

Malaysia: Will Bank Negara turn dovish?

For now, the monetary policy status-quo appears appropriate for the local economy and for markets. We doubt the central bank (BNM) will risk the MYR's "best performer" status with a dovish statement this week



Source: shutterstock

3.25% Overnight policy rate
No change expected

BNM announces policy decision on Wednesday

A unanimous consensus forecast for Bank Negara Malaysia to leave the monetary policy unchanged on Wednesday (11 July) should make it a boring event. Instead, a Bloomberg story over the weekend titled '[Ringgit's Resilience Under Threat as Case for Rate Cut Grows](#)' has aroused some market interest in this event. The story flagged a possibility of BNM "turning dovish due to the worsening US-China trade dispute and the new government's decision to cut back on infrastructure spending to trim its debt burden".

This is the first policy meeting under new governor Nor Shamsiah Mohd Yunus, who took over after predecessor Muhammad Ibrahim quit in June. There may be some room for dovish signals under the new governor as an increasingly restrictive global trade environment weighs on Malaysia GDP growth.

We are sceptical about any dovish statement

Our scepticism about any dovish statement rests on the following:

- **Growth:** 'the trade war threatening growth' will likely to be the key phrase in central bank policy assessments across the globe, not only in Malaysia. What is good for Malaysia is that strong domestic demand continues to power growth at a respectable 5%+ pace. We don't rule out some growth slowdown and have scaled back our 2018 growth forecast to 5.2% from 5.5%, though this isn't a dent sufficient to warrant any policy easing or signals to that effect just yet.
- **Inflation:** Malaysia's inflation outlook remains benign and this will allow scope for continued monetary accommodation, although not a call for an easing. Low inflation isn't due to lack of demand. Instead, it's the result of administrative measures including the removal of Goods and Services Tax. Domestic prices are not completely insensitive to higher global oil prices.
- **Fiscal policy:** it might be too early to get particularly excited by potential downside risk to growth from any fiscal belt-tightening by the new administration. If fiscal policy was loose under the old administration, government spending has hardly played a role in the upward growth momentum underway since 2017. Public consumption and the investment contribution to GDP growth over the last four quarters was small, at only 0.4 percentage points of 5.8% average GDP growth over the four quarters.
- The removal of Goods and Services Tax by the new administration, which in itself is a sign of expansionary fiscal policy, should support private consumption spending to offset potential weakness in investment due to the freeze on projects started under the previous administration.
- **Currency:** the Malaysian ringgit (MYR) appears to be the most vulnerable Asian currency in the event of an all-out trade war (see '[Asian foreign exchange in tariff tantrum](#)'). However, despite a steep depreciation against the USD in the second quarter, the MYR is still 0.9% stronger year-to-date, and the top-performer in Asia. We doubt the central bank will want to risk this status by sounding dovish, especially when PM Mahathir continues to envisage 3.8 as the fair value for the USD/MYR pair.

The policy status-quo and the MYR

Low inflation and the need to support growth in deteriorating global trade environment were the reasons for recent downgrade of our BNM policy view from one more 25bp rate hike this year to no move ([Malaysia: Downgrade of inflation, BNM policy forecasts](#)). We retain this view.

Higher sensitive of the MYR to global trade and commodity prices was the reason for downgrade of our USD/MYR forecast for end-2018 to 4.35 from 4.05. While strong appreciation since last year will allow the BNM stomach some currency weakness ahead, the argument of the central bank following its regional peers (in India, Indonesia, or the Philippines) on the tightening path to support the currency also appears far-fetched. Hence the policy status-quo appears appropriate for both the economy and the markets for now.

