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Global Macro Research

25 November 2026

8:05 minute read

#US / #Inflation / #Monetary Policy

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Fed: mid-cycle adjustment or a sustained tightening cycle?

Protracted interest rate hiking cycles usually only occur when policy starts from a clearly accommodative position. This suggests the Fed's ongoing cycle is likely to be shallow, in line with our call for only two further hikes. But the breadth of inflation, expectations for further strong price rises, and a possible uplift in the short-run neutral rate of interest, point to clear upside risks.

Key Takeaways

- There is no such thing as a 'normal' interest rate hiking cycle – the Fed has variously delivered short, long, steep, and shallow cycles in its history.
- Longer, steeper cycles tend to start when policy begins from a deeply accommodative stance. They are also associated with broad inflation pressures, firmer inflation expectations, a tight labour market, and loose financial conditions.
- Because the Fed can make the policy stance restrictive without a protracted cycle, we don't expect one. Our base case is for it to follow up September's hike with two further rate increases.
- However, the breadth of inflation pressures and rising inflation expectations point to clear upside risks to this call. And policy might be further from restrictive than generally thought, if the short-run neutral rate of interest has risen.
- Indeed, simple regressions on the determinants of past hiking cycle size, as well as Taylor rules, point to a hiking cycle of more like 200-300bps.
- The conclusion is that the balance of risks around our forecast for additional Fed rate hikes in December and March are clearly skewed to the upside – and potentially by a large amount.

Hiking cycles are varied and diverse

The debate over whether the Federal Reserve's (Fed) recent tightening of monetary policy will turn out to be a short series of 'risk management' hikes or a long tightening cycle is a key narrative driving markets.

Since the federal funds rate became the Fed's primary policy instrument in late 1982, there have been seven US hiking cycles, alongside a handful of isolated rate rises during broader periods of easing.

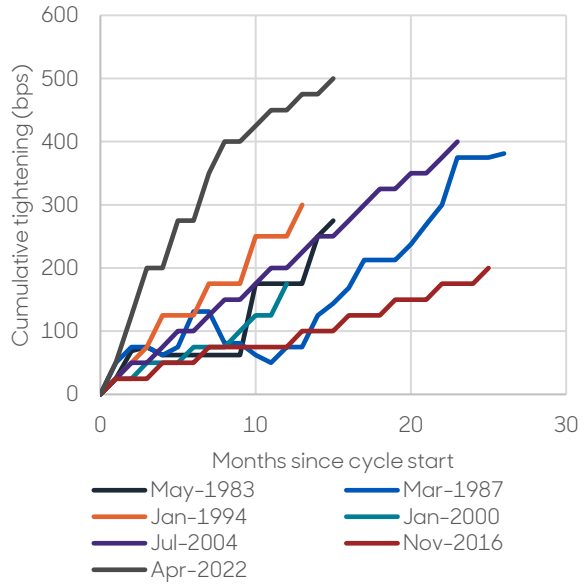
Those one-off moves were overwhelmingly a feature of the 1980s, when the Fed was still transitioning from the Volcker-era focus on monetary aggregates towards an interest-rate-based framework. By the late 1980s, once the latter became firmly established, policy increasingly settled into the more familiar pattern of sustained hiking and cutting cycles.

The seven US hiking cycles since 1982 have seen large differences in both the cumulative rise in rates and the time taken to reach the peak (see Figures 1 and 2).

But a closer look at the data reveals that short and long cycles have distinguishing traits that can help inform our assessment of the path of monetary policy in the near future.

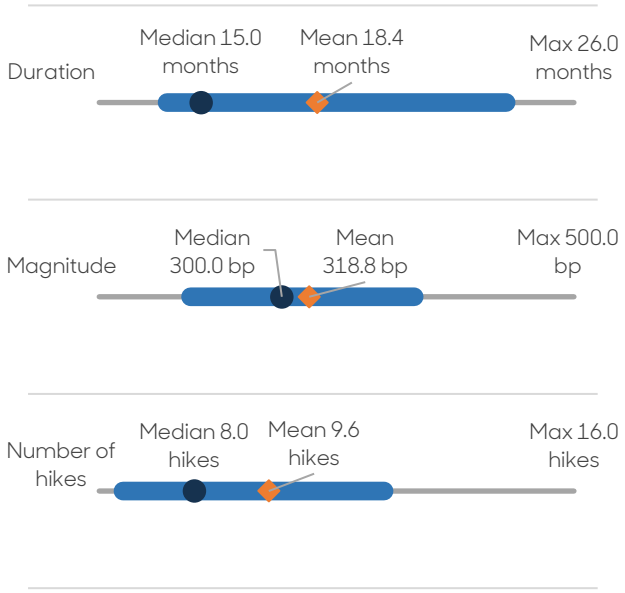
These include: the ex-ante state of financial conditions, the inflation outlook, and the state of the labour market.

Figure 1: Hiking cycles since 1982 have been diverse



Source: Haver, Aberdeen, November 2026

Figure 2: The 'typical' hiking cycle lasts over a year and sees 300+ basis points of hiking

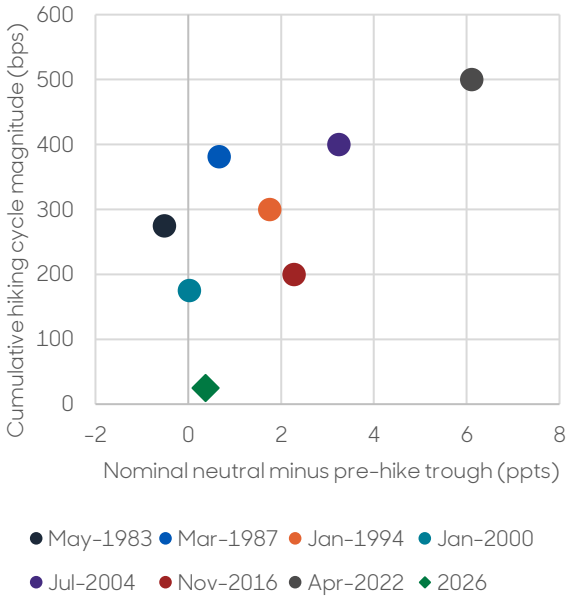


Source: Haver, Aberdeen, November 2026

The ex-ante stance of policy matters

The strongest relationship in the historical data is between hiking cycle size and the initial 'policy gap'. That is to say, larger cycles typically occurred when the policy rate started well below neutral, leaving more distance to travel before policy became restrictive (see Figure 3). By contrast, when rates started near neutral, subsequent tightening was usually more limited.

Figure 3: Larger cycles started with policy very loose



Source: Haver, Aberdeen, November2026

This stands to reason: if conditions requiring restrictive financial conditions arise, the Fed needs to deliver more hikes if policy is deeply accommodative than if policy is neutral. The hiking cycle of 2022-2023 is the most instructive in this regard. Policy had been set to ultra-loose in the aftermath of the Covid pandemic, so the Fed ended up delivering 525bps of tightening to take policy to and above neutral.

Of course, real-time estimates of the neutral rate can be unreliable, and shift over time. But we can also look at non-policy factors that influence broader financial conditions, to gauge how restrictive policy is. These include yields, credit spreads, equities and the dollar.

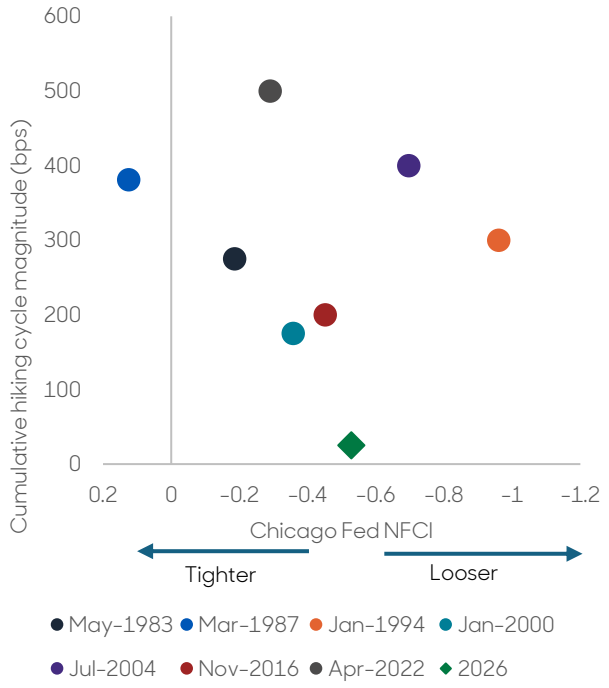
Of course, these measures also reflect the market's expectations for Fed policy: when hikes are expected, financial conditions tighten in anticipation. This circularity means they are an imperfect, real-time gauge of how restrictive policy is, which makes it hard to verify empirically how they relate to the length of the hiking cycle. Even so, financial conditions were loose heading into all extended tightening cycles of the last 35 years (see Figure 4), which is consistent with loose conditions being a precondition for a long cycle. (see Figure 4).

Inflation breadth and expectations matter

Another factor associated with protracted cycles is the unanchoring of inflation expectations. Higher expectations can prompt the Fed to tighten more

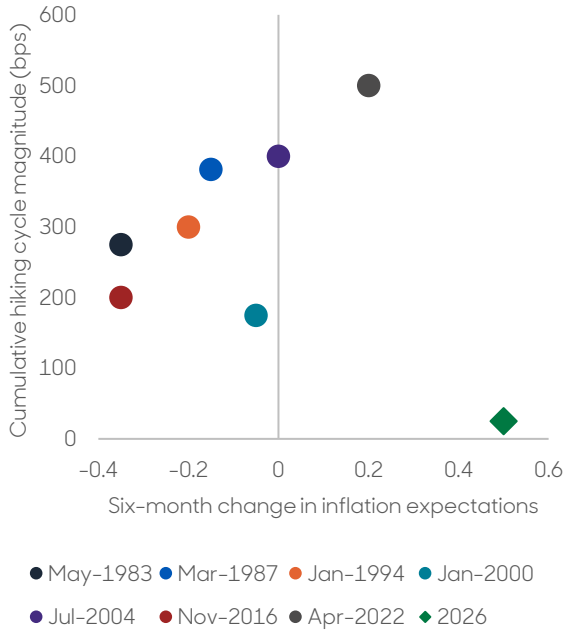
forcefully to preserve its credibility as the custodian of price stability.

Figure 4: Only one major hiking cycle in our dataset began with financial conditions tight



Source: Haver, Aberdeen, November 2026

Figure 5: A correlation exists between inflation expectation stability and hiking cycle length, albeit a messy one



Source: Haver, Aberdeen, November 2026

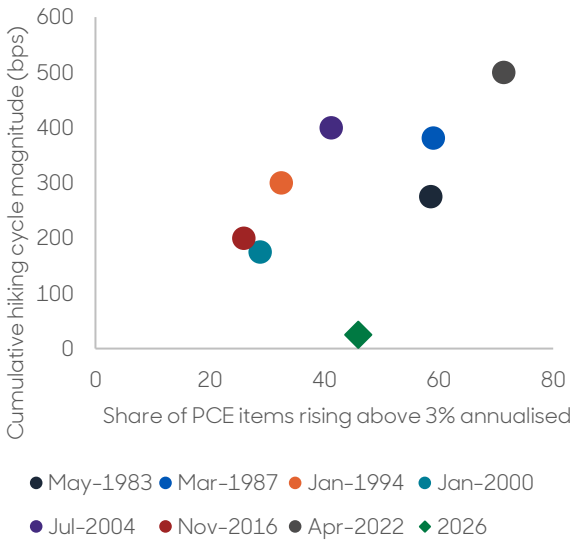
As with financial conditions, the fact that inflation expectations are factored into expectations for central bank policy makes inference difficult. Still, the largest hiking cycles have all come against a backdrop of an acceleration in inflation expectations (see Figure 5).

Admittedly, the relationship is far from clean: some substantial cycles began with inflation expectations contained. However, this might be due to Fed hawkishness itself preventing a run-up in inflation expectations that otherwise would have occurred.

For example, in 1994-95 the Greenspan-led Fed felt hotter labour market conditions were likely to generate an increase in inflation expectations, and so tightened financial conditions *before* this de-anchoring came about. This shows that a run-up in inflation expectations is not a *necessary* condition for a protracted cycle. And the reverse does not follow automatically: rising expectations point towards a larger cycle without guaranteeing one.

Inflation expectations are currently rising: over the past six months they have increased more than they did before previous hiking cycles according to the University of Michigan's survey. Given the historical relationship, this could potentially indicate a larger tightening cycle to maintain Fed credibility. But we place less weight on this signal than the history alone would imply, because we have reservations about the reliability of this survey in recent years, as it has become divorced from financial market indicators of inflation expectations.

Figure 6: Broadly dispersed inflation often leads to longer cycles

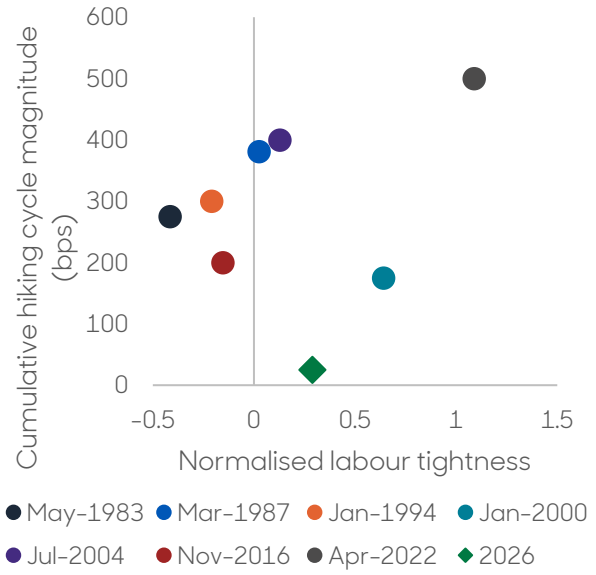


Source: Haver, Aberdeen, November 2026

Inflation breadth has been a relatively good indicator for the size of hiking cycles (see Figure 6). When price increases are dispersed across a large share of the

basket of goods and services, policymakers face a more persistent problem than when inflation is concentrated in a few volatile categories. Broad inflation is harder to reverse through normalisation in individual sectors and is more likely to reflect common demand, wage or expectations dynamics.

Figure 7: A tight labour market is by no means necessary for a larger hiking cycle



Source: Haver, Aberdeen, November 2026

Labour markets matter, too

Labour-market tightness matters for the inflation outlook, but it has not been a necessary condition for a large cycle (see Figure 7). The Fed has sometimes tightened aggressively before the labour market looked especially stretched, either because inflation was already problematic or because policy was clearly too accommodative. Conversely, a tight labour market does not guarantee a long cycle if wage growth and inflation cool quickly. The relationship is therefore asymmetric: a weak labour market can constrain how far the Fed is willing to hike, but a tight one does not by itself produce a large cycle, which depends mainly on inflation. For instance, the softness of the labour market was an important factor keeping the Fed cautious over the hiking cycle of 2016-18.

Today's mix points to further tightening, but not a large cycle

Taken together, extended hiking cycles tend to share a few traits in common: broad, generalised inflation, unanchored expectations, tight labour markets, and inappropriately loose financial conditions.

The current conjuncture features many of these traits (see Figure 8). Inflation expectations have indeed moved higher, inflation is moderately broad-based (but moving lower), the labour market is not excessively loose, while financial conditions have tightened but are by no means tight.

Figure 8: Many, but not all conditions for a protracted hiking cycle are in place

Metric	Avg at prior cycle starts	Current	Current read
R*- r	1.94	0.38	Below neutral, but less scope than average
Inflation expectations momentum	-0.13	0.50	Above average / more inflation concern
Inflation dispersion	45.3	46.0	Above average / broader inflation
Labour market tightness	0.16	0.29	Above average / tighter labour
Financial conditions	-0.4	-0.53	Below average / looser conditions

Source: Haver, Aberdeen, November 2026

But, arguably, it lacks the most important one. By no measure are policy settings clearly loose – the Fed funds target range is set to 3.75%-4% – as they were before the extended cycles of 1994, 2016, and 2022.

This means that the Fed can take policy into restrictive territory with only a handful of hikes.

We see two further hikes

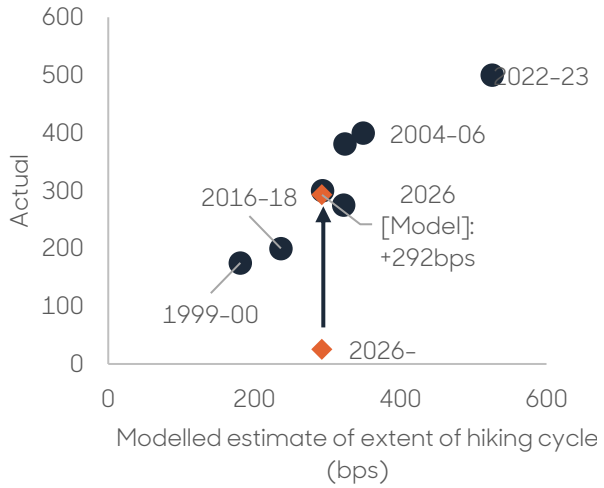
We therefore see a hiking cycle of only moderate length and steepness. In addition to the one raise it has already delivered, our forecast is for two further hikes, in December 2026 and March 2027. Because policy wasn't loose before the hiking cycle started, that's enough to address higher inflation expectations without unduly impairing activity. On our baseline forecasts, the tariff- and energy-driven inflation overshoot should be moderating.

Two ways in which we could be wrong

That said, we also see scenarios that involve a significantly longer tightening cycle. In fact, after

excluding the problematic inflation expectations data, bringing our key variables together in a linear regression model of the depth of the hiking cycle results in an estimate of almost 300bps (see Figure 9).

Figure 9: Many factors point to extensive tightening



Source: Haver, Aberdeen, November 2026

That's primarily due to the breadth of inflation.

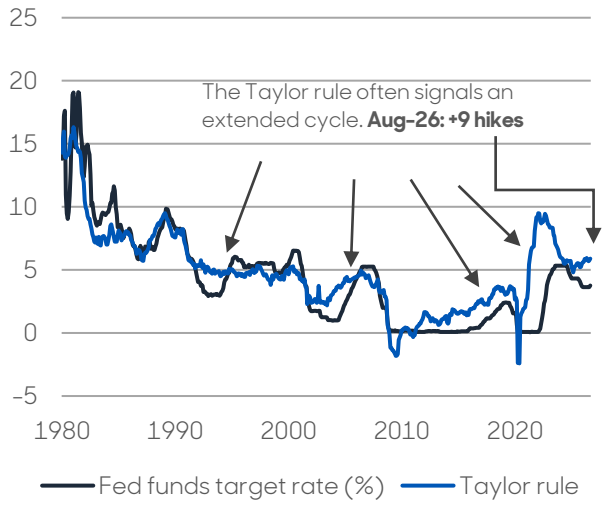
This signal is echoed by the Taylor rule, a simpler, widely used model of monetary policy shocks that takes the neutral rate of interest, the output gap, and the inflation rate as its inputs. It suggests policy started the cycle some 225bps looser than expected (see Figure 10).

These models raise the possibility of an aggressive hiking cycle, in which the Fed would need to rapidly raise rates to demonstrate its credibility and regain control of inflation expectations.

Even an aggressive cycle would not preclude the Fed reversing course and cutting rates once the inflation genie is back in the bottle. But we think this is unlikely. The linear regression tightening cycle model is calibrated only to episodes of hiking that escalated into full-fledged cycle, skewing the estimate higher. So, the model is giving a better sense of how far the hiking cycle could go if it develops along the lines of previous cycles, rather than giving an unconditional estimate. And the Taylor rule estimate could prove to be too high if, as in our base case forecast, core PCE inflation eventually moderates.

On the other hand, it could also be that the estimate of the policy gap we use, the Holston-Laubach-Williams estimate published by the New York Fed, might fail to capture the recent uplift in the short-run equilibrium rate of interest caused by a super-cyclical boost in the demand for financing from governments and AI hyperscalers.

Figure 10: Strong growth and high inflation also point to further hikes



Taylor rule = r* + spot inflation + (spot inflation - 2)/2 + Output gap/2
We use r* = NY Fed L-W estimate, core PCE inflation, and the CBO's estimate of the output gap
Source: Aberdeen, Haver, CBO, FRBNY, October 2026

That would mean the implied 'policy gap' is larger than the data we use suggest, and the Fed would need to deliver several more hikes to make policy meaningfully restrictive.

More hiking in base case, and risks to the upside

Our own forecasts, consensus, and the FOMC's dot plot follow similar contours: a short cycle of a total of two (consensus, the median FOMC member) and three (Aberdeen) hikes, followed by gradual easing in 2028.

That's upwardly revised from our previous estimate of two, but still slightly behind market pricing. Our judgements around the labour market and the inflation outlook underpin this view.

But our empirical analysis shows that risks to both the length and depth of the hiking cycle are skewed to the upside, assuming that the recent wobbles in equity markets don't escalate into an economic slowdown.

Viewed in this light, market pricing for the Fed to follow up its first hike with a further three and then keep policy around 4.5% isn't difficult to square with our forecast.

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