



From the Desk
of the
Chief Economist

BANK ISLAM

BNM'S SURPRISE MOVE – FIRST OPR RATE HIKE SINCE JULY 2020

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ECONOMIC RESEARCH

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BNM DECIDED TO INCREASE THE OPR BY 25 BASIS POINTS (BPS)



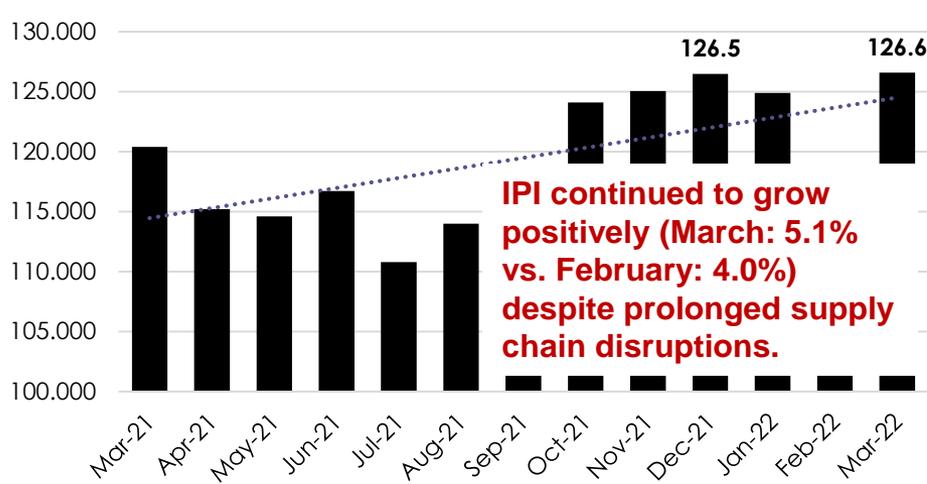
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- ✓ Monetary Policy Committee (MPC) decided to raise the Overnight Policy Rate (OPR) by 25 bps during its meeting on 10-11 May, bringing the rate to 2.00%.
- ✓ Hence, the ceiling and floor rates of the corridor of the OPR increased to 2.25% and 1.75% respectively.

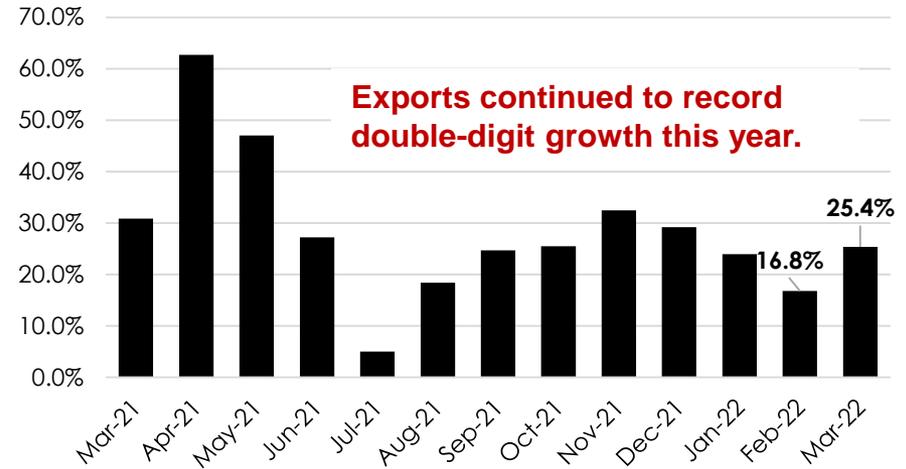
- ✓ Economic activity continued to recover amid the reopening of the global economy, as well as improvement in the labour market. Subsequently, these could cushion the impact of the military conflict in Ukraine and strict containment measures in China.
- ✓ Be that as it may, the rising inflationary pressures have caused several central banks to tighten its monetary policy. Thus, the economic growth prospects will be affected by the global outlook and its uncertainties.
- ✓ On the domestic front, Malaysia's transition to endemicity commenced on 1 April 2022 will strengthen the economic recovery on the back of a better prospect in domestic demand and labour market.
- ✓ Nevertheless, the risk to growth outlook remain, including a weaker-than-expected global growth, further escalation of geopolitical conflict, worsening supply chain disruptions and adverse developments surrounding Covid-19.
- ✓ **Headline inflation is projected to average between 2.2%-3.2% in 2022. Meanwhile, core inflation is expected to trend higher to average between 2.0%-3.0% in the same year.**
- ✓ Looking forward, **further hikes would be done in a measured and gradual way** to ensure that monetary policy remains accommodative to support sustainable economic growth.

OUR VIEW- MALAYSIA'S ECONOMIC DATA POINTED A FIRMER RECOVERY

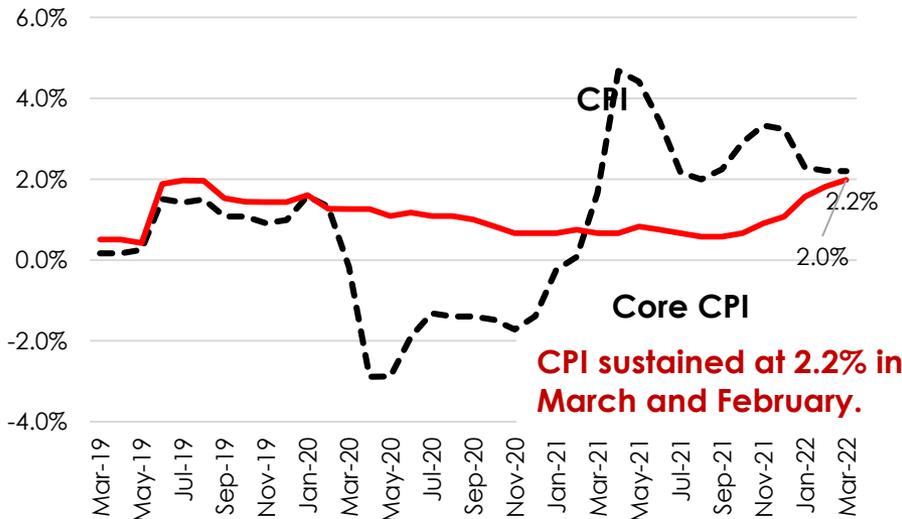
Industrial Production Index (IPI), points



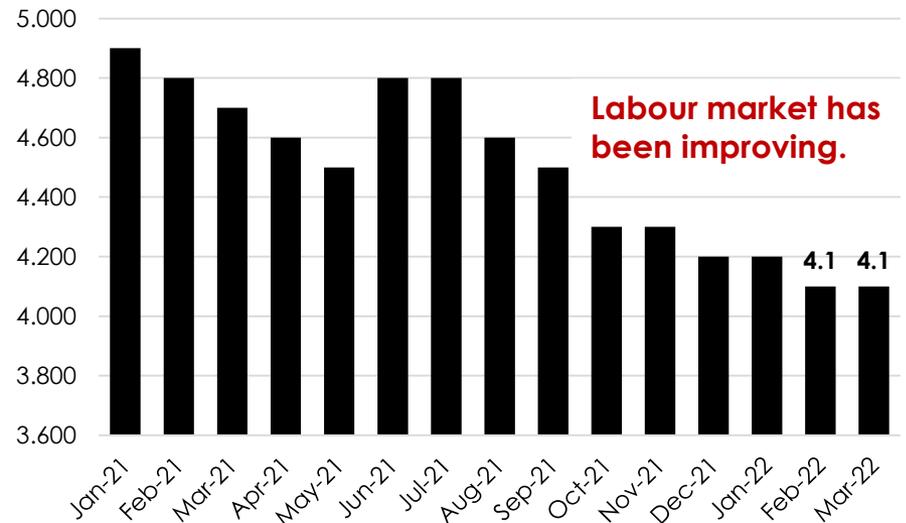
Exports, y-o-y%



Inflation, y-o-y%

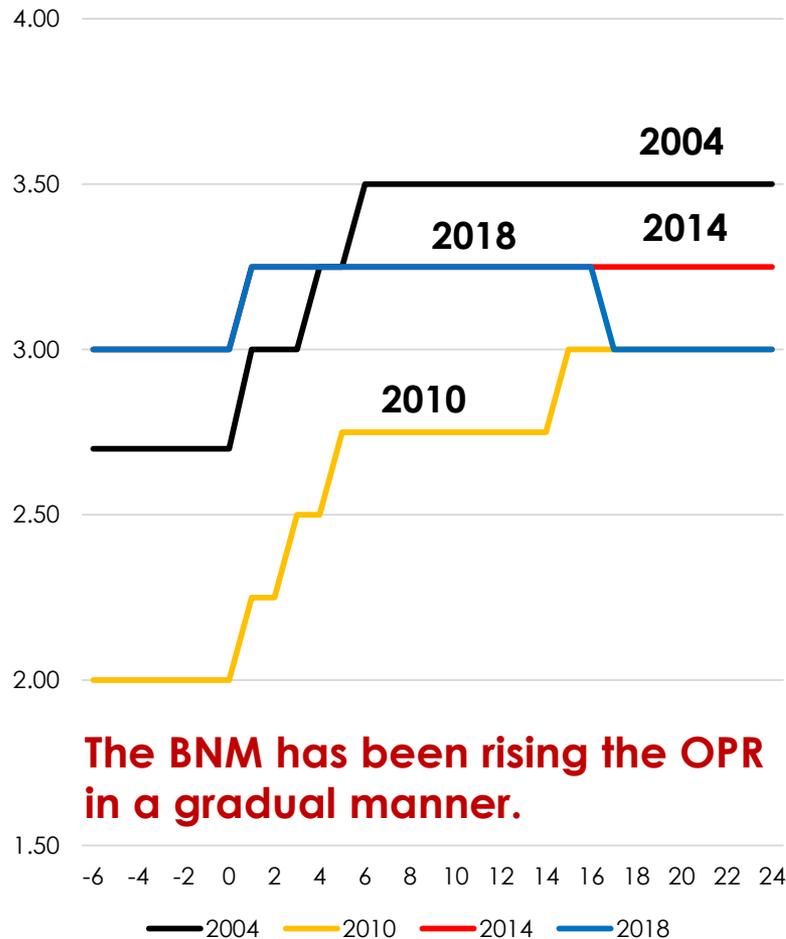


Malaysia's Unemployment Rate, %



Source: CEIC

OPR during post-recession tightening

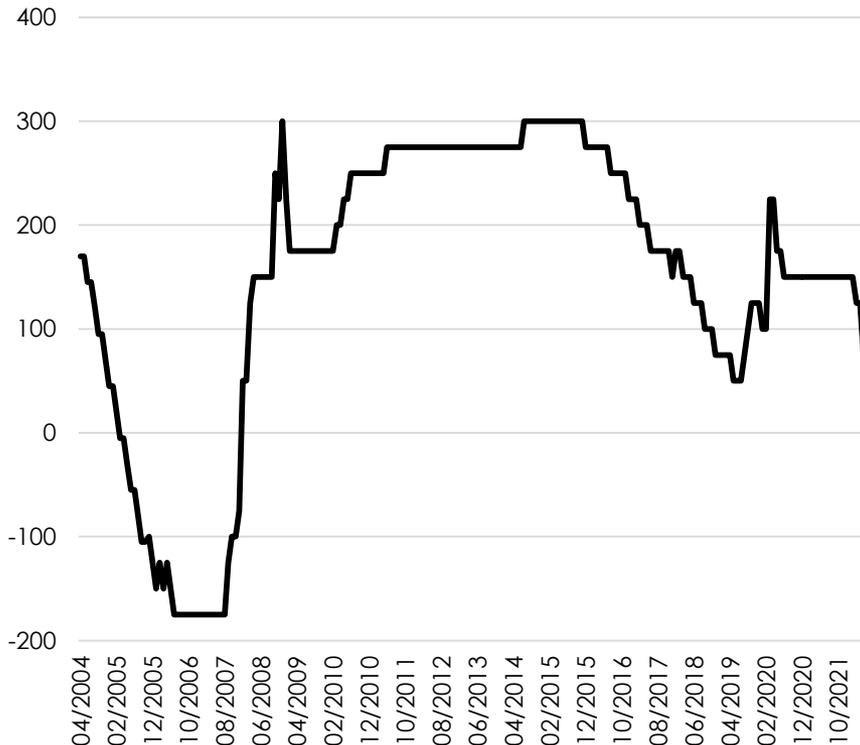


The BNM has been rising the OPR in a gradual manner.

- ✓ Judging from the latest statement from the MPC, it appears that the BNM is quite comfortable with the prevailing economic growth trajectory.
- ✓ Although they continued to acknowledge the downside risks, the excessive monetary policy accommodation would need to be removed which otherwise can cause other problems such as overheating economy, excessive risk taking, as well high level of indebtedness among households and businesses.
- ✓ The door for higher OPR in the near term is still open.
- ✓ Perhaps, another 25 bps hike is quite likely as the BNM would need to be extremely careful in removing the monetary policy accommodation.

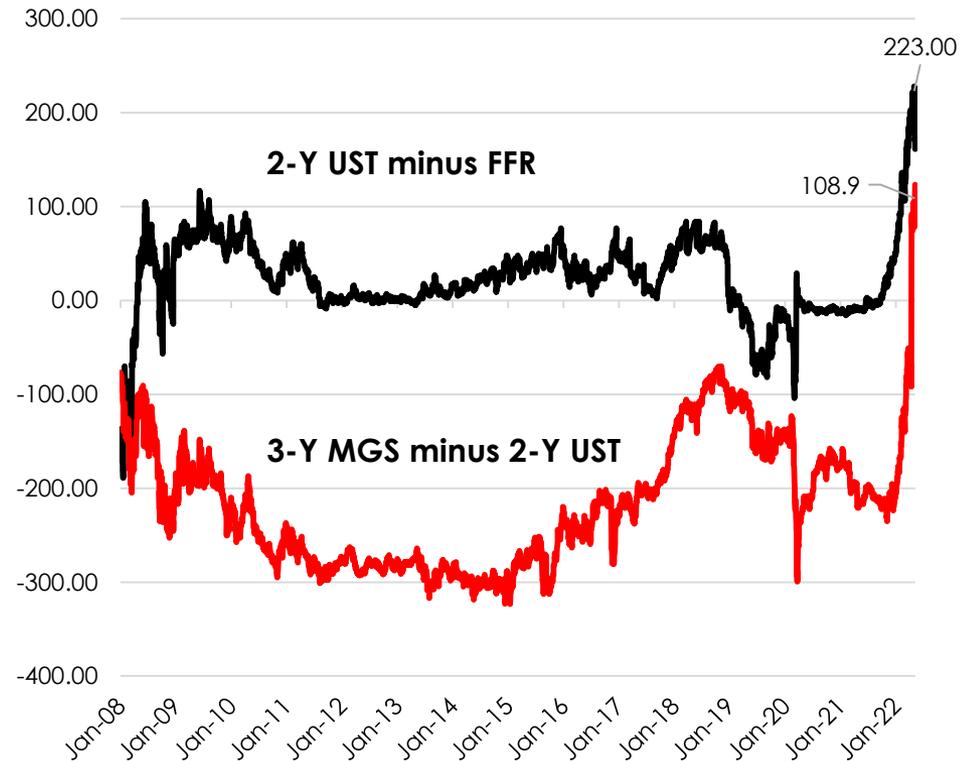
OUR VIEW- BOND YIELDS ARE EXPECTED TO INCREASE GRADUALLY

OPR minus FFR, bps



Source: CEIC

Yields Spread, bps



✓ Increasingly hawkish stance by the Fed has resulted in surge in UST yields. Following this, MGS yields were swayed by the rising UST yields and remained on uptrend while the foreign investors continued to sell-off local govies.

✓ Hence, MGS yields are expected to rise further in view of monetary tightening cycle in the U.S. The 3-Y MGS, 5-Y MGS and 10-Y MGS are likely to close at 4.30%, 4.65% and 4.80% in the medium term.

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- ✓ At its meeting today, the Monetary Policy Committee (MPC) of Bank Negara Malaysia decided to increase the Overnight Policy Rate (OPR) by 25 basis points to 2.00 percent. The ceiling and floor rates of the corridor of the OPR are correspondingly increased to 2.25 percent and 1.75 percent, respectively.
- ✓ The sustained reopening of the global economy and the improvement in labour market conditions continue to support the recovery of economic activity. These have partly cushioned the impact of the military conflict in Ukraine and the strict containment measures in China. Inflationary pressures have increased sharply due to a rise in commodity prices, strained supply chains and strong demand conditions, particularly in the US. Consequently, several central banks are expected to adjust their monetary policy settings at a faster pace to reduce inflationary pressures. The global growth outlook will continue to be affected by the developments surrounding the conflict in Ukraine, COVID-19, global supply chain conditions, commodity price shocks, and financial market volatility.
- ✓ For the Malaysian economy, latest indicators show that growth is on a firmer footing, driven by strengthening domestic demand amid sustained export growth. The labour market is further lifted by a lower unemployment rate, higher labour participation and better income prospects. The transition to endemicity on 1 April 2022 would strengthen economic activity, in line with further easing of restrictions and the reopening of international borders. Investment activity and prospects have also improved, underpinned by the realisation of multi-year projects and positive growth outlook. However, risks to growth remain, which include a weaker-than-expected global growth, further escalation of geopolitical conflicts, worsening supply chain disruptions, and adverse developments surrounding COVID-19.
- ✓ Headline inflation is projected to average between 2.2% - 3.2% in 2022. Given the improvement in economic activity amid lingering cost pressures, underlying inflation, as measured by core inflation, is expected to trend higher to average between 2.0% - 3.0% in 2022. Nevertheless, upward pressure on prices would be partly contained by existing price controls and the continued spare capacity in the economy. The inflation outlook continues to be subject to global commodity price developments, arising mainly from the ongoing military conflict in Ukraine and prolonged supply-related disruptions, as well as domestic policy measures on administered prices.
- ✓ Over the course of the COVID-19 crisis, the OPR was reduced by a cumulative 125 basis points to a historic low of 1.75% to provide support to the economy. The unprecedented conditions that necessitated such actions have since abated. With the domestic growth on a firmer footing, the MPC decided to begin reducing the degree of monetary accommodation. This will be done in a measured and gradual manner, ensuring that monetary policy remains accommodative to support a sustainable economic growth in an environment of price stability.