Malaysia Outlook

OCBC Bank

Will BNM be the first in ASEAN to cut rates?

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Highlights

- **Language in the March 2019 statement may only go so far as indicating an even chance of a May 2019 cut.**
- **Historical cuts/hikes have always been preceded by prior statements strongly indicating actions would be forthcoming (an exception being the July 2016 cut).**
- **Slowing/accelerating growth in the past appears to possibly have been of a major concern for BNM to undertake a cut.**
- **A weakening MYR has been a recent concern but we don't see this as necessarily a negative on the real economy.**
- **Regardless, we still expect BNM to only cut as early as July 2019 as they may want to continue to monitor the situation.**

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As the dovish tone gradually sweeps across central banks in the region, it lingers on people's minds which central bank will be the first to cut in ASEAN. Bank Indonesia (BI) last week gave no clear indication of a future cut but did roll out measures to boost domestic demand. Bangko Sentral ng Pilipinas (BSP) has also recently said that a cut is "a matter of timing" although inflationary fears could be a hindrance to do so. **Our house view is that BI and BSP may be looking to later dates to cut and hence, the question arises if Bank Negara Malaysia (BNM) may find itself being the first to cut in the region.**

Recent BNM language on the timing of the cut has not exactly been clear. The central bank had only simply said, "Recognising that there are downside risks in the economic and financial environment, the MPC will continue to monitor and assess the balance of risks surrounding the outlook for domestic growth and inflation." Such a statement does contrast to other previous occasions when a cut/hike occurs as stronger language had been used in the preceding statements. The stronger language would have included "adjusted", "reviewed", "ensure that the stance of monetary policy is appropriate or "take swift monetary policy action". However, the March 2019 statement does draw some comparison to the surprise July 2016 cut where similar language had been utilized in prior statements to that cut. Even so, such language had been used for a couple of months before a cut did happen. **Overall, the language of the BNM March 2019 statement may appear only to go so far as to indicating an even chance of a May 2019 cut. That said, after the so-called "surprise cut" in July 2016, the next time that BNM did move in January 2018, they had indicated this decision in stronger language in the prior December 2017 statement.**

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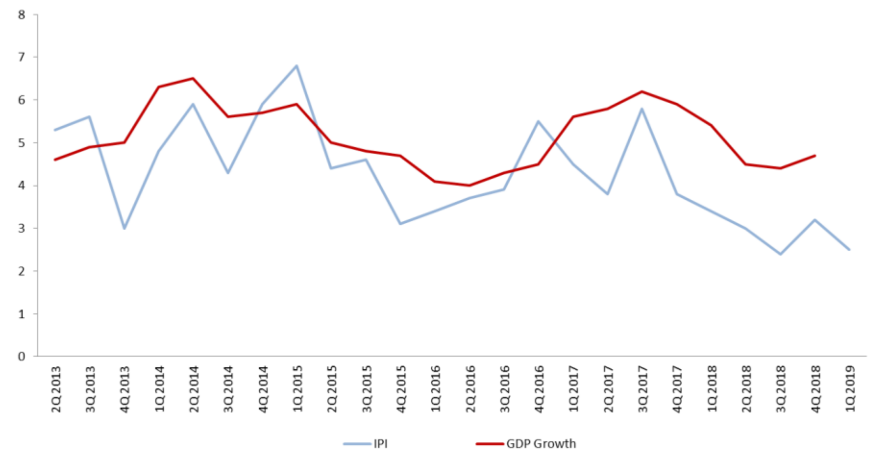
A major concern that may underlie BNM's decision to cut could be regarding the growth situation. The industrial production index for 1Q 2019 (see chart 1) has been on a decline and it has usually been reflective of weaker GDP growth to come. However, the question then becomes the extent to which BNM primarily puts its focus on growth when adjusting the OPR. Historically, this has tended to be the case as a cut would follow a period of slowing growth or a hike similarly would come after some time of robust strong expansion (see chart 2). Furthermore, with the government undertaking fiscal consolidation, tools to stimulate the economy are limited. Externally, there is also now the higher risk that the possibility of any form of a near-term resolution on the US – China trade tensions may not materialize.

On the other hand, concerns have also emerged regarding the value of the MYR as the currency has faced a series of pressures recently. Among them include the consideration by the FTSE Russell to drop Malaysian government bonds out of its World Government Bond Index (WGBI) of which a possible US$8bn of Malaysian Government Securities (MGS) are exposed. Aside that, Norway's Ministry of Finance has also proposed to drop Malaysian government bonds from its fixed income benchmark for the Government Pension Fund Global although the pull out is widely expected to be gradual. A rate cut could likely add some pressure on a further upward movement for the USD – MYR. However, a MYR weakening is not necessarily a negative on the real economy given that inflation is subdued and that its effect on exports maybe at least neutral. Malaysia's economic fundamentals do though remain strong with our growth forecast at 4.4% yoy and the current account slated to still be in surplus this year. Regardless, we are also of the view that BNM may want to wait a bit to monitor the situation at least past July.

At this point in time, it is not fully unclear which direction the Fed is heading towards but we don't believe this will impact BNM's decision. The 10 year real rates difference between Malaysia and US have been quite wide and has climbed substantially (see chart 3) although it can be partially attributable to the weak inflation in Malaysia. Furthermore, we argue that the January 2018 hike cannot be really attributed to the global monetary policy tightening. The January 2018 hike could simply have been a reversal of the July 2016 cut as the economy grew strongly above potential levels in 2017.

Overall, we retain our expectations that BNM may only cut as early as July 2019 rather than the upcoming May 2019 meeting. We believe the central bank may wait to monitor the situation a bit longer before making a decision to cut, especially with the return of US-China trade tensions and USD strength.

Chart 1: Industrial Production Index and GDP Growth, % yoy

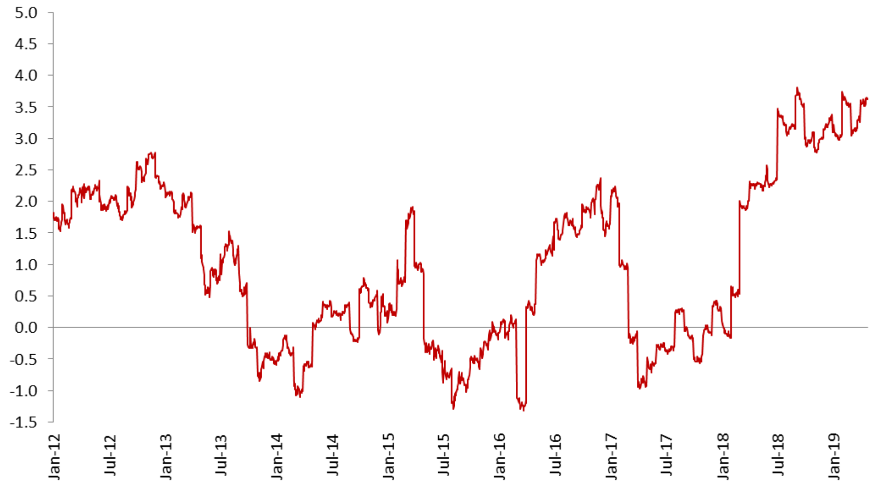


Source: CEIC, Bloomberg and OCBC

Chart 2: OPR - RHS (%) and Growth Rate - LHS (% yoy)

Source: CEIC, Bloomberg and OCBC

Chart 3: MY – US 10 Year Real Rate Differential, %



Source: CEIC, Bloomberg and OCBC

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