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Peak Fed Funds Does Not Last Long

In tomorrow's Brookings Institution speech, Chair Powell will repeat the Fed's intention to further increase interest rates into restrictive territory and to keep them there until inflation meaningfully moderates. **Powell has replaced the mantra of "lower for longer" with "higher for longer."**

Not surprisingly, this is reflected in the Fed's most recent set of interest rate forecasts. The fed funds rate remains in restrictive territory through 2023. Easing does not occur until sometime in 2024. Does this projection hold up to the historical record?

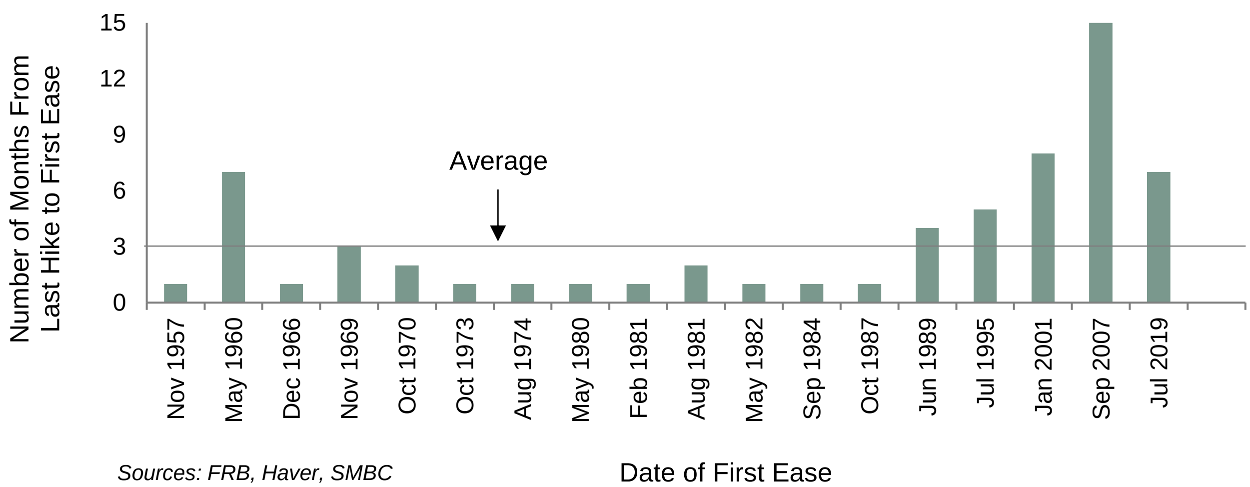
In the past, **the Fed has been quick to reverse interest rates hikes**. According to our calculations, there have been 18 tightening cycles since 1954. **The average time from the last increase in rates to the first reduction in interest rates is just three months**, and the median time is only two months.

However, it is worth noting that **recent history shows a lengthening in the reversal time**. The average over the last five tightening cycles is eight months. Still, this points to an easing of policy next year rather than 2024. The bond market is pushing back against the Fed's projections.

Futures are discounting a 5% peak in the fed funds rate in May 2023 with a full rate cut priced by November 2023 or six months afterward. This scenario is exactly consistent with recent history when the 2007 cycle is excluded, which it should. The Fed waited 15 months before cutting rates in September 2007 because of the unique nature of the previous tightening cycle: the funds rate was increased 25 basis points for 17 consecutive meetings. Nevertheless, **investors may be too patient in thinking the Fed will wait six months after the funds rate reaches its zenith by early 2023**.

As we have highlighted on numerous occasions, the current hiking cycle both in terms of its magnitude and pace has been without recent precedent. Thus, the likelihood of a hard landing with a concurrent and sharp slowing in inflation is high. When this becomes apparent to monetary policymakers, they will quickly reverse course as most of the historical record reflects. Stay tuned.

The peak in fed funds is typically reversed within three months



Sources: FRB, Haver, SMBC

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