US Macroeconomics

February 15, 2023

Joseph Lavorgna, Chief US Economist | 212.610.1741 | joseph.lavorgna@smbcnikko-si.com

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!

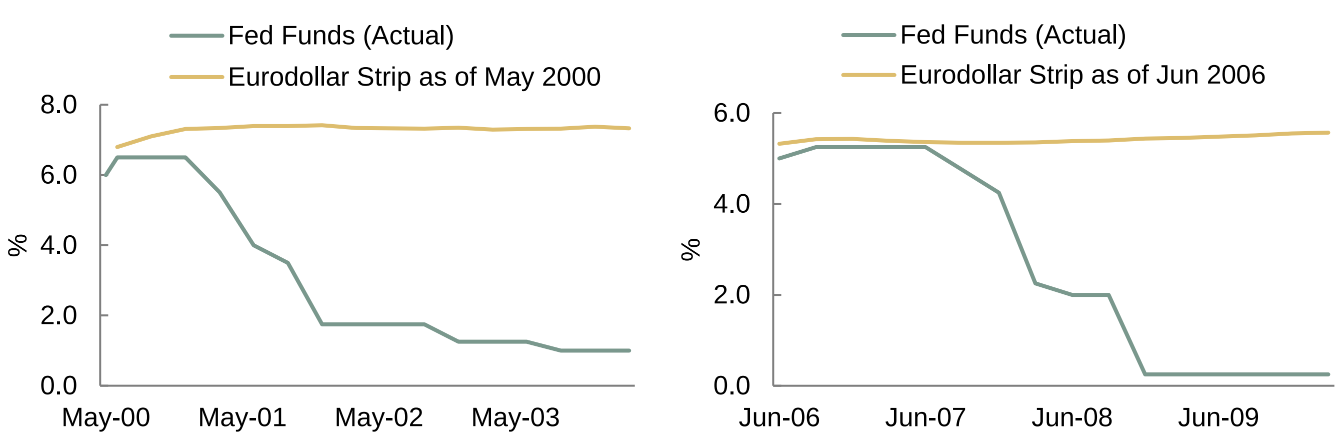
When these substantially higher borrowing costs will more fully impact the broader economy is a great unknown. **The housing market and commercial real estate sector are already in recession, but construction payrolls continue to expand, rising to a new record high last month**. As discussed in previous 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.

Fed Funds Expectations at the End of the 1999-2000 and 2004-2006 Tightening Cycles



Source: Bloomberg, Federal Reserve, SMBC Nikko

Disclaimer

This presentation is for discussion purposes only and is not intended to be an offer to sell or the solicitation of an offer to buy any securities, or any commitment to underwrite, subscribe for or place any securities, is not an offer or commitment to provide any financing or extension of credit or service, and does not contain any tax or legal advice. This presentation has been prepared by SMBC Group (which may include, collectively or individually, any of the following entities in the Americas Division: Sumitomo Mitsui Banking Corporation ("SMBC"), SMBC Nikko Securities America, Inc. ("SMBC Nikko"), SMBC Nikko Securities Canada, Ltd. ("Nikko Canada"), SMBC Capital Markets, Inc. ("SMBC-CM"), SMBC Leasing and Finance, Inc., JRI America, Inc., and SMBC Rail Services LLC) and is being furnished by SMBC Group solely for use by the client or potential client to whom such materials are directly addressed and delivered. This presentation is confidential and is the property of SMBC Group subject to copyright. Any reproduction of this presentation, in whole or in part, is prohibited, and you may not release these materials to any person, except to your advisors and professionals to assist you in evaluating these materials, provided that they are obligated, by law or agreement, to keep the presentation confidential. These materials do not constitute research, a recommendation or an offer or solicitation to any person to enter into any transaction or adopt any hedging, trading, or investment strategy. Prior to participating in any such transaction, you should consult your own independent, competent, legal, tax, accounting, and other professional advisors.

In preparing this presentation, SMBC Group has relied upon information available from third parties, including public sources, and we have assumed, without independent verification, the accuracy and completeness of such information. Specific prices, indices, or measures, including ranges, listed in this document were prepared at the time the document was prepared, and are subject to change without notice. SMBC Group makes no representations to and does not warrant this presentation's accuracy or completeness. SMBC Group expressly disclaims any liability for any use of the information set forth herein, including, without limitation, any use of the information set forth herein in the preparation of financial statements or accounting material.

These materials may contain forward-looking statements, which may include projections, forecasts, income estimates, yield or return, future performance targets or similar analysis. These forward-looking statements are based upon certain assumptions. All forward-looking statements are based upon currently available information and SMBC Group is not obligated to provide an update. Actual events may differ from those assumptions. Opinions, projections, price/yield information and estimates are subject to change without notice. There can be no assurance that estimated returns or projections will be realized, that forward-looking statements will materialize or that actual results will not be materially lower than those presented. Past performance is not necessarily indicative of future results. Any transactions or strategies addressed may not be suitable for all parties. The value, price or income from transactions or strategies may fall as well as rise. SMBC Group or an affiliate may have a position in any of the underlying instruments, assets, indices, or rates mentioned in this document. You should make your own independent judgment or seek independent financial and tax advice with respect to any matter contained herein.

SMBC is subject to Japanese firewall regulations and therefore absent client consent, non-public client information may not be shared with SMBC Nikko Securities Inc.

SMBC Nikko is a U.S. registered broker-dealer of SMBC Group. Nikko Canada is a U.S. and Canadian registered broker-dealer of SMBC Group. SMBC-CM is provisionally registered as a U.S. swap dealer with the CFTC. Capital markets and other investment banking activities for SMBC Group are performed by a combination of SMBC Nikko, Nikko Canada, SMBC Nikko Securities Inc. and SMBC-CM. Lending and other commercial banking activities are performed by SMBC and its banking affiliates. Derivative activities may be performed by SMBC-CM or SMBC. SMBC Group deal team members may also be employees of any of the foregoing entities. SMBC Group does not provide tax advice. Accordingly, any discussion of U.S. tax matters contained herein (including any attachments) is not intended or written to be used, and cannot be used, in connection with the promotion, marketing or recommendation by anyone unaffiliated with SMBC Group or for the purpose of avoiding U.S. tax-related penalties.