8 July 2021

Global Markets Research

Malaysia - Economics

BNM strikes a more cautious note

No change in OPR at a record low of 1.75%

Foresee rising odds of further policy easing given heightened downside growth risks

Duration and stringency of the containment measures are key influencing factors

Summary

BNM maintained the Overnight Policy Rate (OPR) at a record low of 1.75% at its July policy meeting, marking a pause for the sixth consecutive meeting. The decision was in line with our house view and general market consensus although we did see a slim chance of a pre-emptive cut earlier. The overall tone of the policy statement did not come in as dovish as expected, but has turned more cautious nonetheless in our view. The central bank highlighted that the growth outlook remains subject to ***"significant"*** downside risk, a tweak from "downside risk" in the last statement, and commented that the materialization of these downside risks could undermine the growth recovery. This left the door open for an OPR cut in the near future in our view.

Global economic recovery strengthened further

BNM assessment on the global economy remains positive. BNM highlighted that global economic recovery has strengthening further although not all countries are equal. Economies which are making better progress in vaccination rates have been able to see a swifter recovery in economic activities as containment measures are relaxed. BNM also acknowledged that financial conditions remain supportive of growth. All in, BNM reiterated that the balance of risks remains tilted to the downside, due primarily to uncertainties surrounding the Covid-19 pandemic and potential risks of heightened financial market volatility.

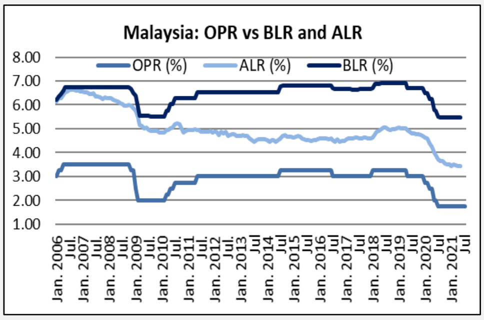
Containment measures pose downside risks to domestic growth

While BNM maintained that improvement in economic activities has extended into April, it no longer said that growth trajectory is expected to pick up going forward. In fact, it highlighted that the growth outlook remains subject to significant downside risks. The reintroduction of nationwide movement restrictions will dampen the growth momentum, where the degree of the impact is highly dependent on the stringency and duration of the containment measures even though permission for certain economic sectors to continue operate will cushion the fallout. Roll-out of various policy support packages, a more favourable external environment, expedition in vaccination rates, and the eventual relaxation of containment measures, are expected to provide some support to domestic economic activities in 2H2021. On inflation, BNM acknowledged that full year 2021 inflation is projected to average at the lower end of its projection of 2.5-4.0% (ours 2.6%).

Outlook

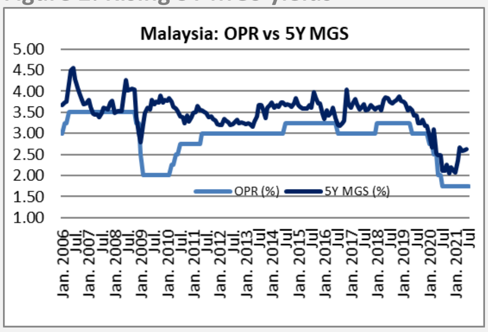
Even though BNM stopped short of offering a strong signal of further policy easing, given the fluidity of the pandemic path and vaccination progress, we are of the view that it is leaving the door open for a rate cut as early as September, adopting a wait and see approach to assess the effectiveness of the containment measures, as well as various economic aid packages. Any further deterioration in the infection situation and delay in the implementation and execution of fiscal measures, and vaccination programme, could intensify the need for monetary policy response.

Figure 1: Average lending rates have been inching down despite a steady OPR



Source: BNM, HLBB

Figure 2: Rising 5Y MGS yields



Source: BNM, HLBB

Side by Side Comparison of BNM Monetary Policy Statement

6-May-2021	8-July-2021
At its meeting today, the Monetary Policy Committee (MPC) of Bank Negara Malaysia decided to maintain the Overnight Policy Rate (OPR) at 1.75 percent.	At its meeting today, the Monetary Policy Committee (MPC) of Bank Negara Malaysia decided to maintain the Overnight Policy Rate (OPR) at 1.75 percent.
The global economic recovery continues to strengthen, particularly in the major economies, supported by improvements in manufacturing and trade activity, although the pace may vary across countries. The ongoing roll-out of vaccination programmes and sizeable fiscal stimulus measures in the US as well as policy support in other major economies will further facilitate an improvement in domestic demand. However, the recovery trajectory in some economies could be disrupted by a re-tightening of containment measures to curb COVID-19 resurgences. Recent financial market volatility has somewhat receded, and financial conditions remain supportive of growth. The balance of risks to the growth outlook remains tilted to the downside, due mainly to uncertainty over the path of the pandemic as well as potential risks of heightened financial market volatility.	The global economic recovery has strengthened further, supported by improvements in manufacturing and services activity. The pace of recovery, however, varies across countries. Economies making better progress in their vaccination programmes have been able to ease containment measures, enabling a swift recovery in domestic activity. In several advanced economies, sizeable fiscal and monetary measures are also supporting a stronger recovery momentum, although activities in some economies are disrupted by tighter containment measures to curb COVID-19 resurgences. Financial conditions remain supportive of growth. Overall, the balance of risks to the growth outlook remains tilted to the downside, due mainly to uncertainty over the path of the pandemic as well as potential risks of heightened financial market volatility.
For Malaysia, latest indicators point to continued improvements in economic activity in the first quarter and into April. While the recent re-imposition of containment measures in select locations will affect economic activity in the short term, the impact will be less severe as almost all economic sectors are allowed to operate. The growth trajectory is projected to improve, driven by the stronger recovery in global demand and increased public and private sector expenditure amid continued support from policy measures. Growth will also be supported by higher production from existing and new manufacturing facilities, particularly in the E&E and primary-related sub-sectors, as well as oil and gas facilities. The progress of the domestic COVID-19 vaccine programme will also lift sentiments and contribute towards recovery in economic activity. The growth outlook, however, remains subject to downside risks, stemming mainly from ongoing uncertainties in developments related to the pandemic, and potential challenges that might affect the roll-out of vaccines both globally and domestically.	For the Malaysian economy, better-than-expected economic activity in the first quarter of 2021 continued into April, as reflected by latest indicators, particularly on exports, retail spending and labour market conditions. The re-imposition of nation-wide containment measures to curb the resurgence in COVID-19 cases, however, will dampen the growth momentum. The degree of impact to the economy is highly dependent on the stringency and duration of containment measures. Nevertheless, continued allowances for essential economic sectors to operate, albeit at a reduced capacity, and higher adaptability to remote work, automation and digitalisation will partly mitigate the impact of restrictions. The various policy support packages will alleviate some of the financial burdens of households and businesses. Favourable external demand conditions will continue to provide a lift to growth. Going forward, the gradual relaxation of containment measures, alongside the rapid progress of the domestic vaccination programme and continued strength in external demand will provide support for the growth recovery into 2022. The growth outlook, however, remains subject to **significant** downside risks, due mainly to factors that could lead to a delay in the easing of containment measures or imposition of tighter containment measures, and a weaker-than-expected global growth recovery. The materialisation of these risks could undermine the growth recovery.
Headline inflation in 2021 is projected to average higher between 2.5% and 4.0%, primarily due to the cost-push factor of higher global oil prices. In terms of trajectory, headline inflation is anticipated to temporarily spike in the second quarter of 2021, due particularly to the lower base from the low domestic retail fuel prices in the corresponding quarter of 2020. However, this will be transitory as headline inflation is projected to moderate thereafter as this base effect dissipates. Underlying inflation, as measured by core inflation, is expected to remain subdued, averaging between 0.5% and 1.5% for the year, amid continued spare capacity in the economy. The outlook, however, is subject to global oil and commodity price developments.	As expected, headline inflation spiked recently due mainly to the base effect from low fuel prices in the second quarter of last year. This spike is transitory and headline inflation is projected to moderate in the near term as this base effect dissipates. For 2021 as a whole, headline inflation is projected to average closer to the lower bound of the forecast range. Underlying inflation, as measured by core inflation, is expected to remain subdued, averaging between 0.5% and 1.5% for the year, amid continued spare capacity in the economy. The outlook, however, is subject to global commodity price developments.
The MPC considers the stance of monetary policy to be appropriate and accommodative. Given the uncertainties surrounding the pandemic, the stance of monetary policy going forward will continue to be determined by new data and information, and their implications on the overall outlook for inflation and domestic growth. The Bank remains committed to utilise its policy levers as appropriate to foster enabling conditions for a sustainable economic recovery.	The MPC considers the stance of monetary policy to be appropriate and accommodative. In addition, fiscal and financial measures will continue to cushion the economic impact on businesses and households and provide support to economic activity. Given the uncertainties surrounding the pandemic, the stance of monetary policy will continue to be determined by new data and information and their implications on the overall outlook for inflation and domestic growth. The Bank remains committed to utilise its policy levers as appropriate to foster enabling conditions for a sustainable economic recovery.

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