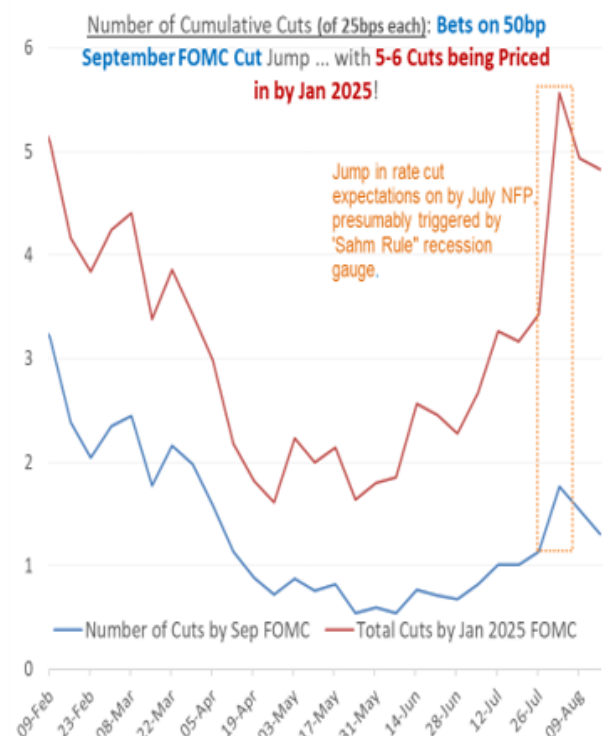


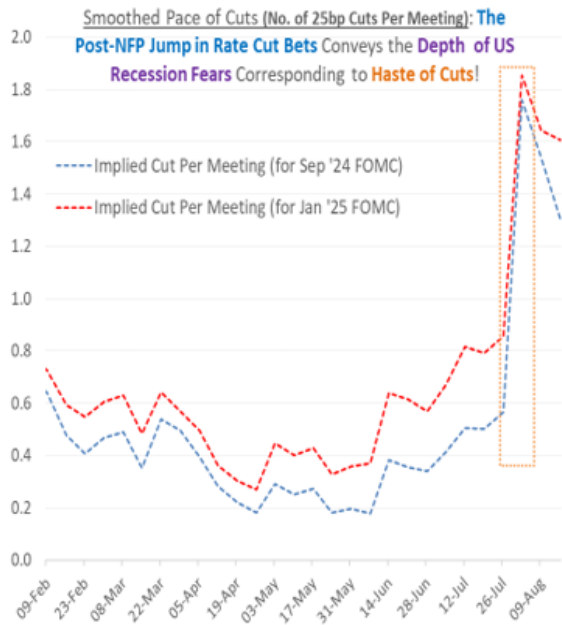
Jackson Hole – Digging In or Out?

- *Admittedly, at the Jackson Hole Symposium of global central bankers, divining shifting sands is ostensibly a tall order given global central banks have already started cutting rates and the Fed is arguably on the cusp of rate cuts too.*
- *But equally, it is too **hasty to dismiss Jackson Hole’s relevance.***
- *Not just due to spots of past prescience, but more importantly, given **the scope for potential glimpses of poignant shifts in policy response function.***
- *If so, this may better inform of more rapid policy shifts.*
- *With the attendant bearing on more emphatic bull steepening of the UST yield curve, and a volatile path to a mellower dollar amid BoJ efforts to subdue JPY volatility.*
- *But for a start, it is **critical to assess if the Fed is digging in** on controlled rate descent premised on a **“soft landing” or digging itself out of non-linear recession risks.***
- Jackson Hole ... Not Always Sexy: **Admittedly**, the annual economic policy symposium hosted by the Kansas City Fed, which gather all major global central bankers and leading academics, **has had hits and misses**. Moreover, this year’s rather academic topic, *“Reassessing the Effectiveness and Transmission of Monetary Policy”*, arguably **does not get hearts racing**.
- But Bears Watching: Nonetheless, it **will command attention, scrutiny even**, given *occasional, but crucial, prescience* (e.g. US housing crisis) and a track

record of *flagging policy shifts* (forward guidance, “taper”, etc.), including the 2022 allusion to “keep at it (tightening)”.

- Especially Given Policy Risks: Especially coming *hot on the heels of the BoJ-NFP shake-down in markets*, which was arguably **triggered by fears of an inadvertent policy mis-step**; be it the *BoJ’s* (being overly hawkish and unwittingly setting off JPY-funded carry unwind) *or the Fed’s* (insofar that “higher for longer” has tipped over into “too high for too long”).

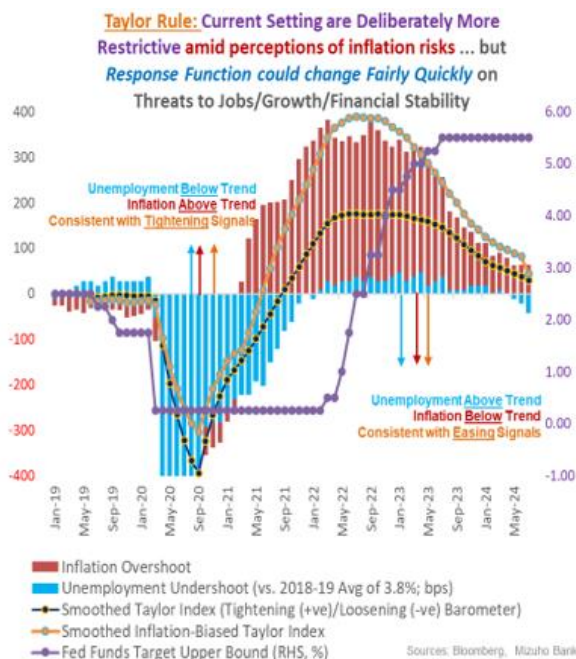




Augmented Policy Response: In particular, if this results in an *admission of materially augmented policy response function*, and associated economic/data triggers.

Fed & Goldilocks

- **Revisiting “long and variable lags”:** For the Fed, this may imaginably entail a more unequivocal deference to “*long and variable lags*” of **monetary policy**. That’s to say, the Fed effectively upgrades risk to jobs in the context of “higher for longer” beginning to bite (albeit

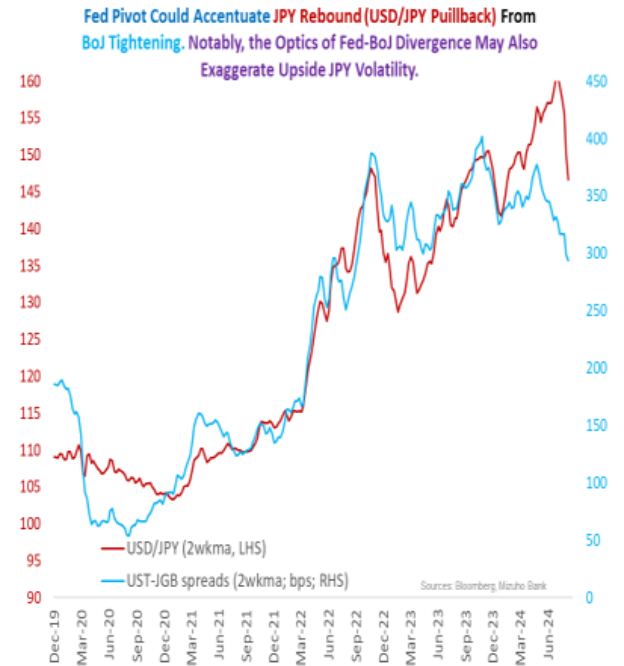
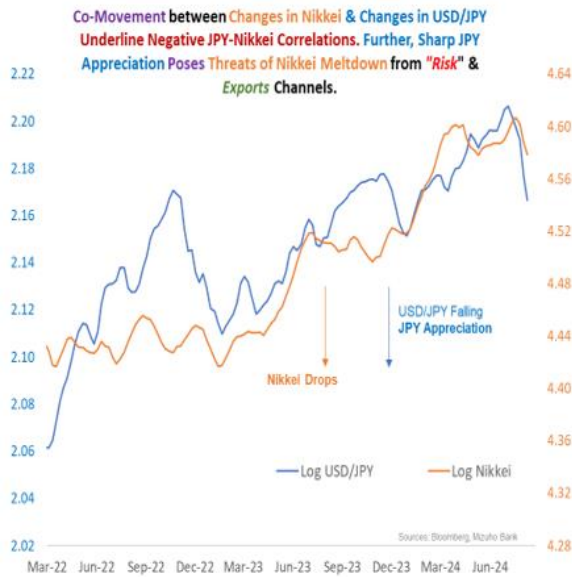


more belatedly than expected given post-pandemic distortions).

- **Dovish Tip:** Therefore, **implicitly tipping policy sensitivity to downside economic risks** (away from inflation obsession), in particular *associated with sharp deterioration of the job market*. In other words, more distinct **dovish accents to data-dependence**.
- **& Respecting Non-Linearity:** Crucially, if the Fed makes reference to **non-linearity associated with job market deterioration**, it will be a significant dovish cue. In other words, any admission to **job market stress** tending to not only **show up belatedly** but also **escalate abruptly** will be code speak for **policy bias to cut deeper and faster on demand sag cues**.
- **Goldilocks Threatened:** The upshot is that a discussion of “*effectiveness and transmission of monetary policy*” could offer the opportunity to concede assumptions of “**Goldilocks**” **soft-landing** being **materially threatened** in the context of “long and variable” lags ultimately coming home to roost despite post-pandemic distortions.

BoJ & JPY Bind

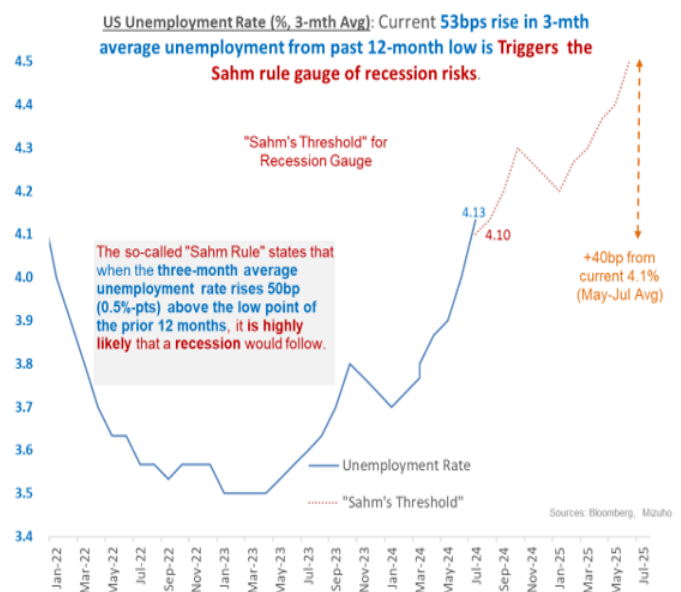
- **JPY Stability Pre-Condition:** For the *BoJ*, necessary policy response shifts ought to entail **JPY stability pre-condition weaved into future policy calibrations**, especially given its divergence from global policy inflection, which potentially amplifies JPY volatility.
- **Clarification:** To some extent, the **BoJ has already flagged** this, with the allusion to **further rate hikes being contingent on market stability**. But Jackson Hole provides an opportunity to clarify and solidify its policy position under calmer conditions.



- **Complex JPY Mechanisms:** Crucially, to point out that **complex JPY mechanisms involving negative correlations with Japanese equities/exporter earnings/tourism gains/implicit profitability** mean that a very guarded and gradual approach to further tightening to “terminal rate” (estimated to be 0.50-0.75%) is critical.
- **Two-Way JPY Risks:** The overarching point being that excessive JPY volatility either way is detrimental for the Japanese economy. And so, while the BoJ was desperately trying to backstop JPY (from persistent depreciation) earlier, it cannot abide by excessively sharp JPY spikes either.
- **Fed Conditionality:** And to that end, the **Fed’s outsized sway on JPY valuations** (via the rate differential pull of UST-JGB spread) *requires BoJ to suspend even calibrated tightening if Fed tips into more aggressive cuts* (on Goldilocks soft-landing threatened). Especially given the inadvertent economic and market turbulence from JPY gyrations.

Hyper-Sensitivity & Volatility

- **Hyper-sensitivity to Demand/Jobs Data:** Given the scope for policy response shifts, expect markets to become far more sensitive to data swings. **Over-reactions** are likely to be skewed in the direction of **US demand/jobs data**. Any disappointment will invoke outsized Fed cut bets while any upside surprise will see relief rebound in rate expectations.



- **Recession Risks vs. Goldilocks Pivot Bets:** Notably, recession risks (such as that

prompted by the Sahn Rule trigger post July NFP) are prone to be “risk off”, in stark contrast earlier “Goldilocks” pivot bets that were risk on.

unwind/risk off and/or adverse demand shocks expected to dent exports/exporter currencies (thereby dampening AXJ).



- **Front-end Yield Volatility:** Given data over-reactions **amplifying gyrations in rate cut bets, front-end UST curve yield volatility** may be par for the course. In particular as data will probably be patchy and clouded heading into the Sep FOMC.
- **Bull Steepening:** But looking past the volatility, the **bigger picture for bull steepening remains compelling**. And a distinct *flip out of an inverted yield curve to an upward-sloping yield curve is likely in coming months*.
- **Bumpy USD:** With Fed rate cuts and UST yields headed lower, the **case for a mellower USD builds**. *But* this is not likely to be a linear path, instead being a **bumpy and uneven** one. Periods of “risk off” could blunt USD sell-off, if not retain **USD dominance**. Especially **against EM/high-yielding currencies amid carry**

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