

# INFOCUS

MACRO COMMENT

MAY 2022



## How fast will the FOMC raise interest rates?

### DISCIPLINED BY NATURE. FLEXIBLE BY DESIGN.

The icons alongside represent our investment process. Through a disciplined provision of investment policy and security selection at the global level, regional portfolio management teams have the flexibility to construct portfolios to meet the specific requirements of our clients.

### HIGHLIGHTED IN THIS PUBLICATION:

 GLOBAL STRATEGIC  
ASSET ALLOCATION

 GLOBAL SECURITY  
SELECTION

 REGIONAL  
ASSET ALLOCATION

 REGIONAL PORTFOLIO  
CONSTRUCTION

# HOW FAST WILL THE FOMC RAISE INTEREST RATES?

The Fed is set to continue to tighten monetary policy. But how fast will it raise rates? In this issue of *Infocus* EFG Chief economist Stefan Gerlach looks at the historical evidence since 1980 and compares what the FOMC and the markets expect in the current cycle.

With CPI inflation in the US exceeding 8% year-on-year in March and with interest rates at 0.25%-0.5% the Federal Reserve is in a tightening mode, having first hiked rates by 25bps on 16 March. But how fast might it raise interest rates from here? To address this question, it is useful to review how the Fed has behaved in past tightening episodes.

## The historical record

Relying on work dating tightening cycles by Federal Reserve staff, the analysis focuses on the six episodes since 1980.<sup>1</sup> Figure 1 shows how the target for the federal funds rate evolved in these episodes. While the first five evolved in broadly similar ways, the sixth tightening cycle, which started in December 2015 and was the first after the Global Financial Crisis (GFC), was much slower but also longer than the earlier five. This is not surprising: since the GFC was centred on the financial system the Fed naturally decided to proceed cautiously.

### 1. Past Fed tightening episodes

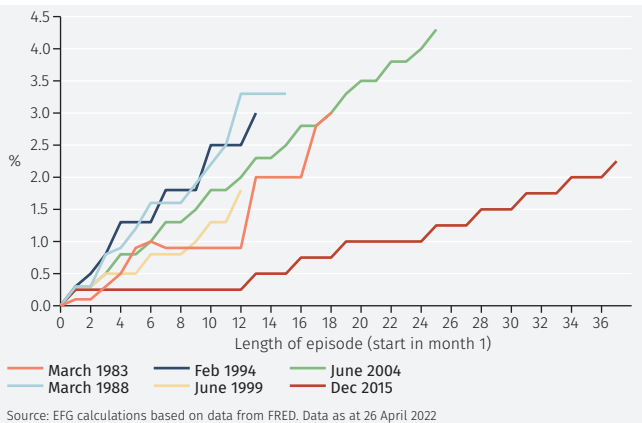
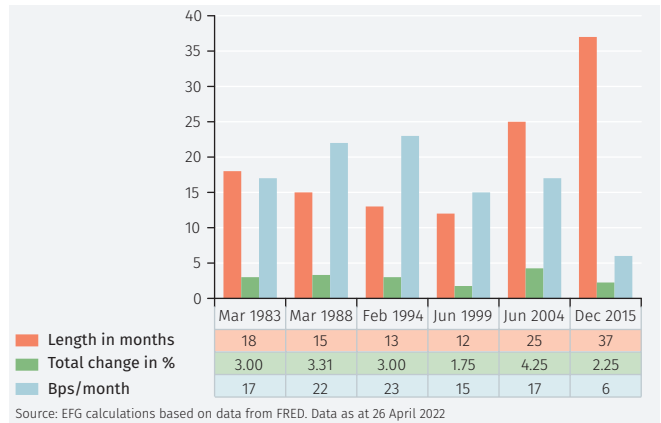


Figure 2 provides more detail about these episodes. The table shows the month of the first interest rate increase, the number of months the episode lasted, the total increase in interest rates and the average increase in rates per month. The first four episodes lasted between 12 to 18 months. The episode that started in 2004 was a little longer, lasting 25 months. The longest was the post-GFC episode that lasted more than three years.

### 2. Average dots and fitted curves



The table shows that these tightening cycles involved a cumulative increase in interest rates of between 1.75% and 4.25%. Interestingly, the long post-GFC episode entailed a relatively small cumulative increase of 2.25%.

Another way to compare these episodes is to look at the 'speed' of tightening, defined as the cumulative increase in interest rates divided by the length of the episode. The episodes have been broadly similar, with an average speed of tightening of 15 – 23bps per month.<sup>2</sup> The exception is the post-GFC episode with an average speed of 6bps per month.

As a rule of thumb, and disregarding the 2015 episode, the historical evidence suggests that tightening episodes last about 15 months and involve around a 3% cumulative increase in interest rates, implying a speed in the order of 20bps per month.

### What do FOMC members, and the markets, expect this time?

Next, we turn to the question of how FOMC members and market participants think this episode of interest rate tightening will evolve. Figure 3 shows the path assuming a monthly increase of 17.3bps, which is the average monthly increase for the episodes reviewed above (disregarding the post-GFC tightening cycle), starting from March 2022 onward. That path implies an interest rate of 1.855% in December.

<sup>1</sup> See *A Look at Fed Tightening Episodes since the 1980s: Part I*, Kevin L. Kliesen, 14 April 2022, Federal Reserve Bank of St. Louis. <https://tinyurl.com/54z5p23c>

<sup>2</sup> Speed is computed using the cumulative increase in interest rates over the first 12 months since that is the shortest episode. Interestingly, the speed of tightening is strikingly similar over that period.

# HOW FAST WILL THE FOMC RAISE INTEREST RATES?

### 3. Expected path of federal funds rate



Interestingly, the median dot for December 2022 in the FOMC's 'dot plot' published in March 2022 is for an interest rate of 1.875%. Thus, the FOMC expects to raise interest rates in a manner compatible with the historical record. Furthermore, the median FOMC member expects interest rates to peak at 2.75% at the end of 2023, which matches very well the historical record of tightening cycles involving about a 3% increase in interest rates in total.

Figure 3 also shows the path priced in by financial market participants on 17 March (the day after the last FOMC meeting) and on 26 April, with each dot indicating an FOMC meeting.<sup>3</sup> The figure shows that while market expectations in March were broadly compatible with the historical record of interest rate increases, there are now far more aggressive increases expected for this year. In particular, the market anticipates rapid interest rate increases in May, June and July, followed by increases according to the historical norm of about 20bps per month until early 2023. It seems likely that FOMC members will revise their dots upward at their June meeting.

### Conclusions

This analysis suggests three main conclusions.

1. A 'standard' Fed tightening cycle lasts about 15 months and involves around a 3% cumulative increase in interest rates, implying a speed of tightening in the order of 20bps per month.
2. The median FOMC member apparently expected at the time of the March meeting that rates would follow a path similar to the historical average.
3. Market participants are pricing in more aggressive interest rate increases at the May, June and July FOMC meetings, but that rates thereafter will rise at the same speed as in past interest rate tightening cycles of about 20bps per month.

<sup>3</sup> The CME's FedWatch Tool (<https://tinyurl.com/ycksjkje>) provides the probability of future FOMC decisions as priced in by financial markets; the figure shows probability-weighted averages.



## Important Information

**The value of investments and the income derived from them can fall as well as rise, and past performance is no indicator of future performance. Investment products may be subject to investment risks involving, but not limited to, possible loss of all or part of the principal invested.**

This document does not constitute and shall not be construed as a prospectus, advertisement, public offering or placement of, nor a recommendation to buy, sell, hold or solicit, any investment, security, other financial instrument or other product or service. It is not intended to be a final representation of the terms and conditions of any investment, security, other financial instrument or other product or service. This document is for general information only and is not intended as investment advice or any other specific recommendation as to any particular course of action or inaction. The information in this document does not take into account the specific investment objectives, financial situation or particular needs of the recipient. You should seek your own professional advice suitable to your particular circumstances prior to making any investment or if you are in doubt as to the information in this document.

Although information in this document has been obtained from sources believed to be reliable, no member of the EFG group represents or warrants its accuracy, and such information may be incomplete or condensed. Any opinions in this document are subject to change without notice. This document may contain personal opinions which do not necessarily reflect the position of any member of the EFG group. To the fullest extent permissible by law, no member of the EFG group shall be responsible for the consequences of any errors or omissions herein, or reliance upon any opinion or statement contained herein, and each member of the EFG group expressly disclaims any liability, including (without limitation) liability for incidental or consequential damages, arising from the same or resulting from any action or inaction on the part of the recipient in reliance on this document. The availability of this document in any jurisdiction or country may be contrary to local law or regulation and persons who come into possession of this document should inform themselves of and observe any restrictions. This document may not be reproduced, disclosed or distributed (in whole or in part) to any other person without prior written permission from an authorised member of the EFG group.

This document has been produced by EFG Asset Management (UK) Limited for use by the EFG group and the worldwide subsidiaries and affiliates within the EFG group. EFG Asset Management (UK) Limited is authorised and regulated by the UK Financial Conduct Authority, registered no. 7389746. Registered address: EFG Asset Management (UK) Limited, Leconfield House, Curzon Street, London W1J 5JB, United Kingdom, telephone +44 (0)20 7491 9111.

If you have received this document from any affiliate or branch referred to below, please note the following:

### Information for investors in Australia:

This document has been prepared and issued by EFG Asset Management (UK) Limited, a private limited company with registered number 7389746 and with its registered office address at Leconfield House, Curzon Street, London W1J 5JB (telephone number +44 (0)20 7491 9111). EFG Asset Management (UK) Limited is regulated and authorized by the Financial Conduct Authority No. 536771. EFG Asset Management (UK) Limited is exempt from the requirement to hold an Australian financial services licence in respect of the financial services it provides to wholesale clients in Australia and is authorised and regulated by the Financial Conduct Authority of the United Kingdom (FCA Registration No. 536771) under the laws of the United Kingdom which differ from Australian laws. This document is confidential and intended solely for the use of the person to whom it is given or sent and may not be reproduced, in whole or in part, to any other person.

### ASIC Class Order CO 03/1099

EFG Asset Management (UK) Limited notifies you that it is relying on the Australian Securities & Investments Commission (ASIC) Class Order CO 03/1099 (Class Order) exemption (as extended in operation by ASIC Corporations (Repeal and Transitional Instrument 2016/396) for UK Financial Conduct Authority (FCA) regulated firms which exempts it from the requirement to hold an Australian financial services licence (AFSL) under the Corporations Act 2001 (Cth) (Corporations Act) in respect of the financial services we provide to you.

### UK Regulatory Requirements

The financial services that we provide to you are regulated by the FCA under the laws and regulatory requirements of the United Kingdom which are different to Australia. Consequently any offer or other documentation that you receive from us in the course of us providing financial services to you will be prepared in accordance with those laws and regulatory requirements. The UK regulatory requirements refer to legislation, rules enacted pursuant to the legislation and any other relevant policies or documents issued by the FCA.

### Your Status as a Wholesale Client

In order that we may provide financial services to you, and for us to comply with the Class Order, you must be a 'wholesale client' within the meaning given by section 761G of the Corporations Act. Accordingly, by accepting any documentation from us prior to the commencement of or in the course of us providing financial services to you, you:

- warrant to us that you are a 'wholesale client';
- agree to provide such information or evidence that we may request from time to time to confirm your status as a wholesale client;
- agree that we may cease providing financial services to you if you are no longer a wholesale client or do not provide us with information or evidence satisfactory to us to confirm your status as a wholesale client; and
- agree to notify us in writing within 5 business days if you cease to be a 'wholesale client' for the purposes of the financial services that we provide to you.

**Bahamas:** EFG Bank & Trust (Bahamas) Ltd. is licensed by the Securities Commission of The Bahamas pursuant to the Securities Industry Act, 2011 and Securities Industry Regulations, 2012 and is authorised to conduct securities business in and from The Bahamas including dealing in securities, arranging deals in securities, managing securities and advising on securities. EFG Bank & Trust (Bahamas) Ltd. is also licensed by the Central Bank of The Bahamas pursuant to the Banks and Trust Companies Regulation Act, 2000 as a Bank and Trust company.

**Bahrain:** EFG AG Bahrain Branch is regulated by the Central Bank of Bahrain with registered office at Bahrain Financial Harbour, West Tower – 14th Floor, Kingdom of Bahrain.

**Bermuda:** EFG Wealth Management (Bermuda) Ltd. is an exempted company incorporated in Bermuda with limited liability. Registered address: Thistle House, 2nd Floor, 4 Burnaby Street, Hamilton HM 11, Bermuda.

**Cayman Islands:** EFG Bank is licensed by the Cayman Islands Monetary Authority for the conduct of banking business pursuant to the Banks and Trust Companies Law of the Cayman Islands. EFG Wealth Management (Cayman) Ltd. is licensed by the Cayman Islands Monetary Authority for the conduct of trust business pursuant to the Banks and Trust Companies Law of the Cayman Islands, and for the conduct of securities investment business pursuant to the Securities Investment Business Law of the Cayman Islands.

**Chile:** EFG Corredores de Bolsa SpA is licensed by the Comisión para el Mercado Financiero ("Ex SVS") as a stock broker authorised to conduct securities brokerage transactions in Chile and ancillary regulated activities including discretionary securities portfolio management, arranging deals in securities and investment advice. Registration No: 215. Registered address: Avenida Isidora Goyenechea 2800 Of. 2901, Las Condes, Santiago.

**Cyprus:** EFG Cyprus Limited is an investment firm established in Cyprus with company No. HE408062, having its registered address at Kennedy 23, Globe House, 6th Floor, 1075, Nicosia, Cyprus. EFG Cyprus Limited is authorised and regulated by the Cyprus Securities and Exchange Commission (CySEC)

**Dubai:** EFG (Middle East) Limited is regulated by the Dubai Financial Services Authority with a registered address of Gate Precinct Building 05, Level 07, PO Box 507245, Dubai, UAE.

**Guernsey:** EFG Private Bank (Channel Islands) Limited is licensed by the Guernsey Financial Services Commission.

**Hong Kong:** EFG Bank AG is authorised as a licensed bank by the Hong Kong Monetary Authority pursuant to the Banking Ordinance (Cap. 155, Laws of Hong Kong) and is authorised to carry out Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management) regulated activity in Hong Kong.

**Jersey:** EFG Wealth Solutions (Jersey) Limited is regulated by the Jersey Financial Services Commission in the conduct of investment business under the Financial Services (Jersey) Law 1998.

**Liechtenstein:** EFG Bank von Ernst AG is regulated by the Financial Market Authority Liechtenstein, Landstrasse 109, P.O. Box 279, 9490 Vaduz, Liechtenstein.

**Luxembourg:** EFG Bank (Luxembourg) S.A. is listed on the official list of banks established in Luxembourg in accordance with the Luxembourg law of 5 April 1993 on the financial sector (as amended) (the "Law of 1993"), held by the Luxembourg supervisory authority (Commission de Surveillance du Secteur Financier), as a public limited company under Luxembourg law (société anonyme) authorised to carry on its activities pursuant to Article 2 of the Law of 1993. Luxembourg residents should exclusively contact EFG Bank (Luxembourg) S.A., 56 Grand Rue, Luxembourg 2013 Luxembourg, telephone +352 264541, for any information regarding the services of EFG Bank (Luxembourg) S.A.

**Monaco:** EFG Bank (Monaco) SAM is a Monegasque Public Limited Company with a company registration no. 90 S 02647 (Registre du Commerce et de l'Industrie de la Principauté de Monaco). EFG Bank (Monaco) SAM is a bank with financial activities authorised and regulated by the French Prudential Supervision and Resolution Authority and by the Monegasque Commission for the Control of Financial Activities. Registered address: EFG Bank (Monaco) SAM, Villa les Aigles, 15, avenue d'Ostende – BP 37 – 98001 Monaco (Principauté de Monaco), telephone: +377 93 15 11 11. The recipient of this document is perfectly fluent in English and waives the possibility to obtain a French version of this publication.

**People's Republic of China ("PRC"):** EFG Bank AG Shanghai Representative Office is approved by China Banking Regulatory Commission and registered with the Shanghai Administration for Industry and Commerce in accordance with the Regulations of the People's Republic of China for the Administration of Foreign-invested Banks and the related implementing rules. Registration No: 310000500424509. Registered address: Room 65T10, 65 F, Shanghai World Financial Center, No. 100, Century Avenue, Pudong New Area, Shanghai. The business scope of EFG Bank AG Shanghai Representative Office is limited to non-profit making activities only including liaison, market research and consultancy.

**Portugal:** The Portugal branch of EFG Bank (Luxembourg) S.A. is registered with the Portuguese Securities Market Commission under registration number 393 and with the Bank of Portugal under registration number 280. Taxpayer and commercial registration number: 980649439. Registered address: Av. da Liberdade, No 131, 6o Dto – 1250-140 Lisbon, Portugal.

**Singapore:** The Singapore branch of EFG Bank AG (UEN No. T03FC6371J) is licensed by the Monetary Authority of Singapore as a wholesale bank to conduct banking business and is an Exempt Financial Adviser as defined in the Financial Advisers Act and Exempt Capital Markets Services Licensee as defined in the Securities and Futures Act.

**Switzerland:** EFG Bank AG, Zurich, including its Geneva and Lugano branches, is authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA). Registered address: EFG Bank AG, Bleicherweg 8, 8001 Zurich, Switzerland. Swiss Branches: EFG Bank SA, 24 quai du Seujet, 1211 Geneva 2 and EFG Bank SA, Via Magatti 2 6900 Lugano.

**United Kingdom:** EFG Private Bank Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority, registered no. 144036. EFG Private Bank Limited is a member of the London Stock Exchange. Registered company no. 2321802. Registered address: EFG Private Bank Limited, Leconfield House, Curzon Street, London W1J 5JB, United Kingdom, telephone +44 (0)20 7491 9111. In relation to EFG Asset Management (UK) Limited please note the status disclosure appearing above.

**United States:** EFG Asset Management (UK) Limited is an affiliate of EFG Capital, a U.S. Securities and Exchange Commission ("SEC") registered broker-dealer and member of the Financial Industry Regulatory Authority ("FINRA") and the Securities Investor Protection Corporation ("SIPC"). None of the SEC, FINRA or SIPC, have endorsed this document or the services and products provided by EFG Capital or its U.S. based affiliate, EFGAM Americas. EFGAM Americas is registered with the SEC as an investment adviser. Securities products and brokerage services are provided by EFG Capital, and asset management services are provided by EFGAM Americas. EFG Capital and EFGAM Americas are affiliated by common ownership and may maintain mutually associated personnel. This document is not intended for distribution to U.S. persons or for the accounts of U.S. persons except to persons who are "qualified purchasers" (as defined in the United States Investment Company Act of 1940, as amended (the "Investment Company Act")) and "accredited investors" (as defined in Rule 501(a) under the Securities Act). Any securities referred to in this document will not be registered under the Securities Act or qualified under any applicable state securities statutes. Any funds referred to in this document will not be registered as investment companies under the Investment Company Act. Analysts located outside of the United States are employed by non-US affiliates that are not subject to FINRA regulations.