Across Asia

Holding Buddies
Malaysia and Indonesia keep rates unchanged

May 19, 2016

- **The reasons behind might differ, but the end decisions are the same. Both Bank Negara and Bank Indonesia chose to keep rates unchanged today.**
- **For Malaysia, a sense that growth prospect is still okay despite some external softness limits any urgency to cut now. Meanwhile, Indonesia is still predominantly focused on transmission of the trio of cuts from earlier this year and moving into a new monetary operation framework.**
- **Looking ahead, BI looks to be the keener of the two to cut further, having shaved down its growth forecast today. BNM, in contrast, is more likely to keep a wait-and-see stance.**

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One-for-One Special

It is a happy coincidence that the two central banks that we look at very closely happen to be announcing their policy decisions on the same day, just half an hour apart. It is also a rather heartening thing to have both of them doing what we said they would do today, i.e. nothing. As we expected, both BNM and BI held their respective policy rates unchanged.

As alluded to at the start, the similarity in final decisions happens to be driven by different underlying reasons, reflecting different key considerations for the two neighbors.

Malaysia: No need to cut

With that in mind, let us first start by considering Malaysia's case. Here, Bank Negara's decision to keep rate unchanged is anchored by a palpable conviction that – despite what casual observers might think given various headlines about the country – the underlying economic fundamentals remain strong. Hence, more than having to consider whether there is space to ease or not, the central bank appears to think that there is not much of a need to ease to begin with.

Such confidence with regard to Malaysia's growth prospects would have been helped by the Q1 GDP print. As we mentioned in our Friday 13th note, "Not So Spooky", even as the print marked the slowest growth rate since mid-2009, it did come above market expectations. More importantly, the strength in private consumption bolsters the overall comfort that Bank Negara appears to possess, that GDP growth will still be within the 4.0-4.5% range that it has in mind for the year.

Tellingly, the wording in a portion of today's policy statement marks an important shift as well. In particular, we are referring to the segment regarding private consumption. Whereas "private consumption is expected to moderate" back on March 9th, "private consumption is expected to expand further" in today's statement. The fact that civil service pay is due to be increased soon is likely to be one of the factors BNM has in mind.

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The conspicuous absence of alarm regarding growth prospects is also evident in how BNM describes the global outlook. Importantly, the central bank points out that the "Volatility in the international financial markets has receded and investor sentiments have improved," even if it adds that the calm is "susceptible to policy and market developments."

As we mentioned before, looking at how BNM looks at the world is important. Given its comfort about domestic growth drivers, the only way in which it would turn more cautious about growth outlook and thus become more dovish and inch towards rate cuts would be if its views of the global growth prospects darken considerably. We do not get the sense that is happening at all from today's statement.

Long story short: when it comes to Malaysia, any dovish expectation that some corners of the market are harboring will face disappointment. Unless export numbers deteriorate massively, or the much-touted domestic consumption uptick gets derailed somehow, here is a central bank that will most likely hold at 3.25% for the rest of the year.

Indonesia: No need to wait

In contrast to the almost-aloof comfort with growth outlook that BNM has, BI appears to be a central bank in quite a bit of a haste to egg growth on more actively. Looking at the policy statement and details from press conference and investors call today, we feel that the Indonesian central bank has a renewed sense of mission in utilizing monetary policy to induce growth.

Crucially, one sentence from the policy statement sticks out: "Provided that the macroeconomic stability maintained in a stable condition, rooms for monetary easing that has been opened may be used at an earlier time." To parse that for you, we believe it essentially means: We can still cut rates, and we will do it sooner than you thought we would.

First thing first, given that the central bank is transitioning into a new way of conducting monetary operations, via the 7-day Reverse Repo Rate instead of the 12-month BI rate, we have been of the view that it will refrain from tinkering with the level of rates until the change is fully completed in August. Hence, the fact that BI is indicating in a rather straightforward manner that the room to cut rate can be utilized earlier puts paid to that line of thinking. In and of itself, that marks a level of confidence that the operational aspect of such a transition is proceeding smoothly and there is no need to fear any complication that might come from pushing rates down. Judging from how the various interbank rates have indeed meandered towards the respective benchmark rates in BI's monetary operations term structure, such confidence may indeed be justified.

With that in mind, we therefore would have to reassess our earlier call that BI would only cut rate beyond August. The natural question becomes, when then?

The conditionality portion of BI's key statement, suggesting how it would cut rates if things are stable, thus takes on extra importance. There is a bunch of related factors such as inflation and current account outlook and global market sentiment, but they all distil into one thing and one thing only at the end of the day: currency stability. If Rupiah remains stable, BI could cut its policy rates – plural here given that they would likely adjust both the old 12-month and its succeeding 7-day rates in tandem – as soon as the next meeting on June 16th. Now given that this date is very close to, and takes place before, the Fed's June 25th meeting date, there is obviously the underlying thinking that the global market would not be shocked enough by any Fed rate hike then for it to threaten the relative stability that Rupiah has had in recent months.

That can be a tricky assumption, naturally, but one that the central bank might be willing to countenance. As it appears, it remains very keen to get loans growth going. While it acknowledges a pick-up in loans disbursement in April to 8.7%yoy (from 8.2% before), it seems to be possess the view that more easing needs to be undertaken to push towards the 11% loans growth targeted. The fact that Q1 growth was at 4.9% - disappointing enough for it to shave down its growth forecast range from 5.2-5.6% to 5.0-5.4% - must be weighing on its mind as well.

Hence, unless global market volatility picks up sharply again – so much so that Rupiah stability is seemingly threatened – we think there is a good chance that Bank Indonesia would reach for easing again next month, shaving the old 12-month policy rate from 6.75% to 6.50% and the new 7-day rate from 5.5% to 5.25%. Given the degree of dovish tilt, it is unlikely to be satisfied with just one further cut, and more likely to have a total of 50bps easing in mind, as well.