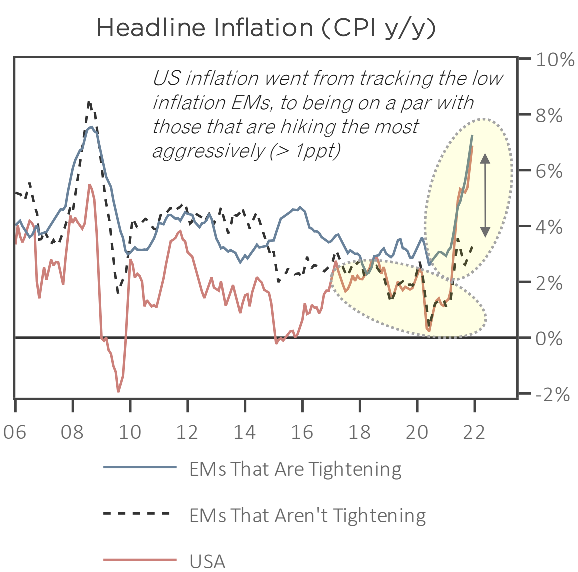
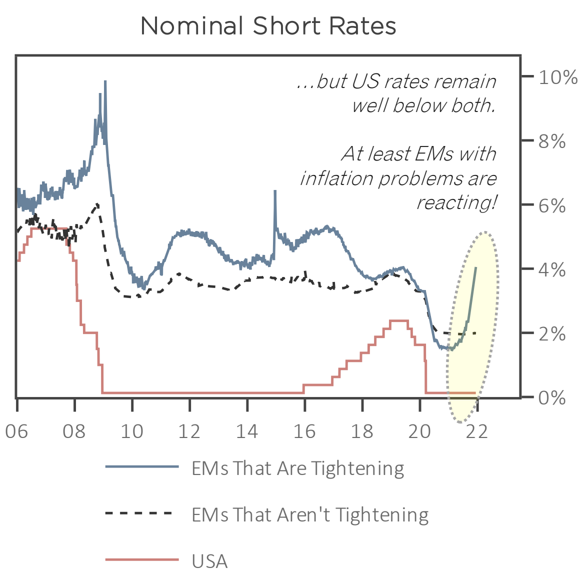
PUT DOWN

We strongly believe whole swathes of dollar and dollar-linked assets are in a bubble, the extremity of which we're unlikely to ever see again in our investing careers. To sum up, we've got a once-in-a-lifetime bubble in the US, and a once-in-a-generation value opportunity in broad sections of EM. Those two things aren't exactly unrelated. Just like the '20s and the '90s, the US bubble has sucked all the oxygen out of the rest of the world. But bubbles die when the flows that drove them slow (because there's no space for folks to own even more than they already do) or reverse (which always happens when rate hikes follow bubbles). After this bizarro year, there can be no doubt that everyone's already all-in. Now we expect faster-than-priced rate hikes well within range…six months out or less.

We've said countless times that this money-fuelled everything bubble would only end with inflation…because QE drove it (both directly and indirectly via monetised fiscal), and because that would be the moment the Fed's hands would be tied, the "put" would be down, and valuations would adjust for higher rates. The inflation's been plain as day for well over a year, but this vampire bubble still lived on. The Fed sold the market this transitory inflation bullshit this whole time, and the market, cued to the "post-GFC deflation" script and not this "exploding liquidity" script, bought it. And to be clear, the market had no incentive to question it as long as the Fed stuck to the script. It takes a while for people to change tack when buy-the-dip is, for many market newbs, all they've ever know, and when it paid out 100% of the time. But the Fed is no longer sticking to the script. *Even they* are willing to admit they were wrong albeit in language reminiscent of Clinton-esque obfuscation ("depends on what the meaning of the word transitory, is"). We've believed that as long as yields and inflation were rising from low levels, like always after recessions risk assets would do well. We said get worried when inflation becomes a problem, and when short end hikes are aggressively pulled forward. That's now. And the truth is, market valuations are way more extreme now than when we said that. All the signposts we described in our June 2020 report "HOW THIS ENDS" are now lining up in a way that, at least to us, makes this the dip not to buy. We continue to lean into the rotation, and we now expect it to be a bearish one.





AT THE END OF A BIZARRO YEAR, NOW GETTING A LENS INTO THE FUTURE

This almost goes without saying, but this year has been extremely unusual. It was by no means obvious that the record-breaking everything bubble would not only sustain but become even more extreme, in the face of massive inflation. Or that the "rotation" to play for was within the tech sector itself – with the five biggest tech stocks generating substantially all global equity returns, even while the rest of the Nasdaq would fall by double digits. Or that inflation hedges didn't work well, and the long end didn't move much despite points one and two! Or that commodity prices

DEC 13th, 2021

would surge, "reformed debtor" EMs would have greater current account surpluses than ever before, and yet EMFX would be flat – also not obvious. The *only reason* for all these things – in short, that macro conditions have unfolded as expected, but the assets that typically hinge on them haven't followed – is rates…it has been a year of folks playing this bubble to its logical death, even though the conditions that it thrived on are themselves, long since dead.

THE WHOLE THING COLLAPSES WHEN RATES RISE

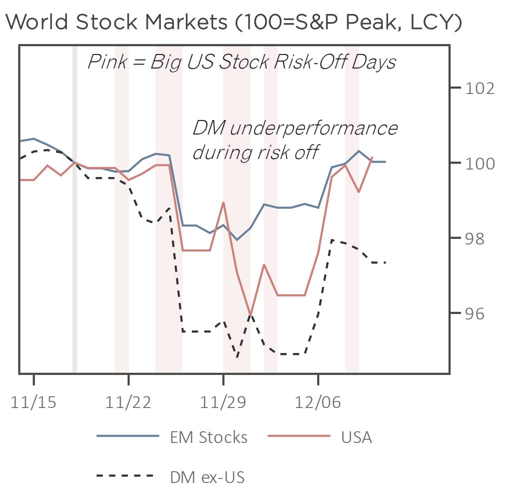
- During November's risk-off action, which, let's remember was driven by a) a marginally *inflationary virus development*; and b) the Fed explicitly telling you *it doesn't have your back anymore*, the market still "de-risked" in this episode by fleeing to treasuries.
- It's time to get ready for what happens when the market internalises that the Fed Put no longer exists – when inflation and yields rising together is what's causing the risk-off. The last few weeks were a lens into what that looks like, with the exception that bonds will offer you no protection in that environment – they'll add to the losses.
- What this means is we're in for a historically unusual period of cash outperformance vs. nearly all DM assets (especially dollar ones in our view), which is pretty bearish considering cash will deliver negative real returns.

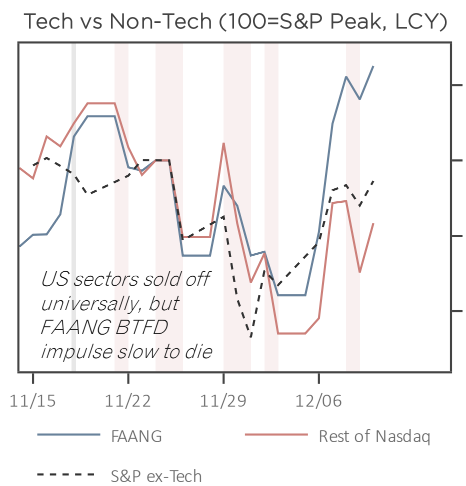
But within that environment, there will be playable risk rotation internals, geographic dispersion, and we'd expect, inflation hedge outperformance (because even if the Fed doublespeed tapers and hikes, they'll still lag what's needed to bring inflation down). To be ultra-clear, here's what we expect to happen along the major asset class dimensions:

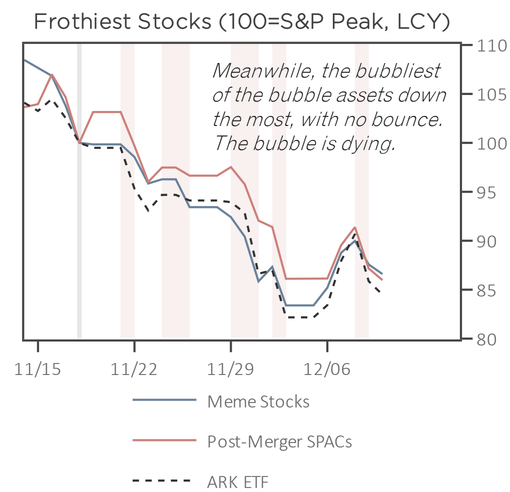
- ***Rates:*** The long-end has been held down by a lack of term issuance (after Fed purchases), and the growth slowdown this year. We believe that's over as supply is inflecting much higher in a sustained way, and inflation will remain extremely elevated until some time well after corrective action is finally taken (monetary tightening).
- ***Equities:*** We are increasingly convinced the bubble is dead or very close to dying and that this bounce will prove ephemeral. We believe the steady march higher in yields will attach a discount rate and risk premium to loss-making, nosebleed valuation stocks and sectors. The huge narrowing of breadth is a classic end-of-bubble hallmark.
- ***Equity Internals:*** Because of points one and two, we expect US and dollar-linked assets to severely underperform cyclical value plays, especially in distressed markets with rate and inflation protection like many in EM (ex-Asia).
- ***Tech Carnage:*** The tech sector is in for a world of pain. Part of the reason FAANG is the only thing that's performing is that it's increasingly taking / absorbing all profitable cashflows in the sector. The vast majority of other new economy tech and tech software companies are loss-making, and dependent on revenues from within the sector itself. That is to say, each tech company's revenues are in large part derived from the rest of the sectors' losses. The problem with simultaneously tighter liquidity, rising rates, and stock price losses is that folks won't be willing to finance these cashflow gaps forever, and where they are willing, they'll do so at much more normal valuations. Many companies within sub-sectors that cumulatively imply astronomical market caps (e.g. EVs, SAAS) won't survive, thus starting a vicious downward spiral of sector-wide revenues, and we expect, failures.
- ***Dollar:*** When the dollar everything bubble cracks, so will the dollar. As we show below, in many ways the dollar is today what EMFX was in 2013 (extremely dependent on foreign flows into domestic bubble assets, and extremely overvalued as a result of those flows, with twin deficits, soaring inflation, and a central bank that's well behind).
- ***Inflation Hedges:*** Even though tightening will come, real rates will continue to deteriorate and extend longer along the curve because that tightening will be too late and too slow. Traditional hedges that work during currency-debasement driven inflation (precious metals, broader commodities, cyclical / inflation assets that can capture elevated nominal GDP as profit, not just revenue) will rise to the fore and we expect, outperform materially. Others, like TIPs, will do less well, but still probably ok in real terms.
- ***Crypto / Bubble Assets:*** We invest in what we know, in areas where our macro frameworks and signals explain the majority of what's going on. Crypto is not something we know much about, or something that has enough history to understand well. That said, our guess is it will prove to be ultra-vulnerable to the end of this bubble, as retail-driven frothy assets typically are. We would guess this will help turbo-charge precious metals.

IN STOCKS, WE EXPECT MORE RISK OFF AND A LENGTHY ROTATION

- The charts below zero in on the recent risk-off episode, which had some interesting characteristics that portend the future. They index to Nov's SPX peak, and pink shading shows days when US indices were off by > 1%.
  - Initially, the risk off was broad-based. But throughout the episode, and on later down days, US stocks did significantly worse than EM stocks (which nobody owns, and therefore don't get liquidated as aggressively). DM ex-US did even worse (because that's where new virus restrictions are being applied with the most vim, and because the virus and central bank tightening were seen ultimately as global growth drags). We expect all to outperform US stocks in the future. It's also telling that the SPX, FAANG and the rest of US tech all did just as badly as each other, but in classic pavlovian fashion, FAANG bounced back. Rising yields will re-condition that response. And whether we look at meme stocks, post-deal SPACs or ARK (as a decent proxy for loss-making tech)…in other words…the assets most characteristic of this bubble, with the most recent inflows…they did horrendously and didn't bounce.

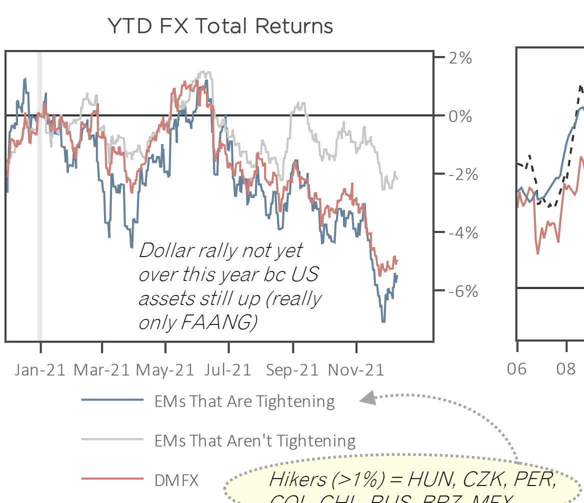


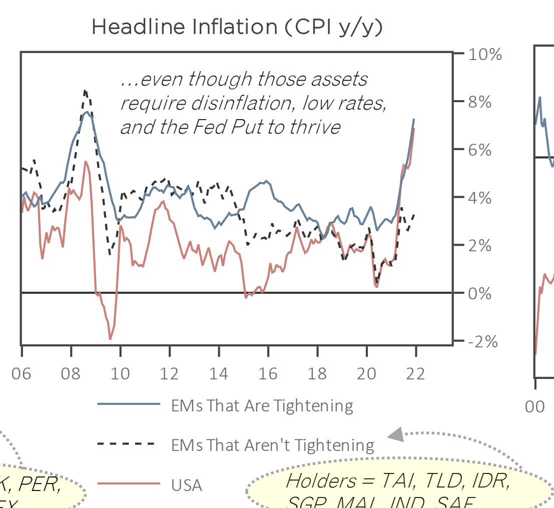


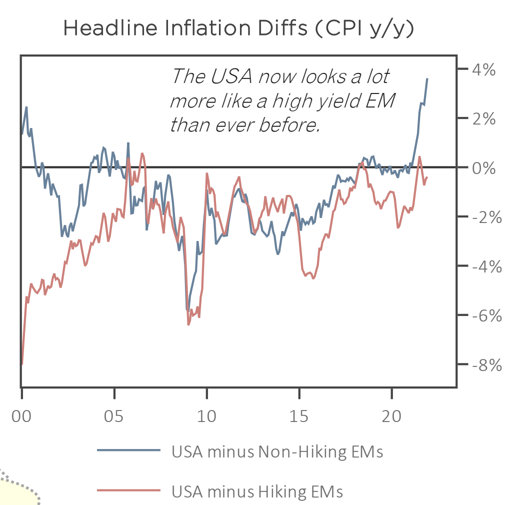


WHEN THE DOLLAR EVERYTHING BUBBLE CRACKS, SO DOES THE DOLLAR

- The YTD dollar rally followed the 2018 playbook: Stronger fiscal impulse in the USA = growth will be better in the USA = short-end tightening being pulled forward = dollar rally and cross-currency basis issues re-appearing.
  - But in trade-weighted terms, the dollar rally hit DMFX spot and "EMs tighteners" by around the same amount, but was less bad for EMs that aren't hiking (and don't have much inflation). That said, total returns in EMFX across the two groups were comparable (and much better than DMFX) because the hikers at least offer 4% carry on average.
  - This time around there wasn't any dollar credit going into EM in the same way there was in 2018 (recall, 2017 was the strongest ever year for hard currency inflows into EM bonds as an example), current accounts are in large surplus, and rates are materially higher. <u>This is why – when it comes to taper and rates – you need to worry about the USA. It's where the flows are going, where inflation is acute, and yet where they're doing nothing about it.</u>

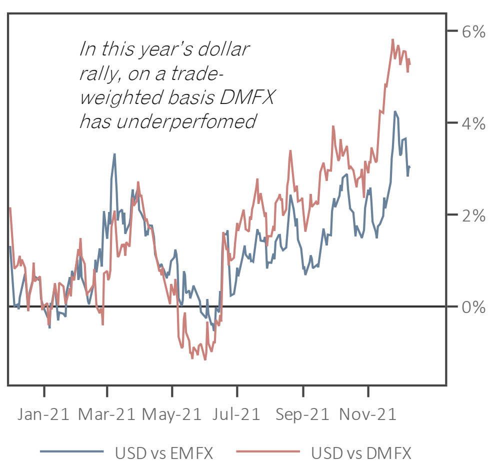




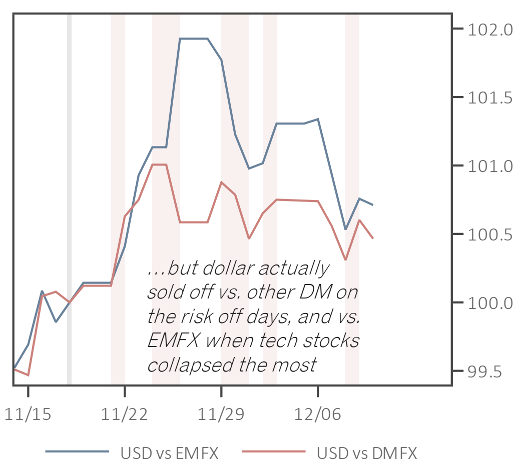


- US stocks (esp. FAANG) still rose (with the dollar) this year. But when there's broad-based risk-off, non-USD G7 currencies (i.e. alternative reserve currencies) rallied, and the dollar sold off. The dollar sell-off during the Black Friday market rout (and the risk off days since) was a window into the dollar's future. This is explained by the idea that the huge recipient of both carry flows within DM and risky-asset flows this cycle (post-2013 taper/ Fed lift-off) was the USA. We truly believe that when this **EVERYTHING BUBBLE CRACKS THE DOLLAR WILL CRACK TOO**, as was the case post dot com. **FOREIGNERS ALREADY CEASED THEIR RAMPANT BUYING OF US STOCKS**. When US tech started to underperform EM stocks in the rout, EMFX actually rallied on US equity risk-off days. Meanwhile, we won't get the classic dollar squeeze dynamic in risk-off because that normally comes from an unwind of carry trades, and the dollar has not been funding any carry trades for the last seven years, even intra-G7. It's been on the receiving end of carry flows. Crypto's performance (selling down alongside tech) is also telling.

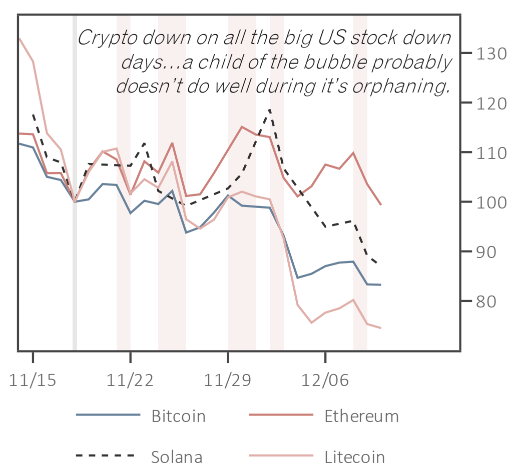
Trade-Wtd Spot USD Index (YTD)



Trade-Wtd Spot USD Index (100=S&P Peak)



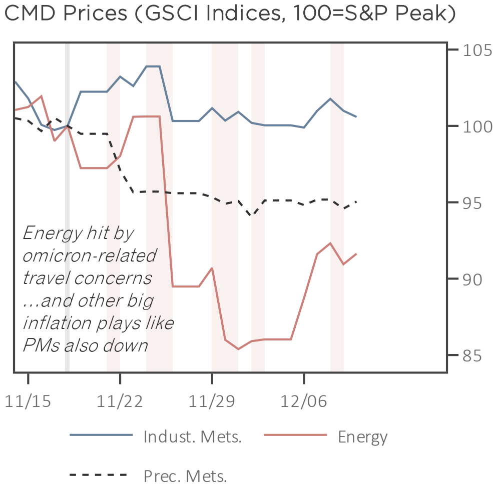
Crypto (100=S&P Peak)



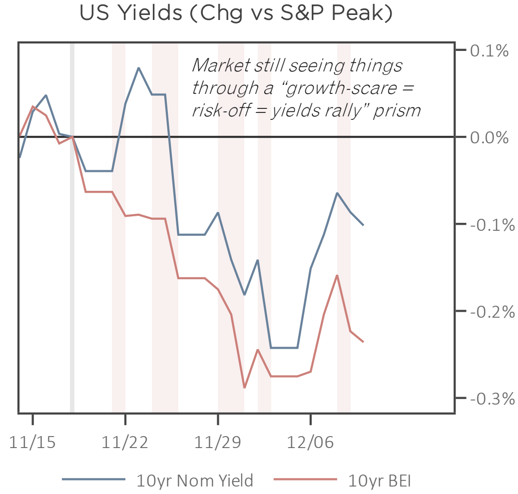
AS RISK DOES BADLY, FOCUS RETURNS TO PROTECTING CAPITAL

- Up until very recently no one's eye was on how to protect their capital. It was on how to flip pre-deal SPACs trading above $10, and how to chase unsustainable bubble gains in meme stocks, crypto, NFTs, "story tech" and all manner of US risk assets. That's starting to change alongside the inflation narrative. But this risk-off episode didn't show any love to traditional inflation-assets like commodities and PMs, while BEIs and nominal yields actually fell.
- So this is the big exception to extrapolating the recent market moves. Markets are still pricing risk-off as if it will somehow bring about some magical deflationary wave that holds yields down, and more forward Fed support (e.g. slower hikes, some concept of a downside Put). In other words, the market's still reading risk-off like it's a deflationary growth shock. But inflation is entrenched, and even the Fed is now telling the market it's on its own.

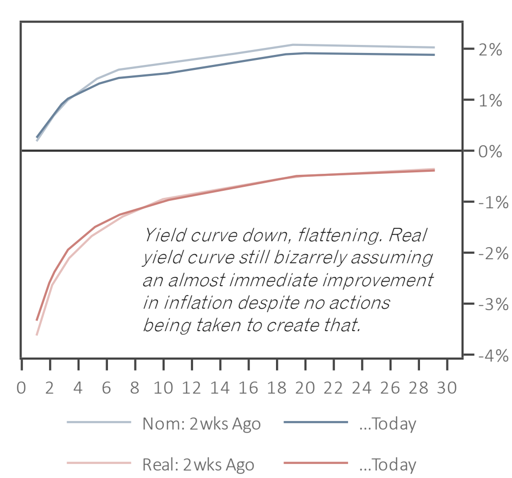
CMD Prices (GSCI Indices, 100=S&P Peak)



US Yields (Chg vs S&P Peak)



US Yield Curves

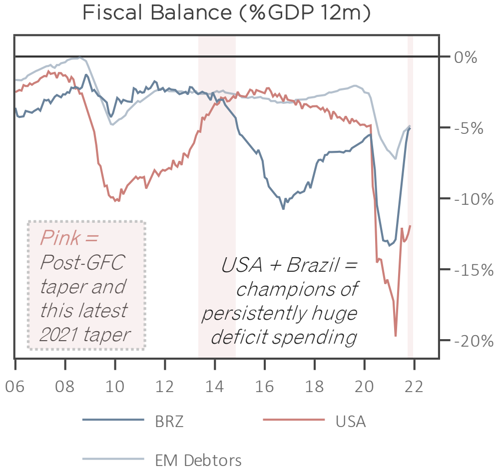


"AMERAZIL": US POLITICIANS HAVE LEARNED FROM THE ABSOLUTE BEST

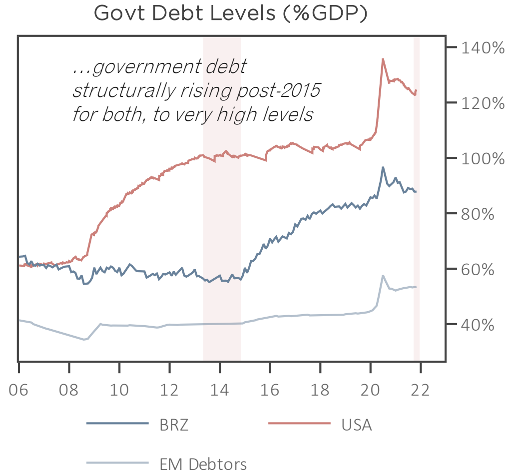
US fiscal shock and awe is causing inflation. From a flows perspective, we have extreme amounts of credit creation (both fiscal and private), and rapid money printing at the same time. Post-GFC we had money printing that was just sufficient to offset contracting credit. That's why there wasn't an explosion in broad money growth / financing then like today, and why this is inflationary, while back then money printing was just an offset to a huge deflationary deleveraging. Considering US demand is responsible for circa 90% of incremental global durable goods spending, and that global inflation is more correlated than ever before, there's a strong case the US is global inflation enemy no.1.

- In the 2000s, the term "Chimerica" came to represent the virtuous self-reinforcing dependency between the US and China, where cheap Chinese goods got sold to US consumers, expanding US trade deficits that were financed by China's recycling of those export-driven surpluses into US bonds and other assets. The US consumers in that cycle financed those same purchases by taking on huge amounts of debt both reflecting and creating the housing bubble, and ultimately paving the way for the subprime crisis.
- The virus took that mercantilist model to its logical extreme, with consumer goods purchases financed directly by fiscal transfers, instead of debt. But the problem is, as an expensive dollar-linked FX, China doesn't have external surpluses to recycle anymore and it's long since de-pegged from the dollar. as have petrocurrencies and other previously pegged EMFX. There are no automatic foreign official purchases of US debt this time around. The buyer of US debt is…the Fed.
- Any seasoned EM investor knows what happens next when a country runs a twin deficit with an overvalued currency, an overheating economy and inflation surge, and deeply negative real rates. The currency falls, rates rise, and equities sell-off. An external adjustment then occurs because domestic tightening and foreign selling stifles demand and chokes off imports. That "BoP downswing" was fully in force for EM during the 2013+ taper tantrum and US hiking cycle, because it was EMs who were doing those mischievous things. This time it's the USA. So we propose an alternative gimmicky name: **AMERAZIL.** This time it's a two-party suicide pact of money-financed fiscal. America is the new Brazil.

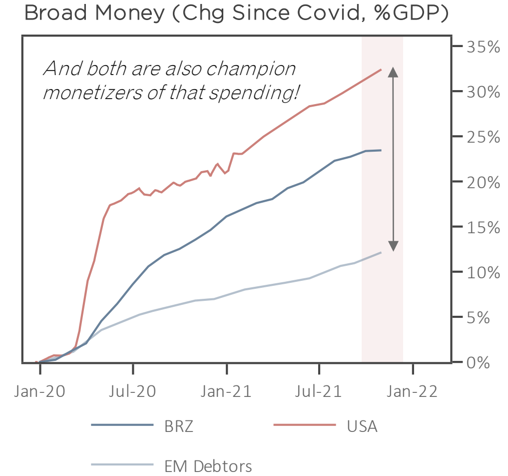
Fiscal Balance (%GDP 12m)



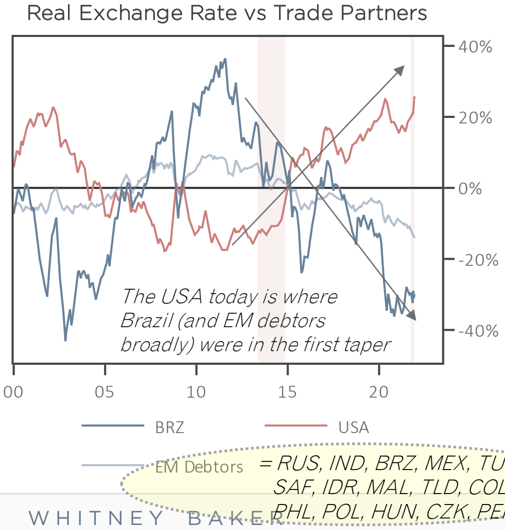
Govt Debt Levels (%GDP)



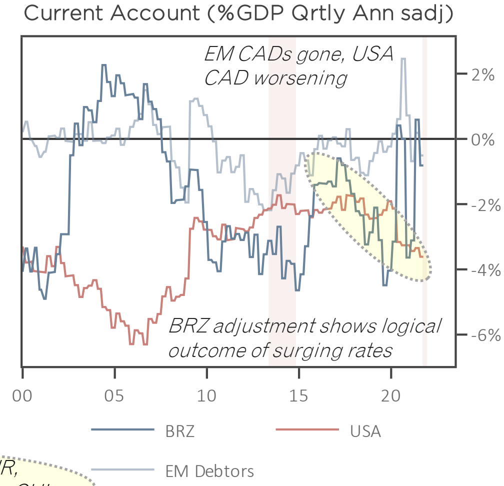
Broad Money (Chg Since Covid, %GDP)



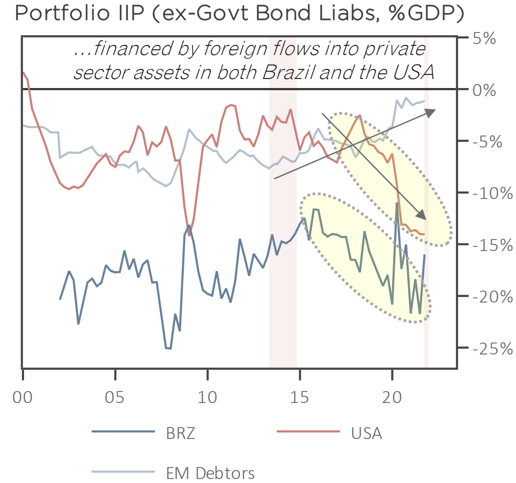
Real Exchange Rate vs Trade Partners



Current Account (%GDP Qrtly Ann sadj)

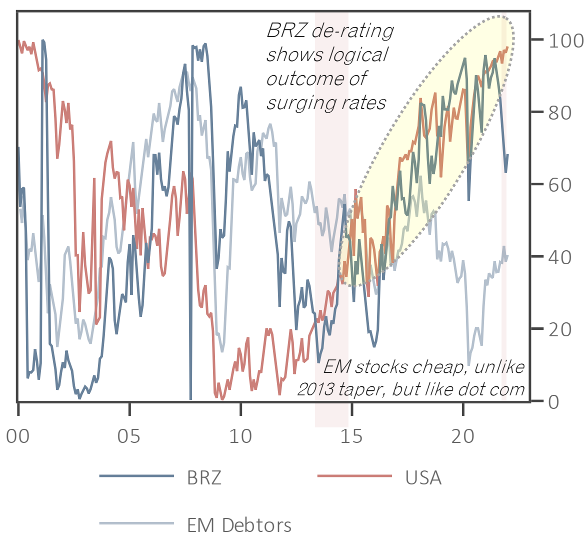


Portfolio IIP (ex-Govt Bond Liabs, %GDP)

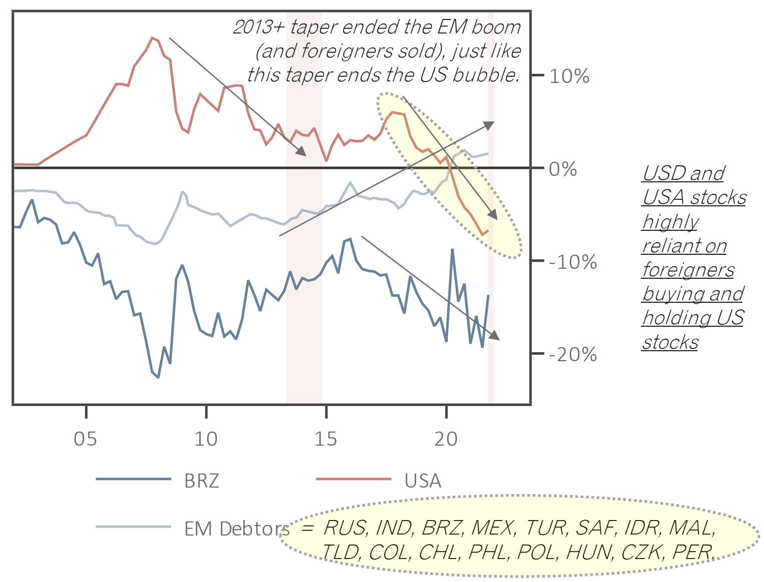


- So who exactly has been financing this twin doom-loop of expanding current account deficits and consumer booms? Why, foreigners buying booming equities and other bubble assets, of course. Low rates throughout this cycle (and for Brazil, since 2015) have propelled stock-rerating and appreciation in both places. Foreigners bought in large.
- You can see on the left that US stocks are trading in their 99th percentile, valuation-wise – a level not seen since the dot com craze. Brazilian stocks were similarly rich – in a massive divergence from other post-BoP adjustment EMs (what we like to call the "reformed debtors")…until Brazil was forced to start hiking in a huge way, prompting outsized equity losses, foreign withdrawal and the growth adjustment described above. Meanwhile, EM debtors are trading extremely cheap – just like after the dot com, and they now own more foreign equities than foreigners own of theirs. Who will be sensitive to taper and rate-driven risk-off? Not those guys. They may actually unwind their own foreign equity ownership, conspiring with their booming current account surpluses to drive material EMFX gains. In the early part of this risk-off environment, their stocks may not rise outright, but at a minimum they shouldn't fall materially. Hence, bearish rotation.

Percentile of Stock Px/Book Ratio



Net Portfolio Equity IIP (%GDP)



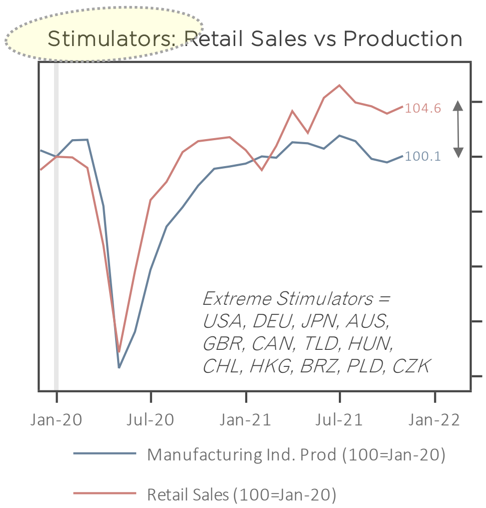
CHECKING IN ON THE EVOLVING GLOBAL GROWTH | INFLATION MIX

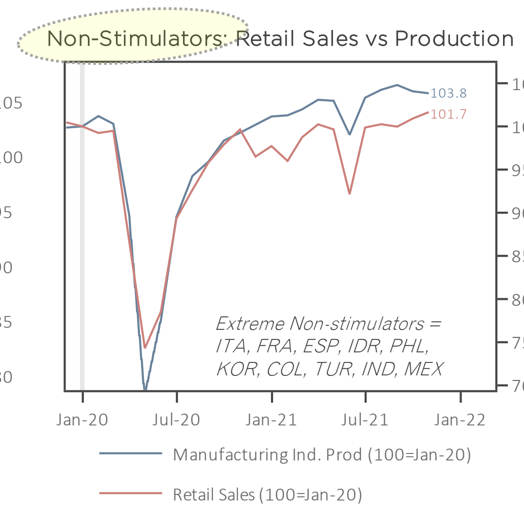
- Growth was slowing well before omicron, due in large part to policy-reactions to delta. The reality is variants will continue to develop, in highly vaccinated populations there's very few serious health outcomes, and yet policy-makers are responding with extremely disproportionate measures regardless. What happened to "two weeks to slow the spread"…maybe this is our love of freedom speaking…but seems we're still under martial law a full year after VE Day (in today's terms, "Vaccine Efficacy Day"). It's not unlike Elizabeth Warren's never-ending bank-bashing political haymaking nigh on a decade after the banking crisis was already resolved.
- Bottomline, anti-growth restrictions are not costless and we fear we are now **ENTERING A WORLD WHERE THEY CONTINUE WITH THIS** in the face of much **MORE CONSTRAINED POLICY-FLEXIBILITY**. At the margin this risks exacerbating goods demand even more by curtailing the services switch we describe below, worsening inflation broadly (especially given zero-covid-tolerance policies across much of goods-producing Asia), and giving central banks more cover to let inflation run, which sets us up for a more vicious catch-up and violent market correction later. We are now at risk of a '70s style market rout, with no Fed Put available.
- We know inflation is now endemic and globalised, we know the second-round effects of it are present and exacerbating it (capex booms, labour market tightness / wage pressure, restocking), we know there's abundant dry powder (e.g. $2.7bn of unspent HH savings in the US), we know **THAT INFLATION IS PERNICIOUS PRECISELY BECAUSE IT MEANS SPENDING DRY POWDER IS EFFECTIVELY INVOLUNTARY** (even if folks are cautious and curtail real spending, 75c of every dollar being spent is being spent to afford stuff people were already buying). And there's more fiscal coming. In the rest of this report we check in on the key inflation and growth dynamics at play and what they mean for the future.

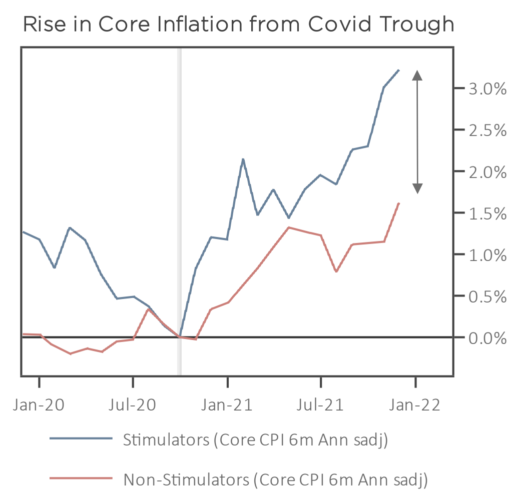
INFLATION: DMS ARE EXPORTING INFLATION INTO EM

- Looking at where goods consumption is vs. goods production is a neat little way of synthesizing the consumer-driven "Demand vs. Supply" imbalances in different places. Consumer spending is up the most where consumer incomes are up the most, which is where consumer stimulus payments have been most generous.

- Unlike DM, EMs have not responded to coronavirus with outsized fiscal stimulus. But EM is not a monolith, and some have (Chile and Brazil are great examples) and have inflation problems like DM. Here's a set of charts comparing extreme global "fiscal stimulators"(largely DM) vs. "non-stimulators" (largely EM). Fiscal support that propped up household incomes, even as wage income contracted (as normal in a recession), is *the dominant driver of demand vs. supply imbalances today* (shown w. r. to goods in the two left charts below. So, as you can see on the right, the acceleration in core CPI vs. trough a) has been most pronounced and b) continues to accelerate unabated in the "fiscal stimulators". The "non-stimulators" have had less, with minimal further acceleration in core inflation since about March of this year.

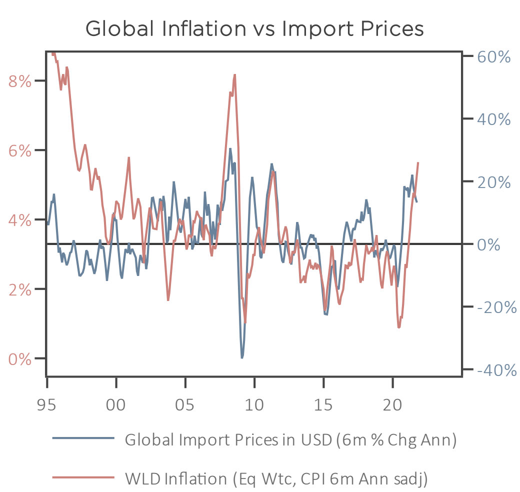


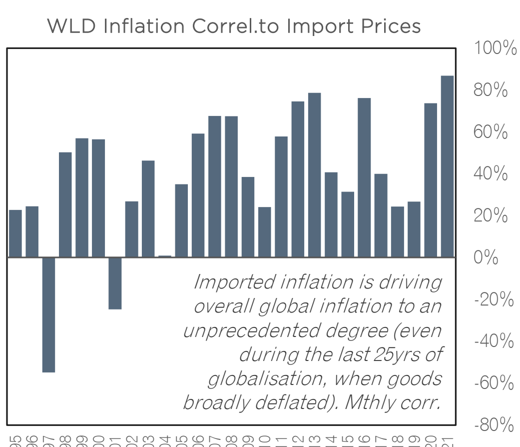


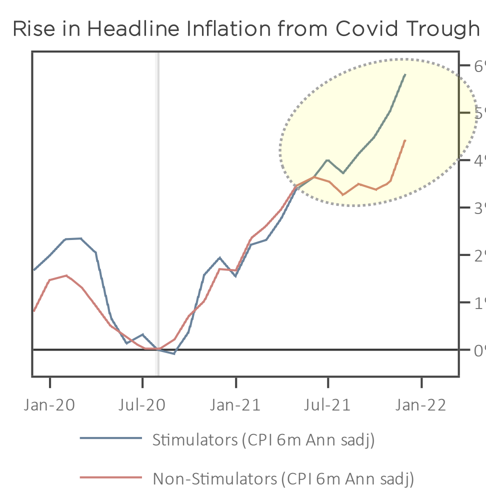


- But essentially EMs are importing DM irresponsibility via the headline components. World inflation is extremely highly correlated to import prices vs. history…the demand shock is obviously acutely hitting goods, which mostly travel by ship ("ships and chips"), and are therefore imports and exports globally. This, for EM, is imported inflation.

- So regardless of their fiscal prudence (e.g. stimulus that was proportionate to or less than the income shock), and lower core inflation issues (as shown above), the non-stimulators are importing inflation visibly in the headline components, even if the overall scale of the problem is mitigated by their lower core inflationary pressures.



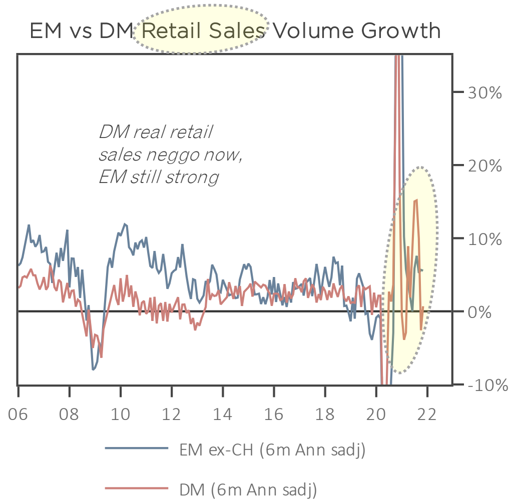


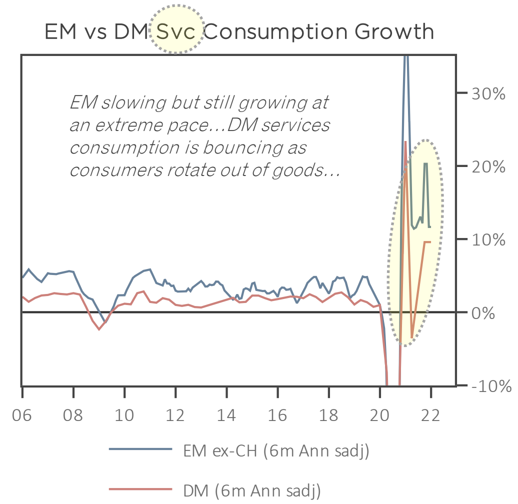


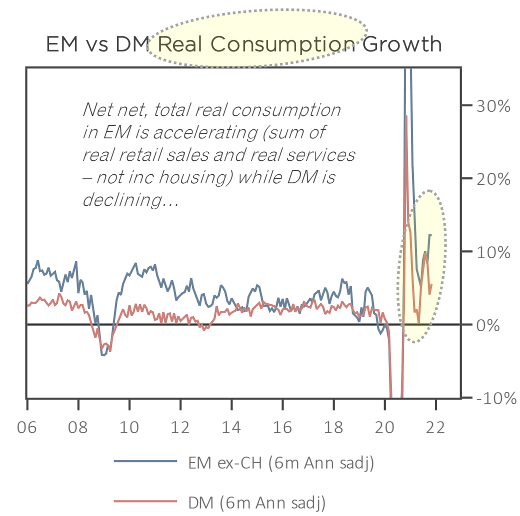
CONSUMER SPENDING: OBSERVATIONS ON EM/DM DIVERGENCE & SERVICES SWITCH

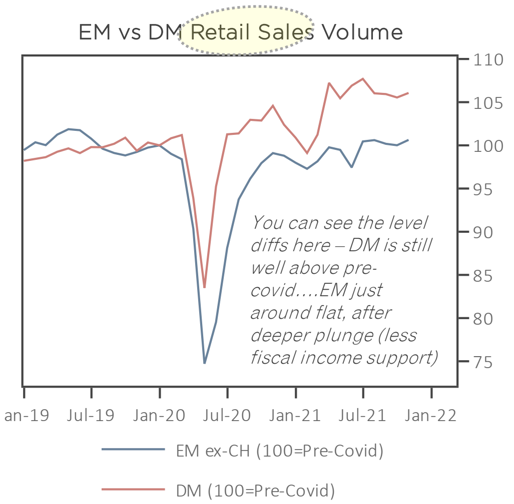
- The inflation analysis above shows there were/are <u>lower levels of retail goods demand within many EM countries</u> vs. DMs at large. The EMs supplied this DM demand. The DMs/stimulators had an early extreme pop in **REAL GOODS SPENDING**, fuelling core inflation. <u>But now, DM goods demand is slowing and below its post-covid peak, while EM goods demand is accelerating as these economies recover</u> (propelled in part by the flow through of export-driven external income windfalls, whether they're goods exporters or commodities exporters, resulting tight labour markets and capex booms, less fiscal drag etc). Asian economies are also adding to the rebound related to the recent loosening of covid restrictions (especially Singapore, Taiwan and Malaysia). <u>On a 3mth basis median EM goods demand is flat (the average is +10% because of skew from these three countries), while DM is –4%.</u> We show 6m ann. charts below to cut through the V-shaped Asian chop. But the broad point remains no matter how you slice it, **EM GOODS DEMAND IS UP** (from lower levels), **WHILE DM GOODS DEMAND IS DOWN BUT STILL HIGH**.

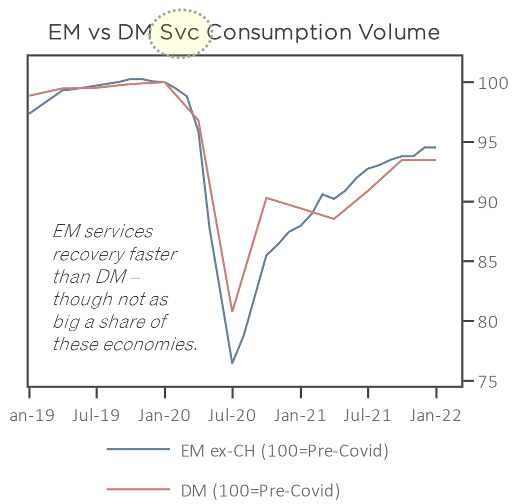
- What about the **SWITCH TO SERVICES DEMAND** globally and away from goods? This is happening like it was supposed to upon reopening, but EM is above DM here too (in growth terms), meaning we see a pretty clear divergence in TOTAL real consumption trends between EM (accelerating) and DM (decelerating with mix-shift).

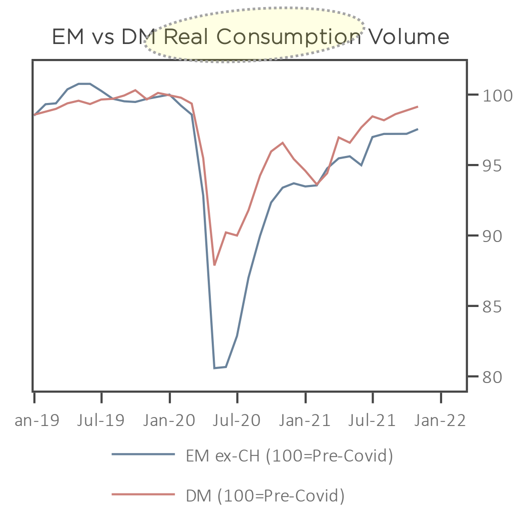








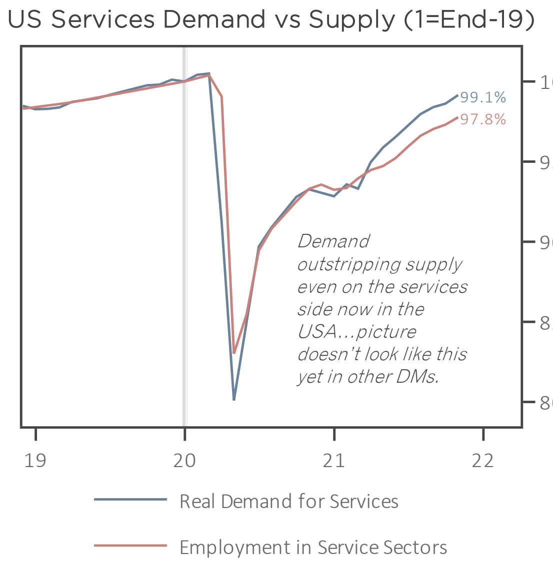


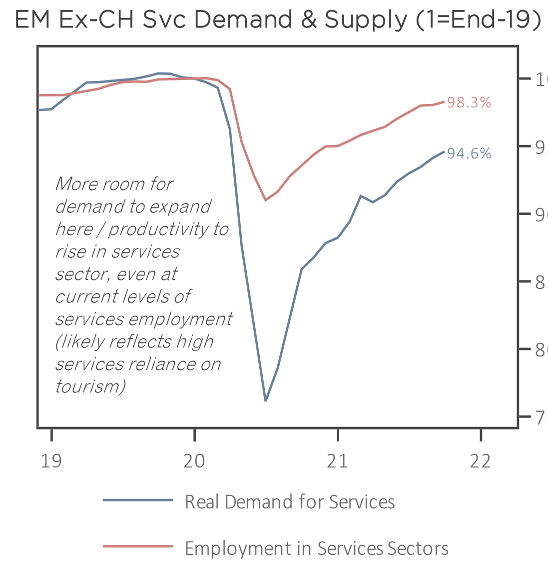


SLACK DIVERGENCE: LABOUR MARKETS TIGHTER, BUT CAP UTILISATION STILL LOW IN EM

- <u>Putting two and two together above, we show below that labour markets are tight broadly, even though services demand is still only just recovering.</u> In the "fiscal stimulators" this is some combo of labour force reductions / falling participation / early retirement (visible in the DM stimulator types), and lots of hiring going on for both goods and services in the non-stimulators (plus also some reduced participation driving this).

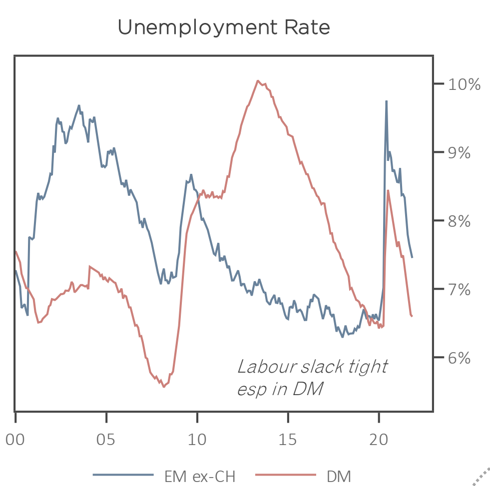
- So already tight labour is potentially a forward problem for incremental DM services "supply" and inflation more broadly (labour is of course the dominant input into services pricing), as services spending ramps up. In EM, services productivity can still expand (e.g. services hiring has outpaced the normalisation in services demand).

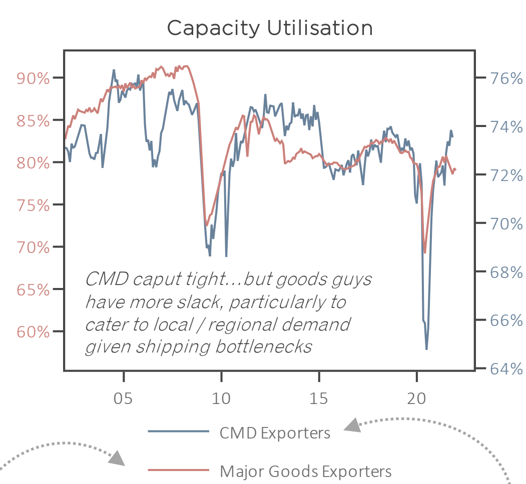


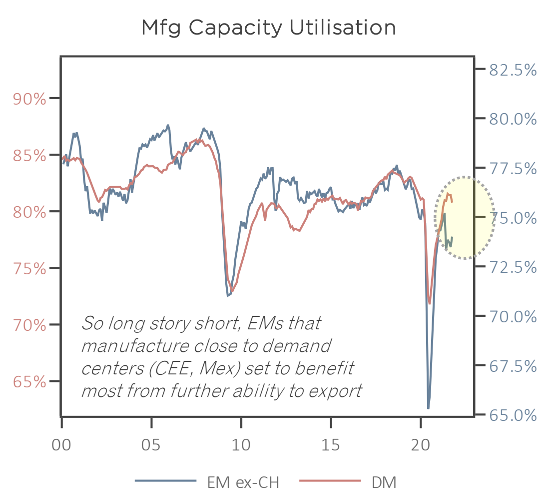


- <u>But also, manufacturing capacity utilisation is getting tighter especially in the DM, while at the same time the EM is now accelerating its own goods demand</u>. Clearly EM had tons of slack post-covid to cater to the surge in goods demand, and they still have the ability to ramp up further in theory, but logistics/shipping problems persist, and there are broad-based shortages in foundational goods components (e.g. semis etc).

- So these are just more points on inflation not being transitory, and the marginal ability to supply even more goods far from demand centres being constrained (and services, especially in the USA – the champion fiscal stimulator).





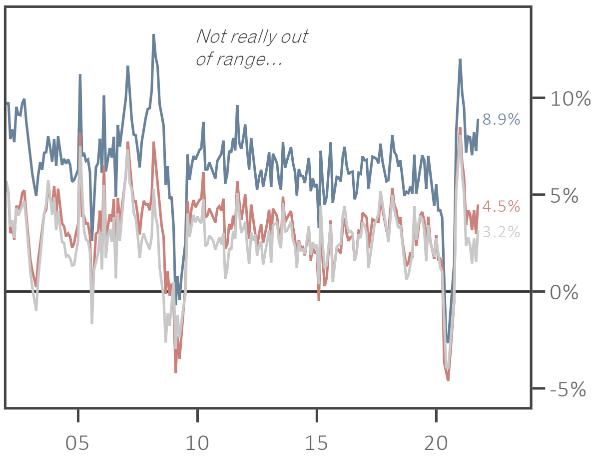


Global Goods Exporters = CHN, CZK, DEU, HUN, JPN, KOR, MAL, MEX, PLD, TLD, TUR

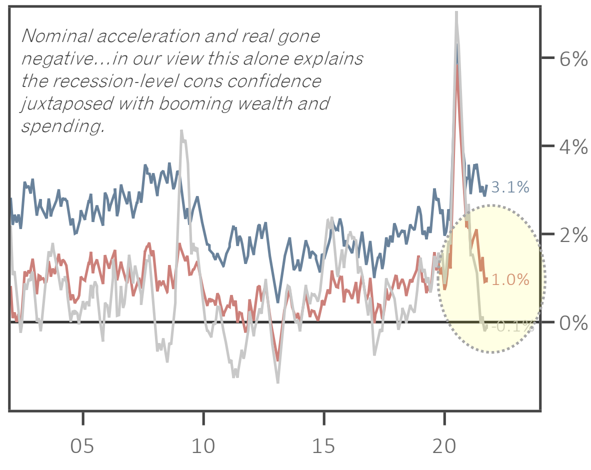
Global CMD Exporters = SAU, PER, IDR, BRZ, SAF, RUS, COL, CHL, CAN, NOR.

- On the wage side… EM (simple average) wage growth is more or less where it always is in nominal terms (a smidge elevated vs. the post GFC period), and real wages are similarly positive (using both headline and core CPI), within their usual ranges. But in DM, there's been a **STEADY NOMINAL WAGE GROWTH BREAKOUT** vs. the post-GFC range, back to where we were during the 2000s boom. <u>The issue for these HHs is real wages are negative (even more, had we used 3m reads) as their spending (just like their overall income) has outpaced nominal wages.</u>

EM ex-CH Wage Growth (6m Ann sadj)



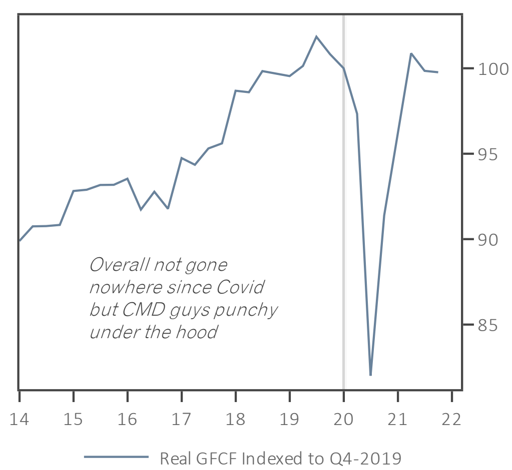
DM Wage Growth (6m Ann sadj)



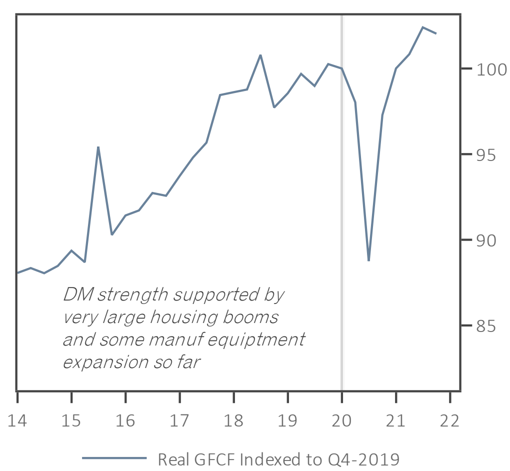
TRACKING CAPEX BOOMS: ANOTHER DEMAND DRIVER AND A CREDIT ACCELERATOR

- On top of all of the above – e.g. still high global goods demand (albeit with DM vs. EM divergences) amidst increasingly tight capacity, an ongoing switch to services amidst increasingly tight labour markets, and overall, the clear inflation problems generated by DM over-stimulators but being felt broadly via imports of headline components everywhere...we also have a capex boom! That just increases demand further, and supply only later.
- This is also most pronounced in the DM (vs. pre-covid levels)...but under the hood within EM the commodity folks are seeing some pretty big capex rebounds vs. the others (consistent with the slack divergence shown above):

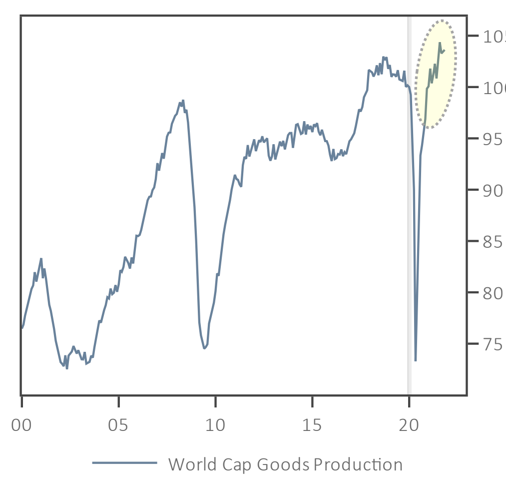
EM Real Fixed Investment (100=Pre-Covid)



DM Real Fixed Investment (100=Pre-Covid)

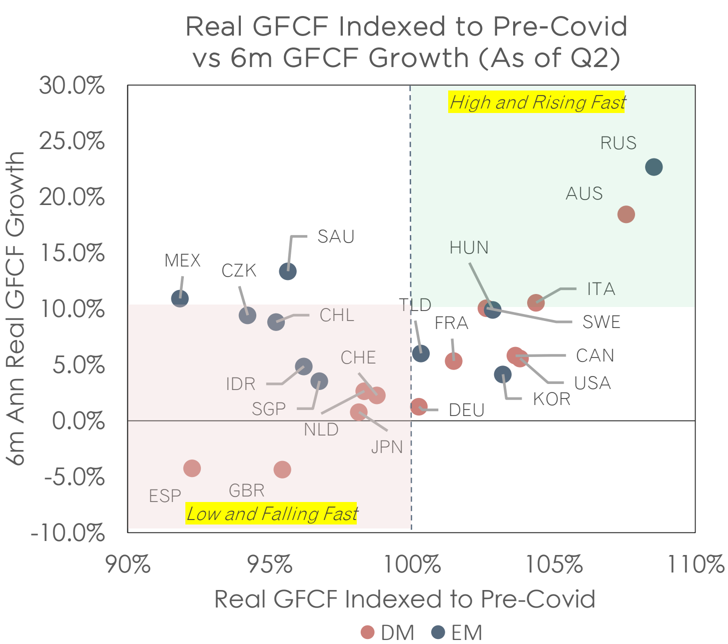


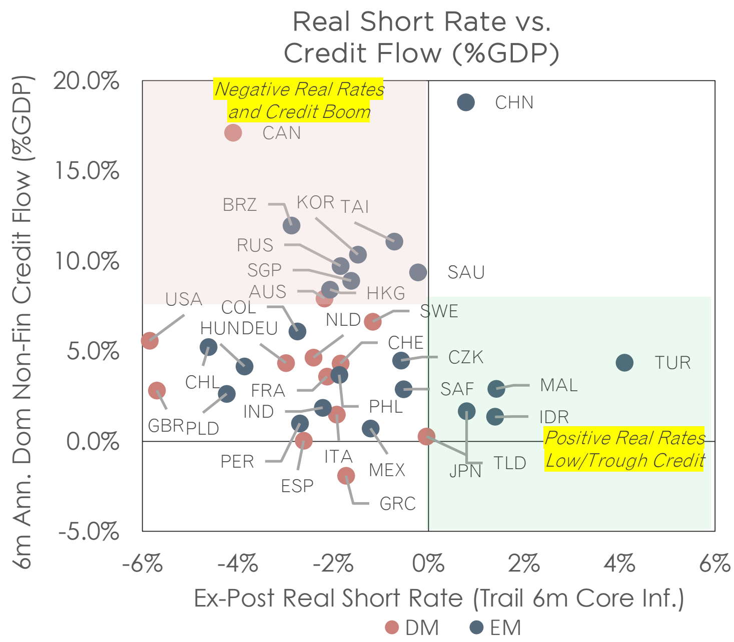
WLD Capital Goods Prod. (100=Pre-Covid)



- This is important for two reasons: It **ADDS ANOTHER PLAYER** to the goods demand bonanza (globally, but especially visible in DMs and CMD producing countries that require capital goods for investment), **AND IT WILL ACCELERATE PRIVATE CREDIT FLOWS** related to financing these projects / capex expansions.
- Private credit creation never went negative in DM in this crisis (just like household incomes) – mortgages, corporates drawing down credit lines in DM and the absolutely huge surge in corporate credit issuance since. This is of course a key difference between what happened post-GFC when all the money and fiscal was designed to offset a huge deleveraging pressure. As you can see below, over the last 6mths private credit is reasonably positive in most places (vertical axis, right chart), particularly outside Asia, even before capex funding is really needed.

- <u>But saying that, private credit creation is only now becoming a big contributor financing-wise to the global demand surge.</u> There's plenty scope for acceleration, and capex booms in response to goods and commodity tightness (plus infrastructure drives and so on) will drive the corporate side. We believe the **MARKETS WITH STEEPLY NEGATIVE REAL RATES, LOW NOMINAL RATES, AND HIGH CREDIT FLOWS** are going to be the most economically sensitive to impending/ongoing hiking cycles. Those in the green quadrant probably not as bad.





A FINAL PARTING THOUGHT...

The way tightening can help with an inflation problem is always and universally by slowing demand. It's not that the Fed hiking magically brings a new advanced nanomode fab onstream. But as we showed in INFLATION PANDEMIC this is a demand shock…not a supply shock. Supply of everything is well-above prior all-time highs. We have real concerns that rate hikes will be less effective in slowing demand this time around for a variety of reasons. So in addition to all our concerns on inflation and it's non-transitoryness, we're **WORRIED ABOUT THE ABILITY TO TIGHTEN EFFECTIVELY VIA INTEREST RATES**, particularly in the context of what will be higher through-the-cycle DM fiscal spending, and trigger happiness with respect to lockdowns. This may mean we need even more hikes than normal, and what's normal is 2 – 4 ppts. That's because:

- This overheating is not fuelled by a private credit cycle (the normal channel by which rate hikes work to slow growth)…it's not like it's 2006 and a hiking cycle will pop a credit boom;

- Fiscal ain't slowing much any time soon, especially in the USA, and it would be hard to contract the dry powder that's already been transferred (absent an outright fiscal tightening and massive tax hike on the poorest folks who a) have the dry powder, and b) have the highest propensity to spend it on things in the broad CPI – highly unlikely to say the least).

- The private credit acceleration is now happening and we believe will continue due to capex booms (with this particular form of credit being less rate sensitive because it's bonds / more fixed rate and once you start a project you kinda have to finish it).

- In the DM much of the capex is housing related – something that doesn't ever contribute to disinflationary goods supply. And we know that the crazy house price booms that have happened almost everywhere are still going to flow through to inflation with a lag. The US CPI for instance, currently has shelter inflation at 3.8% y/y, while house prices are up ~20%. This will continue to pressure the numbers well after tightening has begun, absent a housing collapse.

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