From the Desk of the Chief Economist

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THE TIME HAS COME TO TAPER ASSET PURCHASES, NOT TO HIKE RATES

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ECONOMIC RESEARCH

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FOMC IS REDUCING ITS BOND-BUYING PROGRAMME

The Federal Open Market Committee (FOMC) **decided to keep the Federal Fund Rate (FFR) range near zero** following its 2-3 November meeting. The Committee also announced that the pace of **bond purchase will be reduced by USD10.0 billion for Treasury securities and USD5.0 billion for agency mortgage-backed securities (MBS).**

- ✓ The U.S. economy continued to gain its momentum supported by progress on vaccination and strong policy support while indicators of economic activity and employment have improved further.
- ✓ Nevertheless, rising in Covid-19 cases due to Delta variant has held back the recovery in the sectors that severely affected by the pandemic, particularly tourism and leisure.
- ✓ Meanwhile, the inflationary pressure was elevated following reopening of the economic which has resulted in significant cost increases for some of the sectors. Furthermore, supply shortages are heavily weighing on the production activities. However, the rise in inflation is deemed to be transitory.
- ✓ According to Powell's press conference, the dynamic economy will adjust to the supply and demand imbalances, and that as it does, inflation will decline to levels much closer to 2.0% longer-run goal.
- ✓ As the U.S. economy continues to make substantial progress, the Committee will reduce the purchases of Treasury securities by USD10.0 billion to USD70.0 billion per month and purchases of agency MBS to be lowered by USD5.0 billion to USD35.0 billion per month beginning later this month. Additionally, the FOMC also announced another reduction of pace in monthly purchases to USD60.0 billion per month for Treasuries and by at least USD30.0 billion per month for agency MBS beginning in December this year.
- ✓ Notwithstanding this, the Fed is prepared to adjust the pace of purchases if warranted by changes in the economic outlook. The ongoing monthly 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.
- ✓ 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 and impede the attainment of the Committee's goals.

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

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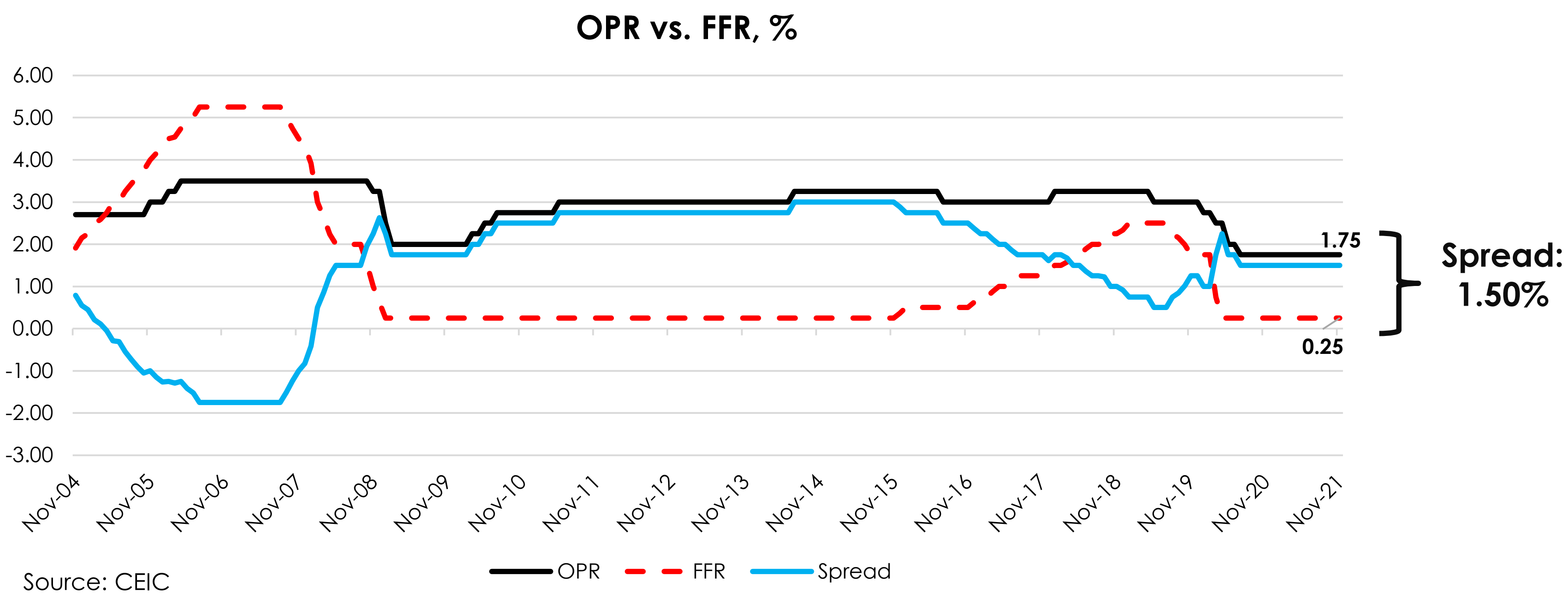

Source: CEIC

- ✓ At the current juncture, the difference between Malaysia's OPR and FFR 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.
- ✓ Assuming that the Fed is likely to normalise 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.
- ✓ Though there has been announcements on tapering of assets purchases beginning later of this month in the recent FOMC meeting following to a stronger pace of economic recovery, a tightening monetary policy is yet to be in plan unless inflation continued to remain elevated. Such monetary policy decision is usually used as benchmark for other countries in formulating their own monetary policies including BNM.

CENTRAL BANK POLICY RATES

Policy rates	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21	Jul-21	Aug-21	Sep-21	Oct-21	Nov-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)	4.25	4.25	4.25	4.00	4.00	4.00	4.00	4.25	4.25	4.50	4.75	4.75	4.75
Brazil (Selic Rate)	2.00	2.00	2.00	2.00	2.75	2.75	3.50	4.25	4.25	5.25	6.25	7.75	7.75
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	38.00
Eastern Europe													
Russia (Key Rate)	4.25	4.25	4.25	4.25	4.50	5.00	5.00	5.50	6.50	6.50	6.75	7.50	7.50
Ukraine (Discount Rate)	6.00	6.00	6.00	6.00	6.50	7.50	7.50	7.50	8.00	8.00	8.50	8.50	8.50
Turkey (1W Repo Rate)	15.00	17.00	17.00	17.00	19.00	19.00	19.00	19.00	19.00	19.00	18.00	16.00	16.00
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)	3.75	3.75	3.75	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	0.50
South Korea (Base Rate)	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75
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	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	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	0.50	0.50
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

Source: Bloomberg
*As at 5 November 2021

- ✓ Thus far, few central banks have started to increase their benchmark interest rate to contain the inflationary pressure such as Brazil's central bank which had raised its interest rate three times this year. Meanwhile, for most emerging market central banks, they are holding their key rates steady to keep the rate low amid ongoing uncertainties on economic prospects.
- ✓ During a meeting which ended on 2 November 2021, the Bank of England (BoE) has decided to maintain its Bank Rate at a record low of 0.10%, as well leaving its bond-buying programme unchanged which currently stands at GBP875.0 billion with an effort to sustain its full support in helping the country's economic recovery from the Covid-19 pandemic. In the coming months, the BoE would probably consider to increase the Bank Rate in order to return the inflation rate's target of 2.0%. As for now, the meeting ended with BoE acknowledging that the existing stance of monetary policy remained appropriate.

LABOUR MARKET IS GRADUALLY IMPROVING

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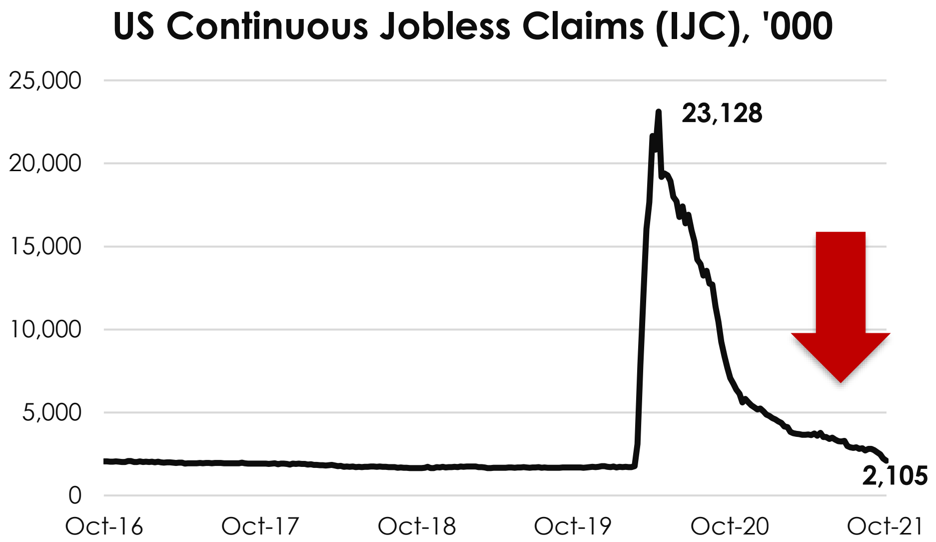

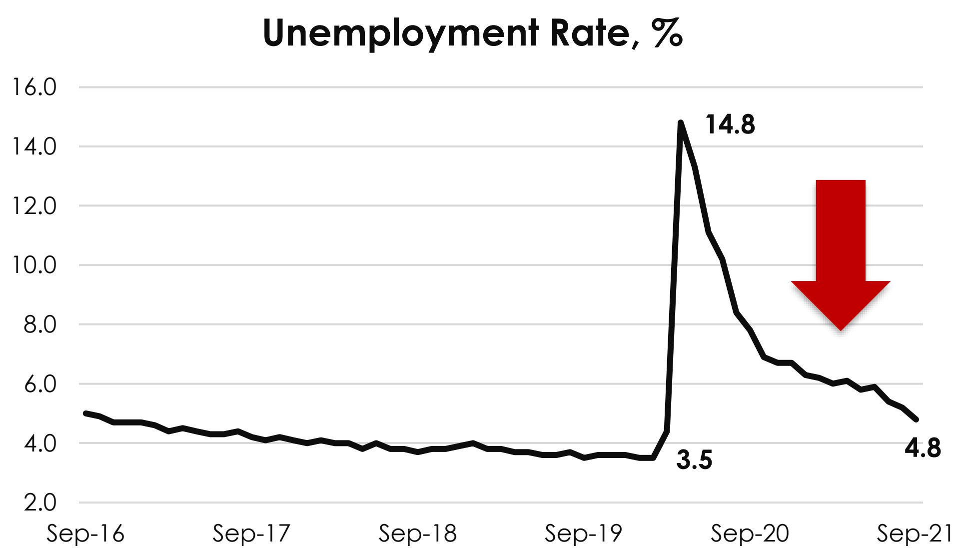

Sources: CEIC, US Department of Labor

- ✓ The number of Americans who have been receiving unemployment benefits fell to 2.11 billion for the week ended 23 October from 2.24 billion in the preceding week. The latest figure was the lowest in the pandemic era, suggesting another sign of healing for the U.S. employment.
- ✓ Apart from that, unemployment rate dropped to 4.8% in September (August: 5.2%), the lowest since March last year as more workers are returning back into the labour force amid broader reopening of the economy in the U.S.
- ✓ Thus far, the U.S. economy added 194k number of jobs in September, though at a softer pace as compared to 366k number of jobs offered in the preceding month. The weakness in the payrolls figure could be a case of businesses struggling to find candidates due to the lack of labour availability rather than being unwilling to hire.
- ✓ Moving forward, we anticipate more job gains in the coming month. This was in tandem with the U.S. private payrolls figure, which increased by 571k jobs in October (September: 523k jobs).

MARKET REACTIONS

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- ✓ Major Wall Street indexes (S&P 500, Nasdaq and Dow Jones) posted solid gains on Wednesday and marked closing record levels as the Fed said it will begin trimming its monthly bond purchases in November with plans to end them in mid-2022, an announcement that investors had been expecting.
- ✓ Meanwhile, the U.S. government bond yields edged higher on Wednesday with the yields on the benchmark 10-Y and 30-Y Treasury note all ended 4.0 basis points (bps) higher on Wednesday at 1.60% and 2.00% respectively. Short-term yields, which are especially sensitive to changes in monetary policy, also closed higher, with the yields on the 3-Y, 5-Y and 7-Y Treasury note both increasing by 4.0 bps.
- ✓ In general, the U.S. government bond yields have been trending higher as of late as investors took note of the Fed's earlier guidance on scaling back its accommodative policy measures in the previous FOMC meeting which has now come into realisation.
- ✓ The start of the asset tapering exercise by the Fed later this month indicates that the Fed is cognizant with the improving economic situation but at the same time be aware of any downside risks by not rushing to raise interest rates.
- ✓ More importantly, better economic prospects will lure investors into the equity market amid stronger corporate earnings, causing bond yields to rise as demand for fixed income securities becomes lower in general.

Changes in U.S Treasury Yields

Tenure of U.S. Treasury Bill	Daily Change in yields (basis points) on 3 November 2021
3-Y	+4.0
5-Y	+4.0
7-Y	+4.0
10-Y	+4.0
30-Y	+4.0

Source: U.S. Department of Treasury

Performance of the U.S. Stock Market

Index	Percentage Change in Index on 3 November 2021
Dow Jones Industrial Average	0.3%
S&P 500	0.7%
Nasdaq	1.0%

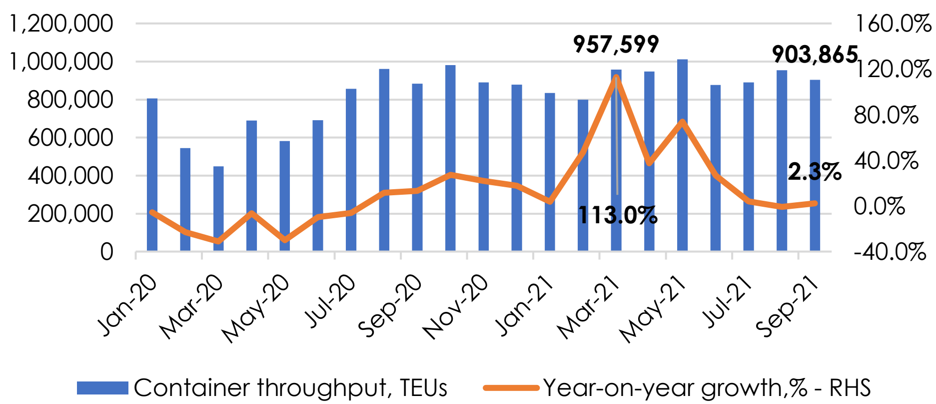
Source: Investing.com

✓ **Supply chain disruptions continue to be seen at ports** – It is clear that supply chain disruptions are ongoing at the moment, evident through the backlog of ships at ports. Port of Los Angeles also marked its busiest September on record, handling a total of 903,865 twenty-foot equivalent units (TEUs) of containers. As such, the urgency of buyers to get their hands on goods combined with the slow delivery sparked by manufacturers feeling overwhelmed with the surge in demand has definitely led to the spike in prices of goods. This can be seen through the U.S. inflation rate which edged up to a 13-year high of 5.4% in September from 5.3% in August.

✓ **Easing of supply chain pressures will happen but the timing is uncertain** – That being said, the Fed continues to consider inflation to be transitory in the sense that it is the supply and demand imbalances that are largely fuelling the price increases compared to organic economic growth. In our view, we believe that businesses may eventually find their way to navigate this sticky situation by optimally managing their manpower, network of suppliers and production capacity. With that, supply chain bottlenecks could ease later, causing inflationary pressures to ease and allowing the inflation rate to gyrate towards the Fed's long run inflation target of 2.0%. However, the exact timing as to when these supply chain pressures will abate is hard to ascertain given the complexity of the supply chain ecosystem.

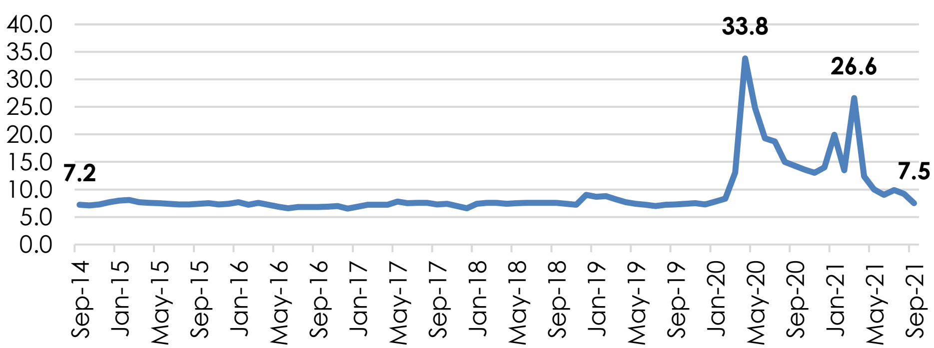
✓ **The start of tapering asset purchases will prepare the Fed to get ready for a rate hike when the time comes** – In the meantime, the Fed's stance on reducing its monthly asset purchases first seems appropriate as personal savings as a percentage of disposable personal income in the U.S. has recently showed a downtrend from 26.6% in March this year to 7.5% in September, indicating stronger spending by individuals. Therefore, the Fed's move to focus on tapering will later enable the Fed to react swiftly when conditions are ripe for a rate hike.

Container throughput at the Port of Los Angeles



Source: Port of Los Angeles

Personal Saving As A Percentage of Disposable Personal Income In The U.S., %



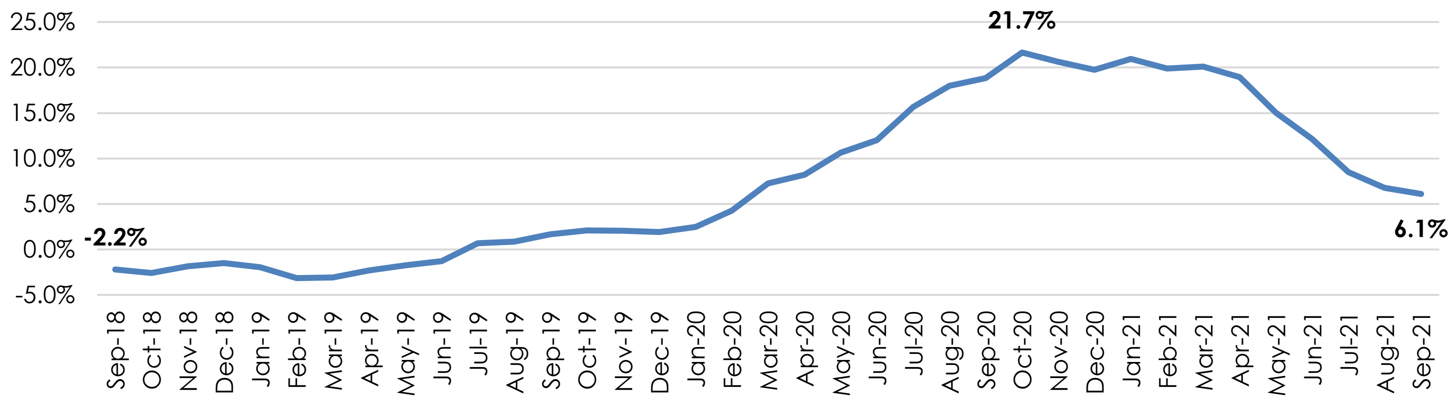
Source: CEIC

- ✓ **The Fed's actions may not necessarily be a main reference point this time for BNM -** With respect to BNM which usually uses the actions of the Fed as a yard stick to determine interest rates, BNM may not necessarily hinge their decision on the Fed this time around as there are other data points to take into account. For instance, the growth in saving deposits by individuals has declined to 6.1% y-o-y in September (August: 6.8%) from a peak of 21.7% seen in October last year, suggesting that the propensity to consume has gradually risen in line with the gradual relaxation of movement restrictions which began in August this year.

- ✓ **Consumer spending to rise further with greater relaxation of restrictions** - We foresee that the growth in saving deposits of individuals in Malaysia is likely to normalie to pre-pandemic levels of below 4.0% in the coming months especially after the resumption of inter-state travel effective from 11 October. Heightened spending will be seen in sectors that were previously affected badly by the pandemic, namely tourism and aviation. In addition, any upcoming festive seasons will likely see a boost in expenditure by households as state borders are no longer closed.

- ✓ **The timeline for BNM to hike the OPR could likely be in 2H2022** - Assuming that the strong consumer spending continues to thrive until 1H2022, barring any unforeseen circumstances from the surge in Covid-19 infections, businesses may have already reached a stronger footing. Aside from that, manufacturers will have also likely reconfigured their business structure to incorporate systems and processes that are flexible towards global supply chain constraints. Therefore, BNM may have a stronger case in 2H2022 to begin hiking the OPR.

Growth In Saving Deposits Of Individuals In Malaysia, %



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.
- ✓ 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 the summer's rise in COVID-19 cases has slowed their recovery. Inflation is elevated, largely reflecting factors that are expected to be transitory. Supply and demand imbalances related to the pandemic and the reopening of the economy have contributed to sizable price increases in some sectors. 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.
- ✓ 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 light of the substantial further progress the economy has made toward the Committee's goals since last December, the Committee decided to begin reducing the monthly pace of its net asset purchases by $10 billion for Treasury securities and $5 billion for agency mortgage-backed securities. Beginning later this month, the Committee will increase its holdings of Treasury securities by at least $70 billion per month and of agency mortgage-backed securities by at least $35 billion per month. Beginning in December, the Committee will increase its holdings of Treasury securities by at least $60 billion per month and of agency mortgage-backed securities by at least $30 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.

MANUFACTURING SECTOR – 15 CONSECUTIVE MONTHS OF GROWTH

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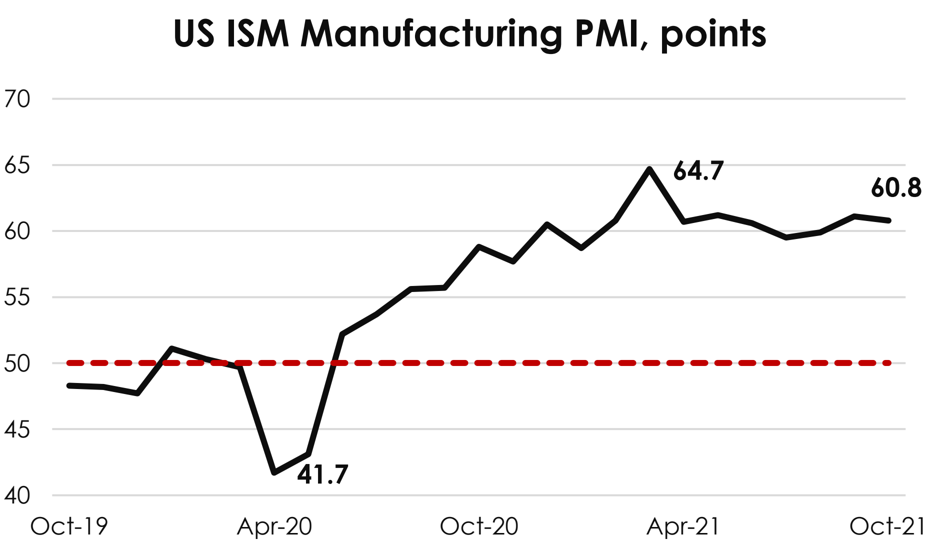
Index	Series Index October 2021	Series Index September 2021	Percentage Point Change	Direction	Rate of Change	Trend (Months)
PMI	60.8	61.1	-0.3	Growing	Slower	17
New Orders	59.8	66.7	-6.9	Growing	Slower	17
Production	59.3	59.4	-0.1	Growing	Slower	17
Employment	52.0	50.2	1.8	Growing	Faster	2
Supplier Deliveries	75.6	73.4	2.2	Slowing	Faster	68
Inventories	57.0	55.6	1.4	Growing	Faster	3
Customers' Inventories	31.7	31.7	0.0	Too Low	Same	61
Prices	85.7	81.2	4.5	Increasing	Faster	17
Backlog of Orders	63.6	64.8	-1.2	Growing	Slower	16
New Export Orders	54.6	53.4	1.2	Growing	Faster	16
Imports	49.1	54.9	-5.8	Contracting	From Growing	1
	OVERALL ECONOMY			Growing	Slower	17
	Manufacturing Sector			Growing	Slower	17

Source: US ISM



Sources: Bloomberg, US ISM

- ✓ According to the U.S. Institute for Supply Management (ISM), Manufacturing Purchasing Manager's Index (PMI) dropped to 60.8 points in October from 61.1 points previously.
- ✓ All segments of the manufacturing sector were impacted by record-long raw materials lead times, continued shortages of critical materials, rising commodities prices, as well as difficulties in transporting products.
- ✓ Apart from that, worker absenteeism, short-term shutdowns due to parts shortages, difficulties in filling open positions, together with supply chain problems globally persisting, have affected the manufacturing growth potential.
- ✓ Be that as it may, the figure still above the 50-point threshold, indicating a expansion in the overall economy for the seventeenth straight month.

MANUFACTURER SENTIMENTS – SUPPLY CHAIN ISSUES REMAIN

Business Sector	Responses from survey
Computer & Electronic Products	Global supply chain issues persists. Microchip and circuit breaker shortages are expected to continue until next year.
Chemical Products	Supply chain is getting worse every day. But, business is still running well.
Transportation Equipment	Stronger sales continue and they have diverted chips (semiconductors) production to their higher-margin vehicles and limited the lower-margin vehicles production schedules.
Furniture & Related Products	Business remains strong with brisk incoming orders. Be that as it may, costs continue to rise and they are considering third price increases this year for their customers.
Plastics & Rubber Products	2022 will be very similar to 2021 — similar demand, constrained supply, restricted logistics and higher inflation.
Food, Beverage & Tobacco Products	Import costs and delays are hurting businesses. Apart from that, rolling blackouts in China are starting to hurt shipments.
Electrical Equipment, Appliances & Components	Demand is strong. However, supply chain issues have hampered production.
Machinery	Covid-19 related supply chain issues still hamper their ability to meet demand. Moreover, labour costs are increasing, making difficult for suppliers to obtain labour – labour shortages.

Source: US ISM

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