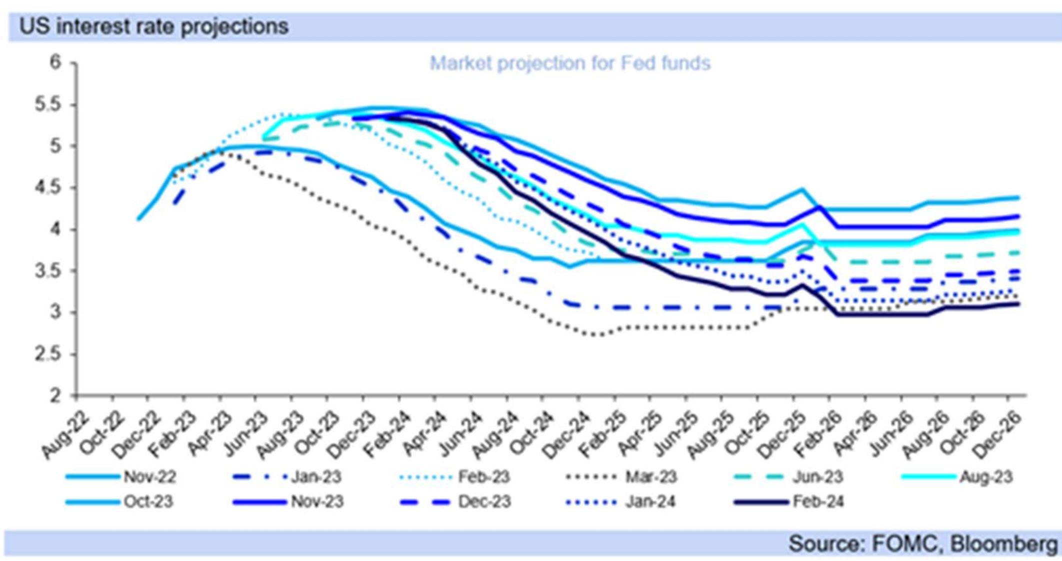
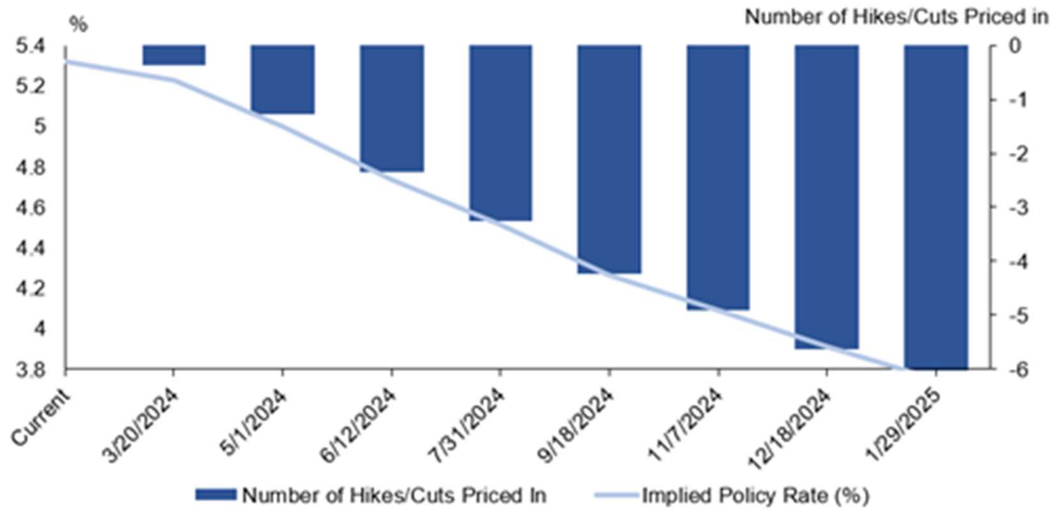
Investec

FOMC note: the FOMC’s tone was less hawkish tone, but not dovish, and rand only strengthened marginally

Thursday 1 February 2024



Implied overnight rate and number of hikes/cuts

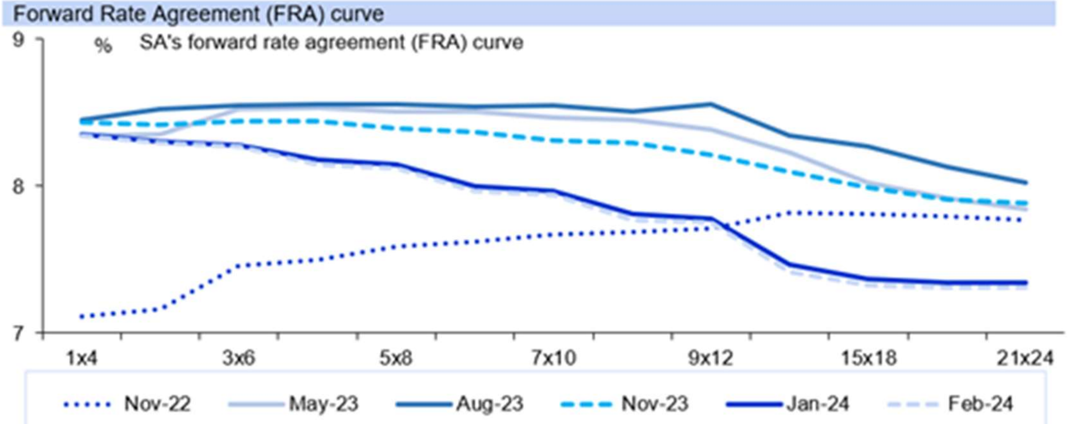


Source: Bloomberg

- The FOMC (Federal Open Market Committee) left the federal funds target rate unchanged at 5.25% - 5.50% as expected, highlighting “inflation is still too high, ongoing progress in bringing it down is not assured, and the path forward is uncertain.”
- The Fed did note “(i)nflation has eased from its highs without a significant increase in unemployment. That is very good news. But inflation is still too high ... Restoring price stability is essential.”
- “Our restrictive stance of monetary policy is putting downward pressure on economic activity and inflation. Over the past two years, we have raised our policy rate by 5-1/4 percentage points.”
- The rapid tightening of the US interest rate cycle has been felt, with the housing market seeing subdued activity levels over the past year on high mortgage rates, and elevated borrowing costs also suppressing business fixed investment.
- The FOMC did highlight “(w)e believe that our policy rate is likely at its peak for this tightening cycle and that, if the economy evolves broadly as expected, it will likely be appropriate to begin dialing back policy restraint at some point this year.”
- “But the economy has surprised forecasters in many ways since the pandemic, and ongoing progress toward our 2 percent inflation objective is not assured.” The tone of the Fed is cautious, not dovish, but has become markedly less hawkish.
- The rand strengthened slightly to R18.57USD in response, but has retraced today to R18.73USD, with markets having centered on May as the first rate cut, but will digest the FOMC statement in the remainder of this week.

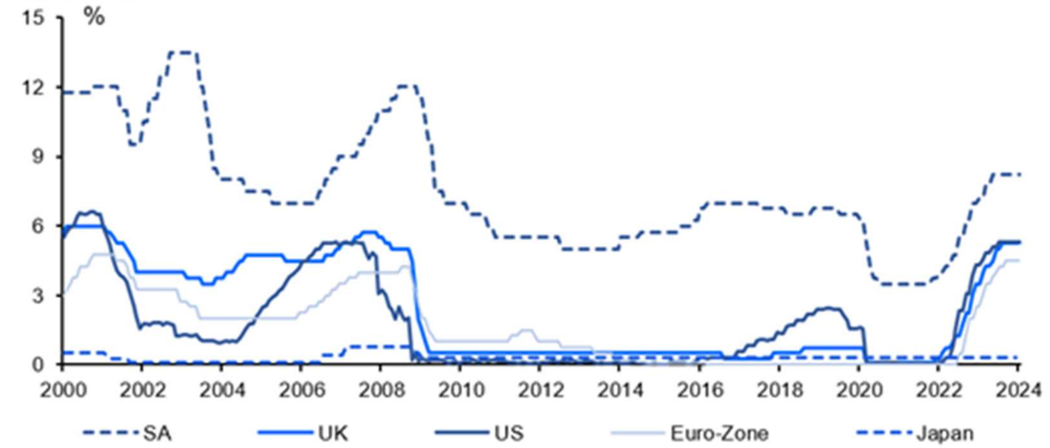
- The market expectations for the first FOMC cut are unlikely to change materially, i.e. be brought forward to the next (March 20) meeting, although US data releases in the interim will remain key for markets.
- The Fed also notes "(w)e are prepared to maintain the current target range for the federal funds rate for longer, if appropriate", placing a quelling tone on market exuberance and seeking to prevent early rate cut expectations.
- Consequently warning "that reducing policy restraint too soon or too much could result in a reversal of the progress we have seen on inflation and ultimately require even tighter policy to get inflation back to 2 percent."
- "The Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent. We will continue to make our decisions meeting by meeting".
- It remains likely the FOMC will not cut its interest rates before May at the earliest, potentially rather at its June meeting, and for SA the SARB is unlikely to cut before July, with the FRA (Forward Rate Agreement) curve aligned to a July cut (all -25bp).

Forward Rate Agreement (FRA) curve



Source: Bloomberg

Interest rates



Source: Iress