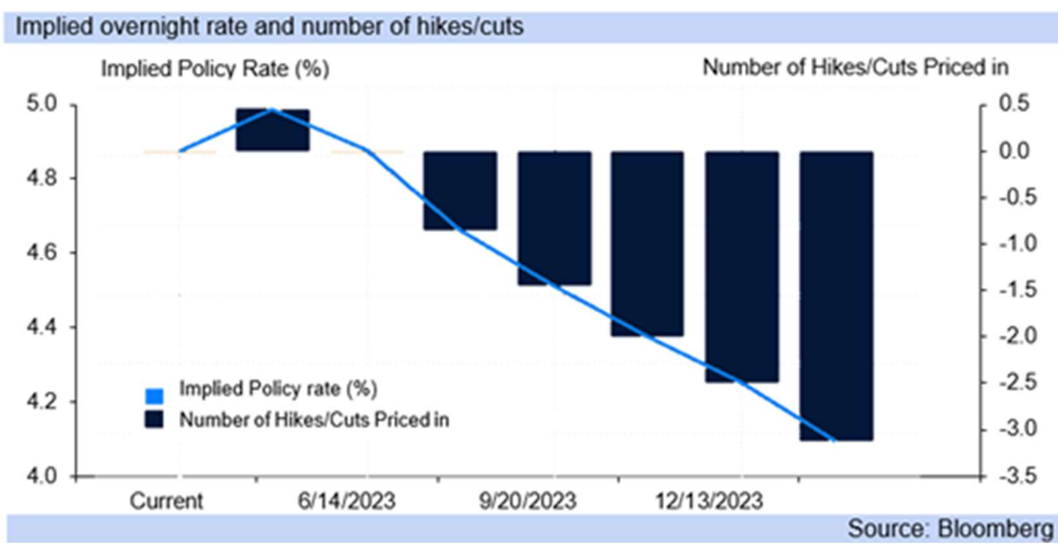
Investec

FOMC note: rand strengthens as Fed dials back on hawkishness seen early this month and last

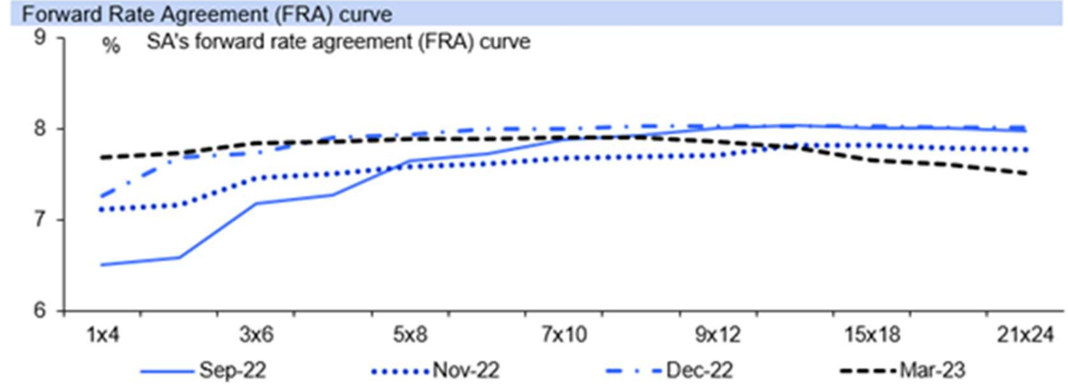
Thursday 23 March 2023



- The FOMC raised its target range for the federal funds rate to 4.75% - 5.00% (25bp higher) as expected last night, balancing the need to continue to seek to return inflation to 2.0% with the impact of high interest rates on financial stability.
- The tone was seen as somewhat less hawkish than commentary coming out early in the month and in February, when market expectations were factoring in a 50bp lift at last night's meeting, although the recent banking crisis in the US saw a more modest hike.
- Fed Chair Powell highlighted "recent developments in the banking sector" "(i)n the past two weeks, … (particularly) serious difficulties at a small number of banks have emerged."
- "History has shown that isolated banking problems, if left unaddressed, can undermine confidence in healthy banks and threaten the ability of the banking system as a whole to play its vital role in supporting the savings and credit needs of households and businesses."
- "(I)n response to these events, the Federal Reserve, working with the Treasury Department and the FDIC, took decisive actions to protect the U.S. economy and to strengthen public confidence in our banking system."
- Higher interest rates have added to some stresses in the US banking system amongst smaller banks, particularly in the case of SVB which had invested heavily in US treasuries, but had not hedged against changes in their value.
- A depositor run, and further problems resulting in the failure of Signature Bank, led to concerns that other financial institutions would be negatively affected by the higher interest rate environment, particularly smaller banks, creating some systemic risk.

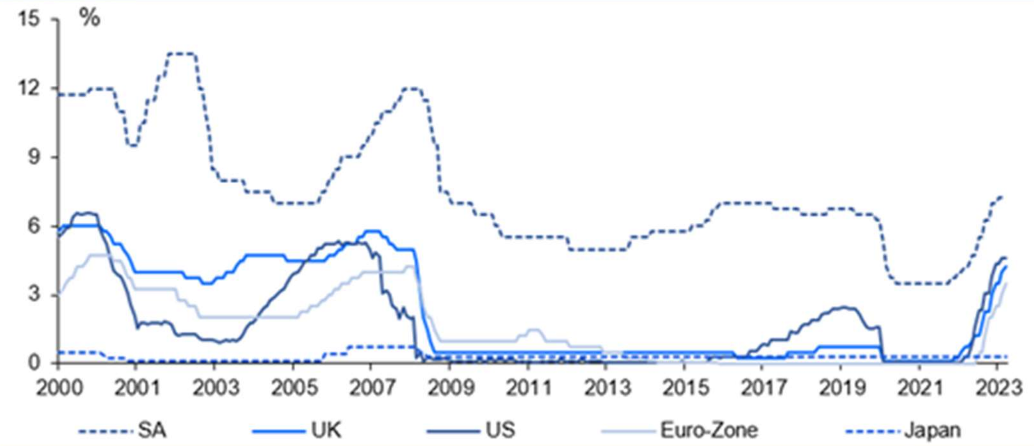
- Market expectations pulled back on US interest rate hike expectations, with yesterday's 25bp lift striking a balance as the FOMC also communicated "inflation remains too high, and the labor market continues to be very tight".
- "Price stability is the responsibility of the Federal Reserve. Without price stability, the economy does not work for anyone. In particular, without price stability, we will not achieve a sustained period of strong labor market conditions that benefit all."
- "Inflation has moderated somewhat since the middle of last year, but the strength of … recent readings indicates that inflation pressures continue to run high. The process of getting inflation back down to 2 percent has a long way to go and is likely to be bumpy."
- The rand strengthened in response to the more modest Fed tone, reaching R18.06/USD on some US dollar weakness from a close of R18.28/USD in SA markets yesterday.
- The FOMC next meets in May (3rd) although the chance of another hike is currently seen around 50% for a 25bp lift, with the Fed statement reading "some additional policy firming may be appropriate".
- The Fed funds futures have factored in implied rate cuts for H2.23, with July (26th) meeting seeing 80% chance of a 25bp cut, and factoring in a second 25bp cut the FOMC's November meeting (1st), although expectations will likely remain volatile.
- South Africa's monetary policy committee (MPC) meets for its interest rate decision at the end of this month, and the FRA curve (Forward Rate Agreement) curve has mostly (but not fully) factored in a 25bp lift in SA's repo rate.

Forward Rate Agreement (FRA) curve



Source: Bloomberg

Interest rates



Source: Iress