

Malaysia: Making our case for lower rates

Unlike most Asian central banks whose rate policies have almost reached the easing limit, Bank Negara Malaysia has some room to stay the course. And, there is a strong case for the central bank to do so this week



Governor of the Central Bank of Malaysia Nor Shamsiah Mohd Yunus

Source: Shutterstock

1.50%

ING forecast of BNM policy rate

After 25bp cut this week

The market favours stable BNM policy

It's policy-making week for Malaysia's central bank, the Bank Negara Malaysia. The BNM Monetary Policy Committee begins its two-day meeting on Wednesday, 9 September. The decision is expected the next day at 3pm local time.

The BNM reviews policy every two months and has delivered a total of 125 basis points of rate cuts in four meetings through July, including a 50 basis point cut at the meeting in May when the Covid-19 pandemic was at its peak. We have long been calling for a 25 basis point cut at this

meeting, taking the overnight policy rate down to a fresh low of 1.50%.

The Bank will continue to utilise its policy levers as appropriate to create enabling conditions for a sustainable recovery. – BNM's July policy statement

We maintain our rate cut call, although that puts us in the consensus minority for this meeting. Out of 14 forecasters in a Bloomberg survey at the time of this writing, only four expect a 25bp rate cut and the rest forecast no change from 1.75%. Until a month ago, the consensus was almost evenly split between '25bp cut' and 'no change' outcomes.

We believe the case for easing continues to be strong.

Making our case for a 25bp rate cut

Here is why we think BNM should cut rates again this week.

Even as Malaysia has been largely immune to the Covid-19 outbreak, its economy has been one of the hardest hit in Asia. The nationwide lockdown to contain the virus dented GDP by 17% year-on-year in 2Q. This was the biggest plunge that the economy has ever seen; the last big drop was 11% at the height of the Asian crisis in 1998.

Things were looking better as we moved into 3Q with a second straight monthly export bounce in July boosting the trade surplus to the highest ever, 25 billion Malaysian ringgit (MYR). While this bodes well for GDP growth, a couple more quarters of negative GDP growth still looks inevitable. Even though a pick-up in exports should support manufacturing, the rest of the economy will continue to be under downward pressure. Mining, construction and services were the worst-affected in 2Q and will remain so over the rest of the year.

Meanwhile, more policy support is required to revitalise domestic demand. The elevated jobless rate (4.9% as of June) is depressing consumer spending and weaker business confidence is delaying investment spending. Reinforcing weak consumer demand is a negative inflation streak that started in March and is likely to prevail through the rest of the year (latest -1.3% YoY in July).

The likelihood of additional stimulus from the fiscal side remains slim. Malaysia's public finances were already stretched before the Covid-19 outbreak. These are under further duress from record stimulus by the Muhyiddin administration to deal with the fallout of the disease – a total 19.5% of GDP package with about 9% in real or on-budget spending. As elsewhere in the region, the budget deficit is poised to rise significantly this year. As the government sets out to plug the gap with market borrowing, the central bank could help it by keeping borrowing costs low.

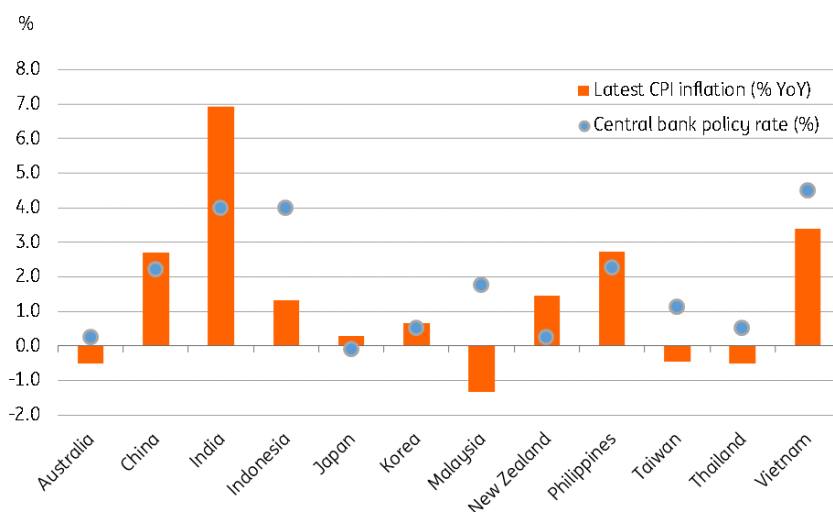
A timely dose of easing, while there is room for it, will go some way in helping the recovery.

Why not ease when there is room to do so? Unlikely most Asian central banks, for whom the rate policy has reached its limit, with rates close to zero, the BNM's 1.75% policy rate, coupled with negative inflation, allows its easing cycle to run further. Moreover, negative inflation means the real policy interest rate is one of the highest in Asia (see figure) - not really a good backdrop for economic recovery. We think one more 25bp rate cut at the last meeting of the year in November wouldn't hurt either.

The outperformance of the MYR in the emerging market rally since June should provide more comfort to the central bank in cutting rates again this week. The currency has appreciated 4.8% against the USD since June, the most in Asia. Besides a broad weak USD environment, the firming of oil prices and record trade surplus underpin some of the outperformance - forces which should remain in place during the rest of the year.

While analysts are split on the outcome of this week's meeting, the market seems to be pricing in a 25bp BNM rate cut. The 10-year government bond yield, at 2.56% currently, is down 25bp since the last BNM meeting in early July. This is despite the ongoing supply overhang from a record stimulus.

Real interest rate * in Malaysia is one of the highest in Asia



Source: CEIC, ING

* Defined as nominal policy rate minus latest inflation rate.

What this means for the markets

We don't expect much reaction in bond markets, which has taken the rate cut in its stride, as noted above. We believe the central bank will maintain its accommodative stance for future policy and this should sustain the positive sentiment in the market over the rest of the year.

The next risk event for Malaysian bonds, however, will be the FTSE Russell's decision on 24 September about retaining these in its global bond market index. These have been on the FTSE's watch-list for potential exclusion on market accessibility grounds. It's been this way for a while though, since April 2019. In the last review a year ago, the index provider decided to keep them in. We expect the same this time. Malaysian bonds aren't performing too badly, judging from the 75bp drop in the 10-year yield year-to-date. Why fix it, if it's not

really broken?

As for the currency market, if you think a rate cut could take the steam out of the ongoing MYR rally, we don't really share this view. On the contrary, we would view it as a further boost to investors' faith in the country's countercyclical macroeconomic policy, suggesting the MYR will remain an outperformer in Asia in the remainder of the year.

Bond market is priced in for a rate cut, while currency market allows for it



Source: CEIC, ING

Author

Alissa Lefebvre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic
420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@asia.ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Germany, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland
Karol.Pogorzelski@ing.pl

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

Viraj Patel
Foreign Exchange Strategist
+44 20 7767 6405
viraj.patel@ing.com

Owen Thomas
Global Head of Editorial Content
+44 (0) 207 767 5331
owen.thomas@ing.com

Bert Colijn
Chief Economist, Netherlands
bert.colijn@ing.com

Peter Vanden Houte
Chief Economist, Belgium, Luxembourg, Eurozone
peter.vandenhoute@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroeder@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Gustavo Rangel
Chief Economist, LATAM
+1 646 424 6464
gustavo.rangel@ing.com

Carlo Cocuzzo
Economist, Digital Finance
+44 20 7767 5306
carlo.cocuzzo@ing.com