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ECONOMIC NEWSLETTER

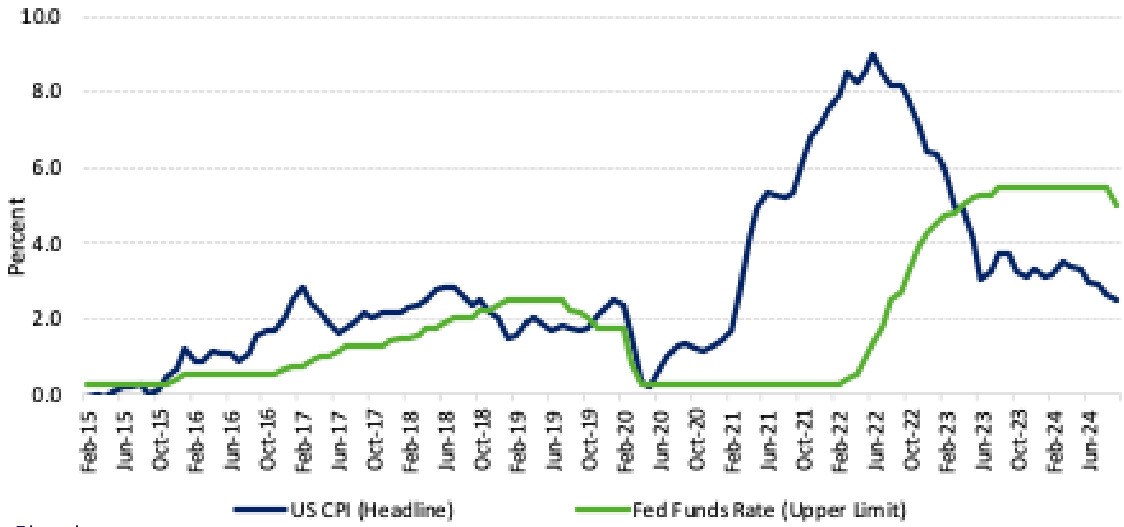
SPEKTRA FINANCIAL SERVICES

RATE CUTS RETURN AMID COOLING INFLATION

THE POWELL PIVOT

At the Federal Open Market Committee (FOMC) meeting in September 2024, the Federal Reserve (the Fed) cut interest rates by 50 basis points in the United States, marking the first time in four years that they've eased monetary policy. The decision was largely influenced by the positive progress toward the Fed's goals of maximizing employment and maintaining price stability. The interest rate reduction brings new target range for interest rates to 4.75% to 5.0%.

Figure1. US Fed Funds Rate & Headline Inflation



Source: Bloomberg

The rate cut is expected to boost economic growth and stabilize the cooling labour market. Interest rates reductions serve to increase the supply of money within the financial system, thereby encouraging businesses and individuals to spend more by making the cost of borrowing cheaper. While the recent interest rate change will impact savings accounts, certificates of deposit, and money market yields, bond markets had already anticipated a shift in policy. As a result, investors might not see significant changes in mortgage rates, which have already fallen by around 100 basis points from their peak earlier in the year. Additionally, yields on 10-year Treasury bonds have risen in recent trading sessions.

In its statement, the Fed noted that the economy continues to grow at a solid pace and reaffirmed its commitment to achieving maximum employment and keeping inflation anchored around the 2% level over the long term. However, the statement reflected some changes in tone regarding inflation and employment. The Fed expressed increased confidence that inflation is moving toward the 2% target rate, with inflation now at 2.5%—closer to the goal than before. The language describing job growth was also revised from "moderated" to "slowed," emphasizing the Fed's strong commitment to supporting employment as the labour market cools.

As a result, the Fed's focus has now shifted from primarily controlling inflation to supporting employment.

THE POWELL PIVOT (CONTINUED)

Looking ahead, Powell stressed that future rate decisions will be made on a "meeting-by-meeting" basis, guided by economic data. This cautious approach allows the Fed to evaluate ongoing economic trends and risks.

Following the Fed's announcement on September 18, U.S. stocks initially rose, with markets reaching intra-day all-time highs. However, by the close of the day, the S&P 500 had fallen 0.29%, the Dow Jones Industrial Average was down 0.25%, and the Nasdaq dropped 0.31%. In early trading on the following Thursday, markets rebounded, with S&P 500 futures up by 1.5%.

THE SARB'S FIRST RATE CUT IN OVER FOUR YEARS

Following the rate cut in the US, the South African Reserve Bank (Sarb) lowered its repo rate by 25 basis points to 8% on Thursday 20 September, marking the first rate cut since the global economic downturn caused by Covid-19 over four years ago. This decision was widely anticipated by economists and market analysts, aligning with their expectations. It is Sarb's first rate reduction since the end of the Covid-related cuts in July 2020. The reduction brings the prime lending rate down to 11.50% for South Africans, which has remained steady at 11.75% since May 2023 after consecutive hikes from November 2021.

In a series of positive economic indicators for South Africa, inflation continued to ease in August. The Consumer Price Index (CPI) showed headline inflation slowing to 4.4% year-on-year, down from 4.6% in July. This figure was slightly below economists' predictions and represents the lowest inflation rate since April 2021. The inflation reading is now below the mid-point of the target range of 3% to 6%, underscoring the SARB's effectiveness in bringing inflation back down to target.

Based on these trends, the domestic interest rate market is now pricing in another potential 25-basis-point cut in November, with the likelihood of further rate reductions growing in the medium term. Following the SARB's announcement, the 3-month and 12-month JIBAR rates dropped by 0.13% and 0.05%, respectively, to 8.1% and 8.275%. These relatively high JIBAR rates suggest that money market funds could offer an attractive real yield over the next year with minimal risk to capital.