Mizuho Chart Speak: Macro & Fed

Economics & Strategy | Asia ex-Japan

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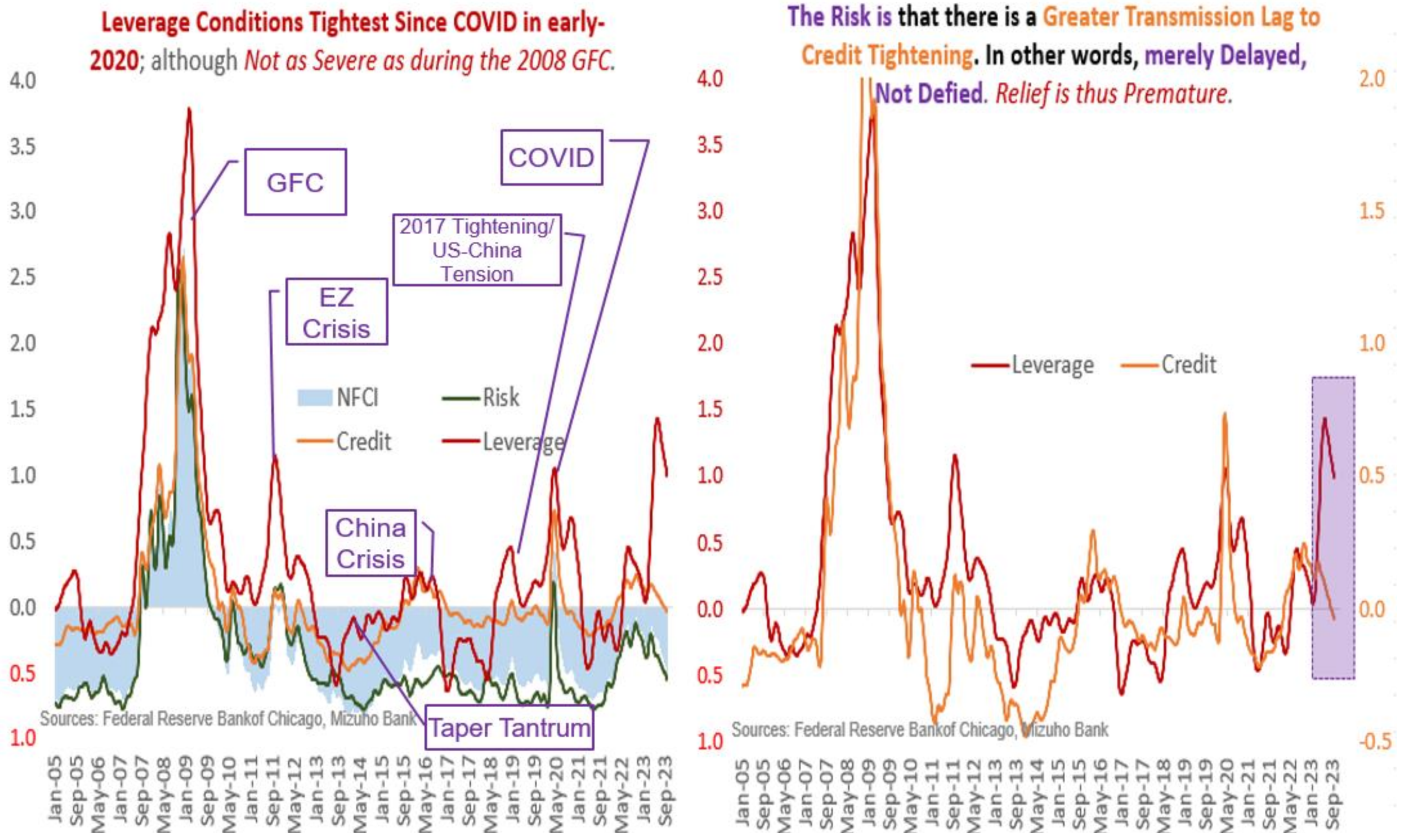
Why the Absence of Credit Tightening is Still Worrying



"Your eyes can deceive you, don't trust them." – ***Obi-Wan Kenobi, Star Wars***

- The conspicuous **absence of** (effective) **credit tightening is worrying** insofar that it might *lull policy-makers and markets alike into a false sense of security*. Crucially, **sanguine credit conditions** are **not merely a passive** "calm before the storm" type of **intermission**, *but* arguably an active **invocation of far more hawkish policy intervention** that *inadvertently amplifies hard-landing risks*.

- Point being, **sanguine credit conditions** *defying brutal rate hikes* are **not to be confused for a tenable policy "sweet spot"**; but instead recognized as *delayed policy transmission* amid *transitory economic/jobs buffer* amid *exceptional post-pandemic obfuscations*.

- For one, it is important to recognise that **post-pandemic quirks**, which *temporarily boosted household savings* and *dulled debt servicing burden* against a backdrop of the *deluge of pandemic liquidity*, have probably merely **stalled, but not stopped, credit transmission from rate hikes**.

- What's more, **credit tightening** (defined as higher price of, and harder access to, credit) may **not** be **durably de-sensitized to**, much less **de-coupled from**, **dramatically tighter leverage conditions that have followed the Fed's tightening cycle**.

- The **"leading" nature of tighter leverage conditions**, reflecting some degree of **slowdown in credit derivative markets** alongside **reduction in marginal credit exposures**, **warns of pre-conditions to precipitate sharp credit tightening**

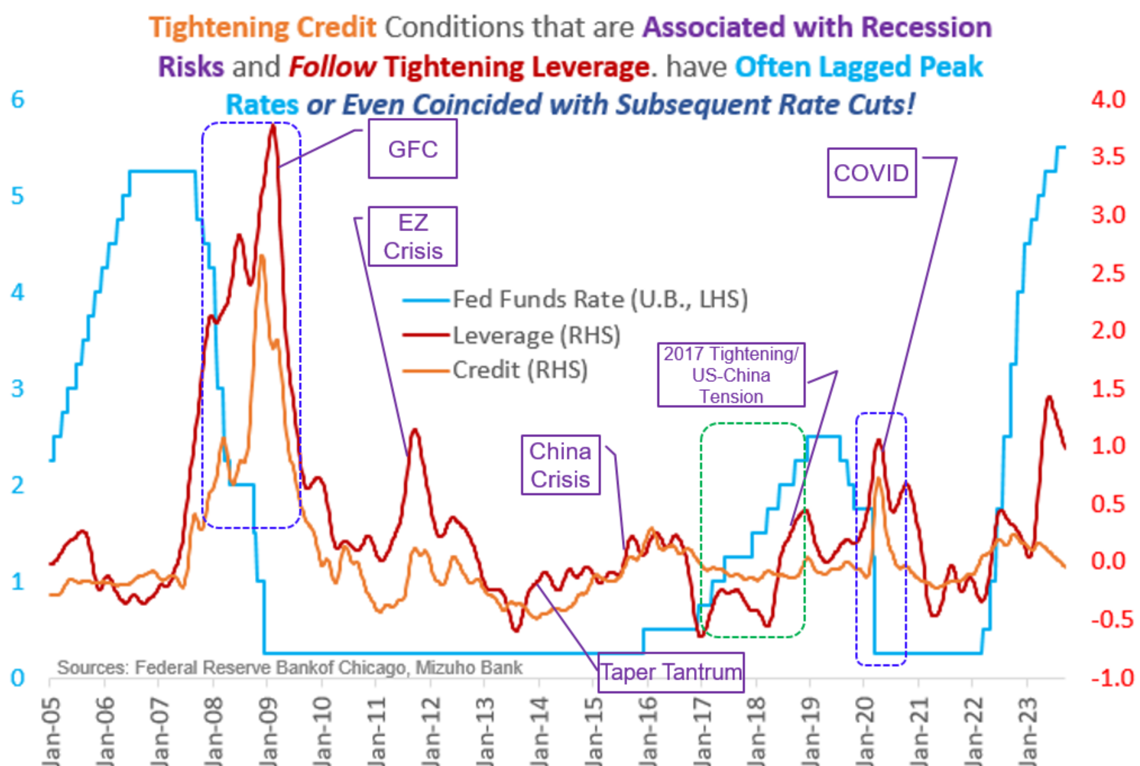
- Finally, **relief about averting downturns from harsh credit tightening is premature**; as history suggests that the **most acute tightening not only took place during, but often, after peak rates**.

- In other words, **worries of a recession** resulting **from credit tightening,** which *inflicts pain in the real economy* and *potentially unleashes financial shocks,* are **not eliminated when the Fed is done hiking; but instead *accentuated only after***.

- All said, **looming economic headwinds** *from tightening are* **chronically underestimated**; as monetary *policy transmission lags* rendered *longer* and arguably *more variable*. Whereas, prevailing **veneer of economic insulation adverse tightening impact is on borrowed time**.

- Worse, **this intervening period of sanguine credit conditions** *ironically* **accentuates hard-landing risks**; insofar that **misguided confidence about "immaculate dis-inflation"** (whereby the economy is spared the jobs/slowdown pain from hikes), *amplifies risks of hawkish policy mis-steps.*

- **Not "seeing"** the usual **signs of credit tightening is no guarantee that it is not looming around the corner**. As Obi-Wan warned our "*eyes*" may "deceive". And **by the time it is "seen"**, **Fed rate cuts in response to credit tightening may be too late to halt the downturn**. Crucially, the *attendant drop in "risk free" (Fed/UST) rates may not adequately compensate for rising risk premium.*



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