

## US Macroeconomics

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### When the Fed Cuts, How Much Does it Cut? A lot

Since the Fed's imprudent decision to hike rates and continue quantitative tightening, the bond market has rallied further. Remarkably, the yield on 2-year treasury notes has fallen nearly 60 basis points (bps) in just two days. This continues the trend that began earlier this month when the 2-year was as high as 5.07% on March 8th. Amazing. In the process, **the slope of the 2s/10s curve is un-inverting with the spread now around -26 bps from a record closing low of -108 bps.** Against this backdrop, the futures market has removed any chance of another rate hike at the next FOMC meeting on May 3rd. Instead, the futures market is starting to price in a small probability of a rate cut. History tells us that this is not outlandish. Pivots come fast and hard. The upshot is that investors need to start thinking about how much the Fed could cut when it begins cutting.

As we have highlighted on numerous occasions **the average time from the last hike to the first cut is just three months.** The median is only two months. Hence, a cut as soon as the June 14th meeting is in line with the historical record. To be sure, some investors will argue this is too soon, as the last handful of pivots have been longer (eight months on average). However, none of those previous episodes were preceded by historical tightening and a rapid rise in household borrowing rates. The Fed will need to cut soon and by a lot. So, how much?

The table below shows 15 rate cutting episodes going back to 1960. There is much variability among the cycles because not all of them were associated with recession such as 1987, 1995, 1998, and 2019. The average amount of easing in these cycles was around 75 bps. Interestingly, this is what the bond market had been discounting a few days ago. But now with the bull steepening of the yield curve, the market is expecting about 150 bps over the next year. This is not enough. The average amount of easing across all the periods below is just over 400 bps. **If there is a recession, which has long been our baseline call, at least several hundred basis points of cuts is warranted.** The bond market rally may still be in its early stages. Stay tuned.

How Much does the Fed Cut in Cutting Cycles?		
First Fed Rate Cut (Month)	Total Cuts (Bps)	Occurring over... (Months)
March 1960	280	17
December 1966	197	8
September 1969	547	18
October 1973	556	20
January 1980	479	7
February 1981	438	2
July 1981	1059	20
September 1984	563	24
November 1987	81	4
June 1989	681	40
July 1995	75	7
September 1998	75	3
January 2001	550	30
September 2007	513	16
July 2019	75	3
Avg->	411	15

Sources: Federal Reserve, Haver, SMBC Nikko

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