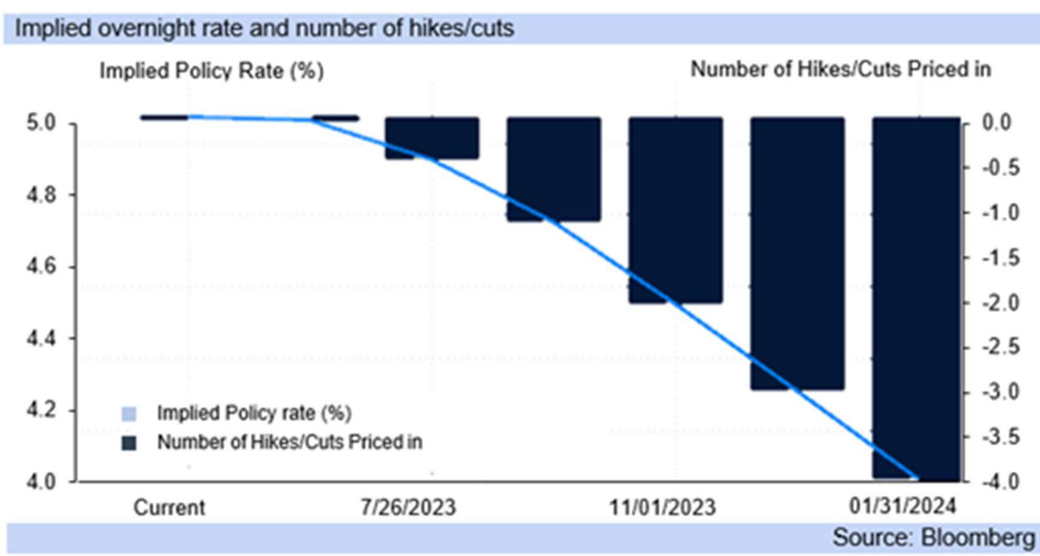
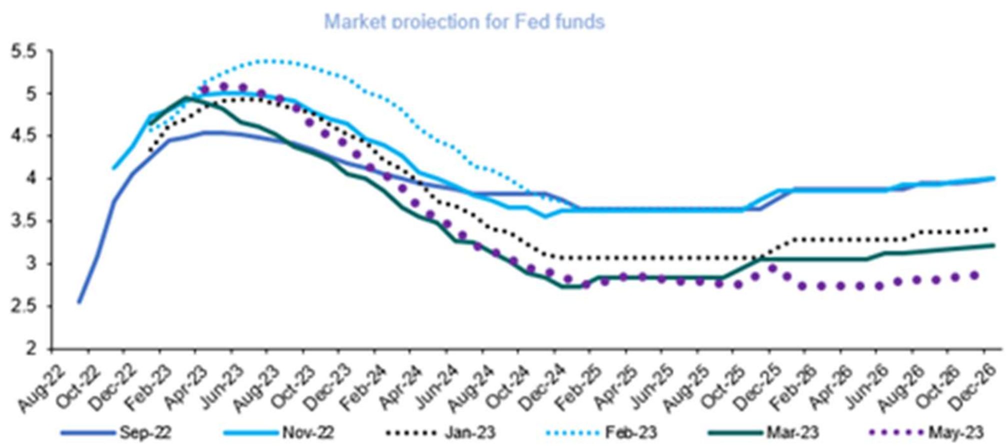
Investec

FOMC note: only slight rand strength as the Fed does not affirm a halt to rate hikes

Thursday 4 May 2023

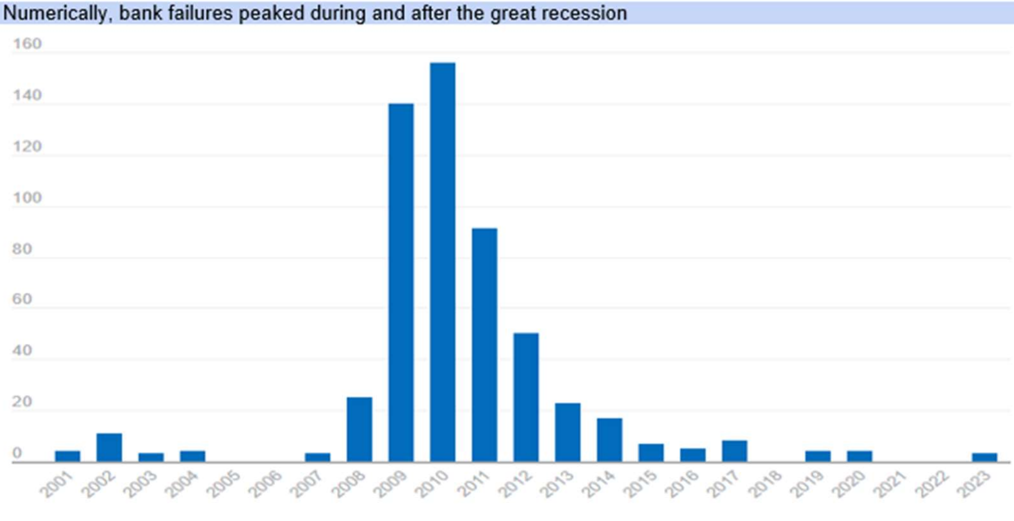


US interest rate projections



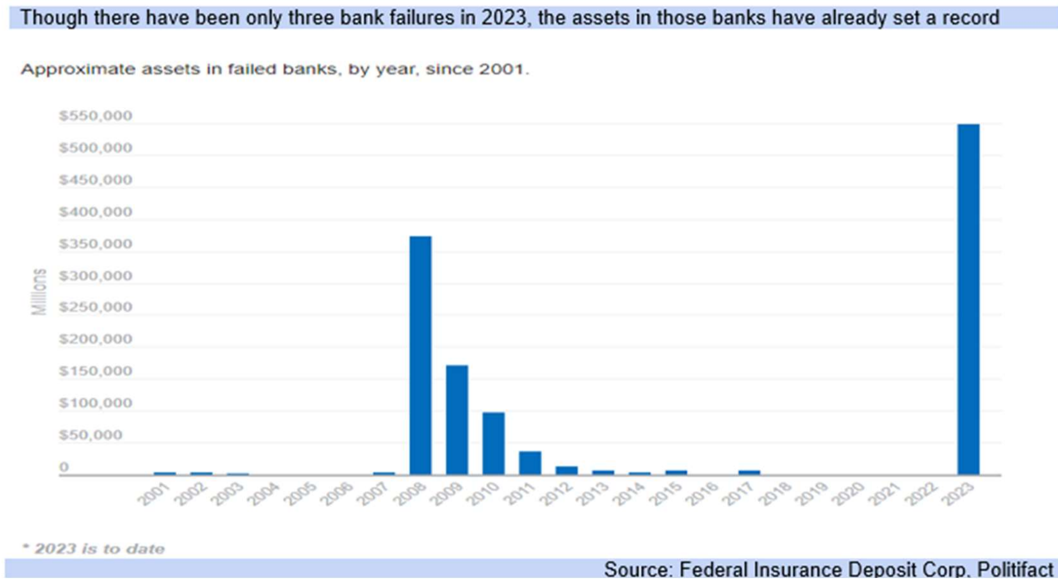
Source: FOMC, Bloomberg

Numerically, bank failures peaked during and after the great recession



** 2023 is to date*

Source: Federal Insurance Deposit Corp, Politifact



- The FOMC raised its target range for the federal funds rate to 5.00% - 5.25% (25bp lift) as widely expected yesterday, but its statement was much more balanced, highlighting all areas of concern versus previously showing a greater inflation focus.
- In particular, it recognised a more flexible approach to "additional policy firming", is appropriate, taking "into account the cumulative tightening of monetary policy" and "the lags with which monetary policy affects economic activity and inflation".
- The very hawkish approach of the earlier FOMC statements was dialed down, and the Fed essentially left the door open for a pause at its next meeting (14th June) or the terminal rate having been reached, but also did not rule out further hikes.
- Chair Powell also placed concerns over instances of weakness in the US banking system front and foremost in his press conference statement, with the failure of a third US bank during the US's very rapid, and severe, rate hike cycle.
- In particular though, last night's statements showed a shift in monetary policy to focus on both employment and inflation (the FOMC's dual monetary policy mandate), from what had become a very unidimensional focus on inflation.
- The Fed has raised its funds rate by a full 5.00% over last year and this year to date, which has only partially reduced inflationary pressures, although subsiding supply side pressures from last year into this was a key driver of lower inflation.
- High commodity prices pushed up the US's inflation CPI and PPI inflation measures last year, and high demand pull pressure the year before. Both have subsided substantially since then, but second round effects have now become entrenched.

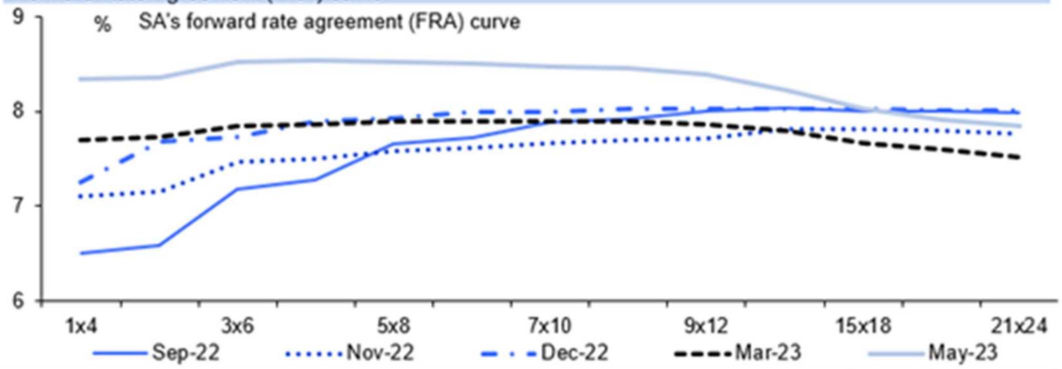
- These are evident in core inflation measures in particular, which are elevated, far removed from the FOMC's implicit inflation target of 2.0% y/y, and proving sticky which is still raising concerns for the FOMC.
- The FOMC has to balance these concerns against the impact of tighter credit conditions on the economy and banking sector, particularly the latter for financial stability, although the FOMC's concerns over high inflation are still very apparent.
- The rand strengthened to R18.21/USD on slight US dollar weakness from a close of R18.29/USD in SA markets yesterday, but has since moved back to R18.25/USD, very slight movements as markets are not sure of the direction of rates yet.
- The FOMC next meets mid-June, and will deliver another monetary policy update. The chance of another hike is currently seen at 0%, and instead the Fed funds futures are tipping towards a greater chance of a cut than a hike at the next meeting.
- That is, markets believe the US has ended its rate hike cycle for this year, and that cuts are likely instead, of 1.00% by the end of January next year, and that July this year will see close to a 50bp drop.
- With markets having seen around a 50% chance of US recession in H2.23, markets believe cuts instead of further hikes from here are likely, and that the Fed did indeed reach its terminal rate (last hike) in the current cycle yesterday.
- South Africa's FRAs have fully priced in a 25bp hike for this month in SA's repo rate, with a 34bp hike indicated, down slightly from closer to 40bp hike factored in on Monday. By July SA markets currently expect another 25bp hike in the repo rate.

Fed Fund Futures implied rates – 4 May 2023

Meeting	#Hikes/Cuts	% Hike/Cut	Implied Rate∆	Implied Rate	A.R.M
06/14/2023	-0.045	-4.5%	-0.011	5.060	0.250
07/26/2023	-0.474	-42.9%	-0.118	4.953	0.250
09/20/2023	-1.174	-70.0%	-0.293	4.778	0.250
11/01/2023	-2.085	-91.1%	-0.521	4.550	0.250
12/13/2023	-3.051	-96.6%	-0.763	4.308	0.250
01/31/2024	-4.034	-98.3%	-1.008	4.063	0.250

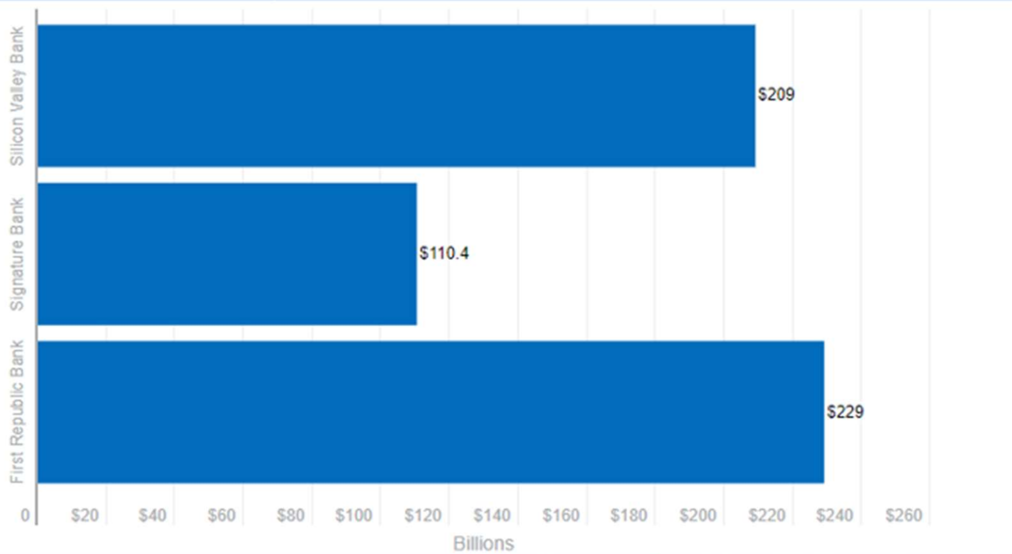
Source: Bloomberg

Forward Rate Agreement (FRA) curve



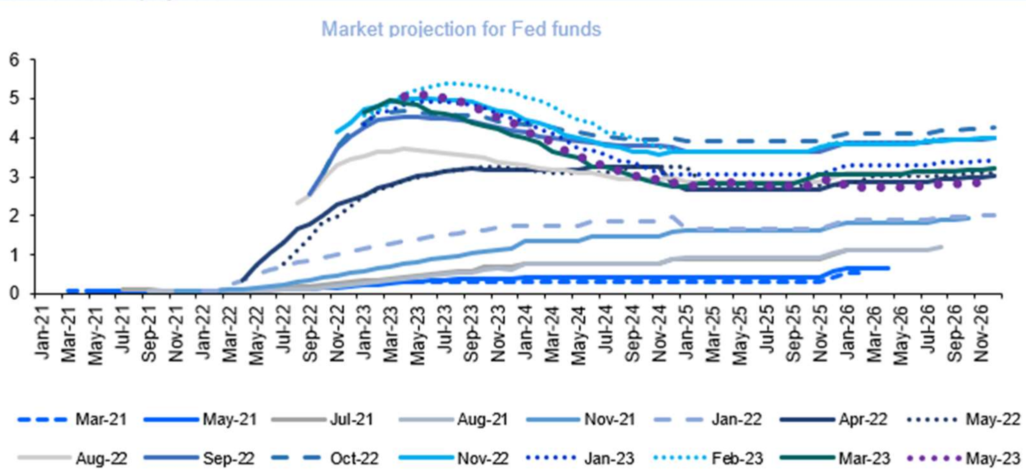
Source: Bloomberg

Three banks have failed in 2023, all with substantial assets



Source: Federal Insurance Deposit Corp, Washington Post, Politifact

US interest rate projections



Source: FOMC, Bloomberg