

# Soft Landings: A History Lesson

A Publication of BMO Capital Markets Economic Research • Douglas Porter, CFA, Chief Economist, BMO Financial Group

**What are the chances the Fed will pull off a soft landing?** History can be instructive. There have been nine U.S. recessions since 1960, all after a tightening cycle. But not all tightenings led to a downturn. The four exceptions were the cycles starting in 1965, 1983, 1994, and 2015 (the expansion was widely forecast to continue until the pandemic struck). These four “successes” suggest several things about the Fed’s chances of not tanking the economy this time.

**First**, inflation was generally low at the start of a successful tightening cycle. In each case, rate hikes were geared toward preventing inflation from rising, as opposed to pulling it down. **Second**, in two cases (1983 and 1994), the unemployment rate was relatively high, suggesting the Fed had some inflation-dampening slack to help its cause. **Third**, with one exception (2015), the real fed funds rate (the policy rate less personal expenditures inflation) was positive, suggesting policy was not overly loose at the start of the tightening period.

The Fed kicked off the **current tightening phase** with a quarter-point increase in the policy rate on March 16. This cycle is starting with the unemployment rate skirting half-century lows, inflation at multi-decade highs, and the real fed funds rate deeply negative (more so than in 2015). Until a week before the rate move, the Fed was still pressing on the gas by purchasing assets. Given the lagged effect of policy changes on demand, it might now need to jam on the brakes to restore price stability, risking a downturn.

Compared with past tightening cycles, how much is the economy at risk of a downturn? By subtracting the unemployment rate and real fed funds rate from the inflation rate, we can **derive an index that assesses the Fed’s chances of achieving a soft landing**. The lower the index at the start of a tightening phase, the greater the odds of averting trouble. Brace yourself—the index is now the highest in at least six decades (*see the chart*). Worse, it’s more than three standard deviations above the average level going into the four “successful” tightening cycles, and at least two standard deviations above the cycles that led to a downturn; so, the difference is pretty significant. Simply put, **current conditions for inflation, unemployment and policy have never (since 1960) been more stacked against the Fed achieving a soft landing**.

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### History of Soft Landings

United States (%)



Shading marks U.S. recessions; boxes mark soft landing cycles  
<sup>1</sup> annual PCE inflation less real fed funds rate less unemployment rate  
Sources: BMO Economics, Haver Analytics

**Does this mean a hard landing is inevitable?** Not necessarily. Policy was fairly loose at the start of the 2015 cycle. But the Fed had a big assist from calm inflation (averaging less than 2%). Of course, inflation is anything but tame today, while real policy rates are lower and worker shortages appear worse. However, the odds of success this time will depend critically on how much inertia is built into current inflation pressure. We know that at least some of the recent run-up is temporary. The fact that long-term expectations (derived from TIPS pricing) are still near 2% is encouraging. With some better news on the commodities and supply-chain fronts, a **soft landing is still possible** and remains our base-case view. But it will take an especially “nimble” touch of the policy levers to pull it off. By waiting too long, the Fed has left itself with precious little room for error.

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