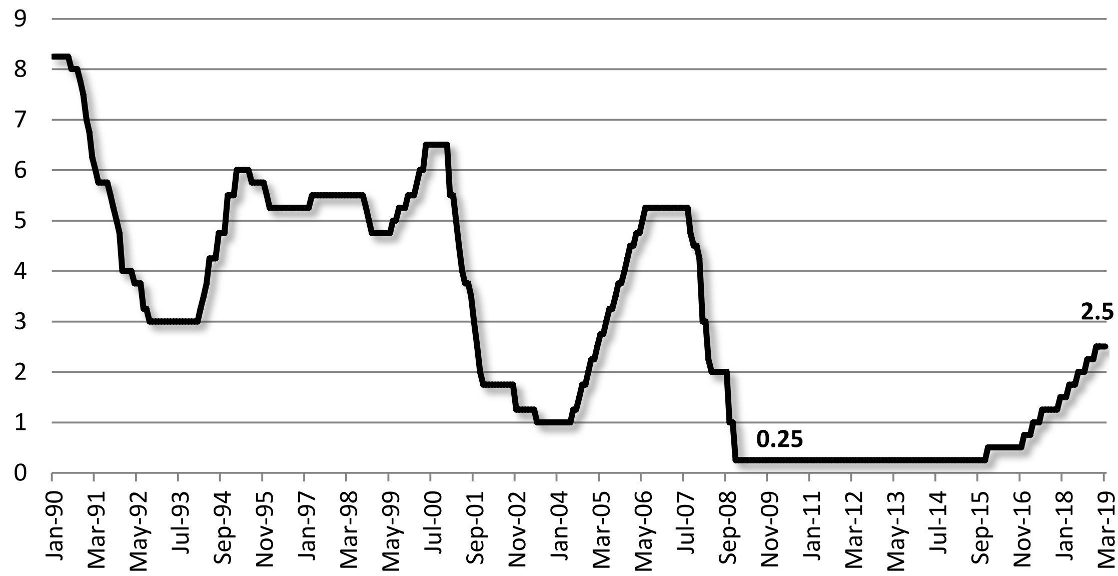
Dr. Mohd Afzanizam Abdul Rashid | Chief Economist | 03-2088 8075 | afzanizam@bankislam.com.my
Shafiz Jamaluddin | Economic Analyst| 03-2088 8075 | shafiz@bankislam.com.my
Nor Jannah Abdullah | Economic Analyst | 03-2088 8075 | norjannah@bankislam.com.my

US FFR kept at 2.25% - 2.50% - status quo for now

Facts

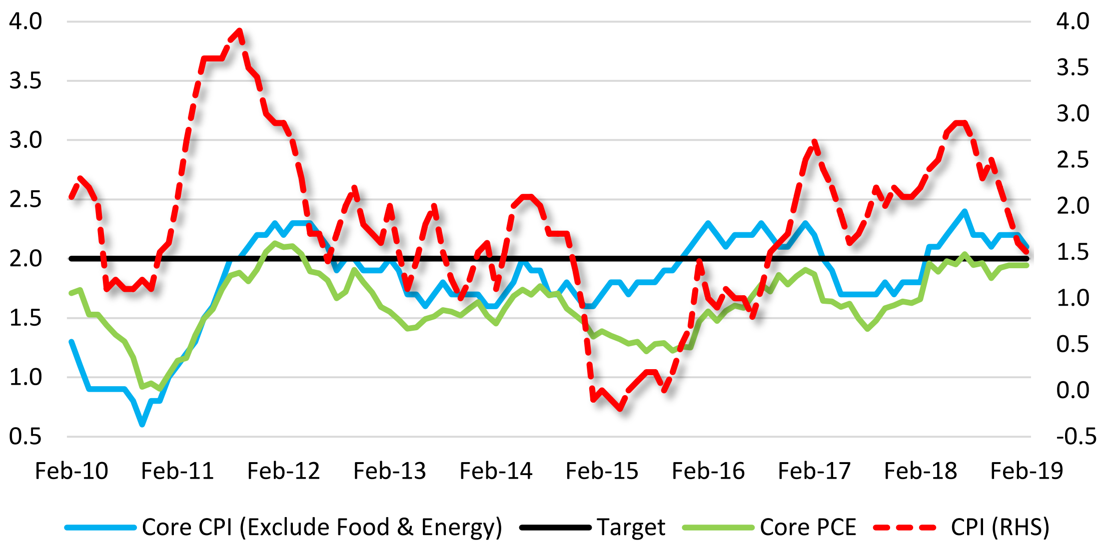
- The US Federal Open Market Committee (FOMC) kept the Federal Fund Rate (FFR) at the current target range between 2.25% and 2.50% after the two-day policy meeting on 20th March. According to the monetary statements, the FOMC members are of the view that the US economy is still growing at a healthy pace and the labour market conditions remain strong while the inflation rate has been revolving around the Committee's 2.0% objective.
- Meanwhile, the statements with regards to the balance sheet normalisation indicates that the Fed intended to reduce the US Treasury securities holdings gradually by cutting the cap on monthly redemptions from USD30.0 billion to USD15.0 billion, commencing in May 2019. As at 20th March, the Fed's balance sheet size has lowered to USD3.97 trillion from USD4.00 trillion in February.
- All in all, the FOMC members have indicated that any future adjustment to the FFR target range will be consistent with their dual mandates i.e. ensuring robust labour market and price stability.
- The next FOMC meeting is scheduled on 30th April to 1st May of 2019. Based on the FFR futures contract, the probability of interest rate cut has risen and has gained traction (see Chart 3). FFR reduction could happen at the end of 2019 or early 2020.

Chart 1: Federal Fund Rate (FFR)



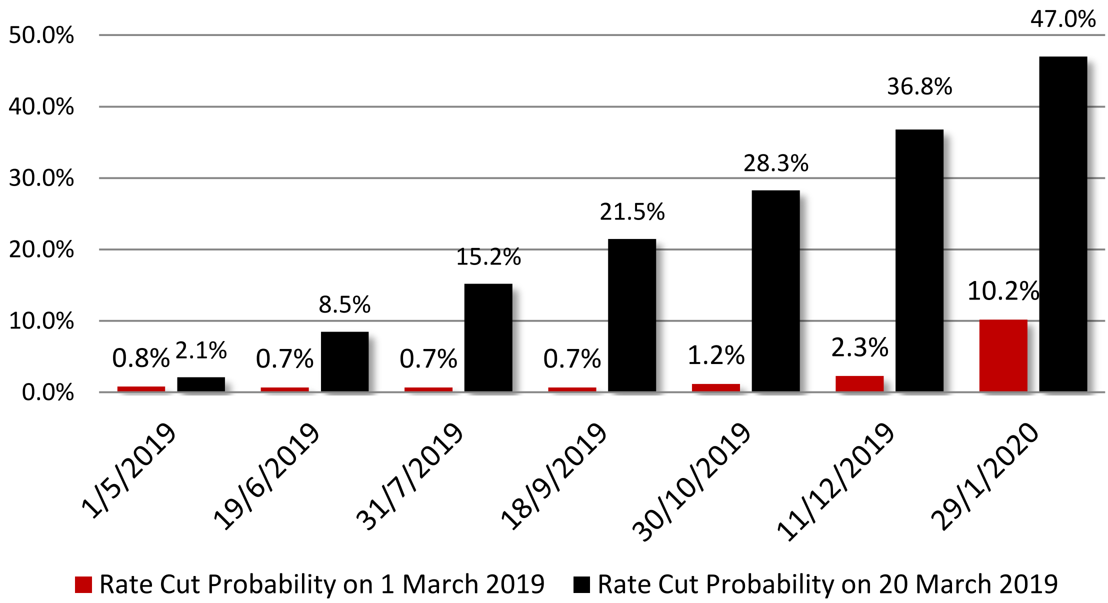
Source: Bloomberg

Chart 2: US CPI y-o-y, %



Source: Bloomberg

Chart 3: Probability of FFR cut based on interest rate futures contract



Source: Bloomberg

Our view

The latest statement has reinvigorated the base case for a long pause for FFR throughout 2019. At the same time, the downward revision in GDP forecast, a slight increase in unemployment rate estimates and stable environment for inflation suggests that monetary policy biases appears to be on the downside. In other words, the Fed can cut their policy rates because inflation rate is likely to be modest as it likely to revolve around the 2 percent target. Nonetheless, GDP growth is expected to be at or around the potential growth level, indicating economic resources (labour, capital and technology) have been deployed nicely in 2019 and 2020. This can be reflected in the Fed's median estimates for GDP growth in 2019 and 2020 which is expected to grow at or above its long run growth of 1.9%. This is the main reason why we think the Fed might opt to keep the rates at status quo for now.

What does it mean to Malaysia's Overnight Policy Rate (OPR)? Essentially, the current development has allowed some space for BNM to maneuver given the excess spread between the two policy rates which currently at 75 basis points are in favour of the OPR. So technically speaking, the BNM could reduce the OPR if they wish to do so. This is especially true when inflation rate is expected to be contained this year following the stability in the global crude oil prices.

The next question would be how soon the OPR cut could happen? This would be highly dependent on the severity of the downside risks to growth. Thus far, business sentiments have been weak based on numerous surveys (MIER, RAM, DOSM and IHS Markit). Foreign funds have been net sellers for five consecutive weeks, implying lack of earnings visibility for listed companies. The MGS yields too have been on declining trend, indicating demand for risk-free assets are on the rise. Against such backdrop, businesses and financial markets are projecting a cautious view on Malaysia's growth prospects. In that sense, there is a need to inject some form of confidence boosters via monetary stimulus. As such, we would wait for more clues from the BNM once they announced their 2018 annual report on 27 March. At the moment, **we are still maintaining our OPR call at 3.25%** but recognised the odds for a lower policy rates has crept up.

Appendix – FOMC statement

Information received since the Federal Open Market Committee met in January indicates that the labor market remains strong but that growth of economic activity has slowed from its solid rate in the fourth quarter. Payroll employment was little changed in February, but job gains have been solid, on average, in recent months, and the unemployment rate has remained low. Recent indicators point to slower growth of household spending and business fixed investment in the first quarter. On a 12-month basis, overall inflation has declined, largely as a result of lower energy prices; inflation for items other than food and energy remains near 2 percent. On balance, market-based measures of inflation compensation have remained low in recent months, and survey-based measures of longer-term inflation expectations are little changed.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. In support of these goals, the Committee decided to maintain the target range for the federal funds rate at 2-1/4 to 2-1/2 percent. The Committee continues to view sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective as the most likely outcomes. In light of global economic and financial developments and muted inflation pressures, the Committee will be patient as it determines what future adjustments to the target range for the federal funds rate may be appropriate to support these outcomes.

In determining the timing and size of future adjustments to the target range for the federal funds rate, the Committee will assess realized and expected economic conditions relative to its maximum employment objective and its symmetric 2 percent inflation objective. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments.

Voting for the FOMC monetary policy action were: Jerome H. Powell, Chairman; John C. Williams, Vice Chairman; Michelle W. Bowman; Lael Brainard; James Bullard; Richard H. Clarida; Charles L. Evans; Esther L. George; Randal K. Quarles; and Eric S. Rosengren.

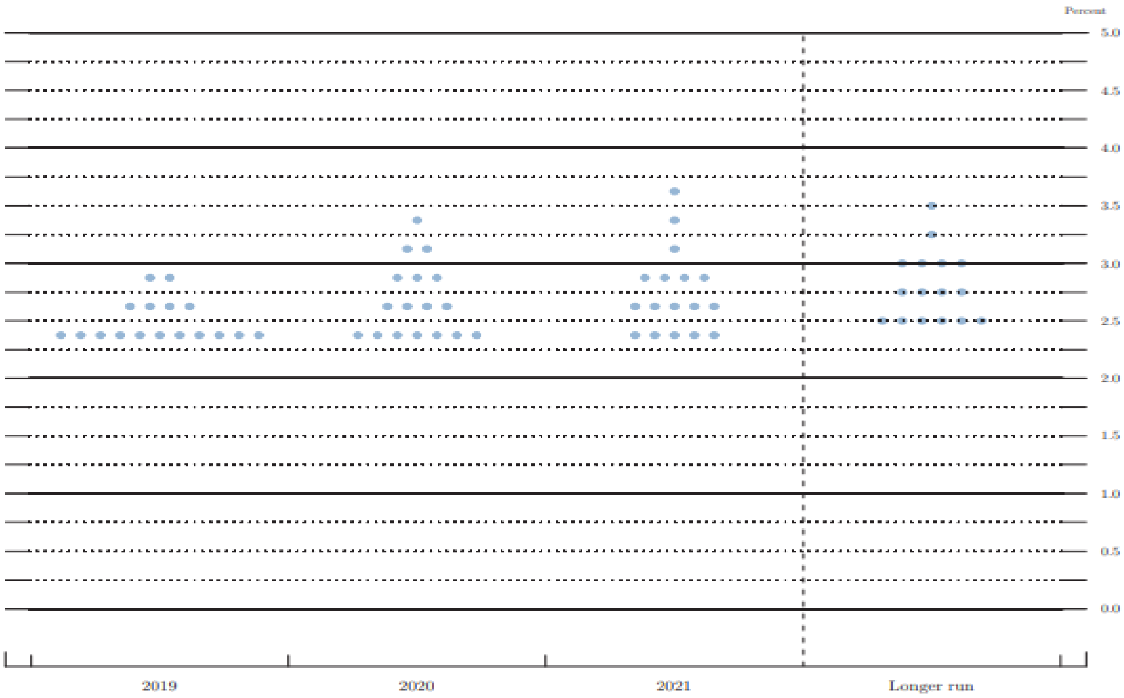
Table 1: Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents (March 2019)

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	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
December projection	2.3	2.0	1.8	1.9	2.3 – 2.5	1.8 – 2.0	1.5 – 2.0	1.8 – 2.0	2.0 – 2.7	1.5 – 2.2	1.4 – 2.1	1.7 – 2.2
Unemployment rate	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
December projection	3.5	3.6	3.8	4.4	3.5 – 3.7	3.5 – 3.8	3.6 – 3.9	4.2 – 4.5	3.4 – 4.0	3.4 – 4.3	3.4 – 4.2	4.0 – 4.6
PCE inflation	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
December projection	1.9	2.1	2.1	2.0	1.8 – 2.1	2.0 – 2.1	2.0 – 2.1	2.0	1.8 – 2.2	2.0 – 2.2	2.0 – 2.3	2.0
Core PCE inflation[4]	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	
December projection	2.0	2.0	2.0		2.0 – 2.1	2.0 – 2.1	2.0 – 2.1		1.9 – 2.2	2.0 – 2.2	2.0 – 2.3	
Memo: Projected appropriate policy path												
Federal funds rate	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
December projection	2.9	3.1	3.1	2.8	2.6 – 3.1	2.9 – 3.4	2.6 – 3.1	2.5 – 3.0	2.4 – 3.1	2.4 – 3.6	2.4 – 3.6	2.5 – 3.5

Source: US Federal Reserve

Chart 4: FOMC's participant's assessments of appropriate monetary policy (the dot plots)



Source: US Federal Reserve