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Consequences of the Most Dramatic Fed Tightening Cycles

When the Fed raises interest rates to tighten monetary policy, it's not just how much that matters, it's the percentage change. The starting point and the ending point are important, but the *multiple* is crucial. When Paul Volker raised rates to fight the inflation of the 1970's he started at 10% and ended at 20%. Most think this is the most aggressive tightening cycle in modern history. The numbers are high, but the percentage change was only 100%. The current tightening cycle (0.25% - 5.50%) raised the rate 2,000%!

We have outlined below the most aggressive tightening cycles since 1972. This was when Fed Chair Arthur Burns raised rates to fight the inflation from President Johnson's "Great Society" spending and the oil shocks that resulted from the OPEC embargo.

The current cycle, with its staggering 2000% increase, stands out as an extreme outlier. It is not a stretch to say that as a result, the balance sheets of banks, insurance companies, pension plans, endowments and all companies that either lend or borrow have been greatly weakened if not decimated.

Most Dramatic Fed Tightening Cycles and Consequences

Date		Start %		End %		% Increase		Consequence
1972-74		3.29%		12.92%		293%		Worst Recession since
								Great Depression
1980		10%		20%		100%		2 Recessions
2004-06		1.00%		5.25%		425%		Great Financial Crisis
Current Cycle		0.25%		5.50%		2000%		?

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The current fight against inflation has been successful. By all measures we are below the long-term averages for both PCE (64 years) and CPI (110 years). The second Federal Reserve mandate is "maximum employment". After recovering 80% of the jobs lost to the COVID shutdowns in 2021, the numbers are dismal. The Bureau of Labor Statistics reported the number of jobs created dropped 37% in 2022, 33% in 2023 and through October we are down 32% this year. Why the Federal Reserve continually worries a strong jobs market is a problem (inflationary) is perplexing.

Our view is that inflation will continue to moderate, and a weak jobs market will add pressure to lower interest rates going forward. If there is a consequence to the intensity of the current tightening cycle (2000%), interest rates could drop substantially.

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