From the Desk of the Chief Economist

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BNM KEEPS OPR UNCHANGED AT 1.75%

20 JANUARY 2021

ECONOMIC RESEARCH

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OPR LEFT UNCHANGED AT 1.75%

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- ✓ The Bank Negara Malaysia (BNM) decided to keep the Overnight Policy Rate (OPR) unchanged at 1.75% (Consensus: 1.75%, Bank Islam: 1.50%) during its first monetary meeting for the year.

- ✓ According to the Monetary Policy Statement (MPS), the global economy has gained its momentum mainly driven by recovery in the manufacturing and export sector. In addition, global efforts to roll out the Covid-19 vaccination campaign coupled with policy support by the governments are anticipated to elevate the growth outlook.

- ✓ On the domestic front, the skyrocketing Covid-19 infection numbers and stricter Coivd-19 related restrictions have further thrown a curveball for revival during final quarter of last year. In light of this, the economic growth for 2020 is anticipated to be near the lower end of the central bank's forecast range. For 2021, the near-term growth will be stymied by tighter lockdown measures in most states effective on 13 January 2021. Be that as it may, the economic activities are likely to pick up from 2Q2021 onwards as the impact is seen less severe compared to MCO in March last year. But then again, unexpected delays in the launch of a Covid-19 vaccine would constitute a downside risk both globally and domestically.

- ✓ As for inflation, the average headline inflation could see negative print in 2020 largely weighed by low global crude oil prices. Nevertheless, it is projected to be higher this year premised on the development of crude oil and commodity prices.

- ✓ The Monetary Policy Committee (MPC) considers the stance of monetary policy to be appropriate and accommodative. The Bank remains committed to utilise its policy levers as appropriate to create enabling conditions for a sustainable economic recovery.

- ✓ The upcoming meeting will be on 4 March 2021.

CENTRAL BANK POLICY RATES

Policy rates	Jan-20	Feb-20	Mar-20	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21*
Advanced countries													
US (Fed Fund Rate)	1.75	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Japan (Policy Balance Rate)	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
Euro Zone (Main Refinancing Rate)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
UK (Bank Rate)	0.75	0.75	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Canada (ON Lending Rate)	1.75	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Latin America													
Mexico (ON Rate)	7.25	7.00	6.50	6.00	5.50	5.00	5.00	4.50	4.25	4.25	4.25	4.25	4.25
Brazil (Selic Rate)	4.50	4.25	3.75	3.75	3.00	2.25	2.25	2.00	2.00	2.00	2.00	2.00	2.00
Argentina (LELIQ 7D Notes Rate)	50.00	40.00	38.00	38.00	38.00	38.00	38.00	38.00	38.00	36.00	38.00	38.00	38.00
Eastern Europe													
Russia (Key Rate)	6.25	6.00	6.00	5.50	5.50	4.50	4.25	4.25	4.25	4.25	4.25	4.25	4.25
Ukraine (Discount Rate)	11.00	11.00	10.00	8.00	8.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Turkey (1W Repo Rate)	11.25	10.75	9.75	8.75	8.25	8.25	8.25	8.25	10.25	10.25	15.00	15.00	17.00
Asia													
China (1Y Loan Prime Rate)	4.15	4.05	4.05	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85
India (Repo Rate)	5.15	5.15	4.40	4.40	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
Indonesia (7D Repo Rate)	5.00	4.75	4.50	4.50	4.50	4.25	4.00	4.00	4.00	4.00	3.75	3.75	3.75
Thailand (1D Repo Rate)	1.25	1.00	0.75	0.75	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
South Korea (Base Rate)	1.25	1.25	0.75	0.75	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Philippines (O/N Lending Rate)	4.00	3.75	3.25	2.75	2.75	2.25	2.25	2.25	2.25	2.25	2.00	2.00	2.00
Australia (Cash Rate)	0.75	0.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.10	0.10	0.10
New Zealand (Cash Rate)	1.00	1.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Malaysia (OPR)	2.75	2.75	2.50	2.50	2.00	2.00	1.75	1.75	1.75	1.75	1.75	1.75	1.75

As at 20 January 2021

Source: Bloomberg

Today, the People's Bank of China (PBOC) has also decided to maintain its 1-year Loan Prime Rate (LPR) at 3.85% since April last year as the economy continues to recover from the impacts of Covid-19 pandemic. We believe that central banks across the globe will keep conditions accommodative – lower for longer - to support the slowing economic activities caused by the virus.

OVERNIGHT POLICY RATE (OPR) VS. FEDERAL FUND RATE (FFR)

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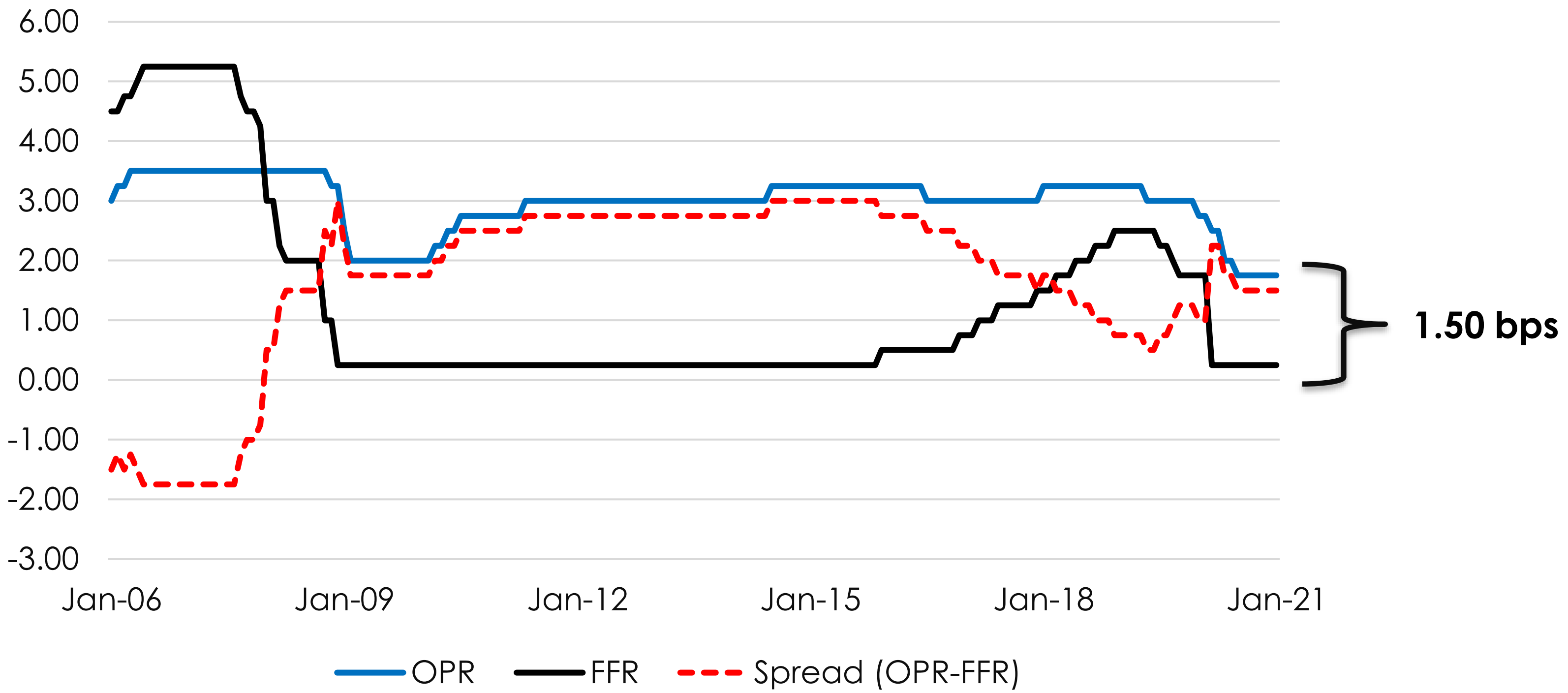

Source: Bloomberg

- ✓ As of today, Malaysia's OPR spread against the FFR stood at 1.50 bps (1.75% minus 0.25%). This means that the BNM still has some policy space to ease the monetary policy amid subdued inflationary pressure (November 2020: -1.7%, October 2020: -1.5%).
- ✓ As such, we anticipate that there is another round of rate cut this year by 25 bps in the next meeting amid mounting concerns over the resurgence of Covid-19 infections in Malaysia.

- ✓ **BNM adopted a wait-and-see approach during the January meeting** - Since the government had announced the RM15.0 billion Perlindungan Ekonomi dan Rakyat Malaysia (PERMAI) two days ago, perhaps BNM is awaiting the response of consumers and businesses towards the policy package before actually reducing the OPR. That said, we believe that BNM stands ready to ease policy rates further in the next upcoming policy meeting in March. The reason being is that the MCO 2.0 has now been imposed in all states of Malaysia except for Sarawak with an estimated daily output loss of RM600.0 million, albeit smaller than to the daily output loss of RM2.4 billion from March until May 2020.

- ✓ **An extension of the MCO 2.0 is highly likely** - With the daily number of new Covid-19 cases showing no signs of slowing down so far, we opine that the MCO 2.0 may be well extended from the current two weeks to a month. Therefore, we have assumed such circumstances to exercise conservatism in our forecasts. To estimate the economic impact of the state of emergency and MCO 2.0, we used the weekly output loss calculated in 2Q2020 for all the states except Sarawak. The reason for not using the output loss in 1Q2020 is that the first MCO came into effect at the tail-end of the said quarter. Therefore, using the weekly output loss derived from 2Q2020 is a more appropriate benchmark in our view. Our analysis indicates that a one-month MCO in all states except Sarawak could lead to a 0.3 percentage points (ppts) reduction in our 2021 GDP growth base estimate of 4.0% when only 8 states were involved.

MCO 2.0 Impact on 2021 GDP Growth Estimates

Year	Absolute GDP (RM Million)	Annual Growth (%)
2018	1,362,814.8	4.8%
2019	1,421,454.0	4.3%
2020	1,343,274.0	-5.5%
2021 (prior to MC0 2.0 announcement)	1,410,437.7	5.0%
2021 (assuming1 month of MCO covering 8 states)	1,393,092.3	4.0%
2021 (assuming 1 month of MCO covering all states except Sarawak)	1,393,092.3	3.7%

Sources: CEIC, DOSM, Bank Islam estimates

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- ✓ **Latest stimulus package funded mainly by Budget 2021** - On further scrutiny, the PERMAI assistance package worth RM15.0 billion will be financed by sources of funds coming mostly from the existing budget 2021 with more prudent spending. This will likely have limited impact on the government's fiscal position and the fiscal deficit will likely remain unchanged at 5.4% of GDP for 2021.

- ✓ **Fiscal deficits need to be managed well** - More importantly, its shows that the government is wary of the recent move by Fitch Ratings to downgrade the sovereign credit rating of Malaysia by a notch to BBB+ from A- in December 2020, citing weakened key credit metrics due to the Covid-19 crisis that were made worse by lingering political uncertainty. Henceforth, the country's fiscal deficit will need to be managed well or otherwise another rating downgrade will happen in the upcoming review period.

Sovereign Rating on Malaysia by Other Agencies

Rating Agency	Latest Rating	Latest Review	Upcoming Review
Moody's	A3 with stable outlook	January 2020	1Q2021
S&P Global Ratings	A- with negative outlook	June 2020	2Q2021

Sources: Moody's and S&P Global Ratings

- ✓ **Smooth distribution of Covid-19 vaccine important to prevent further economic repercussions** - Aside from that, any possible logistical hurdles in distributing the Covid-19 vaccine in the country could somewhat exacerbate downside economic risks following the imposition of the MCO 2.0.

- ✓ **Monetary support appears to be the leveraging point for the economy** - As a result, the government could only afford to focus more in terms of monetary support by reducing the OPR in order to curb the impact from the MCO 2.0 that will have significant bearing on human mobility.

- ✓ **March meeting is set to a see cut in the OPR** - All in all, we are of the view that the OPR will be reduced by 25 basis points in the next BNM policy meeting in March 2021 due to the aforementioned circumstances.

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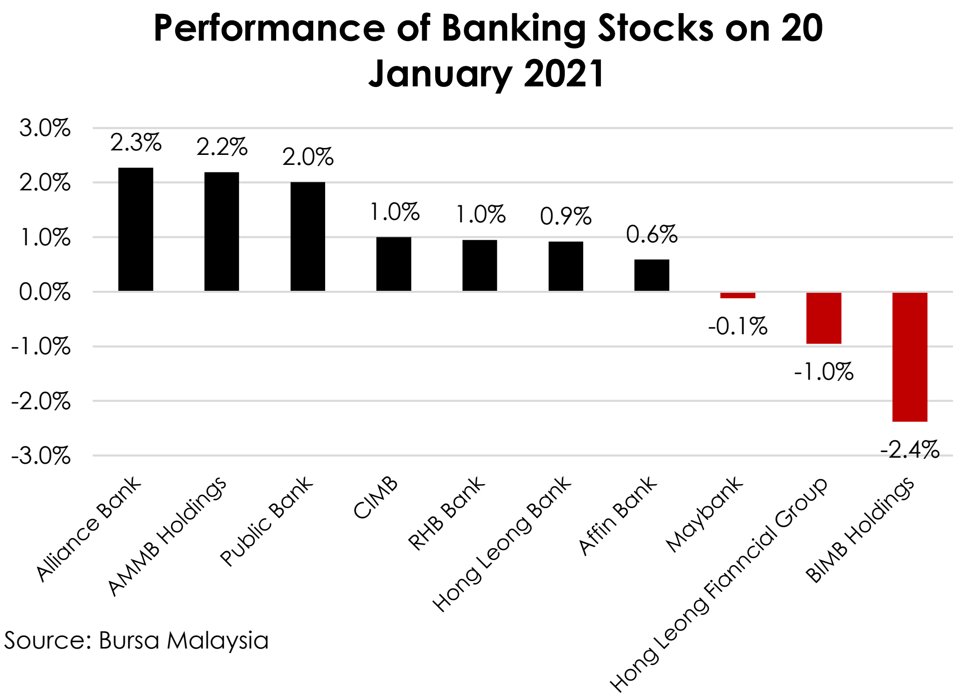
Sector Weightings in the FBM KLCI

Sector	Market Cap (RM Billion) as at 31 Dec 2020	Market Cap Percentage as at 31 Dec 2020
Banks	285.7	26.8%
Consumer Product and Services	101.0	9.5%
Energy	20.3	1.9%
Healthcare	48.3	4.5%
Rubber Gloves	129.5	12.1%
Industrial product and Services	79.5	7.5%
Materials	30.5	2.9%
Plantation	116.0	10.9%
Real Estate	0.0	0.0%
Telecommunication	127.6	12.0%
Transportation	31.1	2.9%
Utilities	97.6	9.1%
Total Market Cap (RM Billion)	**1066.9**	**100.0%**

Source: Bloomberg



Source: Bursa Malaysia

- ✓ **How did the local bourse react?** – An unchanged OPR compared to a cut in it is a positive for the banking sector as less pressure will be exerted on the net income margins. Otherwise, an OPR cut will lead to a downward revision in financing rates especially for those with variable features. Henceforth, a maintained OPR in general was good for the FBM KLCI index by virtue of the banking sector being an index heavyweight, contributing more than 20.0% of the index's total market capitalisation. The Bursa Malaysia Financial Services Index was up by 0.8% on Wednesday with Alliance Bank leading gainers with a 2.3% advance while BIMB Holdings recorded the biggest decline of 2.4%. Overall, the banking sector helped to prevent the FBM KLCI from recording higher losses today as the local bourse only declined by less than 0.1% to settle at 1,601.5 points today.

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Bank Islam ensures that social and environmental considerations are consistently its top priority governed by the Bank's core values and Shariah principles. More initiatives will be developed by the Bank as the Bank strives to make a positive difference for its financial and social performance.

- ✓ At its meeting today, the Monetary Policy Committee (MPC) of Bank Negara Malaysia decided to maintain the Overnight Policy Rate (OPR) at 1.75 percent.
- ✓ The global economy continues to recover, led by improvements in manufacturing and export activity. However, the recent resurgences of COVID-19 cases and the subsequent containment measures have affected economic activity in several major economies. The expedited roll-out of mass vaccination programmes, together with ongoing policy support, are expected to lift global growth prospects going forward. Financial conditions also remain supportive. The overall outlook remains subject to downside risks, primarily if there is further resurgence of COVID-19 infections and delays in mass inoculation against Covid-19.
- ✓ For Malaysia, the resurgence in COVID-19 cases and the introduction of targeted containment measures has affected the recovery momentum in the fourth quarter of 2020. As a result, growth for 2020 is expected to be near the lower end of the earlier forecasted range. For 2021, while near-term growth will be affected by the re-introduction of stricter containment measures, the impact will be less severe than that experienced in 2020. The growth trajectory is projected to improve from the second quarter onwards. The improvement will be driven by the recovery in global demand, turnaround in public and private sector expenditure amid continued support from policy measures, and higher production from existing and new manufacturing and mining facilities. The roll-out of vaccines in the coming months will also lift sentiments. Downside risks to the outlook remain, stemming mainly from ongoing uncertainties surrounding the dynamics of the pandemic and potential challenges that might affect the roll-out of vaccines both globally and domestically.

- In line with earlier assessments, the average headline inflation is expected to be negative in 2020 due mainly to the substantially lower global oil prices. For 2021, headline inflation is projected to average higher, primarily due to higher global oil prices. Underlying inflation is expected to remain subdued amid continued spare capacity in the economy. The outlook, however, is subject to global oil and commodity price developments.

- The MPC considers the stance of monetary policy to be appropriate and accommodative. Given the uncertainties surrounding the pandemic, the stance of monetary policy going forward will be determined by new data and information, and their implications on the overall outlook for inflation and domestic growth. The Bank remains committed to utilise its policy levers as appropriate to create enabling conditions for a sustainable economic recovery.