Capital Markets Strategy

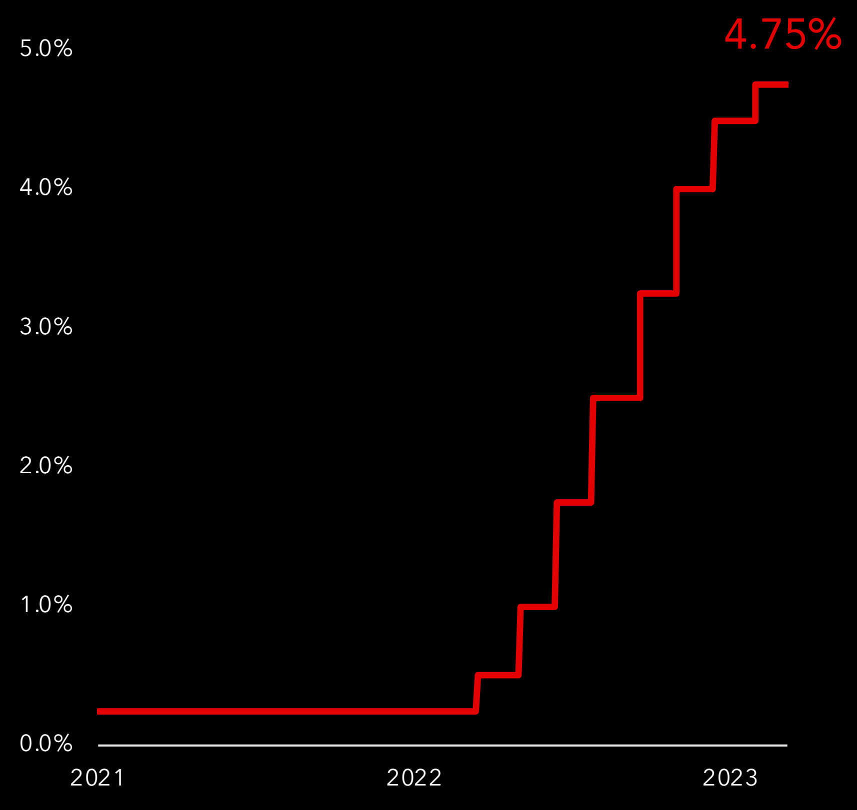
Essential inCights for the C-Suite

MUFG

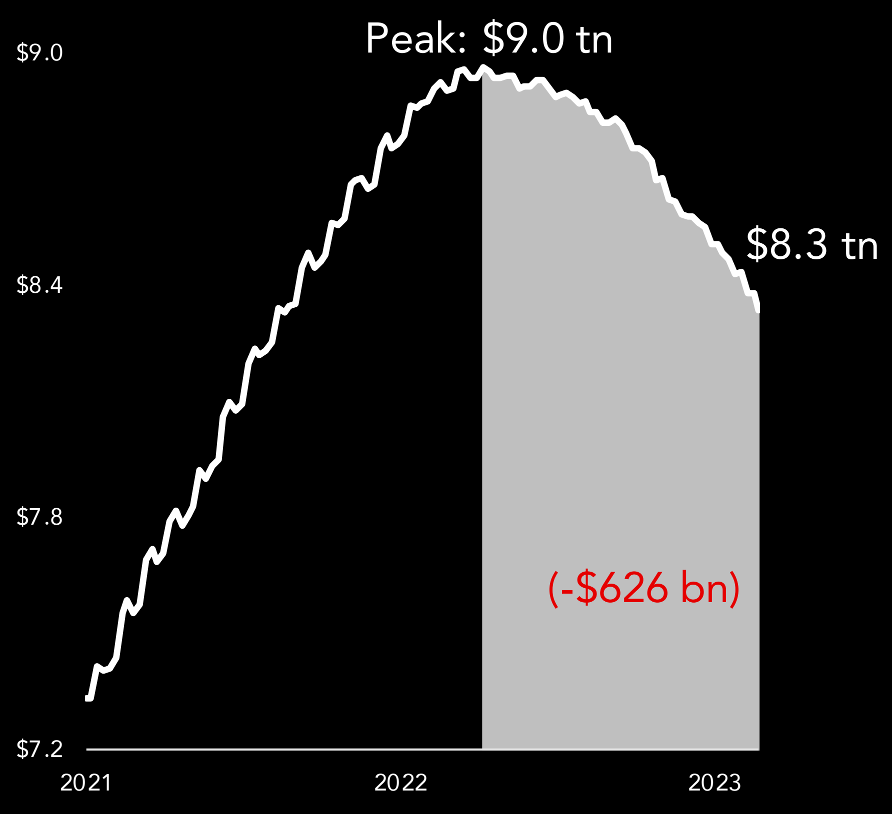
Chart of the Day

While the Fed's historically rapid 2022 tightening cycle is nearly complete, much of the impact has only just begun. In the year ahead, another 2-4 rate hikes are likely, and more than $1 trillion of additional QT. Monetary policy also typically hits the real economy with a 12-18 month lag. Key areas to watch include interest rate sensitive sectors (auto, housing), CMBS, leverage loan markets and more highly levered credits.

Fed funds target rate



Fed total balance sheet assets, USD tn



Every Fed tightening cycle of the last 40 years has claimed a large financial casualty and "unintended consequences", given the impact of US monetary policy on securities portfolios, currency markets and risk assets globally (i.e., 80s LatAm crisis, 80s commercial real estate, 90s Asia financial crisis)

1980

- ***Early 1980s*** LatAm Debt Crisis
- ***Late 1980s*** US Commercial Real Estate
- ***1994*** G10 Bond Turmoil
- ***Late 1990s*** Asia Financial Crisis
- ***2008*** Global Financial Crisis
- ***2014-2016*** Commodities Super Cycle Bust
- svb ***2023*** Silicon Valley Bank / Silvergate Capital

2023

Looking back at the 12 Fed tightening cycles in the post-WWII era, the Fed only avoided a "hard landing" on three occasions (mid-1960s, 1983, and 1994). Historically, recessions have been more likely to follow tightening cycles when the total rate increases were larger and when initial and peak inflation were higher.

US rate cycles and recession periods

Tightening Cycle	Total bps hiked	Peak inflation rate	Hard or soft landing?
1954 - 1957	227 bps	3.7%	Hard
1958 – 1960	305 bps	3.6%	Hard
1964 – 1966	210 bps	3.8%	Soft
1968 – 1969	500 bps	6.2%	Hard
1972 – 1974	850 bps	12.3%	Hard
1977 – 1980	1,040 bps	14.8%	Hard
1980 – 1981	790 bps	11.0%	Hard
1983 – 1984	250 bp	4.8%	Soft
1988 – 1989	300 bps	5.2%	Hard
1994 – 1995	300 bps	3.0%	Soft
1999 – 2000	175 bps	3.8%	Hard
2004 – 2006	425 bps	4.7%	Hard

Source: (1-4) Bloomberg. Data as of March 13, 2023. Oxford Economics, "What History Tells us About Rate Hikes and Recession Risk" (May 9, 2022). 2017-2018 tightening cycle not included because interrupted by exogenous COVID shock.

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"Macro stability isn't everything, but without it, you have nothing."