MNI Bank Negara Malaysia Preview – November 2022

Announcement Date: Thursday, 3 November 2022

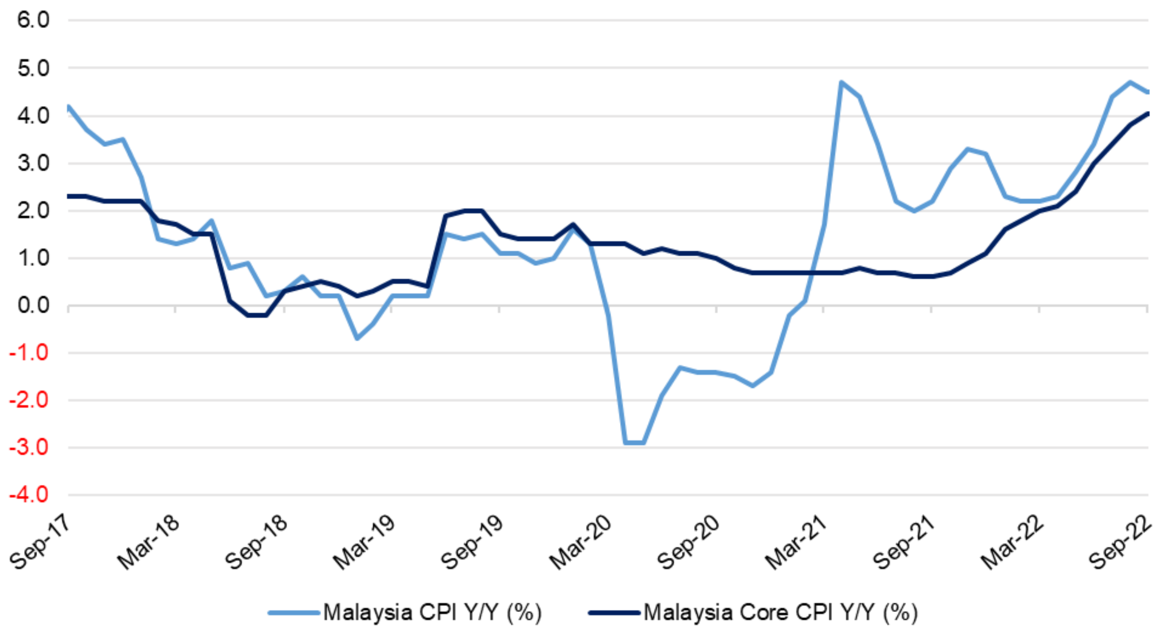
Announcement Time: 07:00 BST/15:00 MYT

Link To Statement: https://www.bnm.gov.my/monetary-stability/opr-decisions

MNI Point of View: Measured & Gradual

Although Bank Negara Malaysia was in a better starting position than many of its regional counterparts, it will likely raise the Overnight Policy Rate by a further 25bp this week. Historically elevated core inflation, intensifying peer pressure, the need to rebuild monetary policy buffers and a lengthy hiatus ahead of the next rate review should be enough to budge policymakers towards a standard-sized rate hike.

On the surface, the latest CPI outturn may have been reassuring. Headline inflation eased more than expected to +4.5% Y/Y, failing to challenge prior cyclical highs. Still, core inflation printed at +4.0% Y/Y, rising to the highest point since at least 2015. Domestic price pressures support the case for continued monetary tightening after the BNM raised its key policy rate by 25bp at each of the last three meetings.



Demand-pull inflationary pressures are supported by robust economic recovery, which translates into tight labour market and decent wage growth. GDP report for the second quarter smashed expectations, with the next report not due until November 11. On top of that, the minimum wage hike that took effect on May 1 is accentuating domestically generated inflation.

Meanwhile, most of the world's major central banks are well into their tightening cycles, reducing country risk premia across emerging Asia and forcing regional monetary authorities to follow suit. Wider yield spreads with the U.S. are exerting pressure on regional currencies, with the ringgit printing 24-year lows versus the greenback, raising the risk of stronger tradeable inflation.

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Meanwhile, the prospect of a global economic slowdown calls for rebuilding monetary policy buffers in time, before deteriorating external conditions filter through into the domestic economy. The outlook for global demand is downbeat, as global efforts to contain runaway inflationary pressures are affecting the real economy.

The fact that this will be the BNM's final monetary policy meeting this year supports the case for raising interest rates further, as more work needs to be done to contain price pressures, while the near-term fiscal outlook (including counter-inflationary measures) remains clouded by a snap general election in Malaysia. Therefore, we expect Bank Negara to deliver the fourth consecutive 25bp rate hike, while reaffirming its "measured and gradual" approach to monetary tightening.

Bank Negara Malaysia September Monetary Policy Statement:

At its meeting today, the Monetary Policy Committee (MPC) of Bank Negara Malaysia decided to increase the Overnight Policy Rate (OPR) by 25 basis points to 2.50 percent. The ceiling and floor rates of the corridor of the OPR are correspondingly increased to 2.75 percent and 2.25 percent, respectively.

The global economy continued to expand, albeit at a slower pace, weighed down by rising cost pressures, tighter global financial conditions, and strict containment measures in China. However, global growth continues to be supported by improvements in labour market conditions, and the full reopening of most economies and international borders. Inflationary pressures have remained high, due to elevated commodity prices and tight labour markets, despite continued easing in global supply chain conditions. Consequently, central banks are expected to continue adjusting their monetary policy settings, some at a faster pace, to reduce inflationary pressures. In particular, aggressive adjustments in US interest rates have contributed to a strong US dollar environment. This has resulted in higher volatility in financial markets, affecting other major and emerging market currencies, including the ringgit. Going forward, the global growth is expected to face challenges from the impact of monetary policy tightening in most economies, and pandemic management measures in China. The growth outlook is subject to downside risks, including elevated cost pressures, the potential energy crisis in Europe, and sharp tightening in financial market conditions.

For the Malaysian economy, the transition to endemicity and policy measures have contributed to the stronger growth performance in the second quarter of 2022. Going forward, indicators point to continued growth, underpinned by support from private sector spending. Labour market conditions and income prospects remain positive, with unemployment and underemployment declining further. The reopening of international borders will lift tourism-related sectors. Investment activity and prospects would be supported by the realisation of multi-year projects. Nevertheless, external demand is expected to moderate following softening global growth. Despite the increased volatility in the global financial and foreign exchange markets, these developments are not expected to derail Malaysia's growth. Domestic liquidity remains sufficient, with continued orderly functioning of the financial and foreign exchange markets. Financial institutions also continue to operate with strong capital and liquidity buffers. These will ensure financial intermediation remains supportive of the economy. Going forward, downside risks to the domestic economy continue to stem from a weaker-than-expected global growth, further escalation of geopolitical conflicts, and worsening supply chain disruptions.

Year-to-date, headline inflation has averaged at 2.8%. Headline inflation is projected to peak in 3Q 2022 before moderating thereafter, due to dissipating base effects and in line with the expected easing of global commodity prices. Underlying inflation, as measured by core inflation, is expected to average closer to the upper end of the 2.0% - 3.0% forecast range in 2022, with some signs of demand-driven pressures amid the high-cost environment. The extent of upward pressures to inflation will remain partly contained by existing price controls, fuel subsidies, and the prevailing spare capacity in the economy. The inflation outlook, however, continues to be subject to domestic policy measures, as well as global commodity price developments arising mainly from the ongoing military conflict in Ukraine and prolonged supply-related disruptions.

With the positive growth prospects for the Malaysian economy remaining intact, the MPC decided to further adjust the degree of monetary accommodation. At the current OPR level, the stance of monetary policy continues to remain accommodative and supportive of economic growth. The MPC is not on any pre-set course and will continue to assess evolving conditions and their implications on the overall outlook to domestic inflation and growth. Any adjustments to the monetary policy settings going forward would be done in a measured and gradual manner, ensuring that monetary policy remains accommodative to support a sustainable economic growth in an environment of price stability.

Sell-side comments:

ANZ (+25bp): Although headline inflation eased to 4.5% y/y in September from 4.7% y/y in August, upside risks continue to cloud the inflation trajectory. Domestic demand remained robust, as reflected in the core inflation print which touched an all-time high reading of 4.0% y/y. The direction of fiscal policy measures in 2023 is still unclear, with the 2023 Budget not mentioning the extent of the roll-back in fuel subsidies. We are expecting details to emerge, most likely after the general election. Meanwhile, the external backdrop is also becoming challenging. While nominal goods balance remains at a healthy level (MYR31.7bn in September) supported by favourable terms of trade and robust global demand, both these advantages have started to recede. Besides, the odds of the US Fed delivering another 75bp hike in November have also risen. This does not bode well for the Malaysian ringgit, especially when the international reserves are also on a steady path of decline. Considering these factors, we expect Bank Negara Malaysia to follow through with another 25bp rate hike.

Bank of America (+25bp): We expect BNM to hike the OPR by another 25bp, consistent with the further gradual withdrawal of policy accommodativeness in line with the strong dataflow on economic activity, labor market and underlying inflation. Upcoming general elections may be a risk, but we expect BNM to remain independent and take the necessary policy actions.

Bank Islam Malaysia (+25bp): US Federal Reserve (Fed) and Bank of England are expected to announce the widely anticipated 75 basis points (bps) hike while Bank Negara Malaysia's (BNM) monetary policy committee (MPC) would likely settle for a 25bps increase on Thursday.

Barclays (unch.): Our base case is for Bank Negara Malaysia (BNM) to pause its tightening cycle at its 3 November meeting to assess the severity of the global economic downturn, though we note the risk of another back-to-back 25bp rate hike. BNM has historically been quick to react to turns in global economic cycles. In this regard, we believe rising concerns over a potential global economic downturn likely prompted the monetary policy committee (MPC) to turn more tentative in its language, and we note that in its 8 September policy statement, BNM said "the MPC is not on any pre-set course." After a brief pause to assess the severity of any slowdown, we expect BNM to hike again, by 25bp, in Q1 23. That said, we note the risk that the central bank decides not to pause and instead proceeds with yet another back-to-back hike.

DBS (+25bp): The debate during BNM's meeting this week will likely be between another 25bps overnight policy rate (OPR) hike or an intermittent pause. We think the probability is slightly skewed towards another 25bps rate increase to 2.75%, supported by various factors. Firstly, Malaysia's domestic economy remained supported by pandemic opening tailwinds helped by a favourable base, coupled with labour market improvements, while exports looked solid despite rising global external demand headwinds. Second, even though headline inflation moderated to 4.5% YoY in September from 4.7% in August, core inflation continued to face upside pressure, rising to 4% YoY from 3.8% over the same period. Third, downside pressures on the Malaysian ringgit vs the USD and rapidly eroding reserves could see policymakers seek to protect wider interest rate differentials, even though BNM does not look likely to match the US Fed's moves given its 'measured and gradual' guidance. Lastly, seeking a wait-and see approach might see BNM miss the narrowing window to rebuild monetary policy buffers ahead of a more difficult 2023.

Goldman Sachs (+25bp): We expect Bank Negara Malaysia (BNM) to hike the overnight policy rate (OPR) by 25bp to 2.75%. Government fuel and food price controls have resulted in lower headline inflation pressures this year compared to other regional economies. However, core inflation (which excludes volatile food and energy prices) continues to gain momentum, rising to 4.0% yoy in September, supported by strong domestic demand, ongoing input cost passthrough, tight labor market conditions and robust wage growth. As core inflation gains momentum, we continue to expect BNM to hike policy rates at consecutive meetings (25bp/meeting pace) through H1 next year, bringing the policy rate up to 3.5%, from 2.5% currently. The evolution of subsidy policy after the elections remains a key risk – a faster shift to targeted fuel subsidies may imply higher inflation pressures, and more hawkish BNM policy outcomes than in our baseline forecasts.

HSBC (+25bp): We expect Bank Negara Malaysia (BNM) to hike its policy rate again by 25bp in the upcoming policy meeting, bringing the OPR to 2.75%. The economy has been recovering at a robust pace, and the latest inflation data release indicates that headline CPI may have peaked. However, core inflation continued to rise at a robust pace. We expect the economic recovery to remain on track, and the labour market is likely to tighten further. This may further intensify risks to core inflation. We think this warrants BNM to continue its hiking cycle, but it will likely be only "in a measured and gradual manner". As this will be BNM's last meeting for the year of 2022, we expect the policy rate to remain at 2.75% when the year ends.

MARC Ratings (+25bp): MARC Ratings Bhd expects Bank Negara Malaysia to remain on a rate-tightening path and lift the Overnight Policy Rate (OPR) by at least another 25 basis points (bps) next week. There are three reasons for this. First, we see risk of the demand-pull side of the inflation equation, given the improving short-term domestic growth outlook, manifesting itself stronger going forward. The second reason is that global inflationary pressures will likely persist from continued disruptions to commodities markets. And finally, the ringgit could remain under pressure in the coming months amid higher interest rate in the US.

Maybank (+25bp): The central bank is expected to raise the rate further by 25 basis points (bps) to 2.75%. We also expect another 25 bps hike early next year to bring the OPR back to the pre-Covid-19 level of 3% by the end of the first quarter of 2023.

Morgan Stanley (+25bp): We expect the BNM to raise the OPR by 25bps to 2.75%. This would be in line with its policy guidance from the previous meeting of adjusting rates at a "measured and gradual" pace. Looking ahead, we see the terminal policy rate at 3.0%, which we expect will be reached by 1Q23. This would effectively reverse the 125bp cumulative cuts introduced over the course of the pandemic.

UOB (unch.): Given that inflation expectations are anchored to official targets and risks to the domestic growth outlook are tilting to the downside, we believe BNM will tread more cautiously. We expect BNM to take an intermittent pause to assess the effect of its cumulative 75bps rate hikes to date, domestic policy outcomes, higher external risks and weaker global outlook. As such, we expect the OPR to be left unchanged at 2.50% at the coming Nov meeting.