Malaysia Monitor

Steady Swan Song

Malaysia holds rate, as an exalted chief exits

Mar 9, 2016

- **It feels like an end to an era. Having presided over countless MPC meetings since 2000, Governor Zeti has just helmed her last one today, before retiring next month.**
- **True to form, she continued to guide the central bank with steady hands, holding the policy rate unchanged at 3.25%. For good measure, the SRR is held steady too at 3.5% after an unexpected cut previously.**
- **How things will change from now on remains an open question. No successor is announced yet to date. The lady has opened the possibility of a rate cut down the road just a wee bit today, however. Inflation momentum is said to be slower than anticipated before.**

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Chief Concerns

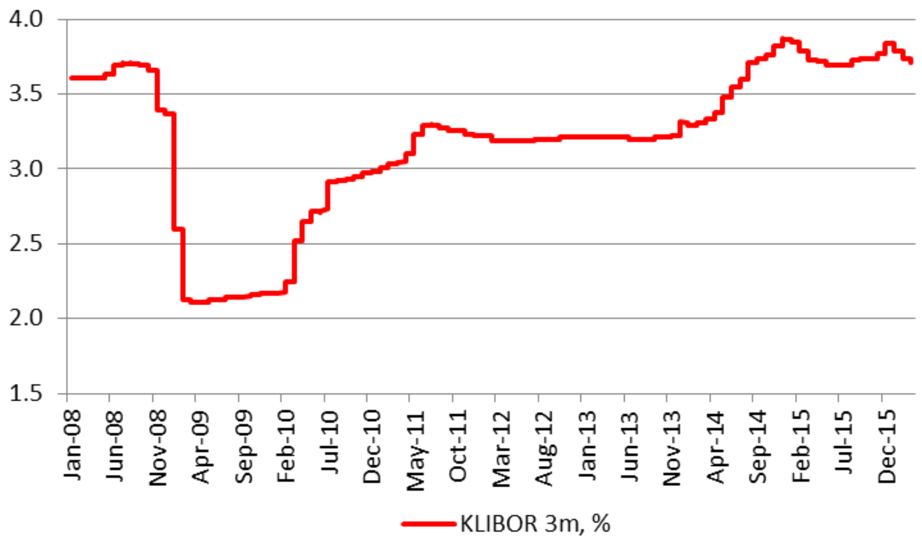
Going into today's meeting, there is practically no expectation in the market that Bank Negara would cut its overnight policy rate from the 3.25% that it has kept it at since July 2014. So, purely from the perspective of policy rate, this is a non-event and probably not worth staying back in office for.

There were some murmurs, including from ourselves, however, that the central bank might just trim the statutory reserve requirement ratio. After all, even after January's unexpected 50bps cut to from 4% level, there is still significant space for it to move down, considering that the ratio stood at 1% until March 2011. Alas, BNM decided to refrain from doing so.

While we think the possibility of such actions remains there, the central bank might have been comforted enough by the drop in the interbank rate since its cut to not move on the reserve requirement just yet. Unlike the previous statement which noted how "external outflows reduced the amount of liquidity in the system," today's mentioned relatively chirpily that "The financial system continues to be sound with financial institutions operating with sufficient liquidity buffers."

In a nod to the flow of financial intermediation process, the statement today also mentioned that "The growth of financing to the private sector have also remained healthy." In other words, shortage of liquidity is less of a concern, so there is little point in cutting the reserve requirement at this stage.

Meanwhile, in terms of growth outlook, there is not much that has changed from the last statement. It continues to mention heightened risks to global growth and that the "Malaysian economy is expected to expand at a more moderate pace in 2016." There is no mention of any revision to its growth forecast for the year just yet, however, although there is likelihood that it may do that in the annual report to be published two weeks from now.



Source: Bloomberg, OCBC.

Now, for the more interesting bit, we would have to zoom in on inflation. While BNM still talks about how 2016 inflation will be higher versus 2015, it has started to play up the idea that “continued low energy and commodity prices” as well as the “generally subdued global inflation” would be mitigating factors. Tellingly, it noted that “the inflation momentum is expected to be slower than earlier anticipated.”

Putting all these nuances together, we get the sense that BNM continues to inch closer towards positioning itself for a potential rate cut. Talking about downside risks to growth equals dialling up the case for rate cut just a bit, while mentioning a tamer-than-previously-expected inflation outlook effectively says that it has more space to do so than anticipated before. Both are on a relative basis, of course, and there is nothing that screams it is ready to pull the trigger just yet.

In terms of timing, it gets complicated by the handover process, as well. The next meeting is going to be on May 20th. Crucially, that will also be the first meeting of the new governor, since the current chief, Zeti Aziz, is due to retire on April 30th. For the successor to start his/her tenure with a rate cut right out of the gate would compound the risk factor of a market misunderstanding, whether the appointee ends up being seen as more of a continuity candidate or otherwise.

All in all, we still think a rate cut remains a low-likelihood scenario in the near term, even if the probability has increased a notch after today’s tamer inflation outlook by the central bank. A lot of things can change on both domestic and external fronts from now, of course. From the current vantage point, however, a rate cut is still unlikely in May. The earliest we might see it happening will have to be in H2, and that is provided that growth loses more momentum than expected.