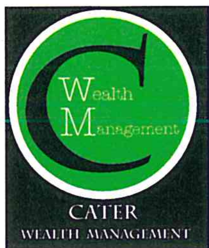

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Gregory Cater Sr. and Greg Cater Jr.

Is the Current Fed Tightening Cycle Too Aggressive?

According to A Garry Shilling Ph.D., over the entire post-WWII era, a 1-point increase in the Fed's policy rate equals a 36 basis point (.36%) increase in the US 10-year-bond rate and a 24 basis point (.24%) increase in the 30-year-bond-rate. At the last Fed meeting (March 15th, 2022), the Fed increased the policy rate 25 basis points. Since March 15th, the 10-year-bond and 30-year bond rates have increased 62 basis points and 32 basis points respectively. The projections of the path of the policy rate made at the March meeting (the Dot Plots) tell us the rate will reach 1.875% in 2022, peak at 2.75% in 2023 and average 2.375% long term. Assuming Shilling's analysis of the long-term relationship between the increases in the policy rate and the increases in the bond rates hold and the Fed's projections are accurate (remember the Fed is predicting a rate they have complete control over) the 10-year-bond will peak at 3.04% and the 30-year will peak at 3.08%.

Today the 10 year is 2.77% and the 30 year is 2.81%. Rates always seem to over-shoot targets, but if our targets are anywhere close to accurate, the 10-year and 30-year bond yields are within 27 basis points from the top for this tightening cycle. We also haven't even started reducing the Fed's balance sheet. Forward guidance has told us that this tightening cycle will be much more aggressive than anything this Fed has done in the past. Remember, The Fed completely reversed course after the Fed Funds rate hit 2.5% during the last tightening cycle and was forced to bring it back to 0% within 6 months. Also after reducing the balance sheet from $4.5 trillion to $3.76 trillion last time it ballooned to over $7 trillion in less than one year. And this time they will be *more* aggressive? Will this time be different? What about the current explosion in inflation? We didn't have an inflation problem last time.

In our last note: "Does High Inflation Lead to High Interest Rates? (Part 2)" which can be found at caterwealthmanagement.com/resources, we explained that the inflation we are seeing today most closely resembles the inflation we saw after both WWI and WWII. In both cases we had very low unemployment and severe shortages of things to buy. Back then, our factories switched from producing consumer goods to war goods. It took time to switch back. Today we are re-opening factories after the global shutdowns and re-establishing supply chains. This type of supply/demand inflation reverses itself.

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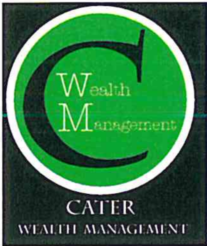

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The high inflation we saw after the war reversed itself quickly.

- In Jun'1920 inflation hit 23.7% and dropped to -15.8% (deflation) in 12 months
- In Apr'1947 inflation hit 19.7% and dropped to 0% in 26 months

The high inflation we experienced both 30 and 40 years ago (that the press is always quick to mention) also reversed itself quickly.

- In Jun'1982 inflation hit 7.1% and dropped to 2.5% in 14 months
- In Nov'1990 inflation hit 6.3% and dropped to 2.6% in 14 months

Today, CPIYOY (CPI Year over Year) is 7.9%. Where will it be in 14 months? We may already be seeing the peak in energy prices. Oil peaked on March 8th and is down Over 20% from its high.

Other note-worthy commodities are also off their highs in the last month:

Copper	down 6.37%
Iron Ore	down 4.53%
Aluminum	down 10.62%
Wheat	down 25.07%
Lumber	down 32.53%

Even used car prices are down 5.38% this year.

Our opinion at Cater Wealth Management is that the Fed did not cause today's high inflation. The cause is supply/demand imbalances. The Fed can, however, reduce demand through monetary policy and they are telling us they will. We believe they will go too far and lead us into a recession. Recessions lead to lower, not higher, interest rates.

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