A History of Fed Rate Hikes

Yesterday the Fed hiked short-term interest rates for the ninth time since 2015.

The stock market did not seem to care for this fact, as the S&P 500 fell more than 1.5% while the Nasdaq was off over 2.1%. Considering stocks are already in the midst of a double-digit drawdown, this result didn't exactly provoke feelings of confidence in market participants.

It's always difficult to pinpoint why markets do what they do on any given day, even when there's a specific catalyst like a Fed action.

Maybe markets fell because they're worried the Fed is going to snuff out the economic recovery.

Maybe they fell because every other bond maturity seems to be calling the Fed's bluff as yield curves are inverting left and right.

Maybe they fell because the Fed signaled they may cut back on rate increases next year because the economic data is softening.

Maybe they fell because it's not a great sign when the economy can't handle short-term rates that still haven't breached 3% yet (too soon for a Robinhood joke here?).

Maybe the Fed is raising rates so they can then lower them during when the next recession strikes.

Maybe stocks still would have sold off because investors were simply looking for another reason to sell and the Fed was a perfect scapegoat either way.

There are no counterfactuals so we don't know what would have happened if the Fed would have paused yesterday.

The Fed does it's best to balance their mandate of stable employment, prices, and interest rates but they can't control all market forces and there's no way they always make the correct decision.

I looked back at the history of Fed funds rate decisions this week to get a better sense of how often the Fed makes policy moves using short-term rates as the lever. Using data from the Federal Reserve, I found the Fed has raised interest rates on 100 occasions since 1970 (including yesterday's move).

That's good enough for around two per year on average. They've also lowered rates more than 80 times in that stretch so the Fed is changing their target rate rather frequently. With this many moves, there's no way they can make the right call every time.

Almost half of these Fed rates hikes took place between 1971 and 1982, as Paul Volcker and crew furiously tried to fight off the rampant inflation of that period.

The Fed funds rate was just 3.75% in early-1971 while inflation was around 4%. That didn't last long as rates hit 13% and inflation almost 12% by 1974.

Inflation and interest rates were back to sub-7% levels by 1978 but quickly rose again. There was a recession in 1980 which saw inflation hit close to 15%. The Fed more or less brought this on by raising short-term rates to 20%.

After a brief stint at 10% that same year, Volcker again raised the Fed funds rate to 20%, which led to yet another recession in the summer of 1981.

The second half of 1982 and all of 1983 saw the Fed take rates below double-digit levels but they were back to 11.75% in 1984. It wasn't until the tail-end of 1984 that the Fed took rates below double-digit levels for good. Rates fluctuated the remainder of the decade, ending the 1980s at 8.25%, just before a minor recession in 1990s.

Interestingly enough the Fed raised rates twice in 1987, once less than a month before the Black Monday crash which saw stocks fall 22% in a day. After this sell-off, they quickly dropped rates by half a percent.

The Fed cut rates more than they raised them in the 1990s by a factor of more than 3-to-1. Alan Greenspan unexpectedly raised rates in 1994, causing some short-term volatility in the bond market but the Fed more or less cut rates in the 90s. The Fed funds rates ended the decade at 5.5%.

Rates rose slightly in early-2000 but the Fed quickly reversed course when the recession began in 2001 and performed further cuts following 9/11. Rates hit 1% in 2003 before a gradual stair-step rise in rates from 2004 through the end of 2006 where they peaked at 5.25%.

I don't have to remind investors what happened in 2008 but the year finished with short-term interest rates on the floor, effectively at 0%. The period from the end of 2008 through December of 2015 was by far the longest time frame the Fed has sat on their hands in terms of interest rate policy over the past 50 years.[1]

Before this period, the longest they went without making any changes to rates was from August of 1992 until February of 1994. Think about this for a minute -- from 1970 through 1992, the Fed didn't go a single year without changing their policy rate.

In fact, they made an average of nearly 5 changes per year. Then nothing in 1993. But from 1994 through the end of 2008, they made an average of roughly 4 changes per year.

Then a big fat nothing for the next 7 years or so.

And maybe this is part of the reason investors, economists and pundits alike have been placing so much emphasis on the Fed lately. The Fed left rates unchanged for so long that now the market may be a little rusty in forecasting the Fed's intentions.

There have always been over- and under-reaction to the Fed's policy tools but maybe this cycle since the Great Recession had desensitized investors to some degree. And now that something is finally happening, that sensitivity has come back in full force.

Back in the day, the Fed wasn't nearly as transparent. For a long time, the Fed didn't even tell investors when they were changing rates. They just had to figure it out themselves. It wasn't until the 1990s that the Fed began communicating to the public in a meaningful way.

Any communication from the Fed is relatively new. Per the Federal Reserve:

The FOMC first announced the outcome of a meeting in February 1994. After making several further post-meeting statements in 1994, the Committee formally announced in February 1995 that all changes in the stance of monetary policy would be immediately communicated to the public. In January 2000, the Committee announced that it would issue a statement following each regularly scheduled meeting, regardless of whether there had been a change in monetary policy.

People used to look at Alan Greenspan's briefcase as a tell to figure out what the FOMC was going to do with rates. The theory was if his briefcase was full, it meant a rate cut was coming because he needed more evidence to back up the move. If it wasn't full, that meant no action would be taken.

The statements we now expect from the Fed have only been around for the past 20 years or so.

So even though the Fed says they're "data dependent" these days, they're far from omnipotent.

They can't guess the future any better than anyone else involved in the markets.

It would be easy to say this time is different in terms of Fed policy but every time is different in some ways.

Further Reading:
Is The Fed Running Out of Ammo?

[1]The Fed performed other forms of monetary policy in this time but didn't change the Fed fund rate.