From the Desk of the Chief Economist

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U.S. FOMC : ON THE CUSP OF MONETARY POLICY NORMALISATION

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ECONOMIC RESEARCH

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THE FOMC DECIDED TO REMAIN STATUS QUO…FOR NOW

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- ✓ The Federal Open Market Committee (FOMC) decided to keep the Federal Fund Rate (FFR) range at 0.00%-0.25% and maintained its asset purchases at USD120.0 billion during its 15-16 June meeting.
- ✓ The US continued to record upbeat economic data mainly supported by rising vaccinations which have successfully reduced the impact on public health accompanied by strong policy support. The sectors most adversely affected by the pandemic remained weak but have shown improvement.
- ✓ In light of this, the FOMC's median forecast for 2021 Gross Domestic Product (GDP) growth was revised up to 7.0% (from the 6.5% projection made in March) before moderating by 3.3% in 2022 and 2.4% in 2023.
- ✓ Similarly, the US Federal Reserve (Fed) projected that the labour market would continue to improve, although the pace of improvement has been uneven. The median projection for the Unemployment Rate (UR) stood at 4.5% at the end of 2021 before falling to 3.8% in 2022 and 3.5% in 2023.
- ✓ In addition, the FOMC lifted its projections for PCE inflation to 3.4% this year (from 2.4% made in March) and softening by 2.1% in 2022. The revision partly due to a very low base effect last year, as well as the pass-through effect from oil prices to consumer energy prices. However, the supply bottleneck effect on inflation has been larger than anticipated amid reopening of the economy which has bolstered demand while hiring difficulties could continue to limit how quickly supply can adjust to the unprecedented rise in demand.
- ✓ Against such backdrop, the Federal Fund Rate (FFR) is expected to rise to 0.6% in 2023 (Previous forecast: 0.1%), signaling that the normalization of monetary would take place at some point in the future.
- ✓ Certain conditions have to be met in order to increase the FFR. Among them is the inflation rate which has to be sustained at more than 2% for a protracted period.

The FOMC's Economic Projections

Percent

Variable	Median[1]				Central Tendency[2]				Range[3]			
	2021	2022	2023	Longer run	2021	2022	2023	Longer run	2021	2022	2023	Longer run
Change in real GDP	7.0	3.3	2.4	1.8	6.8–7.3	2.8–3.8	2.0–2.5	1.8–2.0	6.3–7.8	2.6–4.2	1.7–2.7	1.6–2.2
March projection	6.5	3.3	2.2	1.8	5.8–6.6	3.0–3.8	2.0–2.5	1.8–2.0	5.0–7.3	2.5–4.4	1.7–2.6	1.6–2.2
Unemployment rate	4.5	3.8	3.5	4.0	4.4–4.8	3.5–4.0	3.2–3.8	3.8–4.3	4.2–5.0	3.2–4.2	3.0–3.9	3.5–4.5
March projection	4.5	3.9	3.5	4.0	4.2–4.7	3.6–4.0	3.2–3.8	3.8–4.3	4.0–5.5	3.2–4.2	3.0–4.0	3.5–4.5
PCE inflation	3.4	2.1	2.2	2.0	3.1–3.5	1.9–2.3	2.0–2.2	2.0	3.0–3.9	1.6–2.5	1.9–2.3	2.0
March projection	2.4	2.0	2.1	2.0	2.2–2.4	1.8–2.1	2.0–2.2	2.0	2.1–2.6	1.8–2.3	1.9–2.3	2.0
Core PCE inflation[4]	3.0	2.1	2.1		2.9–3.1	1.9–2.3	2.0–2.2		2.7–3.3	1.7–2.5	2.0–2.3	
March projection	2.2	2.0	2.1		2.0–2.3	1.9–2.1	2.0–2.2		1.9–2.5	1.8–2.3	1.9–2.3	
Memo: Projected appropriate policy path												
Federal funds rate	0.1	0.1	0.6	2.5	0.1	0.1–0.4	0.1–1.1	2.3–2.5	0.1	0.1–0.6	0.1–1.6	2.0–3.0
March projection	0.1	0.1	0.1	2.5	0.1	0.1–0.4	0.1–0.9	2.3–2.5	0.1	0.1–0.6	0.1–1.1	2.0–3.0

Source: US Federal Reserve

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

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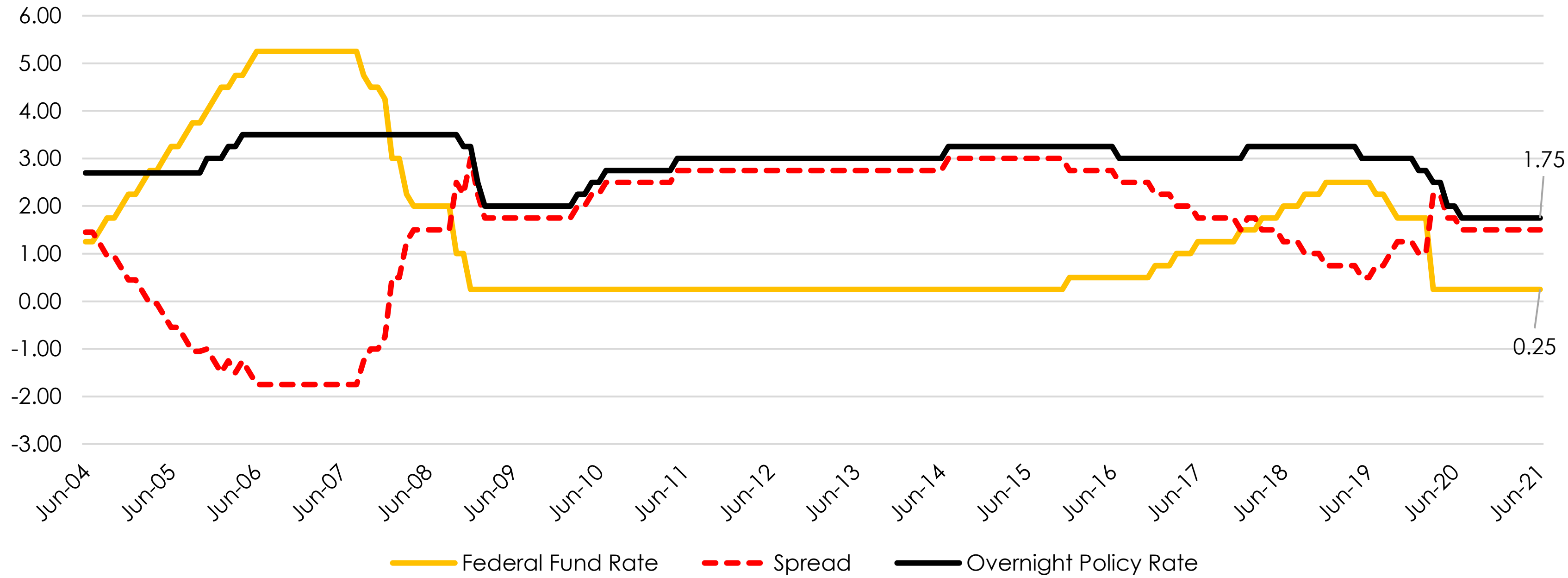

Source: CEIC

- ✓ At the current juncture, the difference between Malaysia's OPR and FFR stood at 150 basis points (bps) (1.75% minus 0.25%).
- ✓ This would mean Bank Negara Malaysia (BNM) would has room for a possible OPR reduction if such decision would be entirely based on the interest rate differentials with the US 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 light of the current economic shocks which have exacerbated the extent of income and wealth disparity, extremely tight monetary stance may not be favourable . This could impede investment activities which is necessary to uplift Malaysia's GDP potential.

CENTRAL BANK POLICY RATES

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Policy rates	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-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	5.00	4.50	4.25	4.25	4.25	4.25	4.25	4.00	4.00	4.00	4.00	4.00
Brazil (Selic Rate)	2.25	2.25	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.75	2.75	3.50	4.25
Argentina (LELIQ 7D Notes Rate)	38.00	38.00	38.00	38.00	36.00	38.00	38.00	38.00	38.00	38.00	38.00	38.00	38.00
Eastern Europe													
Russia (Key Rate)	4.50	4.25	4.25	4.25	4.25	4.25	4.25	4.25	4.25	4.50	5.00	5.00	5.50
Ukraine (Discount Rate)	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.50	7.50	7.50	7.50
Turkey (1W Repo Rate)	8.25	8.25	8.25	10.25	10.25	15.00	17.00	17.00	17.00	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)	4.25	4.00	4.00	4.00	4.00	3.75	3.75	3.75	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	2.25	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	0.25	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)	2.00	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 16 June 2021

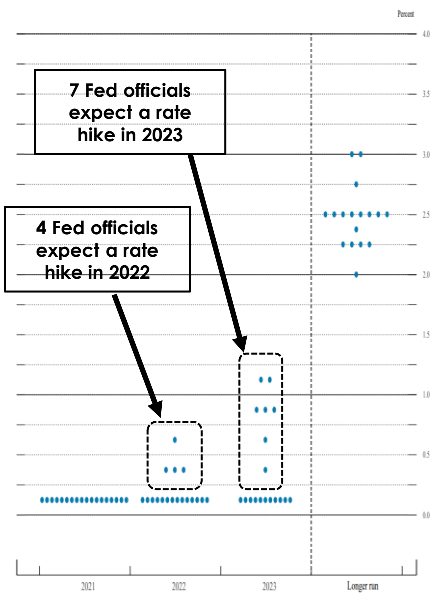
Source: Bloomberg

- ✓ 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.
- ✓ However, central banks in other parts of the world such as Brazil raised its benchmark interest rate by 75 basis points (bps) from 3.50% to 4.25% on 16 June 2021, continuing to wind down its pandemic stimulus stance in the face of rising inflation in Latin America's biggest economy. The annual inflation rate came in at 8.06% in May (April: 6.76%), well above the bank's target range of 2.25% to 5.25%.

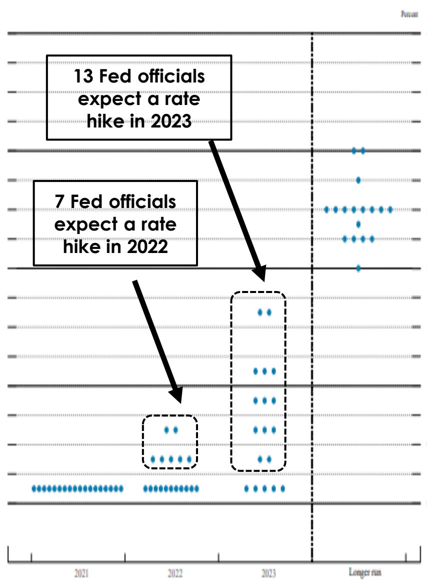
HOW HAS THE FED'S DOT PLOTS EVOLVED IN THE LATEST MEETING?

- ✓ The Fed's so-called dot plot, which the Fed uses to signal its outlook for the path of interest rates, continues to show that officials expect no change in policy this year.
- ✓ However, there has been a change in their tone regarding the target level of the FFR in 2022 and 2023.
- ✓ For example, the dot plot for the June 2021 FOMC meeting showed that 7 Fed officials expect higher interest rates in 2022 (compared to just 4 Fed officials during the March 2021 FOMC meeting) while 13 Fed officials are expecting a rate hike in 2023 (compared to just 7 Fed officials during the March 2021 FOMC meeting).
- ✓ Therefore, expectations among policy makers about a rate hike as early as next year is building up in line with the improving health of the US economy. Acceleration in the vaccination efforts are clearly the key deciding factor.

March 2021 FOMC Meeting



June 2021 FOMC Meeting



Source: The US Federal Reserve Summary Of Economic Projections

- ✓ There had also been initial discussions about when to pull back on the Fed's USD120.0 billion in monthly bond purchases, a conversation that would be completed in coming months as the economy continues to heal.
- ✓ As for now, the path of Covid-19 pandemic continues to cloud the economic outlook while new strains of the virus remain as the key downside risk.
- ✓ The Fed will continue to increase its holdings of Treasury securities by at least USD120.0 billion (USD80.0 billion of Treasury securities and USD40.0 billion of agency mortgage-backed securities) until substantial further progress has been made toward the Committee's maximum employment and price stability goals.

QUANTITATIVE EASING (QE) TAPERING – THE COMMITTEE STILL CONTINUES TO ASSESS PROGRESS OF THE ECONOMY

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Asset purchases following each policy meeting during the 2014 taper:

Date	Treasuries (USD Billion)	MBS (USD Billion)
17-18 September 2013	45	40
29-30 October 2013	45	40
17-18 December 2013	**40**	**35**
28-29 January 2014	**35**	**30**
19-20 March 2014	**30**	**25**
29-30 April 2014	**25**	**20**
17-18 June 2014	**20**	**15**
29-30 July 2014	**15**	**10**
16-17 September 2014	**10**	**5**
28-29 October 2014	**0**	**0**
16-17 December 2014	0	0

Source: FOMC statement

- ✓ The Fed is expected to announce the strategy for reducing its massive bond buying programme in August or September 2021 but would start to reduce the monthly purchases in early 2022.*
- ✓ To recall, the tapering of the Fed's Third Round of Large-Scale Asset Purchases (2012–2014) was announced during FOMC meeting in December 2013.
- ✓ At that time, the FOMC's asset purchases were at a pace of USD85.0 billion per month (USD45.0 billion for Treasury securities and USD40.0 billion for mortgage-backed securities (MBS)).
- ✓ These purchases were reduced gradually to zero within eight scheduled policy meetings, starting from December 2013 to October 2014 (about USD10.0 billion per month reduction after each meeting).

Illustrative if FOMC were to adopt a similar tapering pattern as in 2014:

Date	Treasuries (USD Billion)	MBS (USD Billion)
26-27 January 2021	80	40
16-17 March 2021	80	40
27-28 April 2021	80	40
15-16 April 2021	80	40
27-28 July 2021	80	40
21-22 September 2021	80	40
2-3 November 2021	80	40
14-15 December 2021	**75**	**35**
25-26 January 2022	**70**	**30**
15-16 March 2022	**65**	**25**
3-4 May 2022	**60**	**20**
14-15 June 2022	**55**	**15**
26-27 July 2022	**50**	**10**
20-21 September 2022	**45**	**5**
1-2 November 2022	**40**	**0**
13-14 December 2022	**35**	**0**

Source: FOMC statement

- ✓ If the Fed decided to reduce the pace of its asses purchasing in December 2021 and adopt a similar tapering pattern in 2014, we anticipate that the net purchases of MBS would be concluded by the end of 2022 but net purchases of Treasury securities would still be ongoing until 2023.

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

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

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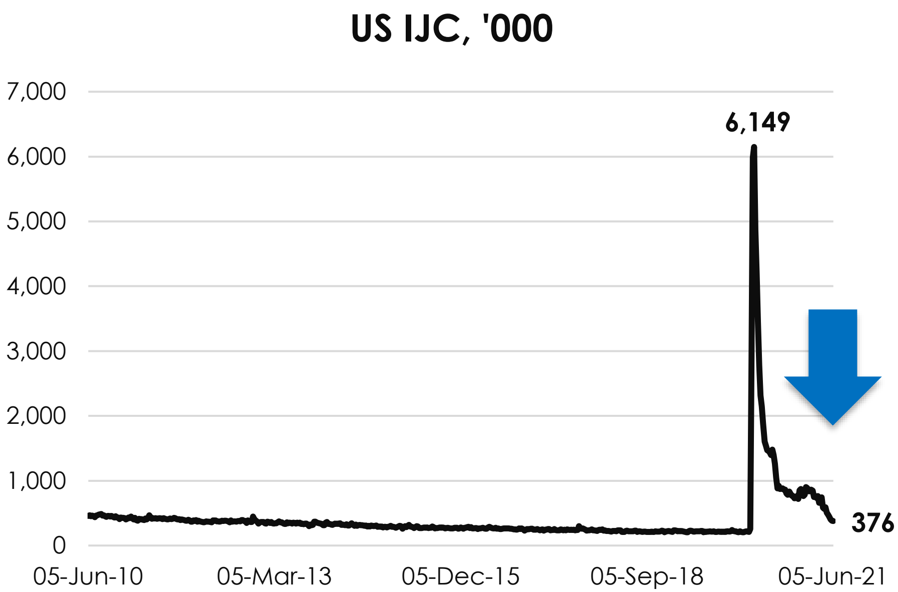

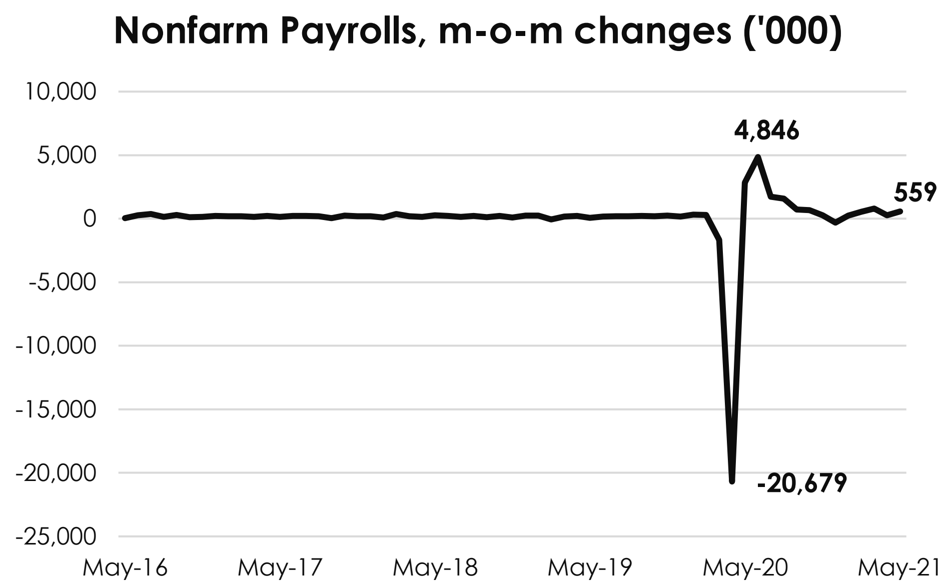

Sources: CEIC, US Department of Labor

- ✓ The number of Americans filing for the US unemployment benefits stood at 376k for the week ended 5 June, down by 9k from 385k in the previous week. This was the lowest number of claims since March last year, suggesting that the labour market continues to show signs of recovery.
- ✓ Broader economic reopening amid a declining trend of daily Covid-19 cases, as well as rapid vaccination programmes in the US have supported the labour market.
- ✓ Thus far, the US economy added 559k number of jobs in May from 278k previously with leisure and hospitality, public and private education, as well as health care and social assistance recording the biggest gains.
- ✓ As such, we can see that the unemployment rate in the US dropped to 5.8% in May (April: 6.1%), the lowest since April last year. The more reasons for the Fed to rethink their monetary stance.

MARKET REACTIONS

- ✓ Wall Street was jostled on Wednesday after the Fed projected interest rate hikes sooner than expected causing major benchmark indexes to close mixed. The S&P 500 index and the Nasdaq index gained by 1.5% and 4.9% on 16 June 2021 respectively, while the Dow Jones index declined by 0.9% on the same day.
- ✓ Meanwhile, US treasury yields jumped sharply following the Fed's meeting as investors sold bonds in expectation of rising rates. For instance, the 3-year, 5-year, 7-year and 10-year yields saw a 7.0 bps, 10.0 bps, 8.0 bps and 6.0 bps increase on Wednesday to reach 0.41%, 0.89%, 1.29% and 1.57% respectively. On the other hand, the 30-year US Treasury yields remained unchanged at 2.20% on the same day.
- ✓ Looking ahead, movement in the US Treasury yields may continue to be range bound in the medium term as the US inflation rate is expected to normalise in 2H2021. Nevertheless, the economic optimism will play a key role in preventing any drastic slump in yields.

Changes in US Treasury Yields

Tenure of US Treasury Bill	Daily Change In Yields (Basis Points) On 16 June 2021
3-year	+7.0
5-year	+10.0
7-year	+8.0
10-year	+6.0
30-year	0.0

Source: US Department of Treasury

Performance of US Stock Market

Index	Percentage Change In Index On 16 June 2021
Dow Jones	-0.9%
S&P 500	1.5%
Nasdaq	4.9%

Source: Bloomberg

INFLATION STILL DEEMED TO BE TRANSITORY IN THE U.S. AS FURTHER NORMALISATION WILL TAKE PLACE IN 2H2021

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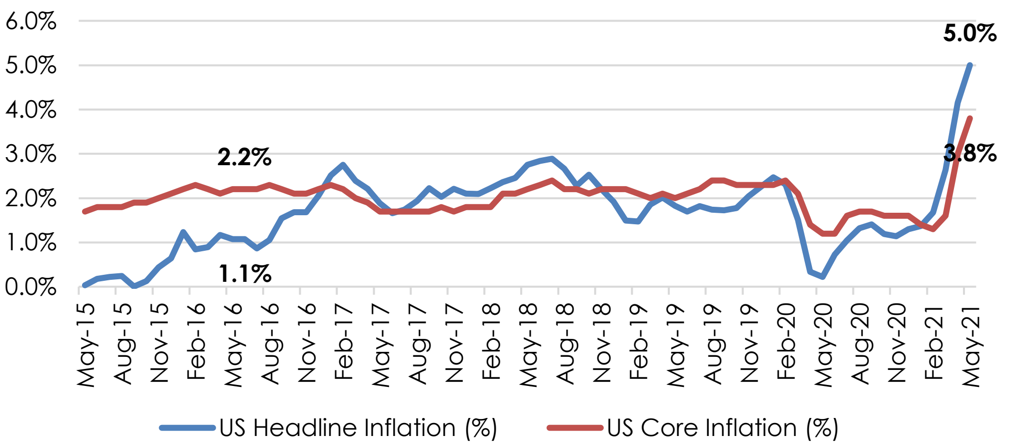
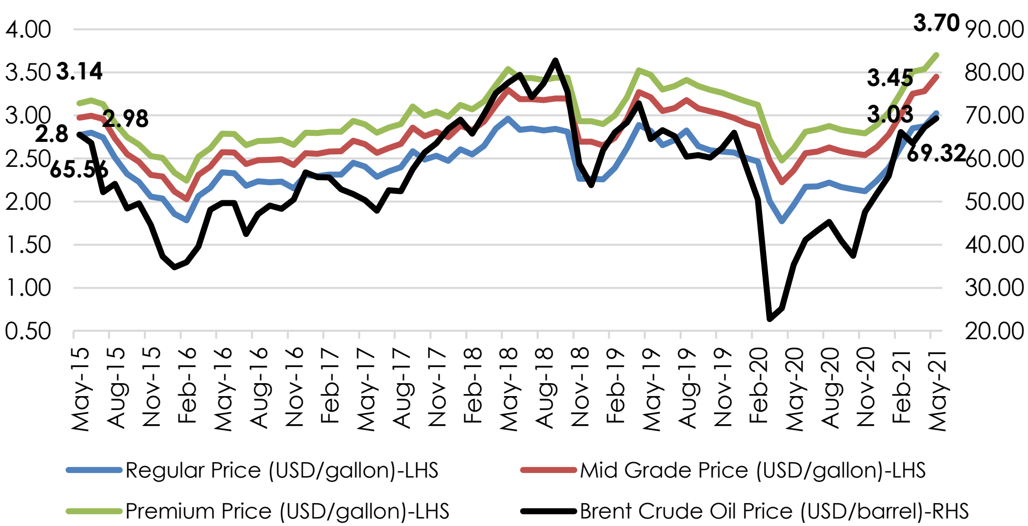
US Headline Inflation vs. US Core Inflation (%)



Source: CEIC

US Gasoline Prices of Different Grades vs. Brent Crude Oil Price



Source: CEIC

- ✓ The U.S. inflation rate reached 5.0% y-o-y in May (April: 4.2%) while the US core inflation stood at 3.8% in the same month (April: 3.0%).
- ✓ Nevertheless, the latest uptick in the US inflation is deemed to be transitory due to the low base from last year's economic slowdown. Moreover, the low base effect gave rise to a larger-than-usual growth in consumer prices.
- ✓ For instance, all grades of US gasoline prices surged by more than 40.0% y-o-y for the second month in May which led to the 28.5% increase in the consumer price index for energy.
- ✓ Elevated inflationary pressures are likely to wane soon once the US regains a more normal footing in 2H2021.
- ✓ Once normalization occurs, inflation will be more tied to trend in consumer spending which is what the Fed will be paying attention to when deciding rate hikes.
- ✓ An increased trend in consumer spending will likely be more prevalent when herd immunity is achieved in the US, spurring high demand for goods as the economy continues to reopen.

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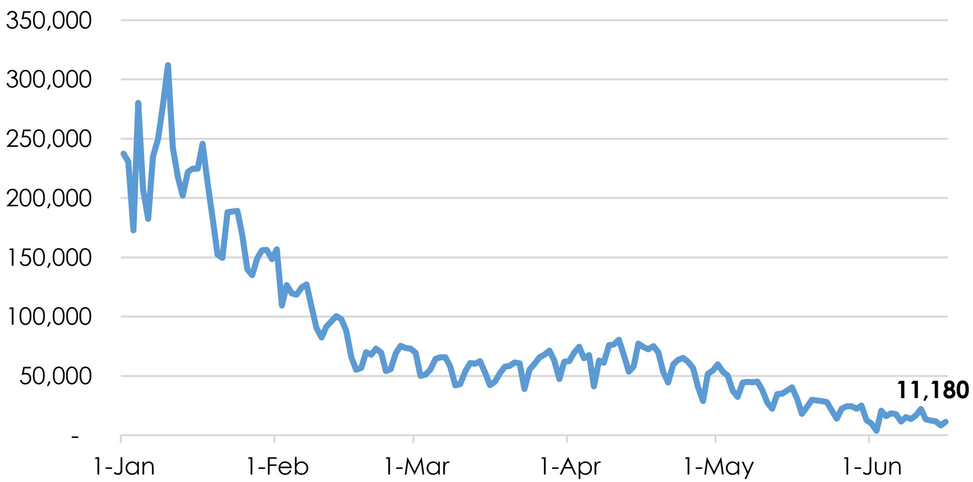
- ✓ **Covid-19 cases in the US declines but global cases remain on the rise** - The trend in daily Covid-19 cases in the U.S. has shown a tremendous decline to reach 11,180 cases on 16 June 2021 from 237,777 cases on 1 January 2021. On further scrutiny, 45.0% of its population have been fully vaccinated while 17.0% of its population have been partly vaccinated, paving way for a faster journey to reach herd immunity. According to the Bloomberg Covid-19 Tracker, the US will need another 5 months from 15 June 2021 in order to vaccinate 75.0% of its population.

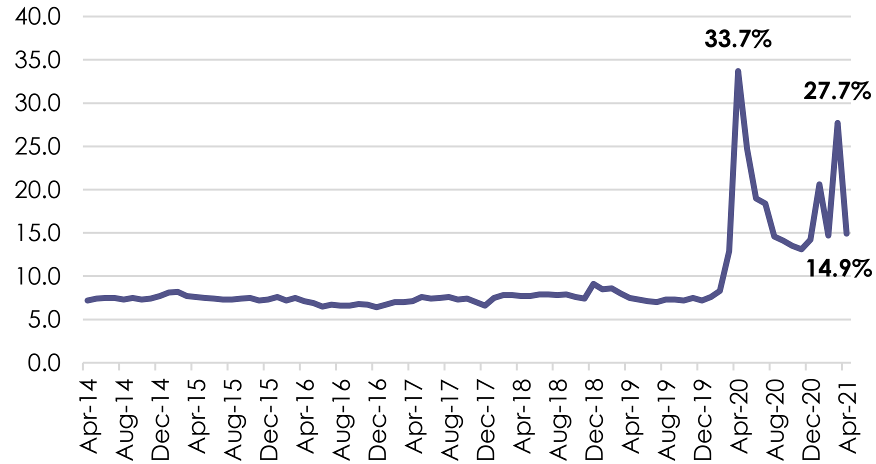
- ✓ **High level of personal savings to boost consumer spending once herd immunity reach in the US** - In the US, the personal savings as percentage of disposable income has remained elevated at 14.9% in April (March 27.7%) compared to pre-pandemic levels of below 10.0%. This provides a ground that the economic recovery in the US can be very strong should the herd immunity is achieved in the next 5. Henceforth, it is not uncommon as more Fed officials are expecting a rate hike as early as next year. Such trends may also jive well with the market expectations that the Fed will begin cutting down asset purchases beginning early next year.

Number of daily Covid-19 cases in the US



Source: CEIC

US personal savings as a percentage of disposable income (%)



Source: CEIC

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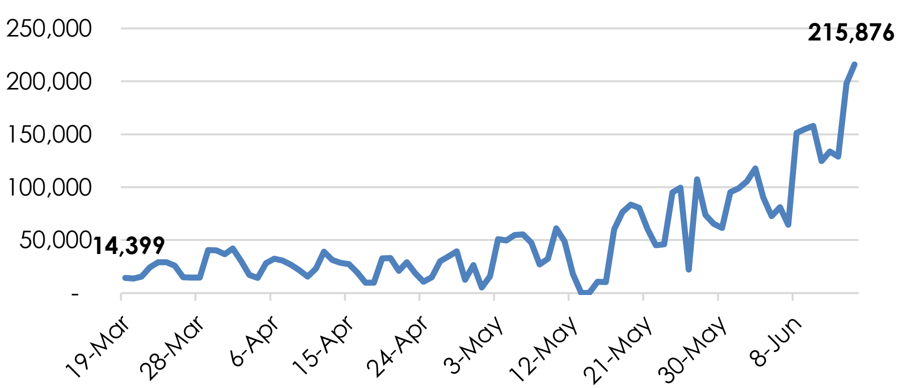
- ✓ **Full-scale lockdown in Malaysia to impact economic growth trajectory -** The latest full scale lockdown which entails a 60.0% working capacity for exempted manufacturing sectors will have a bearing on Malaysia's economic growth trajectory. As such, we have revised our GDP growth forecast downwards to **4.2% (previously 5.0%) for 2021 from a 5.6% contraction in 2020.**

- ✓ **Herd immunity likely to be reached by year-end in Malaysia** - The government is planning to ramp up daily vaccination doses to the tune of 300k to 400k per day on average from August onwards from current average of 150k to 200k doses per day. Should the plan be materialized, Malaysia may be able to vaccinate 80.0% of the country's population to reach herd immunity by end of 2021.

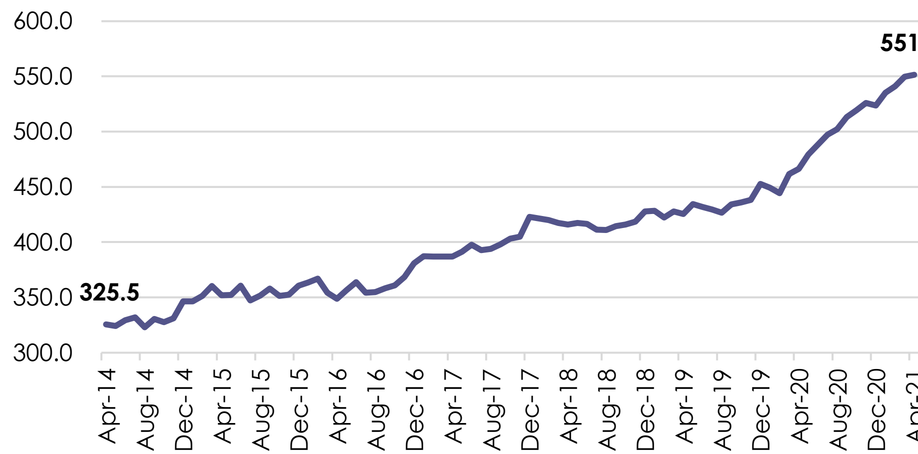
- ✓ **Higher OPR in 2022 is highly likely** - Assuming that herd immunity is reached by year-end in Malaysia with relaxations being probably eased, we opine that the pace of economic recovery will be well supported y strong consumer spending. Judging from M1 growth, it has increased by 18.3% y-o-y in April to RM551.1 billion from RM466.2 million in the same month last year. What it means is that there is a lot of cash circulating in the country. Therefore, higher OPR would make a compelling case in 2022 once the country is fully vaccinated, paving the way for a steady reopening of the economy.

Total number of daily vaccination doses administered in Malaysia



Source: CEIC

Malaysia's M1 Money Supply (RM billion)



Source: CEIC

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APPENDIX

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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.
- ✓ Progress on vaccinations has reduced the spread of COVID-19 in the United States. Amid this progress and strong policy support, indicators of economic activity and employment have strengthened. The sectors most adversely affected by the pandemic remain weak but have shown improvement. 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 will depend significantly 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. In addition, the Federal Reserve will 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 the Committee's maximum employment and price stability goals. 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 – 12 CONSECUTIVE MONTHS OF GROWTH

Index	Series Index May 2021	Series Index April 2021	Percentage Point Change	Direction	Rate of Change	Trend (Months)
PMI	61.2	60.7	0.5	Growing	Faster	12
New Orders	67.0	64.3	2.7	Growing	Faster	12
Production	58.5	62.5	-4.0	Growing	Slower	12
Employment	50.9	55.1	-4.2	Growing	Slower	6
Supplier Deliveries	78.8	75.0	3.8	Slowing	Faster	63
Inventories	50.8	49.7	1.1	Growing	From Contracting	1
Customers' Inventories	28.0	28.4	-0.4	Too Low	Faster	56
Prices	88.0	89.6	-1.6	Increasing	Slower	12
Backlog of Orders	70.6	68.2	2.4	Growing	Faster	11
New Export Orders	55.4	54.9	0.5	Growing	Faster	11
Imports	54.0	52.2	1.8	Growing	Faster	11
OVERALL ECONOMY				Growing	Faster	12
Manufacturing Sector				Growing	Faster	12

Source: US ISM

US ISM Manufacturing PMI, points

Sources: Bloomberg, US ISM

- ✓ According to the US Institute for Supply Management (ISM), Manufacturing Purchasing Manger's Index (PMI) increased to 61.2 points in May from 60.7 points in the preceding month.
- ✓ The growth was mainly contributed by the higher New Orders (May: 67.0 points vs. April: 64.3 points) in May particularly for Non–metallic Mineral Products, Furniture & Related Products, as well as Electrical Equipment, Appliances & Components.
- ✓ Apart from that, with businesses remaining optimistic about the outlook as the economy continues to reopen from Covid19 restrictions, demand is expected to rise further in the next few months.

MANUFACTURERS' SENTIMENTS IN MAY 2021 – MIXED VIEWS

Business Sector	Outlook on Business Activities
Computer & Electronic Products	Demand is high but they are facing supply chain problems and labour shortages.
Chemical Products	Strong consumer demand has led to the increase in sales.
Furniture & Related Products	Business is good, but costs are increasing due to labor and raw materials problems.
Plastics & Rubber Products	Experiencing a high demand and backlog of orders.
Non–metallic Minerals Products	Demand remains strong. However, global supply chain tightness and raw material shortages from the Gulf due to winter storms make it less likely that businesses can recover this year.
Electrical Equipment, Appliances & Components	Labor shortages impacting internal and supplier production, together with poor logistics performance.
Food, Beverage & Tobacco Products	Production delays due to labour shortages. Apart from that, delays at the ports continue to strain inventory levels.

Source: US ISM

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