16 March 2020

ECONOMIC REVIEW | March 2020 US FOMC Meeting

Fed Cuts Rates to Zero to Boost the Economy amid Covid-19 Fallout

- *Fed cut rates to zero. The Fed cut its policy rate by 100bps to 0-0.25% (the levels it hovered for years during and after GFC) in a second emergency move after the first one on 3rd March. In addition, Fed also launched a massive USD 700b quantitative easing program. Concerns increase as the pandemic flare outside of China and perceived to pose evolving risks to economic activities globally. The US in particular is on top ten most-affected countries.*
- *Multiple headwinds are in the air. The US economy is anticipated to experience a substantial slowdown in 2020 amid multiple headwinds including domestic political uncertainty, financial market volatility, oil price war and Covid-19. The economy is surrounded by political uncertainties with Presidential Elections to be held by year-end. In addition, the oil war between Saudi Arabia, Russia and the US will result in commodity prices to remain depressed. Of all the headwinds, the Covid-19 pandemic is expected to the most fearsome.*
- *We expect Fed to maintain rate at current level. Negative policy rate may not be forthcoming as the US Fed may instead opt for further quantitative easing in order to inject additional liquidity. External sector of the US economy is predicted to continue on a weak side in 2020. Hence, domestic demand mainly household spending and business investment should expand steadily to support growth. The current 0-0.25% level on top of USD 700b asset purchase program would be a big boost to domestic demand.*

Fed cut rates to zero. The Fed cut its policy rate by 100bps to 0-0.25% (the levels it hovered for years during and after GFC) in a second emergency move after the first one on 3rd March. In addition, Fed also launched a massive USD 700b quantitative easing program. Concerns increase as the pandemic flare outside of China and perceived to pose evolving risks to economic activities globally. The US in particular is on top ten most-affected countries. The aggressive moves are continuous attempts to combat the possible economic damage caused by Covid-19. These will pump cash into the financial system and encourage bank loans to businesses and consumers.

Multiple headwinds are in the air. The US economy is anticipated to experience a substantial slowdown in 2020 amid multiple headwinds including domestic political uncertainty, financial market volatility, oil price war and Covid-19. The economy is surrounded by political uncertainties with Presidential Elections to be held by year-end. In addition, the oil war between Saudi Arabia, Russia and the US will result in commodity prices to remain depressed. Of all the headwinds, the Covid-19 pandemic is expected to the most fearsome. Lower demand, supply chain disruption and weak market sentiments resulting from the pandemic may exert significant downward pressure on growth. Furthermore, the US-China phase one trade deal is likely to be less successful as China's commitment to the deal is at stake due to Covid-19 and President Trump could flip-flop on trade related issues in ways that will benefit him for the upcoming presidential election.

Weak industrial activities. The US industrial production continued contracting for the fifth consecutive month at -0.8%yoy in Jan-20. Manufacturing output fell by the same rate but improved compared to -1.3%yoy drop in Dec-19. On monthly basis, manufacturing output declined by 0.1%mom after two sequential months of positive growth led by a drop of -0.5%mom in durable goods mainly resulting from falling output of aerospace & misc. transport as Boeing halted production of the 737 Max plane and did not receive any order for all aircraft in Jan-20. The US Markit manufacturing PMI was revised marginally down to a six-month low of 50.7 in Feb-20 from a preliminary of 50.8 but remain on expansionary mode. The slowdown in factory activities was mainly due to weak gains in output and new orders amid Covid-19. This provides cues on what to expect for industrial production performance in upcoming months.

Still strong retail sales. Retail sales in the US managed to grow above 4%yoy in Jan-20. On monthly basis, it had been steadily growing between 0.2-0.3%mom for the past four months. Inflation and labour market remain supportive to the expenditure. Inflationary pressure stay benign, hovering around 2%yoy while unemployment rate at record low levels. Looking ahead, demand for essential goods including food and household necessity will be elevated amid Covid-19. However, reduction in spending could be observed in other segments, influencing the overall retail sales growth.

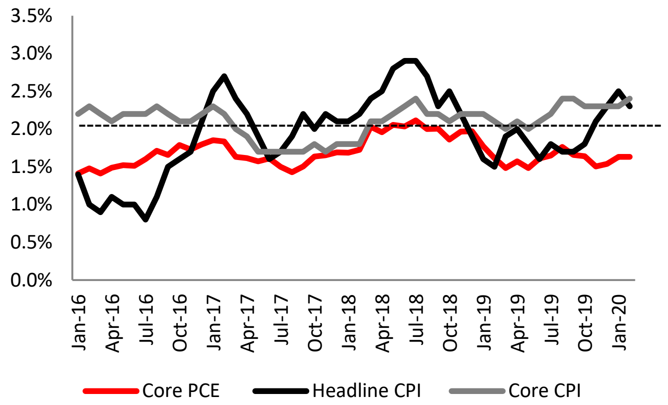
We expect Fed to maintain rate at current level. Negative policy rate may not be forthcoming as the US Fed may instead opt for further quantitative easing in order to inject additional liquidity. External sector of the US economy is predicted to continue on a weak side in 2020. Hence, domestic demand mainly household spending and business investment should expand steadily to support growth. The current 0-0.25% level on top of USD 700b asset purchase program would be a big boost to domestic demand as cost of credit for consumers and businesses are very low. Such policy supports will be more effective when the economy begins to recover. As challenges remain, we foresee the Fed to maintain at current low levels for the remaining of the year.

Table 1: Central Bank Policy Rate by Selected Economies (%)

	Jul-19	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19	Jan-20	Feb-20	Mar-20
Malaysia	3.00	3.00	3.00	3.00	3.00	3.00	2.75	2.75	2.50
Indonesia	5.75	5.50	5.25	5.00	5.00	5.00	5.00	4.75	4.75
Philippines	5.00	4.75	4.00	4.00	4.00	4.00	4.00	3.75	3.75
Thailand	1.75	1.50	1.50	1.50	1.25	1.25	1.25	1.00	1.00
Vietnam	6.25	6.25	6.00	6.00	6.00	6.00	6.00	6.00	6.00
South Korea	1.50	1.50	1.50	1.25	1.25	1.25	1.25	1.25	1.25
India	5.75	5.40	5.40	5.15	5.15	5.15	5.15	5.15	5.15
Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
UK	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.25
EU	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
USA	2.00	2.00	2.00	1.75	1.50	1.50	1.50	1.50	0.00

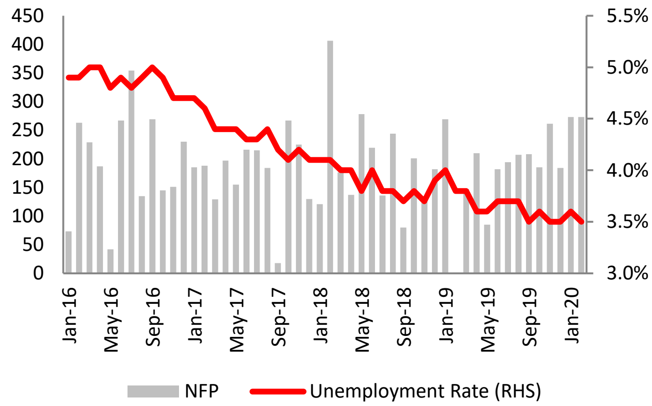
Source: CEIC; MIDFR

Chart 1: Headline vs Core PCE Inflation (%)



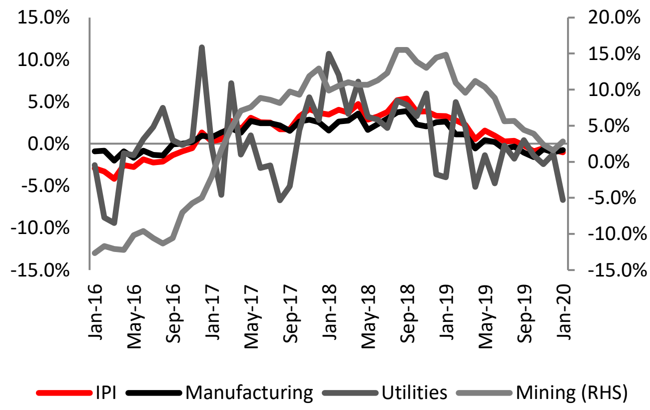
Source: CEIC; MIDFR

Chart 2: Unemployment Rate vs Non-Farm Payroll



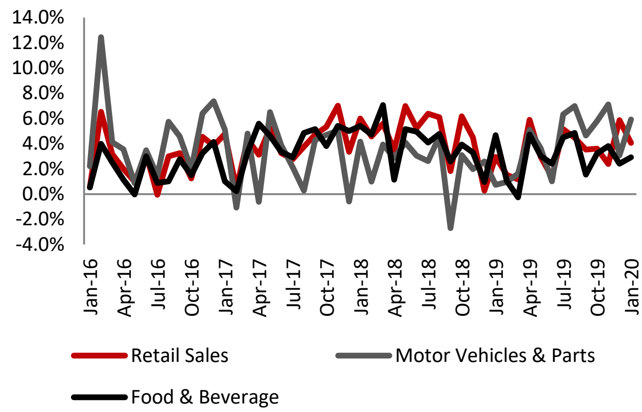
Source: CEIC; MIDFR

Chart 3: IPI Performances (YoY%)



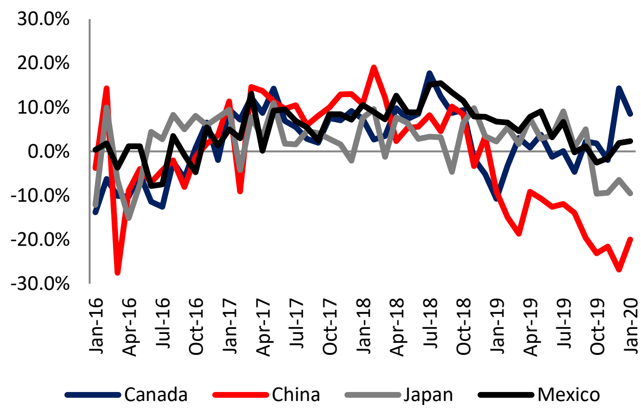
Source: CEIC; MIDFR

Chart 4: Retail Sales (YoY%)



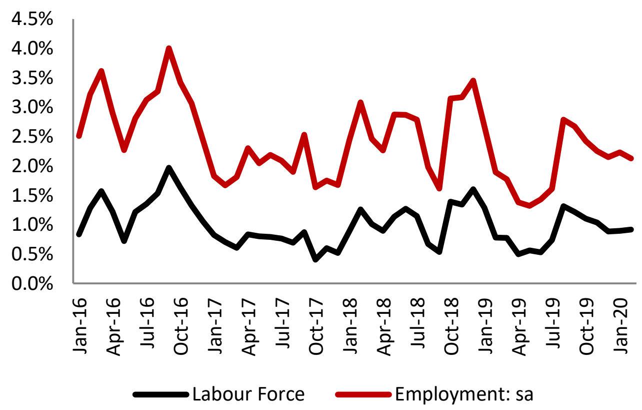
Source: CEIC; MIDFR

Chart 5: Imports from Major Destinations (YoY%)



Source: CEIC; MIDFR

Chart 6: Labour Market (YoY%)



Source: CEIC; MIDFR

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