

Global Markets Research
Malaysia - Economics

Surprised OPR hike

BNM lifted OPR by 25bps from a record low to 2.00%, first hike since Jan-2018
The need to adjust the degree of monetary accommodativeness was cited as the key reason
Expect another 25bps hike for the rest of the year

Summary

BNM decided to increase the Overnight Policy Rate (OPR) by 25bps to 2.00% at today's MPC meeting, lifting it off the record low of 1.75% maintained since August-2020. The decision to hike came earlier than expected, and was premised on BNM's assessment on firmer growth backdrop of the Malaysian economy, hence the need to adjust the degree of monetary accommodativeness last instituted during the beginning of the pandemic to support growth. In addition to that, we believe recent step-up efforts by other central banks in tackling inflation, as well as extended acceleration in core inflation domestically, could have prompted BNM to deliver an earlier than expected rate hike today.

We expect BNM to deliver another 25bps increase in the OPR in the second half of the year, after having kickstarted its policy normalization cycle today. However, it has signalled that this will be done in a measured and gradual manner, suggesting it may not hike back-to-back and will keep to its 25bps move.

Continuous recovery in the global economy

Based on BNM assessment, global economic activities continued to recover, supported by sustained economic reopening and improvement in the labour market, which served to partially cushioned the adverse impact from Russia-Ukraine conflict and potential Covid-induced economic fallout from China. Extended increase in commodity prices amid prolonged supply chain constraints has significantly heightened inflationary pressures, prompting several central banks, the Fed inclusive, to raise rates in a rapid manner although uncertainties surrounding the conflict in Ukraine, Covid-19, global supply chain tightness, commodity price shocks and financial market volatility are key risk factors to watch.

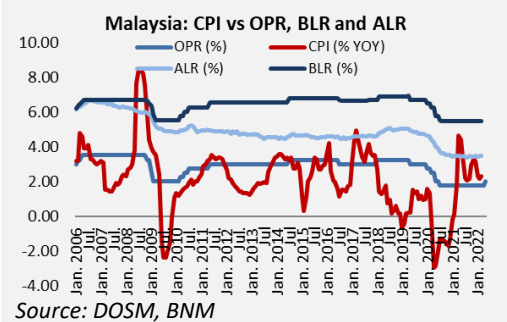
The Malaysian economy is on firmer footing

On the domestic front, BNM commented that the Malaysian economy is on firmer footing, driven by improving domestic demand and sustained exports performance. The labour market continued to improve supported by better income prospects while transition to endemicity on 1 April 2022 would help strengthen economic activities although downside risks remain. Inflation outlook continued to be subject to commodity price movements. Nonetheless, any supply-driven shocks are expected to be cushioned by price control mechanism and spare capacity in the system.

Outlook

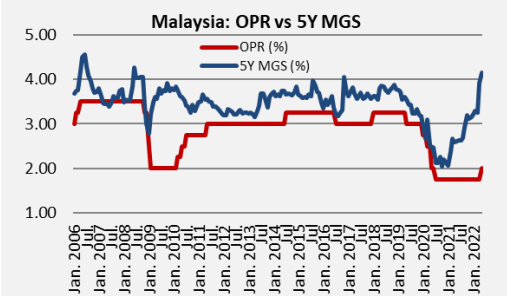
We believe BNM will continue to adopt a cautious approach in its policy normalization path given ongoing uncertainties on the macro backdrop. This view was reaffirmed by its remark in the policy statement saying policy normalization "will be done in a measured and gradual manner, ensuring that monetary policy remains accommodative to support a sustained economic growth in an environment of price stability". What we should bear in mind is BNM is merely adjusting the degree of monetary accommodativeness, and not tightening, to ensure monetary policy remains supportive of economic growth. We therefore expect BNM to raise OPR by another 25bps for the rest of the year. Any further hikes back to more neutral level next year would depend on the evolution of growth and price conditions going forward.

Figure 1: Interest rates to stay accommodative despite the surprised hike



Source: DOSM, BNM

Figure 2: Spread between MGS yields and OPR are widening to historic high amid global bond rout



Source: BNM, Bloomberg

Figure 3: Continuous acceleration in core CPI



Source: DOSM

Side by Side Comparison of BNM Monetary Policy Statement

3-March-2022	11-May-2022
<p>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.</p> <p>The global economy continues to recover. Despite the recent moderation in economic activity due to the Omicron-driven COVID-19 resurgences, the overall recovery trajectory remains on track. Inflation in many economies remain elevated, due to both demand and supply factors. Going forward, more countries will transition to endemic management of COVID-19, hence supporting global growth prospects. The unfolding developments surrounding the military conflict in Ukraine, however, have emerged as a key risk to global growth and trade prospects, commodity prices and financial market conditions. The global growth outlook will also continue to be affected by developments surrounding COVID-19, risks of prolonged global supply disruptions, and heightened financial market volatility amid adjustments in monetary policy in major economies.</p> <p>Despite the challenging environment, the Malaysian economy expanded by 3.1% in 2021. Looking ahead, the growth recovery will strengthen in 2022, driven by the expansion in global demand and higher private sector expenditure, amid improvements in the labour market and continued targeted policy support. The expected reopening of international borders would also provide further support to economic recovery. The economic impact from the recent increase in COVID-19 cases due to the Omicron variant is expected to be considerably less severe than previous waves in the absence of stringent restrictions. Risks to the growth outlook remain tilted to the downside due to external and domestic factors. These include a weaker-than-expected global growth, ongoing geopolitical conflicts, worsening supply chain disruptions, and developments surrounding COVID-19.</p> <p>Headline inflation in 2022 is projected to remain moderate as the base effect from fuel inflation continues to dissipate. Underlying inflation, as measured by core inflation, is expected to normalise to around its long-term average as economic activity continues to pick up amid the environment of high input costs. Nevertheless, core inflation is expected to be modest, with the upside risk partly contained by the continued slack in the economy and labour market. The inflation outlook continues to be subject to global commodity price developments amid risks from prolonged supply-related disruptions.</p> <p>The MPC considers the current stance of monetary policy to be appropriate and accommodative. Fiscal and financial measures will continue to provide support to economic activity. Amid the prevailing uncertainties, the stance of monetary policy will continue to be determined by new data and their implications on the overall outlook for domestic inflation and growth.</p>	<p>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.</p> <p>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.</p> <p>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.</p> <p>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.</p> <p>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.</p>

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