

The Trouble with TACO

In a Nutshell:

The upshot is that **this iteration of TACO**, with **Trump looking to "end the war" in 2-3 weeks** *without committing to re-opening the Straits of Hormuz*, **may inevitably leave shocks intact**. For a start, a **more pugilistic Israel** that may be inclined to persist with attacks **may – despite Trump's desire to exit –** arguably **trap the US in a more prolonged war**, *potentially rendering TACO short-lived*. What's more, **US withdrawal does not guarantee enduring peace**. Notably, the conflict could **extend as Israel-Iran/Lebanon war**, *perversely even intensifying and broadening if the GCC join in*. In turn, **inadvertently exacerbating supply shocks**, thereby **underpinning** (not alleviating) *hard-to-price binary risks to inflation (spirals) and demand destruction*. Crucially, with US' relative energy security/buffer means that the **fallout from the Iran war is socialized globally**, with **Asia hit disproportionately**. Accordingly, **AXJ are set to under-perform – even if USD eases on "TACO" relief** (reversing have gains) amid **adverse feedback loops** with *acute policy dilemma* and *prohibitive economic costs*.

TACO (Again!) – Noise Over Signal?

- In the **latest edition of TACO**, Trump has suggested that the US will pull out of Iran in 2-3 weeks, *albeit not committing to re-opening the Straits of Hormuz**.
- **Markets have ostensibly rejoiced**, with **equities surging** (Wall St up 2.5-3.8%) amid, accompanied by a *mellower USD*.
- *Trouble is*, **exceptionally high noise-to-signal ratio** through the Iran War **challenge linear projections** (and logical progression).
- Upshot is that *even if* this **is intended as a signal**. But **may inadvertently turn into noise**.

* Imaginably, as impaired passage of energy through the Straits of Hormuz is a far greater threat/cost for Asia/Europe than it is for the US. Hence dis-aligning incentives between US and US allies.

Intended Signal

- To be fair, **Trump may** in fact be **sincerely looking for a bail option**.
- Especially **given** that this "excursion" has **blown out** (and **blown-back**) as a wider **Middle East crisis** with dire global impact **that the US/Trump cannot afford**.
- Which is **crucially**, *decimating his approval ratings* and *threatening mid-term prospects* for the Republicans (and Trump's political sway within the Congress).
- Hence, it is **highly conceivable that Trump intends for this to be signal**.

Inadvertent Noise

- But the reality is that there is a **huge gap between intent and outcome**.

- Notably, *despite Trump's desperate desire for intended signal*, **this iteration of TACO may inadvertently turn out to be noise**.
- And there are two broad dimensions as to why that may be the case.
 1. *If Israel manages to drag the US into a prolonged conflict (as it has before)*, the **US/Trump may be trapped in a 'Hotel California' quagmire**** – “*check out any time ... but ... never leave.*”
 2. And **passage through the Straits of Hormuz (SoH) may remain impaired** *even if Trump successfully pulls out US troops. Especially as Trump has disavowed clearing SoH passage as an objective for ending the war.*

** See our earlier publication “No TACO at Hotel California” [[69c9e6aade4f6f0ef5caf8e4_Mizuho Brief_No TACO at Hotel California_260330.pdf](#)]

“Trading Hormuz,” Not Hope

- Point being, **markets need to be clear-eyed about trading Hormuz/wider Middle-East risks**, and *not simply TACO*.
- For a start, a pugilistic Israel (with unrelenting strikes on Iran/Lebanon etc), **accentuates threat of severe Iranian retaliation involving regional energy/strategic assets/passage**.
- What's more, **without US cover**, the GCC could join the conflict exacerbating tail risks.
- Consequently, **energy prices** and **wider risks assets** are **susceptible to any prevailing “Hormuz risks”**.
- And **not resolved merely on unilateral US pull-out from the Iran War**. *Certainly not redeemed by TACO hopes*.

Shock & Flaw

- Meanwhile, what matter more enduringly for markets are the inevitable **impact of various shocks**. Notably:
 - a. **Energy shocks** – both in the form of **price jolts** and flows impeded/physically – emanating from the Middle East conflict.
 - b. But not just. Instead, far **wider** (and **persistent**) **critical supply-shocks** – spanning from fertilizer to inputs for semiconductors –
 - c. The **first-pass** (supply-side) **inflation effects**, and **consequent fiscal pressures imposed** (from *government efforts to blunt shocks*)
 - d. Which may then be quickly followed, if not **accompanied**, by **demand destruction threats** as *activity is restrained by affordability and/or availability* (e.g. of jet fuel)
- Making matters worse, is the **unenviable monetary policy dilemma** caught between the **conflicting inflation risks** and **demand destruction threats**.
- Frustratingly, **policy may end up looking flawed** one way or another. Be it **tightening into a slump** or **holding as inflation lifts off**.

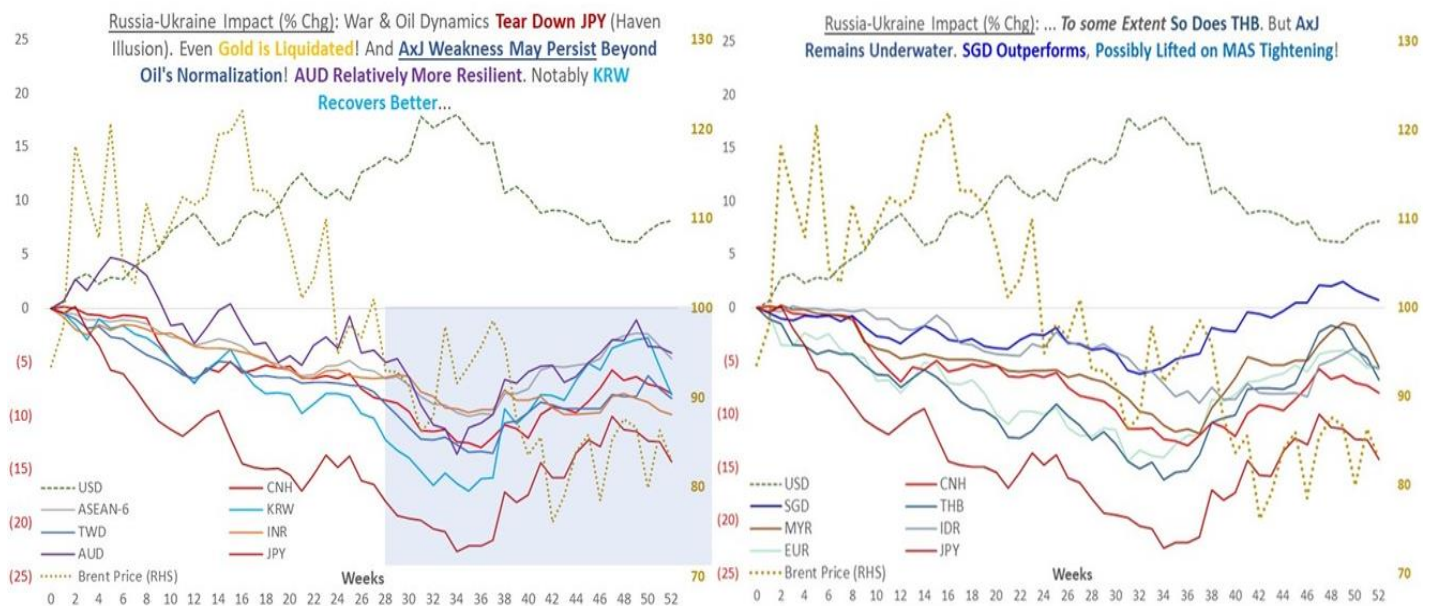
Asia's Acute Vulnerabilities

- *Outside of the Middle East*, **Asia will bear a disproportionate share of the economic pain**. *Both inflation shocks and demand destruction*.
- Especially **given** that **80-90%** (in some specific cases more!) of **crude/refined products** and **LNG** routed **via the Straits of Hormuz** are headed for Asia.

- Accordingly, **Asian central banks may face the harshest policy trade-offs.**

Underpinning AXJ Under-performance

- Arguably, it follows that **Asia will struggle** with the **most acute pressure on currencies**, where macro shocks may be *most sensitively expressed*.
- Whereby **rate hikes to contain inflation** and **to avert self-reinforcing currency depreciation spirals** comes **at the sharp expense of economic growth** (as higher rates exacerbate pain from energy/food shocks).
- And **adverse feedback loop** between *tightening* (amid policy dilemma), *economic pain* and *currency pressures*, threatens to **entrench AXJ underperformance** – as was the case during Russia-Ukraine (See Charts below).
- More so, **amid attendant pressures on Asian assets**, including equities (as margins get hit) as well as *widening credit* spreads pressuring bonds.
- All said, **this version of TACO**, with Trump ending the war without securing the Straits or broader peace, **invariably leave shocks intact** and **socialize the prohibitive economic costs** globally – and **especially acutely to Asia**.



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