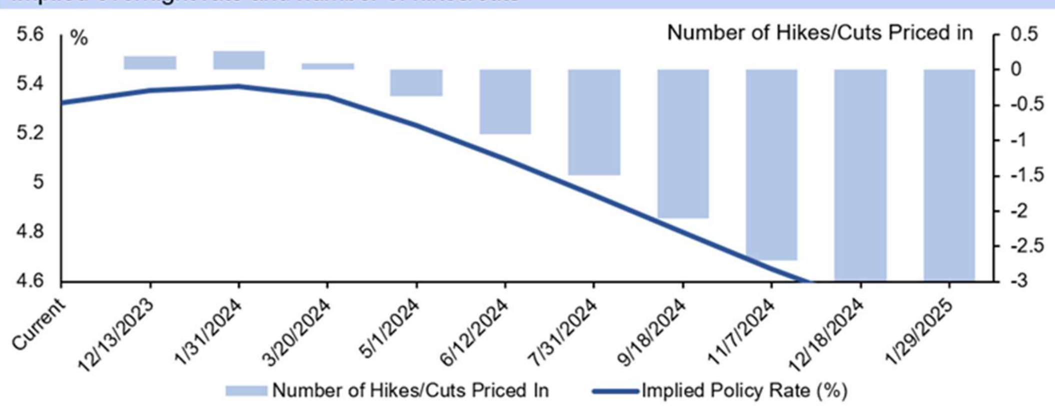
Investec

FOMC note: rand gains further as an end to the US rate hike cycle seen supported

Thursday 2 November 2023

Implied overnight rate and number of hikes/cuts



Source: Bloomberg

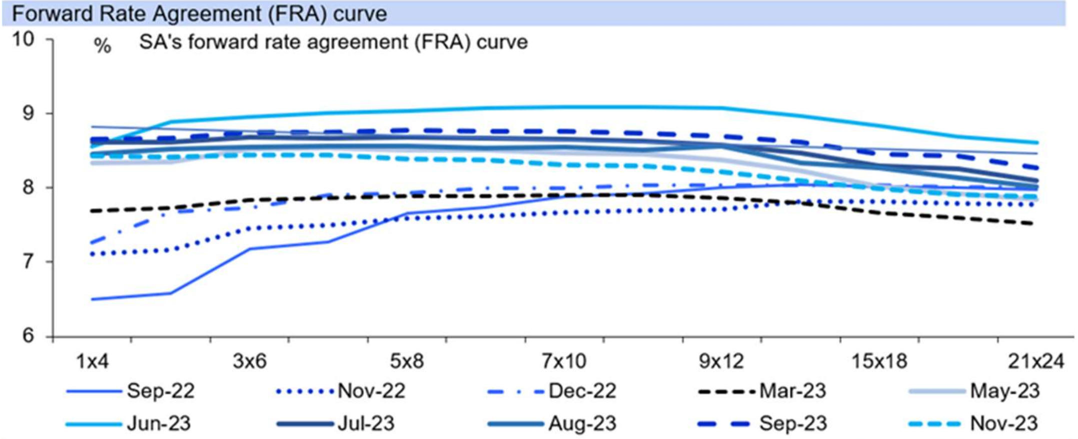
Fed Fund Futures implied rates – 2 November 2023					
Meeting	#Hikes/Cuts	% Hike/Cut	Implied Rate△	Implied Rate	A.R.M
12/13/2023	0.191	+19.1%	+0.048	5.373	0.250
01/31/2024	0.271	+8.0%	+0.068	5.392	0.250
03/20/2024	0.096	-17.5%	+0.024	5.349	0.250
05/01/2024	-0.374	-47.0%	-0.094	5.231	0.250
06/12/2024	-0.913	-53.8%	-0.228	5.097	0.250
07/31/2024	-1.499	-58.7%	-0.375	4.95	0.250
09/18/2024	-2.104	-60.5%	-0.526	4.799	0.250
11/07/2024	-2.696	-59.2%	-0.674	4.651	0.250
12/18/2024	-3.232	-53.6%	-0.808	4.517	0.250
01/29/2025	-3.739	-50.7%	-0.935	4.39	0.250
					Source: Bloomberg

- The FOMC (Federal Open Market Committee) once again left the federal funds target rate unchanged at 5.25% - 5.50%, as widely expected, highlighting “the Committee is proceeding carefully” in its monetary policy approach.
- The strength of the US economy was evident in the most recent GDP data, where activity levels expanded by 4.9% qqsaa, running above expectations, and against prior expectations some forecasters had of a recession in H2.23.
- This is not to say that the effects of the rapid, tightening interest rate cycle have not been felt, with the housing market having flattened out below the levels of a year ago as high mortgage rates temper its momentum.
- Business fixed investment has also seen the suppressing effect of higher borrowing costs while the labour market is seeing increasing balance between demand and supply conditions, but is still tight in areas.
- Lastly the FOMC noted that inflation still remains above the long-run goal of 2.0%, with the core PCE deflator at 3.7% y/y, although “(i)nflation has moderated since the middle of last year, and readings over the summer were quite favorable”.
- However, “a few months of good data are only the beginning of what it will take to build confidence that inflation is moving down sustainably toward our goal. The process of getting inflation sustainably down to 2 percent has a long way to go.”
- The rand strengthened to R18.46/USD in response to the outcome, with expectations that the US rate hike cycle has ended underscored, and that 2024 is still likely to see the beginning of the US interest rate cut cycle.
- The FOMC next meets to deliver its interest rate decision on the 13th December, and after that at the end of January 2024. Markets have factored in no full expectations of another US rate hike this year, and the potential for cuts are building from Q2.24.
- Chair Powell added “(d)espite elevated inflation, longer-term inflation expectations appear to remain well anchored, as reflected in a broad range of surveys of

households, businesses, and forecasters, as well as measures from financial markets”.

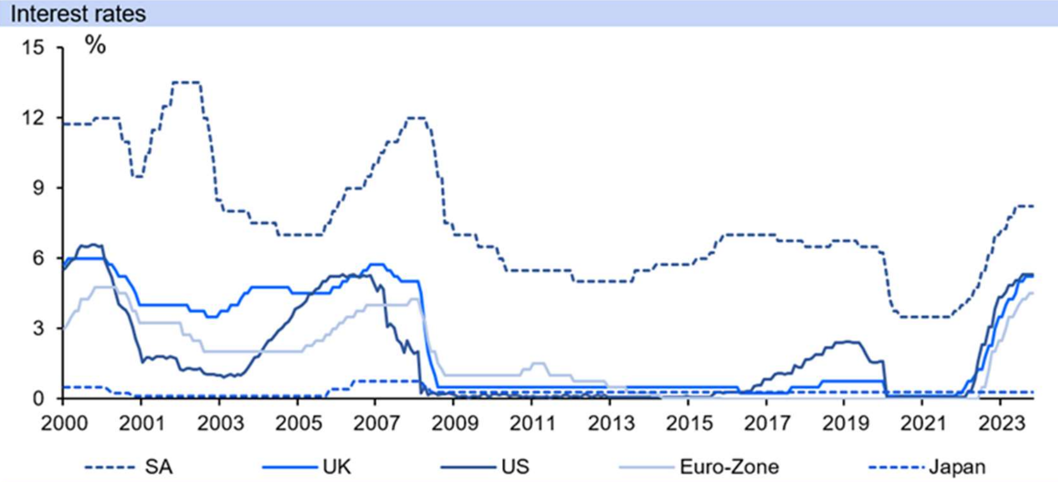
- “Financial conditions have tightened significantly in recent months, driven by higher longer-term bond yields, among other factors. Because persistent changes in financial conditions can have implications for the path of monetary policy, we monitor financial developments closely”.
- This tightening of financial conditions adds to the expectations that the US has seen its last interest rate hike. In South Africa, no further interest rate hikes are likely this year either.
- Next year, SA is only expected to see an interest rate cut in Q3.24, of 25bp, with the FRA (Forward Rate Agreement) curve slow in factoring in rate cuts for SA, but we continue to believe a 125bp drop will occur beginning in 2024 and ending in 2025.

Forward Rate Agreement (FRA) curve



Source: Bloomberg

Interest rates



Source: Iress