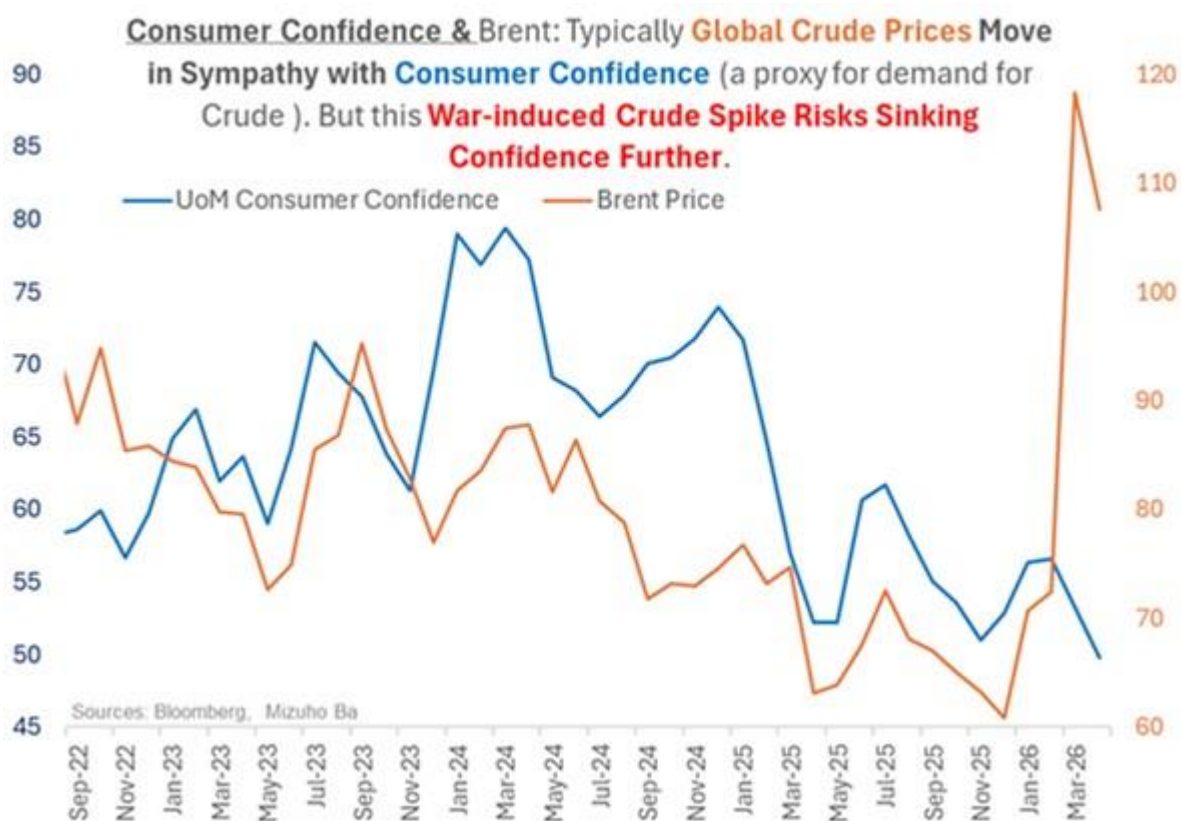


Central Bank Watch: Agitated Inaction

“It is stupidity rather than courage to refuse to recognize danger when it is close upon you.” – Sherlock Holmes



Fraught Hold: The **Fed**, **BoJ**, **ECB** and **BoE**, all **set to be on hold**, this week, will reflect a **fraught pause** amid mounting policy tensions, not a comfortable equilibrium.

Acute Policy Dilemma: To be sure, the **specific calculus may vary**. But what's consistent is the **intensifying policy dilemma** posed by war-induced oil (and wider supply) shocks.

Price & Passage: As the war drags on, the global economy is increasingly exposed not merely to **price shocks** but also **disrupted passage** of critical energy/goods.

Conflicting (Demand-Inflation) Risks: In turn, this **exacerbates conflicting threats** of **inflationary shocks** and **debilitating demand destruction**.

Opposing, Not Offsetting: Crucially, the **opposing inflation** and **demand destruction risks do not** conveniently and costlessly **offset**.

Tipping Points: Instead, posing **significant threats of tipping** one way or the other into acute **as inflation or demand destruction** risk - *even if stagflation-type shock is averted*.

Asymmetry & Hysteresis: What's more, **asymmetric costs/damage** coupled with **hysteresis** suggest **disproportionate pain** as this state of affairs prolongs.

& Polarization: Making matters worse, it will be *hard to predetermine* (hence, *pre-empt*) the **polar-end at which risks blow out**.

Blind Pick: And given that **central banks may only effectively address either inflation or demand destruction** risks, there is a **dimension of a high-stakes “blind pick”** involved in any current policy action.

Policy Conundrum: The **real conundrum** in all of these is that *central banks may inadvertently exacerbate pain if the “wrong” risk is addressed pre-emptively*.

(Interim) Pause ...: **Given the potentially high** (economic and credibility) **cost of getting it wrong** in the “fog of war”, central banks are **likely to pause to assess in coming weeks**.

... before Potential Pivot: **But** inevitably **risk falling behind the curve as the dominant risk reveals itself**. And could then be **forced to pivot to more aggressive action**.

The “EM” Quagmire: Arguably, **some EM central banks have it worse**. Rather than a precarious pause between inflation-demand tensions, a **quagmire imposed by potentially destabilizing currency pressures** that *force* them into (economic) *pain-amplifying tightening*.

Latent DM Rates Volatility: The risks of *sharp policy pivots/inflections down the road* warn of *latent (and possibly sharp) rates volatility* in store.

USD & JPY at Odds: Despite both the Fed and the BoJ holding *JPY may be undermined* while *USD may be underpinned* as **FOMC is be perceived as a hawkish hold** whereas **BoJ may be dismissed as a dovish disappointment**.

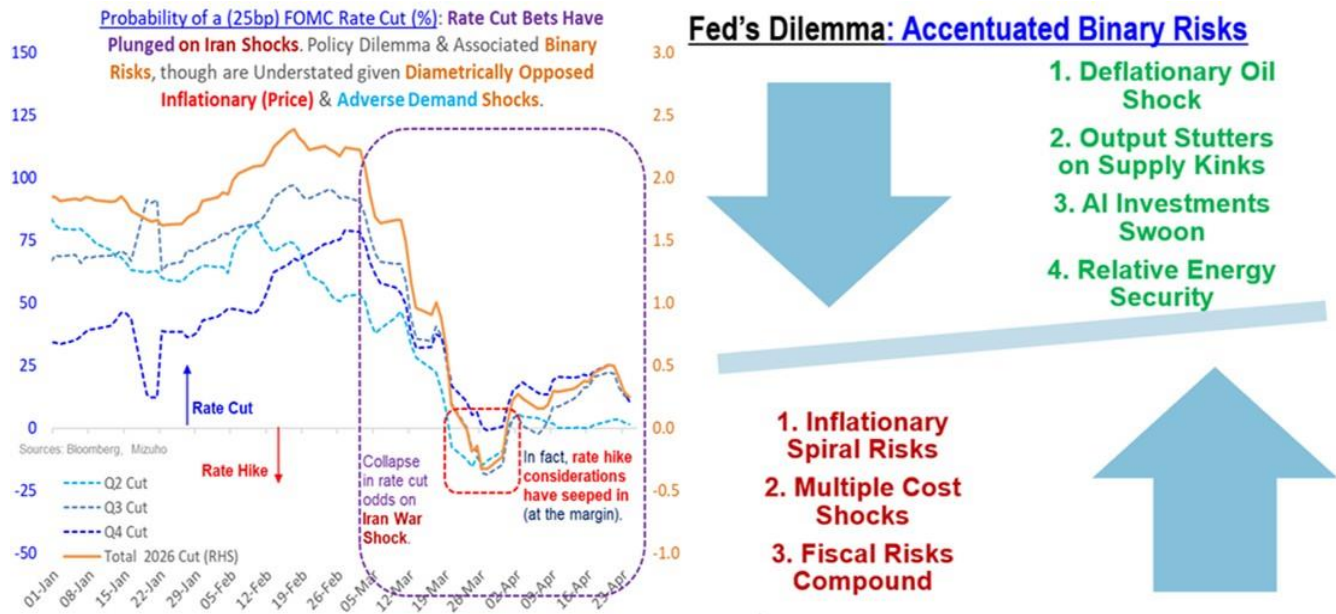
EM Rates Pressured Up Risks: *Prevailing currency pressures* from the war/energy/supply shocks likely to spill-over as upward pressure on EM/AXJ rates on risk re-pricing/tightening.

AXJ Non-Reversion Risks: But **despite rate hikes**, higher-yielding AXJ may not fully reverse declines. *Non-reversion may persist* as the Middle East conflict extends.

FOMC Watch (29 April): Of Guns & Jumps

- The **Fed**, at its April FOMC, is **set to stay on hold**, rightly assessing that it is **premature to jump the gun with policy action (either way!)**.
- And certainly, there is **no necessity to (prematurely) gun for a jump in rates** despite worrying signs of inflationary pressures ahead.
- Point being, it is **too early to conclude whether inflationary risks or adverse demand shocks will prevail**.
- Hence, **current conditions amid the “fog of war” suggests that the “Powell hold” may remain the sweet spot** despite sharp price shocks set off by war.
- Arguably, there is a **case to be made for a hawkish drift in FOMC inclinations** given the **strong jobs print** and the **temperature gauge on inflation rising**.
- In fact, **pipeline price pressures exacerbated by the Middle East conflict**.
- What’s more, this may be **coupled with a growing view that structural/demographic shifts now don't require net job creation**. In other words, zero job created as a trend is acceptable for the Fed.
- Hence, all else equal a reasonable argument is that this **inflation-jobs shift** now **lowers the bar for the Fed to not just suspend cuts, but perhaps even hike**.

- And so, there may be **slight tilt for markets to read the FOMC as a hawkish hold**. Which suggests a *hint of bear flattening* and *USD backstop*.



BoJ Watch (28 April): Rock & Hard Place

- We **expect the BoJ to hold steady** at this meeting as the **oil shocks from the US/Israel-Iran war simultaneously threaten** to **unleash debilitating demand destruction on one hand** and **further inflame pre-existing inflationary risks on the other**.
- And inconveniently, these two **diametrically opposed risks** that *do not negate* one another but *instead morph into an accentuated iteration of one of the two* further down the line.
- Trouble is, until that point, the **BoJ does not have the requisite clarity on which risk will prevail** and the attendant response to adopt.
- The upshot is that the BoJ is inextricably **stuck between a rock and a hard place** with **hands tied by a conundrum rather than clasped in contemplation**.
- Notably the **ability** (and any inclination) **to pre-emptively ease to cushion potential adverse growth shocks** (by easing) **is hobbled by elevated inflation that predated the Middle East crisis** and **acute JPY pressures**.
- **Yet, the BoJ cannot afford to hike too much too soon* lest it ends up irredeemably destroying any shot at enduring, healthy reflation**.
- Especially as **cost shocks decimate profitability, jobs and household confidence**.
- And so, the **BoJ will probably have to sit on its hands** and **buckle up for unwelcome downside JPY volatility**.
- The latter is best addressed outside of the **interest rate tool** as hikes have in the past proven to be **ineffective in durably propping up the JPY**.

* Scars from the “lost” decades of unremitting deflation underpinned by chronic confidence deficit ought to be a haunting warning, even for BoJ hawks.

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