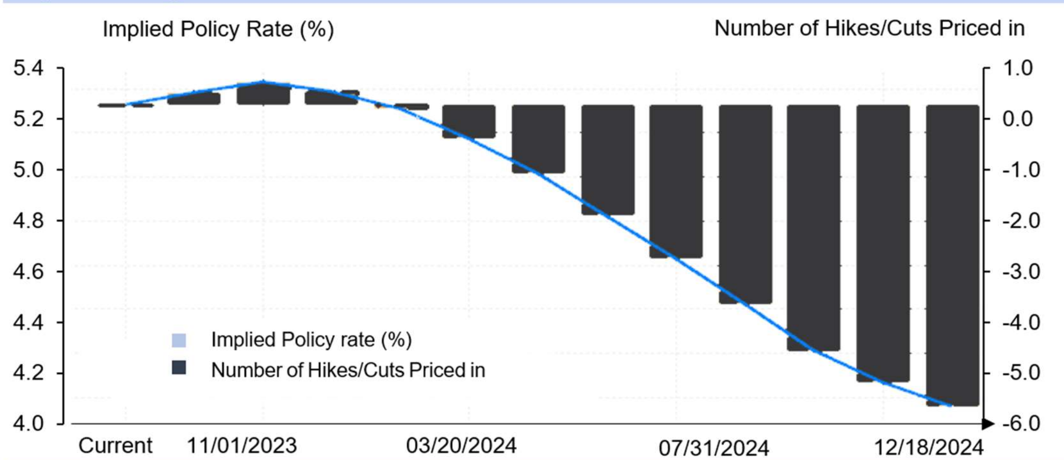
Investec

FOMC minutes: markets see no further hikes currently while Fed signals possibility either way

Thursday 27 July 2023

Implied overnight rate and number of hikes/cuts



Source: Bloomberg

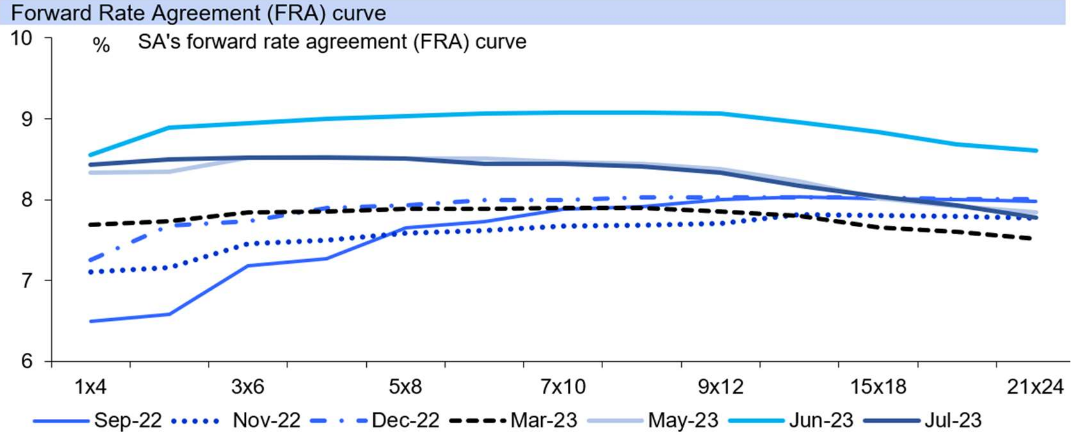
Fed Fund Futures implied rates – 27July 2023					
Meeting	#Hikes/Cuts	% Hike/Cut	Implied Rate△	Implied Rate	A.R.M
09/20/2023	+0.200	+20.0%	+0.050	5.378	0.250
11/01/2023	+0.406	+20.6%	+0.102	5.429	0.250
12/13/2023	+0.237	-17.0%	+0.059	5.387	0.250
01/31/2024	-0.080	-31.7%	-0.020	5.307	0.250
03/20/2024	-0.632	-55.2%	-0.158	5.170	0.250
05/01/2024	-1.261	-62.9%	-0.315	5.012	0.250
06/12/2024	-2.028	-76.7%	-0.507	4.820	0.250
07/31/2024	-2.800	-77.2%	-0.700	4.628	0.250
09/18/2024	-3.632	-83.3%	-0.908	4.419	0.250
11/07/2024	-4.475	-84.2%	-1.119	4.209	0.250
12/19/2024	-5.044	-56.9%	-1.261	4.067	0.250
01/29/2025	-5.490	-44.6%	-1.373	3.955	0.250
					Source: Bloomberg

- The FOMC lifted the federal funds target rate by 25bp (to 5.25% - 5.50%) and indicated that at the September meeting it could hold rates steady if the data warranted it, although a lift was not impossible.
- Fed Chair Powell noted, “(w)e have been seeing the effects of our policy tightening on demand in the most interest-rate-sensitive sectors of the economy” but “(i)t will take time … for the full effects of our ongoing monetary restraint to be realized, especially on inflation.”
- Adding “the economy is facing headwinds from tighter credit conditions for households and businesses, which are likely to weigh on economic activity, hiring, and inflation.”
- “In determining the extent of additional policy firming that may be appropriate … the Committee 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.”
- "We will continue to make our decisions meeting by meeting, based on the totality of incoming data and their implications for the outlook for economic activity and inflation as well as the balance of risks”.
- The FOMC communications leave some possibility for a hike in the Fed funds rate in September, but currently the markets have essentially priced in no change for the remainder of this year, and continue to see US interest rate cuts from next year.
- The rand consequently has retained much of its recent strength, reaching R17.56/USD today, and yesterday R17.52/USD on US dollar weakness, its strongest rate since February this year.

- The FOMC next meets on 20th September, and then will deliver another interest rate decision on the 1st November. Markets have factored in only a 5bp hike at the September meeting, and by November for rates to have risen by only 10bp.
- With the FOMC hiking by 25bp at the July meeting it is not expected to do the same again at the September meeting, and market expectations see no further hikes in the current cycle for the US.
- The last meeting of the year is on 13th December, and market expectations have fallen by then for only a 6bp hike, i.e. no change in rates. The market expectations for the moves at each meeting are not cumulative, but a reading at a point in time.
- It is consequently believed that the FOMC has now reached the end of its interest rate hike cycle, as per the implied Fed funds futures, with the January 2024 meeting seeing the first indications of markets leaning toward a cut instead of a hike.
- However, only by the May 2024 FOMC meeting is a 25bp cut in the Fed funds rate fully factored in (with a 32bp fall implied), while the March 2024 FOMC meeting currently has a 16.5bp cut factored in – as markets see a cut more likely than a hold.
- In South Africa, the FRAs have not priced in any further hikes in the repo rate this year, with the essentially flat trajectory extending over Q1.24. However, as US interest rate cut expectations grow, SA is seen as cutting as early as mid-2024.
- The FRA (Forward Rate Agreement) curve currently shows expectations of a further 25bp cut in the repo rate by the end of 2024, making it a 50bp drop in interest rates in total, although market expectations are subject to rapid change.

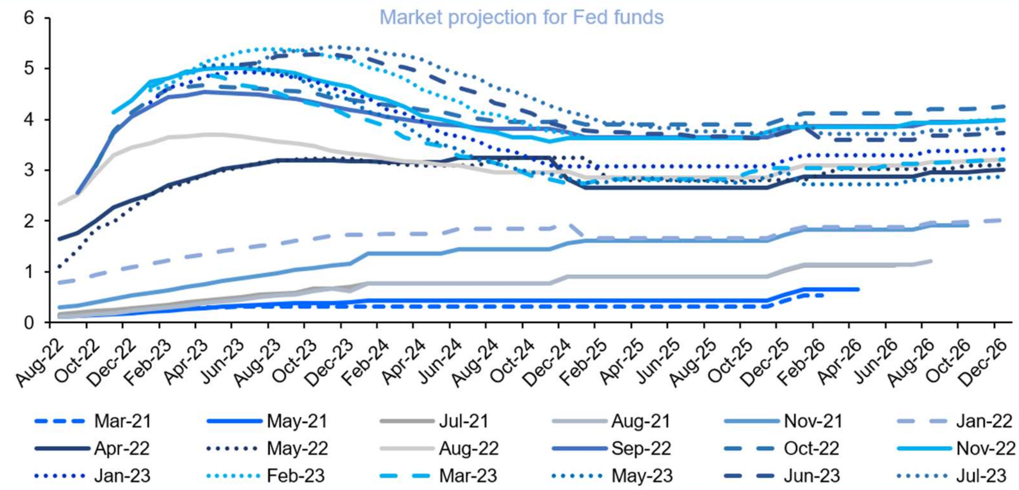
Please scroll down to the second section below

Forward Rate Agreement (FRA) curve



Source: Bloomberg

US interest rate projections



Source: FOMC, Bloomberg