US Macroeconomics

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Anatomy of Easing Cycles

The futures market is fully discounting a 25 basis points (bps) September 18 rate reduction and about a 75% probability there are two more 25 bp rate cuts by yearend: one on November 6 and another on December 18. **By the end of 2025, market participants assume the Fed will have lowered rates 175 bps to just under 3.75%**. A final 25 bp cut is expected in 2026, bringing the funds rate to a trough of 3.50%. Is this reasonable?

The table below shows the 15 Fed easing cycles from 1960 to present. Note that prior to 1995, the fed funds rate traded within a fairly wide band, and policy changes were communicated via open market operations rather than today's official pronouncements. The most obvious historical takeaway is the significant variability among the various periods in both the amount of easing and the length of time in which it took place.

For example, the biggest easing cycle began in July 1981 when the Fed ultimately lowered interest rates nearly 1100 bps over 20 months. But the funds rate came down from a peak of nearly 20%. It took over three years to reduce official rates from almost 10% in June 1989 to cyclical low of 3% in September 1992. There were a handful of modest monetary fine tunings, too.

After the 1987 stock market crash, the Fed cut rates about 75 bps. This happened in three more periods beginning in 1995, 1998 and 2019. Absent the last episode, which was immediately followed by a pandemic, the economy experienced a soft landing following these mini rate cutting cycles. These four cycles are generally considered the exception rather than the rule.

Clearly, there have been times when the Fed has cut a lot and times when the Fed has cut a little. And some easing cycles have been long while others have been short. **Arguably, there is no standard rate cutting cycle**. How much the Fed cuts depends in large part on how restrictive monetary policy is when the easing begins and how the tightening in train may yet adversely affect future economic activity.

Compared to history, **current easing cycle expectations are most consistent with the rate cutting cycle that began in December 1966**. The Fed lowered rates nearly 200 bps in eight months. If the economy can continue to avoid recession and inflation can continue to moderate, then present market assumptions are reasonable. However, if the economy is fundamentally softer than most investors realize, then the next rate cutting cycle could be much deeper and longer than expected.

How Much does the Fed Cut in Cutting Cycles?

First Fed Rate Cut (Month)	Total Cuts (Bps)	Occurring over… (Months)
March 1960	280	17
December 1966	197	8
September 1969	547	18
October 1973	556	20
January 1980	479	7
February 1981	438	2
July 1981	1059	20
September 1984	563	24
November 1987	81	4
June 1989	681	40
July 1995	75	7
September 1998	75	3
January 2001	550	30
September 2007	513	16
July 2019	75	3
Avg->	411	15

Sources: Federal Reserve, Haver, SMBC Nikko

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