MNI Bank Negara Malaysia – May 2022

Announcement Date: Wednesday, 11 May 2022

Announcement Time: 08:00 BST/15:00 MYT

Link To Rate Decision: https://www.bnm.gov.my/press-release-2022

MNI Point of View: Moving Closer To Rate Hike

Heading into this week's meeting, Malaysian policymakers were facing dilemmas which many EM central bankers are no strangers to. Increasingly hawkish posturing by the world's major central banks, with the Fed at the forefront, is piling up pressure on their EM peers to begin normalising monetary policy. The ongoing recovery from the pandemic of Covid-19 is being put at risk by rising price pressures, which call for the withdrawal of monetary support measures. All this considered, we believe that the base-case scenario for Bank Negara Malaysia rate meeting this week is no change to the main policy parameters, although a rate hike cannot be entirely ruled out.

Momentum is building behind Malaysia's economic recovery. The GDP returned to growth in the final quarter of 2021 and expansion is expected to have continued at the start to the new year amid the continued resumption of economic activity. That being said, the broader environment remains challenging and highly uncertain. China is trying to contain a renewed outbreak of Covid-19 with some of the world's strictest lockdowns, with adverse knock-on effects on the rest of Asia and beyond. Elsewhere, Russia's ongoing invasion of Ukraine and the ever-tighter sanctions regime cause disruptions to international trade and result in commodity price shocks. We are not sure if Bank Negara Malaysia will be in a hurry to raise interest rates in such an environment, if only a compelling case can be made against it.

Playing into the hands of doves is the fact that price growth remains manageable. Headline inflation printed at +2.2% Y/Y in March, staying well below last year's peak, right at the lower end of BNM's forecast range for this year, with the last three readings slightly missing Bloomberg median estimates. Core inflation picked up to +2.0% and the rate of food price growth quickened to +4.0% in March, but the magnitudes of these accelerations was by no means alarming. Admittedly, the risks to the inflation outlook are tilted to the upside, although Malaysia's status as a net oil exporter should contain the impact of elevated global crude prices. In addition, the fact that the BNM does not have a formal inflation target gives the central bank flexibility in conducting monetary policy.

On a related note, the recent sharp depreciation in the ringgit begs questions about the implications for domestic prices. These can be addressed with reference to recent comments from Malaysia's top economic officials. Bank Negara's Governor Shamsiah told Bernama that the central bank will focus on ensuring that "there are no sharp and wide swings in the value of the ringgit," but any changes to monetary policy "will be based on our assessment of how recent developments affect domestic inflation and growth prospects." Separately, in his op-ed for the Edge, Finance Minister Zafrul warned that raising the policy rate would increase the repayment value of financing, which "could jeopardise the nascent recovery momentum" despite supporting the ringgit.

Many have looked for hints to the recently released Economic and Monetary Review (EMR) 2021, which flagged potential for policy re-calibration. In this document, the BNM noted that it was "cognisant of the consequences of keeping interest rates low for an extended period of time," such as "emergence of financial imbalances through excessive risk-taking behaviour and unhealthy build-up in leverage." We understand that Bank Negara is treading a tightrope and keeping the Overnight Policy Rate at extraordinary low levels also entails risks.

The explicit recognition of this risks by the BNM and the overall positive outlook for growth and inflation mean that policymakers may well decide to defy consensus and begin policy normalisation as soon as this week. At the same time, we believe that they are in a position where they can still err on the side of caution, as benign inflation allows them to maintain current levels of monetary support before a potential rate hike in 2H2022.

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Bank Negara Malaysia March Monetary Policy Statement:

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 continues to recover. Despite the recent moderation in economic activity due to the Omicron-driven COVID-19 resurgences, the overall recovery trajectory remains on track. Inflation in many economies remain elevated, due to both demand and supply factors. Going forward, more countries will transition to endemic management of COVID-19, hence supporting global growth prospects. The unfolding developments surrounding the military conflict in Ukraine, however, have emerged as a key risk to global growth and trade prospects, commodity prices and financial market conditions. The global growth outlook will also continue to be affected by developments surrounding COVID-19, risks of prolonged global supply disruptions, and heightened financial market volatility amid adjustments in monetary policy in major economies.

Despite the challenging environment, the Malaysian economy expanded by 3.1% in 2021. Looking ahead, the growth recovery will strengthen in 2022, driven by the expansion in global demand and higher private sector expenditure, amid improvements in the labour market and continued targeted policy support. The expected reopening of international borders would also provide further support to economic recovery. The economic impact from the recent increase in COVID-19 cases due to the Omicron variant is expected to be considerably less severe than previous waves in the absence of stringent restrictions. Risks to the growth outlook remain tilted to the downside due to external and domestic factors. These include a weaker-than-expected global growth, ongoing geopolitical conflicts, worsening supply chain disruptions, and developments surrounding COVID-19.

Headline inflation in 2022 is projected to remain moderate as the base effect from fuel inflation continues to dissipate. Underlying inflation, as measured by core inflation, is expected to normalise to around its long-term average as economic activity continues to pick up amid the environment of high input costs. Nevertheless, core inflation is expected to be modest, with the upside risk partly contained by the continued slack in the economy and labour market. The inflation outlook continues to be subject to global commodity price developments amid risks from prolonged supply-related disruptions.

The MPC considers the current stance of monetary policy to be appropriate and accommodative. Fiscal and financial measures will continue to provide support to economic activity. Amid the prevailing uncertainties, the stance of monetary policy will continue to be determined by new data and their implications on the overall outlook for domestic inflation and growth.

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Bank Negara Malaysia Economic and Monetary Review 2021

The Economic and Monetary Review sets out BNM's economic assessments and outlook.

Highlights of EMR 2021 include:

- 2022 is set to be a watershed year as most countries progressively transition towards endemic management of COVID-19. However, even as the global economy is expected to continue its recovery path, policymakers are adjusting their policy settings against rapidly evolving uncertainties, including the military conflict in Ukraine which began in February.
- The pace of economic recovery in Malaysia is projected to gather further momentum amid the reopening of the economy and international borders. With better COVID-19 management and higher vaccination rates, BNM expects less disruption to domestic economic activity and spending in the event of resurgences. Malaysia will also continue to benefit from the expansion in global demand. For 2022 as a whole, the economy is expected to grow between 5.3% and 6.3%.
- Headline inflation is forecasted to average between 2.2% and 3.2% in 2022. While high input costs are projected to exert some pressures on selected fresh food prices, these pressures will be partly mitigated by price controls. Meanwhile, core inflation is expected to average higher between 2.0% and 3.0% in 2022 due to stronger demand conditions amid lingering cost pressures. However, the extent of upward adjustments in core inflation will remain partly contained by the continued slack in the economy and labour market.
- Labour market conditions are expected to improve in 2022 as economic activity picks up. The unemployment rate is expected to decline further to around 4% of the labour force. This sustained recovery in employment and income is expected to drive an improvement in household spending.
- Monetary policy will remain accommodative to support a sustainable economic recovery while ensuring price stability. BNM is cognisant of the consequences of keeping interest rates low for an extended period of time. As the outlook for inflation remains largely supply-driven, BNM is closely monitoring for any signs of potential second-round effects, where price pressures could become more entrenched as domestic demand recovers. Ultimately, any potential adjustments to the degree of accommodation will remain data-dependent and be undertaken in a measured and gradual way to preserve an appropriate level of support to the economy.

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Sell-side comments:

ANZ: Wednesday's monetary policy meeting which takes place two days prior to the GDP data release will likely echo similar optimism. We believe that BNM's approach towards policy normalisation will be gradual as inflation risks remain manageable for now, although recent ringgit weakness has become a moderate risk. Overall, we expect BNM to remain on hold at its upcoming meeting.

Barclays: We expect Bank Negara Malaysia (BNM) to commence its normalisation cycle on 11 May with a 25bp hike, taking the Overnight Policy rate to 2.00%, although we note that this is a close call with a risk of delay to July. Our base case is for a total of 50bp of back-to-back rate hikes this year. We believe that BNM – a particularly forward-looking central bank – is unlikely to see much value in delaying hikes by a few more months when there is now relatively more certainty over the economic recovery. In its 2021 economic and monetary review, BNM expressed confidence in the economy's ability to weather future waves of COVID-19 infections – which have fallen visibly – and raised the need to gradually normalise the policy rate to prevent a buildup of destabilising financial imbalances. Community mobility is also approaching pre-pandemic levels, and we expect Q1 GDP growth (to be released on 13 May) to rise to above 4% y/y, which should further boost BNM's confidence over the economic recovery.

DBS: Considerations for policy interest rate normalisation would be on the table during BNM's meeting this week, making it a close call between a hold at 1.75% and a 25bps hike to 2.0%. Our base case is for BNM to stay on hold for now and begin its hiking cycle in early 2H22. While already having signalled the prospects to withdraw significant monetary support in its recent 'Economic and Monetary Review (EMR) 2021', we think that policymakers would want to see that the economic recovery from the pandemic is durable (GDP figures to be released after the meeting) amid growth downside risks. Based on our estimates, the share of Malaysia's CPI basket items that is above its long-term headline inflation rate of 2.0% YoY remained >30% in March but did not accelerate significantly in March, such that BNM would turn very concerned about the un-anchoring of long-term inflation expectations.

Goldman Sachs: We expect Bank Negara Malaysia (BNM) to initiate policy normalization with a 25bp hike to the overnight policy rate this week. High frequency data suggest that economic activity continues to recover with GDP rebounding another 2.3% qoq s.a. in Q1. Growth momentum is likely to remain robust this year supported by a full relaxation of domestic COVID restrictions, limited pass-through from global commodity prices to domestic energy prices, and a modest investment recovery amid a rebound in public investment spending and higher commodity prices. Ongoing core inflation pressures are likely to build as the output gap shrinks, and accumulated business cost pressures are passed-through to retail goods prices as demand recovers. For now BNM continues to emphasize that policy won't respond to price pressures unless there are signs of second round effects, with inflation becoming more entrenched and broad-based. However, in the recent 2021 Economic and Monetary Review, BNM also highlighted that the economic outlook is significantly better now than in 2020 when emergency accommodation measures were introduced. The report emphasized that the degree of accommodation may need to be re-calibrated to re-build policy buffers and guard against potential financial instability risks down the road. Given this shift in communication, we expect BNM to raise its policy rate to 2% at the upcoming meeting.

Scotiabank: Most expect Bank Negara Malaysia to continue to hold its overnight policy rate at 1.75% on Wednesday. Inflation is only running at 2.2% y/y with core CPI at 2% but climbing. If they do pause again, then watch forward guidance carefully in light of expectations for the central bank to soon commence a tightening campaign.

UOB: The Bank Negara Malaysia (BNM) will have its monetary policy decision on Wed. The prevailing upside risks to Malaysia's inflation outlook amid improving domestic economic activities have seen policy rate hike expectations shift higher lately. There were also changes observed in BNM's monetary policy communications in Mar. Taken together, we stick to our call for the OPR to be raised by 25bps to 2.00% at this meeting, followed by another 25bps hike in 3Q22 that will bring the OPR to 2.25% by end-2022.

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