MNI BNM Preview – January 2022

Announcement Date: Thursday, 20 January 2022

Announcement Time: 07:00 GMT/15:00 MYT

Link To Rate Decision: https://www.bnm.gov.my/opr-decision-and-statement

MNI Point of View: BNM To Hold, Hikes To Come Later This Year

While the consensus view is that Bank Negara Malaysia will keep their Overnight Policy Rate at 1.75% this week, the debate about the most likely starting point of the tightening cycle is already rife. Perhaps the main factor fuelling these discussions is the increasingly hawkish messaging from the Fed, but domestic developments will play a role in determining the starting point of Malaysia's rate-hike cycle.

Consumer price inflation rose to +3.3% Y/Y in November, breaking out of the central bank's forecast range of +2.0%-3.0%, but is expected to ease from there. This expectation is not set in stone, as Covid-19 dynamics may cause further disruptions in the global supply chain, while the impact of severe flooding in late 2021 on domestic food prices is unclear as of yet. Unfortunately, we are not getting the next update on prices until the day after BNM meeting. Furthermore, the ongoing recovery in demand may generate upward pressure on prices.

One thing we know, however, is that the economy hit some speed bumps on the road to recovery. Malaysia's GDP returned into contraction in 3Q2021, owing to restrictions on activity implemented in response to the wave of infections with the Delta coronavirus variant. Furthermore, heavy rains which pummelled a number of Malaysian states at the turn of the year caused damage estimated at MYR6.5bn. While the outlook for this year is notably rosier, it remains clouded by uncertainties over new coronavirus variants of concern.

The Omicron variant has already made inroads into the community, providing a notable risk to the recovery outlook. It should be stressed that Malaysia is relatively well prepared to weather the outbreak. It has one of the highest vaccination rates in the region, as 98% of adults are inoculated with two doses, with the government now rushing to distribute booster jabs. Even if daily cases shoot up eventually (although they have been rather stable so far), Malaysia may manage to avoid the kind of healthcare crisis which struck many countries in earlier phases of the pandemic.

We expect Bank Negara Malaysia to tip hat to the risk posed by Omicron and new variants of concern in general. Together with the hiccups caught by the economy in 3Q2021 and the devastating impact of recent flooding, it provides a justification for holding rates steady. That being said, it would be difficult to pretend that policy tightening remains off the table. The language used by the Bank to describe their assessment of the balance of risks to the outlook will draw the most attention, with markets on the lookout for more clarity on the slope of this year's tightening trajectory.

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Bank Negara Malaysia November Monetary Policy Decision:

At its meeting today, the Monetary Policy Committee (MPC) of Bank Negara Malaysia decided to maintain the Overnight Policy Rate (OPR) at 1.75 percent.

The global economy remains on a recovery path, driven by expansion in manufacturing and services activity. Amid continued strength in global demand, supply chain disruptions, higher commodity prices and labour shortages, inflation has also risen. Nevertheless, global growth prospects will be supported by further progress in vaccination coverage and relaxation of containment measures. In several major economies, sizeable fiscal and monetary policies will continue to support the recovery momentum. Overall, the balance of risks to the global growth outlook remains tilted to the downside. This is attributed mainly to uncertainty surrounding the emergence of variants of concern, the risk of more prolonged global supply chain disruptions, and potential risk of heightened financial market volatility amid adjustments in monetary policy in major economies.

For Malaysia, economic activity weakened in the third quarter, amid the imposition of nation-wide containment measures to curb the resurgence in COVID-19 cases. However, in line with the relaxation of restrictions, latest high frequency indicators show that economic activity has recovered from the trough in July. Going into 2022, the growth momentum is expected to improve, supported by expansion in global demand, higher private sector expenditure in line with the resumption of economic activity and continued policy support. Risks to the growth outlook, however, remain tilted to the downside due to external and domestic factors. These include a weaker-than-expected global growth, a worsening in supply chain disruptions, and the re-imposition of containment measures due to the impact of new COVID-19 variants of concern.

In line with earlier assessments, headline inflation is likely to average within the projected range of between 2.0% and 3.0% for 2021, having averaged 2.3% year-to-date. Underlying inflation, as measured by core inflation, is expected to average below 1.0% for the year. Moving into 2022, headline inflation is projected to remain moderate. As economic activity normalises, core inflation is expected to edge upwards but remain benign given the continued spare capacity in the economy and slack in the labour market. The outlook, however, continues to be subject to global commodity price developments and some risk from prolonged supply-related disruptions.

The MPC considers the stance of monetary policy to be appropriate and accommodative. In addition, fiscal and financial measures will continue to cushion the economic impact on businesses and households and provide support to economic activity. Given the uncertainties surrounding the pandemic, the stance of monetary policy will continue to be determined by new data and information and their implications on the overall outlook for inflation and domestic growth. The Bank remains committed to utilise its policy levers as appropriate to foster enabling conditions for a sustainable economic recovery.

The meeting also approved the schedule of MPC meetings for 2022. In accordance with the Central Bank of Malaysia Act 2009, the MPC will convene six times during the year. The meetings will be held over two days, with the Monetary Policy Statement released at 3 p.m. on the second day of the MPC meeting.

Sell-side comments:

ANZ: We expect Bank Negara Malaysia(BNM) to keep the Overnight Policy Rate (OPR) at 1.75% along with its pro-growth stance at its first meeting of the year. The Malaysian economy has shown steady signs of recovery in Q42021, but is still incomplete and uneven. In addition, slack in the labour market remains with the unemployment rate still noticeably higher than pre-pandemic levels (4.3% in November 2021 compared to 3.3% in February 2020). Hence, policy support is still necessary.

Barclays: With policymakers bracing for a pick-up in Omicron COViD-19 infections, BNM is unlikely to adjust its policy rate until there is greater evidence that the economic impact of the variant is manageable. Overall, the policy statement at BNM's November meeting still appeared to downplay expectations of near-term policy normalisation. Specifically, the monetary policy statement reiterated that the monetary policy committee (MPC) "considers the stance of monetary policy to be appropriate and accommodative," phrasing introduced in September 2020. This is notable as BNM's use of the term "appropriate" has previously flagged the end of tightening and easing cycles. We continue to expect BNM to leave its policy rate unchanged at 1.75% through Q1 22 before it starts to normalise monetary policy from Q2 22. Our base case is for the policy rate to be hiked by 50bp, to 2.25% – 25bp each at the 11 May and 6 July 2022 meetings – and by another 50bp, to 2.75%, in 2023.

DBS: We expect Bank Negara Malaysia (BNM) to maintain its policy rate at 1.75% during its first meeting of 2022. The central bank is likely to highlight that the balance of risks to the global and Malaysian economy is tilted to the downside, partly due to the emergence of the Omicron variant of concern, despite acknowledging the ongoing recovery path that the global economy is on. In our view, Malaysia's headline inflation is likely to end 2021 elevated at above 3%. Severe floods are likely to place upside pressures on already rising food inflation, while oil prices remain elevated. Core inflation meanwhile will continue to inch higher as economic activity normalises. However, the inflation trajectory is within BNM's expectations, and poses little concern for now for tighter monetary policy. The central bank is likely to remain patient and keep monetary conditions accommodative for the time being to support a durable economic recovery, before potentially considering interest rate increases starting from 2H22.

Goldman Sachs: We expect Bank Negara Malaysia (BNM) to keep the overnight policy rate unchanged at 1.75% at its meeting. While high frequency data till November has shown a robust recovery following the slump in Q3, the Omicron variant and recent flooding which impacted half of Malaysia's 13 states pose downside risks to the economic recovery in Q1. With global growth expected to slow modestly as countries battle the Omicron variant and a more uncertain domestic growth outlook, we expect BNM to keep the policy rate unchanged at the upcoming meeting.

Morgan Stanley: We expect BNM to keep the overnight policy rate (OPR) on hold for the ninth straight meeting at the current record low level of 1.75% in order to continue to lend support to the economic recovery. We see a gradual policy rate normalisation starting 3Q22 (two quarters after returning to pre-Covid GDP levels) for a cumulative 100bps hike, which would take the policy rate to 2.75% by 1Q23. If the post-GFC policy normalisation is anything to go by, BNM typically normalises policy rates earlier than other central banks after the economy returns to pre-crisis levels. While headline CPI has picked up more recently (to 3.3%YoY in Nov) on the back of rising food prices, core inflation has remained range-bound, below 1.0% yearto-date Nov, reflecting still-manageable underlying price pressures.

Scotiabank: Malaysia's central bank is expected to hold its overnight policy rate at 1.75%. With inflation running at just over 3% y/y the central bank's communications will be monitored for indications it is getting closer to starting the withdrawal of policy stimulus.

UOB: Given further fiscal policy support from Budget 2022 and a nascent recovery, we continue to expect BNM to stand pat on OPR until mid-2022 and thereafter, we expect a 25bps rate hike to 2.00% in 3Q22.

MNI Policy Team Insights

MNI STATE OF PLAY: Bank Indonesia To Set Policy Views Tighter

By Lachlan Colquhoun

Malaysia's central bank is likely to discuss the timing of monetary tightening at its first meeting for 2022 this week as inflation tracks higher than expected and the economy recovers from pandemic restrictions.

Bank Negara Malaysia is unlikely to change its Overnight Policy Rate from the current setting of 1.75%.

But headline inflation rose to 3.3% in November, outside what is understood as the target range of between 1% and 3% and with growth likely to reach close to 6% in 2022 the scene is being set for a rise in official interest rates in the third or fourth quarters.

That makes the Thursday BNM meeting one that will be watched for changes in language on the outlook for monetary policy. The last move in rates was a cut in July 2020, just as the pandemic prompted the first lockdowns.

Malaysia, like neighbouring emerging market Indonesia, also has to keep an eye on expected hikes in U.S. interest rates this year to stem inflation and any potential impact on the ringgit.

--UPBEAT PROSPECTS

Inflation in Malaysia however is expected to ease in the early months of the year as supply-chain pressures abate.

And Malaysia has among the highest vaccination rates in Southeast Asia, with almost 80% of the population fully vaccinated.

There is also optimism about the country's economic prospects for 2022, with Malaysia, a 15 Asia-Pacific nation trade pact known as RCEP in force this year, overtaking Vietnam as a destination for foreign investment with a focus on the manufacturing sector.

November trade figures surprised on the upside, with exports surging 32.4% year-on-year, coming after a 25.5% increase in October.

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