Dr. Mohd Afzanizam Abdul Rashid | Chief Economist | 03-2088 8075 | afzanizam@bankislam.com.my
Shafiz Jamaluddin | Economic Analyst| 03-2088 8399 | shafiz@bankislam.com.my
Nor Jannah Abdullah | Economic Analyst| 03-2782 1417 | norjannah@bankislam.com.my

The US Fed has become more dovish

US FOMC Meeting (18 – 19 June 2019)

The Federal Open Market Committee (FOMC) was held during 18 and 19 June 2019. As expected, the target Federal Fund Rate (FFR) was left unchanged at between 2.25% and 2.50%. However, the decision was not unanimous as one of the FOMC members, James Bullard, has voted for a 25 basis points (bps) cut. Judging from the statement, the Fed was increasingly worry about the pace of economic expansion especially investment activities among the private firms. In addition, inflation has been moderating in particular the core inflation which excludes the volatile items such as energy and food has been lingering below the 2% level.

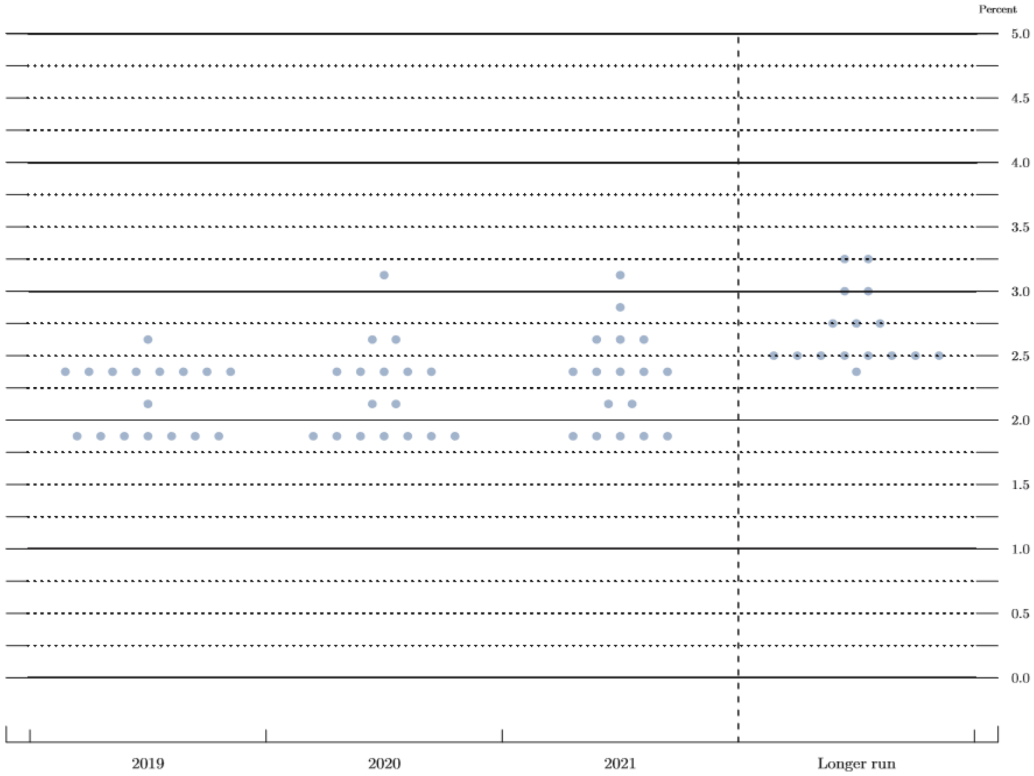
The infamous "dot plot" charts was pointing to an easing monetary stance (see Chart 1). There are 7 participants expecting the FFR to be at 1.75% and 2.00% this year, implying the Fed could deliver as much as 50 bps FFR cut in 2019. One participant looking FFR at between 2.00% and 2.25%, a 25 bps reduction. Another 8 participants are of the view the FFR 2.25% and 2.50%, suggesting the Fed could remain status quo this year. Based on the median projection, the Fed is projecting GDP to grow at a rate of 2.1%, still above its longer term trend of 1.9% while unemployment rate would remain low at 3.6% versus 3.7% projection made during March. Core PCE inflation is likely to be at 1.5% in 2019 which is significantly below the 2.00% target (see Table 1).

All in all, the Fed is preparing themselves and the financial markets for the imminent rate cut this year. The next question would be, is the cut going to be deep? And how long the monetary stimulus would remain in place. This hinges very much upon the development of the trade conflict between the US and China. As it this, the trade friction has not yielded favourable outcome to the US economy other than more 80% growth in tariff collection. Businesses are scrambling to find the new suppliers and production base. Estimates from private economists suggests that Vietnam, Taiwan, Chile and Malaysia are the key beneficiaries from trade diversion. In that sense, the US will be worst-off should the present war on tariff continues (see Chart 2).

More policy space to BNM

Having said that, the BNM would have more policy space to prescribe additionally monetary easing. At the moment**, we are still sticking to our view that the Overnight Policy Rate (OPR) would remain at 3.00% throughout 2019.** However, **the odds for the potential cut has gone up**, in our view, as business sentiments have been very weak and the government spending appears to be constrained by rising debt level. We would wait for the 2Q2019 GDP which will be announced sometime in August in order to see the merit to change our present call on OPR. As for the USDMYR, we believe there could be some support as the US dollar could weaken following the recent FOMC meeting. **The USDMYR could range between RM4.15 and RM4.17 in the immediate terms. However, we still maintain our year-end target of RM4.21 as risk-off** mode would continue to prevail, leading to higher demand for the safe haven currencies such as the US dollar and Yen.

Chart 1: The Dot Plots – survey on US Federal Fund Rate among the FOMC members



Source: US Federal Reserve

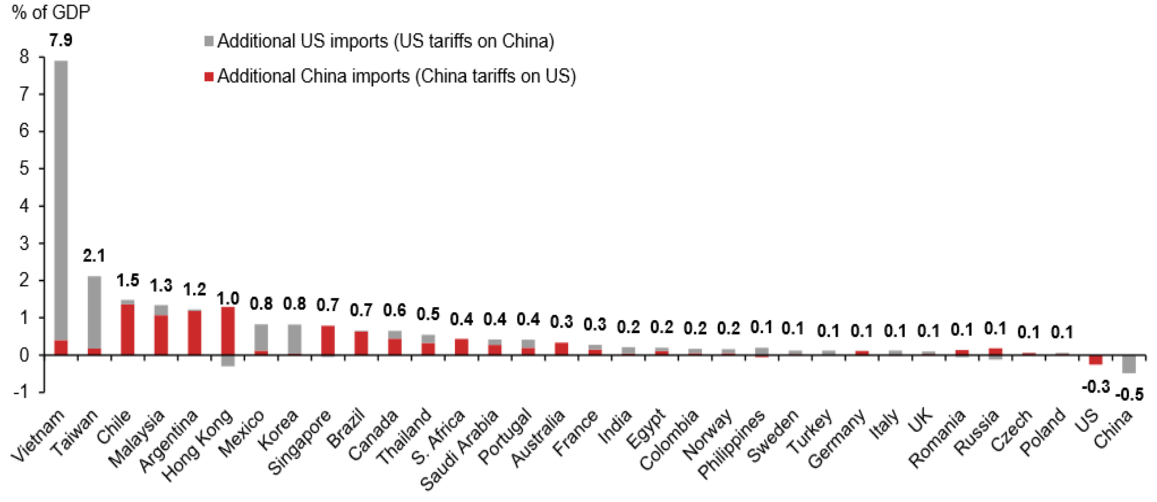
Table 1: US Federal economic projection

Percent

Variable	Median[1]				Central tendency[2]				Range[3]			
	2019	2020	2021	Longer run	2019	2020	2021	Longer run	2019	2020	2021	Longer run
Change in real GDP	2.1	2.0	1.8	1.9	2.0 – 2.2	1.8 – 2.2	1.8 – 2.0	1.8 – 2.0	2.0 – 2.4	1.5 – 2.3	1.5 – 2.1	1.7 – 2.1
March projection	2.1	1.9	1.8	1.9	1.9 – 2.2	1.8 – 2.0	1.7 – 2.0	1.8 – 2.0	1.6 – 2.4	1.7 – 2.2	1.5 – 2.2	1.7 – 2.2
Unemployment rate	3.6	3.7	3.8	4.2	3.6 – 3.7	3.5 – 3.9	3.6 – 4.0	4.0 – 4.4	3.5 – 3.8	3.3 – 4.0	3.3 – 4.2	3.6 – 4.5
March projection	3.7	3.8	3.9	4.3	3.6 – 3.8	3.6 – 3.9	3.7 – 4.1	4.1 – 4.5	3.5 – 4.0	3.4 – 4.1	3.4 – 4.2	4.0 – 4.6
PCE inflation	1.5	1.9	2.0	2.0	1.5 – 1.6	1.9 – 2.0	2.0 – 2.1	2.0	1.4 – 1.7	1.8 – 2.1	1.9 – 2.2	2.0
March projection	1.8	2.0	2.0	2.0	1.8 – 1.9	2.0 – 2.1	2.0 – 2.1	2.0	1.6 – 2.1	1.9 – 2.2	2.0 – 2.2	2.0
Core PCE inflation[4]	1.8	1.9	2.0		1.7 – 1.8	1.9 – 2.0	2.0 – 2.1		1.4 – 1.8	1.8 – 2.1	1.8 – 2.2	
March projection	2.0	2.0	2.0		1.9 – 2.0	2.0 – 2.1	2.0 – 2.1		1.8 – 2.2	1.8 – 2.2	1.9 – 2.2	
Memo: Projected appropriate policy path												
Federal funds rate	2.4	2.1	2.4	2.5	1.9 – 2.4	1.9 – 2.4	1.9 – 2.6	2.5 – 3.0	1.9 – 2.6	1.9 – 3.1	1.9 – 3.1	2.4 – 3.3
March projection	2.4	2.6	2.6	2.8	2.4 – 2.6	2.4 – 2.9	2.4 – 2.9	2.5 – 3.0	2.4 – 2.9	2.4 – 3.4	2.4 – 3.6	2.5 – 3.5

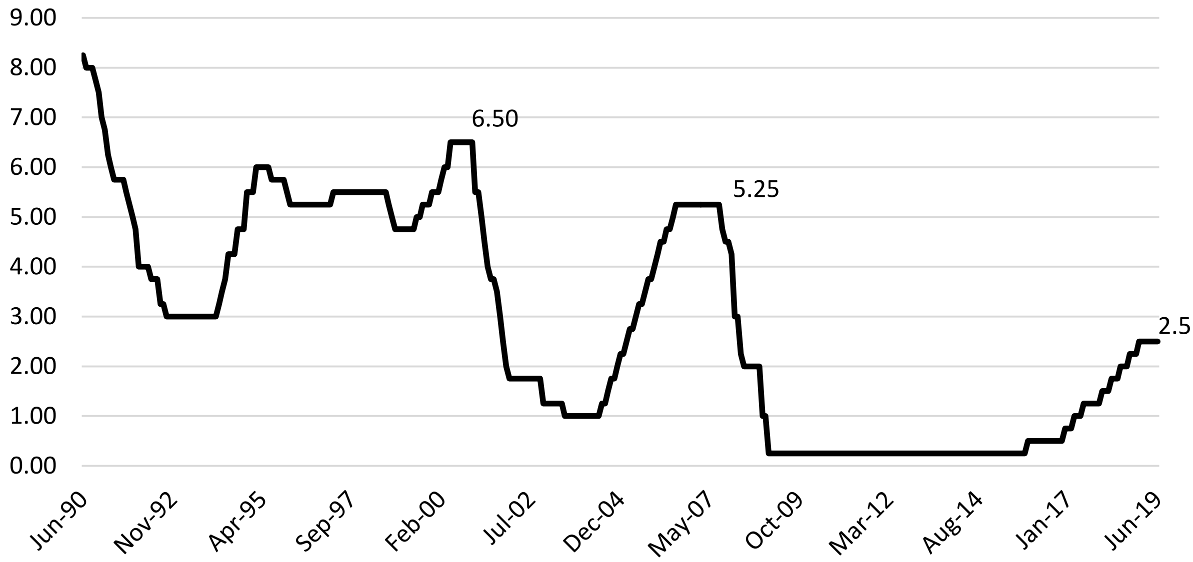
Source: US Federal Reserve

Chart 2: Estimates of trade diversion beneficiaries by country (% of 2019 country GDP)



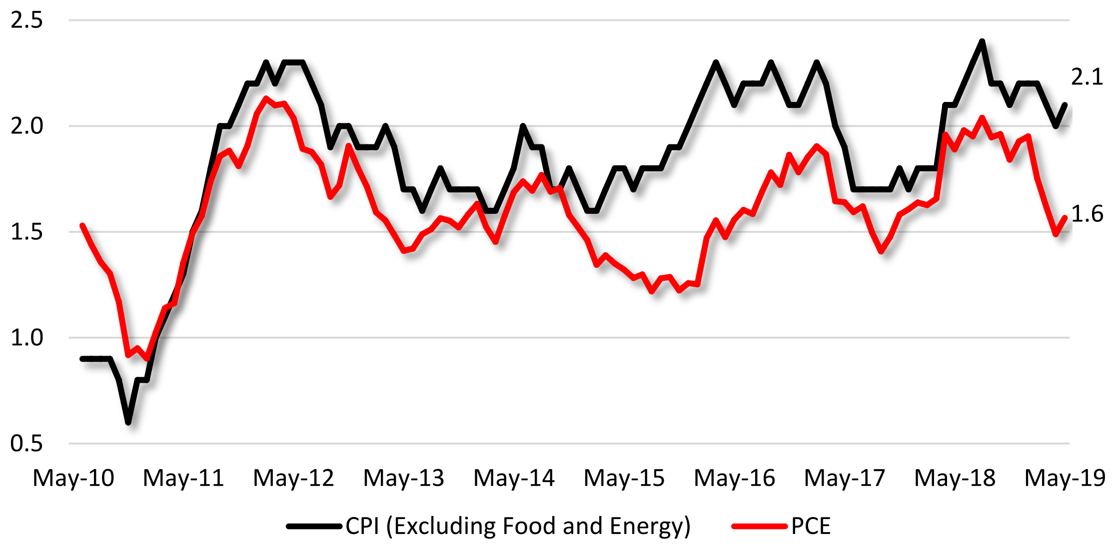
Source: Nomura – Exploring US and China Trade Diversion – 3 June 2019

Chart 3: Federal Fund Rate (FFR)



Source: Bloomberg

Chart 4: US Core Inflation – Personal Consumption Expenditure (PCE) and Consumer Price index (CPI)



Source: Bloomberg