

When Will Fed Rate Hikes Slow the Economy?

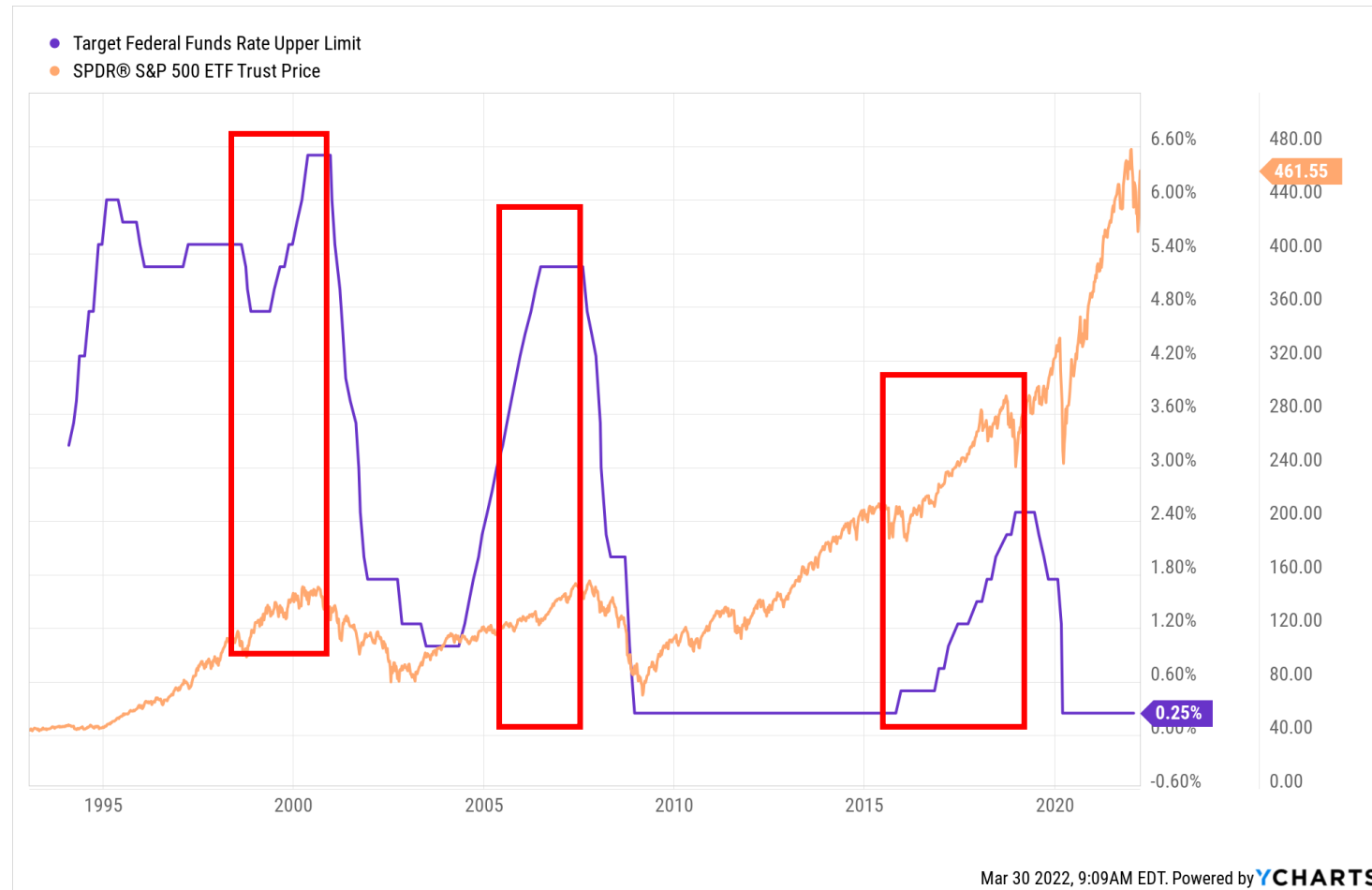
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Tom Essaye, President Sevens Report Research

Current Situation: Rates are Rising, and the Pace is Accelerating



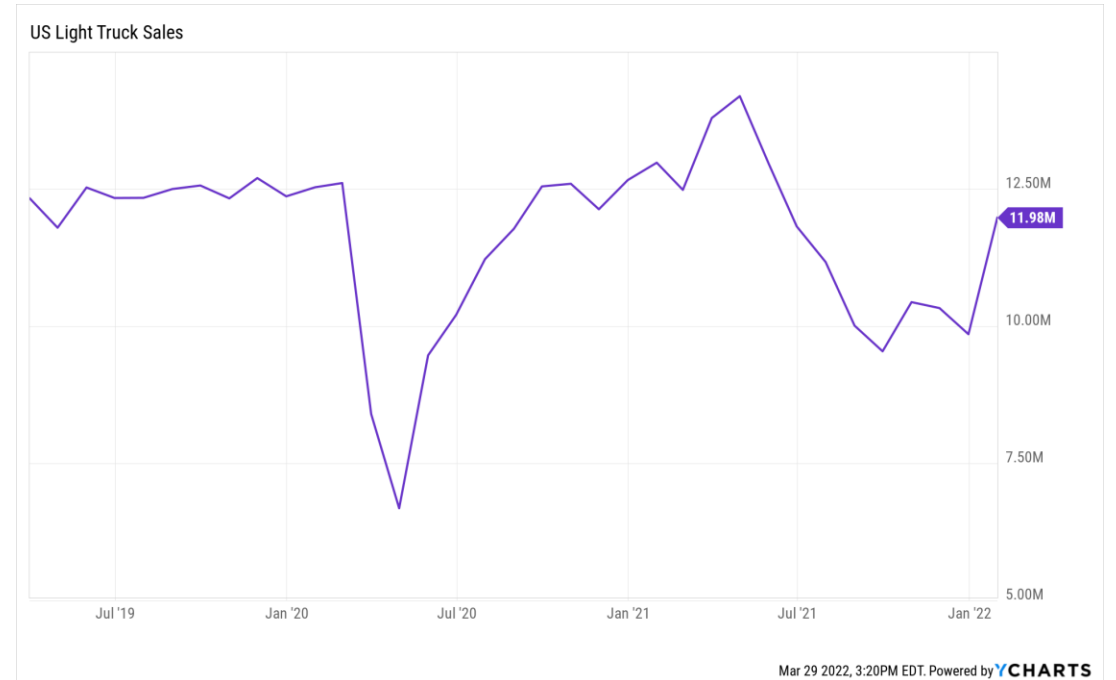
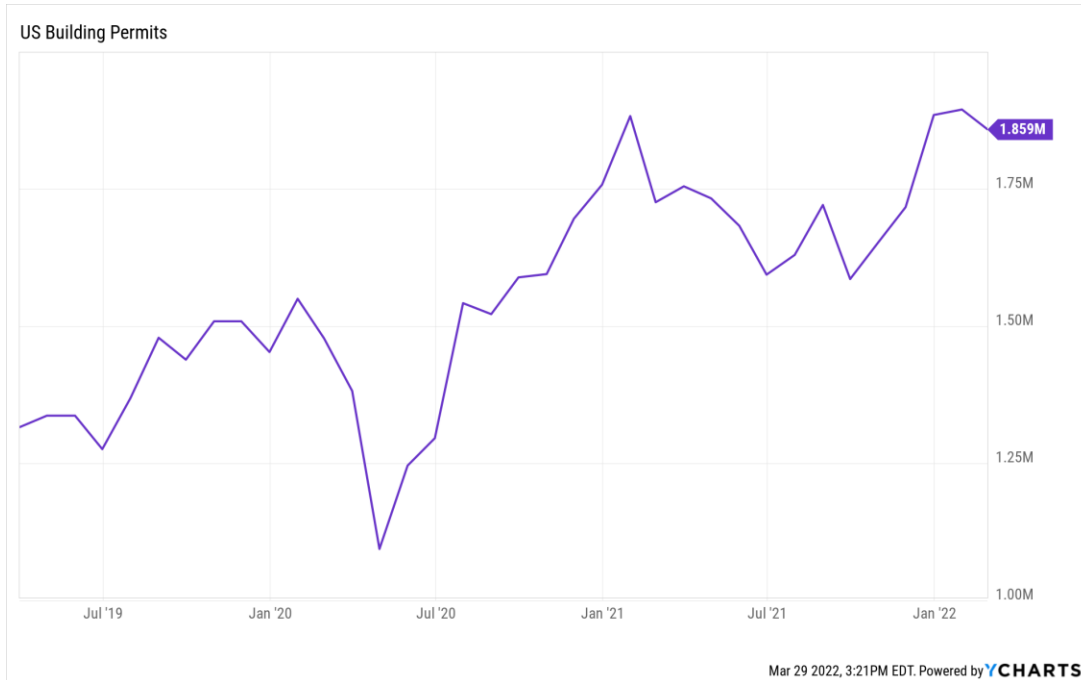
History Tells Us That Rising Rates Eventually End Bull Markets



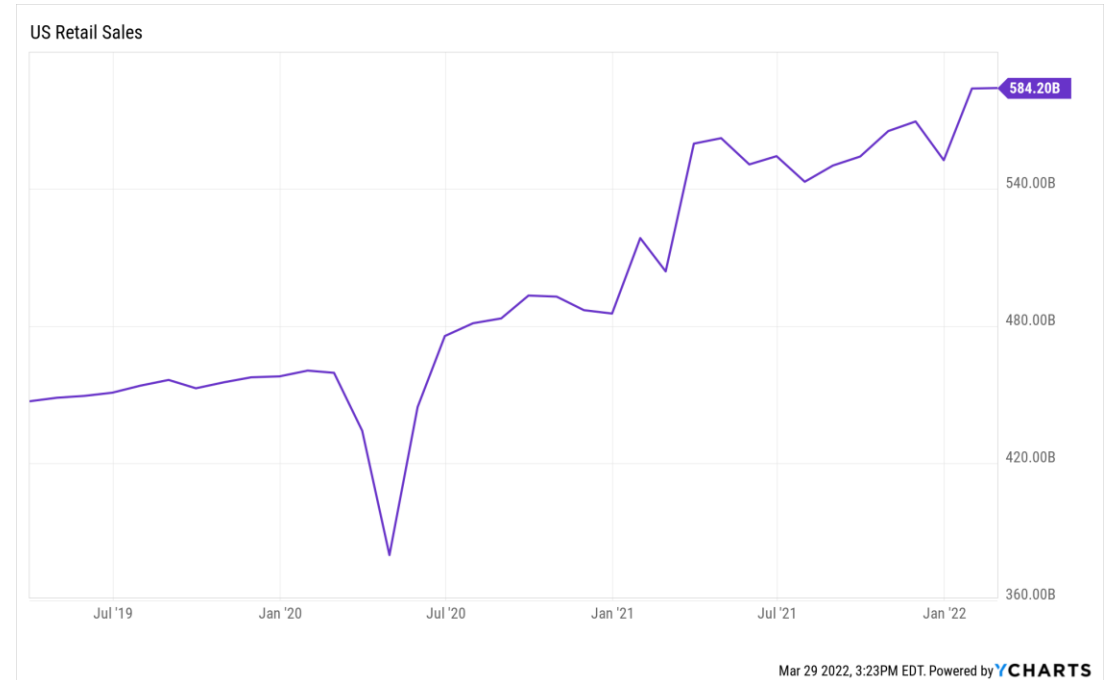
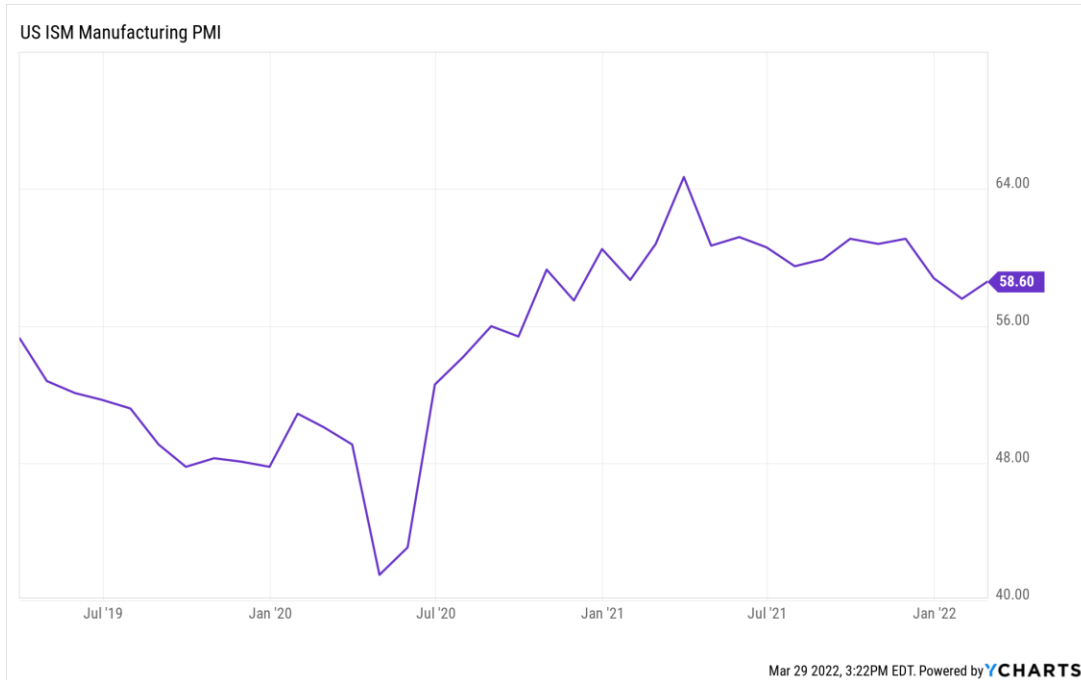
So, when will rate hikes and higher rates kill this bull market?

- That depends on:
 - The current state of the economy (how strong is growth?)
 - How quickly rates rise

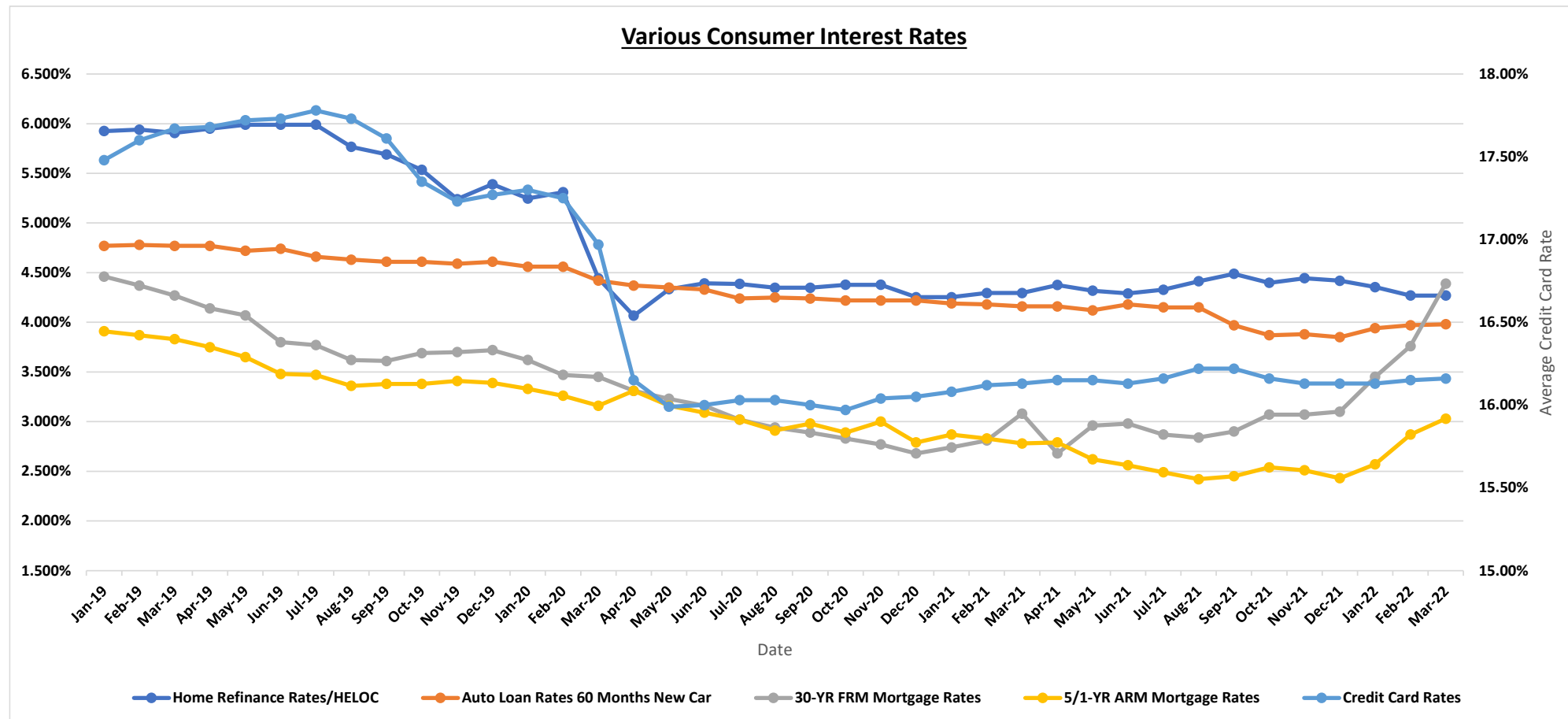
The current state of the economy (Just how strong is growth right now?)



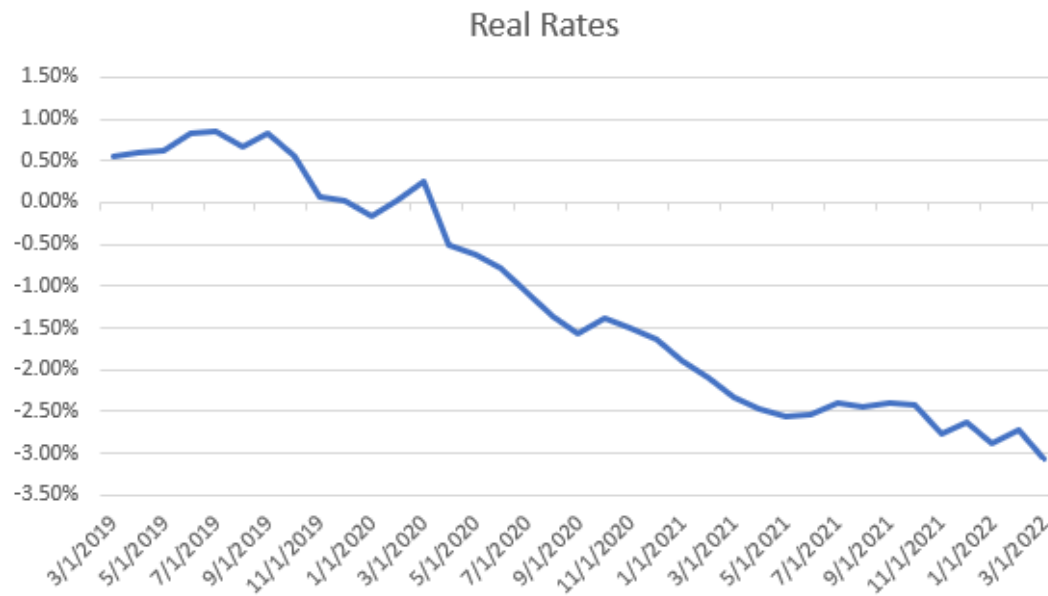
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- While rates have risen over the past few months, the data implies they aren't close to levels yet that would slow economic growth.
- Major consumer lending rates mostly are below pre-pandemic levels.
- Real interest rates (nominal Fed Funds – annual inflation) are massively negative still.

So, how do we know when rates rise enough to start to slow growth? Yield Curves.

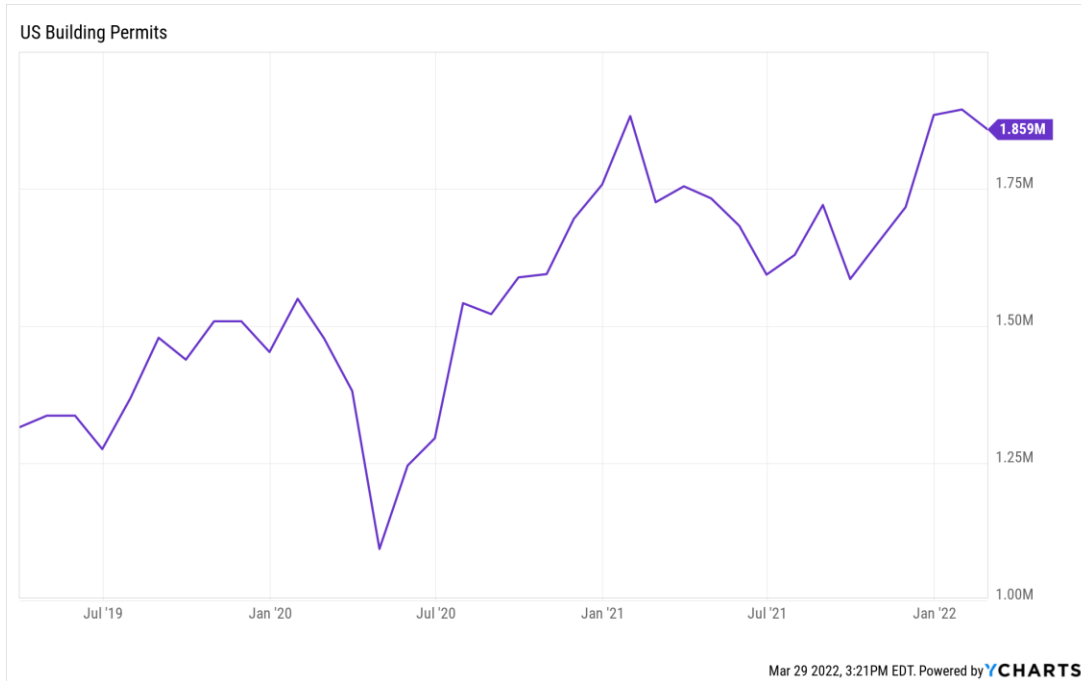


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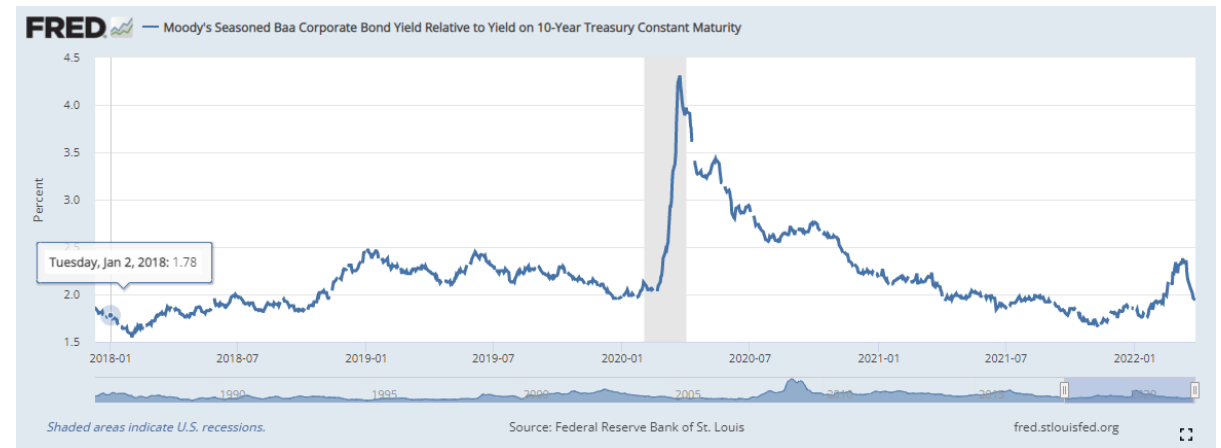
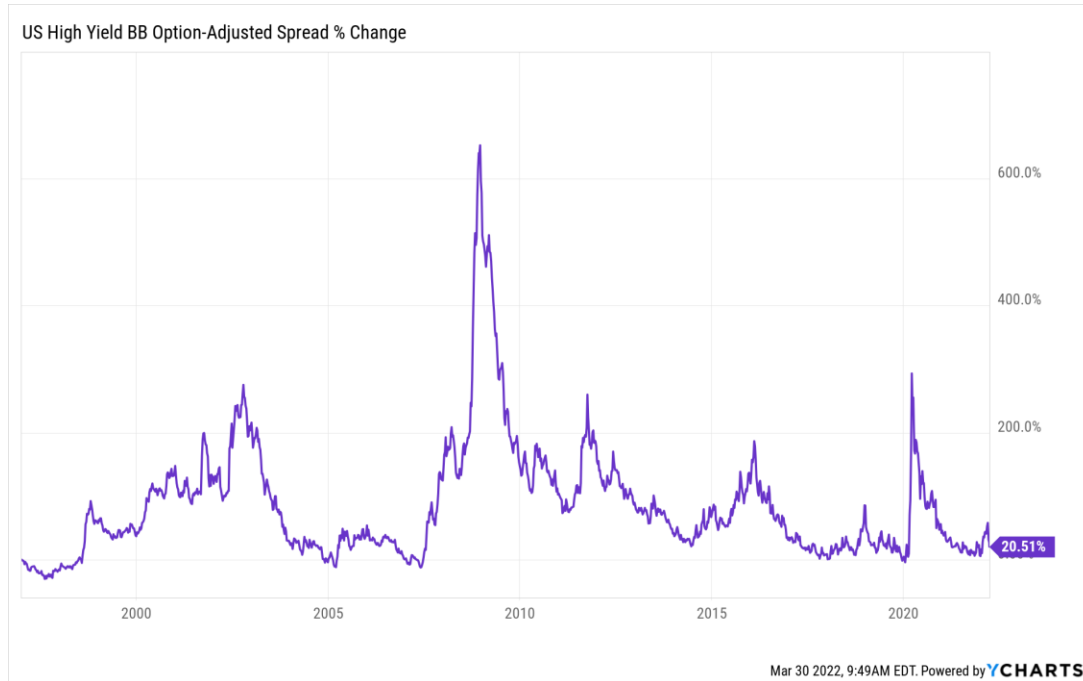
- Yield curves are starting to flash warning signs as the 30's-5's have inverted for the first time since 2006, and 10's-2's inverted for the first time since 2019.
- But, there are mixed signals as 5's-3-month yield spreads are rising.
- We'll look for signals across the curve for more inversions, but even then, we know markets can rally for a year or more after the inversion occurs (and the return on the S&P 500 over that time can be 15% or more).



So, how do we know when rates rise enough to start to slow growth? Leading Economic Indicators



So, how do we know when rates rise enough to start to slow growth?
Credit Spreads



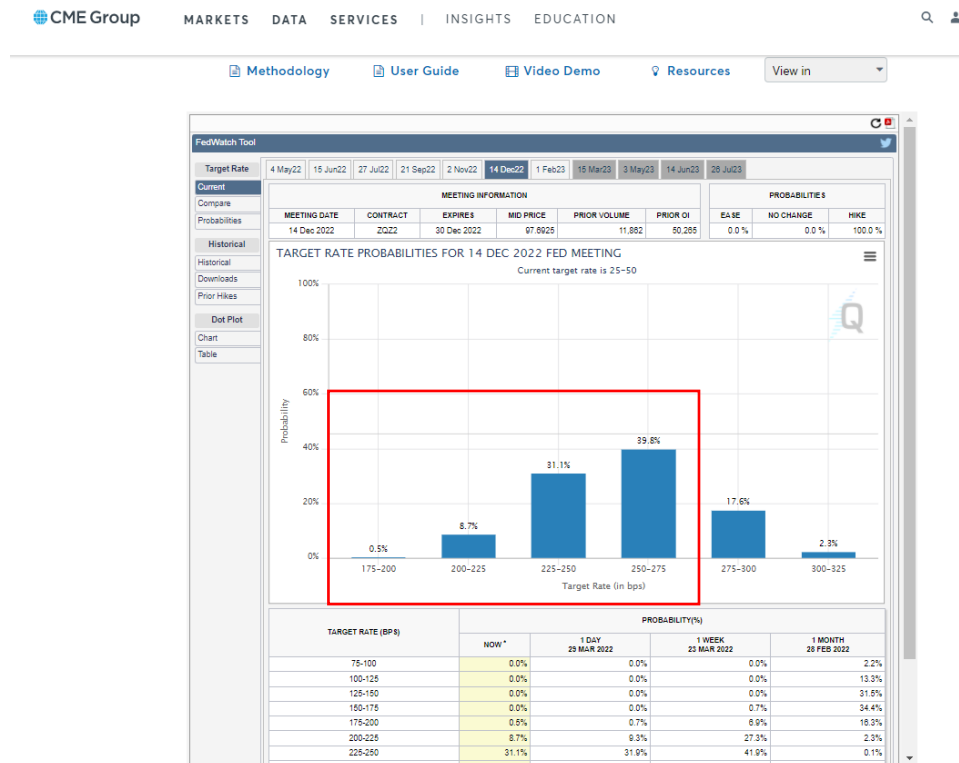
Conclusion

- Right now, there isn't a lot of evidence that the Fed is close to levels where rates might stall economic growth and end the bull market.
- So, in normal times, I'd expect this bull market has at least a few more quarters to run.
- But, these are not normal times.

Two Wildcards to Watch

Fed Rate Hike Expectations: More than an 80% chance we see 225 bps of additional rate hikes by year-end.

Balance Sheet Reduction a Major Wild Card – That's like additional rate hikes. Watch \$100 bln/month.



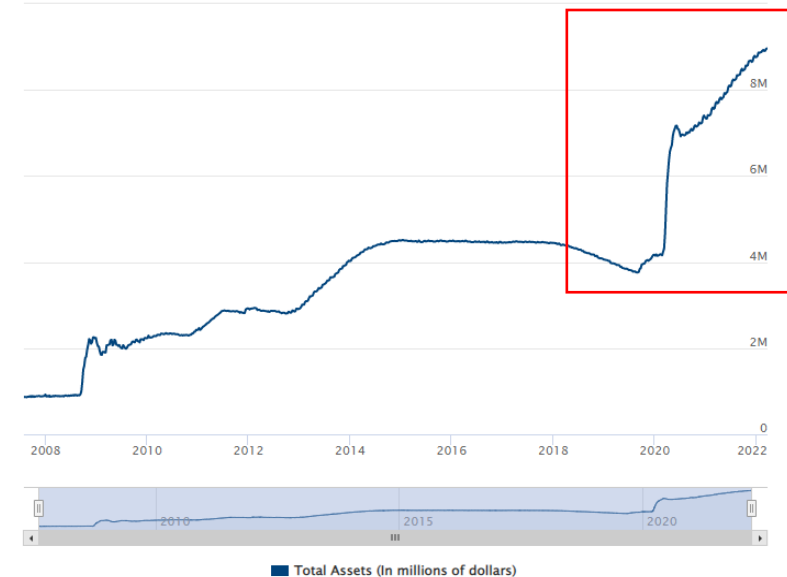
Recent balance sheet trends

Choose one of the 5 charts.

Total Assets of the Federal Reserve

Zoom 1m 3m 6m YTD 1y All

Jul 30, 2007 → Mar 23, 2022



Bottom Line

- Growth is solid and rates are not close to levels that would end this bull market – so in normal times I'd feel confident saying this could run for another year, or more.
- But, these are not normal times. The Fed is continuously getting more aggressive with rate hike threats, and this economy hasn't seen a 2.5% rate hike in a calendar year since the early 1990's.
- Meanwhile, balance sheet reduction (Quantitative Tightening) is a major wildcard. It's only been done once before, and it was very gradual. That won't be the case this time.
- Bottom line, the outlook appears favorable, but especially starting this summer we need to watch very closely for signs the economy is slowing, because if we enter recession the February lows will be tested, and possibly violated.