6 July 2022

Global Markets Research

Malaysia - Economics

A further 25bps increase in the OPR

BNM raised OPR by a measured 25bps to 2.25% as expected

Positive domestic growth momentum necessitated the measured policy adjustment

Expect another 25-50bps hike for the rest of the year

Summary

BNM decided at its monetary policy meeting today to raise the OPR by a further 25bps to 2.25% as widely expected. This was premised on improving growth prospects of the Malaysian economy, and in line with the central bank's earlier guidance back in May for a gradual and measured policy normalization path.

This is a cautious and more sensible move in our view, given increasing risks of a slowdown in the world economy, more so with amplified recession noises in recent weeks. Acknowledging the need to further adjust the degree of monetary accommodativeness as the domestic economy recovers following migration to endemicity and reopening of international borders, which should see growth picking up further in 2Q and 3Q, we maintain our view for another 25-50bps hike for the remaining of the year, bringing the OPR to 2.50-2.75% levels.

Global growth is expected to moderate

On its assessment on the global economy, BNM acknowledged that global growth was driven by economic reopening and recovery in the labour market, but the recovery has been partly curbed by rising cost pressures arising from the Ukraine conflict and supply chain disruption. Given such lingering risk factors, BNM expects the pace of global growth to moderate, "continue to be affected by the elevated cost pressures, conflict in Ukraine, global supply chain conditions, and financial market volatility".

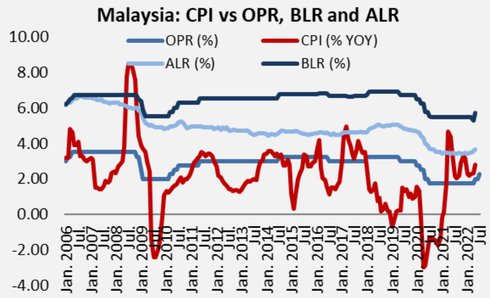
Malaysia on a steady recovery path

On the contrary, the domestic economy continued to see positive growth momentum recently, supported by an improving labour market and income level. Going forward, domestic demand will be the key growth engine as exports are expected to moderate in line with a softening global economy. That said, the economy remains susceptible to downside risks stemming from a weaker-than-expected global growth, further escalation of geopolitical conflicts, and worsening supply chain disruptions. Inflation trajectory is penning out as expected and well within the forecast range of 2.2-3.2%

Outlook

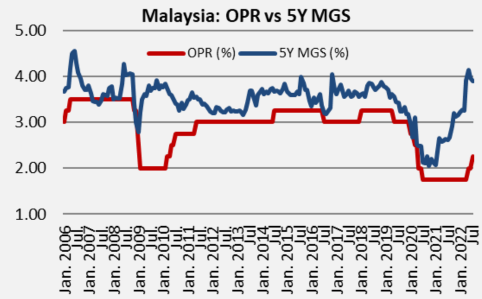
We maintain our view that BNM will adopt a cautious approach in its policy normalization path given increasing uncertainties surrounding the global economy. Rapid and aggressive rate hikes by major central banks globally with 50bps hike becoming a norm to rein in runaway inflation have heightened concerns of a recession. The Fed acknowledged increased risk of a recession last week, while the BOE echoed the same in its latest Financial Stability Report released on Tuesday, warning that economic outlook has "deteriorated materially", and expecting further shocks ahead. A global economic downturn will undoubtedly have repercussion on the Malaysian economy, although we could still fare relatively well compared to many economies this year following economic reopening, ongoing fiscal policy support and a favourable base effect from last year. A comparatively moderate inflationary condition given the heavily subsidized consumer staples are also expected to allow BNM to take on less aggressive moves compared to other central banks in our view. We therefore maintain our view for a further 25-50bps increase in the OPR to 2.50-2.75% this year, seeking to minimize the gap with the Fed whilst ensuring longer term growth and price stability.

Figure 1: Overall interest rates remain low and accommodative



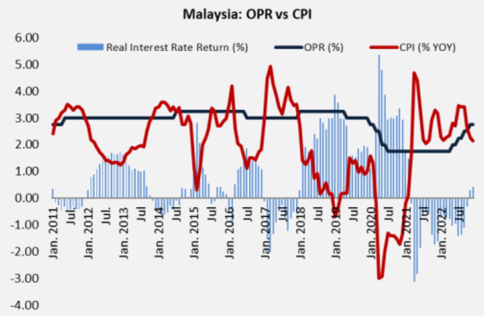
Source: DOSM, BNM

Figure 2: Spread between MGS yields and OPR remains near historical high



Source: BNM, Bloomberg

Figure 3: Real interest rates likely stay negative before turning positive towards year end



Source: DOSM, BNM

Side by Side Comparison of BNM Monetary Policy Statement

11-May-2022	6-July-2022
At its meeting today, the Monetary Policy Committee (MPC) of Bank Negara Malaysia decided to increase the Overnight Policy Rate (OPR) by 25 basis points to 2.00 percent. The ceiling and floor rates of the corridor of the OPR are correspondingly increased to 2.25 percent and 1.75 percent, respectively. The sustained reopening of the global economy and the improvement in labour market conditions continue to support the recovery of economic activity. These have partly cushioned the impact of the military conflict in Ukraine and the strict containment measures in China. Inflationary pressures have increased sharply due to a rise in commodity prices, strained supply chains and strong demand conditions, particularly in the US. Consequently, several central banks are expected to adjust their monetary policy settings at a faster pace to reduce inflationary pressures. The global growth outlook will continue to be affected by the developments surrounding the conflict in Ukraine, COVID-19, global supply chain conditions, commodity price shocks, and financial market volatility. For the Malaysian economy, latest indicators show that growth is on a firmer footing, driven by strengthening domestic demand amid sustained export growth. The labour market is further lifted by a lower unemployment rate, higher labour participation and better income prospects. The transition to endemicity on 1 April 2022 would strengthen economic activity, in line with further easing of restrictions and the reopening of international borders. Investment activity and prospects have also improved, underpinned by the realisation of multi-year projects and positive growth outlook. However, risks to growth remain, which include a weaker-than-expected global growth, further escalation of geopolitical conflicts, worsening supply chain disruptions, and adverse developments surrounding COVID-19. Headline inflation is projected to average between 2.2% - 3.2% in 2022. Given the improvement in economic activity amid lingering cost pressures, underlying inflation, as measured by core inflation, is expected to trend higher to average between 2.0% - 3.0% in 2022. Nevertheless, upward pressure on prices would be partly contained by existing price controls and the continued spare capacity in the economy. The inflation outlook continues to be subject to global commodity price developments, arising mainly from the ongoing military conflict in Ukraine and prolonged supply-related disruptions, as well as domestic policy measures on administered prices. Over the course of the COVID-19 crisis, the OPR was reduced by a cumulative 125 basis points to a historic low of 1.75% to provide support to the economy. The unprecedented conditions that necessitated such actions have since abated. With the domestic growth on a firmer footing, the MPC decided to begin reducing the degree of monetary accommodation. This will be done in a measured and gradual manner, ensuring that monetary policy remains accommodative to support a sustainable economic growth in an environment of price stability.	At its meeting today, the Monetary Policy Committee (MPC) of Bank Negara Malaysia decided to increase the Overnight Policy Rate (OPR) by 25 basis points to 2.25 percent. The ceiling and floor rates of the corridor of the OPR are correspondingly increased to 2.50 percent and 2.00 percent, respectively. The reopening of the global economy and the improvement in labour market conditions continue to support the recovery of economic activity. However, these have been partly offset by the impact from rising cost pressures, the military conflict in Ukraine and strict containment measures in China. Inflationary pressures have continued to increase mainly due to elevated commodity prices and strong demand conditions, despite some easing in global supply chain conditions. Consequently, central banks are expected to continue adjusting their monetary policy settings, some at a faster pace, to reduce inflationary pressures. Going forward, the pace of global growth is expected to moderate, and will continue to be affected by the elevated cost pressures, conflict in Ukraine, global supply chain conditions, and financial market volatility. For the Malaysian economy, economic activity continued to strengthen in recent months. Exports and retail spending indicators affirm the positive growth momentum, supported by the transition to endemicity. In the labour market, the unemployment rate declined further, with higher labour participation and improving income prospects. Looking ahead, while external demand is expected to moderate, weighed by headwinds to global growth, economic growth will be supported by firm domestic demand. Additionally, the reopening of international borders since 1 April 2022 would facilitate the recovery in tourism-related sectors. Investment activity and prospects continue to be supported by the realisation of multi-year projects. However, downside risks to growth continue to stem from a weaker-than-expected global growth, further escalation of geopolitical conflicts, and worsening supply chain disruptions. Year-to-date, headline inflation has averaged 2.4%. While it is projected to remain within the 2.2% - 3.2% forecast range for the year, headline inflation may be higher in some months due mainly to the base effect from electricity prices. Underlying inflation, as measured by core inflation, is expected to average between 2.0% - 3.0% in 2022 as demand continues to improve amid the high-cost environment. Nevertheless, the extent of upward pressures on inflation will remain partly contained by existing price controls, fuel subsidies and the continued spare capacity in the economy. The inflation outlook continues to be subject to global commodity price developments, arising mainly from the ongoing military conflict in Ukraine and prolonged supply-related disruptions, as well as domestic policy measures. Amid the positive growth prospects for the Malaysian economy, the MPC decided to further adjust the degree of monetary accommodation. This is consistent with the MPC's view that the unprecedented conditions that necessitated a historically low OPR have continued to recede. At the current OPR level, the stance of monetary policy remains accommodative and supportive of economic growth. The MPC will continue to assess evolving conditions and their implications on the overall outlook to domestic inflation and growth. Any adjustments to the monetary policy settings going forward would be done in a measured and gradual manner, ensuring that monetary policy remains accommodative to support a sustainable economic growth in an environment of price stability.

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