

Policy at the Edge



BUREAU OF COMPUTUM ANALYSIS (BCA) OFFICIAL ECONOMIC REPORT

Title: *Policy at the Edge: Navigating Inflation Persistence and Monetary Overshoot in a Fragmenting Global Economy*

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Executive Summary

Global monetary authorities are confronting a policy environment fundamentally different from that which defined the prior four decades. The prevailing risk is no longer confined to inflation itself, but rather to **policy miscalibration under structural uncertainty**. Central banks, in attempting to avoid the errors of

delayed tightening observed in the post-pandemic period, now face an equally consequential hazard: **overcorrection into economic contraction.**

This report establishes a dual-risk framework—balancing the dangers of *doing too little* against *doing too much*—while incorporating the structural realities of increased geopolitical shocks, diminished globalization, and destabilized inflation expectations. The conclusion is clear: **traditional linear policy responses are insufficient in a nonlinear macroeconomic regime.**

I. The Policy Dilemma: Between Inflation Persistence and Monetary Overshoot

Central banks are effectively operating within a constrained policy corridor bounded by two adverse outcomes:

- **Under-tightening (Policy Lag):** Sustained inflation, erosion of purchasing power, and de-anchoring of expectations.
- **Over-tightening (Policy Overshoot):** Demand destruction, credit contraction, and recessionary spirals.

The critical distinction in the current cycle is that inflation is not purely demand-driven. A significant portion originates from **exogenous supply shocks**, particularly in energy and geopolitically sensitive inputs. As such, conventional monetary tightening exhibits **diminishing marginal effectiveness.**

II. Structural Transformation of the Global Economy

1. Persistent Supply-Side Frictions

Global supply chains have transitioned from efficiency-maximizing systems to **resilience-oriented architectures.** This shift introduces structural cost increases, embedding a higher baseline inflation rate across advanced economies.

2. Fragmentation of Global Trade

The gradual unwinding of globalization—characterized by regional blocs, tariffs, and strategic decoupling—removes a decades-long deflationary force. Capital allocation is increasingly influenced by **political alignment rather than comparative advantage.**

3. Elevated Frequency of Exogenous Shocks

The global system now experiences **compressed and overlapping economic cycles**, driven by pandemics, geopolitical conflicts, and resource volatility. These shocks reduce the predictive power of traditional models and increase the likelihood of policy error.

4. Instability of Inflation Expectations

Repeated inflationary episodes have weakened the credibility of long-term price stability assumptions. Expectations are becoming **adaptive and reactive**, amplifying both inflationary and disinflationary dynamics.

III. Regime-Based Macroeconomic Framework

To address this complexity, the Bureau adopts a **multi-regime analytical model**, replacing single-path forecasts with probabilistic scenario weighting.

A. Inflation Persistence Regime

Characterized by ongoing supply shocks and accommodative policy bias.

- Real assets outperform
- Long-duration financial assets underperform
- Inflation-linked instruments gain strategic relevance

B. Monetary Overshoot Regime

Defined by aggressive tightening and subsequent economic contraction.

- Liquidity becomes a primary asset
- Fixed income regains value post-peak rates
- Cyclical equities experience pronounced downside risk

C. Structural Volatility Regime (Baseline Condition)

A hybrid state marked by rapid transitions between inflationary and contractionary pressures.

- Cross-asset correlations destabilize
 - Market pricing becomes narrative-sensitive
 - Tactical allocation supersedes static positioning
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IV. Strategic Allocation Principles

Given the coexistence of dual policy risks, optimal positioning requires **simultaneous exposure to divergent outcomes**.

1. Barbell Allocation Strategy

Capital distribution should balance:

- **Inflation-resilient assets:** commodities, real assets, and inflation-indexed securities
- **Recession-resilient assets:** sovereign bonds, high-quality cash equivalents
- **Optionality layer:** tactical instruments designed to capture volatility-driven mispricing

2. Dynamic Rebalancing

Static portfolio construction is increasingly untenable. Allocation must respond to **real-time shifts in policy tone, inflation trajectory, and geopolitical developments**.

3. Scenario-Weighted Valuation

Valuation frameworks must incorporate multiple macroeconomic paths:

Value = $(P_1 \times \text{Inflation Scenario}) + (P_2 \times \text{Overshoot Scenario}) + (P_3 \times \text{Volatility Scenario})$

This approach mitigates the risk of overreliance on a single macroeconomic assumption.

V. Implications for Monetary Authorities

The report underscores a critical shift in policy effectiveness:

- Interest rate adjustments alone are insufficient to address supply-driven inflation
- Communication strategy now functions as a **primary policy instrument**
- Credibility must be maintained through **consistency and transparency**, not reactive tightening

Central banks must resist the inclination to mechanically replicate prior policy responses. The current environment demands **context-sensitive decision-making**, informed by structural changes rather than historical precedent.

VI. Forward Outlook

The global economy is entering a phase best described as **persistent disequilibrium**. Stability, where it appears, will likely be temporary and contingent.

Key expectations include:

- Continued volatility in inflation prints
- Increased frequency of policy reversals or pivots
- Elevated dispersion across asset classes and regions

The defining risk is not misjudging inflation alone, but **misjudging the nature of the system producing it**.

Conclusion

The prevailing macroeconomic challenge is not inflation, recession, or growth in isolation—it is the **interaction of all three within a structurally altered global framework**. Policymakers are navigating an environment where traditional tools yield uncertain outcomes and delayed feedback.

In such conditions, the objective shifts from precision to resilience.

Those who anchor strategy in adaptability, probabilistic reasoning, and structural awareness will be best positioned to preserve and compound capital. Those who remain tethered to legacy frameworks risk compounding the very errors they seek to avoid.

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