

BNM on hold but more vigilant

Tuesday, March 05, 2019

Highlights

- Bank Negara Malaysia (BNM) held the overnight policy rate (OPR) at 3.25% as expected.
- It appears prudent for BNM to keep rates on hold for now.
- We believe that BNM will hold at 3.25% for at least the first half of 2019.
- If a cut is to happen, we see it coming only in the second half of 2019.

BNM held the OPR at 3.25% as expected. The central bank still believed “on the balance” that the Malaysian economy will “remain on a steady growth path”. They also highlighted downside risks from “unresolved trade tensions, heightened uncertainties in the global and domestic environment, and prolonged weakness in the commodity-related sectors”. Regarding inflation, BNM expects that “inflation is expected to be broadly stable compared to 2018” and also for it to “remain low mainly due to policy measures”.

Recent economic data does though appear to point to an increasingly likelihood of a cut in the benchmark rate in the future. The country had reported headline deflation in January 2019 at 0.7% yoy. Growth rates in the last few quarters have also fallen below trend growth. In addition, the Fed has become dovish recently and our house view is for the Fed rate to hold for the entire year.

However, for now, it appears prudent on BNM’s part to keep the benchmark rate on hold. It is probably better for BNM to wait to get more certainty on how the economic situation eventually pans out before making any decision on the OPR. There still remains a lot of ambiguity regarding the global environment especially in relation to a resolution for the US – China trade talks. As Malaysia is a small open economy, the outcome of the talks would obviously have a substantial impact on the country’s economy. Also, regarding prices, core inflation in January 2019 was still positive at 0.2% yoy. According to BNM, if the direct impact of tax policy changes were excluded, they estimated core inflation would have come out at 1.5% yoy. The headline deflation itself was mainly driven by lower fuel prices, the replacement of GST by SST and the lower broadband prices. The effect of the latter two will probably gradually wear away although the recent introduction of a cap on fuel prices will help to keep inflation lower. The deflation though can still be viewed as transitory. We do expect headline inflation to come out at 1.3% yoy for 2019 which is still rather benign.

Therefore, at this point, we believe BNM will probably hold the OPR at 3.25% for the first half of 2019. If a cut is to happen, we see it coming only in the second half of 2019. The central bank is also appearing more vigilant this time around as they said, “recognizing that there are downside risks in the economic and financial environment, the MPC (Monetary Policy Committee) will continue to monitor and assess the balance of risks surrounding the outlook for domestic growth and inflation”.

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