MARKET REACTIONS TO FIRST RATE HIKES BY THE FED IN PREVIOUS CYCLES

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Market reactions to first rate hikes by the Fed in previous cycles

Central bankers continue to focus on supporting growth, and this is likely to remain the case for quite some time. Nevertheless, if the current recovery scenario is confirmed, the end of ultra-loose monetary policy is in sight. In the next 6 to 12 months the BoE and, far more importantly, the Fed are expected to start raising their policy rates. This change in monetary policy is likely to be the most important issue for financial markets in the next 12 months.

One way to reflect on this is to look at what happened with previous first rate hikes by the Fed (even if it is always possible that things are different this time).

Previous rate hiking cycles started in 1987, 1994, 1999 and 2004 (before the mid-80s US monetary policy was conducted in a rather different way, which makes comparison less relevant), and each of these episodes had its own peculiarities:

- 1987: the aftermath of the first hike was clouded by Black Monday, the October crash which had nothing to do with the first rate hike (which was 6 months earlier)
- 1994 – the surprise: the Fed tried (and succeeded) to surprise markets, since then Fed policy has rather been to avoid surprises
- 1999 – tech bubble
- 2004 – the conundrum: in spite of a series of rate hikes, longer yields fell significantly, which has been linked to the global savings glut (and specifically, Chinese buying US bonds)

Market reactions to first rate hikes by the Fed in previous cycles (2)

Some conclusions on US market behavior around the first rate hike in previous cycles:

Equity markets

- Equity markets continue to increase up to the first hike with an important part of the increase coming in the 6m before the hike
- Initial hit of about 5 to 10% with the first rate hike, but recovery from 3m after the hike
- Basically, the reason for the first rate hike, stronger economic growth, is the main driver for equity markets in the initial phase of the hiking cycle

Bond markets

- Significant increase in 10y interest rates before the hike, mostly in the last 3 months before the hike
- Further increase in 10y in the 6 months after the first hike, with 2004 (the conundrum) as notable exception
- Massive curve flattening as the long end rises significantly less than the short end

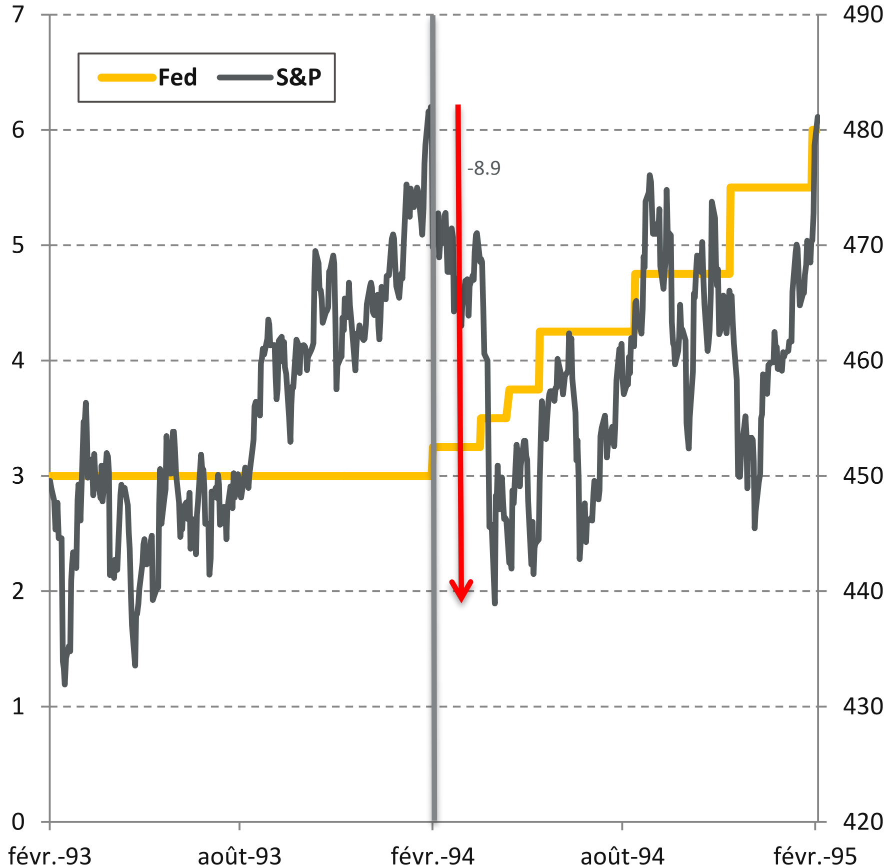
See the following pages for more details.

1987

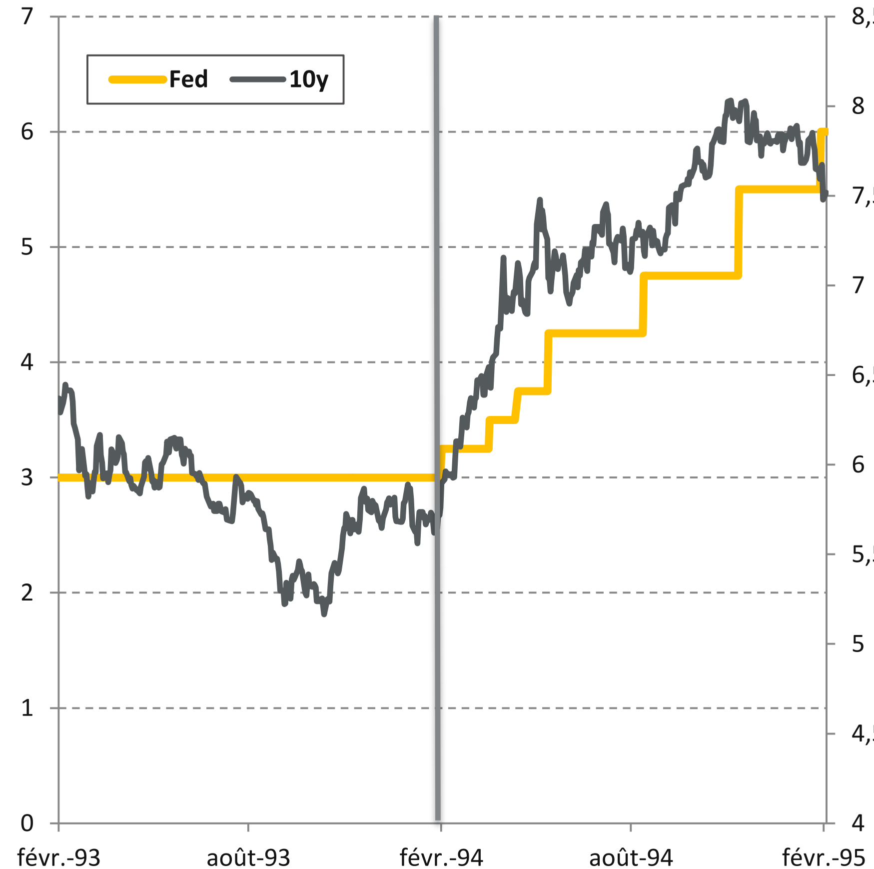

Fed
S&P
-5.8
7,5
7
6,5
6
5,5
5
360
340
320
300
280
260
240
220
200
avr.-86
oct.-86
avr.-87
oct.-87
avr.-88


Fed
10y
7,5
7
6,5
6
5,5
5
10,5
10
9,5
9
8,5
8
7,5
7
6,5
6
avr.-86
oct.-86
avr.-87
oct.-87
avr.-88

1994



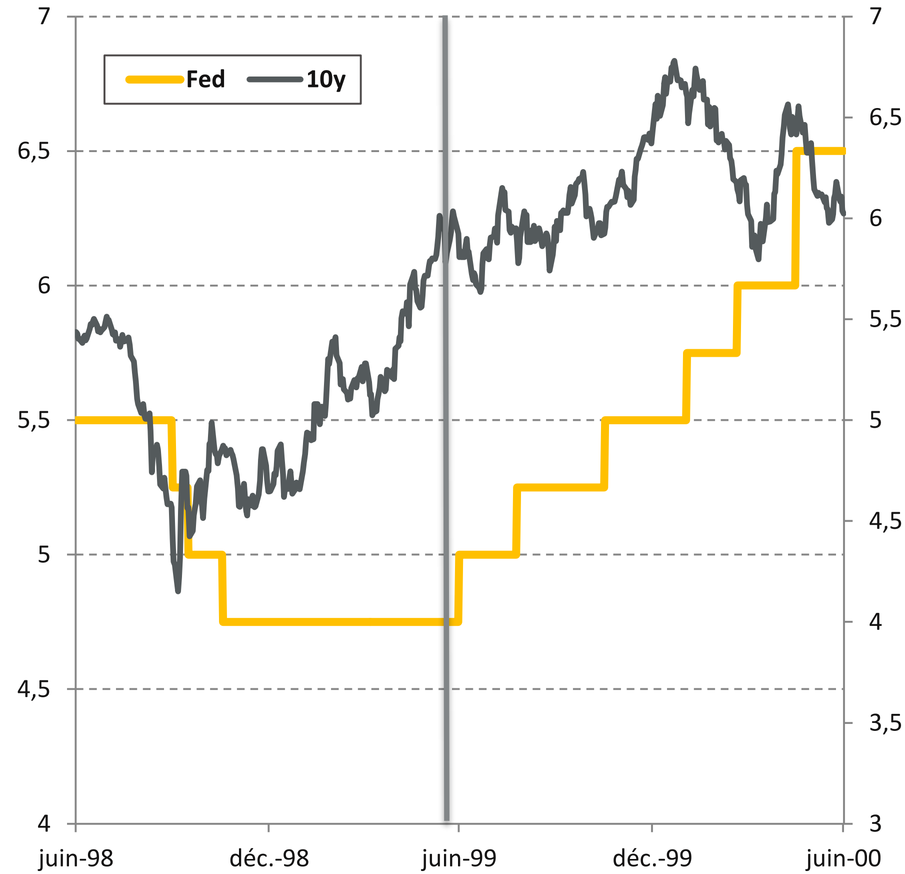
Fed
S&P
-8.9
7
6
5
4
3
2
1
0
490
480
470
460
450
440
430
420
févr.-93
août-93
févr.-94
août-94
févr.-95



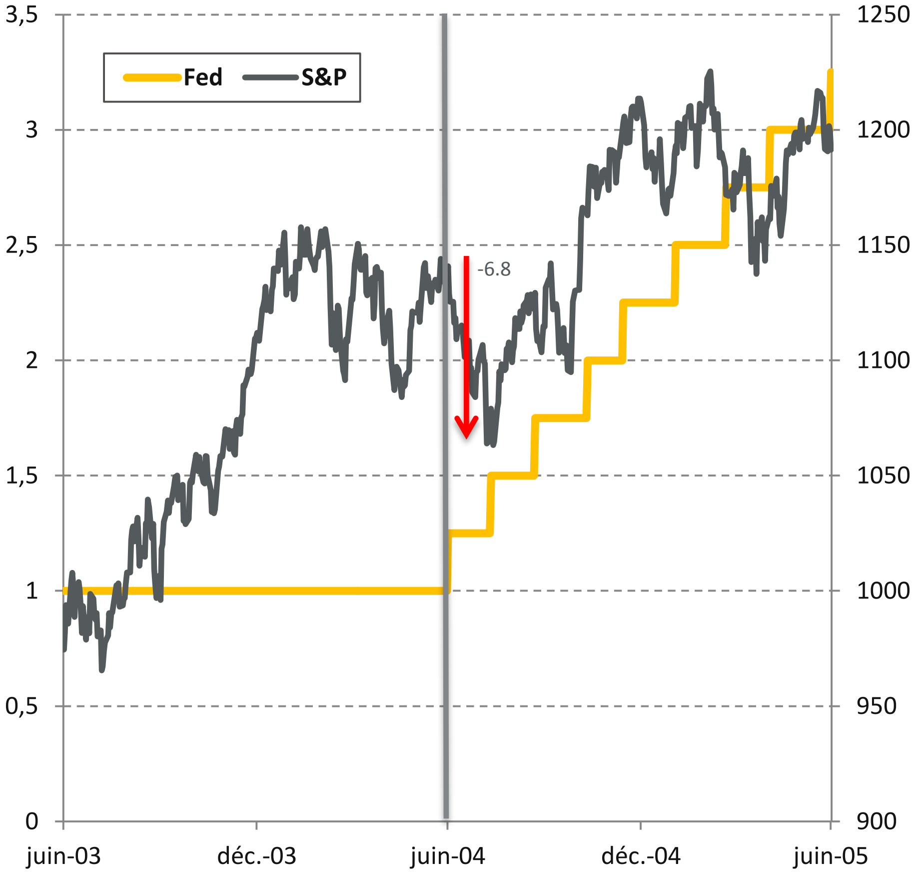
Fed
10y
7
6
5
4
3
2
1
0
8,5
8
7,5
7
6,5
6
5,5
5
4,5
4
févr.-93
août-93
févr.-94
août-94
févr.-95

1999

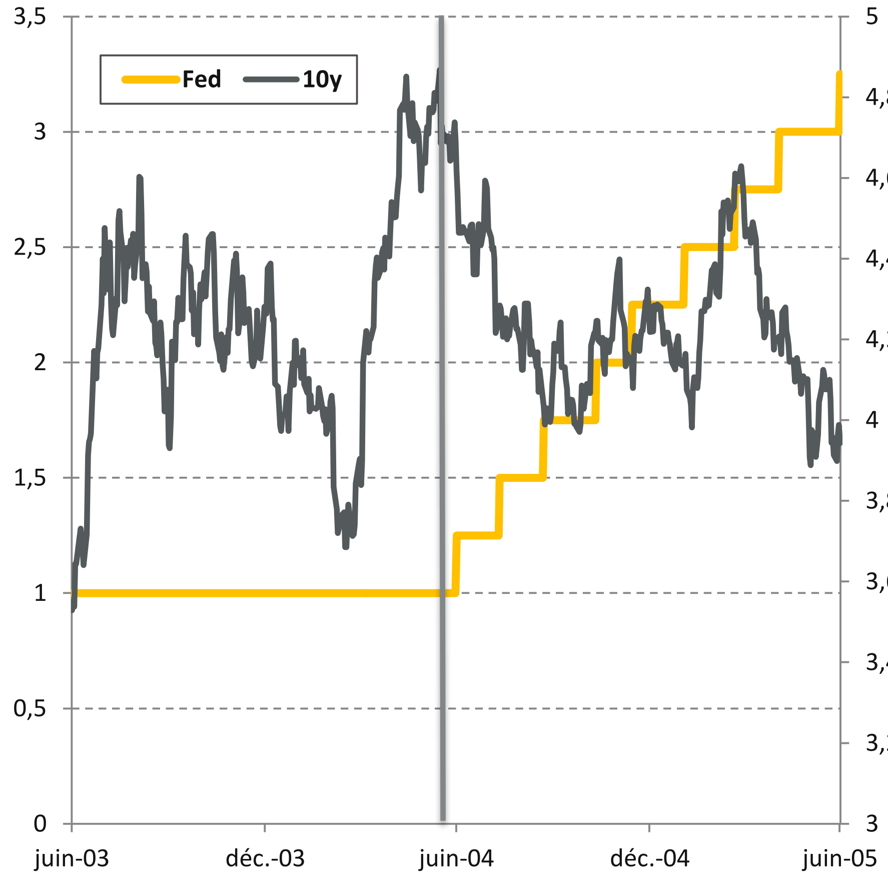

Fed
S&P
7
6,5
6
5,5
5
4,5
4
1600
1500
1400
1300
1200
1100
1000
900
-12.1
juin-98
déc.-98
juin-99
déc.-99
juin-00


Fed
10y
7
6,5
6
5,5
5
4,5
4
7
6,5
6
5,5
5
4,5
4
3,5
3
juin-98
déc.-98
juin-99
déc.-99
juin-00

2004



Fed
S&P
-6.8
3,5
3
2,5
2
1,5
1
0,5
0
1250
1200
1150
1100
1050
1000
950
900
juin-03
déc.-03
juin-04
déc.-04
juin-05



Fed
10y
3,5
3
2,5
2
1,5
1
0,5
0
5
4,8
4,6
4,4
4,2
4
3,8
3,6
3,4
3,2
3
juin-03
déc.-03
juin-04
déc.-04
juin-05

Market behavior around first rate hike

	1987*		1994		1999		2004	
	S&P	10y	S&P	10y	S&P	10y	S&P	10y
-12m	18	96	7	-66	19	46	17	116
-6m	18	97	7	-8	9	122	2	41
-3m	3	124	5	12	4	73	1	79
First rate hike								
+3m	12	22	-7	158	-6	3	-2	-61
+6m	-10	62	-5	155	9	51	7	-48
+12m	-8	51	0	176	7	11	5	-75
6m pre to 6m after	6	159	2	147	18	173	9	-6
12m pre to 12m after	9	147	8	110	27	58	22	41

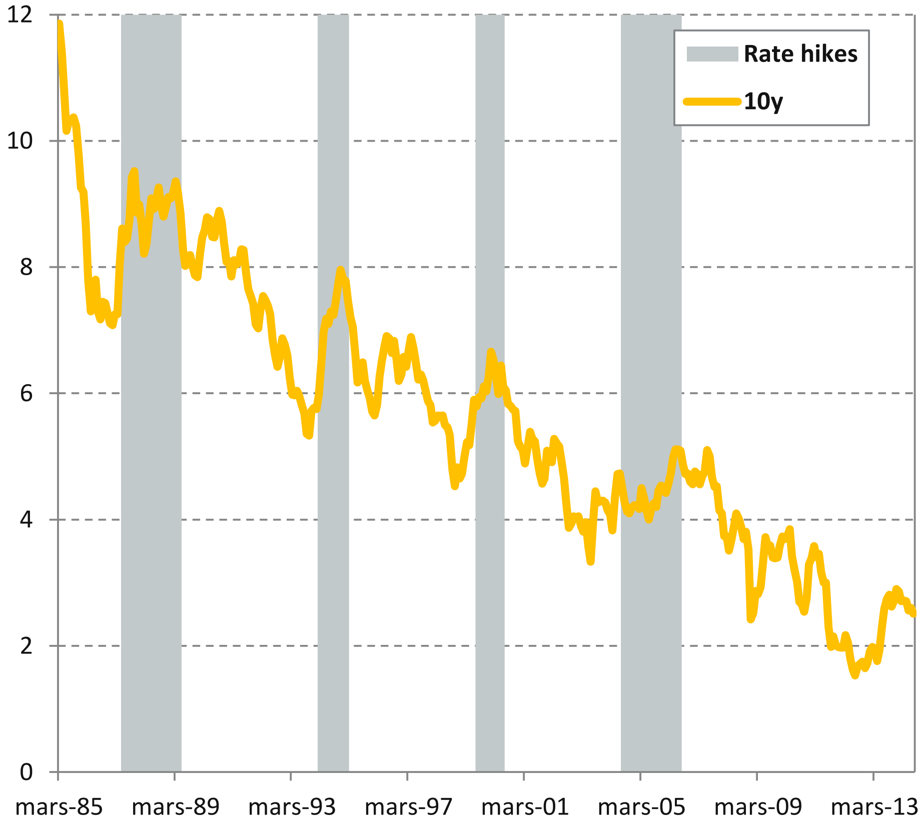
(*) Black Monday (Oct 1987)
S&P: change in %, 10y: change in bps

S&P:
- Increases up to the hike, with an important part of the rise coming in the 6m before the hike
- Modest initial hit with the first hike, but recovery from 3m after the hike

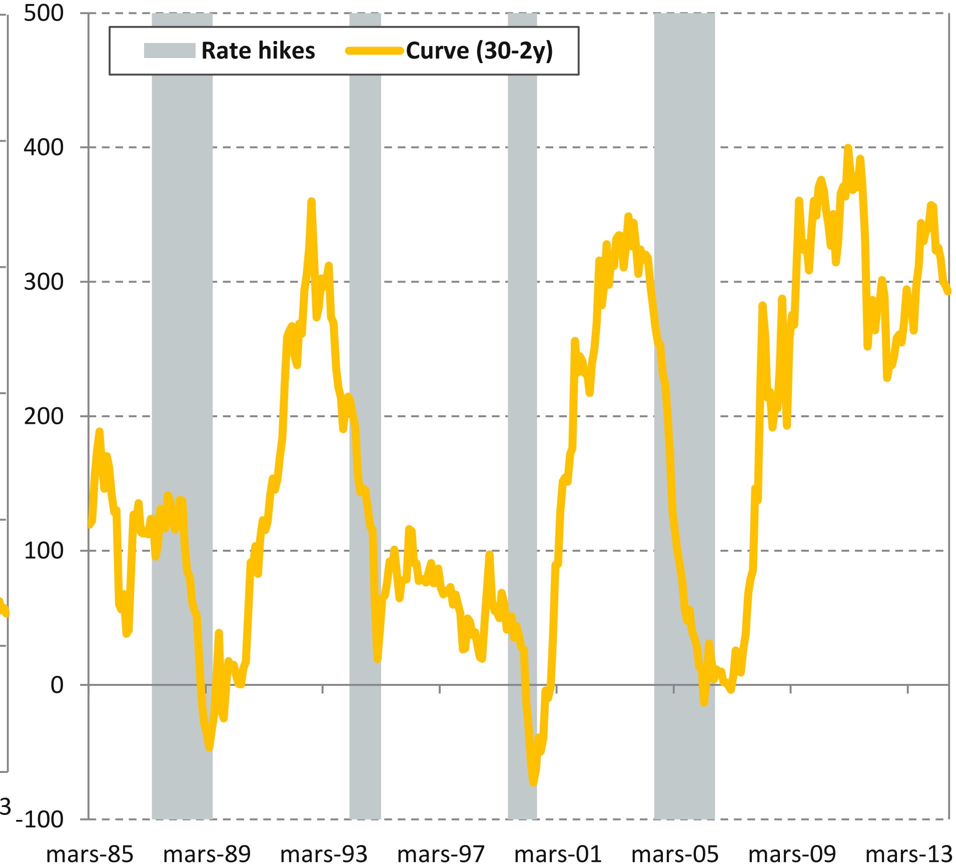
10y:
- Significant increase before the hike, mostly in the 3m before the hike
- Further increase in the 6m after the first hike, with 2004 (the conundrum) as notable exception

Impact of rate hikes on bond markets

10y



Curve (30-2y)



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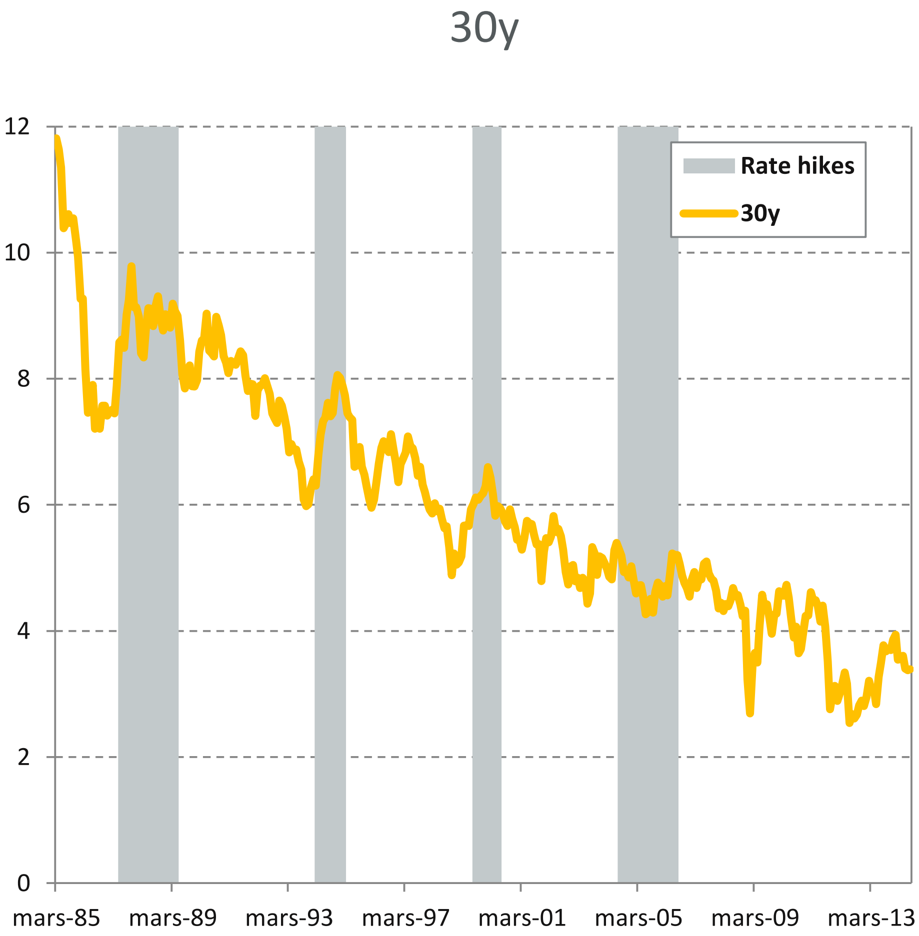
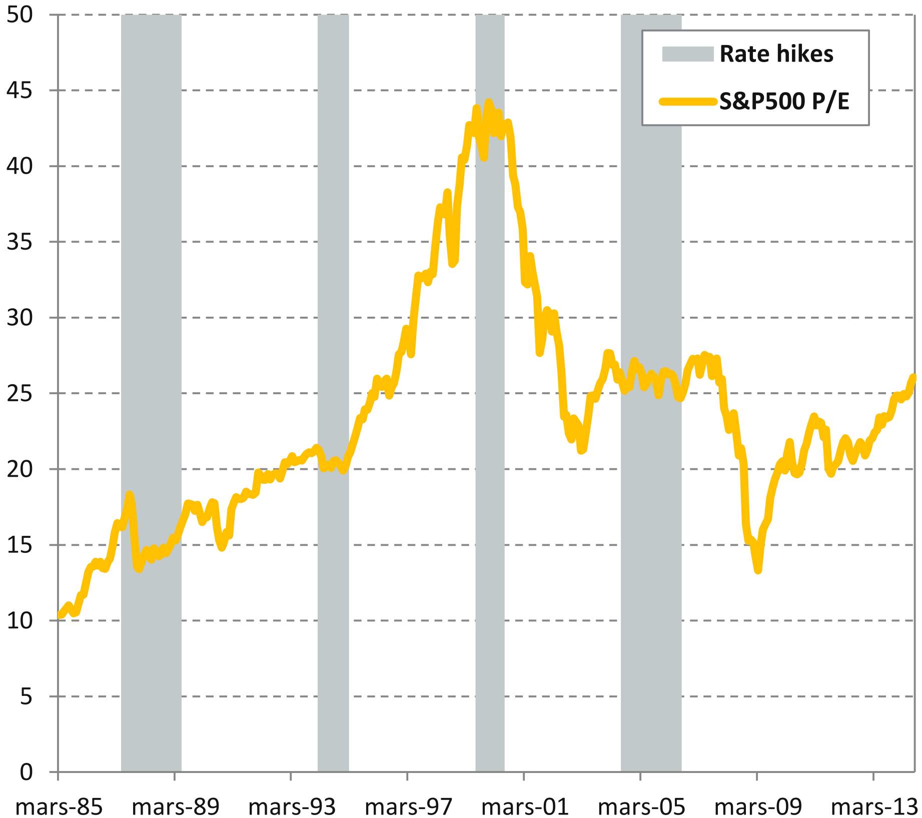
Impact of rate hikes on bond markets

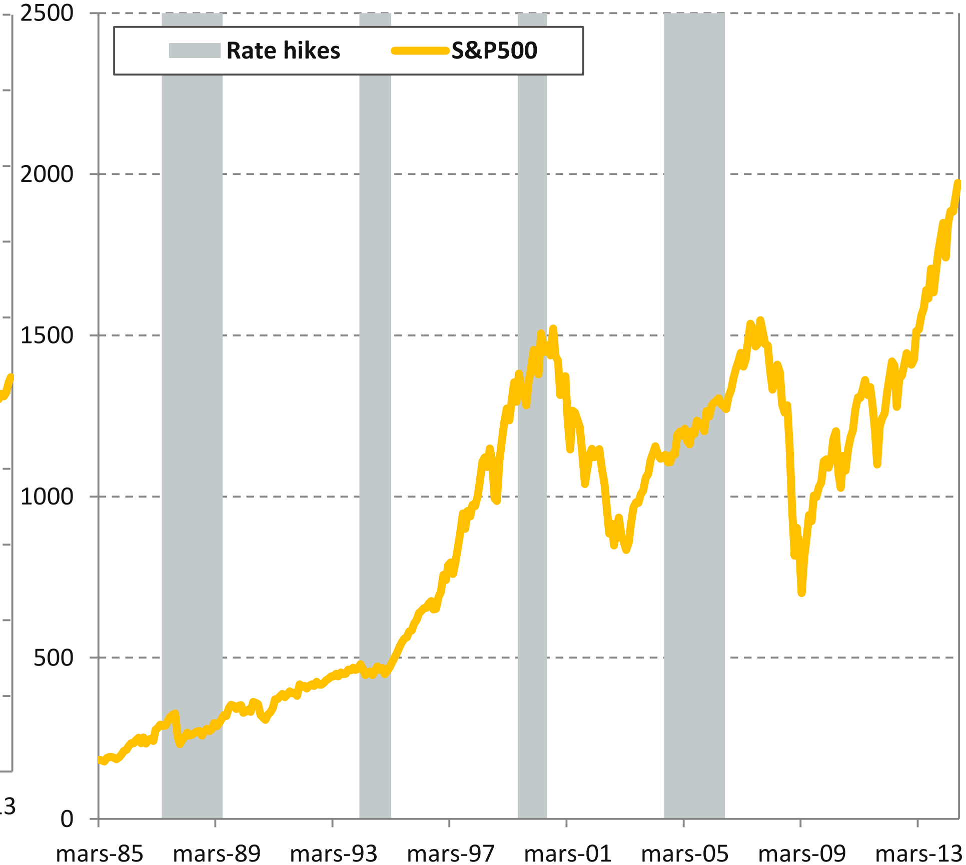


Impact of rate hikes on equity markets

P/E



S&P500



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