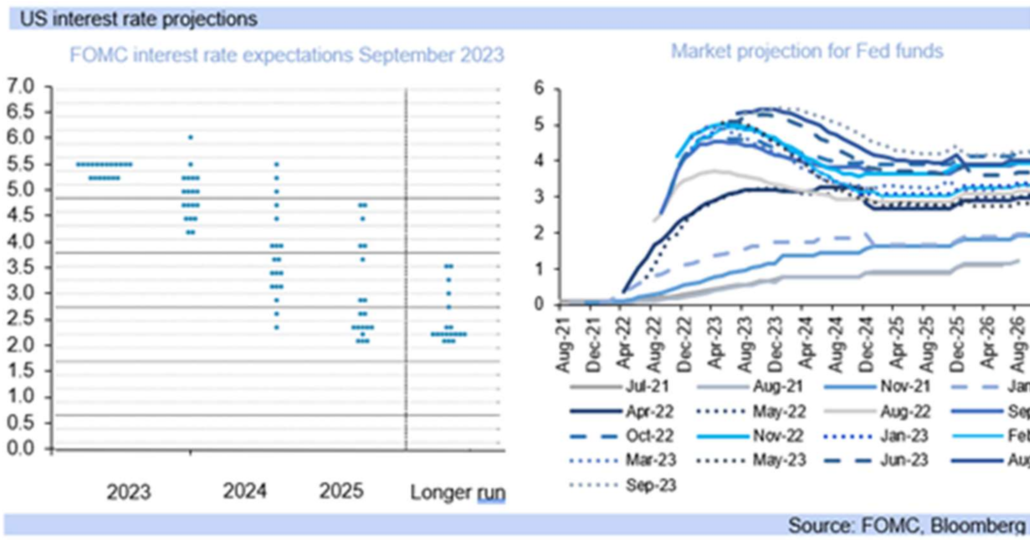
FOMC minutes: while the US interest rate hike cycle is expected to have ended, risks remain

Thursday 21 September 2023



Fed Fund Futures implied rates – 21 August 2023

Meeting	#Hikes/Cuts	% Hike/Cut	Implied Rate∆	Implied Rate	A.R.M
11/01/2023	+0.331	+33.1%	+0.083	5.410	0.250
12/13/2023	+0.547	+21.6%	+0.137	5.464	0.250
01/31/2024	+0.580	+3.3%	+0.145	5.472	0.250
03/20/2024	+0.435	-14.5%	+0.109	5.436	0.250
05/01/2024	+0.191	-24.4%	+0.048	5.375	0.250
06/12/2024	-0.187	-37.8%	-0.047	5.281	0.250
07/31/2024	-0.610	-42.3%	-0.153	5.175	0.250
09/18/2024	-1.160	-55.0%	-0.290	5.038	0.250
11/07/2024	-1.734	-57.4%	-0.433	4.894	0.250
12/18/2024	-2.293	-55.9%	-0.573	4.754	0.250
01/29/2025	-2.890	-59.7%	-0.723	4.605	0.250

Source: Bloomberg

- The FOMC (Federal Open Market Committee) left the federal funds target rate unchanged at 5.25% - 5.50%, as widely expected and as already indicated at its July meeting, with the members concluding that recent data warranted its stance.
- The projections materials showed a downwards revision in unemployment expectations, to 3.8% from 4.1% for this year, while the GDP growth figure was revised up, to 2.1% y/y from 1.0% y/y, highlighting the likelihood of a soft landing.

- Fed Chair Powell noted that “(r)ecent indicators suggest that economic activity has been expanding at a solid pace, and so far this year, growth in real GDP has come in above expectations.”
- And additionally, “(r)ecent readings on consumer spending have been particularly robust. Activity in the housing sector has picked up somewhat, though it remains well below levels of a year ago, largely reflecting higher mortgage rates.”
- The projections for next year also showed a revision in unemployemt expectations, to 4.1% from 4.5% previously, while the GDP growth figure was revised up, to 1.5% y/y from 1.1% y/y, still representing some cooling next year.
- Indeed, 2025 sees economic growth recover to 1.8% y/y in the FOMC forecasts, and the US unemployment rate remain at 4.1%, and then drop to 4.0% in 2026 (as the real GDP growth projection remains at 1.8% y/y in 2026).
- The rand strengthened to R18.80/USD in response, from yesterday’s close of R18.84/USD, but the markets are likely to continue to digest the FOMC statements, and the rand consequently has room for further strength against the USD.
- The FOMC next meets to deliver its interest rate decision on 1st November, and then its last meeting this year will be on the 13th December. Markets have factored in no full expectations of another US rate hike this year, and still see cuts next year.
- Chair Powell added last night that “(t)he labor market remains tight, but supply and demand conditions continue to come into better balance”, with the Fed showing less concern overall about the labour market”.
- Indeed, he added, that “(t)he unemployment rate ticked up in August but remains low, at 3.8 percent”, with the Fed previously having said that the labour market has to weaken substantially for inflation to cool.
- Fed projections also show core PCE inflation nearing, then reaching, 2.0% over the next few years, as the Fed’s projections see inflation returning to the implied target, averaging 2.6% next year, from 3.7% y/y this year, then 2.3% y/y in 2025.
- Changes in interest rates take a while to have an effect on inflation, with this lag potentially two to three quarters initially and the full effects coming through over a year to eighteen months.
- The Fed itself says it “will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments”.
- While the Fed members signal the possibility of another hike, this is likely aimed at quelling inflation expectations and is not widely expected to transpire. In SA as well markets expect no further hikes this year, and cuts from next year.

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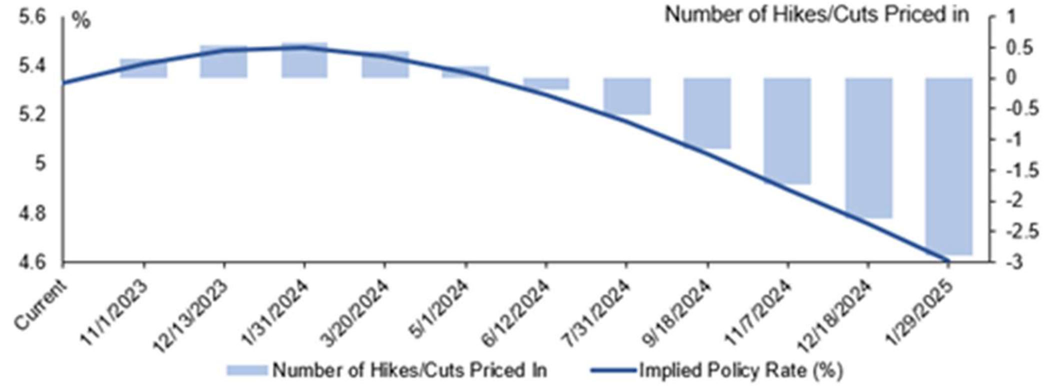
Implied overnight US rate and number of hikes/cuts



Source: Bloomberg

Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, September 2023

	Median[1]					Central Tendency[2]				
Variable	2023	2024	2025	2026	Longer run	2023	2024	2025	2026	Longer run
Change in real GDP	2.1	1.5	1.8	1.8	1.8	1.9-2.2	1.2-1.8	1.6-2.0	1.7-2.0	1.7-2.0
June projection	1.0	1.1	1.8		1.8	0.7-1.2	0.9-1.5	1.6-2.0		1.7-2.0
Unemployment rate	3.8	4.1	4.1	4.0	4.0	3.7-3.9	3.9-4.4	3.9-4.3	3.8-4.3	3.8-4.3
June projection	4.1	4.5	4.5		4.0	4.0-4.3	4.3-4.6	4.3-4.6		3.8-4.3
PCE inflation	3.3	2.5	2.2	2.0	2.0	3.2-3.4	2.3-2.7	2.0-2.3	2.0-2.2	2.0
June projection	3.2	2.5	2.1		2.0	3.0-3.5	2.3-2.8	2.0-2.4		2.0
Core PCE inflation[4]	3.7	2.6	2.3	2.0		3.6-3.9	2.5-2.8	2.0-2.4	2.0-2.4	
June projection	3.9	2.6	2.2			3.7-4.2	2.5-3.1	2.0-2.4		
Memo Projected appropriate policy path										
Federal funds rate	5.6	5.1	3.9	2.9	2.5	5.4-5.6	4.6-5.4	3.4-4.9	2.5-4.1	2.5-3.3
June projection	5.6	4.6	3.4		2.5	5.4-5.6	4.4-5.1	2.9-4.1		2.5-2.8

Source: Federal Reserve Bank

Economic projections (continued)

	Range[3]				
Variable	2023	2024	2025	2026	Longer run
Change in real GDP	1.8-2.6	0.4-2.5	1.4-2.5	1.6-2.5	1.6-2.5
June projection	0.5-2.0	0.5-2.2	1.5-2.2		1.6-2.5
Unemployment rate	3.7-4.0	3.7-4.5	3.7-4.5	3.7-4.5	3.5-4.3
June projection	3.9-4.5	4.0-5.0	3.8-4.9		3.5-4.4
PCE inflation	3.1-3.8	2.1-3.5	2.0-2.9	2.0-2.7	2.0
June projection	2.9-4.1	2.1-3.5	2.0-3.0		2.0
Core PCE inflation[4]	3.5-4.2	2.3-3.6	2.0-3.0	2.0-2.9	
June projection	3.6-4.5	2.2-3.6	2.0-3.0		
Memo Projected appropriate policy path	5.4-5.6	4.4-5.6	2.6-5.6	2.4-4.9	2.4-3.8
Federal funds rate	5.4-5.6	4.4-6.1	2.6-5.6	2.4-4.9	2.4-3.8
June projection	5.1-6.1	3.6-5.9	2.4-5.6		2.4-3.6

Source: Fed Reserve Bank

Note: Projections of change in real gross domestic product (GDP) and projections for both measures of inflation are percent changes from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The projections for the federal funds rate are the value of the midpoint of the projected appropriate target range for the federal funds rate or the projected appropriate target level for the federal funds rate at the end of the specified calendar year or over the longer run. The June projections were made in conjunction with the meeting of the Federal Open Market Committee on June 13–14, 2023. One participant did not submit longer-run projections for the change in real GDP, the unemployment rate, or the federal funds rate in conjunction with the June 13–14, 2023, meeting, and one participant did not submit such projections in conjunction with the September 19–20, 2023, meeting.

1. For each period, the median is the middle projection when the projections are arranged from lowest to highest. When the number of projections is even, the median is the average of the two middle projections.
2. The central tendency excludes the three highest and three lowest projections for each variable in each year.
3. The range for a variable in a given year includes all participants' projections, from lowest to highest, for that variable in that year.
4. Longer-run projections for core PCE inflation are not collected.