Mizuho Macro Themes

Economics & Macro Strategy | Asia ex-Japan

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The "Jerry Maguire Fed"

In a Nutshell:

- In declaring that "***the time has come***" for rate cuts, **Powell's Jackson Hole speech marked the most distinct and unequivocal dovish shift**. **Especially book-ended by** pronouncements that "***the direction of travel is clear***".

- So, even if "***timing and pace of rate cuts … depend on incoming data, the evolving outlook and the balance of risks***", it is arguably a **much higher bar for inflation to even merely temper** (much less throw off) **rate cut plans**.

- In other words, the **Fed's (risk) response function is now focused on averting a hard landing**. Especially insofar that it entails sharp worsening of job conditions from lagged effect of earlier tightening.

- It appears a dovish **Fed has coyly conceded** ***"you had me at hello"***. And without missing a beat, **markets have heard** ***"show me the money"*****, with the attendant "pivot risk on" across all assets at the expense of the USD**.

- But the word of caution is that **continued exuberance on Fed cuts will require a "fairly tale (soft-)landing"**. ***Whereas*** **recession fears**, if invoked by US data buckles along the way, **may result in "risk off" Fed rate cut bets**.

- In which case *equities could stumble despite falling UST yields,* thereby decoupling currently synchronized equity and bond market rallies.

- And *spots of USD squeeze could also defy UST yield cues,* upsetting the extended play of bearish USD bets based on Fed pivot.

- What's more, the widening Middle East conflict, US elections and US-China risks also warn against a steady, one-dimensional "pivot risk on" narrative for the rest of 2024.

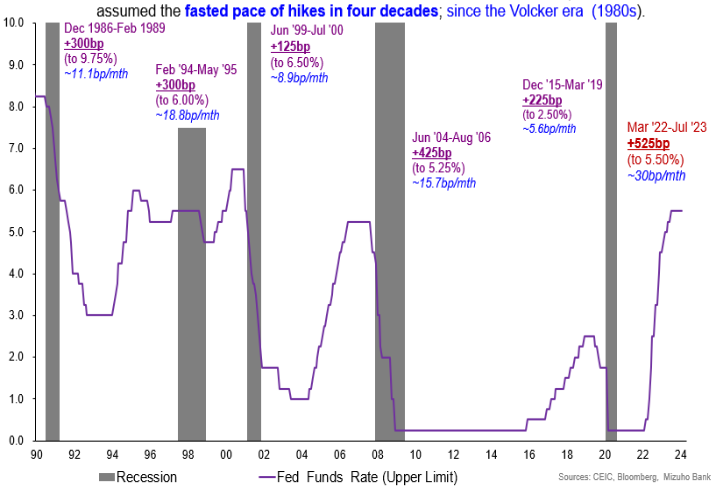
- Against this backdrop, the risk is that **scope for EM Asia central banks to cut rates *on account of a dovish Fed* bandwagon** may be **overstated**.

- Instead, it may be best to **temper rate cuts as well as easing expectations** *to sufficiently buffer against* ***"risk off" externalitie*****s** (US elections, geo-politics, China risks). That's over and above less distinct easing scope from relative ***inflation and policy differentials*** (vs. US).

From "Kokomo Fed"

- **In 2022**, when the Fed embarked on one of the most aggressive rate hike cycles, we called a "***Kokomo Fed***" that intended to "*get there fast, and then … take it slow*".

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

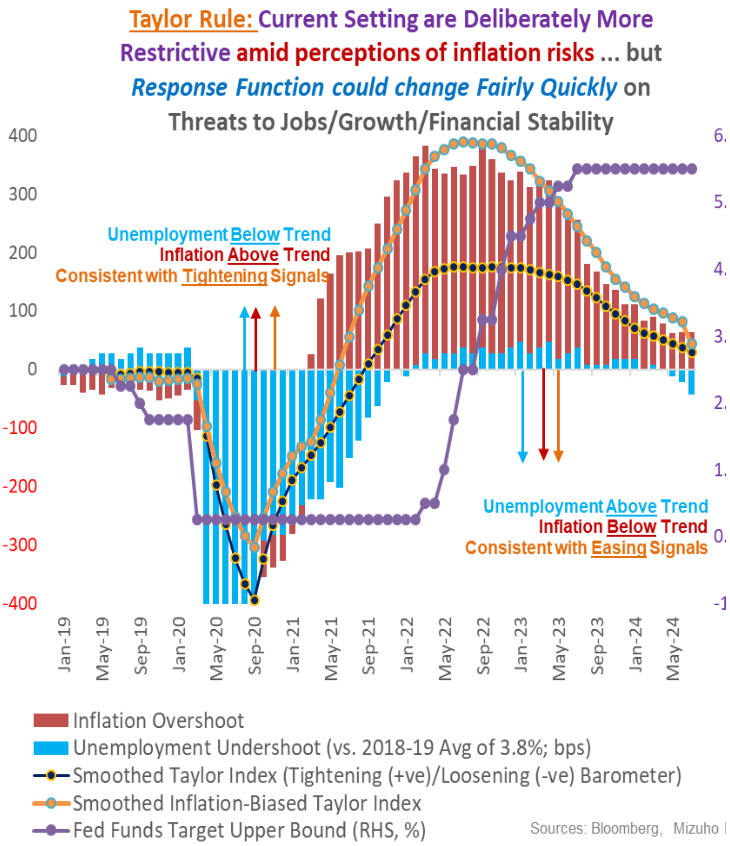


- And the **2022 Jackson Hole speech**, famous of its hard-hitting brevity, **left no doubt about outsized hikes to lift rates quickly and** to stay at restrictive setting for a prolonged period. In other words, "*higher for longer*".

To "Jerry Maguire Fed"

- *But now,* **Powell's 2024 Jackson Hole speech**, has **convinced markets that the Fed has unequivocally transformed into "*Jerry Maguire Fed*"**.

- That is, a Fed that is perceived to be *convincingly and comfortingly dovish.*



- ***With resultant "risk on" rallies that subscribe to a "Goldilocks" soft-landing** rather than suspecting than something may be broken*

1) *"You had me at hello."*

- It really **didn't take much for market exuberance from the idea of a complaisant Fed pivot**. And to be fair, **Powell struck all the right notes** with his Jackson Hole address.

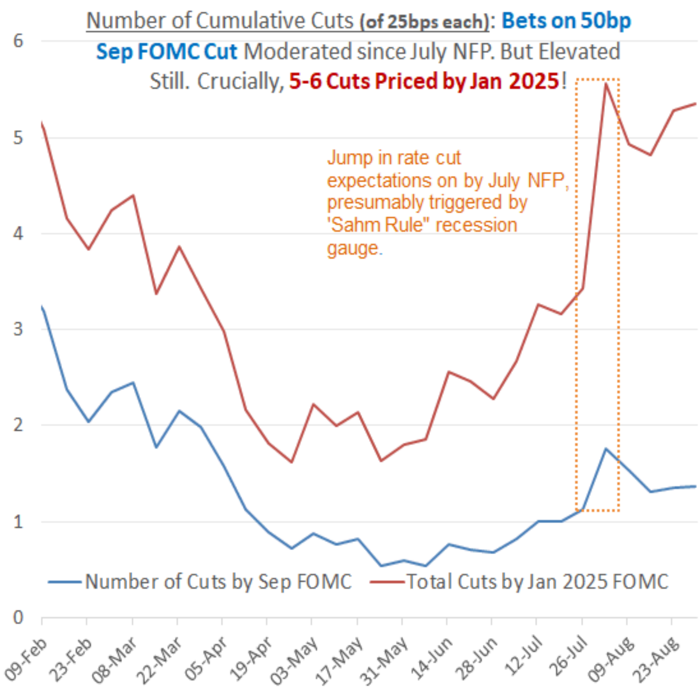
- Notably, his pronouncement that "***the time has come for policy to adjust***". And this **justifiably impressed pivot bulls-in-waiting**. Simply because such a signal is *as unambiguous as any policymaker can flag imminent rate cuts.*

- To be sure, this shift should **not** have come as **a proper surprise that jolts markets**. Afterall, Powell has been alluding to shifting balance of risks that are now more two-way.

- Nonetheless, this is **deemed to be the authoritative call to imminent action**, which *validates fully priced-in September FOMC rate cut* (although the size of cut is uncommitted).

- Crucially, from a policy signal point of view, this **entails a critical shift in policy bias; from** a **cautiously less restrictive posturing of "*when, not if*"** guidance earlier **to the unbridled urgency of "now"** in terms of signaling cuts.

- Simply put, the **optics of Jackson Hole address** *in the context of post July NFP* is one of "***you had me at hello***" **for a dovish Fed trigger**.



2) *"I just want to be inspired."*

- What's more, the **expected *data-dependence* caveat was *augmented by an unexpected but unequivocal dovish anchor***.
- Specifically, declaring that "***the*** *(downward)* ***direction of travel is clear***" (for Fed rates).
- This ***retains, but* softens**, the **data-dependence conditionality** to **merely a matter of "*timing and pace of rate cuts*"**.
- To be sure, the pace and magnitude of rate cuts "*will depend on incoming data, the evolving outlook, and the balance of risks*".
- But the overarching point is that the **wheels of Fed rate cuts have been set in motion**.
- And crucially, with an appreciably **higher bar for the Fed to dial-back rate cut prospects**.
- This ***inspires*** more unfettered pivot bets to pile in as markets adjust for US exceptionalism that had earlier rubbed off on to policy.

3) *"Show me the money!"*

- So much so that markets are rallying on "pivot risk on", expecting **a more emphatic and earlier Fed pivot** to "***show me the money***".
- Particularly so, given that **Fed expectations** are clearly ramped up for ***a rate cut cycle, not merely a (rate cut) calibration***, *square with*
- The *smoking gun* being a more *sobering assessment of* "**unmistakable**" ***cooling in jobs*** **coupled with** an apparent ***aversion for inadvertently setting off a harsher downturn*** in jobs and demand.
- Powell's candid, unambiguous admission that the Fed "***do(es) not seek or welcome further cooling in labor market conditions***" was **pay-dirt for those looking for an emphatically dovish shift in policy response function**.
- Specifically, ***expectations of the Fed's tendency to cut more and sooner*** as **downside growth risks associated with** "*too high for too long*" **have overtaken inflation risks that require** "*higher for longer*".
- ***But*** expectations of **deeper Fed cuts sooner do not always inspire unqualified "risk on"**.
- In fact, under certain less favourable conditions it maybe distinctly "risk off". At very least there may be some bumpiness associated with the

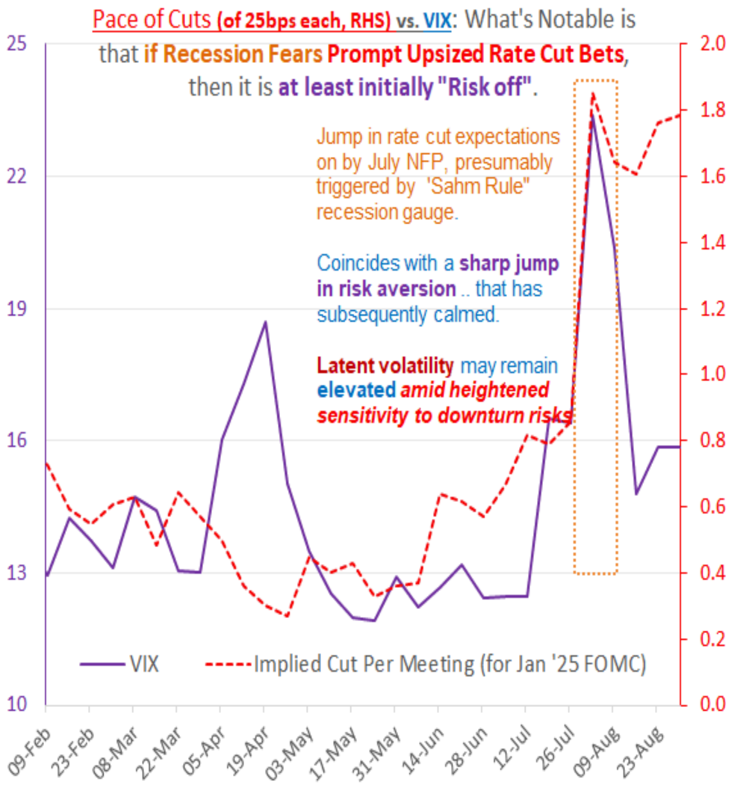
4) *"24 hours ago, I was hot. Now I'm a cautionary tale."*

- **Two particular risks/threats** to unfettered "pivot risk on" that are **not negated** are;

  i) ***markets*** may be ***hyper-sensitive to in-coming data, accentuating latent volatility*** *in UST yields and USD*. Fact is, beyond a "Goldilocks threshold" for US slowdown, **RORO-type* price action in equities** may be inadvertently triggered.

  ii) **US recession fears**, related to *worse case iterations of jobs deterioration*. In contrast to exaggerated Fed pricing from data volatility, US recession fears dislocate "usual" "risk on" pivot dynamics", instead *pressuring equities rallies* despite *falling yields. USD* too *defiantly* turns *higher amid "risk off" and softer yields.*

*RORO is short hand for describing highly volatile markets wildly swing between "risk on and risk off".



- And so, not only will there be **two-way volatility from fluid Fed cut expectations and noisy re-pricing** playing off data, but crucially, there may be ***sudden "risk off" from recession risks*** **that overwhelm "pivot risk** on" from rate cut bets.

- Hence, the **pivot bet favourite for bulls** ***conceals potential for being a cautionary tale*** of downside risks not fully priced into currently exuberant equities.

5) *"Help me help you."*

- Put differently, and perhaps in helpful perspective, it is pertinent that current **"risk on" pivot bets** are *necessarily dependent on some degree of* ***"Goldilocks" soft-landing*** **assumptions** (hopes?) *remaining intact.*

- Necessarily this implies that market **exuberance about Fed rate cuts assume** ***sufficiently large*** and ***adequately timely*** **Fed rate cuts to avert a recession**.

- But **if** in coming weeks/months **doubts emerge** (and fester) as to ***whether the Fed ultimately will ultimately*** pull off a historic feat of deftly timed and executed rate cut cycle that manages to **avert a recession**, then payback is likely. Consequently, the easy gains from "feel good" ***Goldilocks bets may unravel rapidly.***

- So data, Fed response and market sentiments will all have to conspire for unfettered risk on to endure.

- And this is a tall order against a backdrop of elevated geo-political threats juxtaposed against binary US election risks and problematic China conundrum.

Fed View

- For the record, your scribe's call (unchanged from May) for ***at least* 8 cuts** (totaling 200bp) **by mid-2025** is beginning to look distinctly docile from being outlandish earlier.

- Our sense is that this will **most likely be a** ***2-6 or a 3-5 split*** (between 2024 and H1 205) in terms of the timing of rate cuts between now and mid-2025.

- And to be sure, the ***risks are tilted to the Fed responding with more cuts,*** not fewer than what we have assumed.

	End-2021	End-2022	End-2023	2024				2025				2026		2027	
			Q4 23	Q1 24	Q2 24	Q3 24	Q4 24	Q1 25	Q2 25	Q3 25	Q4 25	H1 26	H2 26	H1 27	H2 27
Fed Funds Target Rate Ceiling	0.25	4.50	5.50	5.50	5.50	5.25	5.00	4.25	3.50	3.00	2.75	2.50	2.50	2.50	2.50
Fed Funds Target Rate floor	0.00	4.25	5.25	5.25	5.25	5.00	4.75	4.00	3.25	2.75	2.50	2.25	2.25	2.25	2.25
UST 2Y Yields	0.73	4.43	4.25	4.62	4.75	3.87	3.27	2.70	2.69	2.80	2.53	2.50	2.30	3.33	3.18
UST 10Y Yields	1.51	3.87	3.88	4.25	4.40	3.78	3.65	3.22	3.35	3.42	3.28	3.33	3.18	3.33	3.18

Sources: Bloomberg, Mizuho Forecasts

- And with **distinct risk of at least one upsized**

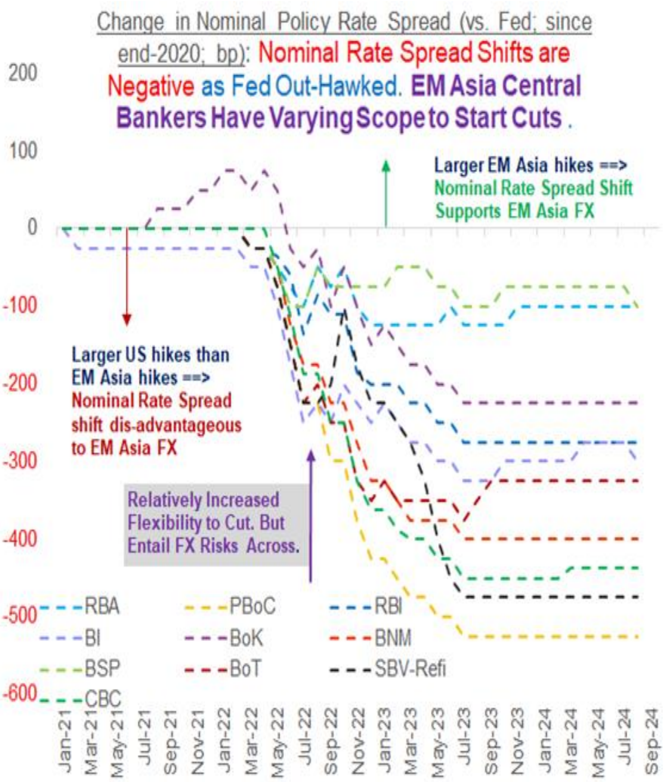
50bp cut along the way. Probably more. This squares with our bias that the Fed is more likely to cut more, not less.

EM Asia (Policy) Window

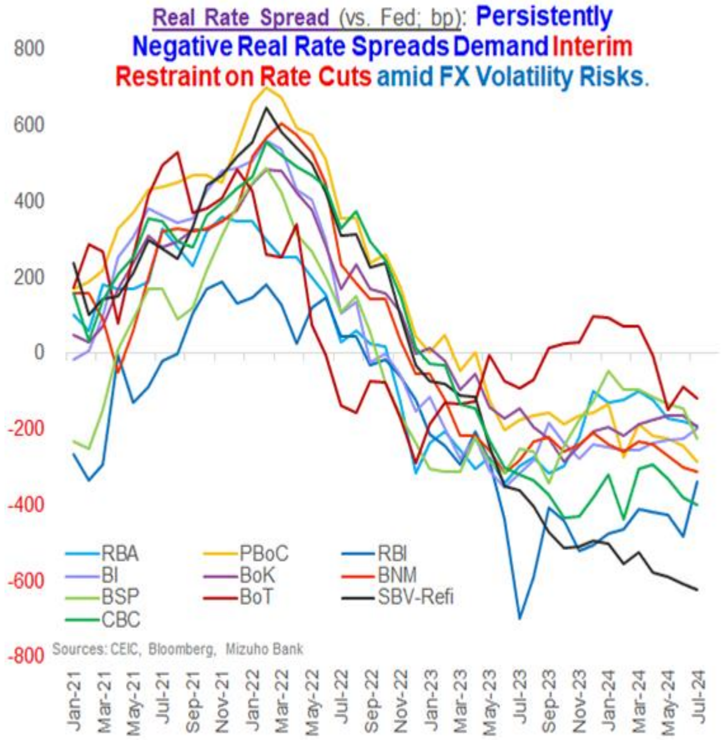
- The **Fed view through the EM Asia policy window** is one that reveals **binary risks** for most EM Asia central banks.

- Specifically, the *payoff from rate cuts rates amid falling USD and UST yields forgone* on one hand. And on the other, *potential payback from macro-/currency-stability undermined* should wider risk sentiments be upset.

- As we have flagged earlier, a **cautious approach to EM Asia central bank rate cuts** is *key to navigating US elections and eider geo-political risks*. Especially as relative US exceptionalism is checked, not decimated.



- In any case, EM Asia central banks need to be **cognizant of evolving inflation differentials** (versus the US) and **relative nominal policy rate differentials space** (based on the path of hikes) in assessing scope for rate cuts.



- As we have recently published, **acute dovish shifts* in Fed expectations,** *book-ended by a sharp and anticipatory drop in UST yields and USD,* is **suggests scope for EM Asia central banks to start cutting**.

- But only cautiously and tentatively as nascent **rate cut plans** must ***necessarily be responsive to any flux in market conditions*** and ***ready for any remedial interim suspension***.