Mizuho Brief: Fed

Economics & Strategy | Asia ex-Japan

16 February 2026 |
Vishnu Varathan | Head Macro Research, Asia ex-Japan

The Fed's Dilemmas & Distractions

"Do not assume anything Obi-Wan. Clear your mind must be if you are to discover the real villains behind this plot. "—
Master Yoda, Star Wars

- The **palpable relief over somewhat cooler-than-expected US CPI** reveals **underlying tensions within the Fed** amid ***diverging views on pertinent (for policy) risks***.
- The upshot though is that all this **agonizing over opposing inflation** and **jobs risks** – and for some **stagflation-type dilemma –** that **divides the Fed** is justifiable, *but **ultimately a distraction*** from the **overarching**, *albeit obscured,* **threat of "too little, too late"**.
- More so, given **weak underlying demand dynamics set to** override, **tariff-induced price shocks**, which are more likely to fade than fester.
- Point being, risk of **inflationary spirals are contained** as **neither** the *post-pandemic, pent-up "YOLO*" demand agitations* **nor** any price shock akin to the *persistent "oil shock" of the 1970s* are likely to be sustained.
- Especially not when *adverse tariff shocks, fragile confidence, softening job sentiments* and *disinflationary energy dynamics* conspire to **dampen overheating risks** from ***demand-pull*** and ***wage-price*** dynamics.
- Hence, *even if* dovish inclinations are *presently hamstrung by prominent inflation risks,* ***demand deficiency will overtake*** *as the more persistent threat,* **warranting further policy easing**.
- Nonetheless, the **current policy quagmire** is **unavoidable** *given acute uncertainty. And so, the **probability of belated policy response rises**.*
- But the **greater intervening risk** is **perceived challenges to policy independence** *from misguided political interference* that undermine policy credibility and complicate policy calculus.
- Ultimately, the **greatest policy danger** is from **high-stakes US geoeconomic adventurism**, inadvertently **gambling with *USD's reserve currency dominance*** *alongside UST reserve asset allure.*
- Resultant *USD debasement threats* as *US credit worthiness* takes a knock in the wake of **geoeconomic-fiscal upheaval will feature** as **structurally higher term premium**.
- In any case, *fiscal slippage woes*, *stagflation risks*, and *Fed easing* (further out) will **steepen the curve**.
- Wrap: **Runaway inflation risk is a red herring**. But **impaired transmission**** poses a serious **problem**, **compounded by impeded rate cuts** *amid superficially conflicting risks*. ***Attacks on Fed independence*** and ***"de-dollarization" risks*** are the Fed's ***greater structural challenges***.
- Ripples Beyond (the Fed): The repercussions from which are not just **profound** but **pervasive**.

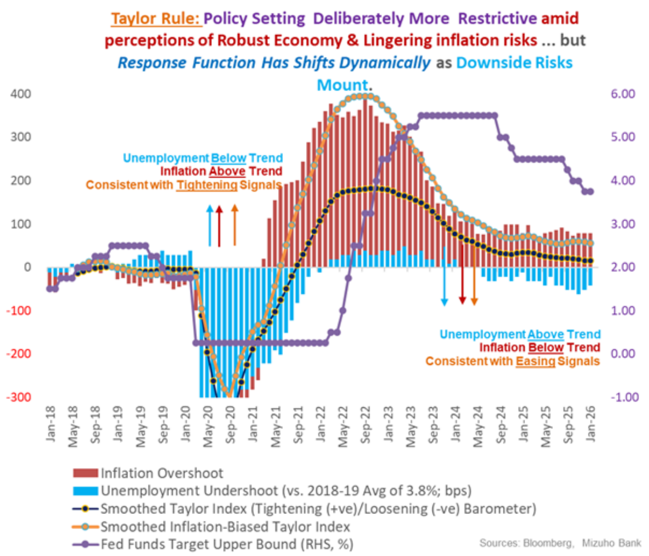
  a. Sharper Fed rate catch-down later in 2026 may cyclically induce ***enlarged volatility*** in *JPY, AUD, NZD* (given relatively divergent hawkish BoJ, RBA and RBNZ).

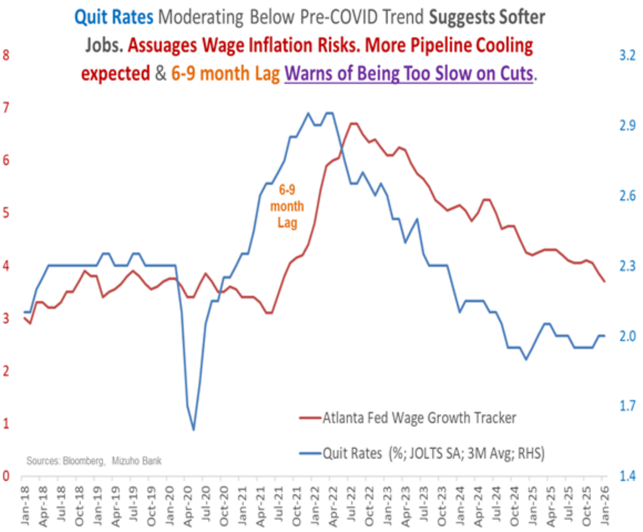
  b. Structurally, surge in demand for non-fiat monetary alternatives (e.g. Gold), at the expense of "stable portfolio returns", could perversely incentivize ***greater, compensatory, risk-taking*** elsewhere.

c. Yet, amid structurally higher term premium means that ***risk re-pricing*** may be ***more pronounced*** and ***differentiated*** as significantly and durably **term premium conspires** with **more intense demand for capital** (accentuated by AI capex demand). This *sets up EMs for sharper differentiation along fiscal-monetary and governance risks.*

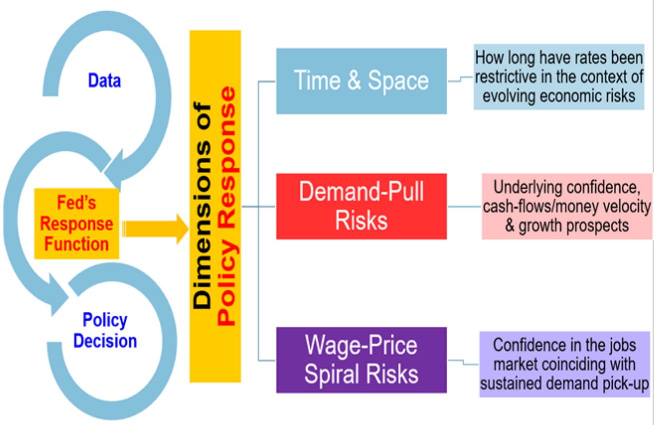
* "YOLO" is shorthand for "you live only once" approach that prioritizes gratification/consumption over associated risks and resultant debt/future liabilities.

** Evident in sticky long-end yields (holding above 4% despite a cumulative 175bp of rate cuts.

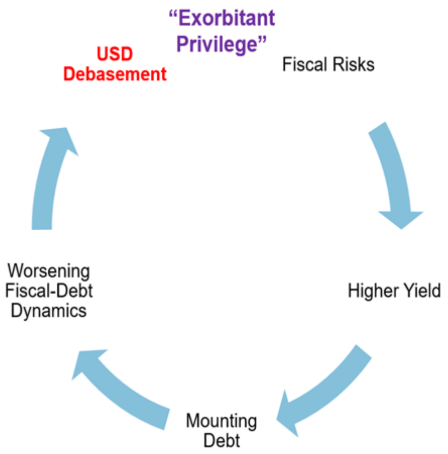


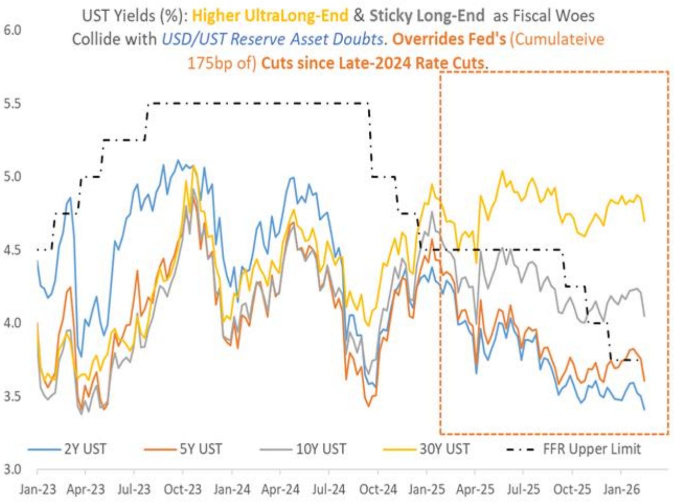


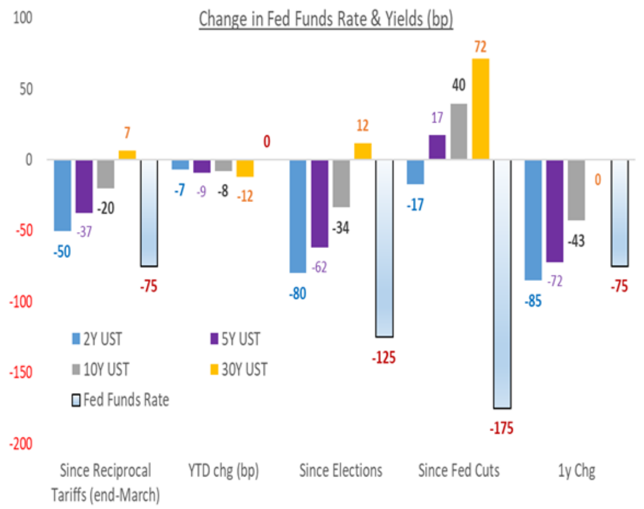
Dimensions of Fed Response Function

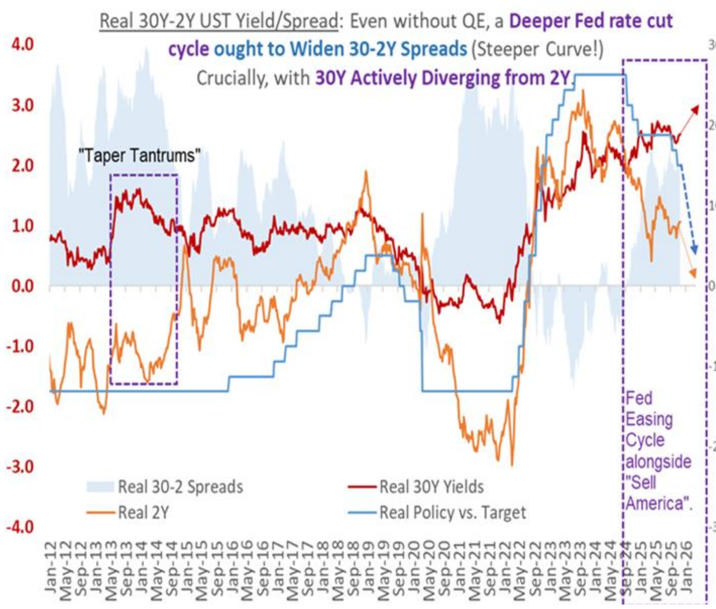


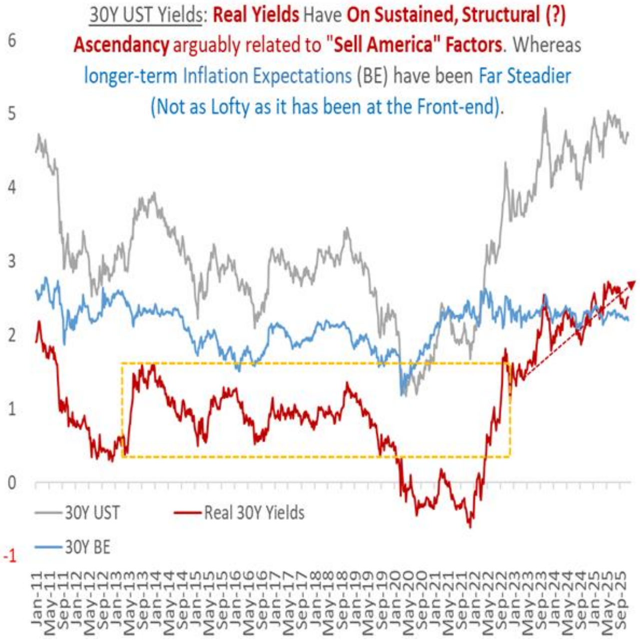
"Sell America" Ultimately Most Acute in USD → Where the Buck Stops




UST Yields (%): Higher UltraLong-End & Sticky Long-End as Fiscal Woes
Collide with USD/UST Reserve Asset Doubts. Overrides Fed's (Cumulateive
175bp of) Cuts since Late-2024 Rate Cuts.
2Y UST
5Y UST
10Y UST
30Y UST
FFR Upper Limit
Jan-23 Apr-23 Jul-23 Oct-23 Jan-24 Apr-24 Jul-24 Oct-24 Jan-25 Apr-25 Jul-25 Oct-25 Jan-26


Change in Fed Funds Rate & Yields (bp)
2Y UST
5Y UST
10Y UST
30Y UST
Fed Funds Rate
Since Reciprocal Tariffs (end-March)
YTD chg (bp)
Since Elections
Since Fed Cuts
1y Chg


Real 30Y-2Y UST Yield/Spread: Even without QE, a Deeper Fed rate cut
cycle ought to Widen 30-2Y Spreads (Steeper Curve!)
Crucially, with 30Y Actively Diverging from 2Y
"Taper Tantrums"
Fed Easing Cycle alongside "Sell America".
Real 30-2 Spreads
Real 30Y Yields
Real 2Y
Real Policy vs. Target


30Y UST Yields: Real Yields Have On Sustained, Structural (?)
Ascendancy arguably related to "Sell America" Factors. Whereas
longer-term Inflation Expectations (BE) have been Far Steadier
(Not as Lofty as it has been at the Front-end).
30Y UST
Real 30Y Yields
30Y BE