6 March 2015

Malaysia

BNM kept OPR unchanged as the current rate still perceived accommodative

- **Despite many EM central banks moved to ease their monetary policy in recent weeks, BNM maintained its neutral stance and kept OPR unchanged at 3.25% at its recent meeting as monetary policy is still considered to be accommodative.**
- **BNM continued to highlight that the liquidity in the financial system remained ample with continued orderly functioning of the financial markets despite the elevated risk on the external front. The central bank expects inflation is set to decline in 1Q and to edge up thereafter for the rest of 2015 but at below trend which should underpin sustained strong contribution from domestic demand to ensure economic growth not deviating too far off from its steady path.**
- **We maintain our expectation that BNM may keep the rate unchanged for the rest of the year, despite the likely positive real interest rate and growth slowing down. While interest rate upward move may do little to boost Ringgit that is currently still relatively weak, any move to cut may not be seen as favourable given the already huge capital outflows in the 4Q 14.**

BNM maintained OPR at 3.25% despite the easing wave across EM Asia as monetary policy still accommodative. The most recent cut was by the Reserve Bank of India which cut twice in the span of 3 months, just after few days People's Bank of China cut its lending rate again just after 4 months it did so. Earlier on, Bank Indonesia cut its reference rate in January as its inflation numbers and trade deficit improved amidst signs of growth losing significant momentum. The monetary policy committee believed that the current monetary stance is still accommodative. It stated that *"While the introduction of the Goods and Services Tax and the lower earnings in the commodity sector are expected to have some impact on private consumption, household spending will continue to be supported by the steady increase in income and employment. Additionally, the lower fuel prices are contributing to higher disposable income. Investment activity is also expected to remain resilient, with broad-based capital spending by both the private and public sectors, thus cushioning the lower investment in the oil and gas sector."*

State of liquidity and the intermediation process intact despite volatility in the financial markets. As we have highlighted in pour previous report on BNM's January's MPC decision, BNM is likely to be monitoring very closely the state of liquidity in the financial system and potential risks of destabilizing imbalances that could emanate from the volatility in the financial markets with the weak Ringgit adding to the uncertainty. Nonetheless, as BNM have reported, the liquidity in the domestic financial system remained ample and *"..the banking institutions are also operating with strong capital and liquidity buffers, and continue to provide financing to the economy. There has, therefore, been no disruption to financial intermediation."*

Inflation is increasingly becoming less of a concern. The lower fuel prices had led the CPI to record a meagre 1% yoy rise (Dec: 2.7%). Our calculations showed that inflation could slip to below 1% in February before rebounding albeit marginally. BNM expects inflation to remain low in the 1Q 15 and while it is expected to trend higher, as the impact of GST kicks in, the pace is now expected to be below its historical average for the rest of the year which we estimated that to be at 2.5 – 3.0%.

We maintain our expectation that BNM may keep the rate unchanged for the rest of the year, despite the likely positive real interest rate and growth slowing down may call for a rate cut. While it can be argued that interest rate upward move may do little to boost Ringgit that is currently still relatively weak, hence BNM should not raise OPR just for the sake of ensuring Ringgit would not weaken too much, any move to cut may not be seen as favourable too given the already huge capital outflows in the 4Q 14.

Chart 1: The lower fuel prices - relative to last year's level should help offset the impact of GST

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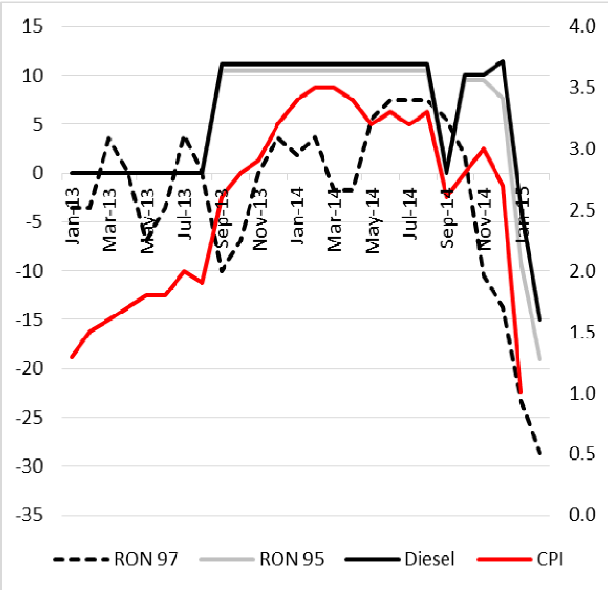
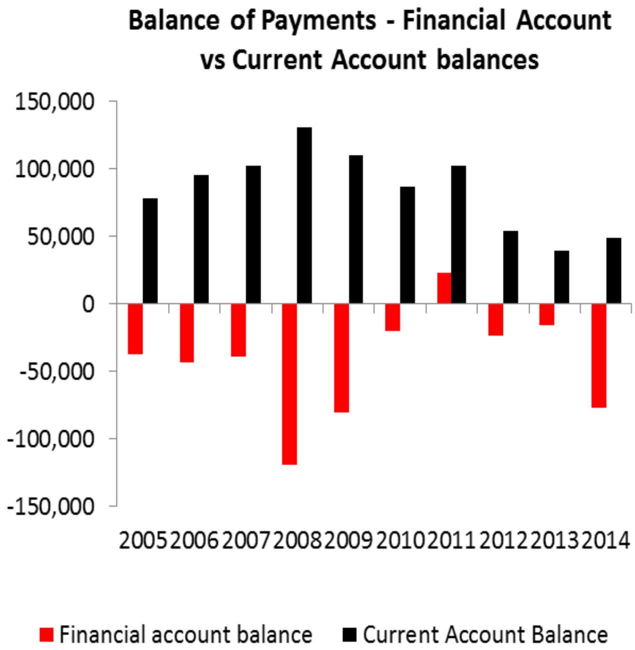


Chart 2: A rate cut may not bode well against the worsening balance of payments position.



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