U.S. FED- TOWARDS RESTRICTIVE MONETARY POLICY

16 JUNE 2022

ECONOMIC RESEARCH

DR. MOHD AFZANIZAM ABDUL RASHID
SHAFIZ BIN JAMALUDDIN
NOR JANNAH ABDULLAH
RAJA ADIBAH RAJA HASNAN

THE U.S. FOMC INCREASED THE FEDERAL FUND RATE (FFR) BY 75 BASIS POINTS (BPS)

BANK ISLAM

Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, June 2022

Percent

Variable	Median[1]				Central Tendency[2]				Range[3]			
	2022	2023	2024	Longer run	2022	2023	2024	Longer run	2022	2023	2024	Longer run
Change in real GDP	1.7	1.7	1.9	1.8	1.5–1.9	1.3–2.0	1.5–2.0	1.8–2.0	1.0–2.0	0.8–2.5	1.0–2.2	1.6–2.2
March projection	2.8	2.2	2.0	1.8	2.5–3.0	2.1–2.5	1.8–2.0	1.8–2.0	2.1–3.3	2.0–2.9	1.5–2.5	1.6–2.2
Unemployment rate	3.7	3.9	4.1	4.0	3.6–3.8	3.8–4.1	3.9–4.1	3.5–4.2	3.2–4.0	3.2–4.5	3.2–4.3	3.5–4.3
March projection	3.5	3.5	3.6	4.0	3.4–3.6	3.3–3.6	3.2–3.7	3.5–4.2	3.1–4.0	3.1–4.0	3.1–4.0	3.5–4.3
PCE inflation	5.2	2.6	2.2	2.0	5.0–5.3	2.4–3.0	2.0–2.5	2.0	4.8–6.2	2.3–4.0	2.0–3.0	2.0
March projection	4.3	2.7	2.3	2.0	4.1–4.7	2.3–3.0	2.1–2.4	2.0	3.7–5.5	2.2–3.5	2.0–3.0	2.0
Core PCE inflation[4]	4.3	2.7	2.3		4.2–4.5	2.5–3.2	2.1–2.5		4.1–5.0	2.5–3.5	2.0–2.8	
March projection	4.1	2.6	2.3		3.9–4.4	2.4–3.0	2.1–2.4		3.6–4.5	2.1–3.5	2.0–3.0	
Memo: Projected appropriate policy path												
Federal funds rate	3.4	3.8	3.4	2.5	3.1–3.6	3.6–4.1	2.9–3.6	2.3–2.5	3.1–3.9	2.9–4.4	2.1–4.1	2.0–3.0
March projection	1.9	2.8	2.8	2.4	1.6–2.4	2.4–3.1	2.4–3.4	2.3–2.5	1.4–3.1	2.1–3.6	2.1–3.6	2.0–3.0

Source: Federal Reserve

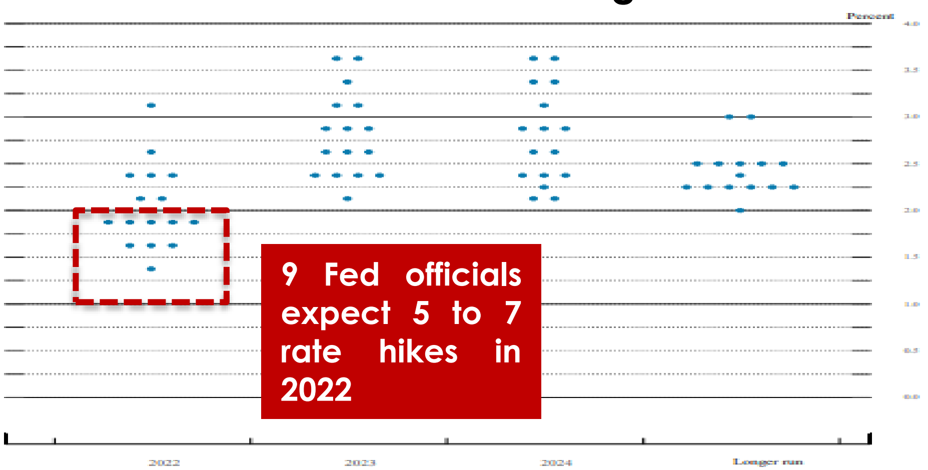
- ✓ During its meeting on 14-15 June, the U.S. Federal Open Market Committee (FOMC) **delivered the 75 bps hike in the benchmark rate to between 1.50% and 1.75%.**
- ✓ Based on the latest Summary Economic of Projections, **the Fed has cut the Gross Domestic Product (GDP) forecast to 1.7% growth for 2022 and 2023 compared to 2.8% and 2.2% projections made in March.**
- ✓ As for the inflation, it remains elevated on the back of supply and demand imbalances due to pandemic, higher energy prices, as well as broader price pressures. Hence, the Fed has upgraded its **2022 forecast for both Personal Consumption Expenditure (PCE) and Core PCE inflation to 5.2% and 4.3% respectively from previous March projection**.
- ✓ Meanwhile, the unemployment rate is anticipated to be higher at 3.7% during the year from 3.5% in March's forecast.

MORE RATE HIKES IN COMING

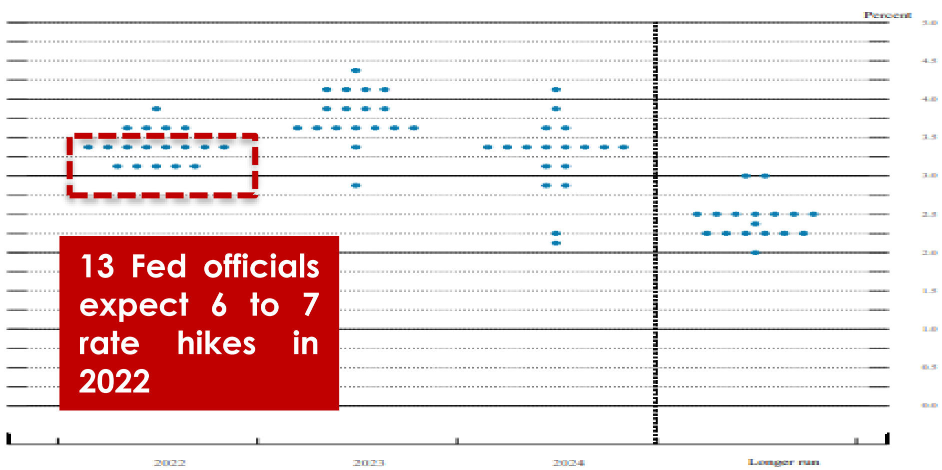
BANK ISLAM

The dot plot- the Fed uses to signal its outlook for the path of interest rates.

March FOMC Meeting



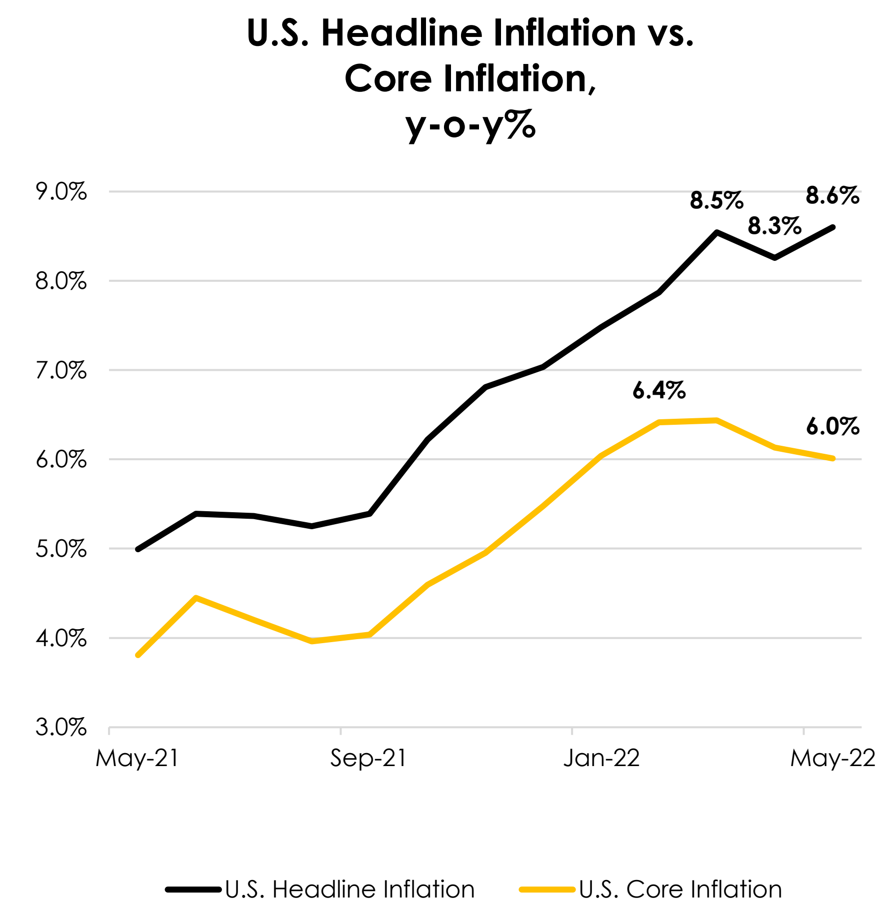
June FOMC Meeting

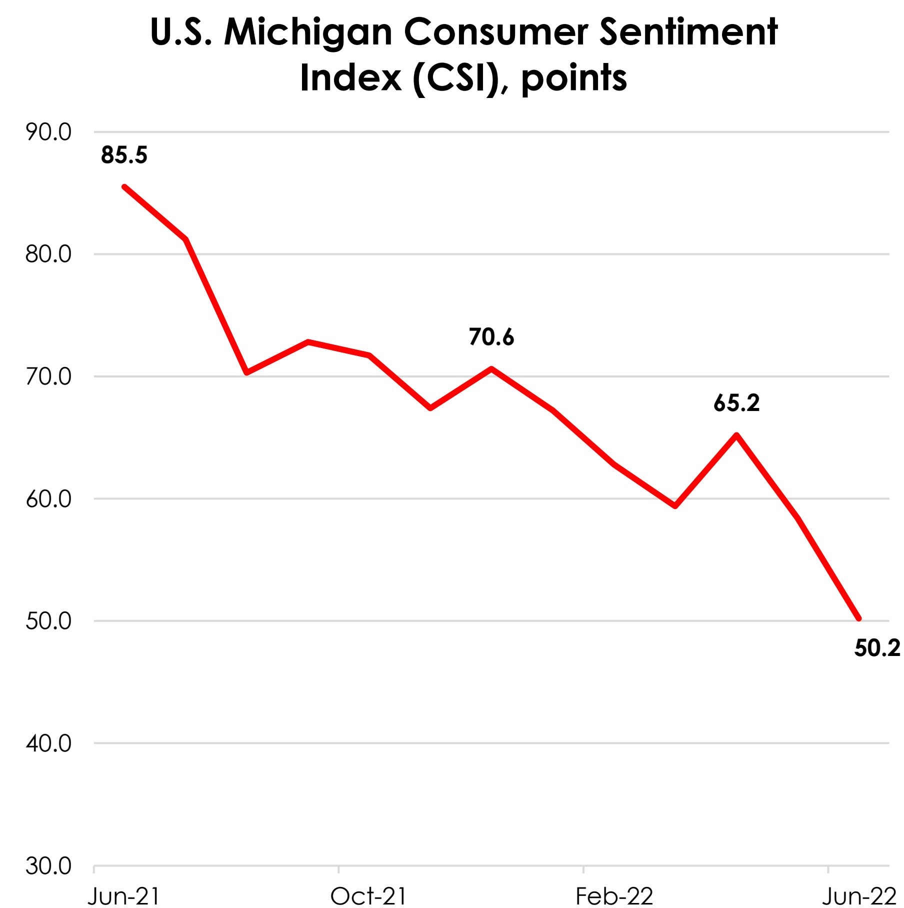


Source: The Fed

- ✓ The latest dot plot indicates that the FFR is expected to reach 3.50% by end of the year. **This could mean another 175 bps would be announced in the remainder of 2022.**
- ✓ In 2023, the FFR could reach between 3.75% and 4.00% while in 2024 it might go lower to 3.25% - 3.50%.
- ✓ Meanwhile, the **median projection of the FFR has gone up to 3.4% by the end of 2022, representing 1.5% higher than projected in March 2022 (1.9%).**
- ✓ Additionally, the median projection rises further to 3.8% at the end of next year and declines to 3.4% in 2024.
- ✓ Apart from that, the Committee is continuing the process of reducing the balance sheet size significantly which plays an important role in firming the stance of monetary policy
- ✓ As such, the Fed is pushing for a more restrictive monetary policy going forward.

THE U.S. INFLATION CONTINUED TO SOAR WHILE CONSUMER SENTIMENT HAS BECOME MORE PESSIMISTIC



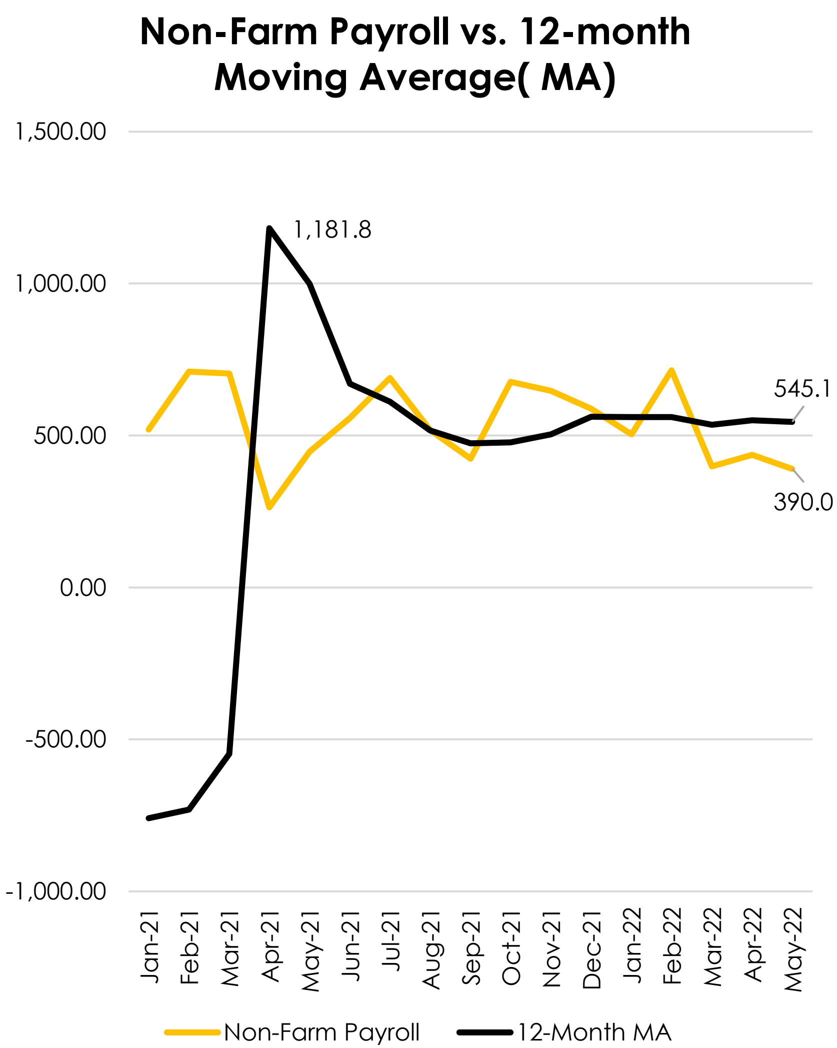


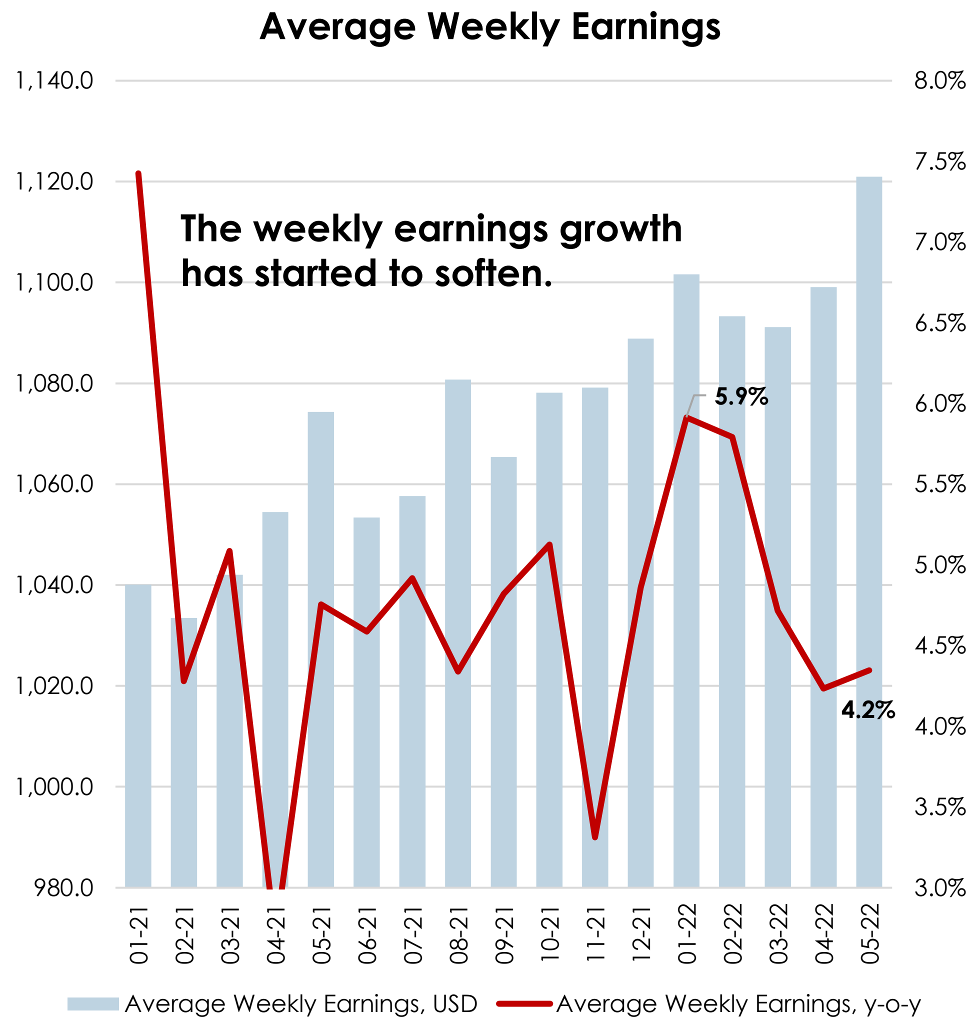
Source: CEIC

- ✓ The U.S. inflation was higher, rising by 8.6% y-o-y in May (April: 8.3%), showing no signs that it will abate as fast as expected.
- ✓ The month of June saw the worst reading of consumer sentiment which plunged to 50.2 points (May: 58.4 points), reflecting pessimism among consumers amid surging inflation in four decades.

THE LABOUR MARKET WAS REALLY TIGHT, HOWEVER IT HAS STARTED TO SHOW SIGN OF MODERATION

BANK ISLAM



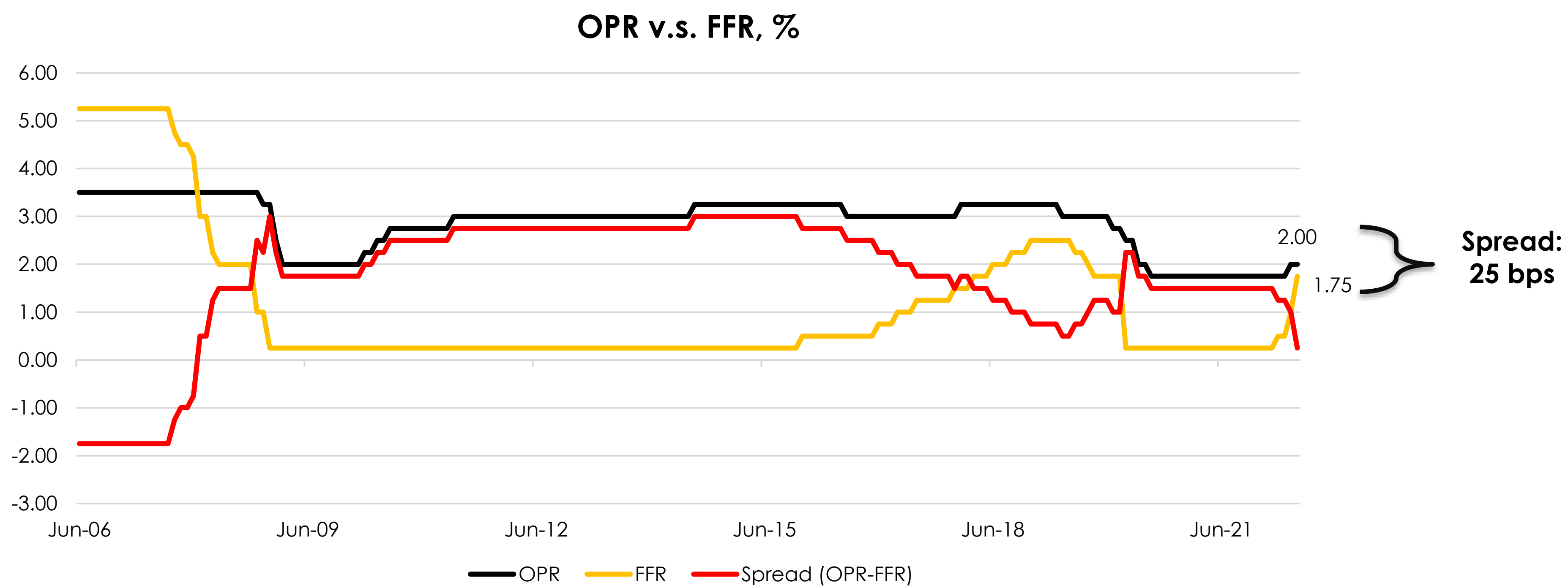


Hence, the Fed will remain cautious during their monetary tightening process.

Source: CEIC

OVERNIGHT POLICY RATE (OPR) vs. FEDERAL FUND RATE (FFR)

BANK ISLAM



Source: CEIC

- ✓ The difference between Malaysia's OPR and FFR has narrowed to 25 bps (2.00% minus 1.75%) following the hawkish stance by the Fed.
- ✓ Such aggressive rate hike was in line with committee's view that inflation continued to surprise to the upside.
- ✓ Domestically, Malaysia is quite comfortable with the prevailing economic growth trajectory though downside risks remain visible.
- ✓ The BNM is expected to place more weight on domestic economy when assessing the level of monetary policy accommodation. This would mean they would embark a gradual approach in removing the policy support as the economic activities normalise further.
- ✓ Therefore, a rate hike between 25 bps and 50 bps in OPR during the 2H2022 is very likely.

OUR VIEW- THERE IS MORE CLARITY NOW IN FED DECISION AS THEY ARE GOING TO LASER FOCUS ON INFLATION

The pace of interest rate hike would slow going forward- The median projection for 2023 and 2024 suggests that the Fed would pause their interest rate hike campaign. This should provide comfort to the market participants as the Fed is committed to bring their monetary policy stance into a restrictive zone which could lead to moderation in the inflation rate thereby meeting their dual policy goal i.e. price stability and maximum employment.

How the BNM will react?– The door for 25-50 bps rate hike in OPR is still open in the near term, depending on the development surrounding the inflationary pressures and economic growth trajectory. However, the BNM will keep a cautious approach and the OPR rate hike will be done in a gradual manner.

The Ringgit could reach RM4.28 this year- We have revised our USD/MYR forecast for year-end 2022 from RM4.15 to RM4.28. Such revision was due to aggressive tightening cycle by the Fed, as well as geopolitical uncertainties between Ukraine and Russia. Hence, this will translate into a stronger exchange rate in favour of the U.S. Dollar.

BANK ISLAM

Assuring Trust. Delivering Value.

Thank You

APPENDIX

- ✓ Overall economic activity appears to have picked up after edging down in the first quarter. Job gains have been robust in recent months, and the unemployment rate has remained low. Inflation remains elevated, reflecting supply and demand imbalances related to the pandemic, higher energy prices, and broader price pressures.
- ✓ The invasion of Ukraine by Russia is causing tremendous human and economic hardship. The invasion and related events are creating additional upward pressure on inflation and are weighing on global economic activity. In addition, COVID-related lockdowns in China are likely to exacerbate supply chain disruptions. The Committee is highly attentive to inflation risks.
- ✓ The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. In support of these goals, the Committee decided to raise the target range for the federal funds rate to 1-1/2 to 1-3/4 percent and anticipates that ongoing increases in the target range will be appropriate. In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities, as described in the Plans for Reducing the Size of the Federal Reserve's Balance Sheet that were issued in May. The Committee is strongly committed to returning inflation to its 2 percent objective.
- ✓ In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on public health, labor market conditions, inflation pressures and inflation expectations, and financial and international developments.
- ✓ Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michelle W. Bowman; Lael Brainard; James Bullard; Lisa D. Cook; Patrick Harker; Philip N. Jefferson; Loretta J. Mester; and Christopher J. Waller. Voting against this action was Esther L. George, who preferred at this meeting to raise the target range for the federal funds rate by 0.5 percentage point to 1-1/4 percent to 1-1/2 percent. Patrick Harker voted as an alternate member at this meeting.

DISCLAIMER

BANK ISLAM

Produced and issued by BANK ISLAM MALAYSIA BERHAD (Bank Islam) for private circulation only or for distribution under circumstances permitted by applicable laws. All information, opinions and estimates contained herein have been compiled or arrived at based on sources and assumptions believed to be reliable and in good faith at the time of issue of this document. This document is for information purposes only and has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. No representation or warranty, expressed or implied is made as to its adequacy, accuracy, completeness or correctness. All opinions and the content of this document are subject to change without notice and may differ or be contrary to opinions expressed by other business areas or groups of Bank Islam as a result of using different assumptions and criteria. No part of this document may be used, reproduced, distributed or published in any form or for any purpose without Bank Islam's prior written permission.