Malaysian central bank to join tightening binge

Strong growth, negative real interest rates, and an undervalued currency are the arguments for BNM (Bank Negara Malaysia) tightening this year, even as inflation slows

3.25%   ING forecast of BNM policy rate

BNM begins policy normalisation

We share the consensus view that BNM will start raising interest rates at the next policy meeting on January 25. The consensus is a 25bp hike in BNM's overnight policy rate to 3.25%.

BNM signalled the move at the previous meeting in early November, the statement for which noted "Given the strength of the global and domestic macroeconomic conditions, the Monetary Policy Committee may consider reviewing the current degree of monetary accommodation".

Growth vs. inflation

The last BNM policy statement signalled a shift in BNM's assessment of economic risks toward inflation, from being balanced between growth and inflation. However, a dip in consumer price inflation in recent months might have reduced some of their inflation anxiety. The inflation argument takes a further beating as normalisation of base effects from administered fuel price hikes in early 2017 will continue to push year-over-year CPI inflation lower this year. Malaysian ringgit (MYR) appreciation is also keeping imported inflation at bay.

11% MYR appreciation against USD in 2017

Still weak MYR argument for rate hike

Notwithstanding an 11% appreciation in 2017 against the USD, the MYR remains an undervalued Asian unit on both nominal and real effective measures. This provides BNM with substantial room for a rate hike. Negative real interest rates provide further room for tightening. The MYR may struggle to repeat last year's impressive performance this year while investors start to factor in some political risk premia in face of election uncertainty. But BNM will likely provide some impetus with tighter monetary policy. General elections will be held by August this year.