Insurance Cut

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Bank Negara cut OPR to historic low on pandemic resurgence risk

- While BNM appears to be heartened by the recovery in economic activities since early May, it repeatedly highlights the continued spectre of downside risks. It repeatedly points out the risk of a pandemic resurgence that might bring about the reintroduction of containment measures.
- We had expected BNM to be on hold today to leave space to act in September closer to the end of the loans moratorium, but recent news flow about 2nd wave lockdowns might have brought the risk of another slap on global economy too forcefully for them to wait.
- Given the resolute dovishness and newly uncertain outlook in H2 due to virus resurgence fears, the bar for another cut later this year has gotten lower than before. 1.75% may not be historic low for long, since September may invite another cut, especially if global conditions suffer a relapse.

The Pandemic Problem

The Bank Negara's MPC statement runs 415 words long today, but for all intents and purposes, the word that ultimately matters is "pandemic".

The central bank does not mince its words when it states that "The impact of Covid-19 on the global economy is severe." Even as it duly highlights the fact that a trough is expected in Q2 for the global economy, it has also signalled that the recovery going forward is going to be affected by "weakness in labour markets and precautionary behaviour by households and businesses". Specifically, it warns of the threat of downside risks to the global outlook, "especially if a resurgence of the pandemic necessitates the reintroduction of containment measures."

Coming at a time when global markets are increasingly contending with the prospect of more lockdowns – with news about Melbourne imposing a 6-week lockdown as we speak as a case in point – BNM's warning would appear to be all the more ominous. Indeed, the same mixed feeling where hopefulness about near-term recovery is heavily tinged with caution about the potential for more shutdowns due to pandemic resurgence is evident when the MPC statement discusses Malaysia's domestic conditions as well.

On one hand, it notes that after the opening-up of the country in early May, "economic activities have begun to recover from the trough in the second quarter" and that "the projected improvement in the domestic economy is expected to be further supported by a gradual recovery in global growth conditions." The flip side, however, is that the "pace and strength" of Malaysia's economic recovery remain subject to downside risks. These include, yet again, "the prospect of further outbreaks of the pandemic leading to re-impositions of containment measures."

In short, be it onshore or offshore, as heartening as it is to see that growth has troughed from the earlier virus onslaught, the spectre of another round of attacks on the horizon is a considerable cause for concern.

It is against such a backdrop that the BNM decided to cut its OPR further, even as it has already eased by 100bps before today. With today's 25bps cut, the OPR now stands at a historic low of 1.75% - a testament of just how unprecedented our current situation has been.

While the statement categorically states that "The reduction in the OPR provides additional policy stimulus to accelerate the pace of economic recovery", the extensive focus on the risk of virus resurgence suggests that today's easing may be just as much about bolstering Malaysia's defences against the onslaught of what may come as spurring the ongoing recovery.

Looking ahead, given the increasingly real potential for the virus resurgence to deal our global economy another severe blow – and BNM's resolute dovishness to continue doing what it can to limit what Malaysia has to suffer through because of that – 1.75% where OPR is going to be now may not be the lowest historically for long. Indeed, we now see a good chance that BNM may have to bring the OPR down yet again to 1.5% in the next meeting in September.

Perhaps two months from now, the renewed anxiety about virus would prove to be unfounded and BNM may be comfortable holding again. We simply, frankly, do not know. But it would not be a bad thing if that turns out to be the case and we are wrong.

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