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.
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