Malaysia Outlook

OCBC Bank

Expect BNM to cut in July 2019

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Highlights

- **Bank Negara Malaysia (BNM) has put out a growth forecast of 4.3% - 4.8% yoy for 2019, which is lower than the Ministry of Finance's (MoF) 4.9% yoy forecast announced during budget 2019.**
- **The central bank highlighted that downside risks mainly stemmed from external uncertainties, of which our house view is that such risks could materialize to some degree.**
- **BNM also sees that Malaysia will record a marginally negative output gap for 2019 whilst inflation will be in the range of 0.7% - 1.7% yoy for 2019.**
- **We think that BNM will only move after at least another Asian central bank acts first.**
- **Given all this, we now expect that BNM will cut the benchmark by 25bps from 3.25% to 3.00% on as early a date as their 9th July 2019 policy meeting.**
- **Meanwhile, BNM has decided to liberalize the foreign exchange framework which would help residents and businesses better manage their currency risks.**

Bank Negara Malaysia (BNM) has announced a growth forecast range of 4.3% - 4.8% yoy for 2019 yesterday during the release of their annual report. Overall, this is lower than MoF's forecast of 4.9% yoy that was put out during the 2019 budget. **Our own OCBC forecast at 4.4% yoy for 2019 is actually at the lower end of their range.** However, BNM in their own presentation did highlight that there were "higher" downside risks whilst there were only "some" upside risks. Indeed, we had believed this is very much the case when we released our own 2019 GDP forecast.

The central bank itself had mentioned that downside risks were mainly stemming from external uncertainties and our house view is that these risks could materialize to some degree. The central bank mentioned that escalation in trade tensions, sharper moderation in global demand, weaker than expected commodity prices and production and disruption in global financial markets were among the downside risks. The growth prospect of the global economy is fairly benign as a whole. China and the USA may be working towards reaching a trade agreement but what really matters is the nature of the agreement that can be reached. Trump has said they are "not talking about removing" tariffs and hence, it is difficult to see at this point that the type of agreement being hinted at can be net positive for Malaysia. Meanwhile, global demand is facing a stronger risk of slowing down especially on top of weaker Eurozone manufacturing PMI numbers and softer US data recently. In terms of commodity prices, we don't expect crude prices to be at US$59, which is the IMF projection as highlighted by BNM in their annual report. However, we still expect it to average lower than last year which would be a negative for the country.

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The central bank also sees that Malaysia will record a marginally negative output gap in 2019 but this wasn't any different from our own expectations. Earlier, we had already highlighted (see chart 1) that Malaysia's growth had fallen below trend in 2018 and we see this continuing to be the case going into 2019. Just like the central bank, we don't similarly expect that potential output would grow significantly in 2019 due to subdued capital expenditure from both the public and private sector. The former is a result of ongoing fiscal consolidation whilst the latter would be the result of weaker optimism amid a slowing global economy.

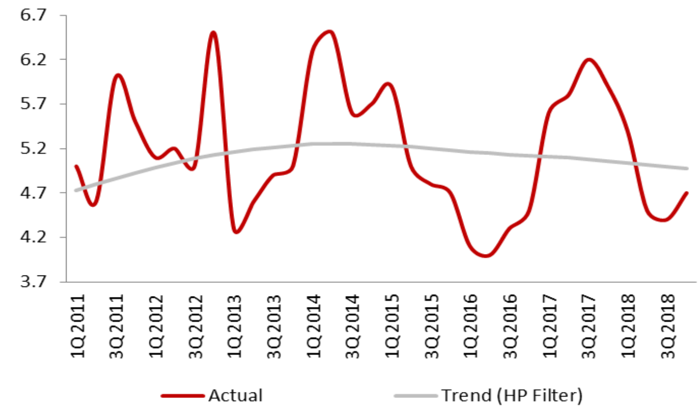
Meanwhile, there has recently been a fall in headline CPI and it looks like inflation could possibly be benign for the rest of 2019. The central bank sees headline inflation would be in the range of 0.7% - 1.7% yoy for 2019 with core inflation expected to remain steady. BNM views that any current deflation is transitory and the effects of any one off policy changes would gradually wear off. At this point, we have penciled headline inflation to come out at 1.3% yoy for 2019. Currently, the government has set a ceiling on the RON95 price at RM2.08, which is much lower than the price of RM2.20 that was set for 2H 2018. We have made our inflation forecast on the premise that the government may make some upward adjustments to the overall fuel price eventually given that they had committed during budget 2019 to introduce a targeted fuel subsidies scheme this year. However, if they fail to do so, inflation could come out below 1.0% yoy for 2019. For further information on inflation, please refer to a previous piece of ours (Deflation but still expect BNM to hold 1H 2019).

The MYR continues to hover in the range of 4.00 – 4.20 for this year and there are also concerns on 10 year real rates climbing (see chart 2). Fund flows month to date at the same time were negative in December 2018 and January 2019 (see chart 3) but did come out positive for February 2019. There may be market worries about the impact that an OPR cut can have on the MYR but a weaker MYR can still help provide support to Malaysian exports.

Given BNM's more cautious view, we are now calling for the central bank to cut the benchmark rate by 25bps from 3.25% to 3.00%. The question now though would be the timing of this cut. We expect BNM to actually wait for at least another Asian central bank to act first though before moving themselves. Our house view is that Bangko Sentral ng Pilipinas (BSP) may cut first in June whilst Bank Indonesia (BI) would more likely make the move later in the year. On the other hand, we expect the Bank of Thailand (BoT) to remain static. **Hence, we see that BNM could announce an OPR cut on as early a date as their 9th July 2019 policy meeting.**

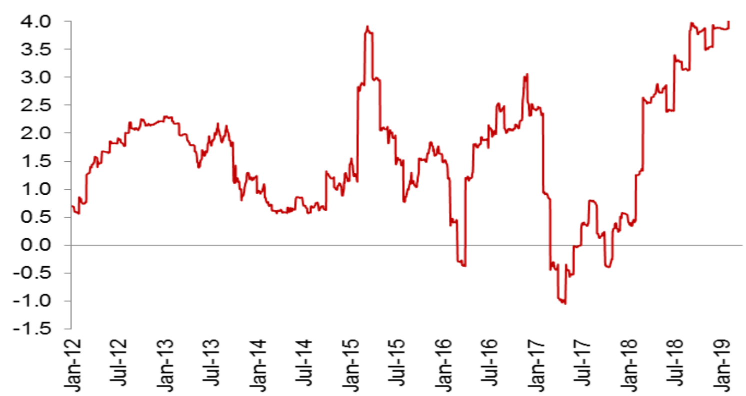
Meanwhile, BNM has decided to liberalize the foreign exchange administration framework which would now make it easier for residents and businesses to manage their currency risks in this volatile external environment. The first change that the central bank has made is to allow residents to hedge their current account obligations and loan repayments for up to 12 months compared to six months before. The other change made was to now allow resident exporters to make payments in foreign currency to resident net importing small medium enterprises for settlement of domestic trade in goods and services upon one-off registration with respective banks.

Chart 1: Actual and Trend GDP Growth, % yoy



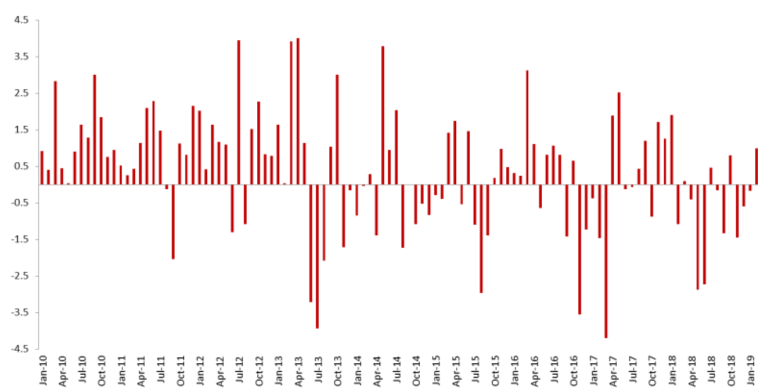
Source: CEIC, Bloomberg and OCBC

Chart 2: Malaysia 10 Year Real Rates, %



Source: CEIC, Bloomberg and OCBC

Chart 3: Fund Flows, US$bn



Source: CEIC, Bloomberg and OCBC

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