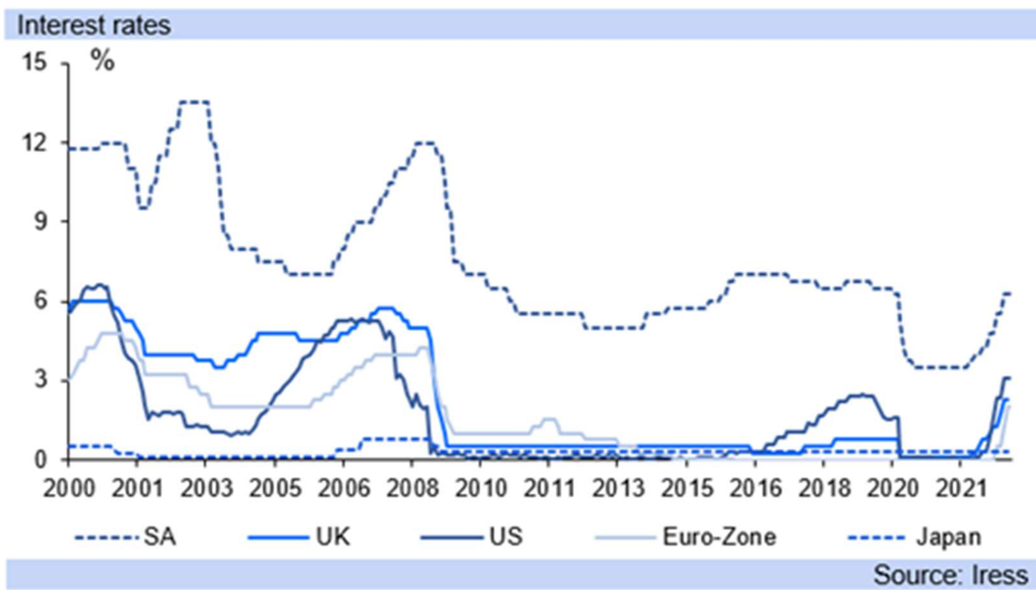
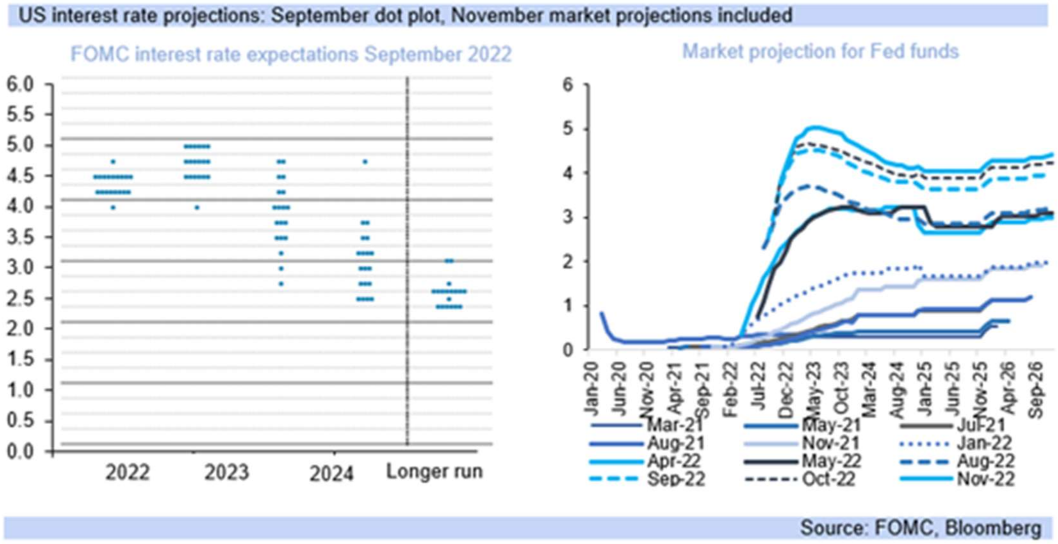
Investec | Out of the Ordinary

SA Economics

Thursday 3 November 2022

FOMC note: the widely anticipated 75bp hike last night was accompanied by a statement that the terminal rate will be higher than previously expected





- The Federal Open Market Committee (FOMC) raised its target range for the federal funds rate to 3.75% - 4.00% (75bp higher) last night as expected, stating “we continue to anticipate that ongoing increases will be appropriate to attain a stance of monetary policy that is … restrictive."
- The tone of the FOMC became more hawkish, with FOMC members raising their interest rate hike expectations again, and the Fed highlighting that “incoming data since our last meeting suggest that the ultimate level of interest rates will be higher than previously expected.”
- This was not balanced by the repeated communication from the last two meetings that “(a)t some point … it will become appropriate to slow the pace of increases, as we approach the level of interest rates … sufficiently restrictive to bring inflation down to our 2 percent goal”.
- Markets found relief in both the expected hike materialising, and the likelihood that future hikes would be 75bp or lower in size, although the FOMC added on its expected terminal rate (level of last hike in the cycle) “(t)here is significant uncertainty around that level of interest rates”.
- The tone did not become less hawkish as was hoped, and decidedly held the line on its “overarching focus (which) is using our tools to bring inflation back down to our 2 percent goal and to keep longer-term inflation expectations well anchored”.
- Adding “(r)educing inflation is likely to require a sustained period of below-trend growth and some softening of labor market conditions. Restoring price stability is essential to set the stage for achieving maximum employment and stable prices in the longer run.”
- “The historical record cautions strongly against prematurely loosening policy”. This is particularly significant, as the FOMC aims to move to restrictive monetary policy, and then stay there for a while, avoiding a premature move to neutral or loose monetary policy.
- This means both higher interest rates for longer, and a higher level of interest rates than was previously indicated by the September dot plot graph which showed a peak (terminal rate) of 4.75% to 5.0% next year. The December FOMC meeting will yield a new dot plot graph.

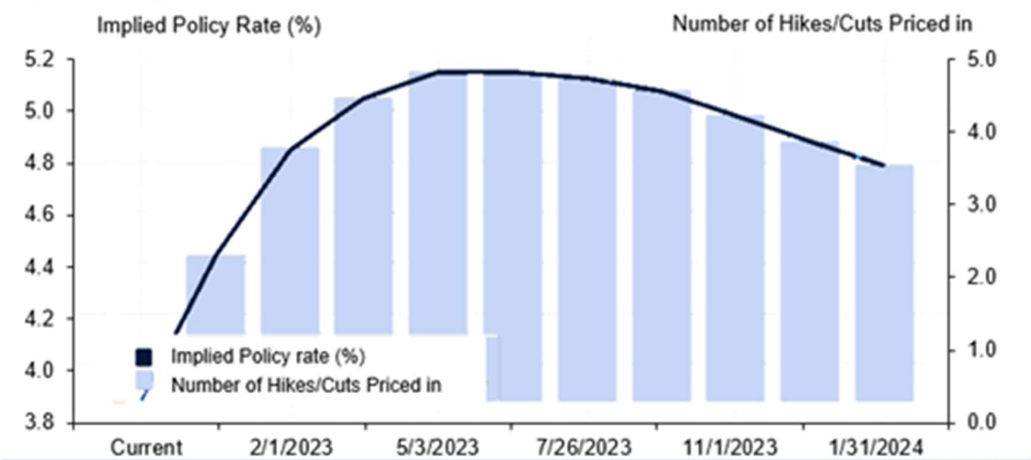
- The rand has weakened to R18.46/USD in response, from a close of R18.26/USD yesterday, with FOMC highlighting that it will "stay the course, until the job is done" in "returning inflation to our 2 percent objective."
- We continue to expect that SA will hike its interest rates by 100bp on 24th November, with the Federal Reserve Bank hiking by 3.75% so far in the current cycle, and the SARB only by 2.75%. The MPC's last meeting this year is in November, but the FOMC meets again in December.
- The FOMC communication signals it does not feel ready to slow the pace of rate hikes from 75bp per meeting, and could likely do so again on 14th December, and allowing for a further hike at its next meeting following around six weeks on (likely 1st February 2023) of 75bp.
- By the end of the year the FOMC likely have hiked rates by 5.50% in the current cycle, and SA by 4.75%, with the MPC likely to discuss a larger hike than 100bp in November particularly given the higher end rate now signalled by the FOMC, and so could surprise on the upside.
- The fed fund futures will likely rise somewhat, as markets digest the FOMC statement and Fed Chair Powell's comments to the press over this week, lifting the expectation for the December rate hike towards 75bp, and placing the rand at risk of further weakness.

Fed Fund Futures implied rates – 3 November 2022

Meeting	#Hikes/Cuts	% Hike/Cut	Implied Rate∆	Implied Rate	A.R.M
12/14/2022	+2.303	+230.3%	+0.576	4.423	0.250
02/01/2023	+3.998	+169.5%	+1.000	4.846	0.250
03/22/2023	+4.803	+80.5%	+1.201	5.048	0.250
05/03/2023	+5.224	+42.1%	+1.306	5.153	0.250
06/14/2023	+5.232	+0.9%	+1.308	5.155	0.250
07/26/2023	+5.123	-10.9%	+1.281	5.128	0.250
09/20/2023	+4.923	-20.0%	+1.231	5.078	0.250
11/01/2023	+4.519	-40.4%	+1.130	4.977	0.250
12/13/2023	+4.113	-40.7%	+1.028	4.875	0.250
01/31/2024	+3.743	-37.0%	+0.936	4.783	0.250

Source: Bloomberg

Implied overnight rate and number of hikes/cuts



Source: Bloomberg