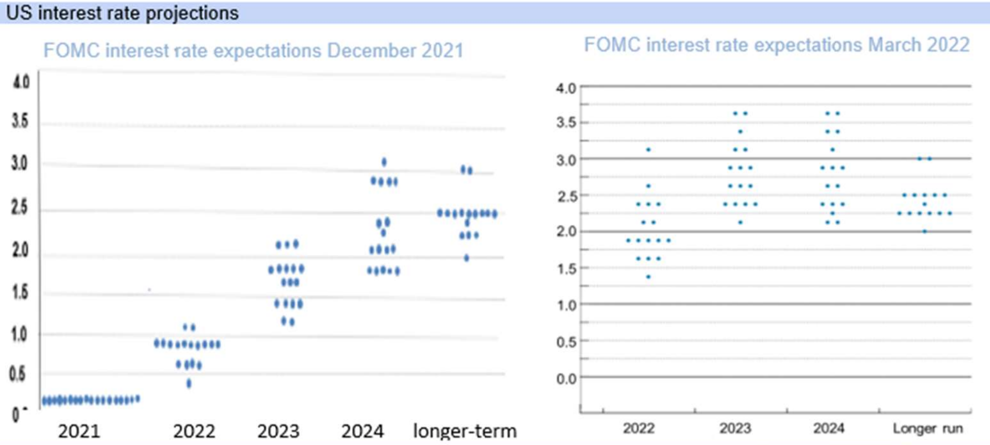
Thursday 17 March 2022

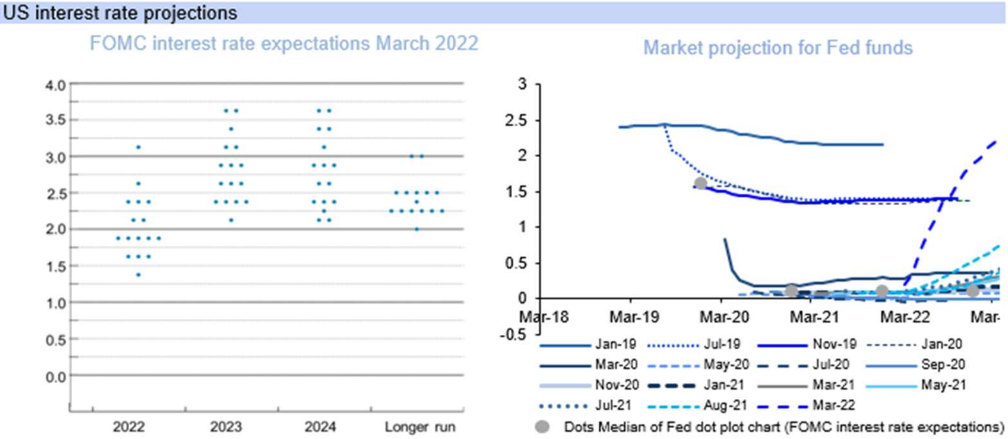
FOMC note: the Fed hiked by 25bp as expected, its tone became more hawkish with rate hikes seen at every meeting this year, and its strong growth outlook strengthened the rand

US interest rate projections



Source: FOMC, Bloomberg

US interest rate projections



Source: FOMC, Bloomberg
Note: in left graph each circle/dot is individual's judgement of appropriate fed funds rate per period

- Last night's Federal Open Market Committee (FOMC) meeting saw the target range for the federal funds rate rise to 0.25% to 0.50% as widely expected , and the committee highlighted that it "anticipates that ongoing increases in the target range will be appropriate".
- Additionally, the Fed will begin to reduce its holdings of US treasuries (and agency debt) on its balance sheet, the accumulation from its QE programme at an upcoming meeting (likely May). All the members voted for a hike, with even one preferring 50bp instead of 25bp.

- The statement added that the implications of the Russian/Ukraine war “for the U.S. economy are highly uncertain, but in the near term the invasion and related events are likely to create additional upward pressure on inflation and weigh on economic activity”.
- Indeed, the Fed Chairman remained focused on inflation without economic growth concerns, and indeed was very confident on economic growth with little expectation of a recession in the US. Markets reacted positively to his comments, with risk-off receding materially.
- Risk assets benefited from the very positive reading of the US economy, with Chairman Powell specifically saying “(t)he economy is very strong”, “(a)ggregate demand is strong, and bottlenecks and supply constraints are limiting how quickly production can respond.”
- “Although the invasion of Ukraine and related events represent a downside risk to the outlook for economic activity, FOMC participants continue to foresee solid growth of … 2.8 percent this year, 2.2 percent next year, and 2 percent in 2024.”
- While the US rate hike was expected, the tone of the FOMC statement was very hawkish with heightened concern about further future inflationary pressures, concluding “(w)e are attentive to the risks of potential further upward pressure on inflation and inflation expectations.”
- Also at the conclusion of Chair Powell’s press conference he highlighted for the third time that the “American economy is very strong”, finishing with the statement that the US is consequently “well positioned to handle tighter monetary policy”.
- The South African Reserve Bank is expected to hike the repo rate by 25bp on the 24th, following on from the Fed’s hike last night, and the FRA curve has fully factored this in, but the positioning for a 50bp hike has come out of the system over the past few weeks.
- The FOMC projection shows the target range for the federal funds rate at 1.75% to 2.00% this year, which is a substantial ramp up from December’s projections of a range of 0.75% to 1.00% the last time the Fed’s interest rate forecasts were published (December 2020).
- With the Fed’s funds rate currently in the 25bp to 50bp range, this implies a hike at every FOMC meeting this year of 25bp, with six meetings remaining in the year. This aggressive rate hike cycle has been presented in order to squash forty decade high US inflation.
- South Africa’s FRAs have fully factored in a 25bp lift the repo rate this month, and are building in another one for May and yet another for July, and indeed a 25bp hike is factored in by the markets for every MPC meeting this year, if not 50bp hikes at some MPC meetings.
- The MPC often follows the FRA curve at a meeting, but FRA curve expectations are volatile and change often, and so the future expectations out to twenty-four months have less effect than the nearest months reading on the SARB’s interest rate decision.
- Also supportive of a March 25bp lift in SA’s repo rate is the 25bp hike last night in the Fed funds target rate, with the SARB mindful of the need to maintain the interest rate differential between the US and SA in order to prevent very severe rand depreciation.
- The rand today reached its strongest level this year, at R14.89/USD, with financial market sentiment buoyed by the Fed’s strong economic outlook, bolstering risk assets. However, there is still uncertainty on the effects of the war, but the outlook for ceasefire is improving.

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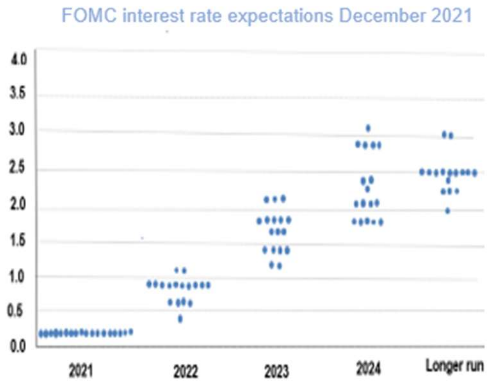

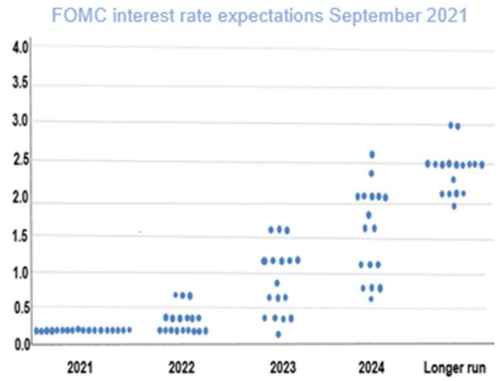

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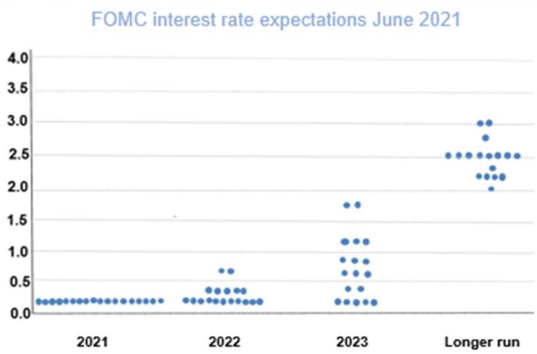

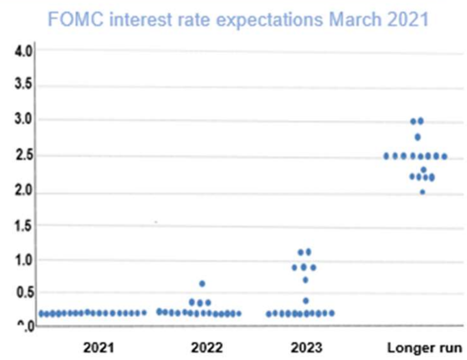

Source: FOMC, Bloomberg