Malaysia Monitor

OCBC Bank

Blame it on the Brits

Global unease prompts Malaysia to cut rate

Jul 13, 2016

- **Goodness me. Barely two months after painting a sanguine picture on growth outlook, Bank Negara surprised the market today by cutting rate to 3.0% - ostensibly on growth concerns.**
- **What prompted this huge shift? Post-Brexit repercussions that would subject global markets to greater volatility and Malaysia's economy to greater downside risks, as the central bank tells it.**
- **There is also the sense that global rates would be low for longer, which gives BNM the manoeuvre space to begin with. Looking ahead, if it deems that both the need to act and the space to do so are present, it will move again.**

A Darker Take on Things

Despite the jitters in the immediate aftermath of Brexit shock, market sentiment has improved sharply in the past few weeks. As a case in point, both Dow Jones and S&P 500 equity indices of the US have just clocked their record-high levels overnight, illustrating the market thinking that – even as the UK economy might have it bad – the rest of the world should do just fine.

Alas, as it appears today, Bank Negara does not seem to buy that story. Indeed, it has taken on a decidedly darker view of things.

Rather than speaking with a relatively chirpy tone of how "Global economic expansion continues" a la its last MPC statement on May 19th, it now mutters about how "there are increasing signs of moderating growth momentum in the major economies." Moreover, not only has the actual momentum slowed, BNM now points out that "Global growth prospects have also become more susceptible to increased downside risks".

Why are things, all of a sudden, not looking great and indeed may get worse? The key reason, going by BNM's statement, is the "possible repercussions from the EU referendum in the United Kingdom." Indeed, it adds that "international financial markets could also be subject to greater volatility going forward."

The subdued global environment that BNM sees in the days ahead would naturally pose a threat to Malaysia's exports sector and thus weigh on its growth prospects. Hence, even as BNM still talks about how "domestic demand continues to be the main driver of growth," the DIY drivers are no longer enough, just because the external risks are now deemed to be weighing too heavily.

All in all, BNM appears to see the Brexit vote as exacting a heftier toll on the global – and hence Malaysian – economies than market appears to think, prompting the need to cut rate – a compulsion that was conspicuously absent in its statement barely two months ago.

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Wellian Wiranto
Economist
Treasury Research & Strategy,
Global Treasury,
OCBC Bank

+65 6530-5949
wellianwiranto@ocbc.com

Interestingly enough, apart from prompting a greater need for rate cut, the global uncertainties courtesy of the Brits have also inadvertently given BNM the space to act. Indeed, its statement today points out that “global monetary conditions are expected to remain highly accommodative.”

Those are essentially code words for the idea that global rates are going to stay lower for longer, encompassing both the higher possibility of further postponement of Fed fund rate hike and also that of more rate cuts and deployment of unorthodox monetary policy accommodation by the likes of ECB, BOE and BOJ. The subtext of it all is that, any usual concerns about how BNM rate cuts would prompt Ringgit weakness might be more muted now that the stubbornly low global rates would still preserve substantial yield differential anyway.

Now, having surprised the market with its rate cut today, BNM has obviously invited the question of whether it is going to adopt further rate cuts or not. Given the relatively dark tone of its statement today, the chance of further rate cut is inescapably there. However, on balance, we believe that it would adopt a wait-and-see attitude in the coming meeting on September 7th, to gauge whether the hit to global economy is really as bad as it now thinks. If things do turn out to be as unfavourable as it may fear, it may cut again in the following meeting on November 23rd, especially if Q3 GDP out on November 11th proves to be subpar.

Overall, we are of the view that the room for monetary policy accommodation is not infinite, even in an era where global central bankers are openly contemplating once-crazy ideas of helicopter money and what not. In case things do turn further south in the future, BNM may actually want to preserve as many bullets as it can now. This is especially so when Malaysia has even less manoeuvre room on the fiscal and structural reform sides to help.