Not There Yet

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Malaysia signals that it will not be hiking rate anytime soon

- Given that Bank Negara Malaysia had refrained from cutting rates even when the pandemic scare was at its worst earlier this year, its decision to keep rate unchanged yet again today should not come as a surprise at all, since the situation has stabilized, and the economy is reopening once again.
- As per before, even as it offered a cheery tone in highlighting the recovery momentum due to global demand and domestic reopening, the statement left a cautious note therein. Uncertainties remain par for the course ahead, as it pointed out how the balance of risks to the global growth outlook remains tilted to the downside and domestic growth is still hostage to any re-imposition of containment measures due to any new Covid-19 variant.
- Still, to us, the words of caution are not there to pave the way for any rate cut. Instead, they are meant to ward off any sense that BNM will be in a hurry to hike rate soon, particularly when coupled with its emphasis that inflation pressure will remain moderate. Set against the backdrop of how major central banks are starting to lean on tightening, BNM is keen to note that it will not be compelled to follow suit just yet.

From no cut to no hike

For those who have followed our reports, you would notice that we had been banging the drums about the need for Malaysia to have lower policy rates in the face of pandemic resurgence and threat to the economic momentum. And you would have noted, as well, that the view was proven to be wrong time and again, with BNM opted to keep rate unchanged, including in the last meeting on September 9th.

Given the history of inaction during the height of the pandemic threat, it should follow then that today's decision to keep its policy rate unchanged yet again should not be surprising at all, with the rapid stabilization of the pandemic situation and focus on economic reopening.

Part of the reason why we thought rate cuts were timely back then had been that policy easing would very soon become unfashionable – if not frowned upon – by the end of the year due to growing market concerns about tightening stance by major central banks. Essentially, we thought it best for BNM to use the space to cut rate while it could, because the window would rapidly close by year end once the global markets start to fret more about potential rate hikes by the likes of the Federal Reserve, etc.

That scenario is now starting to take place, with hours to go before the Fed is likely to announce the start of asset purchase tapering – presaging potential rates lift-off thereafter – and coming after hawkish postures from Bank of Canada and Reserve Bank of Australia alike in recent weeks.

Indeed, while today's MPC statement has by and large hewed close to the tones of previous pronouncements, there are aspects that suggest that BNM is now anticipating the need to pre-empt any rise in market anticipation for policy rate hike in Malaysia.

Most tellingly, BNM is keen to portray that inflation remains tame and not a big issue in Malaysia. Core inflation is expected to remain low at below 1% for this year, for instance, while headline inflation is "projected to remain moderate" moving into 2022. Even as it acknowledges that "core inflation is expected to edge upwards" as activities normalize, it is seen to "remain benign given the continued spare capacity in the economy and slack in the labour market."

To be sure, it did throw in caveats such as how "global commodity price developments" and "prolonged supply-related disruptions" might affect the inflation outlook. However, the underlying message that inflation is not a 'biggie' for Malaysia – and hence do not expect us to have to tighten our policy because of that – is hard to miss.

Whether the inflation outturn is as subdued as it expects to be, the focus there suggests that the conversation has shifted considerably. While it was all about how growth would be okay despite near-term challenges – and hence there is no need to cut rate – it has evolved perceptibly to a heavier emphasis now on how inflation is still subdued – and how policy rate does not need to shift up.

To us, we continue to see a central bank that will be committed to supporting growth for as long as it can by keeping the policy rate anchored at the current low level. Inflation should remain broadly anchored as well given the lingering output gap. For instance, the unemployment rate remains lofty at 4.6%. Even if it has come down from the peak of 5.3% last year, it remains well above the 3.3% pre-pandemic run rate, just one sign of how the impact of the pandemic on the labour market remains far from being resolved.

Hence, our baseline remains that BNM can and will leave its OPR unchanged at 1.75% throughout 2022. Such a view will require 'cooperation' from a few factors, naturally. Apart from domestic inflation outturn into next year, perhaps what matters more ultimately will be the global market sentiment, especially when it comes to any marked upshift in Fed fund rates outlook.

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