



From the Desk  
of the  
**Chief Economist**

**BANK ISLAM**

# **THE FOMC HELD INTEREST RATE NEAR ZERO**

**17 SEPTEMBER 2020**

## **ECONOMIC RESEARCH**

**DR. MOHD AFZANIZAM ABDUL RASHID  
ADAM MOHAMED RAHIM  
SHAFIZ BIN JAMALUDDIN  
NOR JANNAH ABDULLAH**

- ✓ The US Federal Reserve (Fed) decided to keep its target range for the Federal Fund Rate (FFR) between 0.00% and 0.25% at the two-day meeting ended on 16 September.
- ✓ In addition, the FFR is expected to remain at current level until the US's labour market has recovered and inflation achieves the rate of 2.00% over the long run.
- ✓ A survey of Fed officials showed the group anticipates the rate to stay through 2023, a year later than the previous survey conducted in June.
- ✓ Be that as it may, the economic has picked up its momentum from depress level caused by the Covid-19.
- ✓ Therefore, the Fed has revised its GDP forecast from -6.5% to -3.7% for 2020 and would likely to rebound to 4.0% in 2021 and 3.0% in 2022.
- ✓ As for the labour market, the unemployment rate (UR) was revised downwards to 7.6% from 9.3% for 2020, thanks to the ease in lockdown measures which allows people return to work.
- ✓ All in all, the Committee would continue to monitor the economic development in order to assess appropriate monetary policy stance.

Percent

Variable	Median <sup>1</sup>					Central Tendency <sup>2</sup>					Range <sup>3</sup>				
	2020	2021	2022	2023	Longer run	2020	2021	2022	2023	Longer run	2020	2021	2022	2023	Longer run
Change in real GDP	-3.7	1.0	3.0	2.5	1.9	-4.0--3.0	3.6-4.7	2.5-3.3	2.4-3.0	1.7-2.0	-5.5-1.0	0.0-5.5	2.0-4.5	2.0-4.0	1.6-2.2
June projection	-6.5	5.0	3.5		1.8	-7.6--5.5	4.5-6.0	3.0-4.5		1.7-2.0	-10.0--4.2	-1.0-7.0	2.0-6.0		1.6-2.2
Unemployment rate	7.6	5.5	4.6	4.0	4.1	7.0-8.0	5.0-6.2	4.0-5.0	3.5-4.4	3.9-4.3	6.5-8.0	4.0-8.0	3.5-7.5	3.5-6.0	3.5-4.7
June projection	9.3	6.5	5.5		4.1	9.0-10.0	5.9-7.5	4.8-6.1		4.0-4.3	7.0-14.0	4.5-12.0	4.0-8.0		3.5-4.7
PCE inflation	1.2	1.7	1.8	2.0	2.0	1.1-1.3	1.6-1.9	1.7-1.9	1.9-2.0	2.0	1.0-1.5	1.3-2.4	1.5-2.2	1.7-2.1	2.0
June projection	0.8	1.6	1.7		2.0	0.6-1.0	1.4-1.7	1.6-1.8		2.0	0.5-1.2	1.1-2.0	1.4-2.2		2.0
Core PCE inflation <sup>4</sup>	1.5	1.7	1.8	2.0		1.3-1.5	1.6-1.8	1.7-1.9	1.9-2.0		1.2-1.6	1.5-2.4	1.6-2.2	1.7-2.1	
June projection	1.0	1.5	1.7			0.9-1.1	1.4-1.7	1.6-1.8			0.7-1.3	1.2-2.0	1.2-2.2		
Memo: Projected appropriate policy path															
Federal funds rate	0.1	0.1	0.1	0.1	2.5	0.1	0.1	0.1	0.1-0.4	2.3-2.5	0.1	0.1	0.1-0.6	0.1-1.4	2.0-3.0
June projection	0.1	0.1	0.1		2.5	0.1	0.1	0.1		2.3-2.5	0.1	0.1	0.1-1.1		2.0-3.0

Source: US Federal Reserve

Gross Domestic Product (GDP) in the US is projected to contract by 3.7% in 2020, better than 6.5% plunge expected from the previous estimate in June.

# CENTRAL BANK POLICY RATES

Policy rates	Oct-19	Nov-19	Dec-19	Jan-20	Feb-20	Mar-20	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sept-20*
<b>Advanced countries</b>												
US (Fed Fund Rate)	1.75	1.75	1.75	1.75	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Japan (Policy Balance Rate)	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
Euro Zone (Main Refinancing Rate)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
UK (Bank Rate)	0.75	0.75	0.75	0.75	0.75	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Canada (ON Lending Rate)	1.75	1.75	1.75	1.75	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25
<b>Latin America</b>												
Mexico (ON Rate)	7.75	7.50	7.25	7.25	7.00	6.50	6.00	5.50	5.00	5.00	4.50	4.50
Brazil (Selic Rate)	5.00	5.00	4.50	4.50	4.25	3.75	3.75	3.00	2.25	2.25	2.00	2.00
Argentina (LELIQ 7D Notes Rate)	68.00	63.00	55.00	50.00	40.00	38.00	38.00	38.00	38.00	38.00	38.00	38.00
<b>Eastern Europe</b>												
Russia (Key Rate)	6.50	6.50	6.25	6.25	6.00	6.00	5.50	5.50	4.50	4.25	4.25	4.25
Ukraine (Discount Rate)	15.50	15.50	13.50	11.00	11.00	10.00	8.00	8.00	6.00	6.00	6.00	6.00
Turkey (1W Repo Rate)	14.00	14.00	12.00	11.25	10.75	9.75	8.75	8.25	8.25	8.25	8.25	8.25
<b>Asia</b>												
China (1Y Loan Prime Rate)	4.20	4.15	4.15	4.15	4.05	4.05	3.85	3.85	3.85	3.85	3.85	3.85
India (Repo Rate)	5.15	5.15	5.15	5.15	5.15	4.40	4.40	4.00	4.00	4.00	4.00	4.00
Indonesia (7D Repo Rate)	5.00	5.00	5.00	5.00	4.75	4.50	4.50	4.50	4.25	4.00	4.00	4.00
Thailand (1D Repo Rate)	1.50	1.25	1.25	1.25	1.00	0.75	0.75	0.50	0.50	0.50	0.50	0.50
South Korea (Base Rate)	1.25	1.25	1.25	1.25	1.25	0.75	0.75	0.50	0.50	0.50	0.50	0.50
Philippines (O/N Lending Rate)	4.00	4.00	4.00	4.00	3.75	3.25	2.75	2.75	2.25	2.25	2.25	2.25
Australia (Cash Rate)	0.75	0.75	0.75	0.75	0.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25
New Zealand (Cash Rate)	1.00	1.00	1.00	1.00	1.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Malaysia (OPR)	3.00	3.00	3.00	2.75	2.75	2.50	2.50	2.00	2.00	1.75	1.75	1.75

\* As at 17 September 2020

Source: Bloomberg

**Central banks have put a hold on interest rate cuts in the past two months, indicating that the expectation of economic recovery is under way barring any unforeseen circumstances from any resurgence in Covid-19 infections.**

- ✓ The labour market has improved as reflected by the UR and the number of Americans claim for unemployment benefits. The UR declined to 8.4% in August from 10.2% in the previous month, suggesting that the economy is able to create employment amid Covid-19 pandemic. As noted earlier, the Fed has lowered its projection for UR in 2020 at 7.6% from 9.3% estimate in June.
- ✓ Apart from that, business sentiments in the US continued to enhance in August. According to the IHS Markit, the US Manufacturing PMI increased to 53.1 points in August from 50.9 points previously. Similarly, Services PMI up notably from 50.0 points in July to 55.0 points in August due to greater client demand and further reopening of businesses.
- ✓ Be that as it may, temporary extra jobless benefits are running out and the political stalemate over a new round of stimulus threatens to set back the economy. Uncertainty could hang over government policies at least until the outcome of the presidential and congressional elections is clear. Republicans including President Donald Trump, who trails challenger Joe Biden in national polls have proposed a smaller package of aid than Democrats have.
- ✓ All in all, the Fed is expected to keep the interest rate near zero for a long period of time at least until 2023 (as shown in Fed's dot plot of funds rate projections in page 3) in order to support the recovery process.
- ✓ On the domestic front, BNM would be inclined to follow their US counterparts by keeping OPR unchanged at 1.75% until 2021, barring any unforeseen circumstances from the pandemic.

- ✓ The Treasury yield curve steepened slightly on Wednesday after the Federal Reserve signalled it will keep rates near zero for at least three years and as investors digested Chair Jerome Powell's remarks on the central bank's plans for further bond purchases.
- ✓ 10-year and 30-year US Treasury yields briefly spiked to session highs of 0.70% and 1.46%, respectively, during a press conference Powell held after the central bank's latest policy decision. That caused the spread between 2-year and 10-year yields, along with the gap between 5-year and 30-year yields, to widen slightly.
- ✓ Turning to the US equity market, the market took another step higher to session highs after Fed Chair Jerome Powell said that the central bank would keep its target interest rate steady until inflation was on track to exceed the 2.0% target for a period of time. The Dow was trading above 350 points after the comments before logging in a 0.1% gain at 28,032.38 points on Wednesday.

## Changes in US Treasury Yields on 16 September 2020

US Treasury	Change in Yields (basis points) on 16 September 2020
3-Year	0.00
5-Year	+0.96
7-Year	+1.59
10-Year	+1.80
30-Year	+2.80

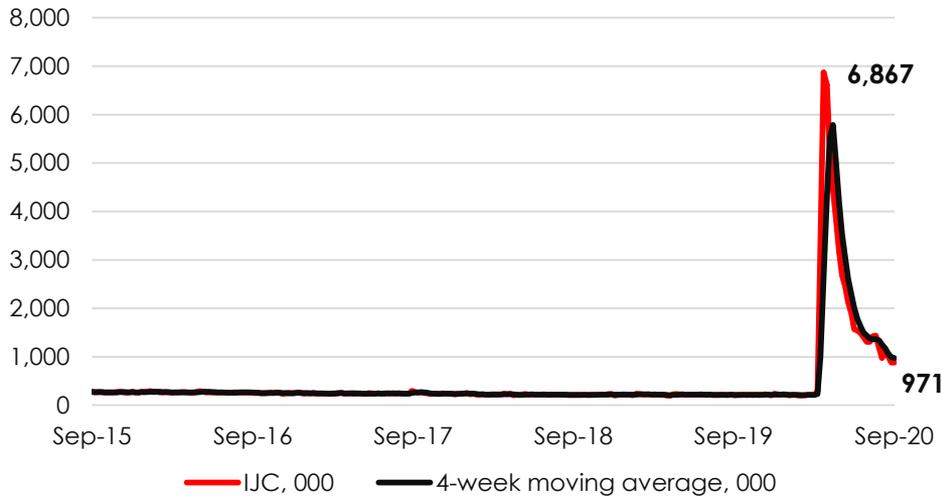
Source: Bloomberg

## Performance of US Stock Market on 16 September 2020

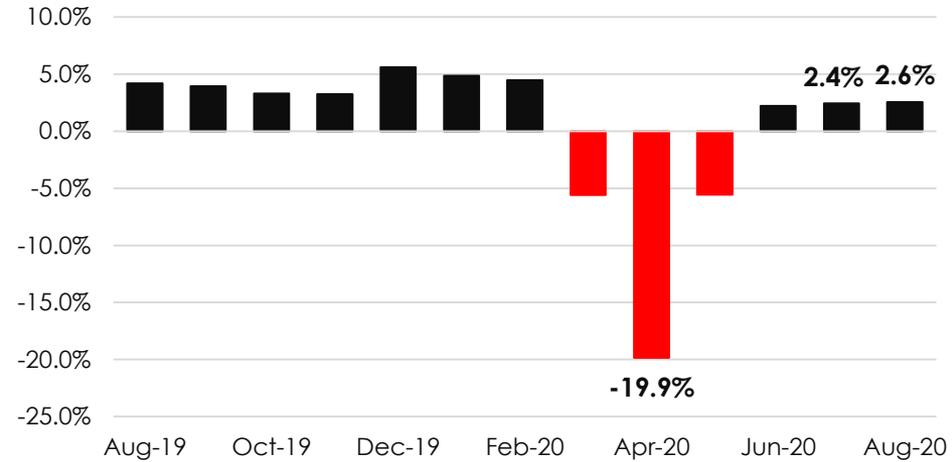
Index	Gain/Loss on 16 September 2020
Dow Jones	0.1%
S&P 500	-0.5%
Nasdaq	-1.2%

Source: Bloomberg

### US Initial Jobless Claims (IJC), 000



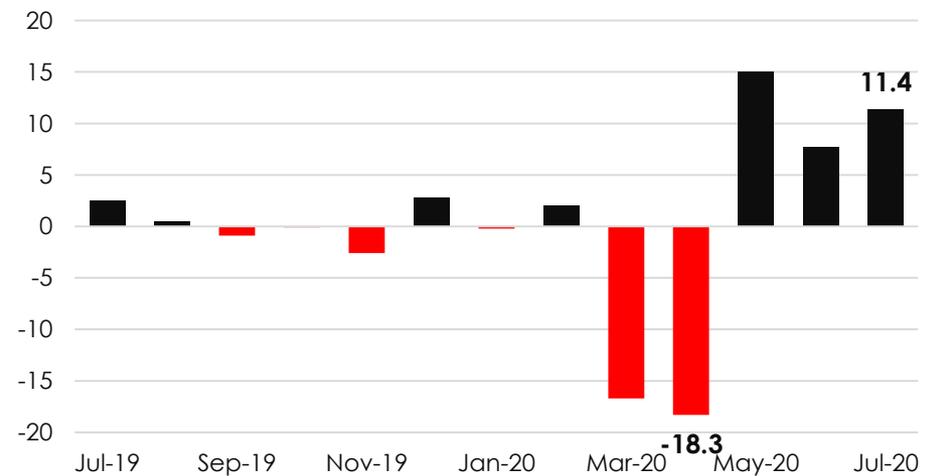
### Retail Sales & Food Services, y-o-y%



### US Unemployment Rate, %



### Durable Goods Orders, m-o-m%



Sources: CEIC, Bloomberg

# MANUFACTURING SECTOR HAS IMPROVED

Index	Series Index August	Series Index July	Percentage Point Change	Direction	Rate of Change	Trend (Months)
PMI	56.0	54.2	1.8	Growing	Faster	3
New Orders	67.6	61.5	6.1	Growing	Faster	3
Production	63.3	62.1	1.2	Growing	Faster	3
Employment	46.4	44.3	2.1	Contracting	Slower	13
Supplier Deliveries	58.2	55.8	2.4	Slowing	Faster	10
Inventories	44.4	47	-2.6	Contracting	Faster	2
Customers' Inventories	38.1	41.6	-3.5	Too Low	Faster	47
Prices	59.5	53.2	6.3	Increasing	Faster	3
Backlog of Orders	54.6	51.8	2.8	Growing	Faster	2
New Export Orders	53.3	50.4	2.9	Growing	Faster	2
Imports	55.6	53.1	2.5	Growing	Faster	2
<b>OVERALL ECONOMY</b>				Growing	Faster	4
<b>Manufacturing Sector</b>				Growing	Faster	3

US ISM Manufacturing PMI, points



- ✓ The US Institute for Supply Management (ISM) Manufacturing Purchasing Manger's Index (PMI) **increased to 56.0 points in August** from 54.2 points in the previous month.
- ✓ This was the **highest figure recorded since November 2018 at 58.8 points**, suggesting a continued rebuilding of manufacturing sector activities amid Covid-19 pandemic globally.
- ✓ The growth was mainly **supported by the strong expansion in New Orders** (August: 67.6 points vs. July: 61.5 points) and **Production** (August: 63.3 points vs. July: 62.1 points) indexes during August.

Sources: Bloomberg, US ISM

Business Sector	Outlook on Business Activities
<b>Computer &amp; Electronic Products</b>	Lines of supply no longer impacted by Covid-19 related events.
<b>Chemical Products</b>	Business is very good. Production cannot keep up with demand.
<b>Wood Products</b>	Homebuilder business continues to be robust, with month-over-month gains continuing since May. Business remains favorable and will only be held back by supply issues across the entire industry.
<b>Electrical Equipment, Appliances &amp; Components</b>	Strong demand from existing and new customers, stable-to-decreasing input costs for operations, and record numbers of new business opportunities from prospective customers' reshoring measures.
<b>Fabricated Metal Products</b>	Current sales to domestic markets are substantially stronger than forecasted. Retail and trade customer markets are very strong and driving shortages in raw material suppliers, increasing supplier orders.
<b>Plastics &amp; Rubber Products</b>	Looking to add a few factory operators.

Source: US ISM

# THANK YOU

Bank Islam ensures that social and environmental considerations are consistently its top priority governed by the Bank's core values and Shariah principles. More initiatives will be developed by the Bank as the Bank strives to make a positive difference for its financial and social performance.

Assuring Trust. Delivering Value

# APPENDIX

- ✓ The Federal Reserve is committed to using its full range of tools to support the U.S. economy in this challenging time, thereby promoting its maximum employment and price stability goals.
- ✓ The COVID-19 pandemic is causing tremendous human and economic hardship across the United States and around the world. Economic activity and employment have picked up in recent months but remain well below their levels at the beginning of the year. Weaker demand and significantly lower oil prices are holding down consumer price inflation. Overall financial conditions have improved in recent months, in part reflecting policy measures to support the economy and the flow of credit to U.S. households and businesses.
- ✓ The path of the economy will depend significantly on the course of the virus. The ongoing public health crisis will continue to weigh on economic activity, employment, and inflation in the near term, and poses considerable risks to the economic outlook over the medium term.
- ✓ The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. With inflation running persistently below this longer-run goal, the Committee will aim to achieve inflation moderately above 2 percent for some time so that inflation averages 2 percent over time and longer-term inflation expectations remain well anchored at 2 percent. The Committee expects to maintain an accommodative stance of monetary policy until these outcomes are achieved. The Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent and expects it will be appropriate to maintain this target range until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time. In addition, over coming months the Federal Reserve will increase its holdings of Treasury securities and agency mortgage-backed securities at least at the current pace to sustain smooth market functioning and help foster accommodative financial conditions, thereby supporting the flow of credit to households and businesses.
- ✓ 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; Richard H. Clarida; Patrick Harker; Loretta J. Mester; and Randal K. Quarles.
- ✓ Voting against the action were Robert S. Kaplan, who expects that it will be appropriate to maintain the current target range until the Committee is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals as articulated in its new policy strategy statement, but prefers that the Committee retain greater policy rate flexibility beyond that point; and Neel Kashkari, who prefers that the Committee indicate that it expects to maintain the current target range until core inflation has reached 2 percent on a sustained basis.