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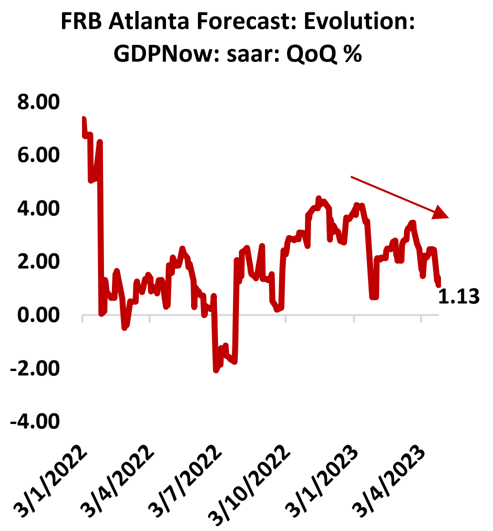
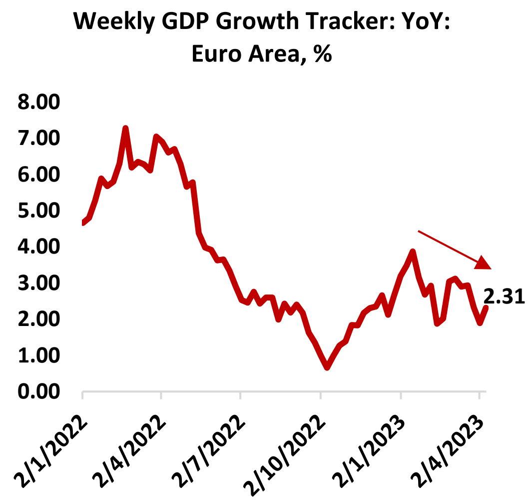
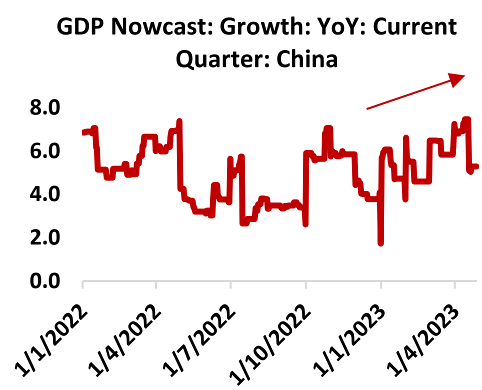
BNM TO EXTEND OPR PAUSE AT 2.75%

- Bank Negara Malaysia (BNM) hit the brakes on its policy normalisation cycle in the first two monetary policy committee (MPC) meetings in 2023 to assess the impact of cumulative 100bps OPR hikes on the economy. As growth will likely moderate further in 2H2023 alongside sluggish labour market recovery, the probability of keeping the OPR at 2.75% throughout 2023 is also high. Therefore, we believe that BNM will hold the OPR steady in the coming MPC meeting while keeping its policy normalisation open-ended. This research note aims to highlight the possible key considerations in pursuing such an accommodative stance in the near term.

1. **Nowcasting: Major Western economies are losing growth momentum, China is improving**







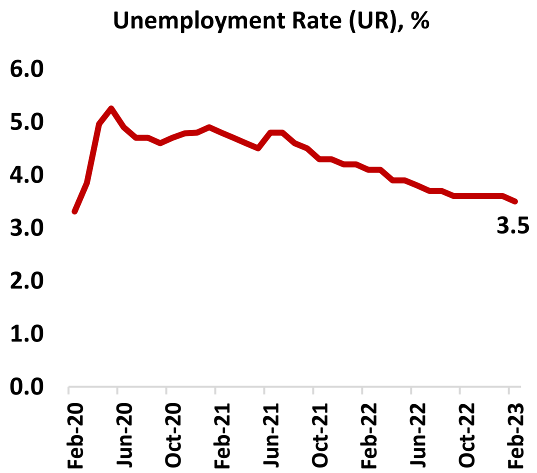
Sources: Federal Reserve Bank of Atlanta, OECD, National Bureau of Statistics (NBS), Now-Casting Economics Ltd. Bank Islam

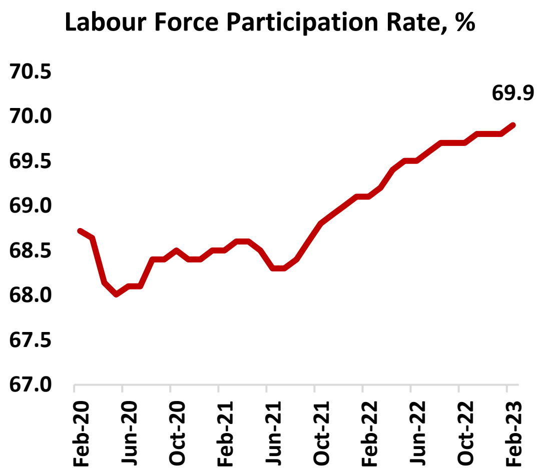
- On the global front, the latest nowcasting 1Q2023 figures for the U.S. and Eurozone appear to lose momentum amid recessionary fears but are broadly positive. The recent banking turmoil makes policymakers cautious, searching for possible fault lines to growth. The U.S. Bureau of Economic Analysis released its 1Q2023 advance estimate yesterday, highlighting that the country's GDP grew by 1.1% during the quarter (4Q2022: 2.6%), although personal consumption came in higher at 3.1% (4Q2022: 1.0%).

- Furthermore, the OECD's weekly GDP Growth Tracker appears to be softening of late, with its latest estimate coming in at 2.31%. We foresee that such a resilient performance will be short-lived as the high interest rate environment persists.

- The Chinese economy expanded by 4.5% y-o-y in 1Q2023 after abandoning its zero-COVID strategy. China's fixed asset investment rose moderately to 5.1% y-o-y during the first three months, down from 5.5% from January to February 2023. Additionally, private investment grew a mere 0.6% y-o-y from January to March, suggesting low confidence among businesses, lower than the 0.8% growth recorded from the year's first two months. While the Chinese economy is poised for a rebound in 2023, we have yet to see a positive spill over into the Malaysian economy just yet.

2. <u>Sluggish labour market recovery amid hiring difficulties of foreign workers and constrained wage growth</u>



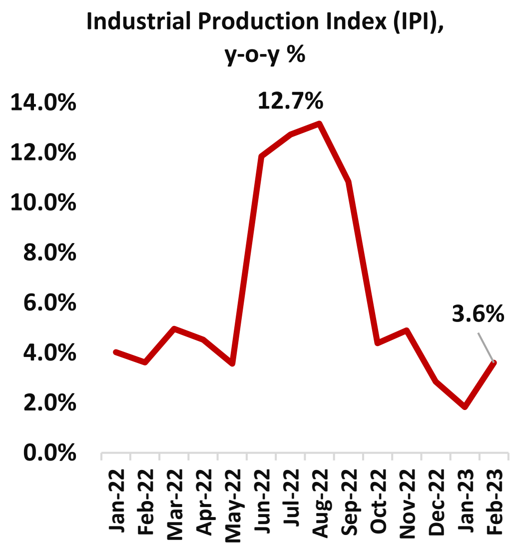


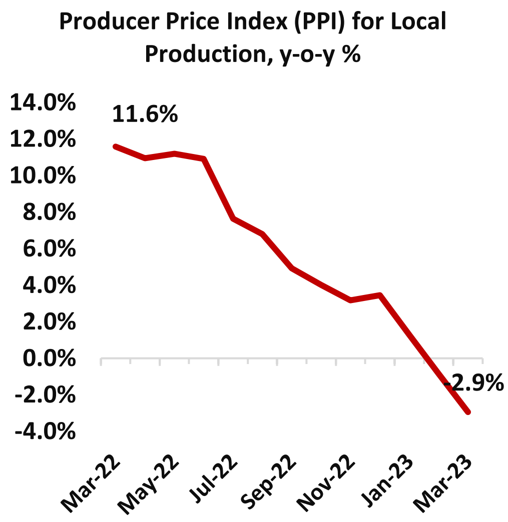
Sources: Department of Statistics Malaysia (DOSM), Bank Islam

- Malaysia's UR recovered to a 3-year low at 3.5% in February 2023 after five consecutive months in static mode at 3.6%, contributed by increased economic activity. The jobless rate reached BNM's unemployment rate expectations of 3.5% in 2023, albeit still relatively lower than the pre-pandemic level of 3.3%. In addition, labour force participation uptrend slightly to 69.9% in February, inched up slightly from 69.8% since November 2022.

- Nevertheless, we posit that the labour market is most likely to remain flat amid the difficulties in hiring foreign workers, which would impact labour-intensive industries. The ongoing investigations into allegations of corruption in recruiting foreign workers may also affect overall job growth. Of note, downside factors to further wage growth include limited wage bargaining and a slower pace of minimum wage implementation.

3. Moderating global economy impacts local production



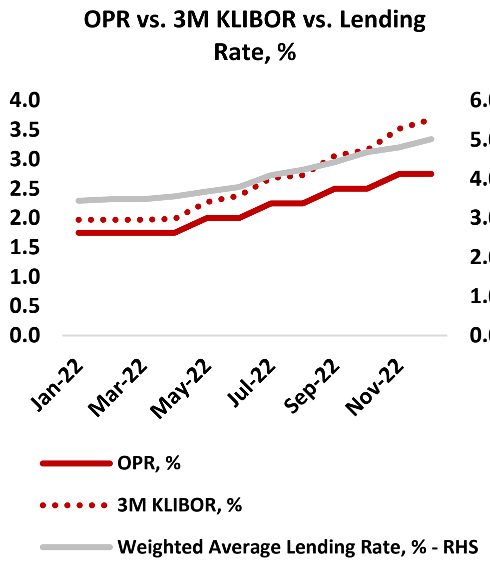


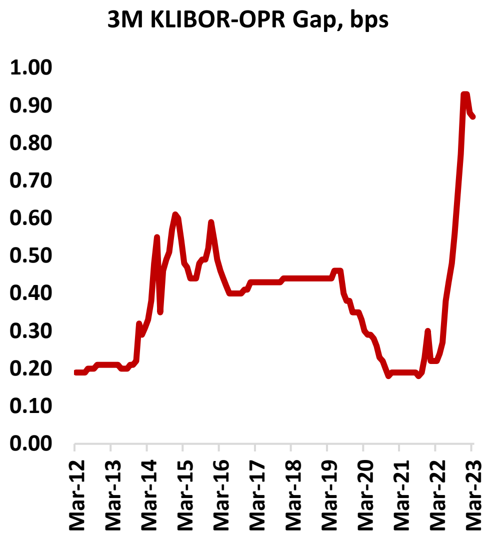
Sources: BNM, Bank Islam

- Although the latest IPI figure recorded a growth of 3.6% y-o-y in February, industrial production is losing steam, with the figure coming in at -5.1% m-o-m (January: -2.3%) amid softening external demand. The contraction is mainly due to the mining sector falling steeply by 0.5% y-o-y (January: 5.9%), with demand for crude oil and natural gas production decreasing. As such, a hike would be unwise as the outlook on production remains unfavourable. Furthermore, Malaysia's exports y-o-y peaked in 3Q2022 and have been softening since (1Q2023: 2.82%, 4Q2022: 11.8%).

- The PPI is also downward-trending, with inflationary pressures mitigated amid a resilient global supply chain, moderating DXY and easing commodity prices. The latest data shows PPI dropping by 2.9% y-o-y (February: -0.8%), marking the second straight month of decline. The need for further policy tightening is low as inflation is no longer a threat as it did last year.

4. OPR and 3MKlibor gap remains wide

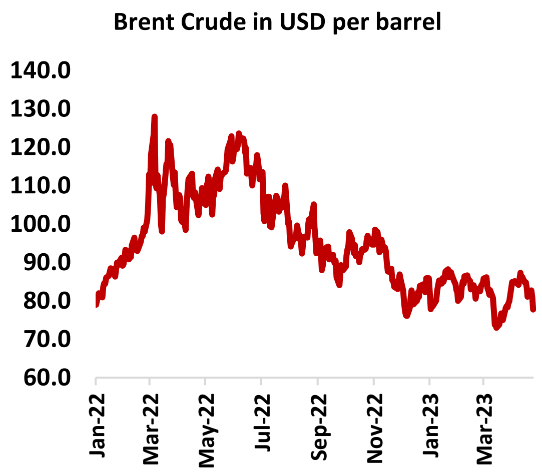


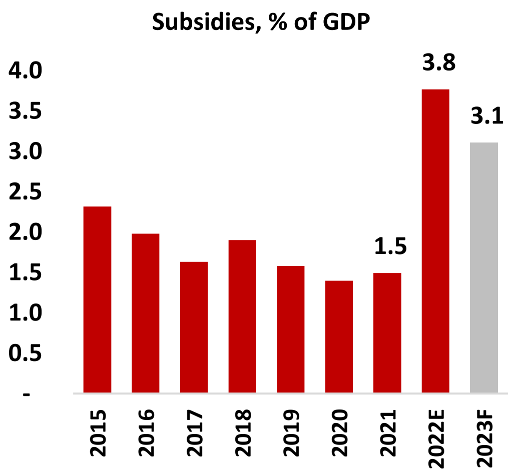


Sources: BNM, Bank Islam

- The spike in the OPR-3MKlibor gap has since abated but remains high amid rate hike expectations, leading to intense deposit competition among banks. It remains high to a level unseen in decades. Likewise, lending rates increased in line with the OPR adjustments throughout 2022.

5. Elevated crude oil, along with another OPR hike, will hinder subsidy rationalisation effort



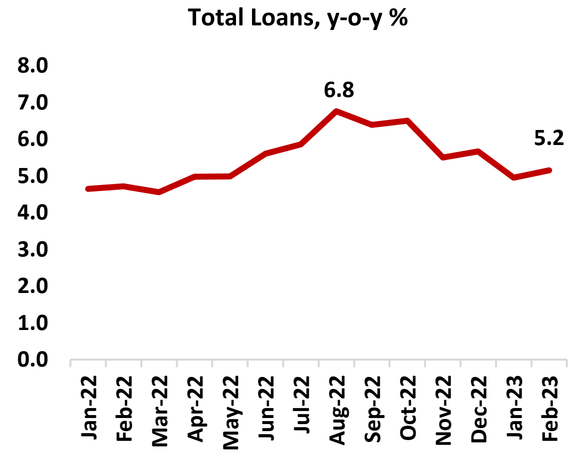


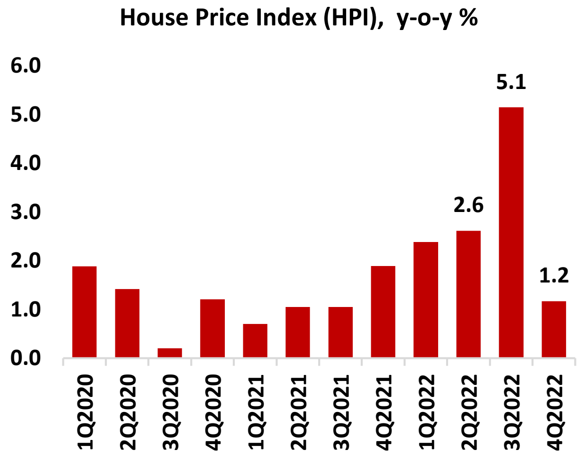
Sources: Bloomberg, BNM, Ministry of Finance (MOF), Bank Islam

- Global crude oil prices have somewhat moderated amid recessionary fears, although geopolitical tensions have yet to subside by any means. At the time of writing, Brent crude is trending above

USD80.0 per barrel YTD and will likely trend high throughout 2023 amid supply and underinvestment concerns. The downtrend in PPI will open up an avenue for the government to push for subsidy rationalisation. Further rate hikes will limit the government's fiscal space when revenue collection remains contentious in 2023.

6. **<u>Green shoots in loan growth call for a steady interest rate</u>**





Sources: CEIC, MOF

- The total cumulative OPR hikes of 100bps last year may have affected Malaysia's loan growth to trend under 6.0% since 2H2022. In addition, the latest data on HPI in 4Q2022 showed a slowing growth momentum after peaking in 3Q2022.

- However, total loans grew by 5.2% y-o-y in February 2023, a marginal increase from January's 5.0%, thanks to the rate pause. Such a policy approach has led to positive expectations among prospective buyers, encouraging their spending on residential properties. Housing loan applications have increased in February by 29.0% y-o-y (January: -30.2%). These green shoots led us to believe that holding the rates steady would be sensible without disrupting loan growth momentum.

CONCLUSION: OPR to remain flat in 2023

- BNM may wish to maintain the current degree of accommodative stance amid growth and inflation outlook. We believe BNM should eventually resume its policy normalisation without a specific timeline. As such, we conclude that OPR may rest at 2.75% throughout 2023.