Why Wait?

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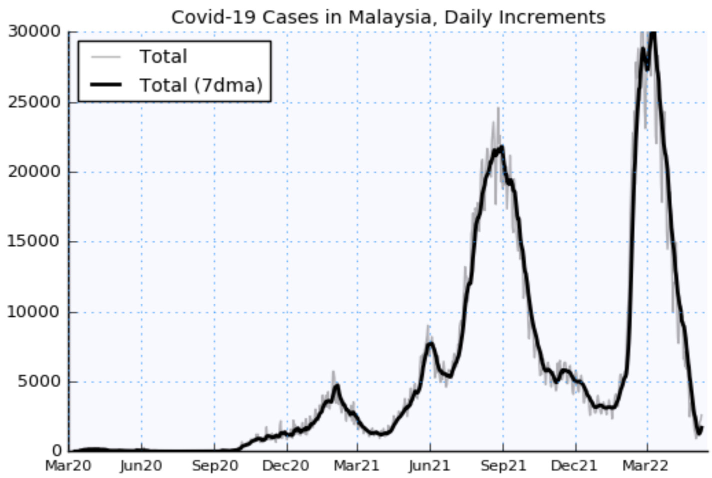
Malaysia surprised the market by hiking its policy rate today

- Bank Negara Malaysia raised its Overnight Policy Rate by 25bps to 2.0% today, in a move that surprised the market consensus and us. Although we pencilled in a hike, we had thought that inflation rate that remains relatively tame would allow the central bank to wait until the July meeting to act.
- Alas, the stickiness of global inflationary pressures – which have "increased sharply" in its view – together with its confidence in the "firmer footing" of the domestic economy, cemented the decision to start withdrawing the monetary accommodation that was put in place because of the pandemic, especially because the Covid-19 crisis carries less existential threat now.
- Going forward, more rate hikes are to come. Still, we see "a measured and gradual manner" as BNM itself pointed out. Our central scenario is for the next hike to come in September, allowing it the space to gauge whether upside risk to inflation or downside risk to growth will be the greater foe, before deciding on whether to hike further from there.

Out of the E.R.

Malaysia's policy rate has been anchored at 1.75% since July 2020, having reached that historically low level after Bank Negara slashed it by 125bps since the onset of the pandemic at the start of that year. In many ways, the fact that BNM opted to depart from the pandemic-level policy rate today speaks to the sense that normalcy has started to establish itself once again.

Indeed, in its MPC statement today, it is keen to point out that the "unprecedented conditions" that necessitated such extraordinary accommodation "have since abated."



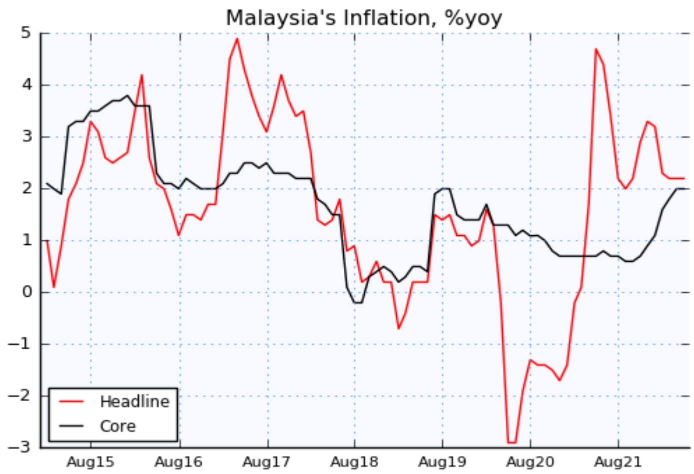
Source: OCBC, Bloomberg.

For one, the root cause of the issue has seen a significant resolution. Even as the threat of more tricky variants remains ever present, the Covid-19 virus itself no longer threatens to upend the economy the same way that it did even months ago. Exiting the extraordinary policy setting because life is becoming more ordinary therefore seemed like the most prudent thing to do.

That is just one dimension of today's decision of course. Rather than a simple return-to-normalcy response, the monetary policy setting has to take in some rather abnormal circumstances as well, even if they are not as dominated by health concerns anymore.

Indeed, BNM made it clear what ultimately prompted the hike today. In no uncertain terms, its statement declared that "Inflationary pressures have increased sharply," driven by "a rise in commodity prices, strained supply chains and strong demand conditions, especially in the US." It noted how, in response, "several central banks are expected to adjust their monetary policy settings at a faster pace to reduce inflationary pressures." While it did not name names, the recent 50bps move by the Fed – with strong signals of a few more such big moves to come – would have featured prominently in the MPC discussion.

The reality of higher inflation is something that BNM has to countenance on the domestic front too, noting how "the underlying inflation, as measured by core inflation, is expected to trend higher between 2.0% - 3.0% in 2022", due to economic momentum and "lingering cost pressures."



Source: OCBC, Bloomberg.

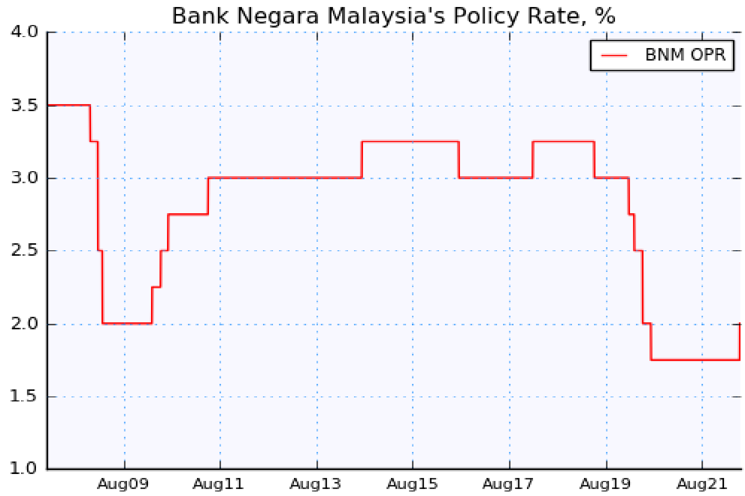
The fact that BNM is wide-eyed about such inflation risks and has started to act proactively to contain them is laudable. This is especially so because contemporaneous core inflation remains relatively low at 2.0% and headline inflation actually surprised on the tame side at 2.2% in March. Rather than hide behind those tame prints, it has decided that it is a lot better to be pre-emptive and to hike rates sooner rather than later.

BNM's forthright decision is helped by the fact that Malaysia's economy is recovering well. It stated that the "latest indicators show that growth is on a firmer footing, driven by strengthening domestic demand amid sustained export growth." Coming two days before the Q1 GDP data, it should presage a good print, as well and there may be some upside risk to our admittedly conservative forecast of 3.0% yoy growth.

Going forward, the overall backdrop of tighter global monetary policy landscape and incipient domestic price pressures amid steadying economic recovery should give BNM the space to raise rates further.

However, given the unpredictability of growth trajectories globally, with the statement pointing out risks of "further escalation of geopolitical conflicts, worsening supply chain disruptions and adverse developments surrounding Covid-19" for instance, this is not a central bank that will act in haste.

Indeed, by embarking on the rate hike cycle earlier than expected, it has won itself some wiggle room and should be able to tighten in "a measured and gradual manner" that it envisions.



Source: OCBC, Bloomberg.

We see a central scenario of BNM hiking once again in the September meeting by 25 bps. If growth continues to be sustained and the underlying inflationary pressures remain considerable, it will hike by another notch to bring the OPR to 2.50% by year-end.

On the flip side, if some of the downside risks to growth that it has pointed out unfortunately materialize, it will prioritize supporting the economic recovery and leave rate unchanged in the last quarter, ending the year at 2.25% instead.

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