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ECONOMIC REVIEW | February 2017 BNM MPC

OPR Unchanged in March, Maintains at 3.00%

- *Interest rate maintained at 3.0%. In its most recent MPC statement, BNM notes global economic activity saw encouraging recovery and faster domestic output growth.*
- *Higher headline inflation in 2017. The central bank foresees higher inflation which is reflection of higher domestic retail fuel prices. It further adds that it sees inflation to remain relatively high for the first half before moderating after. We foresee headline inflation to breach the 3% upper bound level anticipated by the government for 2017.*
- *We see Bank Negara to maintain interest rate at 3.00% in 2017, revised from our earlier forecast of one OPR cut. The revision is made in view of the strengthening global activity which if sustain should bodes well for domestic economic growth. Besides, there is now higher probability for the Fed to normalise at faster rate, especially after Trump has delivered his most recent speech to the Congress.*

Interest rate maintained at 3.0%. In its most recent MPC statement, BNM notes global economic activity saw encouraging recovery. The same reflection was made for world trade and we concur given the positive feeds that we have observed regionally. The latest evident is early readings on Korea's exports performance for the month of February – the highest in more than 6 years. Outbound shipment growth to China was excellent, reaching 28.7%yoy.

BNM highlighted modest growth for 2016 but expects current good growth momentum to sustain for 2017. At the moment, we see domestic growth to accelerate slightly in 2017 at 4.3% vs 4.2% in 2016. BNM noted growth was underpinned by private sector and external activity to contribute to higher domestic growth. We are on the same page in the sense that we have already expecting external demand to pick up a few months ago. Our forecast for exports is maintained at 3.0% annual growth at the moment.

However, while BNM was pointing towards widening of net exports to bring give tailwinds to domestic growth, such case may not materialise should the economy strengthened further. Merchandise imports are often positively correlated with domestic economic activity due to sourcing of capital and intermediate inputs. Meanwhile, consumers tend to travel more overseas when they have good current and future sentiment on the economy, contributing towards higher imports of services and smaller magnitude of net exports.

Higher headline inflation in 2017. The central bank foresees higher inflation which is reflection of higher domestic retail fuel prices. It further adds that it sees inflation to remain relatively high for the first half before moderating after. On our part, our forecast model reflects the same inflation quantum for both half of 2017. We foresee headline inflation to breach the 3% upper bound level anticipated by the government for 2017. This means an upward pressure on bond yields in the future, having to compensate for the expected inflation. Worldwide strong demand on local government securities may mitigate the increase in the bond yield. We see high possibility for good part of this year for the 10-year yield to trend below the headline inflation, an occurrence similar to the 2008 period.

Ringgit stabilises, along with other emerging market currencies. YTD, Ringgit has appreciated by 0.8% against the greenback, a modest gain compared to other peers. The two best performing currencies in Asia i.e South Korea won has gained 5.6% while Taiwanese dollar edged higher by 4.9% against the US dollar. Nonetheless, it was reflective of the positive net foreign flow to Malaysia's market which reached a combined RM1.37b for the first two months of the year (RM418.7m and RM935.7m for January and February respectively).

We see Bank Negara to maintain interest rate at 3.00% in 2017, revised from our earlier forecast of one OPR cut. The revision is made in view of the strengthening global activity which if sustain should bodes well for domestic economic growth. Besides, there is now higher probability for the Fed to normalise at faster rate, especially after Trump has delivered his most recent speech to the Congress.

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