3 May 2023

Global Markets Research

Malaysia - Economics

BNM raised OPR by 25bps; signalled pause ahead

BNM resumed a 25bps hike lifting OPR to 3.00%; citing resilient domestic growth prospects

Current OPR level remains "slightly" accommodative; Covid-related stimulus has been withdrawn

We maintain our view for OPR to stay pat at 3.00% for the remaining of the year

Summary

At its May MPC meeting, BNM raised the OPR by 25bps to 3.00%, putting a halt to two consecutive pauses in January and March. Today's hike generally surprised the markets but is in line with our house view for a 25bps hike. We gathered that today's decision is premised on (1) resilient domestic growth outlook; (2) no signs of excessive tightening that is affecting consumption and investment activities; (3) risks to domestic growth outlook is fairly balanced; and (4) upside risks to inflation. Following today's move, BNM commented that "the MPC has withdrawn the monetary stimulus intended to address the COVID-19 crisis in promoting economic recovery" while the current stance of monetary policy has turned "slightly accommodative", a less hawkish tone compared to "accommodative" in the previous statements, implying that the current OPR rate is near neutral level. This, coupled with moderating growth and inflation trajectory especially in 2H of the year (Figure 3), support our view for OPR to stay unchanged at 3.00% for the remaining of 2023.

Resilient global economy but downside risks remain

Based on the latest BNM assessment, the world economy continues to expand underpinned by resilient domestic demand thanks to strong labour market conditions, and a stronger than expected rebound in the China economy. However, elevated cost pressures and earlier policy tightening will continue to weigh on growth prospects. In addition, downside risks continue to emanate from escalation of geopolitical tensions, higher than expected inflation, and sharp tightening in financial market conditions including further stress in the banking sector.

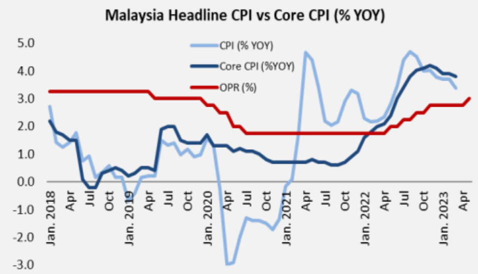
Fairly balanced growth risk in the Malaysian economy vs upside risk to inflation

The Malaysian economy has stayed resilient thus far with further expansion in 1Q23 anticipated, where we are pencilling in a mid-6% growth pending the release of some key indicators next week ahead of the release of 1Q GDP on 12-May. Growth will primarily be driven by domestic demand and a pick-up in tourism activities, cushioning the slowdown in exports. Meanwhile, weaker than expected global growth and more volatile global financial market conditions are key risks to contend with. Core inflation is expected to remain sticky amid firm demand condition, keeping risk to inflation outlook on the upside.

Outlook

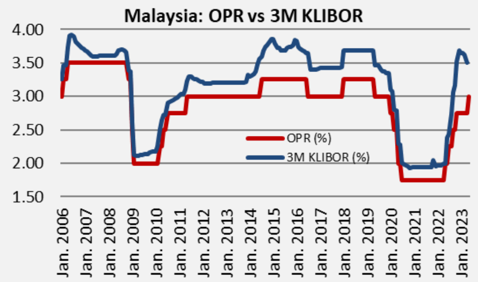
Global macro indicators and financial conditions are showing increasing signs continuous policy tightening is having undesirable effects on growth outlook, with risk of a global recession still standing tall. This, coupled with signs of moderating inflation, suggest global central banks are nearing the last leg of rate hike cycle. Taking cue from looming challenges in the external environment, and as the base effect sets in in 2H2023 as highlighted before, we expect growth to decelerate sharply in 2H, while inflation is expected to taper off to the 2.0% levels, likely closing the door for further OPR hikes for the remaining months of 2023. We therefore expect OPR to stay pat at 3.00% for the rest of the year, a level which is "slightly accommodative and remaining supportive of growth".

Figure 1: Headline inflation has been softening; core CPI easing more slowly



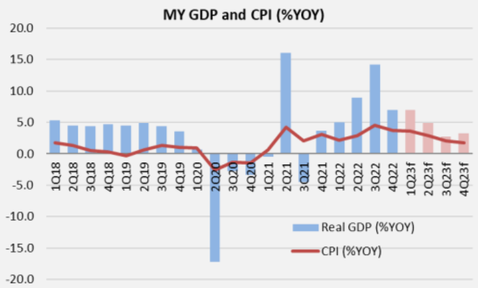
Source: DOSM, BNM

Figure 2: Spread between 3-month KLIBOR and OPR is seen narrowing from historical high



Source: BNM, Bloomberg

Figure 3: Moderating inflation and growth outlook are closing the window for further OPR hike



Source: BNM, HLBB Global Market Research

Side by Side Comparison of BNM Monetary Policy Statement

9-March-2023	3-May-2023
At its meeting today, the Monetary Policy Committee (MPC) of Bank Negara Malaysia decided to maintain the Overnight Policy Rate (OPR) at 2.75 percent. In the global economy, there were some positive developments with the reopening of China's economy and better-than-expected growth outturns in major economies, supported by resilient domestic demand. Nevertheless, the global economy continues to be weighed down by elevated cost pressures and higher interest rates. Headline inflation moderated slightly from high levels in recent months, but core inflation remained above historical averages. Some central banks are expected to continue raising interest rates to manage inflationary pressures. This will continue to pose headwinds to the global growth outlook. The growth outlook remains subject to downside risks, mainly from an escalation of geopolitical tensions, higher-than-anticipated inflation outturns, and a sharp tightening in financial market conditions. The Malaysian economy expanded strongly by 8.7% in 2022 driven by the recovery in private and public sector spending following the full reopening of the economy. After the strong performance in 2022, the economy is expected to moderate in 2023 amid a slower global economy. Growth will remain driven by domestic demand. Household spending will be underpinned by sustained improvements in employment and income prospects. Tourist arrivals are expected to continue rising, further lifting tourism-related activities. The continued progress of multi-year infrastructure projects will support investment activity. The implementation of projects from the recently re-tabled Budget 2023 would provide upside risks to the domestic growth outlook. Downside risks continue to stem mainly from global developments, including from weaker-than-expected growth outturns or much tighter and more volatile global financial conditions. Headline and core inflation are expected to moderate over the course of 2023, but will continue to be elevated amid lingering demand and cost factors. The extent of upward pressures to inflation will remain partly contained by existing price controls and fuel subsidies, and the remaining spare capacity in the economy. The balance of risk to the inflation outlook is tilted to the upside and continues to be highly subject to any changes to domestic policy on subsidies and price controls, as well as global commodity price developments. At the current OPR level, the stance of monetary policy remains accommodative and supportive of economic growth. The MPC will continue to assess the impact of the cumulative OPR adjustments, given the lag effects of monetary policy on the economy. The MPC remains vigilant to cost factors, including those arising from financial market developments, that could affect the inflation outlook. Further normalisation to the degree of monetary policy accommodation would be informed by the evolving conditions and their implications to the domestic inflation and growth outlook. The MPC will continue to calibrate the monetary policy settings that balance the risks to domestic inflation and sustainable growth.	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 3.00 percent. The ceiling and floor rates of the corridor of the OPR are correspondingly increased to 3.25 percent and 2.75 percent, respectively. The global economy continues to be driven by resilient domestic demand supported by strong labour market conditions, and a stronger-than-expected rebound of China's economy. Nevertheless, the global economy continues to be weighed down by elevated cost pressures and higher interest rates. Headline inflation continued to moderate, but core inflation has persisted above historical averages. For most central banks, the monetary policy stance is likely to remain tight. The growth outlook remains subject to downside risks, mainly from an escalation of geopolitical tensions, higher-than-anticipated inflation outturns, and a sharp tightening in financial market conditions including from further stress in the banking sector. For the Malaysian economy, latest developments point towards further expansion in economic activity in the first quarter of 2023 after the strong performance in 2022. While exports are expected to moderate, growth in 2023 will be driven by domestic demand. Household spending remains resilient, underpinned by better labour market conditions as unemployment continues to decline to pre-pandemic levels. The pickup in tourist arrivals is expected to lift tourism-related activities. Further progress of multi-year infrastructure projects will support investment activity. Domestic financial conditions also remain conducive to financial intermediation, with no signs of excessive tightening affecting consumption and investment activities. Risks to the domestic growth outlook are relatively balanced. Upside risks mainly emanate from domestic factors such as stronger-than-expected tourism activity and implementation of projects including those from the re-tabled Budget 2023, while downside risks stem from weaker-than-expected global growth and more volatile global financial market conditions. As expected, headline inflation trended lower in recent months on account of moderating cost factors. Both headline and core inflation are expected to moderate over the course of 2023, averaging between 2.8% – 3.8%. However, core inflation will remain at elevated levels amid firm demand conditions. Existing price controls and fuel subsidies will continue to partly contain the extent of upward pressures to inflation. The balance of risk to the inflation outlook is tilted to the upside and remains highly subject to any changes to domestic policy including on subsidies and price controls, financial market developments, as well as global commodity prices. With the domestic growth prospects remaining resilient, the MPC judges that it is timely to further normalise the degree of monetary accommodation. With this decision, the MPC has withdrawn the monetary stimulus intended to address the COVID-19 crisis in promoting economic recovery. In light of the continued strength of the Malaysian economy, the MPC also recognises the need to ensure that the stance of monetary policy is appropriate to prevent the risk of future financial imbalances. At the current level, the monetary policy stance is slightly accommodative and remains supportive of the economy. The MPC will continue to ensure that the monetary policy stance remains consistent with the outlook of domestic inflation and growth.

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