Will This Time be Different?

Booming retail sales makes the near-term bond-bull case more difficult because because monetary policymakers will raise rates at least another two times and possibly more. Given the lags in monetary policy, a sizeable chunk of the Fed’s actions have yet to fully impact the economy, but they will.

Already, mortgage rates are nearly double their year ago level. New car loans are at their highest reading in almost 13 years. Rates on personal loans have jumped by the most since 1981, and the current average 19% rate on credit cards has never been higher. Importantly, these rates began to surge AFTER the Fed started raising rates. So higher fed funds means households will experience even higher borrowing costs over the coming months. Memo to the Fed — financial conditions have tightened!

When these substantially higher borrowing costs will more fully impact the broader economy is a great unknown. The housing market and commercial real estate sector are already in recession, but construction payrolls continue to expand, rising to a new record high last month. As discussed in previous work, the current yawning gap between construction activity and hiring is the largest since the early 1950s. When there have been similar discrepancies in the past, they were resolved with employment falling to match the growth in construction spending. Will this time be different?

With the bond market now rightly discounting more Fed tightening, the yield curve continues to further invert. And while the market still has easing priced in 2023, it has been pushed out to November, and the amount of cuts between then and this time next year is now under 50 basis points. The futures market has almost given up on a 2023 policy pivot.

This is ironic. The bond market had been predicting much sooner and more aggressive 2023 easing just a few weeks ago. But that changed following the gangbuster January employment report, which was then followed by hawkish Fed commentary and a blowout retail sales release. In the past, just before the Fed begins easing rates, the bond market had not been expecting it. This is evident from the two slides below showing what the futures market was expecting at the time of what turned out to be the Fed’s last rate hike.

The upshot is that whenever the Fed reverses course, however far off that may seem to be, history tells us that investors will miss the turn. Hence, this time is unlikely to be different.


![Graph showing Fed Funds Expectations at the End of the 1999-2000 and 2004-2006 Tightening Cycles](source: Bloomberg, Federal Reserve, SMBC Nikko)
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