Safety First

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Bank Negara Malaysia cut rate pre-emptively

- With the conclusion of US-China Phase 1 deal and a nascent pickup in global trade flows, the outlook for Malaysian economy should have been looking better now versus two months ago, when BNM's MPC last met.
- It appears that better may not be good enough, however. BNM surprised the market and us by cutting its OPR by 25bps to 2.75% - a level not seen since early 2011. Ostensibly, it is labelled as a "pre-emptive measure".
- The out-of-left-field nature of the cut, plus a tell-tale wariness on both global and domestic growth drivers in the statement, signal this may not be the last cut for the year – especially if economic momentum does not pick up.

Why now?

We thought they might pull the trigger in the last MPC meeting in November 2019. Not only did they do not, the statement at that time also painted a relatively sanguine picture such that it prompted us to believe that a rate cut would come any time soon.

As it turns out, Bank Negara's assessment of the 2020 economic outlook has apparently shifted quite a bit in the interim. Given that the last few weeks have seen a trade truce between US and China – Malaysia's two biggest trading partners – and a tentative pickup in global trade flows, as evidenced by early January exports data from South Korea's semiconductor industry, the change in tone is a tad surprising.

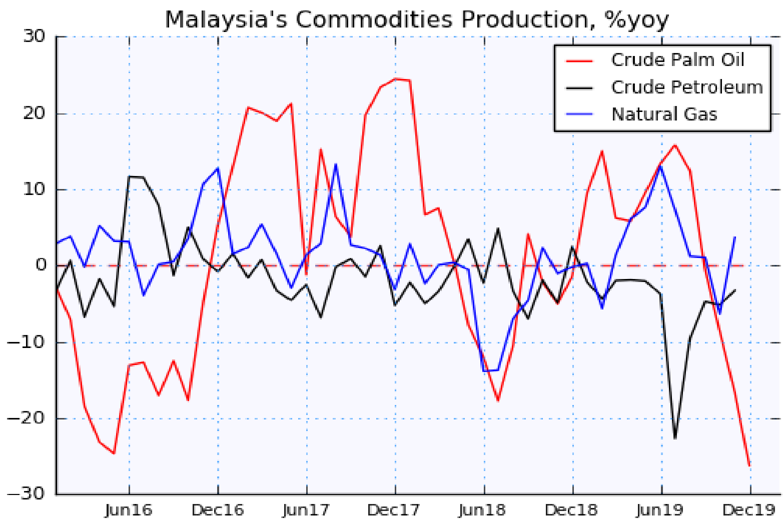
While today's statement spoke about how "*latest indicators and the recent dissipation of trade tensions point to improving trade activity*", it also categorically said that "*downside risks remain due to geopolitical tensions and policy uncertainties in a number of countries.*" Heavily, it added that "*This could cause a resurgence of financial market volatility and weigh on the global growth outlook.*"

The same reference to downside risks to growth pops up when the statement turned to the domestic economy, as well. Even as it highlighted how "*continued support from household spending and better export performance*" should help 2020 growth to gradually improve, it also threw in a smattering of factors that increase the uncertainty to such an outlook.

In verbatim, the list of downside risk factors "*include uncertainty from various trade negotiations, geopolitical risks, weaker-than-expected growth of major trade partners, heightened volatility in financial markets, and domestic factors that include weakness in commodity-related sectors and delays in the implementation of projects.*"

The kitchen-sink list of downside factors on the global front are not exactly new, but not so much for the domestic ones. For one, it is slightly surprising to see references to the commodity sector weakness. While crude palm oil production has indeed slumped to a decline of 16% and 26% yoy in November and December, due in part to bad weather, the industry contributes just about 3% to the overall economy. (Fig 1).

Fig 1. Palm oil production has slumped; At -26% yoy in Dec 2019



Source: OCBC, CEIC, Bloomberg.

There is some possibility here that the statement might be referring to slowdown in the crude petroleum and natural gas production instead, which contribute around 7-9% to national GDP, for which we only have production data up to November 2019 (which have yet to show any marked slump).

On delayed projects, BNM could well be referring to the East Coast Rail Link (ECRL) that is supposed to connect Kota Baru in the eastern Peninsular state of Kelantan to Port Klang in Selangor, as well as the Bandar Malaysia project in the Kuala Lumpur capital region. After months of cost reviews, the tenders were supposed to have been opened by now, but not yet.

At the broad level, BNM's cut today can be seen as its way to help juice up growth at a time when fiscal measure is limited and any structural reform may be curtailed by a relative pickup in political uncertainties. We had highlighted before that the 4.8% 2020 growth rate that underpins the fiscal assumption is too optimistic, and we reckon growth is likely closer to 4.2% that we expect.

Even with today's cut, the official growth assumption may still be hard to reach, especially if global trade flows become curtailed again by breakdown in US-China trade truce or if the Wuhan virus scare takes on a life of its own. Hence, this is unlikely to be BNM's last action of the year. We continue to see the possibility of an aggregate of 50bps rate cuts this year. That is to say, one more rate cut is to be expected after today's move.

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