Mizuho Chart Speak: Global Inflation

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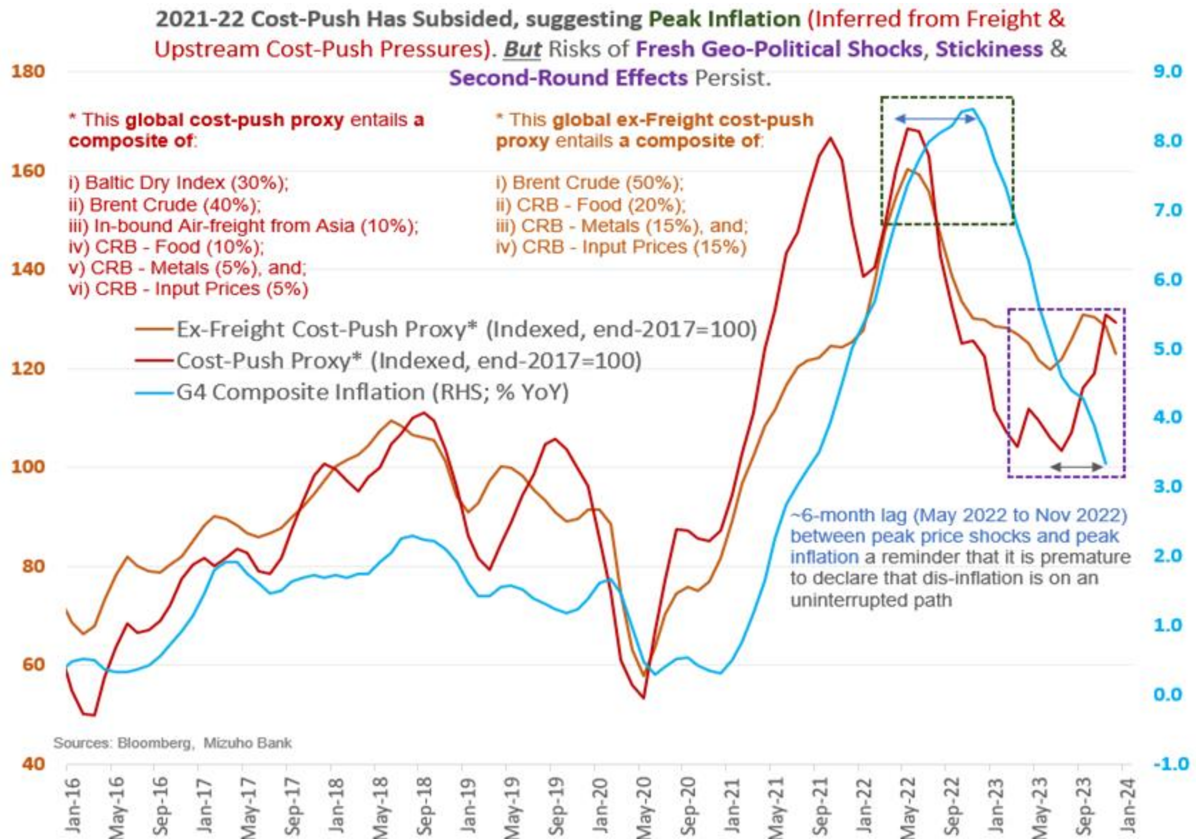
Dis-Inflation Risks: Interrupted, Not Immaculate



*"I am afraid, my dear Watson, that most of your conclusions were erroneous." - **Sherlock Holmes***

- Given that even expectations of **uninterrupted dis-inflation** are **overly optimistic**, **premature exuberance about "immaculate dis-inflation"** risks being a **costly departure from reality**.

- To be sure, the **worst of inflation risks are undeniably behind** us (with inflation peaking late-2022); and the depth as well as pace of dis-inflation in 2023 has been encouraging, if not substantial.

- *But* that is *neither* **sufficient** *nor* **likely to be sustained** at a brisk pace. Especially not **as fresh cost shocks** from geo-politics/El Nino **conspire with spots of demand-pull "second-round"** inflation.

  Recent evidence of (~6-month) ***transmission lag*** *between upstream cost shocks* and *realized inflation* (Chart) suggests it is ***premature to conclude on a linear dis-inflation*** to 2-3%. Instead, **sharp pick-up in upstream/freight costs accentuate risks of interrupted dis-inflation** in coming months.

- In turn, **upping incentives** and **urgency** for central banks **to resist imminent pivot bets**; *deferring timing* and *dampening magnitude of expected rate cuts. Inadvertently,* the **threat of a not-so-soft landing** is **amplified** (by resultant "higher for longer" policy rates imposed).

- *Perversely,* this could **subsequently trigger even sharper rate cuts**; *eventually validating the more aggressive spectrum of rate cut (pivot) bets* in the market. But that would be *for the wrong reasons.*

- Crucially, being **devastatingly wrong on exuberance about "immaculate dis-inflation"** (dis-inflation achieved without any economic damage). Instead, succumbing to a **"forced" a scramble to cut rates in response to an unexpected**, *currently under-estimated,* **risks of a sharper downturn**.

- And there is no mistaking that this (route to steep rate cuts) is **a distinction with a difference**.

- At the most macro level, this spells a **discomforting, if not disconcerting, bout of sobering "risk off"**, and **not *fairy tale* "risk on"** from "immaculate dis-inflation", which markets have fed off.

- Across asset classes, it is **set to play out as**; i) *two-way volatility in yields* with notable rebound risks interim), than linear softening; ii) *sell-off in equities* on recession risks, upsetting unfettered "boom town Charlie" mentality (before relief from rate cuts further out), and; iii) *left-tail USD strength* incited by "risk off"/relative desirability (vs. EUR), overturning unrefined "pivot (bearish) USD" bets.

- Resonating with Sherlock Holmes' reality check for Watson, *"most … conclusions"* on **risk sentiments and attendant asset market outcomes may prove** *"erroneous";* if overly-hopeful expectations of "immaculate dis-inflation" and associated market exuberance are *confronted by under-stated risks of interrupted inflation*, *imposed policy restraint* and *inevitable risk re-pricing.*

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