Malaysia

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A Case for Cutting

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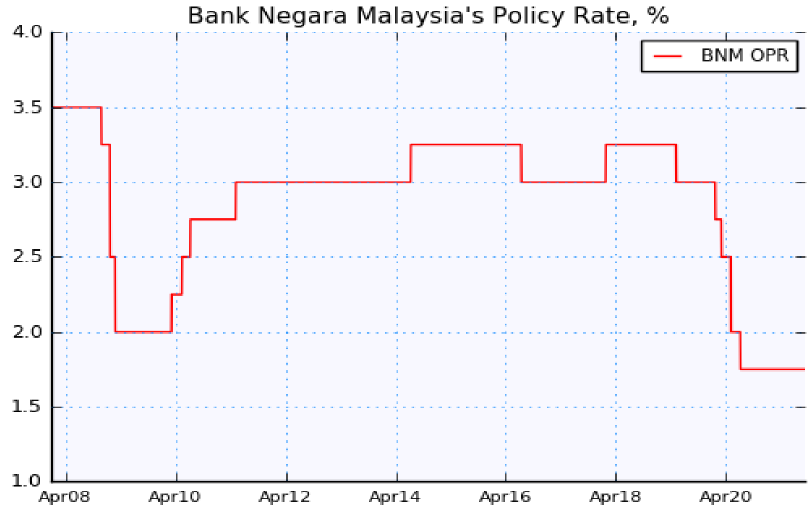
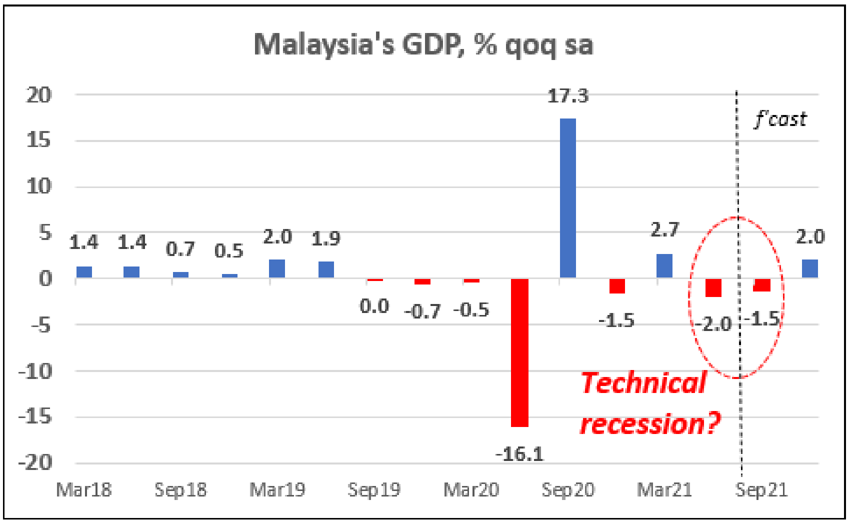
Why we think Malaysia's policy rate should be trimmed

Back in July, Bank Negara kept its policy rate unchanged at 1.75%. Going forward, even though the bar for easing remains high given the previous decisions to hold, we remain of the view that further monetary policy accommodation is helpful to smoothen the path towards recovery into Q4 and 2022. To us, the need to cut rate by 25bps on Sep 9 remains clear.



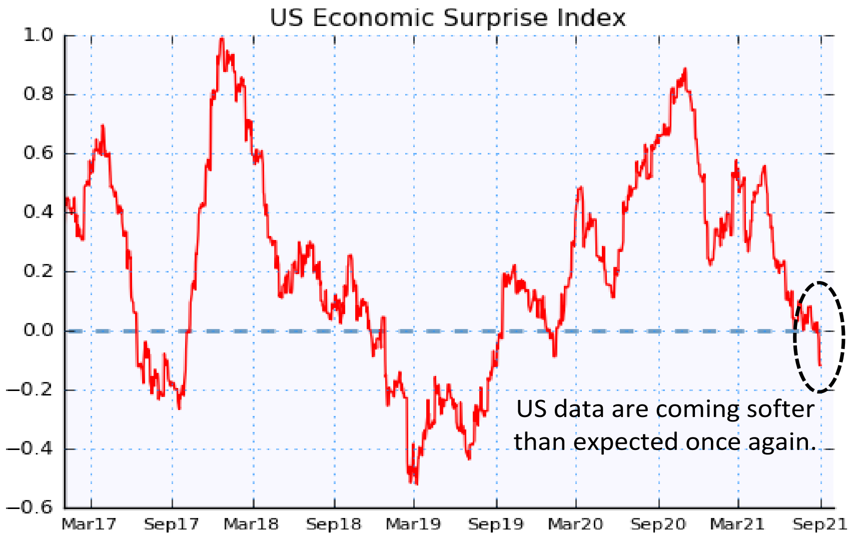
Source: OCBC, Bloomberg.

For one, the economic momentum in recent months have continued to be sub-par due to prolonged MCO restriction orders. Indeed, Q3 is likely to post another sequential GDP contraction. Following the 2% contraction in Q2, this would present a spectre of technical recession for the Malaysian economy.



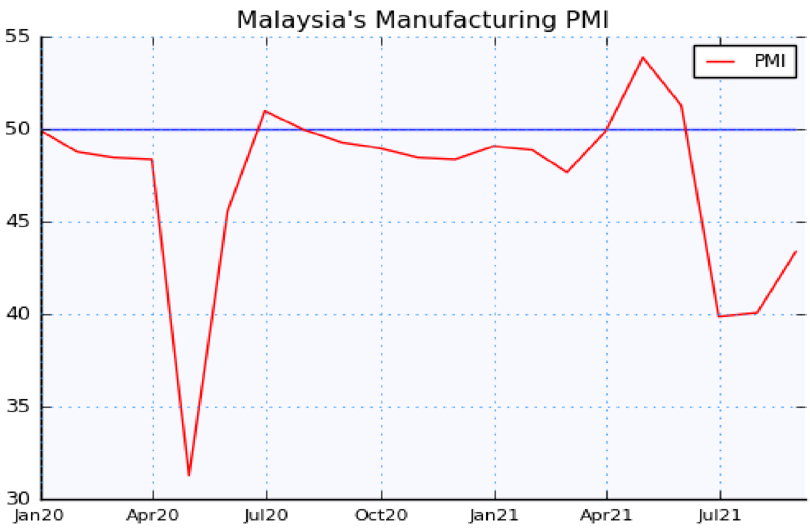
Source: OCBC, Bloomberg. Note: Q3 and Q4 2021 numbers are our forecasts.

For its part, BNM had slashed its 2021 GDP forecast from 6.0-7.5% before to 3.0-4.0% now. While we concur with its view that growth should improve from Q4 and into 2022, downside risks remain considerable. For one, exports which have been powering growth recently, might step into a soft patch, with potentially weaker demand from the two major markets of US and China.



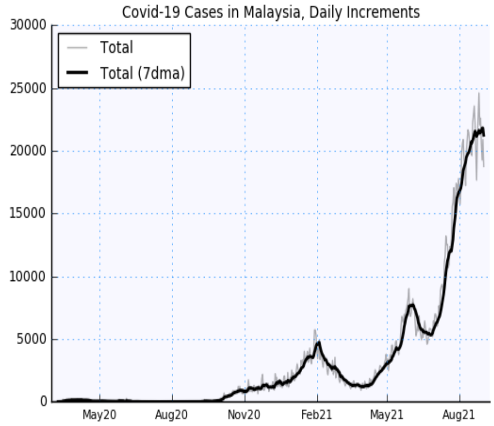
Source: OCBC, Bloomberg.

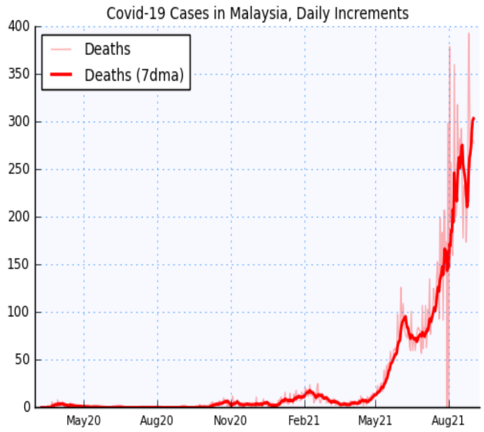
The most recent manufacturing PMI print alludes to a still-unclear outlook for the sector. While the August reading improved to 43.4 from an average reading of 40 of the prior two months, it has nonetheless languished squarely in the contractionary zone, coming well below the 50 breakeven line. A recent survey by FMM-MIER also noted that that sentiments among manufacturers remain weak, with only 15% respondents expecting business to pick up soon.



Source: OCBC, Bloomberg.

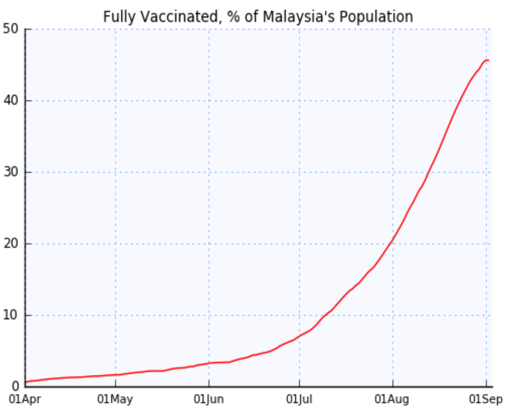
On the domestic front, even though new Covid-19 cases continue to linger at high levels of around 20k per day, the silver lining is that the long-suffering Klang Valley area appears to have started to turn the corner. However, other areas such as Johor and East Malaysia risk becoming the new epicentres. Moreover, death rate continues to remain high, presenting a grim reminder that the fight against the delta variant is an arduous marathon, not a sprint.

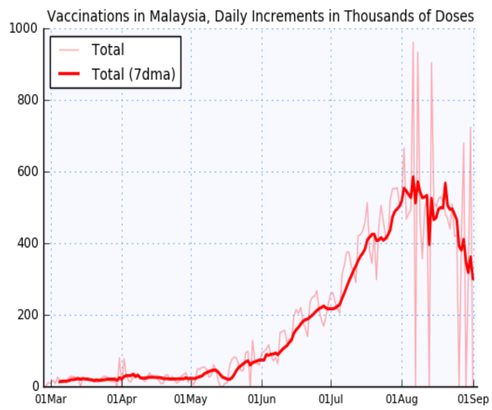




Source: OCBC, Bloomberg.

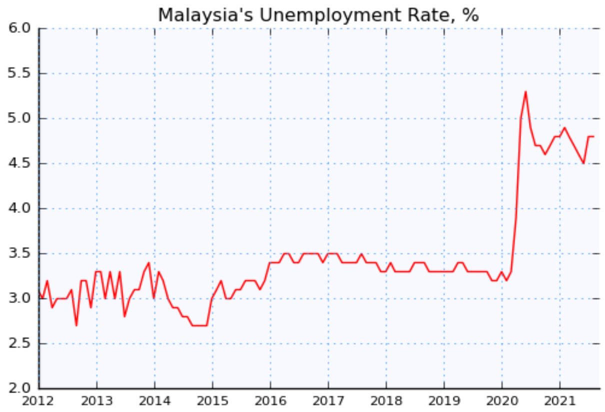
The new government appears keen to push for a reopening of the Klang Valley which would present a lift to the economy given its status as the country's manufacturing hub. This would be predicated on a high vaccination rate of over 90% of the area population. While the overall inoculation rate nationwide enjoyed a big boost in recent months such that more than 45% of Malaysians are now fully inoculated, it remains some distance away from 80-90% that might be deemed safe for a full reopening. Moreover, the rate of inoculation appears to have flagged in recent weeks at a national level. Without a renewed push under the new cabinet, this would present a risk to the reopening hope.





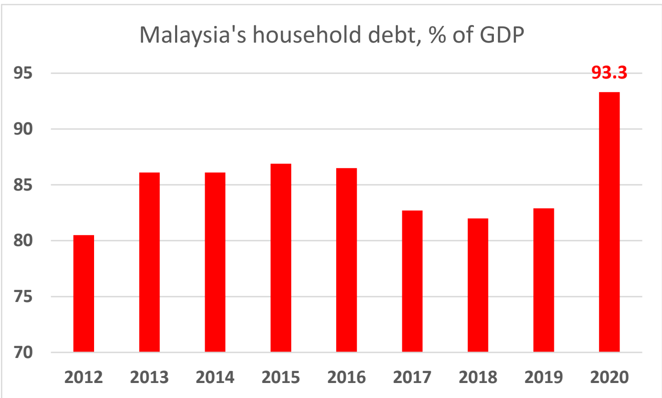
Source: OCBC, Bloomberg.

The ongoing Covid-19 situation would continue to act as headwinds to domestic consumption, which had been playing a greater role in the economy in pre-pandemic years. The resumption of an uptick in the unemployment rate further complicates any expectation of a quick return of Malaysian shoppers. This may be especially so given that the labour market outlook may not improve markedly soon. The [FMM-MIER] survey noted that among manufacturers, for instance, only 12% expect to increase their headcount in the coming months, compared to 25% that intend to reduce employment.



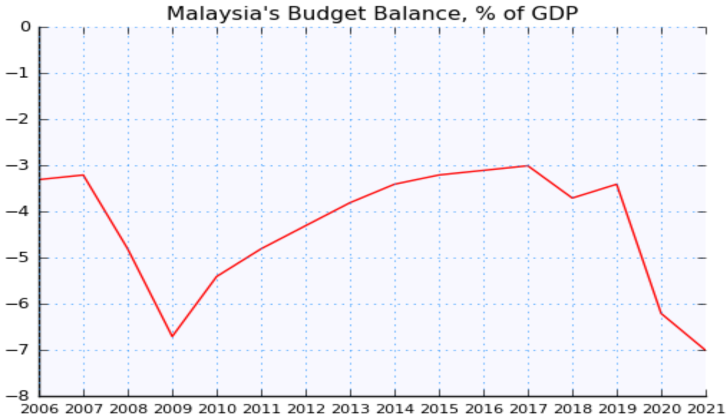
Source: OCBC, Bloomberg.

Apart from the lack of clarity on employment – and hence income – another factor that could curb consumption would be the level of indebtedness. Before the pandemic, Malaysia's household debt already ranked as one of the highest in the region as a proportion of its economy. That ratio ballooned to over 93% in 2020. While easing policy rate may have the side effect of egging on further debt build up – indeed Bank of Korea recently hiked rate partly due to that – in Malaysia's case, the cyclical need of salvaging household purchasing power may yet trump the structural compulsion to curb debt build-up. Even though loans moratorium has helped to offer some relief, lower servicing costs would help too, especially given the accruing of interests during the period.



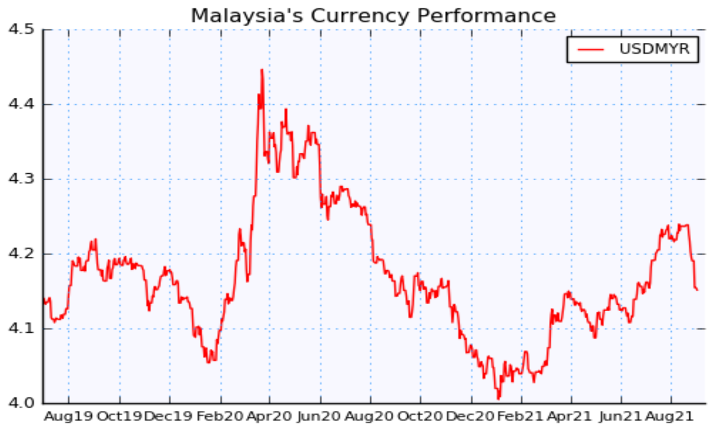
Source: OCBC, Bloomberg.

The need for further monetary policy help comes at a time when fiscal space is crimped. Already, 2021 budget balance may reach as low as -7% of GDP, the widest gap since 2009. Together with lower-than-expected GDP growth, it would push the statutory debt-to-GDP ratio to above 60% by end of this year. While the new government may push for a higher ratio of, say, 65% of GDP, it may not offer that much more headroom, even as we expect a still-expansionary 2022 budget. Moreover, the negative outlook by S&P would act to curb any overtly gung-ho fiscal spending as well.



Source: OCBC, Bloomberg.

The Sep 9 MPC meeting comes at a time when global market sentiment appears well-anchored, with Fed's Powell striking a right balance between paving the way for tapering and divorcing that from rate hike expectation. Ringgit's gains recently could signal less concerns of any currency impact that might come from rate cuts. While its recent history of holding come-what-may suggests that another hold remains the path of least resistance, we believe that BNM could utilize the space presented by global market calm to trim rate. This would aid an economy that has suffered hits from the pandemic resurgence and is now facing a less-clear exports-led recovery outlook ahead.



Source: OCBC, Bloomberg.

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