From the Desk of the Chief Economist

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U.S. FOMC : THE COUNTDOWN TO TAPER ASSET PURCHASES BEGINS

29 JULY 2021

ECONOMIC RESEARCH

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

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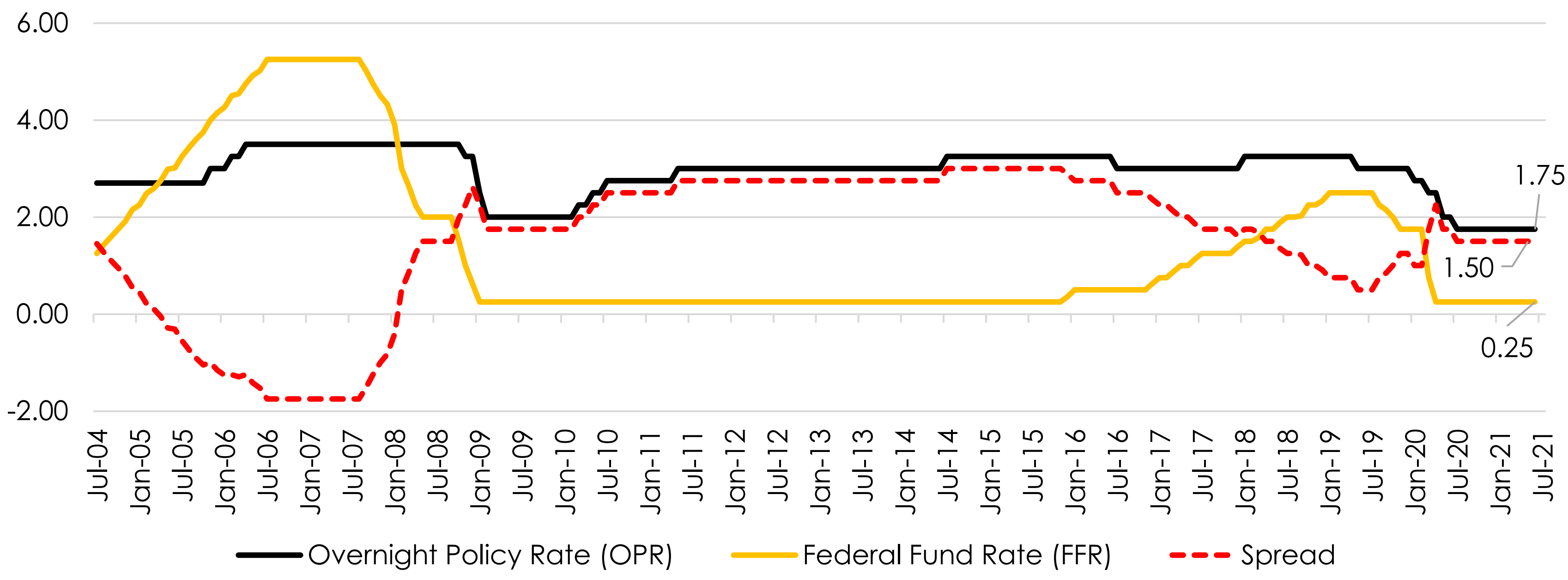
The Federal Open Market Committee (FOMC) **decided to keep the Federal Fund Rate (FFR) range near zero** and **maintained its asset purchases at USD120.0 billion** following its 27-28 July meeting.

- ✓ According to the Fed, the U.S. economy continued to pick up largely supported by progress in vaccination alongside strong policy support. In addition, the U.S. economic indicators and labour market have continued to strengthen, while sectors most negatively impacted by the pandemic have signaled improvement. However, the recovery remains uneven. Moreover, consumer spending continued to gain its momentum as the restrictions measures were lifted. On top of that, the housing sector remains firm and business investment is rising at a solid pace.
- ✓ As for inflation, it has increased notably and will likely remain elevated in coming months driven by spending rebounds and bottleneck effects as the economy continue to reopen. However, it is expected to drop back toward the Fed's longer-run goal of 2.0% as transitory supply effects abate.
- ✓ The FOMC officials are prepared to adjust the stance of policy the path of inflation or longer-term inflation expectations if the inflation is moving materially and persistently beyond levels consistent with the goal.
- ✓ Apart from that, the Fed's new framework for monetary policy emphasizes the importance of having well-anchored inflation expectations, both to foster price stability and to enhance the ability to promote broad-based and inclusive maximum-employment goal.
- ✓ Nevertheless, vaccination in the country has slowed while fast spread of Covid-19 "Delta" variant in some areas remain as main downside risks to the economic outlook.
- ✓ On a final note, the Committee continued to discuss the progress made toward the goals since the Committee adopted its asset purchase guidance last December. The FOMC members also reviewed some considerations to adjust the asset purchases, including their pace and composition, once economic conditions warrant a change.

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%) since July last year.
- ✓ This demonstrates that the Bank Negara Malaysian (BNM) still has room if the OPR warrant for a rate cut if such decision would be entirely based on the interest rate differentials with the U.S. Fed.
- ✓ Assuming that the Fed is likely to normalize its benchmark rate to 2.50% (long run FFR), the OPR could reach 3.50% in order to maintain a reasonable spread with the FFR.
- ✓ In view of ongoing economic fallout from Covid-19 crisis, a tightening monetary policy would be premature as the consumer and business are still grappling with the impacts.

THE CASE FOR MONETARY POLICY NORMALISATION IS RISING AS LABOUR MARKET IS GRADUALLY IMPROVING

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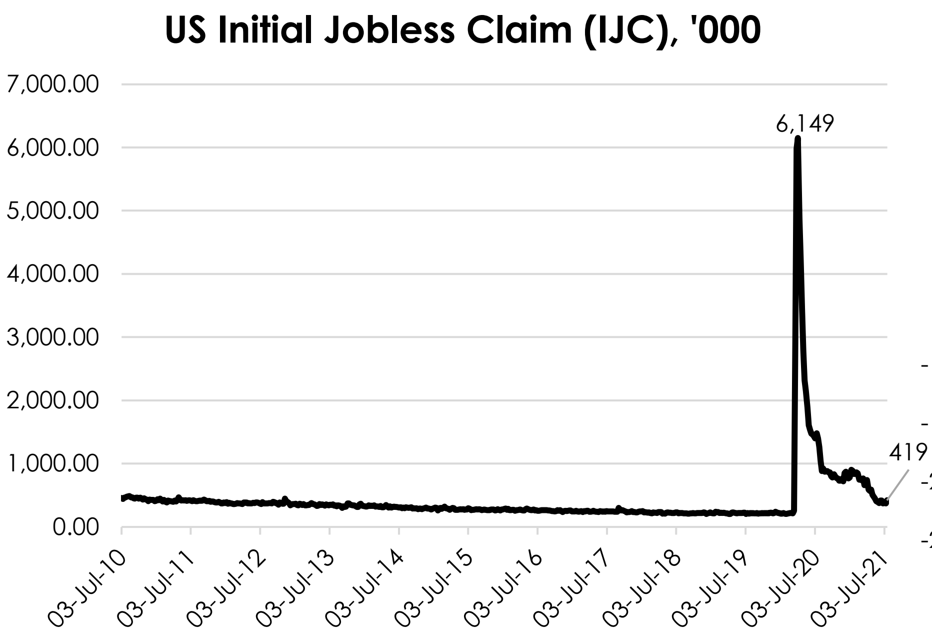
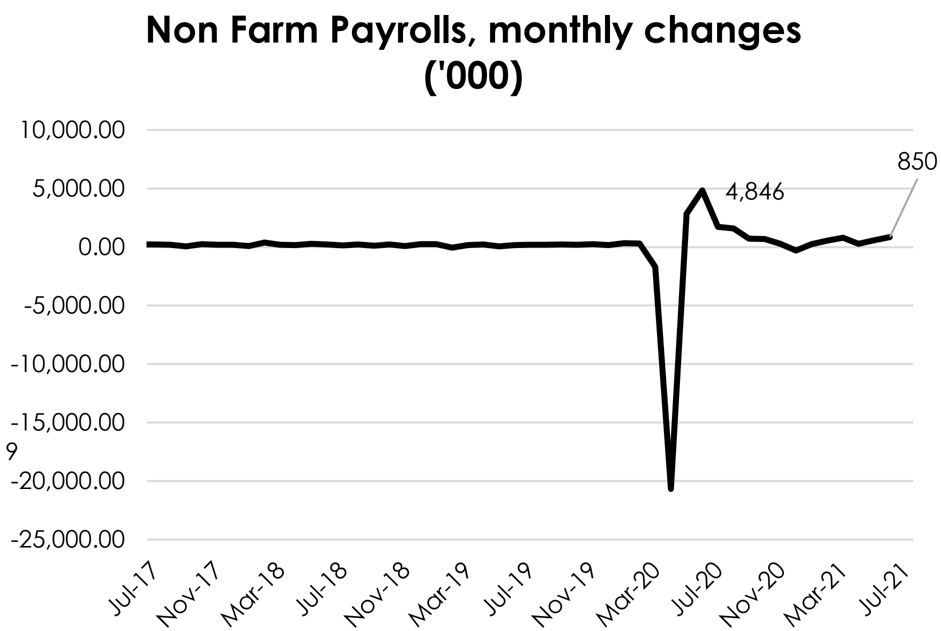




Sources: CEIC, US Department of Labor

- ✓ The number of Americans filing for the U.S. unemployment benefits stood at 419k for the week ended 17 July, higher by 51k from 368k in the previous week. Despite the uptick in number of applicants, it continued to show downtrend since the Covid-19 outbreak last year amid progress in vaccination that allow the economy continued to reopen.
- ✓ On the other hand, the U.S. economy added 850k number of jobs in June from 583k in the pervious month. It was the highest print since September last year with a notably gain was seen in leisure and hospitality on the back of ease in restriction measures in some parts of the country.
- ✓ Nevertheless, the unemployment rate in the U.S. was slightly higher at 5.9% in June from 5.8% in May, suggesting the recovery in the U.S. remains uneven.

CENTRAL BANK POLICY RATES

Policy rates	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21	Jul-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	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	-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	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	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	0.25
Latin America													
Mexico (ON Rate)	5.00	4.50	4.25	4.25	4.25	4.25	4.25	4.00	4.00	4.00	4.00	4.25	4.25
Brazil (Selic Rate)	2.25	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.75	2.75	3.50	4.25	4.25
Argentina (LELIQ 7D Notes Rate)	38.00	38.00	38.00	36.00	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	4.25	4.25	4.25	4.25	4.25	4.25	4.50	5.00	5.00	5.50	6.50
Ukraine (Discount Rate)	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.50	7.50	7.50	7.50	8.00
Turkey (1W Repo Rate)	8.25	8.25	10.25	10.25	15.00	17.00	17.00	17.00	19.00	19.00	19.00	19.00	19.00
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	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	4.00
Indonesia (7D Repo Rate)	4.00	4.00	4.00	4.00	3.75	3.75	3.75	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	0.50
South Korea (Base 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	0.50
Philippines (O/N Lending Rate)	2.25	2.25	2.25	2.25	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Australia (Cash Rate)	0.25	0.25	0.25	0.25	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	0.25	0.25	0.25	0.25
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	1.75

As at 29 July 2021

Source: Bloomberg

- ✓ Central banks across the globe particularly in Asia have decided to remain with their accommodative monetary policy stance as risks from the Covid-19 pandemic continue to linger.
- ✓ Meanwhile, central banks in other parts of the world such as Russia raised its benchmark interest rate by 100 basis points (bps) from 5.50% to 6.50% on 23 July 2021. The move was to curb the stubbornly high inflation which reached 6.5% in June (May: 6.0%), the highest level since mid-2016. Similarly, the central bank of Ukraine also hiked its benchmark rate by 50 bps from 7.50% to 8.00% due to the rising probability of a longer and more pronounced surge in global inflation.

- Wall Street ended mixed on Wednesday after the Fed signaled that it would begin to monitor progress toward its threshold to begin tapering monthly bond purchases at upcoming meetings. The S&P 500 index closed flat by recording a 0.0% change while the Dow Jones Industrial Average Index was down by 0.4%. The tech-heavy Nasdaq index was the only benchmark that recorded gains during the day, ending 0.7% higher.
- Meanwhile, the U.S. government bond yields edged higher on Wednesday with the yields on the benchmark 10-year and 30-year Treasury note both ending 1.0 bps higher at 1.26% and 1.90% respectively. Short-term yields, which are especially sensitive to changes in monetary policy, also closed higher, with the yields on the 3-year and 5-year Treasury note both increasing by 1.0 bps to 0.38% from 0.72% respectively.
- In general, U.S. government bond yields have been trending lower since March as investors expected the Fed to sustain its purchases despite the U.S. economy's strong rebound from a historic contraction in 2Q2020. Perhaps any reveal of the Fed's plan on tapering its asset purchases in the coming months could push the U.S. government bond yields higher in the medium term.

Changes in US Treasury Yields

Tenure of U.S. Treasury Bill	Daily Change in yields (basis points) on 28 July 2021
3-year	+1.0
5-year	+1.0
7-year	0.0
10-year	+1.0
30-year	+1.0

Source: US Department of Treasury

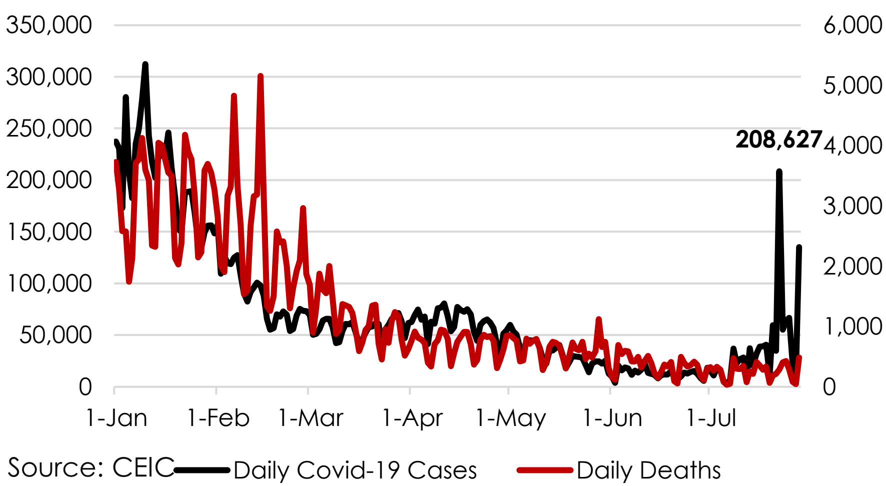
Performance of US Stock Market

Index	Percentage Change in Index on 28 July 2021
Dow Jones Industrial Average	-0.4%
S&P 500	0.0%
Nasdaq	0.7%

Source: Bloomberg

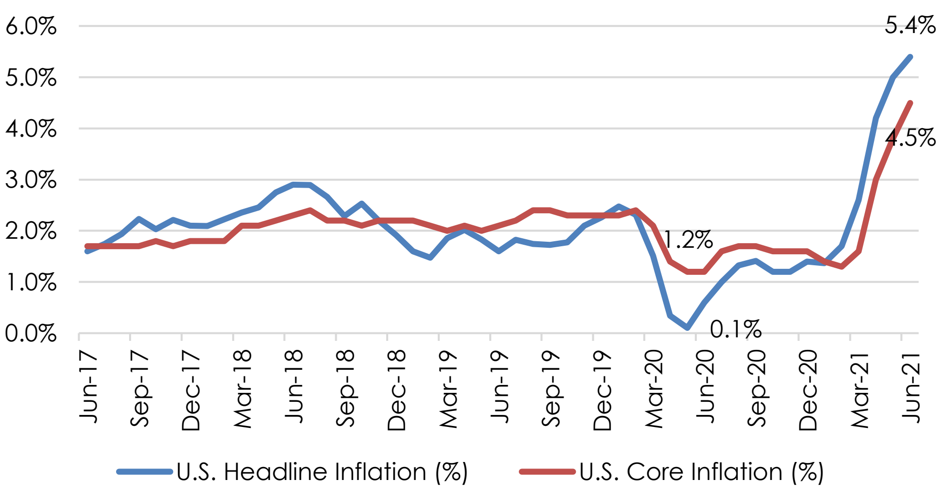
- ✓ **Delta variant causes cases to rise in the U.S.** – The highly infectious Delta variant has caused an uptick in the number of daily Covid-19 cases reported in the U.S. In 48 states, the rate of new Covid-19 cases last week jumped by at least 10.0% compared to the previous week, according to data from Johns Hopkins University. In 34 of those states, the rate of new cases increased by more than 50.0%.
- ✓ **No slowdown seen in the U.S. inflation rate -** At the same time, the U.S. headline inflation rate seems to show no signs of slowing down as it reached 5.4% y-o-y in June (May: 5.0%) while the U.S. core inflation stood at 4.5% in the same month (April: 3.8%). In fact, the latest U.S. headline rate was the highest in 13 years.
- ✓ **Demand on used vehicles rises -** On further scrutiny, the CPI for Used Cars & Trucks sub-index grew by 45.2% in June from 29.7% in May, the largest increase on record. This was closely associated with the shortages of semiconductor chips which has become prevalent in the new vehicle parts. Therefore, the shift to used vehicles among the U.S. citizens suggests that consumer demand has really picked up.
- ✓ **Timing for tapering asset purchases must be appropriate** - The issue now for the Fed is gauging if inflation is becoming more entrenched at the time when the highly transmissible Delta variant pose risks to economic growth. Although a tighter monetary policy might tackle inflation, it could also lead to a shock in growth, creating a stagflationary environment. With that, the Fed must keep a closer eye on the economic progress needed to begin trimming its bond purchases.

Daily Covid-19 Cases And Deaths In The U.S.



Source: CEIC

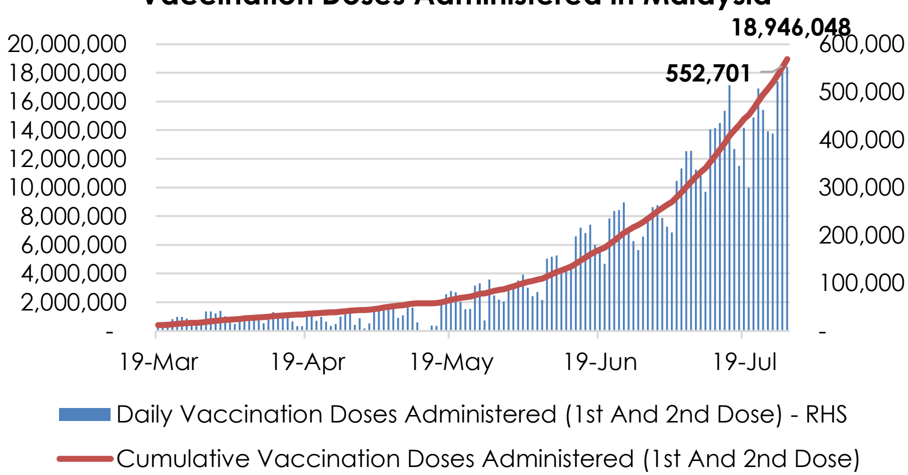
U.S. Headline Inflation vs. U.S. Core Inflation (%)



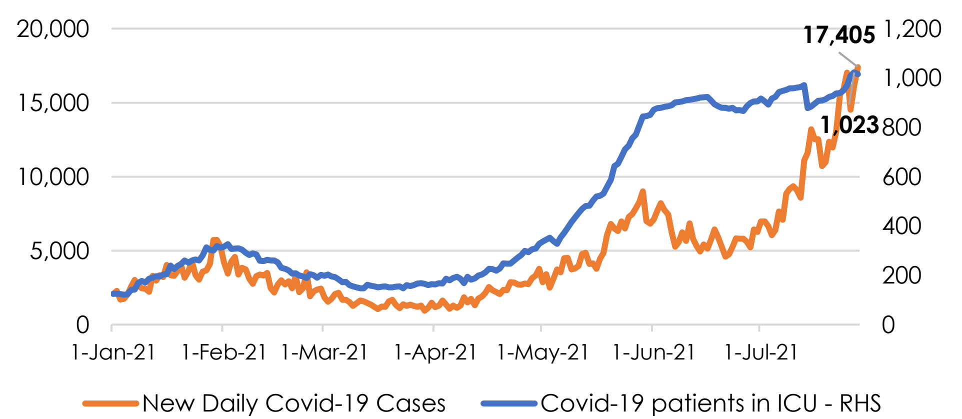
Source: CEIC

- ✓ **Adjustment in bond purchasing plans will depend on data points–** In future meetings, the Fed will again assess the timing of any change in the pace of purchases which will depend on the incoming data.
- ✓ **Risks for an earlier tightening of monetary policy** - If inflationary pressure persists while the impact from the pandemic towards the U.S. economy remains manageable and the labour market improves, we cannot rule out the possibility of the Fed to announce its strategy for reducing its massive bond buying programme in August or September 2021 but would start to reduce the monthly purchases in early 2022.* As such, an earlier timeline for an expected rate hike could be on the cards if this materializes.
- ✓ **BNM may not necessarily follow the Fed's timing** - An earlier-than-expected monetary policy tightening is expected to see other central banks of the world including Bank Negara Malaysia to follow suit. Notwithstanding this, the monetary policy decision by BNM will continue to hinge on economic data, just like the Fed.
- ✓ **Target to fully vaccinate population likely to be reached by year-end in Malaysia** – We note that vaccination progress in the country has been very encouraging recently with daily vaccine doses administered reaching over 500,000 doses. In the meantime, the number of daily Covid-19 cases remain high, reaching a record high of 17,405 cases on 28 July amid the spread caused by the Delta variant. Therefore, the path to recovery will be uneven and may not warrant a similar monetary policy timing to the Fed. At this juncture, we are maintaining our view that BNM will keep the Overnight Policy Rate (OPR) unchanged at 1.75% until the end of 2021.

Vaccination Doses Administered in Malaysia



Malaysia- New Daily Covid-19 Cases vs. Covid-19 Patients In ICU



Source: CEIC

*https://www.reuters.com/business/fed-announce-qe-taper-aug-or-sept-rising-inflation-concerns-2021-06-11/

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APPENDIX

FOMC STATEMENT

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- ✓ 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 shown improvement but have not fully recovered. Inflation has risen, largely reflecting transitory factors. 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 will likely continue to reduce the effects of the public health crisis on the economy, but risks to the economic outlook remain.
- ✓ The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. With inflation having run 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. Last December, the Committee indicated that it would continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month until substantial further progress has been made toward its maximum employment and price stability goals. Since then, the economy has made progress toward these goals, and the Committee will continue to assess progress in coming meetings. These asset purchases help 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.

MANUFACTURING SECTOR – 13 CONSECUTIVE MONTHS OF GROWTH

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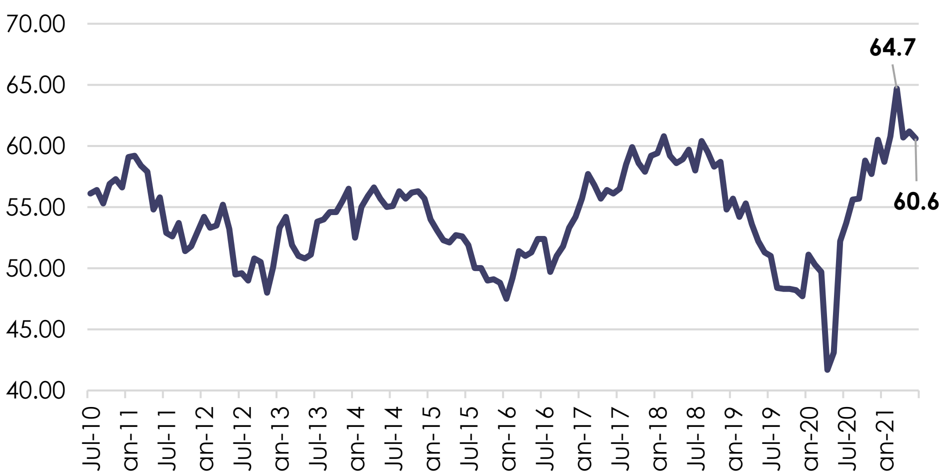
Index	Series Index Jun 2021	Series Index May 2021	Percentage Point Change	Direction	Rate of Change	Trend (Months)
Manufacturing PMI	60.6	61.2	-0.6	Growing	Slower	13
New Orders	66.0	67.0	-1.0	Growing	Slower	13
Production	60.8	58.5	2.3	Growing	Faster	13
Employment	49.9	50.9	-1.0	Contracting	From Growing	1
Supplier Deliveries	75.1	78.8	-3.7	Slowing	Slower	64
Inventories	51.1	50.8	0.3	Growing	Faster	2
Customers' Inventories	30.8	28.0	2.8	Too Low	Slower	57
Prices	92.1	88.0	4.1	Increasing	Faster	13
Backlog of Orders	64.5	70.6	-6.1	Growing	Slower	12
New Export Orders	56.2	55.4	0.8	Growing	Faster	12
Imports	61.0	54.0	7.0	Growing	Faster	12
Overall Economy				**Growing**	**Slower**	**13**
Manufacturing Sector				**Growing**	**Slower**	**13**

Source: US ISM

US ISM Manufacturing PMI, points



Sources: CEIC, US ISM

- ✓ According to the US Institute for Supply Management (ISM), Manufacturing Purchasing Manger's Index (PMI) moderated to 60.6 points in June from 61.2 points in the preceding month.
- ✓ The softer growth was due to slower expansion in New Orders (June: 66.0 points vs. May: 67.0 points), Supplier Deliveries (June: 75.1 points vs. May: 78.8 points) and Backlogs of Orders (June: 64.5 points vs. May: 70.6 points).
- ✓ Apart from that, the survey reported that companies and suppliers continue to struggle to meet increasing levels of demand as economy reopens in many countries. Record-long raw-material lead times, wide-scale shortages of critical basic materials, rising commodities prices and difficulties in transporting products are continuing to affect all segments of the manufacturing activities in the U.S.

MANUFACTURERS' SENTIMENTS IN MAY 2021 – SUPPLY SHORTAGE AND INFLATIONARY PRESSURE WAS FELT

Business Sector	Outlook on Business Activities
Computer & Electronic Products	✓ Supply chain constraints from both availability and logistics perspectives. ✓ Inflationary pressure on materials due to supply and demand imbalance. ✓ Electronic components by far the biggest challenge, with lead times going from 16 weeks to 52-plus weeks. ✓ Processors are a critical shortage, leading to working 24/7 to redesign printed circuit board assemblies to change components.
Food, Beverage & Tobacco Products	✓ Poultry markets are higher, as demand for chicken has been very strong. ✓ Higher costs are starting to be passed along to customers.
Chemical Products	✓ Continue to see very strong demand across all business units. ✓ In many cases, they are limited on ability to supply by raw-materials availability. ✓ Even if they were able to get all the raw materials needed, they would have capacity issues on many of our production units. ✓ Manpower has been a concern.
Transportation Equipment	✓ Strong sales continue and production output is at 100.0%. ✓ Covid-19 restrictions have been mostly lifted. ✓ Global chip allocation continues to limit some feature offerings — production schedules have been updated to restrict content affected by the chip shortage.
Electrical Equipment, Appliances & Components	✓ Higher prices, inflation and lack of available labor are impacting all organizations in our supply chain.

Source: US ISM