

Malaysia: Why we buck the consensus on BNM policy

We believe more pre-emptive easing to counter potential downside growth risks will be a strong consideration at the Bank Negara Malaysia's policy meeting this week. Hence a 25 basis point rate cut shouldn't come as a real surprise



Governor of the Central Bank of Malaysia Nor Shamsiah Mohd Yunus

Source: Shutterstock

2.75%

ING forecast of BNM policy rate on Wednesday

A 25bp cut

Consensus favours stable policy

Bank Negara Malaysia's (BNM) Monetary Policy Committee begins its two-day meeting on Wednesday, 11 September. The policy decision is expected on Thursday at 3pm local time.

The consensus is skewed towards no action with 15 out of 23 analysts in a Bloomberg survey

calling for the BNM's overnight policy rate of 3% to remain unchanged. We are in the minority expecting a 25 basis point (bp) rate cut to 2.75%.

The BNM's last policy move was a 25bp rate cut in May this year. That was more like an insurance cut rather than one needed by the economy. Things haven't got any worse since then to warrant another cut. On the contrary, the economy has been bucking the global slump on the back of a surprisingly strong semiconductor sector, despite the ongoing slack in global electronics demand.

GDP growth accelerated to 4.9% year-on-year in the second quarter from 4.5% in the first, prompting the authorities to raise the growth outlook for the year to 4.5-5.0% from 4.3-4.8%. We see growth hovering near the top-end of this range for the rest of the year, with full-year growth staying steady at the 4.7% pace of 2018. Meanwhile, inflation continues to be benign with a 0.3% rate in the year through July, down sharply from 1.5% a year ago.

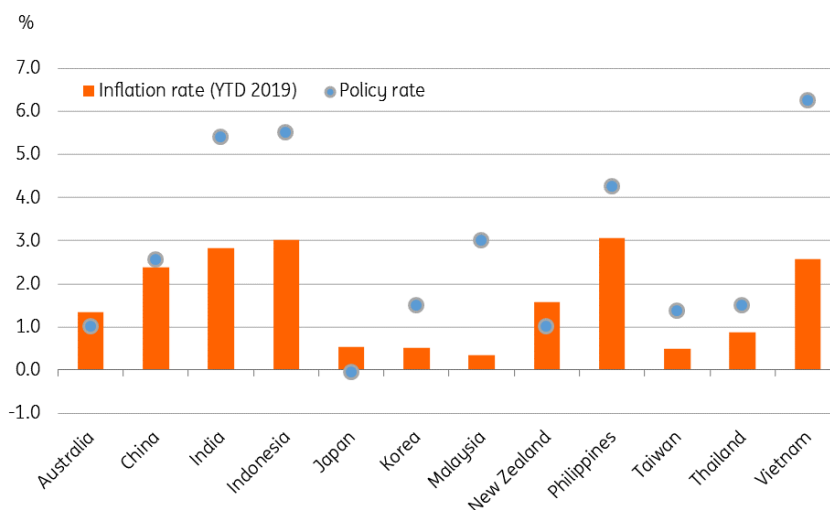
Some more insurance easing won't hurt

The economic risks may appear to be fairly balanced between growth and inflation right now. However, it will be challenging for the economy to maintain this outperformance in an increasingly unfriendly external trade environment. Therefore, we believe more pre-emptive easing to counter potential downside growth risks will be a strong consideration at this meeting.

A move in that direction wouldn't hurt either, especially when there is sufficient room for cutting rates to shore up growth going forward. With the lowest inflation rate in Asia, Malaysia's real (policy) interest rate is among the highest in the region. This is not good for investment demand which has, in fact, contributed negatively to the country's GDP growth in the first half of the year.

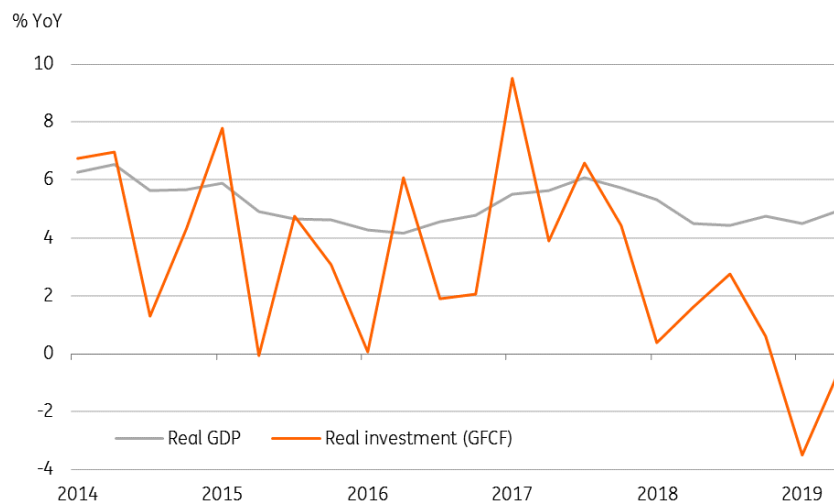
Moreover tight public finances, with the government aiming to cut the fiscal deficit down to 3% of GDP by 2020 from 3.4% projected for the current year, puts the onus on the central bank for growth-boosting policies.

Real interest rates among highest in Asia



Source: Bloomberg, CEIC, ING

Investments have been a drag on GDP growth this year



Source: CEIC, ING

No end of the easing cycle just yet

We don't think the BNM's easing cycle will end with a rate cut this week if indeed we get one. We are also looking for one more cut in the fourth quarter of the year, taking the policy rate down to 2.50%. And with persistently low inflation - a trend which has a long way to run amid low commodity prices - the central bank will still be left with enough policy space for the future.

How low could the policy rate go? The lowest level it dropped to was 2% during the global financial crisis in 2009. Although the current US-China trade war and tech slump don't compare to the global financial crisis, its impact is more focused on Asia. Consequently, we believe we can draw parallels between the BNM policy response then and the current situation. Even so, we believe the central bank will tread a cautious path and abstain from excessive easing.