3 November 2022

Global Markets Research

Malaysia - Economics

BNM raised OPR; odds of further hike remain

BNM raised OPR by 25bps to 2.75% as expected and left the door open for further hikes

Pre-emptive move to manage demand-driven pressure amid positive growth prospects

The door remains open for another 25bps hike to 3.00% in January

Summary

BNM decided to raise the OPR by a further 25bps to 2.75% as widely expected at today's meeting, marking its fourth straight quarter-point increase since the normalization cycle began in May. Continued positive growth prospects in the Malaysian economy, emerging signs of demand-pull inflation and second round price effects, as well as higher volatility in the financial markets due to insistent rate hikes by major central banks specifically the Fed, were key reasons behind today's decision in our view.

Although the statement continued to highlight downside risks to growth, BNM has stopped short of highlighting any concerns of a potential global recession, and we sense that the focus has shifted to increased volatility in the financial markets and its implication on both the major as well as emerging economies. The Fed's overnight hawkishness in signalling a higher terminal rate despite slowing the pace of the hike would continue to drive USD strength, at the expense of other currencies including the MYR. We believe BNM is leaving the door open for another 25bps hike in January, given the imminent widening in yield gap between the US and local rates, and that the current level of OPR remains accommodative and supportive of economic growth.

Less sanguine global growth outlook

BNM commented that rising cost pressures, tighter global financial conditions, and strict containment measures in China, are offsetting the boost from positive labour market conditions and economic and international border reopenings. BNM also expects many central banks to continue raising rates to manage stubbornly high inflationary pressures, hence expectations for higher volatility in the financial markets. Key downside risks include escalation of geopolitical tensions, worsening domestic headwinds in China and potential energy rationing in Europe.

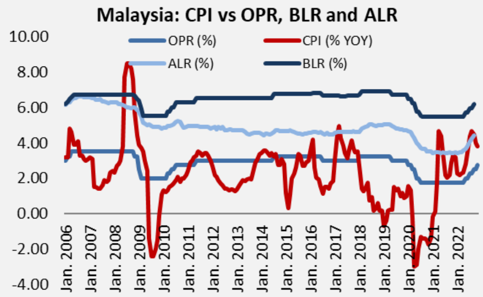
Malaysian growth prospects remain favourable

The Malaysian economy is expected to strengthen further in 3Q, a view that we shared with real GDP growth (due next Friday) hitting double-digit levels. Domestic demand, particularly private consumption will remain the key growth pillar, with increased tourism related activities provided an added boost. BNM appeased that the heightened volatility in the global financial and foreign exchange markets are not expected to derail growth in the Malaysian economy. Domestic liquidity remains sufficient, and financial institutions continue to operate with strong capital and liquidity buffers. Inflation outlook meanwhile, remains skewed to the upside, subject to domestic policy measures on subsidies, and prolonged supply-related disruptions.

Outlook

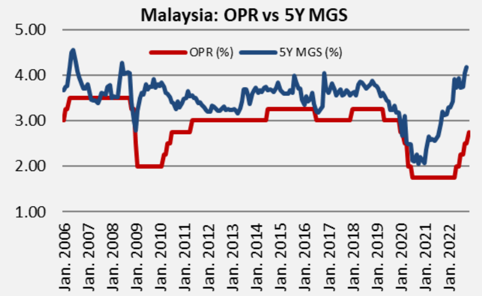
Despite recent deterioration in global growth outlook and rising concerns over a global recession as earlier aggressive rate hikes filter through the economy, we do not see this being emphasized in today's statement. Indeed, we feel that the focus is on continuous policy tightening, increased volatility and potential fallout in the financial and foreign exchange markets, and to a certain extent, China development. In view of this and given still positive growth in the Malaysian economy, we believe BNM could deliver another 25bps hike at its next meeting in January, bringing the OPR to 3.00%.

Figure 1: Overall interest rates remain accommodative and supportive of growth



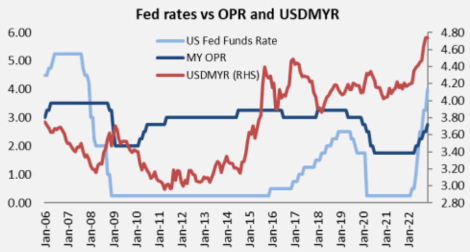
Source: DOSM, BNM

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



Source: BNM, Bloomberg

Figure 3: Widening yield differentials with the US



Source: BNM, Bloomberg

Side by Side Comparison of BNM Monetary Policy Statement

8-September-2022	3-November-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 2.50 percent. The ceiling and floor rates of the corridor of the OPR are correspondingly increased to 2.75 percent and 2.25 percent, respectively. The global economy continued to expand, albeit at a slower pace, weighed down by rising cost pressures, tighter global financial conditions, and strict containment measures in China. However, global growth continues to be supported by improvements in labour market conditions, and the full reopening of most economies and international borders. Inflationary pressures have remained high, due to elevated commodity prices and tight labour markets, despite continued 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. In particular, aggressive adjustments in US interest rates have contributed to a strong US dollar environment. This has resulted in higher volatility in financial markets, affecting other major and emerging market currencies, including the ringgit. Going forward, the global growth is expected to face challenges from the impact of monetary policy tightening in most economies, and pandemic management measures in China. The growth outlook is subject to downside risks, including elevated cost pressures, the potential energy crisis in Europe, and sharp tightening in financial market conditions. For the Malaysian economy, the transition to endemicity and policy measures have contributed to the stronger growth performance in the second quarter of 2022. Going forward, indicators point to continued growth, underpinned by support from private sector spending. Labour market conditions and income prospects remain positive, with unemployment and underemployment declining further. The reopening of international borders will lift tourism-related sectors. Investment activity and prospects would be supported by the realisation of multi-year projects. Nevertheless, external demand is expected to moderate following softening global growth. Despite the increased volatility in the global financial and foreign exchange markets, these developments are not expected to derail Malaysia's growth. Domestic liquidity remains sufficient, with continued orderly functioning of the financial and foreign exchange markets. Financial institutions also continue to operate with strong capital and liquidity buffers. These will ensure financial intermediation remains supportive of the economy. Going forward, downside risks to the domestic economy 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 at 2.8%. Headline inflation is projected to peak in 3Q 2022 before moderating thereafter, due to dissipating base effects and in line with the expected easing of global commodity prices. Underlying inflation, as measured by core inflation, is expected to average closer to the upper end of the 2.0% - 3.0% forecast range in 2022, with some signs of demand-driven pressures amid the high-cost environment. The extent of upward pressures to inflation will remain partly contained by existing price controls, fuel subsidies, and the prevailing spare capacity in the economy. The inflation outlook, however, continues to be subject to domestic policy measures, as well as global commodity price developments arising mainly from the ongoing military conflict in Ukraine and prolonged supply-related disruptions. With the positive growth prospects for the Malaysian economy remaining intact, the MPC decided to further adjust the degree of monetary accommodation. At the current OPR level, the stance of monetary policy continues to remain accommodative and supportive of economic growth. The MPC is not on any pre-set course and 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.	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 2.75 percent. The ceiling and floor rates of the corridor of the OPR are correspondingly increased to 3.00 percent and 2.50 percent, respectively. The global economy continues to be weighed down by rising cost pressures, tighter global financial conditions, and strict containment measures in China. These factors more than offset the support from positive labour market conditions, and the full reopening of most economies and international borders. Inflationary pressures were more persistent than expected due to strong demand, tight labour markets, and elevated commodity prices, despite improvements in global supply chain conditions. Consequently, many central banks are expected to continue raising interest rates to manage inflationary pressures. In particular, continued aggressive adjustments in US interest rates and expectations of a higher terminal rate in the US, have contributed to a persistently strong US dollar environment. This has resulted in higher volatility in financial markets, affecting other major and emerging market currencies, including the ringgit. Going forward, the global growth outlook will continue to face headwinds from tighter financial conditions amid elevated inflation in major economies and the domestic challenges in China. The growth outlook remains subject to downside risks, including escalation of geopolitical tensions, worsening of domestic headwinds in China and potential energy rationing in Europe. For the Malaysian economy, latest indicators show that economic activity strengthened further in the third quarter, driven primarily by robust domestic demand. Going forward, despite the challenging global environment, domestic demand will remain the key driver of growth. Household spending will continue to be underpinned by improvements in labour market conditions and income prospects. Tourist arrivals have increased following the reopening of international borders and will further lift tourism-related sectors. Investment activity and prospects will be supported by the realisation of multi-year projects. Nevertheless, external demand is expected to moderate following softening global growth. Despite bouts of heightened volatility in the global financial and foreign exchange markets, these developments are not expected to derail Malaysia's growth. Domestic liquidity remains sufficient, with continued orderly functioning of the financial and foreign exchange markets. Financial institutions also continue to operate with strong capital and liquidity buffers. These will ensure financial intermediation remains supportive of the economy. Downside risks to the domestic economy continue to stem from a weaker-than-expected global growth, higher risk aversion in global financial markets amid more aggressive monetary policy tightening in major economies, further escalation of geopolitical conflicts, and worsening supply chain disruptions. In line with earlier assessments, headline inflation is likely to have peaked in 3Q 2022 and is expected to moderate thereafter, albeit remaining elevated. Underlying inflation, as measured by core inflation, is projected to average closer to the upper end of the 2.0% - 3.0% forecast range in 2022, having averaged 2.7% year-to-date, given some demand-driven price pressures amid the high-cost environment. Moving into 2023, headline and core inflation are expected to remain elevated amid both demand and cost pressures, as well as any changes to domestic policy measures. The extent of upward pressures to inflation will remain partly contained by existing price controls, subsidies, and the remaining spare capacity in the economy. The balance of risk to the inflation outlook in 2023 is tilted to the upside and continues to be subject to domestic policy measures on subsidies, as well as global commodity price developments arising mainly from the ongoing military conflict in Ukraine and prolonged supply-related disruptions. Against the backdrop of continued positive growth prospects for the Malaysian economy, the MPC decided to further adjust the degree of monetary accommodation. The adjustment would also pre-emptively manage the risk of excessive demand on price pressures consistent with the recalibration of monetary policy settings that balances the risks to domestic inflation and sustainable growth. At the current OPR level, the stance of monetary policy remains accommodative and supportive of economic growth. The MPC is not on any pre-set course, which means that monetary policy decisions will continue to depend on evolving conditions and their implications on the overall outlook to domestic inflation and growth. Any

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adjustments to the monetary policy settings going forward would continue to be done in a measured and gradual manner, ensuring that monetary policy remains accommodative to support sustainable economic growth in an environment of price stability.

The meeting also approved the schedule of MPC meetings for 2023. In accordance with the Central Bank of Malaysia Act 2009, the MPC will convene six times during the year. The Monetary Policy Statement will be released at 3 p.m. on the final day of each MPC meeting.

Schedule of Monetary Policy Committee Meetings for 2023	
MPC Meeting No	**Dates**
1st	18 and 19 January 2023
2nd	8 and 9 March 2023
3rd	2 and 3 May 2023
4th	5 and 6 July 2023
5th	6 and 7 September 2023
6th	1 and 2 November 2023

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