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BNM Monetary Policy Committee meeting: Higher OPR in the Near Term?

Economic Research Led By:

Nor Zahidi Alias
Chief Economist
+603 2717 2900
zahidi@marc.com.my

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In a nutshell

- Bank Negara Malaysia (BNM) decided to maintain its key policy rate – the Overnight Policy Rate (OPR) – at 3% during its meeting on November 9, 2017. In its statement, BNM said that the current policy stance remains accommodative but added that it *"may consider reviewing the current degree of monetary accommodation"*, which MARC thinks may lead to an interest rate hike by 25 basis points (bps) as early as in the first quarter of 2018. In elaborating on its decision, BNM viewed the global economy favourably, stressing that it foresees sustained growth in 2018.

- As for Malaysia, BNM elaborated that the country's economic strength was supported by the strong performance of both its domestic and external sectors. The strong spillover effects from the external sector on the domestic economy are key to a sustained growth momentum in 2018. BNM's overall favourable assessment of the Malaysian economy is summarised in its statement that says, *"growth to remain strong in 2018".*

- The decision was in line with market expectations. Scrutinising the statement, MARC senses BNM's growing confidence in the economy from its language. Specifically, in this latest policy statement, there is an increasing number of words such as *"strong", "stronger"* or *"strengthened"* being used to describe the strength of the global and Malaysian economy when compared to the statements it made in May, July and September 2017. The overall count of the abovementioned words was *eight* in the latest policy statement as opposed to *four, five* and *six* in the statements in May, July and September 2017 respectively. Interestingly, the count of the abovementioned words also increased when describing the strength of the Malaysian economy – *six* in the latest statement as opposed to *three* in both the May and July statements as well as *four* in September 2017. We believe the increasing trend in the number of such words implies BNM's overall positive feeling about the economy that could lead to a decision to raise the OPR as early as in the first quarter of 2018, the first time since July 2014.

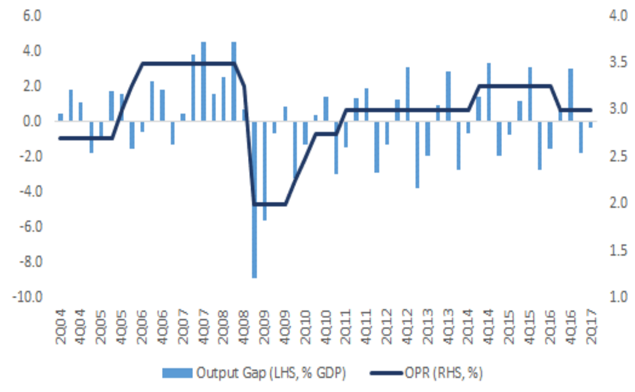
- MARC believes that major factors behind the possible rate hike in the near term include spillover effects from the stronger-than-expected headline growth in 2017. Going into 2018, MARC believes the headline GDP growth will sustain above its long-term trend of 5%, attributed partly by strong trade performance. This is in line with global trade volume which has been gaining momentum in the past 10 months. According to the latest projections by the World Trade Organisation (WTO), global merchandise trade volume which is estimated to expand by 3.6% in 2017 - its strongest pace since at least 2013 - is expected to register another equally strong growth of 3.2% in 2018. Stable crude oil prices in 2018 would also add to the strength of the Malaysian economy.

- At the same time, Malaysian economic growth is also expected to be supported by resilient domestic demand, led by the strengthening of private consumption. MARC expects the growth in private consumption to surpass its long-term trend of 7% per annum in 2018.

- Another factor that supports the possible increase in the OPR in 2018 is the continuing rise in the United States (US) Fed Funds rate following the further strengthening of its economy. With rising interest rates in the US and possibly in Europe, some capital may start to flow out from Asia, favouring dollar-denominated assets. In addition, further improvements in wages and a stable labour market as well as the increasing strength in consumer spending may prevent inflation from moderating substantially in the near term. The consumer sentiment is now turning around, as reflected by the Malaysian Institute of Economic Research (MIER) consumer sentiment index which has generally been trending upward since 4Q2015. Against such a backdrop, higher interest rates in the domestic economy will, to some extent, prevent significant outflows of capital from Malaysian shores in 2018 and keep inflation in check. It will also have a positive impact on the ringgit.

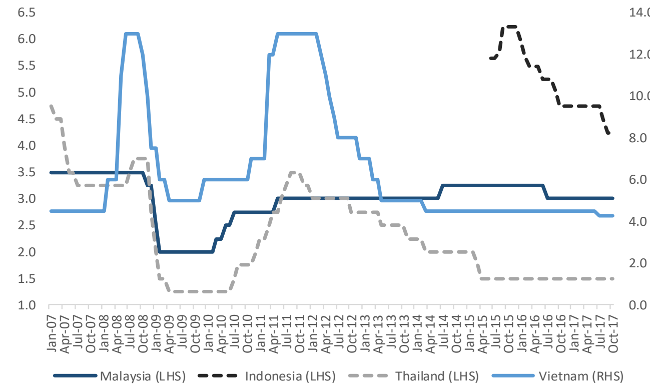
- While MARC believes that a sharp increase in the OPR will affect the household balance sheet, a minor upward tweak in the costs of borrowing may not lead to a deterioration in the household's debt servicing capacity. We are of the view that BNM has been managing household debt cautiously so as to not affect the economy, especially private consumption.

Chart 1: Output gap versus OPR



Source: CEIC, MARC Economic Research

Chart 2: Selected ASEAN countries policy rates



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MALAYSIAN RATING CORPORATION BERHAD (Company No.: 364803-V)
19-07, 19th Floor, Q Sentral, 2A Jalan Stesen Sentral 2, Kuala Lumpur Sentral, 50470 KUALA LUMPUR
Tel.: +603 2717 2900 Fax: +603 2717 2910 E-mail: marc@marc.com.my
Homepage: www.marc.com.my