

Five Compelling Charts

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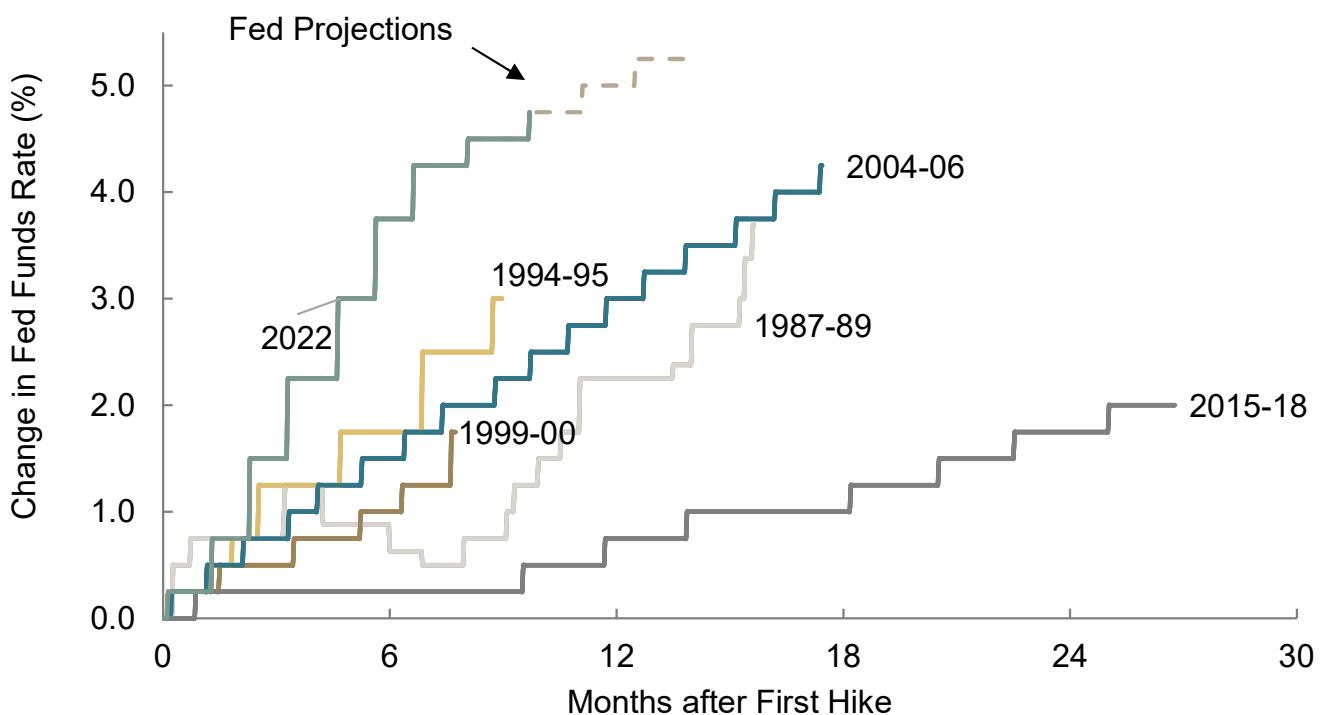
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A lot of Tightening in not a lot of Time

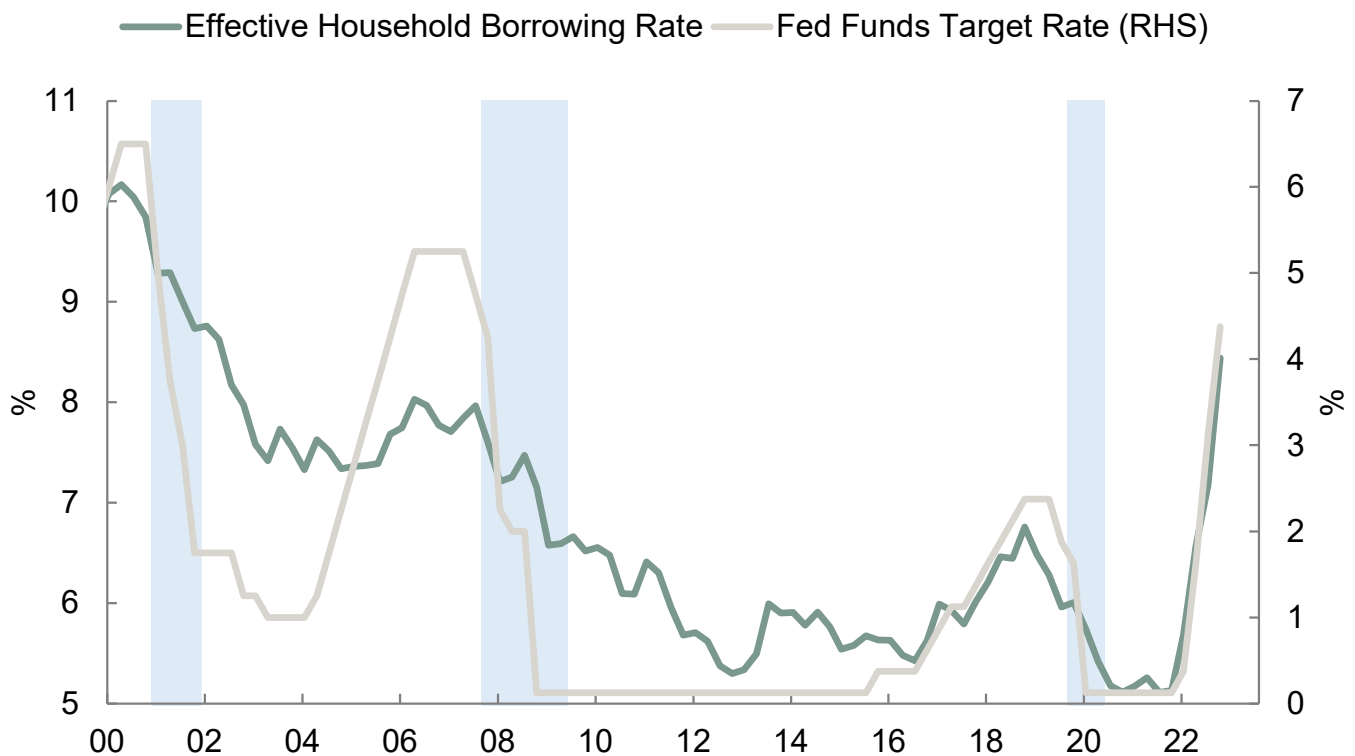
The change in interest rates has been massive! The Fed has raised the fund rates 450 basis points the past 11 months. This is the biggest and fastest hiking cycle in over four decades. This imprudently aggressive action has caused major fissures in the financial foundation. More monetary tightening—high fed funds and QT—will only further aggravate market instability and risk an even deeper downturn.



Source: FRB, Haver, SMBC Nikko

No Conundrum This Time as Rates Have Soared

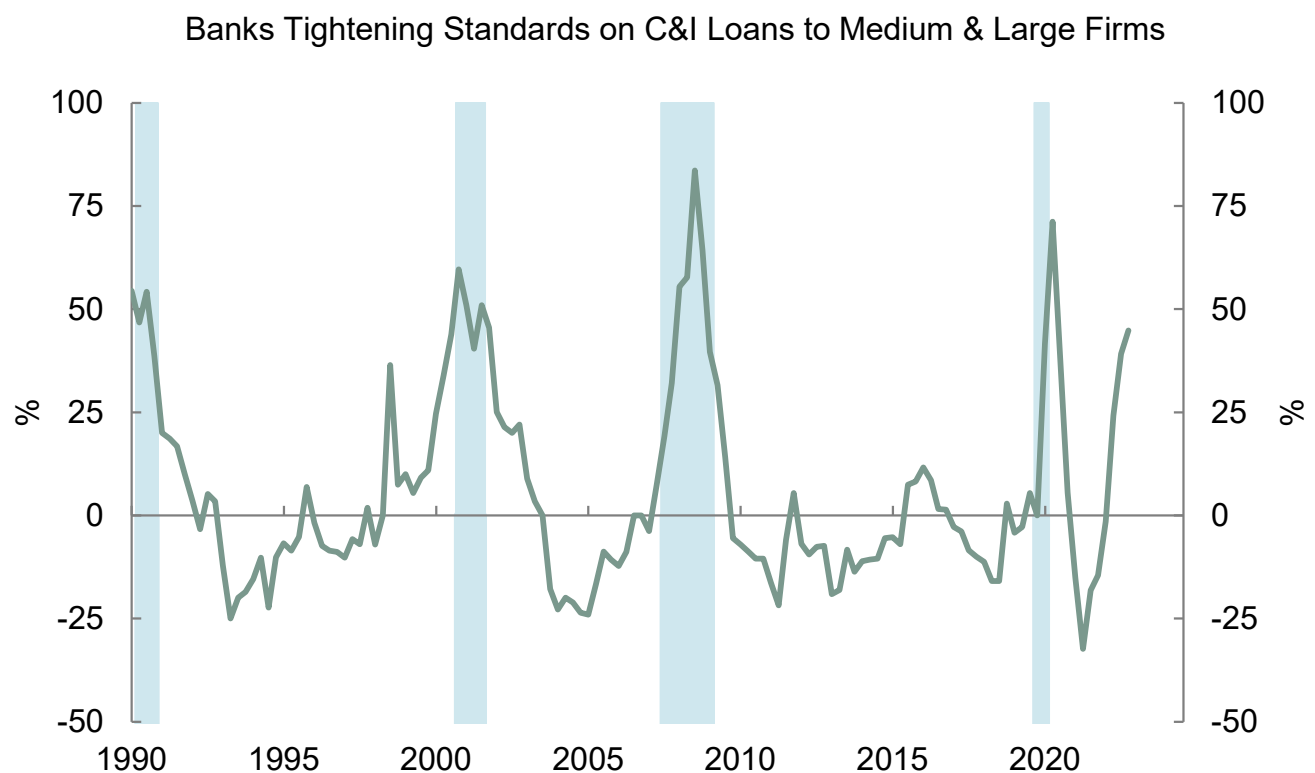
Additionally, the level of rates has increased a lot too! Household borrowing costs, which include mortgages, credit cards and auto/personal loans, have risen to their highest reading in over 20 years. This will depress consumption. Remember that a rising funds rate was not much of a dampening factor in the last tightening cycle (2004-06) because of the bond conundrum whereupon household borrowing costs had hardly increased.



Source: FRB, Freddie Mac, Haver, SMBC Nikko

Credit Getting Much Harder to Come by

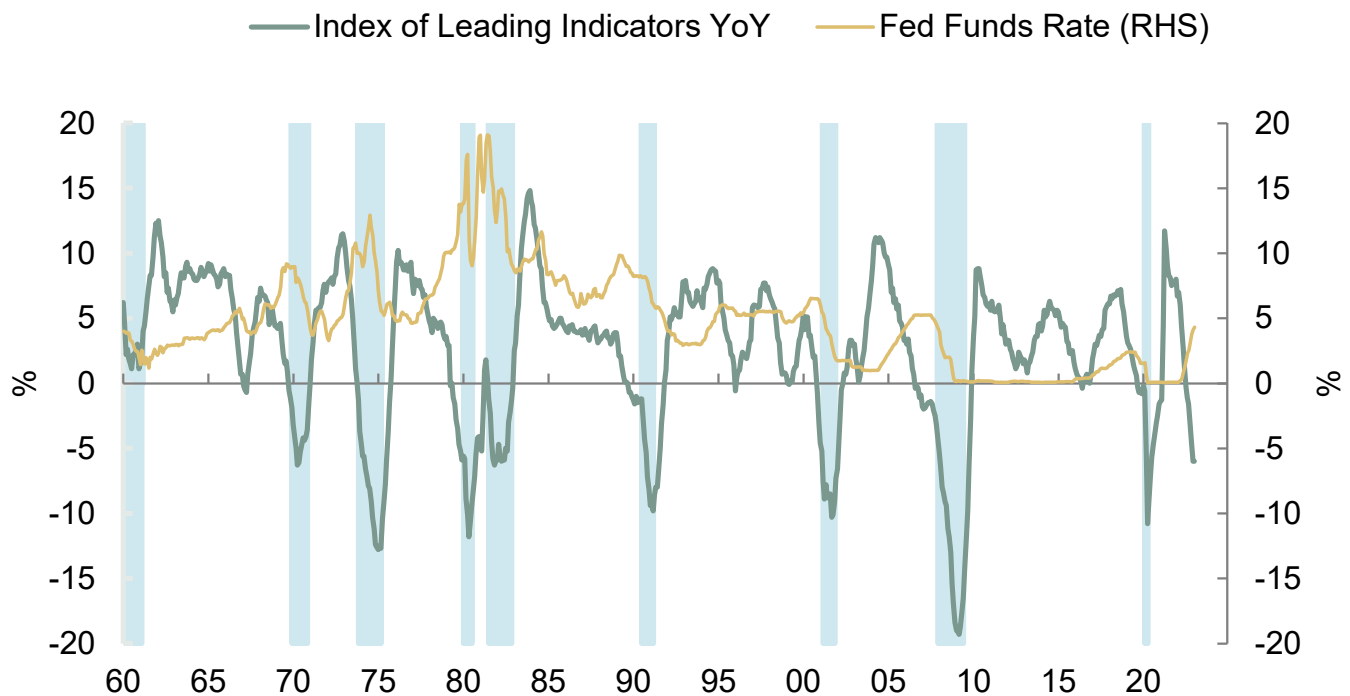
The Treasury yield curve inverted last July and hit a record inversion earlier this month when normalized for the level of interest rates. When this happens, banks are not incentivized to make loans. We can see this in lending standards, which tightened at their fastest pace since the Great Financial Crisis. Troublingly, recent developments point to a further tightening in lending standards this quarter.



Source: FRB, Haver, SMBC Nikko

Tightening Into a Recession

So far, the Fed has ignored leading indicators of the economy which are pointing to a recession by the second half of this year. Instead, policymakers have focused on inflation—a lagging indicator. This is a classic policy error which means the Fed will have to start easing this year and into next year (and probably more than investors expect). Keep in mind this will be happening against the backdrop of a US Presidential Election. Fed independence could be on the line.



Source: Conference Board, FRB, Haver, SMBC Nikko

Anchored Inflation Expectations

Despite some of the highest inflation readings in 40 years, the bond market has never worried about a 1970s repeat—at least not yet. Investors expect the recent inflation storm to pass. In fact, breakeven inflation has plunged and is now consistent with longer-term price stability which is also being corroborated by forward 5y5y inflation swap rates. Bottom line: The Fed should pause and appraise the current situation.



Source: Bloomberg, FRB, Haver, SMBC Nikko

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