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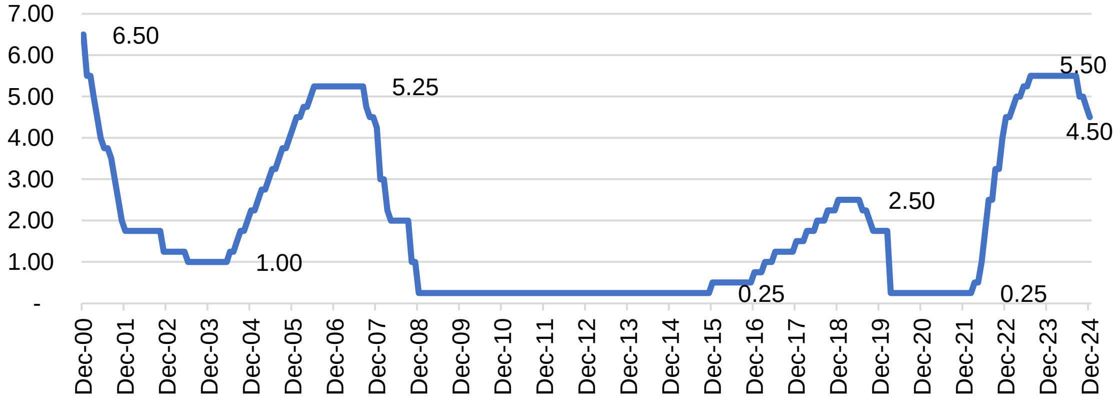
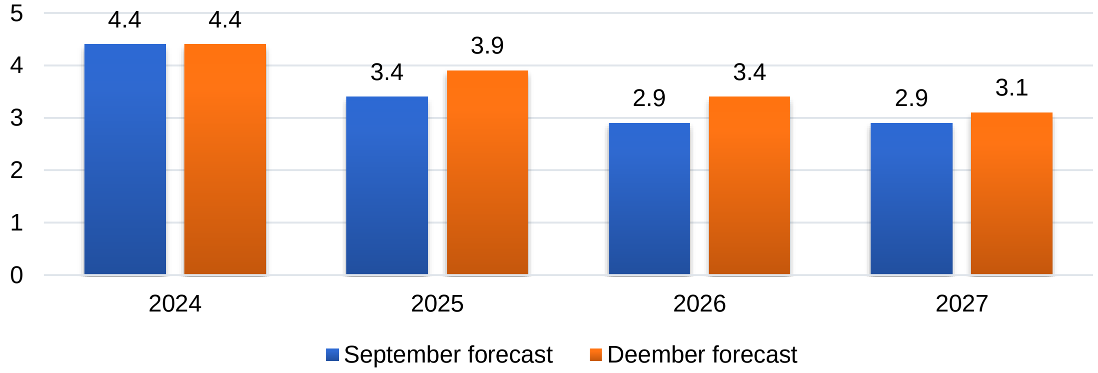
19 DECEMBER 2024

US Fed Fund Rate – the Fed raises the bar for 2025

Federal Fund Rate (FFR)



FOMC members FFR forecast



Sources: Federal Reserve & Bloomberg

The Federal Open Market Committee (FOMC) concluded its meeting on December 17–18, 2024, deciding on the final interest rate adjustment of the year. The committee voted 11-1 to lower the Federal Funds Rate (FFR) by 25 basis points, setting the benchmark interest rate at a range of 4.25% to 4.50%, down from 4.50% to 4.75%. The sole dissenting vote came from Beth M. Hammack, President of the Federal Reserve Bank of Cleveland, who preferred maintaining the current rate.

The accompanying statement highlighted the Fed's assessment that risks between economic growth and inflation are now relatively balanced, with a cautionary focus on inflationary pressures. This stance was mirrored in their updated quarterly forecast, projecting the FFR to decline to 3.9% by the end of 2025, a revision from September's forecast of 3.4%. Consequently, the expected rate cuts for 2025 have been adjusted from 100 basis points to 50 basis points. Furthermore, inflation projections for 2025 have been revised upwards, from 2.1% to 2.5%, signaling continued concerns over persistent inflation risks.

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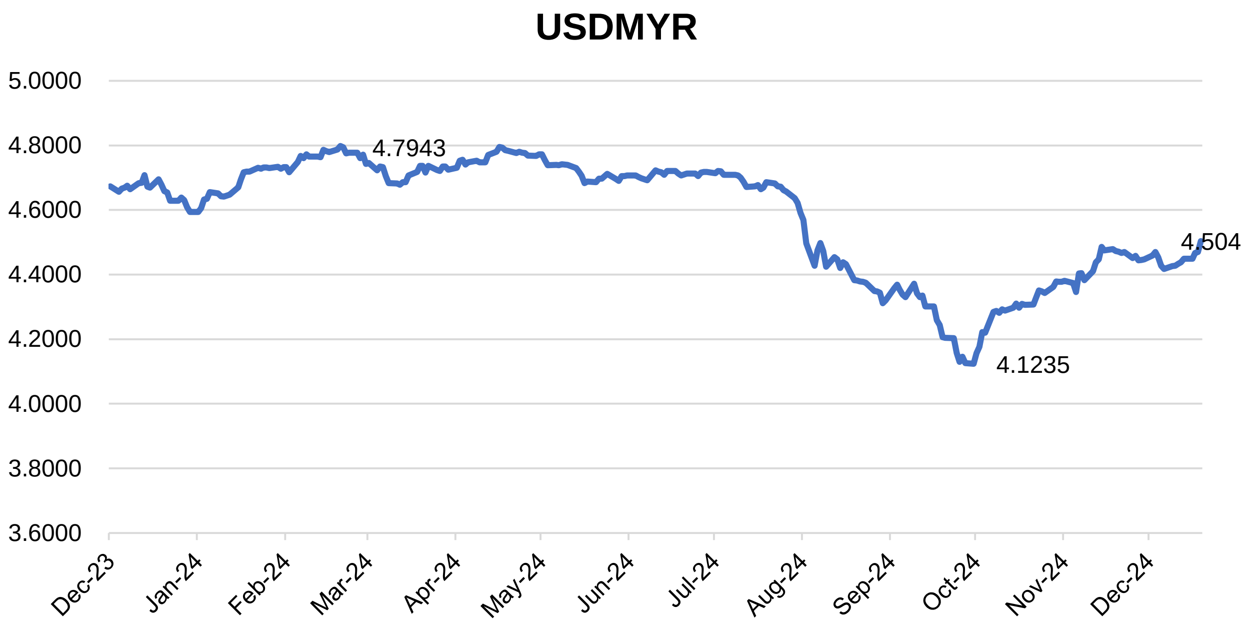
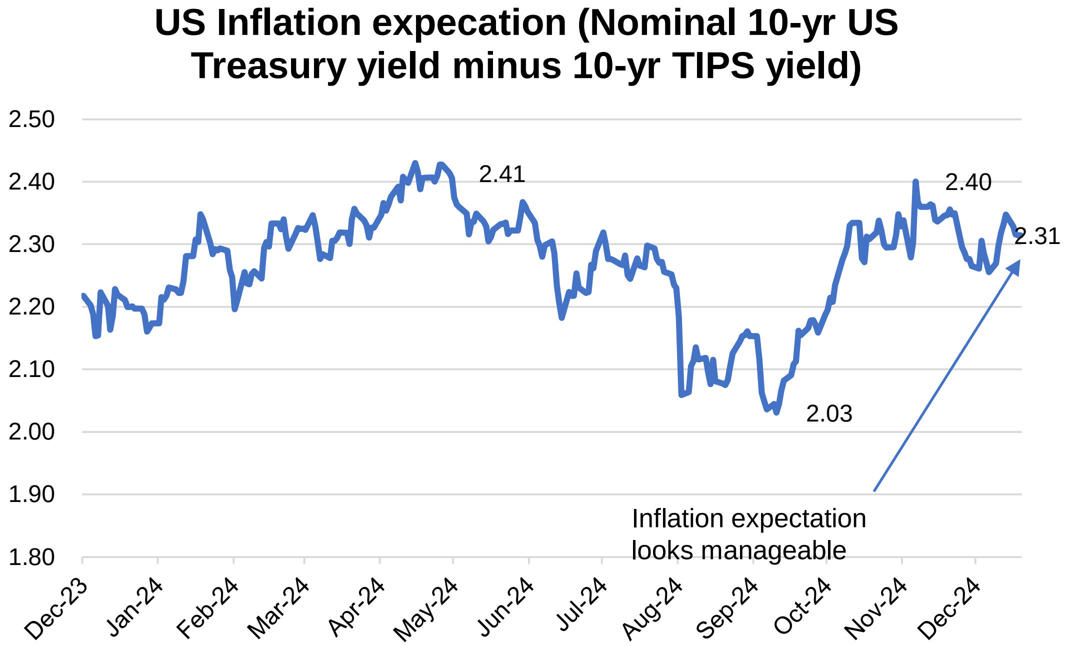
Ringgit took a beating but US inflation expectation fairly stable





Source: Bloomberg

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The Ringgit, along with other regional currencies, faced significant pressure following the FOMC's projections for the coming year. The Fed's latest forecast and assessment are viewed as dollar-positive, especially as other G7 economies struggle with weaker economic conditions and may lean toward easing their monetary policies to support growth. Throughout 2024, the Ringgit performed well up to the third quarter, with the USDMYR exchange rate reaching RM4.1235 on September 30, reflecting an 11.4% gain since the start of the year. However, as of now, the Ringgit has depreciated by 8.4% against the US dollar since September 30, 2024. Despite this, inflation expectations in the U.S., while remaining elevated, did not spike alarmingly after the FOMC meeting. This suggests that the Fed effectively communicated that its current monetary policy stance remains restrictive, helping to mitigate the risk of runaway inflation. The Fed's ability to maintain its credibility in managing inflation is critical, as it prevents nominal bond yields from rising excessively. This, in turn, helps keep borrowing costs manageable in credit markets, supporting economic stability.

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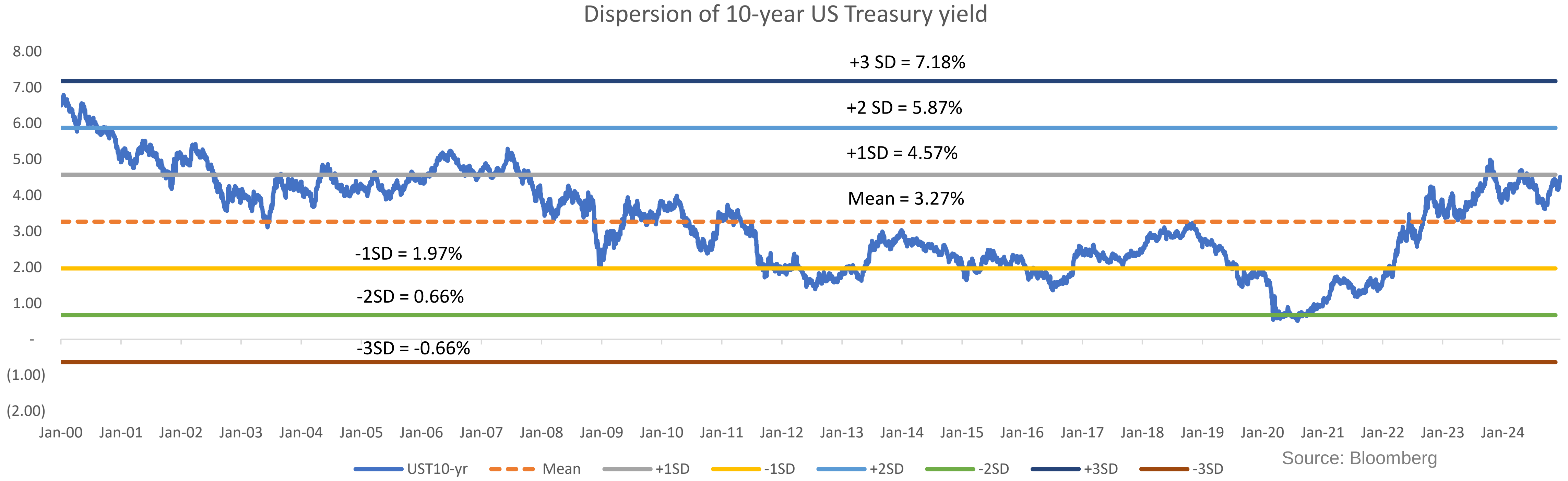
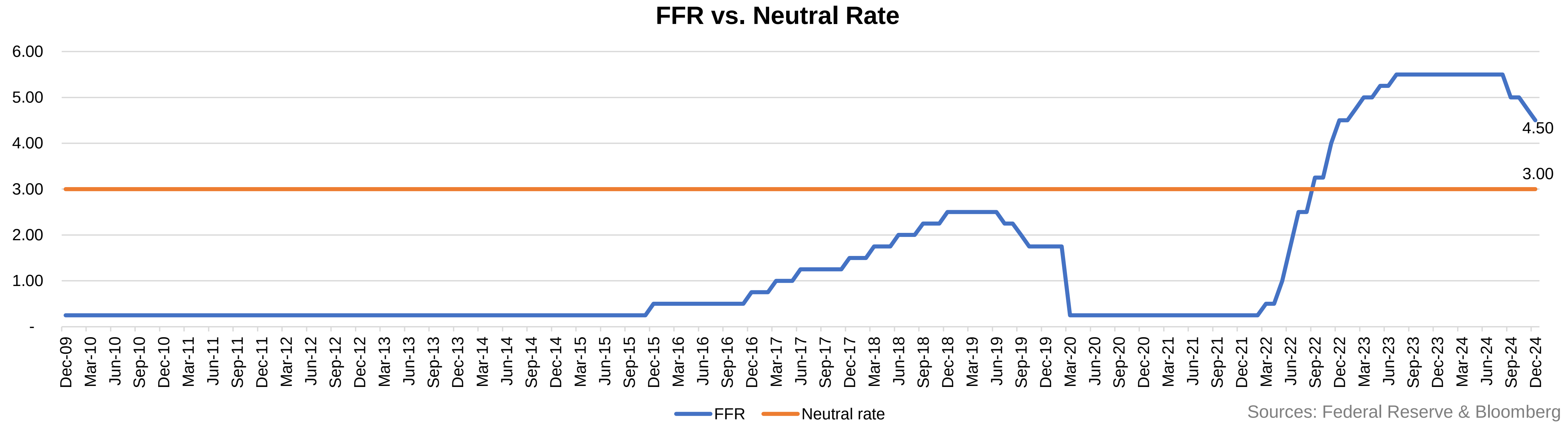
Expect volatile market in the near term



Source: Bloomberg

The US Treasury market remained bearish in December, despite expectations of a Federal Funds Rate (FFR) cut. The yield on the 10-year US Treasury (UST) increased by 32 basis points since the start of the month, rising from 4.19% on December 2 to 4.51% on December 18, 2024. This indicates that bond markets are more focused on the outlook for further rate cuts in 2025. As signaled by the Fed, a cautious approach to policy rate reductions next year is expected. Given this scenario, the 10-year UST yield appears poised to approach the +1 Standard Deviation (SD) level of 4.57%. Similarly, the 10-year Malaysian Government Securities (MGS) yield is likely to remain elevated, hovering between 3.80% and 3.85% (revised from 3.76%), as it closely tracks movements in the 10-year UST yields. Regarding the USDMYR, the current resistance and support levels are positioned at RM4.5339 and RM4.4500, respectively. The exchange rate is expected to stabilize around RM4.5000 (previously estimated at RM4.4000) as the year comes to a close.

While market can be volatile, the interest cut thesis stays



Sources: Federal Reserve & Bloomberg

There is considerable apprehension surrounding the incoming U.S. administration, which may introduce additional challenges to the macroeconomic landscape and potentially to foreign policy as well. Despite this, the Federal Reserve remains steadfast in its view that the current monetary policy stance is significantly restrictive and could suppress economic activity.

According to Fed estimates, the neutral rate (the rate that is neither stimulative nor restrictive) is approximately at 3.00%. With the Federal Funds Rate (FFR) projected at 3.9% for 2025, this suggests room for more than 100 basis points of cuts if the Fed opts to align closer to the neutral zone. Such a shift could occur if FOMC members perceive that economic growth is significantly slowing amid a stable inflationary environment. Consequently, in our assessment, the downside risks for bond yields remain intact.

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Appendix – Correlation matrix

	FFR	UST3M	UST2YR	UST10YR	MGS3YR	MGS5YR	MGS10YR	MGII3YR	MGII5YR	MGII10YR
FFR	100%									
UST3M	100%	100%								
UST2YR	96%	97%	100%							
UST10YR	75%	76%	80%	100%						
MGS3YR	41%	42%	51%	70%	100%					
MGS5YR	34%	36%	48%	68%	97%	100%				
MGS10YR	21%	23%	37%	65%	89%	94%	100%			
MGII3YR	31%	32%	42%	64%	98%	96%	89%	100%		
MGII5YR	24%	26%	38%	62%	95%	98%	96%	96%	100%	
MGII10YR	12%	14%	28%	58%	87%	92%	98%	88%	96%	100%