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US Macroeconomics

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Timing the Fed Pivot

The Fed raised rates 25 basis points to a range of 5 to 5.25% and omitted the phrase "In determining the extent of future increases in the targe range" from its post-meeting statement. This is an important alteration because it tells us the Fed could be done hiking interest rates. Put another way, this is the closest policymakers can come to announcing a pause without explicitly saying so. They want maximal optionality especially if the economy proves more resilient or if inflation proves stickier than expected. So, they are not going to explicitly state a pause. Beyond this important statement tweak, there were minimal changes elsewhere.

Given the speed and magnitude of Fed rate hikes which has brought about a similarly large increase in household borrowing costs, there is significant monetary tightening in train. This will meaningfully dampen consumer spending in the months immediately ahead from the current recession underway in manufacturing and residential housing. The potential for a nastier credit crunch emanating from the regional banking crisis raises the risk of a deeper and more extended downturn. While we are not there yet, it will not take much to push growth lower. Over the last five quarters, real GDP has grown at a meager 0.9% annualized pace. In the past, a stall in growth always presaged recession. This time is unlikely to be different. Consequently, we should expect a Fed pivot toward easing and that pivot should happen relatively soon.

The chart below shows all 18 tightening cycles from 1951 to present. A tightening is one in which the Fed raised rates *several* times, so the single 25 bp hike in April 1997 does not constitute a cycle. **When the Fed has finished lifting rates, interest rate cuts commenced soon thereafter**. This implicitly means the Fed has always overtightened. If it did not, then the Fed would not have to reverse course so quickly. Given the inverted curve and the banking crisis, policy is clearly tight. The Fed already has gone too far.

The average time from the last rate hike to the first rate cut is just three months, and the median is even less at just two months. Granted the last five cycles have experienced an eight month lag but in none of these cycles did the Fed move as aggressively as it has over the past 14 months. For example, the long 15 month wait between the last June 2006 hike and the September 2007 cut was preceded by a molasses-like increase in the funds rate. Hence, we expect a pivot that is likelier to align with the full historical record.

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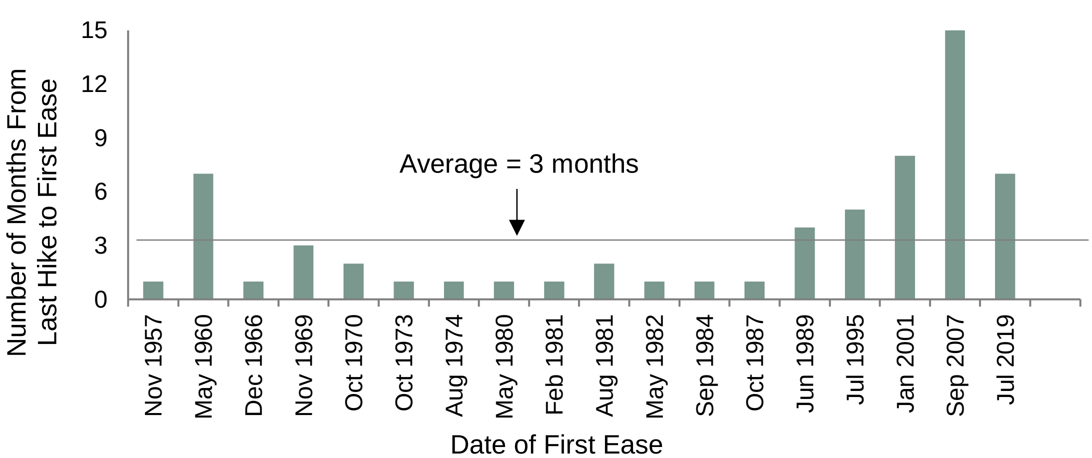

Sources: FRB, Haver, SMBC

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