

US Macroeconomics

November 7, 2023

Joseph Lavorgna, Chief US Economist | 212.893.1528 | joseph.lavorgna@smbcnikko-si.com

When Is the Fed Cutting?

If the Fed is done tightening, **history suggests that the Fed could be cutting rates as soon as March 2024**. A tightening cycle is a period when multiple interest rate hikes follow multiple interest rates cuts. There have been 18 tightening cycles since the 1950s. In the table below, we show the amount of time in months between what turned out to be the last interest rate hike to the first interest rate cut.

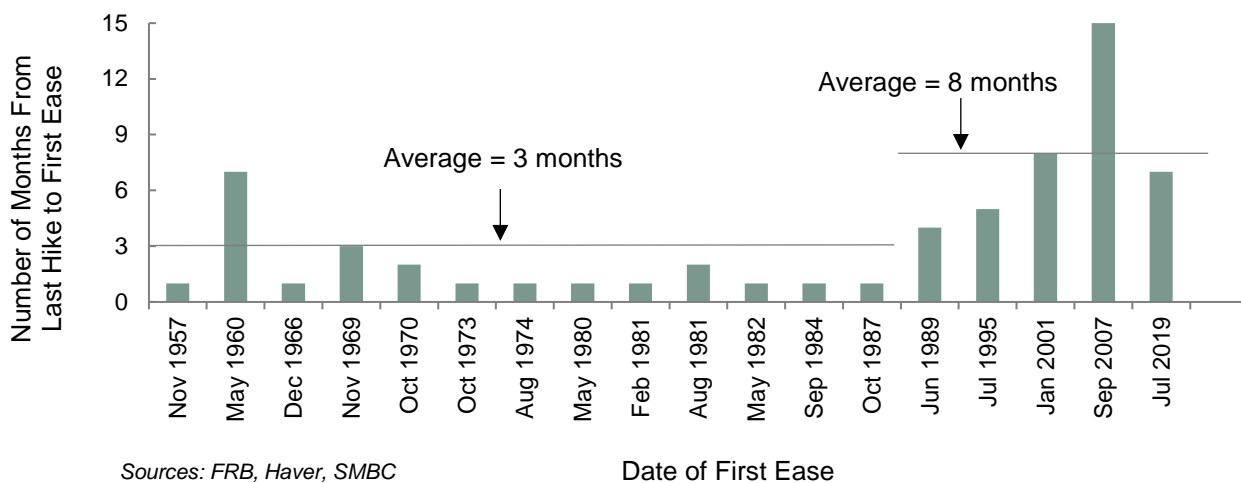
The average time for policy pivots over the full history is three months, but we can see that the timing has been lengthening over the last three decades. In other words, the Fed has become slower in reversing rate hikes, perhaps fearful of a 1970s type inflation redux. Surely, this has been a major consideration in the current tightening cycle given the dramatic and unsettling surge in headline and core inflation, the result of excessive fiscal stimulus. The Fed has stated numerous times that it wants to be certain that the inflation rate is going back to 2% before pivoting. Consequently, there is little easing built into the FOMC’s central tendency forecasts.

But this situation could change. If the unemployment rate rose substantially further, as it became clear the economy was in recession, the Fed would likely reevaluate its current “higher for longer” stance. What does the last handful of cycles show?

After what turned out to be the final hike in February 1989, the Fed cut rates four months later in June 1989. The pivot extended to five months when the Fed cut rates in July 1995 following the completion of the tightening cycle that ended in February 1995. This lengthening continued following the 1999 to 2000 and 2004 to 2006 hiking cycles. The Fed waited eight months before cutting rates in January 2001, and then a record long 15 months in September 2007 before relenting toward easier money.

In the last tightening cycle prior to the pandemic, seven months separated the December 2018 rate hike and the July 2019 rate cut. **The average timing of policy pivots for the last five cycles is eight months.** Therefore, if the Fed is done raising rates, a switch toward easing could come in March 2024. Interestingly, the futures market is starting to discount this outcome, with the probability of a March 2024 rate cut rising to between 25% and 30% after last week’s disappointing October employment report.

Since inflation likely will still be well above target for the next six months, an early 2024 policy pivot will come as the result of deteriorating economic fundamentals, especially in the jobs market. Consequently, investors must focus on all things labor.



Disclaimers

This document is provided by SMBC Nikko Securities America, Inc. ("SMBC Nikko"), the US-registered broker-dealer affiliate of Sumitomo Mitsui Banking Corporation, for informational purposes only. This document was prepared by SMBC Nikko's economist(s). The views, statements, assumptions and forecasts expressed herein are those of the author(s) and do not reflect the judgment of any other person or of SMBC Nikko. It does not constitute an offer, or solicitation of the sale or purchase, of securities or other investments. The information contained herein is obtained or derived from sources believed to be reliable, but SMBC Nikko and the author(s) make no representations as to its accuracy or completeness. In some cases, such information may be incomplete or summarized. This document has been prepared based on assumptions and parameters determined by the economist(s) in good faith. The assumptions and parameters used are not the only ones that could have been selected, and therefore no guarantee is given as to the accuracy, completeness, or reasonableness of any such quotations, disclosures, or analyses. Past performance is not a reliable indicator of any future results.

This document has been prepared for and is directed at institutional investors and other market professionals, and is not intended for use by retail customers. It does not take into account any specific investment objective, financial situation, or particular need of any recipient. The information contained herein should, for whatever purpose, be used solely at the discretion and responsibility of the recipient. SMBC Nikko and its affiliates do not accept any liability or responsibility for any results in connection with the use of such information. Recipients are responsible for making final investment decisions and should do so at their own discretion after conducting a careful examination of all documentation delivered prior to execution, explanatory documents pertaining to listed securities, prospectuses, and other relevant documents, and their own independent analysis and assessment of the merits of any transaction. The financial instruments discussed may be speculative and may involve risks to principal and interest.

Conflicts of Interest Disclosures

The views, statements, assumptions and forecasts expressed herein may differ from those expressed in globally branded research produced by SMBC Nikko or its affiliates. The trading desks of SMBC Nikko and its affiliates trade or may trade as principal in the financial instruments that are the subject of this material, and the author(s) of this document may have consulted with the trading desks while preparing this document. The proprietary interests of SMBC Nikko and its affiliates may conflict with those of the recipient. SMBC Nikko and its affiliates may seek to do business with the companies mentioned in this material and the trading desks may have accumulated, be in the process of accumulating, or accumulate long or short positions in the financial instruments mentioned and may have acquired them at prices no longer available. The trading desks may also have or take positions inconsistent with the views expressed in this document or may have already traded on those views.

This material is not a research report, and neither this material nor its author(s) is subject to SMBC Nikko policies and procedures that apply to the globally branded research reports and research analysts of SMBC Nikko and its affiliates or to legal requirements designed to promote the independence of investment research. It is not subject to any prohibition on dealing ahead of the dissemination of investment research. This means that on the date of this document, SMBC Nikko, its affiliates, and their respective directors, representatives, or employees, may have a long or short position in any of the instruments mentioned in this document and may make a market or trade in instruments economically related to the securities, derivatives or other underlying assets mentioned herein, in each case either as principal or as agent.

No part of the author(s) compensation was, is, or will be, directly or indirectly related to the specific recommendations or views expressed herein. The personal views of authors may differ from one another.

Distribution, possession or delivery of this document in, to or from certain jurisdictions may be restricted or prohibited by law. Recipients of this document are required to inform themselves of and comply with all such restrictions or prohibitions.

© 2023 SMBC Group. All rights reserved.