Mizuho Brief: US

Economics & Strategy | Asia ex-Japan

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Vishnu Varathan | Head Macro Research, Asia ex-Japan

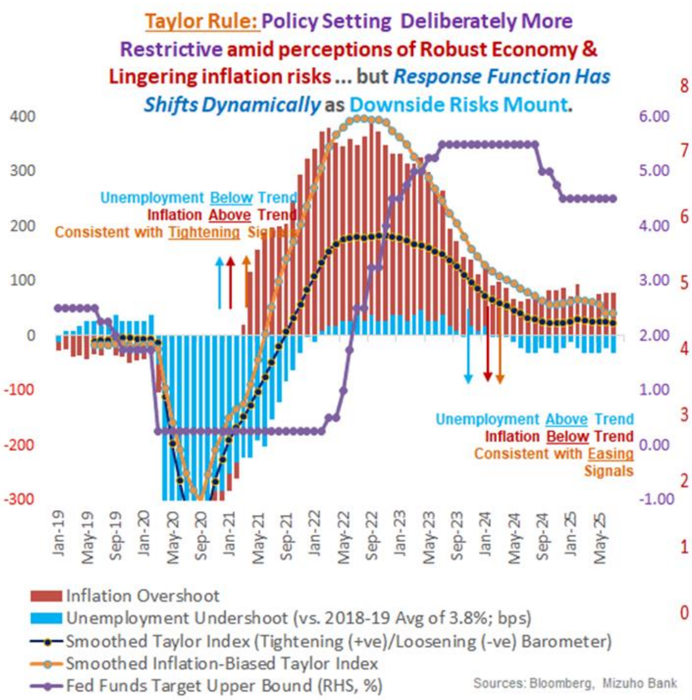
FOMC: Reconciling Concerns & Calculus

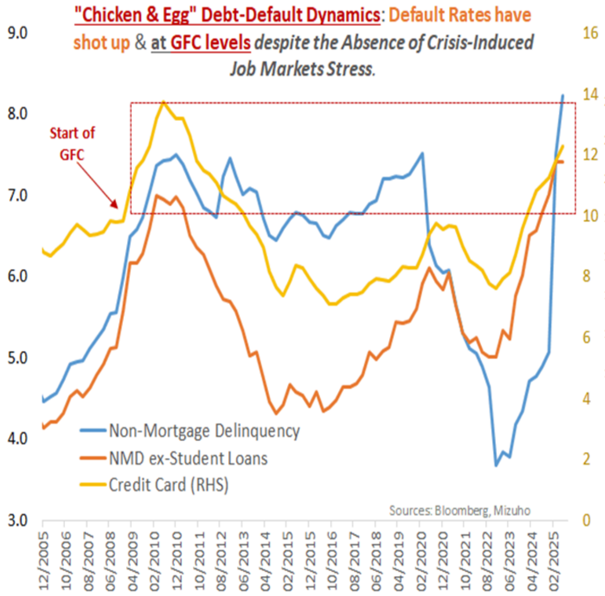
"Your focus determines your reality" – **Qui-Gon Jinn**

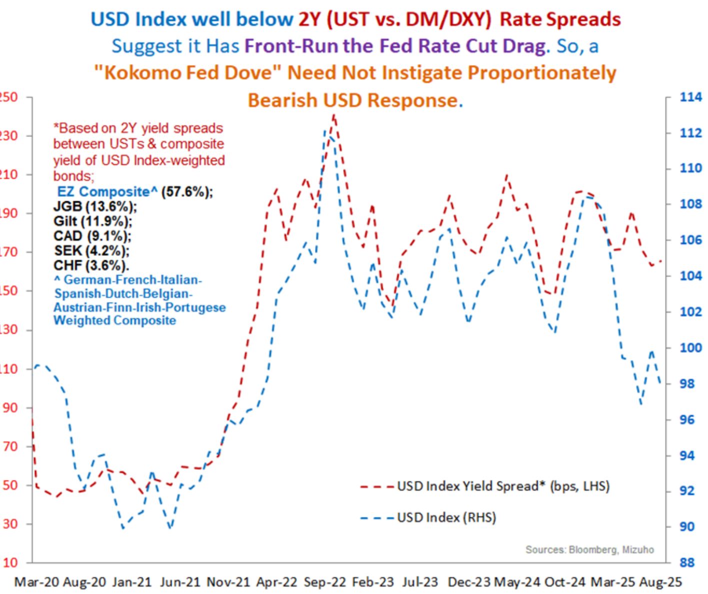
- Inflation Concerns Not Disputed: That the "majority" of **FOMC members deemed risks to inflation as the greater concern** at the July FOMC is a fact we do not dispute. But the focus is misleading.
- But Concerns & Calculus Not One and the Same: But the critical thing that is easy to overlook in the heat of the headlines is that concerns are one thing. But monetary policy calculus quite another.
- Context of Restrictive Fed Fund Rates: For one, context matters. At 4.25-4.50%, the **Fed Funds rate is unequivocally restrictive**. *Even with "concerns" about inflation being elevated above 2%* for a prolonged period.
- So, Direction of Travel of For Lower Rates: Which is to say that the **direction of travel for Fed Fund rates is lower**, not higher. In fact, by Powell's own admission, the **rate cut cycle is suspended only on account of tariff uncertainty**.
- Timing & Depth: Instead, **the core of Fed calculus** now concerns the *timing* and *depth* of rate cuts. In other words, **how soon cuts resume**, followed by **how fast these cuts then take place**. And then **how far the cuts go** (in determining "neutral").
- "Taylor Rule" Type Gauge Suggest Materially Lower Rates: ***On depth***, **Taylor Rule type analysis suggest rates may be much lower**. So, while the Administration's methods of jawboning are questionable, *Bessent's point on models suggesting the materially lower rates is not negated*.
- So, Risks are "Too High for Too Long": What that means is that the *Fed's prolonged pause has actively extended considerable policy restriction*. In which case, the **risk is passively stumbling into "too high for too long"** as tariff uncertainty inadvertently imposes policy paralysis.
- Inconvenient, Not Inflammatory, Inflation: Crucially, *sticky inflation* and *pipeline tariff-induced price shock risks* are likely to be **inconvenient, not inflammatory given** compelling evidence of *softening jobs* and *household cashflows* getting *considerably constricted.*
- Wage-Price Spirals Checked: Fact is, a **softening job market**, with *starkly diminished confidence* (as highlighted by a sharp pullback in quit rates), suggests that **wage-price spiral risks are checked**.
- Demand-Pull Damped: What's more, **mounting** evidence of **household cashflows constriction is suggests demand-pull mechanics damped**, *if not impaired*. Admittedly, **credit delinquencies need not trigger a crisis**. ***But*** cash-flow constraints will **significantly dent demand**.
- Ironically, Tariff Shocks Ultimately Deflationary: And arguably, **tariff-induced price shocks juxtaposed against constricted household cashflows accentuate demand shocks**. Ironically, may even be **ultimately deflationary** as *eroding profit margins* and *weakening jobs* market/*wage dynamics* conspire.
- Doves Interrupted, Not Hawks Instigated: The upshot is *despite inflation concerns*, the **FOMC is really a case of doves interrupted**, ***not hawks instigated.*** **Room for rate cuts** (at least 75-100bp into early-2026) is

undisputed. And the **timing of resumption** is **sooner rather than later** (25bp cut at he September FOMC to resume the cycle).

- Catch-Down Doves, Lower Yields, Steeper Curve: Barring unforeseen adverse fiscal shocks, this ought to **lower yields**. But far *more distinctly at the front-end*, with **further curve steepening** par for the course (amid fiscal and inflation uncertainty inducing long-end volatility).
- Softer, But Not Slumping, USD: Counter-intuitively, **expectations of corresponding and proportionate USD weakness** is bound to **be misguided** as **USD pullback appears to have front-run rate cuts**. Hence, **softening in the USD is likely to be more measured** (DXY at 95-98).
- Cover for Rate Cuts in Asia: The **cover of** a sufficiently **softer USD** and **inflation spreads** broadly in favour of Asia (stickier and/or more elevated US inflation vis-à-vis Asia) will by and large provide **scope for more rate cuts/easing for Asian central banks**, *whilst mitigating macro-/currency-stability risks.*




"Chicken & Egg" Debt-Default Dynamics: Default Rates have shot up & at GFC levels despite the Absence of Crisis-Induced Job Markets Stress.
Start of GFC
Non-Mortgage Delinquency
NMD ex-Student Loans
Credit Card (RHS)
Sources: Bloomberg, Mizuho


USD Index well below 2Y (UST vs. DM/DXY) Rate Spreads Suggest it Has Front-Run the Fed Rate Cut Drag. So, a "Kokomo Fed Dove" Need Not Instigate Proportionately Bearish USD Response.
*Based on 2Y yield spreads between USTs & composite yield of USD Index-weighted bonds;
EZ Composite^ (57.6%);
JGB (13.6%);
Gilt (11.9%);
CAD (9.1%);
SEK (4.2%);
CHF (3.6%).
^ German-French-Italian-Spanish-Dutch-Belgian-Austrian-Finn-Irish-Portugese Weighted Composite
USD Index Yield Spread* (bps, LHS)
USD Index (RHS)
Sources: Bloomberg, Mizuho