Economic Research

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The BNM MPC Statement:

Easing Adjustment on the Cards?

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Summary

- The latest Bank Negara Malaysia (BNM) Monetary Policy Committee (MPC) statement has provided hints of a possible adjustment in the benchmark policy rate (Overnight Policy Rate or OPR) going forward. Given current global and domestic circumstances, MARC sees the statement preparing the market for a slight downward tweak in the OPR, especially if headline GDP growth continues below long-term growth and inflation below initial forecast.

- In its statement, BNM pointed out that "***tighter global financial conditions and elevated political and policy uncertainty could lead to financial market adjustments, further weighing on the overall outlook".*** This is in reference to, among other things, the impact of higher US Fed funds rate (FFR) and US-China trade tensions, with ***"policy uncertainty"*** referring to US and/or Chinese trade policy options. MARC sees these global developments driving "***financial market adjustments,"*** i.e. volatility in equity, bond and foreign exchange markets, and ultimately the direction of global capital flows.

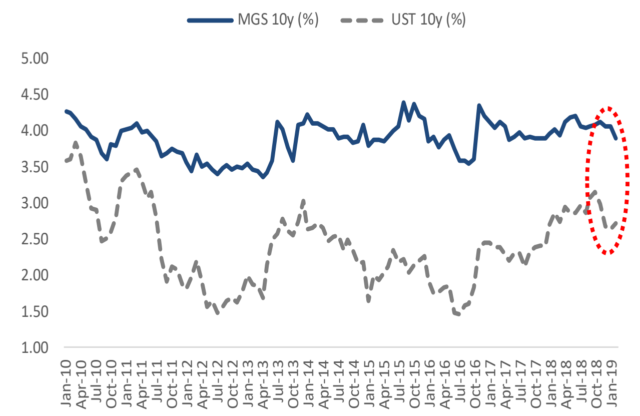
- On the outlook of the Malaysian economy, BNM stressed that **"*on balance, the baseline forecast is for the Malaysian economy to remain on a steady growth path. However, materialisation of downside risks from unresolved trade tensions, heightened uncertainties in the global and domestic environment, and prolonged weakness in the commodity-related sectors could further weigh on growth*.**" This is not surprising because Malaysia is a very open economy. In 2018, for example, real export growth of goods and services had weakened significantly to 1.5% from 9.4% in 2017.

- Given the importance of commodities such as crude oil, palm oil and rubber to the economy, policymakers are expected to keep a close watch on commodity prices. It is a concern, for example, that recent crude oil market weakness had briefly brought the Brent crude oil price down to below the government's projected average oil price range of USD60-USD70 per barrel between 2019-2021. With the global economy expected to weaken further, MARC sees global crude oil prices facing pressure in the months ahead. In addition, palm oil prices have also retraced roughly by 11.3% from its recent high at the end of January 2019. Similarly, rubber prices have declined slightly by 1.6% from its recent high in early March this year.

- ***"Uncertainties in domestic environment*"** likely refer to uncertainties related to mega project cutbacks, toll road decisions, as well as the unexpected decline of the consumer price index (CPI) in January. The fall of the CPI, the first since the recession in 2009, has led to the widening of the OPR-CPI gap (see chart 5). The last time the gap widened as sharply was in June 2016 when it approached two percentage points after a sharp drop in global crude oil prices. As a result, the OPR was reduced by 25 basis points in the subsequent month.

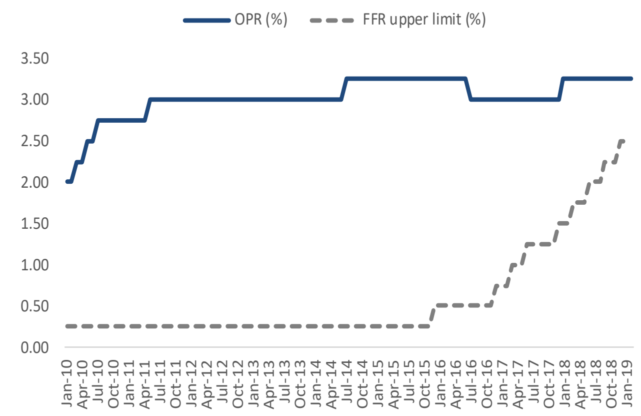
- MARC believes that "***downside risks in the economic and financial environment"*** will be given added weight in BNM's policymaking decisions going forward. It is possible that BNM could ease monetary policy even without the GDP growth pace slipping below 4%, as we initially anticipated. We feel that the timing for an OPR cut could not have been better, if it happens in the near term. Crude oil prices have recovered, the ringgit has appreciated (1.1%% since beginning of the year) and there has been a pause in the US rate hike. Given these developments, an OPR cut is unlikely to stoke domestic financial market volatility.

Chart 1: Fed hinted at pausing its interest rate hikes and ending its balance sheet runoff



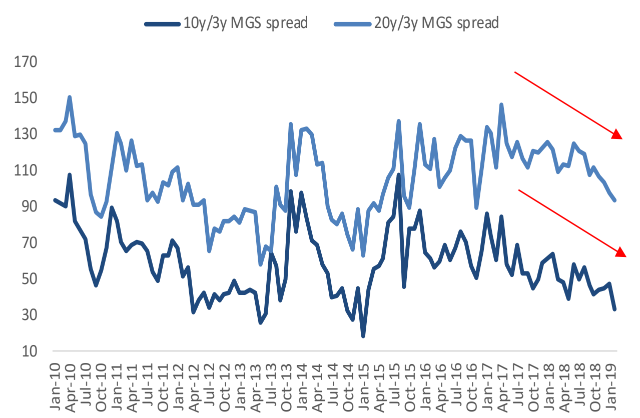
Source: Bloomberg, MARC Economic Research

Chart 2: OPR was maintained at 3.25% despite Fed's decision to pause interest rate hikes



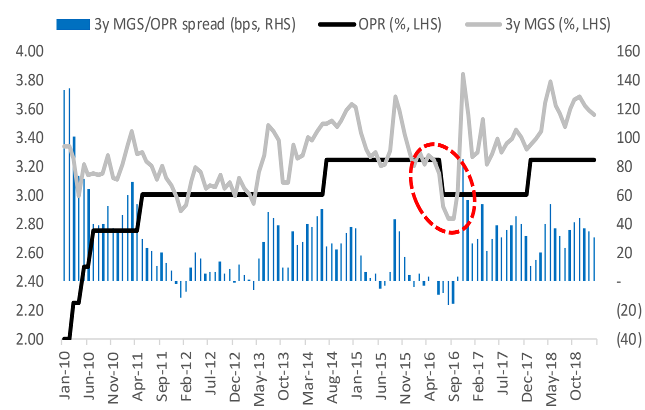
Source: Bloomberg, MARC Economic Research

Chart 3: MGS spreads narrowed as longer-dated yields fell more sharply than shorter-dated yields



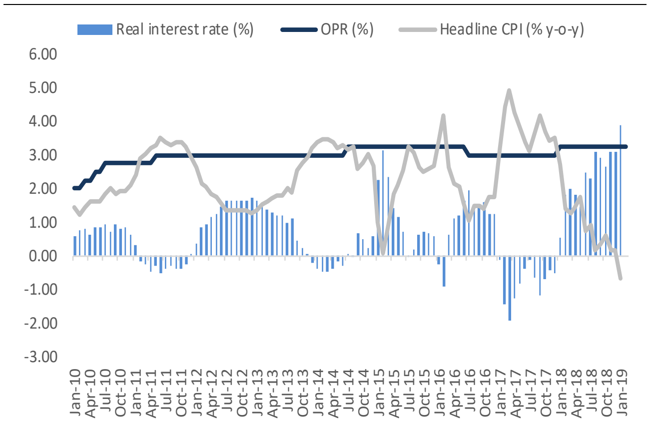
Source: Bloomberg, MARC Economic Research

Chart 4: MGS yield momentarily dropped after BNM cut OPR in 2016



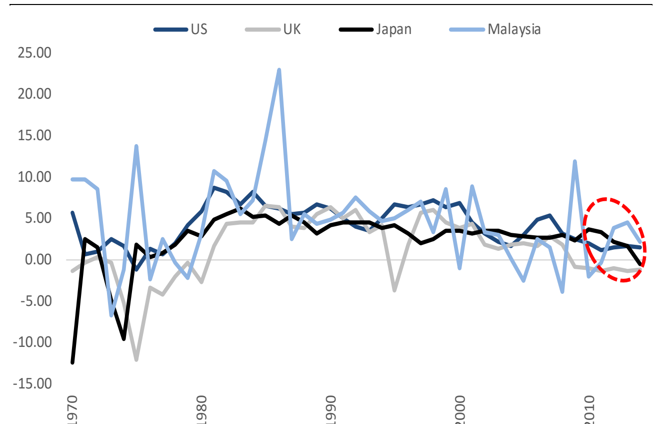
Source: Bloomberg, MARC Economic Research

Chart 5: Real interest rates climbed after inflation slowed since 2H2018



Source: Bloomberg, MARC Economic Research

Chart 6: Real interest rate trends have converged across countries



Source: World Bank, MARC Economic Research

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