage growth acceleration.

2) BoJ: Introspection, Not Dovish Inflection

- **PM Ishiba's unexpected** (and surprising) **allusions** to "*the environment is not conducive to additional rate hikes,*" **coincides with the BoJ's pre-existing inclination for a pause**.

- This however **falls far short of a guaranteed dovish inflection** at this point.

- Point being, the **BoJ was already predisposed to gradual and calibrated tightening**, consistent with a patient "wait and watch" stance.

- In particular, as the **fragile state of household confidence** alongside **exaggerated income boost from sharp JPY weakness** warn against excessive tightening too soon.

- In which case, **inadvertent** (and unwelcome) **heightened *upside* JPY volatility**, **reinforces the case not to rush hikes**.
- Notably, as *risks of adverse income and equity market shocks from sharp JPY appreciation loom.*

  - This is only too **obvious in BoJ Governor Ueda's conditional hawkish bias**.

  - Specifically his allision to **further hikes only if**; i) *USD/JPY is around 150* and; ii) *Nikkei holds around record high.*

  - In other words, only if positive income impact (exports and tourism) and asset market buoyancy are intact will further hikes be considered.

- But **volatile market may initially only prompt a pensive BoJ hold** that weighs off JPY volatility and policy credibility.

- For markets, that could read as ***BoJ hawks dampened, but not unequivocally derailed***.

3) Bullish JPY Risks: Dampened. Not Derailed

- Nonetheless, the **BoJ's pause may not be sufficient to resist the global easing tide, inevitably unleashing JPY bulls**.
- Point being, *diminishing global rate spreads vis-à-vis JPY rates* is **likely to exert quite a bit on upward pressures on JPY** (dragging Cross/JPY).
- If upside JPY volatility proves to be too extreme, the BoJ may be forced to respond to this with easing signals, outright cuts or intervention to soften JGB yields.
- Although that is not our base case for the BoJ policy plan. In fact longer-term policy projection suggest jus the opposite in terms of (upward) direction of travel for BoJ rates.
- All said, this reinforces our point that ***JPY upside risks are not derailed*** with the BoJ's current policy stance, ***even if dampened by a coincidence of factors***.

4) China Optimism Dampened

- As China returns from the Golden Week holiday, the big **question is whether the pre-Golden week euphoria will fizzle, if not reverse**?
- For one, **returning to be confronted by markedly higher UST yields** and a **stronger USD** could **take some wind out of "all things China" rallies**.
- Crucially, the **details/execution plans for announced stimulus** may also **risk falling short of rising, and rather lofty market expectations**.
- We expect a bit of a mixed bag, with a divergence between economic optimism, CNH buoyancy and equity market exuberance.
- Insofar that the stimulus **plans may fall short of unambiguous central government underwriting** on all the financing needs, **economy-wide optimism will at least be dampened**.
- The balance inherent tensions between cyclical fillip and structural/geo-political impediments may further invoke circumspection.
- But growth outcomes for the next 3-6 quarters are likely to be revised up, even if fundamentally longer-term growth potential is still seen being pressured to 4%.

5) But China Equity Bulls Unlikely to be Derailed

- **Chinese equities** are **more inclined to remain jubilant, even if** incremental rallies are **somewhat dampened from late-September's staggering double-digit surge**.
- For one, the *depth and breadth of liquidity push* proposed to support equities and implicit "National Team" buying.
- Point being, markets will understandably be **incentivized to ride the liquidity and chase equities higher**, ***with a propensity for self-reinforcing positive dynamics***.
- More so, as the remit for revived equity market sentiment is **less dependent on broader**

economic stimulus details (unlike fiscal stimulus).

- Point being, ***equity rallies are more likely to be inebriated on a liquidity deluge***, and **not** *(at least in the short-term)* **as tightly tethered to coincident economic (out-) the short-run**.

- **Especially given the compelling valuations** that lag most global equities; even after the late-September surge.

- To be sure, follow-through **exuberance will *probably* be *dampened*** as *low-hanging fruits are exhausted* and *US election uncertainty emerge.*

- *But* the liquidity-driven upside in Chinese equities is ***unlikely to be derailed prematurely*** at this juncture.

6) CNY Rallies Denied

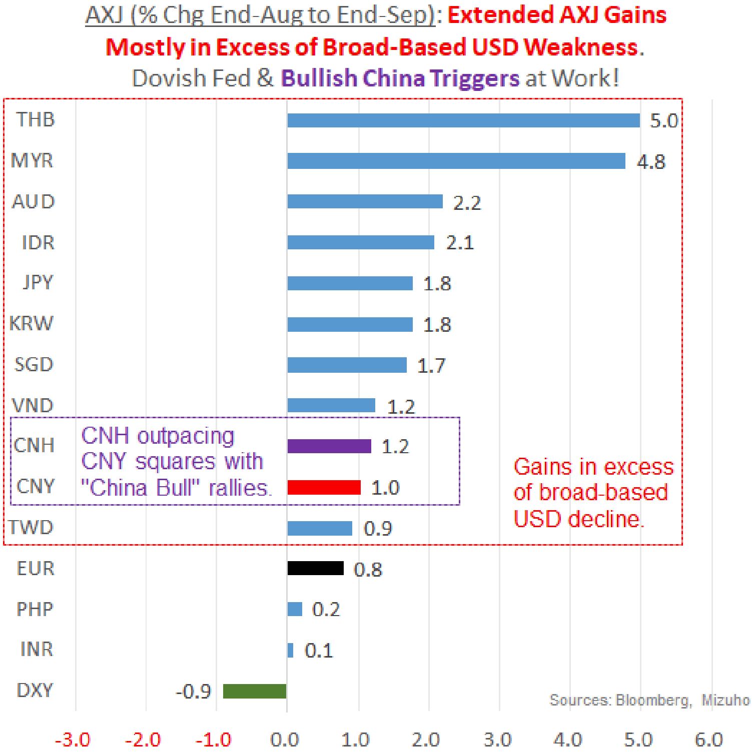
- Nonetheless, **CNY bulls** though will be unequivocally **side-lined** for now. ***Possibly even derailed** until clarity on USD and US elections emerge.*

- For one, it is **unlikely that the PBoC and/or markets will challenge USD bulls (*backed by higher UST yields*) head on**.

- Especially not after the sharp **pre-Golden Week surge in CNY**, which **leaves room for moderation and acclimatization**.

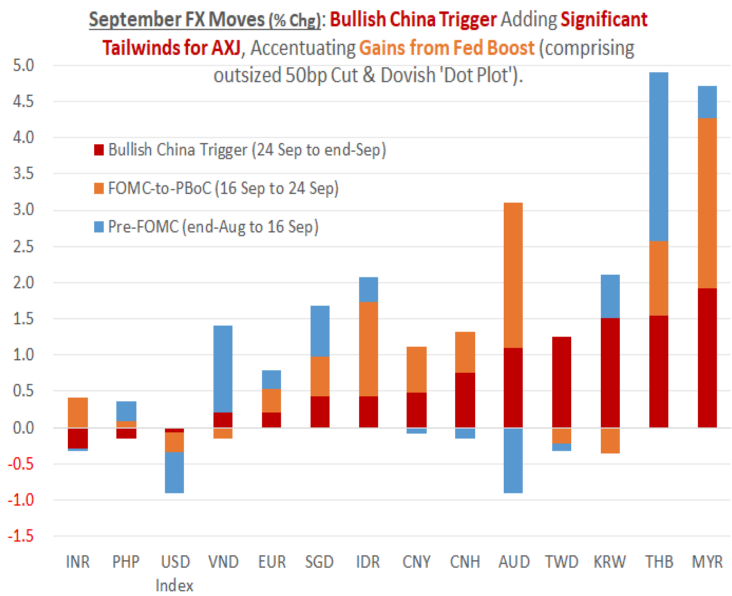
- What's more, all else equal, **further monetary easing by the PBoC** (against relative Fed restraint) suggest that **overdone CNH rallies will be subject to payback** risks.

- Above all, with **geo-political risks** that overhang ***alongside*** the ***PBoC's preference for trade-weighted stability***, it is likely that **further CNY rallies will be denied**.



7) AXJ Dented

- Such a conspicuous pullback of CNH bulls alongside a softer JPY suggest that **AXJ may be relegated to the back-foot, possibly even dented**.

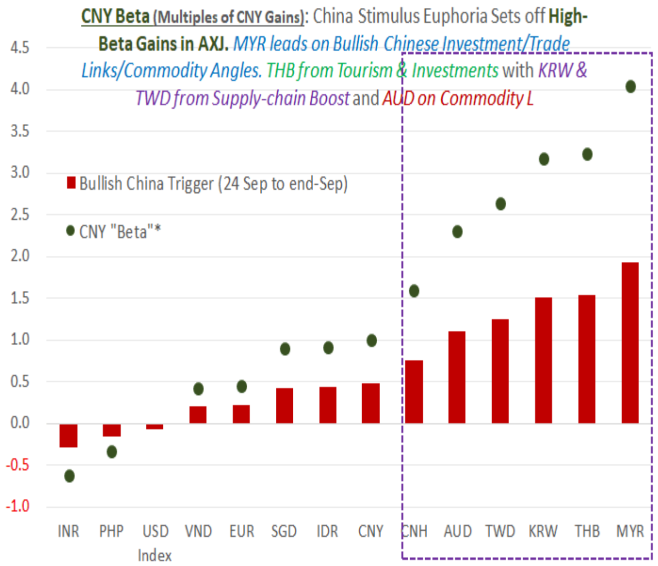


- Especially **given the overdone rallies in the wake of China stimulus** announcements in late

September, that piggy-backed (even exceeding) corresponding CNH rallies.

- **Sharp CNH pullback** could thus **impose disproportionately adverse impact** on AXJ generally.

- And notably with the ***payback most pronounced on high-beta units such as MYR, AUD, KRW***, which had earlier benefitted the most from CNH rallies.



- Elsewhere, **further upside surprise in US data** (and ***implied Fed cut restraint***) may take ***a toll on the likes of IDR and PHP*** given the easing bias indicated by respective central banks.

- But critically by inserting