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ECONOMIC REVIEW | September 2016 BNM MPC

BNM Keeps OPR at 3.0% Despite Weak External Economy

- *After surprising the market by cutting the benchmark interest rate by 25 bps last July, Monetary Policy Committee (MPC) decided to keep the overnight policy rate (OPR) at 3.00% in September meeting. The decision was in line with market consensus which mainly expected BNM to keep the rate at the current level, though it differs with our own as we have been expecting BNM to conduct another rate cut today.*
- *In line with our views, BNM is expecting that the external demand will remain weak while the market remains vulnerable to setbacks and change in sentiments. However, BNM view differs from ours in which they continue to expect that private consumption will grow at a faster pace, supported by wage and employment growth and additional impetus coming from announced Government measures to increase disposable income.*
- *We are maintaining our OPR forecast at 2.75% by year-end 2016, which we are now expecting the next rate cut will be in November 2016 by 25 bps. At the same time, we are keeping our USDMYR forecast of RM3.95/USD for year-end 2016 and GDP forecast for 3Q16 and the whole of 2016 at 4.1% and 4.0% respectively. Additionally, we are maintaining our stance of no rate hike by Fed for the remaining of 2016.*

BNM keeps OPR at 3.00% in September MPC Meeting. After surprising the market by cutting the benchmark interest rate by 25 bps last July, Monetary Policy Committee (MPC) decided to keep the overnight policy rate (OPR) at 3.00% in September meeting. The decision was in line with market consensus which mainly expected BNM to keep the rate at the current level, though it differs with our own as we have been expecting BNM to conduct another rate cut today.

No improvement from external factors, the hope lies with domestic economy. In line with our views, BNM is expecting that the external demand will remain weak while the market remains vulnerable to setbacks and change in sentiments. However, BNM view differs from ours in which they continue to expect that private consumption will grow at a faster pace, supported by wage and employment growth and additional impetus coming from announced Government measures to increase disposable income. On the other hand, BNM is expecting private investment to remain strong anchored by the on-going implementation of infrastructure projects and capital spending in the manufacturing and services sectors.

The domestic strength could be seen in yearly basis, but it was mainly due to low base effect. Although both private consumption and private investment remained strong on year-on-year basis, most of the strengths were mostly due to low base effect. Recall that goods and services tax (GST) was introduced in second quarter of last year, which caused both private consumption and investment contracted on quarterly basis. As such, the strong private consumption and investment activity in 2Q16 by 6.3%yoy and 5.6%yoy respectively were mostly due to the low base effect rather than actual strength of domestic economy. On seasonally adjusted quarter-on-quarter basis, the private consumption grew by a marginal 0.7%qoq while gross fixed capital formation grew by only 0.5%qoq.

The high fiscal deficit numbers could mean slower intake and investment activity by Government. As of July 2016, Malaysia's fiscal deficit has reached RM32.9 billion, close to Government's full year target of RM38.6 billion based on average oil price of USD30 per barrel. The situation is dire as even with a much higher oil price with an average of USD42.7 per barrel year-to-date; our fiscal deficit is much higher than the initial estimate due to falling revenue. As of July 2016, Government revenue fell by 10.5%yoy, mostly due to lower direct taxes which include both corporate and income tax as well as lower than expected GST collection which only amounts to RM7.1 billion in 2Q16. Moving forward, we are expecting that Government will continue to be prudent with their spending, as such it is unlikely that there will be much room for fiscal stimulus due to the fiscal consolidation process.

Keeping the OPR at 3.00% may be a discretionary move. There are two plausible explanation of no rate hike decision in the recent September meeting. Firstly, it may be a discretionary move, in which BNM does not want to give a signal to the market that the economy is in a dire situation by making two consecutive rate cuts. If it is because of that, then it could be understood on why BNM decided to cut the rate as early as July, but keeping the rate in September, which will allow them to cut in November. Secondly, BNM may be waiting for the 2017 budget to be presented first, before making any move from the monetary policy front. In the event of an expansionary budget – in which we think quite unlikely – BNM may decide that it is unnecessary for them to conduct another rate cut as fiscal policy should be sufficient in order to support the domestic economy.

Table 1: Global Monetary Policy (%p.a.)

	Oct-15	Nov-15	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16	Sep-16
Australia	2.000	2.000	2.000	2.000	2.000	2.000	2.000	1.750	1.750	1.750	1.500	1.500
China	4.350	4.350	4.350	4.350	4.350	4.350	4.350	4.350	4.350	4.350	4.350	4.350
EU	0.050	0.050	0.050	0.050	0.050	0.000	0.000	0.000	0.000	0.000	0.000	
India	6.750	6.750	6.750	6.750	6.750	6.750	6.500	6.500	6.500	6.500	6.500	6.500
Indonesia	7.500	7.500	7.500	7.250	7.000	6.750	6.750	6.750	6.500	6.500	6.500	
Japan	0.000	0.000	0.000	-0.100	-0.100	-0.100	-0.100	-0.100	-0.100	-0.100	-0.100	
Korea	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.250	1.250	1.250	
Malaysia	3.250	3.250	3.250	3.250	3.250	3.250	3.250	3.250	3.250	3.000	3.000	3.000
Philippines	4.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000	3.000	3.000	3.000	
Singapore	Grad.	Grad.	Grad.	Grad.	Grad.	Grad.	Neut.	Neut.	Neut.	Neut.	Neut.	Neut.
Taiwan	1.750	1.750	1.625	1.625	1.625	1.500	1.500	1.500	1.375	1.375	1.375	1.375
Thailand	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.500	
United Kingdom	0.500	0.500	0.500	0.500	0.500	0.500	0.500	0.500	0.500	0.500	0.250	
United States	0.250	0.250	0.500	0.500	0.500	0.500	0.500	0.500	0.500	0.500	0.500	
Vietnam	6.500	6.500	6.500	6.500	6.500	6.500	6.500	6.500	6.500	6.500	6.500	6.500

*Red indicates easing policy while yellow indicates contractionary policy
Source: Bloomberg, CEIC; MIDF Research

We are maintaining our expectation that BNM will cut OPR by another 25 bps in 2016. We are maintaining our OPR forecast at 2.75% by year-end 2016, which we are now expecting the next rate cut will be in November 2016 by 25 bps. At the same time, we are keeping our USDMYR forecast of RM3.95/USD for year-end 2016 and GDP forecast for 3Q16 and the whole of 2016 at 4.1% and 4.0% respectively. Additionally, we are maintaining our stance of no rate hike by Fed for the remaining of 2016.

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