Mizuho Brief: FOMC

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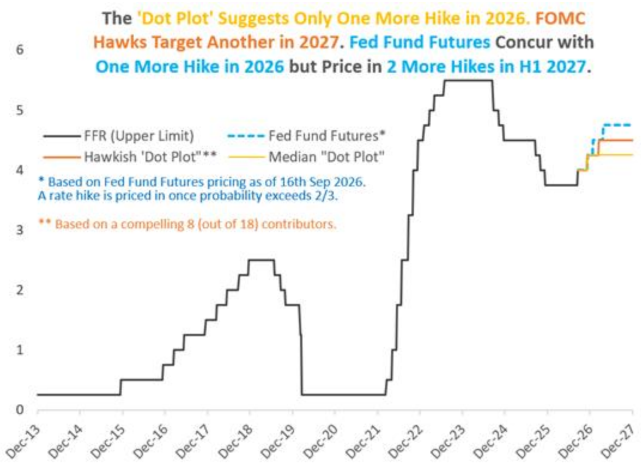
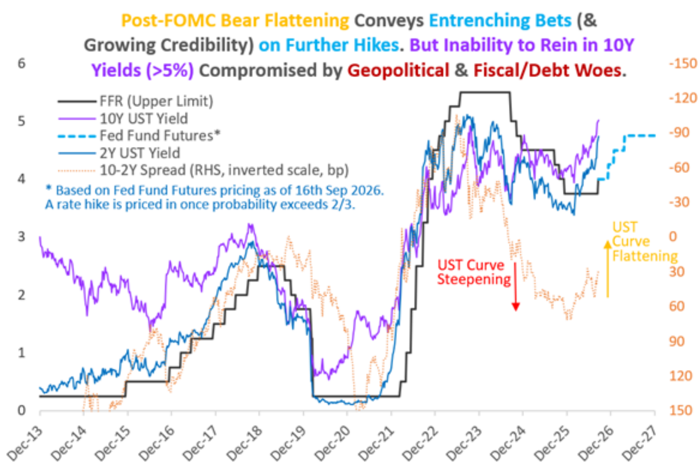
Credibly Hawkish FOMC is Pain Relief Not a Panacea (for Long Bonds)





- <u>A *Credibly* Hawkish Hike</u>: The **Fed** appears to have pulled off **a sufficiently hawkish hike**. The litmus test for which is having successfully <u>**averted the worst-case outcome of long-end led bear steepening to the detriment of the USD**</u>.

- <u>Marked by Bear Flattening & Bullish USD</u>: In fact, the consequent **post-FOMC bear steepening** (2Y: +7-8bp to 4.74%; 10: +2bp to 5.02%) **alongside an appreciably stronger USD** (DXY up ~0.6% at 100.3) **suggests** that the **September FOMC –** *both in its walk and talk* **– has been constructive for Fed credibility**.

- <u>Walk, Talk & "Dot"</u>: Point being the **rhetoric unwaveringly backed** the unflinching **25bp hike**, (regardless of a 9-3 vote). Especially as Fed Chair Warsh stressed on the "*start of*" **Fed response to stubborn inflation** – even if it is driven by supply-shocks. And further backed by a **hawkish shift in the 'Dot Plot'**.

- <u>Leaning Towards 2 More Hikes</u>: The **"Dot Plot" median** reveals **one more hike for 2026** that lends itself to a decisively hawkish approach. What's more, *median for a 2027 hold is obfuscated by a dovish minority* (of just 4). Whereas **a significant 8 out of 18 contributors** (with Fed chair Warsh abstaining) have **pencilled in a second follow-up hike in 2027**.

- <u>"Removed a Dose of Accommodation"</u>: Notably, **Warsh's characterization** that this 25bp **hike** "*removed a dose of accommodation*" in the context of "*inflation (that) is too high, and has been for too long*" lends itself to a **credibly hawkish Fed tackling inflation**. Which in turn **underpins** the **USD alongside front-end yields**.

- Ahead of, Not Inverting, the Curve: *Nonetheless*, as highlighted in our Fed views yesterday, it is **one thing** for a credibly hawkish Fed to get "ahead of the curve" but **quite another to invert the UST yield curve**. Which means **getting long-end yields to materially lower** (beyond containing the ascendancy) **remains a very long shot**.

- As Bond Bears Have Fodder Other Fed Credibility: Notably, as **reining in inflation expectations** *alongside reinstated Fed credibility/independence* **merely contain**, **not dramatically reverse**, **long-end yield ascendancy**. Especially considering **overwhelming upside long-end yields pressures attributable to** *serious US fiscal/debt/debasement woes* conspiring with *geopolitical/energy shocks* amid *AI capex boom* (driving robust growth, "chip-flation" and bond issuances) without "active QE offset".

- "5 is the New 4"?: And so, ***even as the Fed re-establishes credibility*** and ***reins in inflation risks***, **10Y yields may not revert to the 4.0-4.5% H1 2026 range** (which would necessarily require yield curve inversion from current front-end yields corresponding to Fed Funds pricing), *instead consolidating sub-5% to 5.4%*. ***Without compelling resolution to Iran-Hormuz*** and/or ***US fiscal/debt woes***, "5 may be the new 4" for 10Y UST yields.

- Adversely Impacting JPY-BoJ Dynamics & Pressuring AXJ: Inevitably (and it is beside the point that this is inadvertent), the *hawkish Fed expectations driving higher long-end UST yields* alongside a *stronger USD* **not only pose additional headwinds for AXJ**, but crucially, **further frustrate attempts to stabilize BoJ-JPY dynamics**. And more acutely so **as the Fed-UST yield-USD dynamics exacerbate pressures/vulnerabilities from resurgent oil**.