Economic Research, Strategic Management

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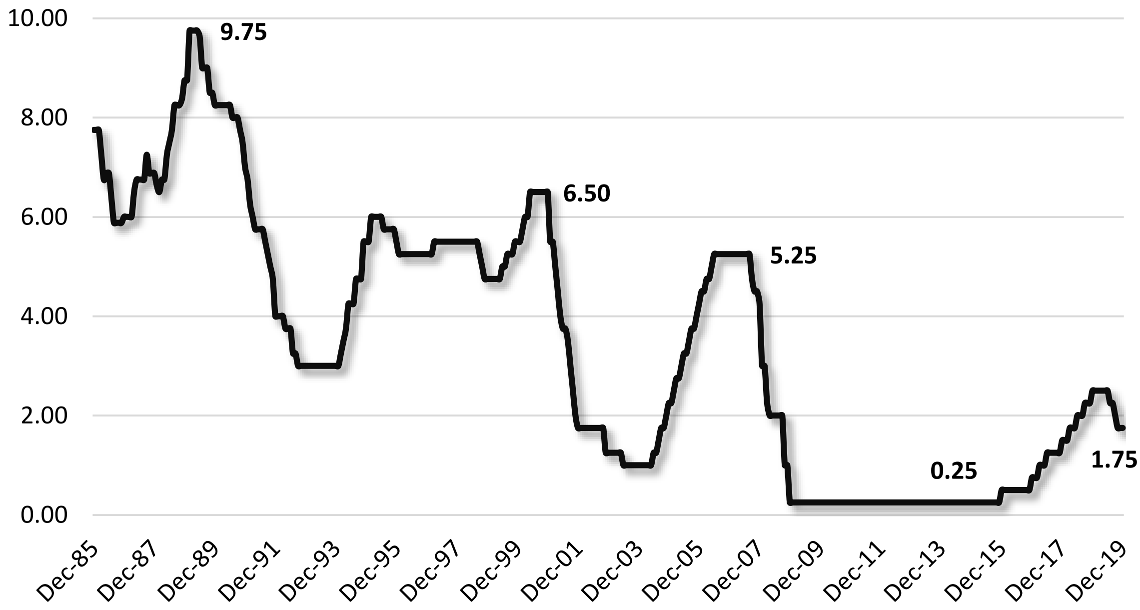
The US FFR held steady at between 1.50% - 1.75%

Facts

- The US Federal Open Market Committee (FOMC) meeting was held from 10 to 11 December. The FOMC members decided to keep the Federal Fund Rate (FFR) target range between 1.50% and 1.75%, after three earlier cuts this year. It was a unanimous decision among the committee members.
- In the accompanying statement, the FOMC members mentioned that the current stance of monetary policy is appropriate to support the economic growth. Moreover, the labour market remains strong, resulting from strong job creations and low unemployment rate.
- However, the members acknowledged that the economic activity has been expanding at a modest pace. Apart from that, business fixed investment and exports performance have been inconsistent, suggesting business sentiments are likely to be weak in the foreseeable future.
- The upcoming FOMC meeting will be held between 28 and 29 January 2020.

Chart 1: US Federal Fund Rate (FFR)

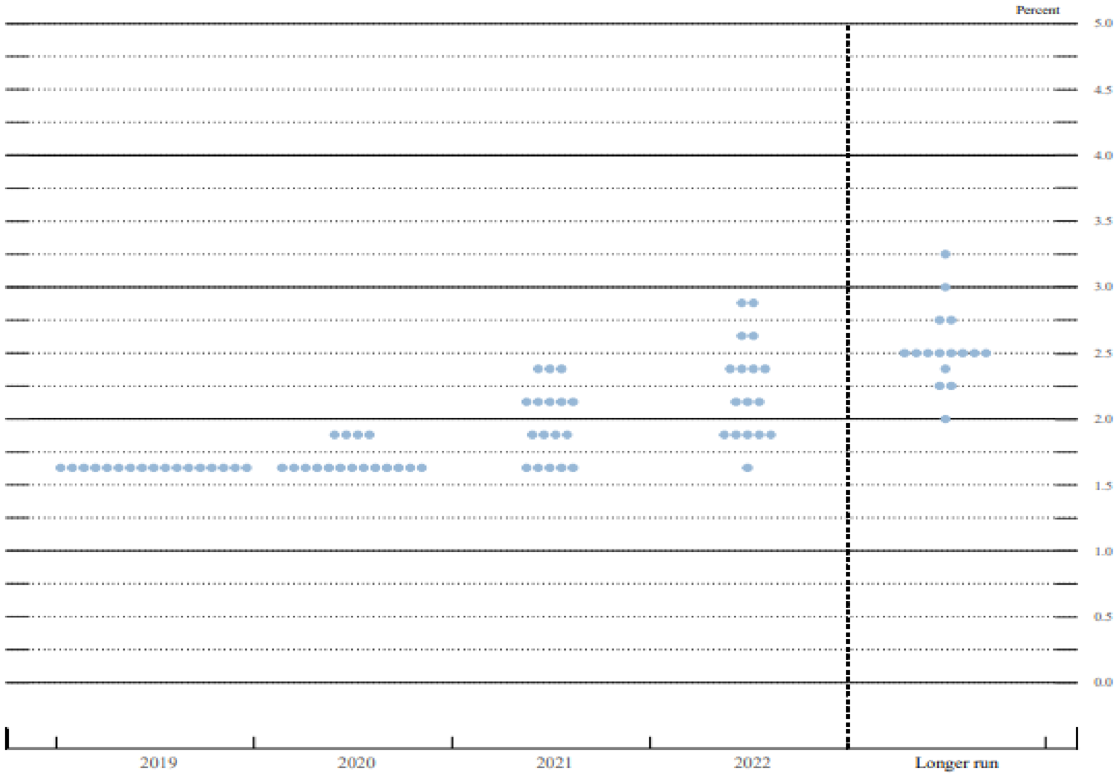


Source: Bloomberg

Our view

The Fed Chairman, Jerome Powell strongly suggested that the FFR will not vary anytime soon. This statement indicates that the current level of FFR is “appropriate” to provide support to the slowing economic conditions. This can be seen via the dot plot chart (See Chart 1) as 13 officials envisaged no change of FFR in 2020, while another 4 predicting a quarter-point increase to 2.0%, implying the Fed could remain at status quo. Notwithstanding, based on the median economic projection, the Fed is forecasting the Gross Domestic Product (GDP) to expand at a rate of 2.2% in 2019 and 2.0% in 2020. This was higher that the longer-term trend, suggesting the Fed is still sanguine about the state of economy. In addition, unemployment rate is expected to remain low at 3.6% in 2019 (Longer-term trend: 4.1%) from 3.7% projection made during September. Similarly, Core Personal Consumption Expenditure (PCE) inflation is projected to rise at 1.6% in 2019, which is below than 1.8% projection in September.

Chart 2: The Dot Plots – Survey on the US FFR among the FOMC members



Source: US Federal Reserve

Table 1: The US Economic Projections

Percent

Variable	Median[1]					Central Tendency[2]					Range[3]				
	2019	2020	2021	2022	Longer run	2019	2020	2021	2022	Longer run	2019	2020	2021	2022	Longer run
Change in real GDP	2.2	2.0	1.9	1.8	1.9	2.1–2.2	2.0–2.2	1.8–2.0	1.8–2.0	1.8–2.0	2.1–2.3	1.8–2.3	1.7–2.2	1.5–2.2	1.7–2.2
September projection	2.2	2.0	1.9	1.8	1.9	2.1–2.3	1.8–2.1	1.8–2.0	1.7–2.0	1.8–2.0	2.1–2.4	1.7–2.3	1.7–2.1	1.6–2.1	1.7–2.1
Unemployment rate	3.6	3.5	3.6	3.7	4.1	3.5–3.6	3.5–3.7	3.5–3.9	3.5–4.0	3.9–4.3	3.5–3.6	3.3–3.8	3.3–4.0	3.3–4.1	3.5–4.5
September projection	3.7	3.7	3.8	3.9	4.2	3.6–3.7	3.6–3.8	3.6–3.9	3.7–4.0	4.0–4.3	3.5–3.8	3.3–4.0	3.3–4.1	3.3–4.2	3.6–4.5
PCE inflation	1.5	1.9	2.0	2.0	2.0	1.4–1.5	1.8–1.9	2.0–2.1	2.0–2.2	2.0	1.4–1.7	1.7–2.1	1.8–2.3	1.8–2.2	2.0
September projection	1.5	1.9	2.0	2.0	2.0	1.5–1.6	1.8–2.0	2.0	2.0–2.2	2.0	1.4–1.7	1.7–2.1	1.8–2.3	1.8–2.2	2.0
Core PCE inflation[4]	1.6	1.9	2.0	2.0		1.6–1.7	1.9–2.0	2.0–2.1	2.0–2.2		1.6–1.8	1.7–2.1	1.8–2.3	1.8–2.2	
September projection	1.8	1.9	2.0	2.0		1.7–1.8	1.9–2.0	2.0	2.0–2.2		1.6–1.8	1.7–2.1	1.8–2.3	1.8–2.2	
Memo: Projected appropriate policy path															
Federal funds rate	1.6	1.6	1.9	2.1	2.5	1.6	1.6–1.9	1.6–2.1	1.9–2.6	2.4–2.8	1.6	1.6–1.9	1.6–2.4	1.6–2.9	2.0–3.3
September projection	1.9	1.9	2.1	2.4	2.5	1.6–2.1	1.6–2.1	1.6–2.4	1.9–2.6	2.5–2.8	1.6–2.1	1.6–2.4	1.6–2.6	1.6–2.9	2.0–3.3

Source: US Federal Reserve

Be that as it may, at the current juncture, many companies have been badly impacted from the US-China trade friction. The rise in tariffs rates which is very punitive in nature have led higher operating cost among the businesses. Such notion was in tandem with the US Institute for Supply Management (ISM) for the manufacturing sector which dropped to 48.1 points in November from 48.3 points previously (Consensus: 49.2 points). The ISM index has been hovering below the 50-point demarcation line for four straight months, suggesting a further deterioration in the manufacturing industry amid global trade uncertainties. This was attributed by the decrease in the new orders which saw a steep decline from 49.1 points in October to 47.2 points in November (Consensus: 49.0 points). Apart from that, employment index also fell to 46.6 points in November from 47.7 points in October. As such, manufacturers have become pessimistic, suggesting weak fixed asset investment growth is unlikely to be reversed in the immediate terms.

While the FFR may stand pat next year, we believe there is always a scope for the Overnight Policy Rate (OPR) to be reduced next year. Positive interest rate differentials between the OPR and FFR (+125 to +150 basis points), as well as the expected below trend inflation rate in 2020 (CPI forecasted at 1.8% vs. long-term inflation of 2.5%) indicates that a 25 basis points OPR cut would not be detrimental to the economy. Lower OPR would stimulate investment and consumption as borrowing costs would be cost effective. We believe the case for lower OPR is building up as we foresee the economy would operate below its potential level in 1H2020.

Appendix

FOMC Statement

Information received since the Federal Open Market Committee met in October indicates that the labor market remains strong and that economic activity has been rising at a moderate rate. Job gains have been solid, on average, in recent months, and the unemployment rate has remained low. Although household spending has been rising at a strong pace, business fixed investment and exports remain weak. On a 12-month basis, overall inflation and inflation for items other than food and energy are running below 2 percent. Market-based measures of inflation compensation remain low; 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. The Committee decided to maintain the target range for the federal funds rate at 1-1/2 to 1-3/4 percent. The Committee judges that the current stance of monetary policy is appropriate to support sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective. The Committee will continue to monitor the implications of incoming information for the economic outlook, including global developments and muted inflation pressures, as it assesses the appropriate path of the target range for the federal funds rate.

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