Timing the Fed Pivot From Tightening to Easing

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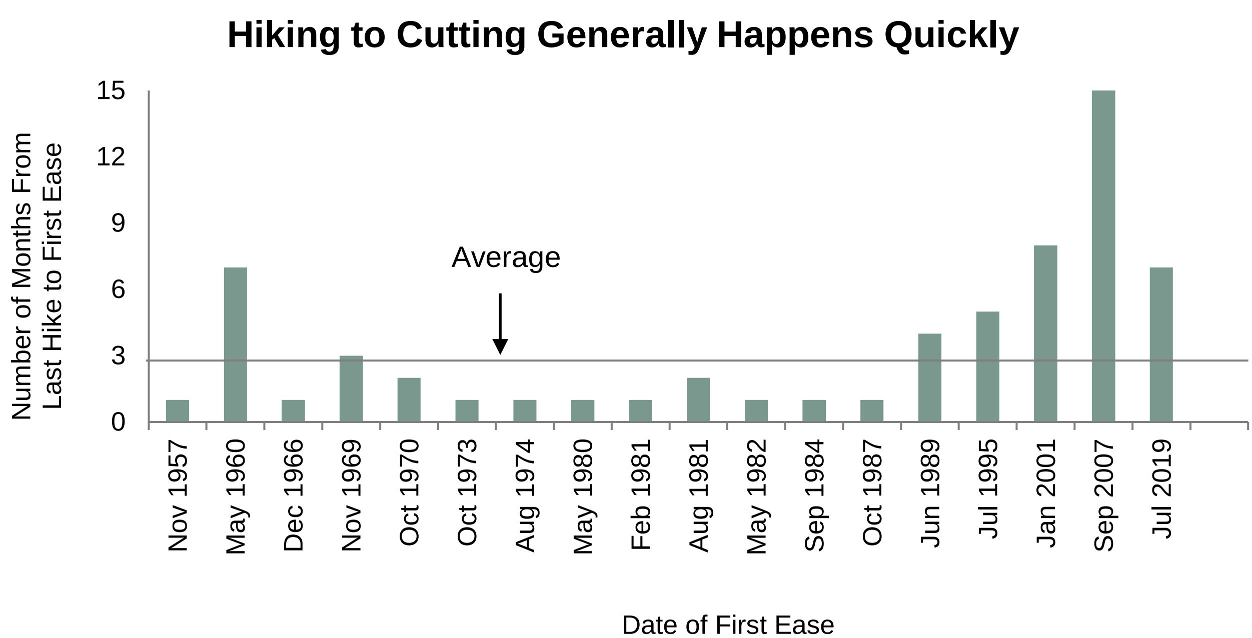
The Fed Has Not Waited Long to Cut Rates After Raising Them

In the past, the Fed has been quick to reverse interest rates hikes. There have been 18 tightening cycles since 1954. **The average time from the last increase in rates to the first reduction in interest rates is just three months**, and the median time is only two months. All tightening episodes are shown in the chart below.

Notice that recent history shows a lengthening in the reversal time with the average over the last five tightening cycles at eight months. However, there was an unusually long time from the last hike in June 2006 to the first rate cut in September 2007. The average falls to six months if the 2006-07 period is excluded. Two recent tightening to easing cycles are noteworthy.

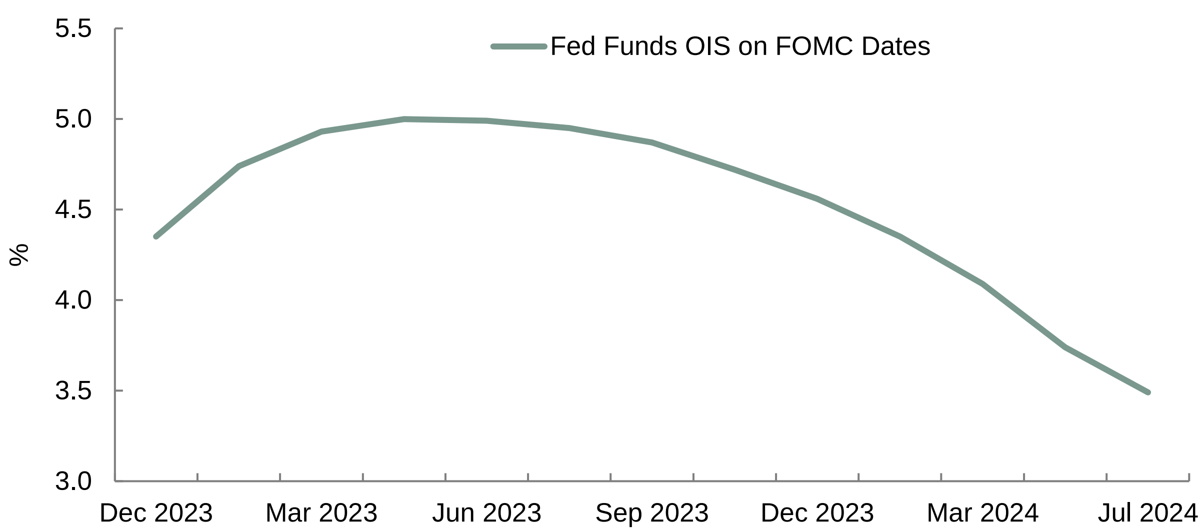


Sources: FRB, Haver, SMBC

Last Two Soft Landings Experienced Quick Turnarounds

The Fed achieved a soft landing in 1995 after having raised interest rates by 300 basis points in the 12 months ending February 1995. Following that last rate hike in February, **<u>the Fed began cutting rates five months later in July 1995</u>**. In the last tightening cycle, when the fed funds rate peaked in December 2018, **<u>the Fed began cutting rates seven months later in July 2019</u>**. The bond market is currently discounting another similar scenario as illustrated in the chart below.

<u>At present, the futures market expects the funds rate to peak at 5.0% in March 2023 and to stay there until September 2023 (or six months later) at which point the Fed begins cutting</u>. A total of 50 basis points (bps) of rate cuts is expected in the second half of next year. These expectations are consistent with history assuming there is not a recession. If there is, the Fed may be cutting rates sooner but more importantly, the Fed will be cutting rates a lot more than 50 bps next year. While this is a discussion for another commentary, bond investors have been forewarned.



Sources: Tullet Prebon, Bloomberg FRB, SMBC

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