From the Desk of the Chief Economist

BANK ISLAM

THE FED DOUBLES PACE OF TAPERING

16 DECEMBER 2021

ECONOMIC RESEARCH

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

THE FOMC MAINTAINED FFR TARGET RANGE OF 0.00%-0.25%

The Federal Open Market Committee (FOMC) **decided to keep the Federal Fund Rate (FFR) range near zero** following its 14-15 December meeting. The committee doubled the pace of tapering, **reducing by USD20.0 billion for Treasury securities and USD10.0 billion for agency mortgage-backed securities (MBS).**

- ✓ The U.S. economic activities and employment continued to strengthen backed by strong policy support, together with progress on vaccinations. As such, sectors that have been affected by the Covid-19 crisis are now showing some improvement though the impacts from the pandemic are still unfolding.
- ✓ The Federal Reserve (Fed) mentioned that the path of economy would depend on the development of Covid-19 infections. However, the vaccination progress and an easing of supply constraints are expected to support economic activities moving forward.

Percent

Variable	Median[1]					Central Tendency[2]					Range[3]				
	2021	2022	2023	2024	Longer run	2021	2022	2023	2024	Longer run	2021	2022	2023	2024	Longer run
Change in real GDP	5.5	4.0	2.2	2.0	1.8	5.5	3.6–4.5	2.0–2.5	1.8–2.0	1.8–2.0	5.3–5.8	3.2–4.6	1.8–2.8	1.7–2.3	1.6–2.2
September projection	5.9	3.8	2.5	2.0	1.8	5.8–6.0	3.4–4.5	2.2–2.5	2.0–2.2	1.8–2.0	5.5–6.3	3.1–4.9	1.8–3.0	1.8–2.5	1.6–2.2
Unemployment rate	4.3	3.5	3.5	3.5	4.0	4.2–4.3	3.4–3.7	3.2–3.6	3.2–3.7	3.8–4.2	4.0–4.4	3.0–4.0	2.8–4.0	3.1–4.0	3.5–4.3
September projection	4.8	3.8	3.5	3.5	4.0	4.6–4.8	3.6–4.0	3.3–3.7	3.3–3.6	3.8–4.3	4.5–5.1	3.0–4.0	2.8–4.0	3.0–4.0	3.5–4.5
PCE inflation	5.3	2.6	2.3	2.1	2.0	5.3–5.4	2.2–3.0	2.1–2.5	2.0–2.2	2.0	5.3–5.5	2.0–3.2	2.0–2.5	2.0–2.2	2.0
September projection	4.2	2.2	2.2	2.1	2.0	4.0–4.3	2.0–2.5	2.0–2.3	2.0–2.2	2.0	3.4–4.4	1.7–3.0	1.9–2.4	2.0–2.3	2.0
Core PCE inflation[4]	4.4	2.7	2.3	2.1		4.4	2.5–3.0	2.1–2.4	2.0–2.2		4.4–4.5	2.4–3.2	2.0–2.5	2.0–2.3	
September projection	3.7	2.3	2.2	2.1		3.6–3.8	2.0–2.5	2.0–2.3	2.0–2.2		3.5–4.2	1.9–2.8	2.0–2.3	2.0–2.4	
Memo: Projected appropriate policy path															
Federal funds rate	0.1	0.9	1.6	2.1	2.5	0.1	0.6–0.9	1.4–1.9	1.9–2.9	2.3–2.5	0.1	0.4–1.1	1.1–2.1	1.9–3.1	2.0–3.0
September projection	0.1	0.3	1.0	1.8	2.5	0.1	0.1–0.4	0.4–1.1	0.9–2.1	2.3–2.5	0.1	0.1–0.6	0.1–1.6	0.6–2.6	2.0–3.0

Source: Federal Reserve

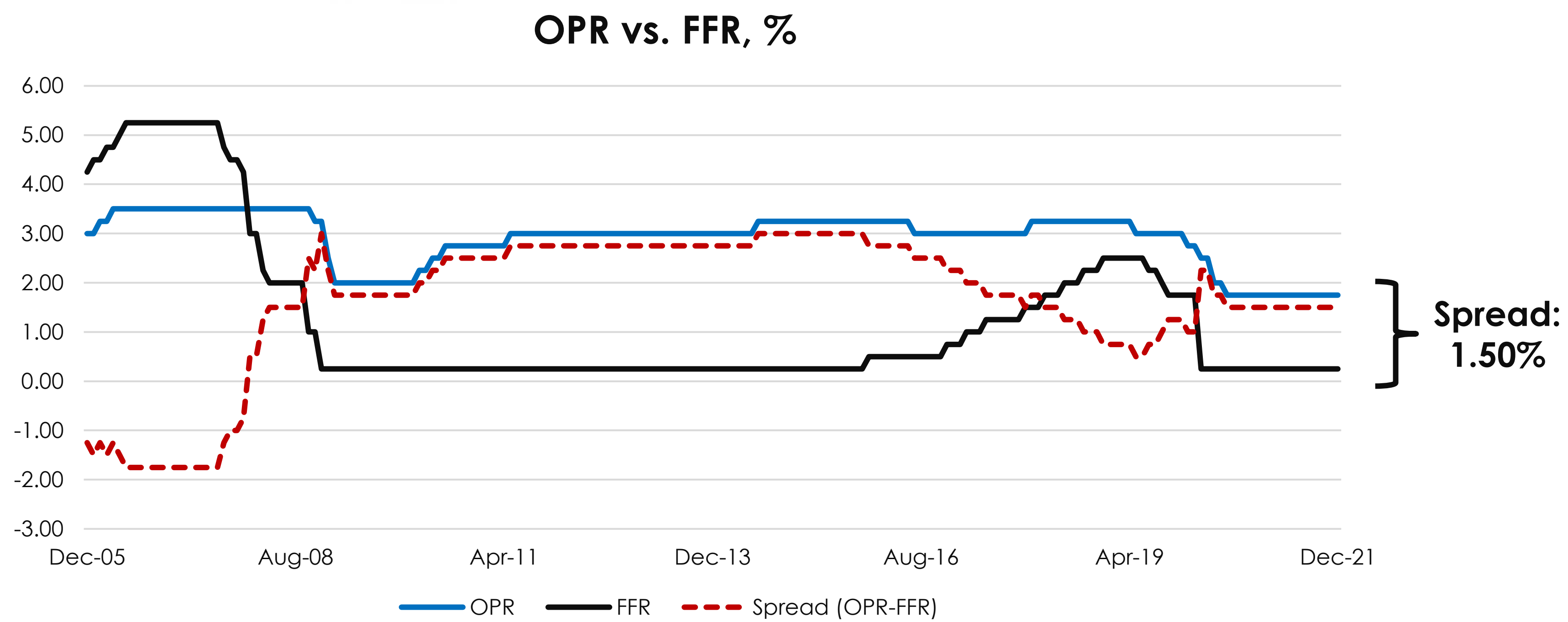
- ✓ According to the latest Summary of Economic Projections, the Fed is anticipating that the U.S. economy would grow by 5.5% this year, a slightly lower compared to an estimate of 5.9% expansion made in June as risks to economic outlook persist, including from the new variants.

THE FOMC MAINTAINED FFR TARGET RANGE OF 0.00%-0.25% (CONT'D)

BANK ISLAM

- ✓ Meanwhile, the inflationary pressure remains elevated due to supply and demand imbalances in light of the pandemic, as well as reopening of the economy which have caused a significant increase in costs.
- ✓ The Fed is of the view that it will be appropriate to maintain the FFR at current target range of 0.00%-0.25% until labor market conditions have reached levels consistent with the Committee's assessment of maximum employment and inflation at the rate of 2.0% over the longer run.
- ✓ Notwithstanding that, due to the current development of inflation and further improvement in the U.S. labour market, the Committee decided to reduce the purchases of Treasury securities by USD20 billion to USD60.0 billion per month and MBS by USD10.0 billion to USD30.0 billion per month respectively.
- ✓ Amid gradual changing of the central bank policy, quicker rate hikes is expected next year. Judging from the Fed's so-called dot plot, which the Fed uses to signal its outlook for the path of interest rates, it continues to show changes in tone pertaining to the target level of the FFR in 2022 and 2023.
- ✓ For instance, the dot plot for the December 2021 FOMC meeting showed that all Fed officials are expecting higher interest rates in 2022 (compared to 9 and 7 Fed officials during the September and June 2021 FOMC meeting respectively).
- ✓ Therefore, expectations among policy makers about a rate hike early next year is building up with more businesses are preparing to embrace the impact from the pandemic.
- ✓ All in all, the Committee will continue to monitor the implications of incoming information for the economic outlook. The FOMC members 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.

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



Source: CEIC

- ✓ At the current juncture, the difference between Malaysia's OPR and FFR remains at 150 basis points (bps) (1.75% minus 0.25%).
- ✓ This suggests that Bank Negara Malaysia (BNM) still has room for a possible OPR reduction if such decision lies solely on the interest rate differentials with the FFR.
- ✓ However, the expansionary fiscal policy alongside with robust external demand would mean BNM can afford to keep the OPR steady at 1.75% until 1H2022.
- ✓ Apart from that, the demand-pulled inflation amid reopening of economy and higher vaccination rate in Malaysia could necessitate the BNM to raise the OPR in order to anchor the inflation expectation.

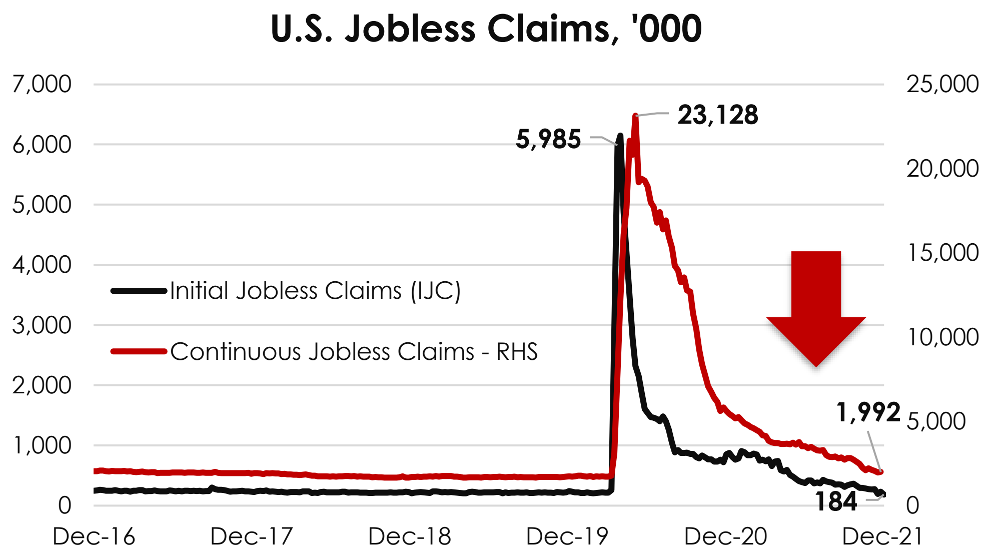
CENTRAL BANK POLICY RATES

Policy rates	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21*
Advanced countries												
US (Fed Fund Rate)	0.25	0.25	0.25	0.25	0.25	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)	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Canada (ON Lending Rate)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Latin America												
Mexico (ON Rate)	4.25	4.00	4.00	4.00	4.00	4.25	4.25	4.50	4.75	4.75	5.00	5.00
Brazil (Selic Rate)	2.00	2.00	2.75	2.75	3.50	4.25	4.25	5.25	6.25	7.75	7.75	9.25
Argentina (LELIQ 7D Notes Rate)	38.00	38.00	38.00	38.00	38.00	38.00	38.00	38.00	38.00	38.00	38.00	38.00
Eastern Europe												
Russia (Key Rate)	4.25	4.25	4.50	5.00	5.00	5.50	6.50	6.50	6.75	7.50	7.50	7.50
Ukraine (Discount Rate)	6.00	6.00	6.50	7.50	7.50	7.50	8.00	8.00	8.50	8.50	8.50	9.00
Turkey (1W Repo Rate)	17.00	17.00	19.00	19.00	19.00	19.00	19.00	19.00	18.00	16.00	15.00	15.00
Asia												
China (1Y Loan Prime Rate)	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85
India (Repo Rate)	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
Indonesia (7D Repo Rate)	3.75	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50
Thailand (1D Repo Rate)	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
South Korea (Base Rate)	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	0.75	0.75	1.00	1.00
Philippines (O/N Lending Rate)	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Australia (Cash 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
New Zealand (Cash Rate)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	0.75
Malaysia (OPR)	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75

Source: Bloomberg
*As at 16 December 2021

- ✓ In effort to contain inflationary pressure, we have seen few central banks continue to increase their benchmark interest rate in December. For instance, the Central Bank of Brazil decided to raise its Selic Rate by 150 bps to 9.25% on 8 December and signaled another such hike in the next policy meeting in February 2022. Thus far, the central bank has increased the interest rate seven times this year, making its current tightening cycle the most aggressive globally.
- ✓ In a similar move, the National Bank of Ukraine rose its policy rate by 50 bps to 9.00% on 9 December. It has raised the rate five times this year amid higher inflation rate. To date, the inflation rate surged more than 10.0% y-o-y (November 2021: 10.3% vs. January 2021: 6.1%), the highest level since 2018 and more than double compared to the central bank's target range of about 5.0%.

LABOUR MARKET IS IMPROVING



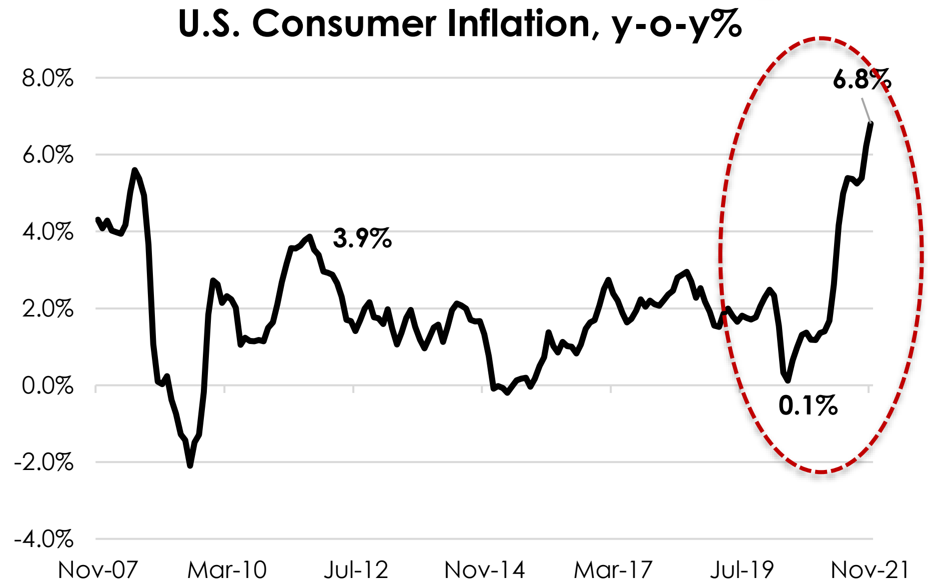
Source: CEIC

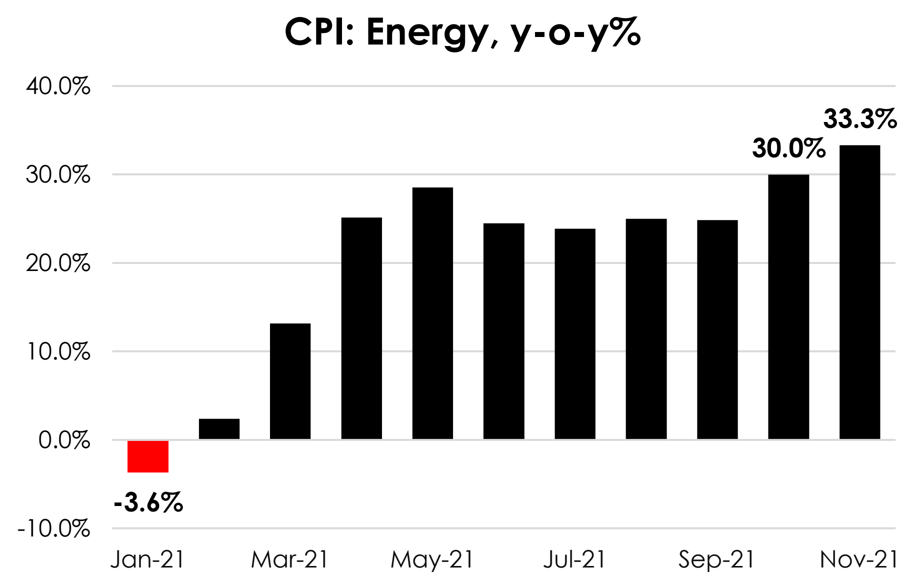
- ✓ The number of Americans filing new claims for unemployment benefit declined by 43k to 184k in the week ending 4 December (27 November: 227k). The latest figure was the lowest since September 1969, suggesting a robust recovery of the U.S labour market conditions.
- ✓ Apart from that, unemployment rate dropped to 4.2% in November (October: 4.6%), the lowest since February last year, indicating that the U.S job market is recuperating from last year's coronavirus recession.
- ✓ Meanwhile, the U.S. economy added 210k number of jobs in November, lower as compared to 546k number of jobs offered in the preceding month as employers continue to report difficulties in hiring and retaining workers amid a strong economic recovery.
- ✓ All in all, labour market is gaining its momentum with shrinking of unemployment rolls indicates that more people are expected to return to the labour force.

THE U.S. INFLATION SURGED BY 6.8% IN NOVEMBER 2021, THE HIGHEST SINCE 1982

BANK ISLAM

- ✓ The U.S. Consumer Price Index (CPI) accelerated by 6.8% y-o-y in November (October: 6.2%), marking the ninth consecutive month that the inflation stays above the Fed's 2.0% target.
- ✓ The significant increase was driven by global commodities rally which has caused the price of energy to soar by 33.3% in November (October: 30.0%).
- ✓ Furthermore, inflationary pressure was seen in price of essentials items such as food & beverages and transports, rising by 5.8% (October: 5.1%) and 21.1% (October: 18.7%) in November.
- ✓ Additionally, supply-demand imbalances due to pent-up demand, as well as prolong supply chain disruptions have pushed up the price higher.
- ✓ Meanwhile, the discovery of new variant of Omicron could further stretch the ongoing global supply shortages as some of the countries have re-imposed restriction measures.
- ✓ These would pose a risk for individuals and families, particularly those with limited means to absorb higher cost for essentials products.
- ✓ Following this, the Fed is anticipated to raise the interest rate sooner than expected.





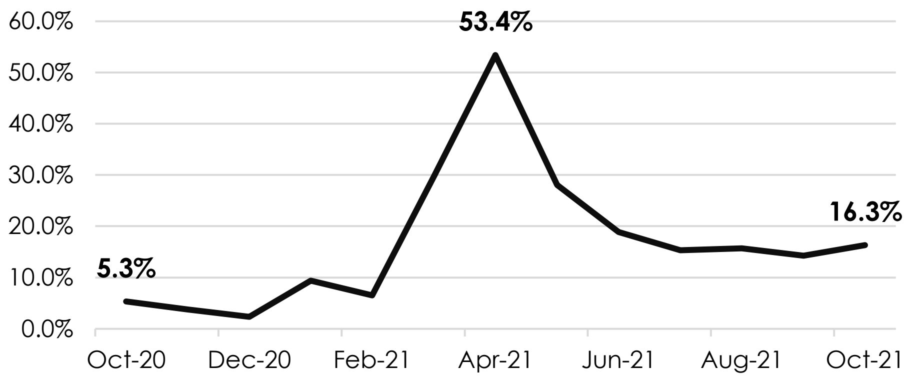
Source: CEIC

- ✓ **Strong consumer spending continues to be seen in the U.S.** – Retail and food services in the U.S. grew by 16.3% y-o-y in October (September: 14.3%) marking eighth consecutive months of double-digit growth as citizens in the U.S. have learnt to live with the virus.

- ✓ **More people flock to retail and recreational sites** – Apart from that, the movement of people at retail and recreational sites in the U.S. have improved tremendously from the start of 2021 based on the Google Mobility trends. The number of visits to the retail and recreational sites only dropped by 9.0% on 10 December 2021 compared to the baseline. This is an improvement considering the 47.0% drop seen on 1 January 2021. As such, this is in line with the robust growth seen the U.S. retail and food services mentioned above.

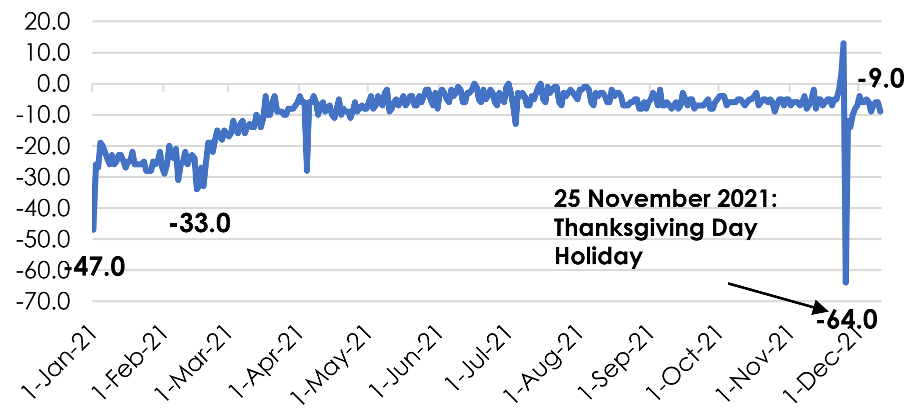
- ✓ **The faster tapering of asset purchases will prepare the Fed to get ready for a rate hike when the time comes** – In the meantime, the Fed's stance on reducing its monthly asset purchases first seems appropriate as personal savings as a percentage of disposable personal income in the U.S. has recently showed a downtrend from 26.6% in March this year to 7.3% in October (September: 8.2%), indicating stronger spending by individuals. Therefore, the Fed's move to speed up tapering would enable the Fed to react swiftly when conditions are ripe for a rate hike.

U.S. Retail & Food Services Growth, y-o-y%



Source: CEIC

Google Mobility Trends for the U.S. at retail and recreational places, % change from the baseline



Source: Google Mobility Report as at 10 December 2021

Note: The chart above shows the change in movements of people at retail and recreational sites compared to the baseline (pre-pandemic period). A positive change from the baseline indicate more people are at a location than the pre-pandemic period. Meanwhile, a negative change from the baseline indicates that more people are staying away from a particular place compared to pre-pandemic periods.

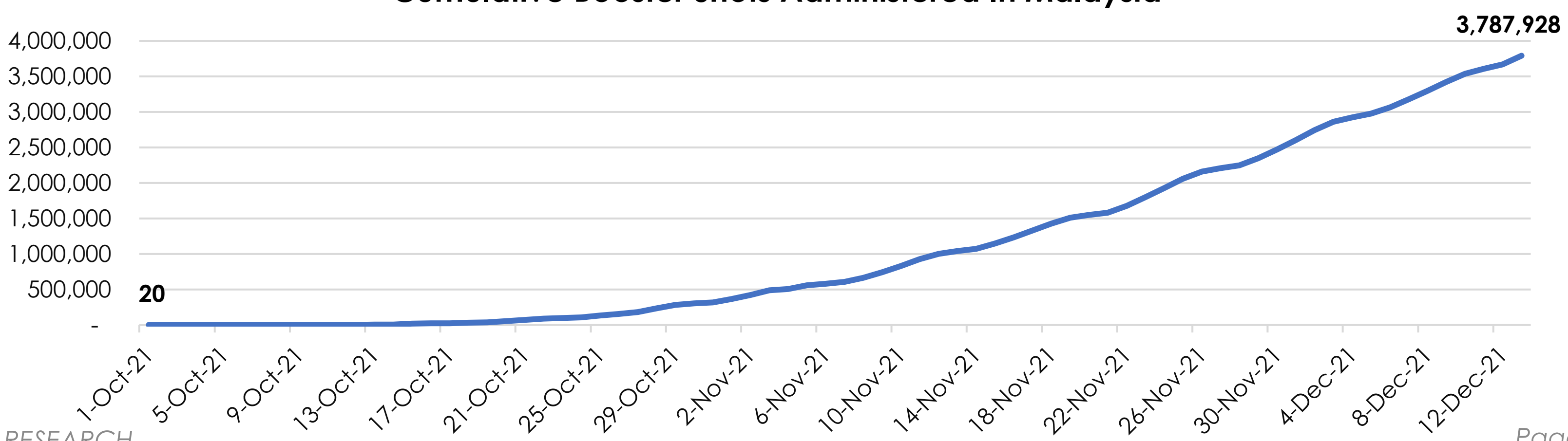
OUR VIEW (CONT'D)

✓ **The Omicron variant is an impending risk towards the path of monetary policy normalization** – Notwithstanding this, threat from the Omicron variant remain a downside risk towards the timing of a rate hike by the Fed. According to a U.S. report published on 10 December, 34 of the 43 Covid-19 cases caused by the Omicron variant identified in the U.S. at that point of time were in people who were fully vaccinated while 14 of them had received a booster dose. So far, California and New York have reinstated indoor mask mandates amid Omicron concerns but a reimposition of lockdown related measures if the situation worsens may dampen economic growth in the U.S.

✓ **Malaysia has only recorded one Omicron related case so far -** On domestic front, Malaysia registered a total of 298 new Covid-19 Variants of Concern (VOC) cases reported between 19 November and 8 December this year. Of the cumulative VOC cases, 4,722 cases were Delta, 233 were Beta, 14 were Alpha and one under Omicron. Meanwhile, booster shots which began in October have also progressed well, from just 20 booster shots on 1 October to 3.9 million booster shots as at 14 December. In a nutshell, the situation regarding Omicron is still too early to determine its severity.

✓ **BNM to hinge monetary policy decision based on available data points** – While the timeline for the Fed to raise policy rate is used as a benchmark by other central banks, the BNM will continue to utilise its policy levers based on prevailing data points. Our base case scenario as of now is that BNM will likely raise the OPR in 2H2022 with July 2022 being the earliest time to do so. However, if a prudent approach is warranted in light of the threat of the Omicron, the timing for a rate hike could take place later towards end of 2022 depending on the overall economic condition.

Cumulative Booster Shots Administered In Malaysia



Source: Covid-19 Now website


BANK ISLAM
Assuring Trust. Delivering Value.
Thank You

APPENDIX

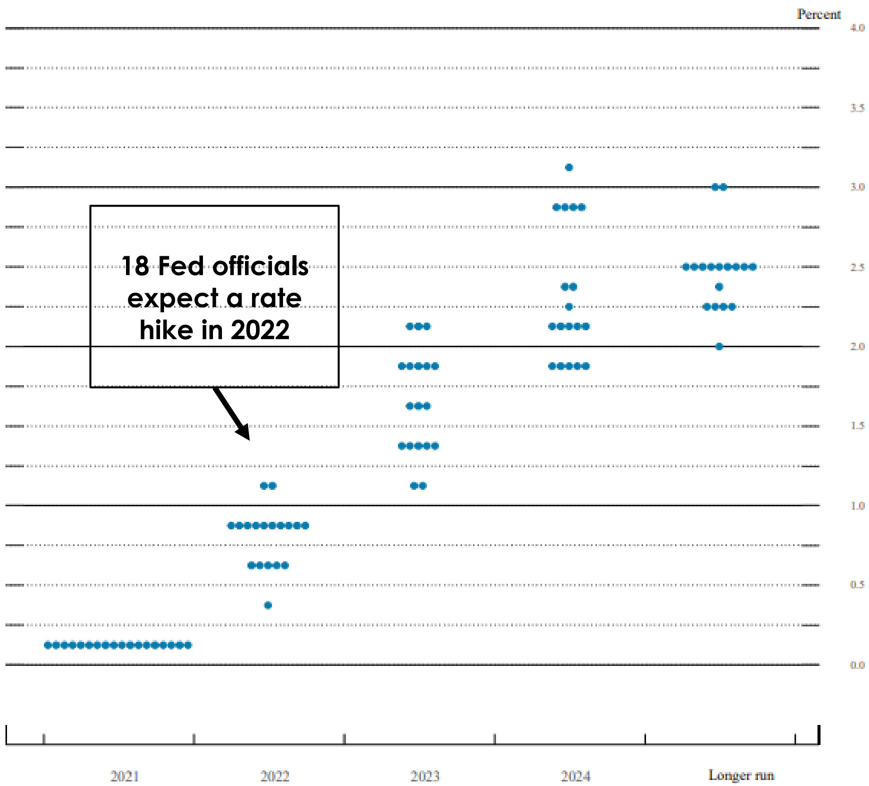
FOMC STATEMENT

BANK ISLAM

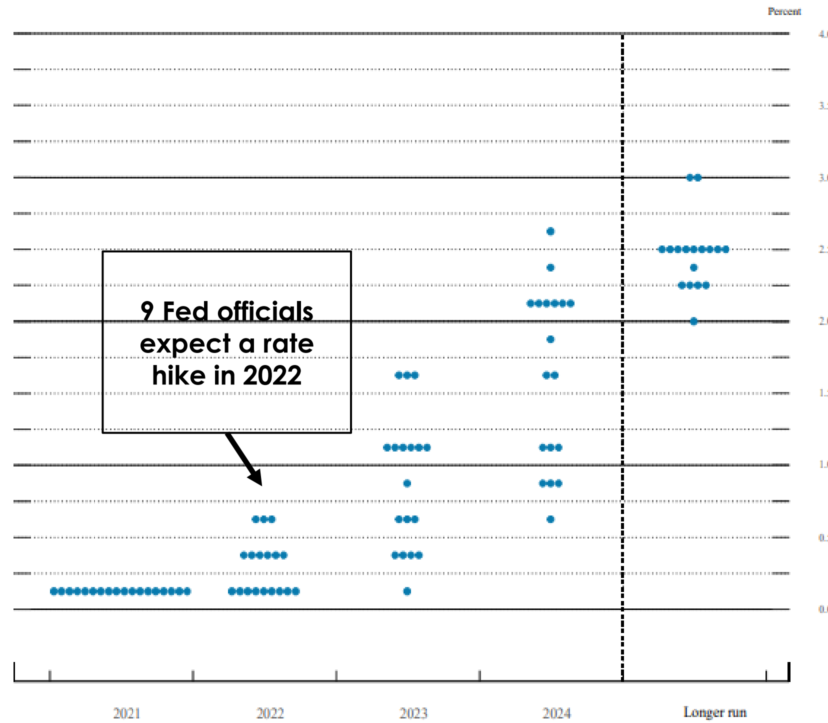
- ✓ The Federal Reserve is committed to using its full range of tools to support the U.S. economy in this challenging time, thereby promoting its maximum employment and price stability goals.
- ✓ With progress on vaccinations and strong policy support, indicators of economic activity and employment have continued to strengthen. The sectors most adversely affected by the pandemic have improved in recent months but continue to be affected by COVID-19. Job gains have been solid in recent months, and the unemployment rate has declined substantially. Supply and demand imbalances related to the pandemic and the reopening of the economy have continued to contribute to elevated levels of inflation. Overall financial conditions remain accommodative, 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 continues to depend on the course of the virus. Progress on vaccinations and an easing of supply constraints are expected to support continued gains in economic activity and employment as well as a reduction in inflation. Risks to the economic outlook remain, including from new variants of the virus.
- ✓ 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 keep the target range for the federal funds rate at 0 to 1/4 percent. With inflation having exceeded 2 percent for some time, the Committee 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. In light of inflation developments and the further improvement in the labor market, the (more) For release at 2 p.m. EST December 15, 2021 -2- Committee decided to reduce the monthly pace of its net asset purchases by $20 billion for Treasury securities and $10 billion for agency mortgage-backed securities. Beginning in January, the Committee will increase its holdings of Treasury securities by at least $40 billion per month and of agency mortgage-backed securities by at least $20 billion per month. The Committee judges that similar reductions in the pace of net asset purchases will likely be appropriate each month, but it is prepared to adjust the pace of purchases if warranted by changes in the economic outlook. The Federal Reserve's ongoing purchases and holdings of securities will continue to foster smooth market functioning and 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; Thomas I. Barkin; Raphael W. Bostic; Michelle W. Bowman; Lael Brainard; Richard H. Clarida; Mary C. Daly; Charles L. Evans; Randal K. Quarles; and Christopher J. Waller.

THE FED'S DOT PLOTS

December 2021 FOMC Meeting:



September 2021 FOMC Meeting:



Source: The US Federal Reserve Summary Of Economic Projections

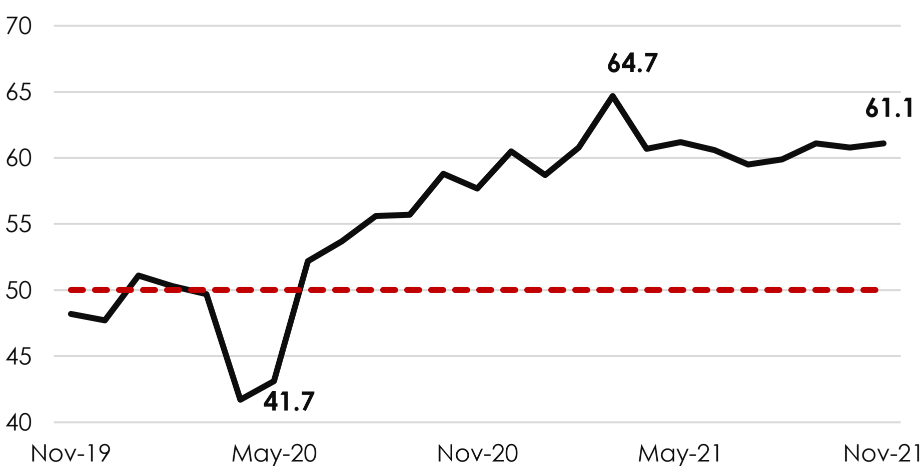
MANUFACTURING SECTOR – 18 CONSECUTIVE MONTHS OF EXPANSION

BANK ISLAM

Index	Series Index November 2021	Series Index October 2021	Percentage Point Change	Direction	Rate of Change	Trend (Months)
PMI	61.1	60.8	0.3	Growing	Faster	18
New Orders	61.5	59.8	1.7	Growing	Faster	18
Production	61.5	59.3	2.2	Growing	Faster	18
Employment	53.3	52.0	1.3	Growing	Faster	3
Supplier Deliveries	72.2	75.6	-3.4	Slowing	Slower	69
Inventories	56.8	57.0	-0.2	Growing	Slower	4
Customers' Inventories	25.1	31.7	-6.6	Too Low	Faster	62
Prices	82.4	85.7	-3.3	Increasing	Slower	18
Backlog of Orders	61.9	63.6	-1.7	Growing	Slower	17
New Export Orders	54.0	54.6	-0.6	Growing	Slower	17
Imports	52.6	49.1	3.5	Growing	From Contracting	1
OVERALL ECONOMY				Growing	Faster	18
Manufacturing Sector				Growing	Faster	18

Source: U.S. ISM

U.S. ISM Manufacturing PMI, points



Sources: Bloomberg, U.S. ISM

- ✓ According to the U.S. Institute for Supply Management (ISM), Manufacturing Purchasing Manager's Index (PMI) increased to 61.1 points in November from 60.8 points in the preceding month.
- ✓ This was mainly attributable to the higher demand conditions with New Orders Index went up to 61.5 points in November from 59.8 points previously, supported by continued expansion in new export orders.
- ✓ Be that as it may, all segments of the manufacturing economy are still impacted by record-long raw materials and capital equipment lead times, shortages of critical materials, high commodities prices, as well as difficulties in transporting products due to continuing obstacles from the pandemic.

MANUFACTURER SENTIMENTS – SUPPLY CHAIN ISSUES PERSIST

BANK ISLAM

Business Sector	Responses from survey
Computer & Electronic Products	Global components shortages continue, causing delays in completing orders.
Chemical Products	Seeing some improvement in petrochemical supply chain issue.
Food, Beverage & Tobacco Products	Input costs increased across the board.
Petroleum & Coal Products	Capital spending remains flat and no new orders at this time.
Furniture & Related Products	Shortages of raw materials and labour, leading to a difficulty in meeting customers' demand.
Electrical Equipment, Appliances & Components	Electronic component lead times are still moving out.
Fabricated Metal Products	The biggest challenge they have at the moment is to find qualified workers.
Machinery	Sales remain strong but are not growing at the same pace from the previous six to nine months.
Miscellaneous Manufacturing	Experiencing significant supply chain disruptions, leading to long lead times to get product to the customers.

Source: U.S. ISM

DISCLAIMER

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.