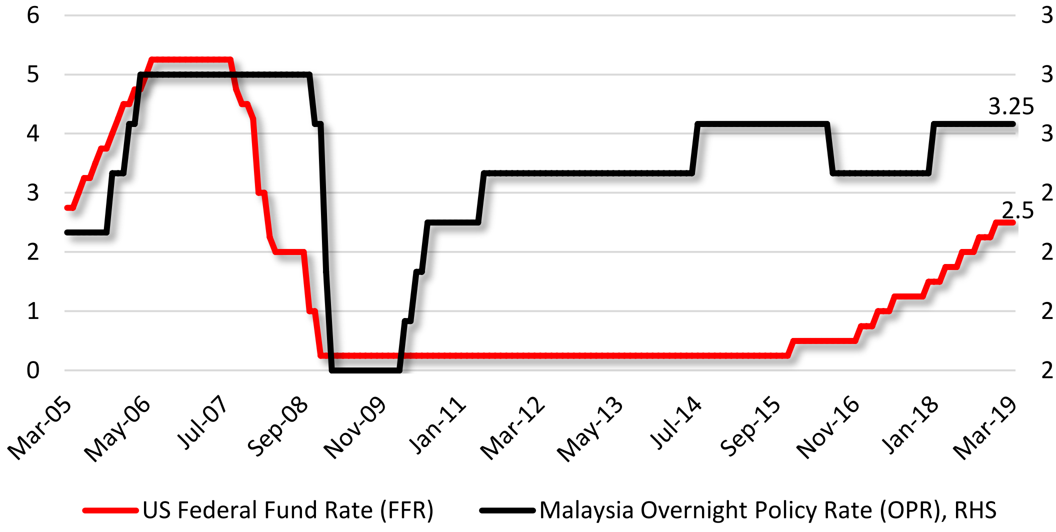
Dr. Mohd Afzanizam Abdul Rashid | Chief Economist | 03-2088 8075 | afzanizam@bankislam.com.my
Shafiz Jamaluddin | Economic Analyst| 03-2088 8399 | shafiz@bankislam.com.my
Nor Jannah Abdullah | Economic Analyst| 03-2088 8399 | norjannah@bankislam.com.my

OPR kept at 3.25% but MPC members leaned on the softer side

Facts

- The Monetary Policy Committee (MPC) meeting was convened today. The committee members have decided to hold the Overnight Policy Rate (OPR) at 3.25%. This was in line with the market consensus which anticipated that the Bank Negara Malaysia (BNM) would not budge the prevailing OPR.
- The accompanying statements suggests that the global economy has signaled a softening growth path in most major advanced as well as in emerging market. On top of that, heightening concern over trade war between the US and China could weigh on the trade and investment activities in Malaysia.
- Already, the Malaysian economy has shifted into lower gear last year with GDP grew by 4.7% in 2018 as compared to 5.9% in 2017. Nevertheless, the private sector will remain as the key driver for the nation's economic growth. The improvement in household purchasing power was supported by stable labour market (unemployment rate at 3.3% in 4Q2018 vs. 3.4% in 3Q2018) and private sector wages growth (4Q2018: 5.9% vs. 3Q2018: 5.7%).
- The deflationary pressures seen during January was likely to be transitory as this was primarily driven by the fall in the retail fuel prices as global crude oil prices slipped recently. Consequently, the central bank is of the view that the average headline inflation would remain low attributed by the government intervention such as lower price ceiling on the domestic retail fuel prices as well as the impacts on the replacement of Good and Service Tax (GST) to Sales and Service Tax (SST) which took effect on 1 September last year.
- In a nutshell, the MPC committee is leaning on the softer side in view of the apparent downside risks in the on horizon.

Chart 1: US FFR and Malaysia OPR



Source: Bloomberg

Table 1: Central Bank Policy Rates

Policy rates	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Y-o-Y
Advanced countries								
US (Fed Fund Rate)	2.00	2.25	2.25	2.25	2.50	2.50	2.50	0.00
Japan (Policy Balance Rate)	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	1.00
Euro Zone (Main Refinancing Rate)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
UK (Bank Rate)	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.00
Canada (ON Lending Rate)	1.50	1.50	1.75	1.75	1.75	1.75	1.75	0.25
Latin America								
Mexico (ON Rate)	7.75	7.75	7.75	8.00	8.25	8.25	8.25	0.00
Brazil (Selic Rate)	6.50	6.50	6.50	6.50	6.50	6.50	6.50	0.75
Argentina (LELIQ 7D Notes Rate)	60.00	65.00	68.05	60.75	59.25	53.69	50.13	-0.25
Eastern Europe								
Russia (Key Rate)	7.25	7.50	7.50	7.50	7.75	7.75	7.75	0.00
Ukraine (Discount Rate)	17.00	18.00	18.00	18.00	18.00	18.00	18.00	0.25
Turkey (1W Repo Rate)	17.75	24.00	24.00	24.00	24.00	24.00	24.00	2.00
Asia								
China (12M Lending Rate)	4.35	4.35	4.35	4.35	4.35	4.35	4.35	0.00
India (Repo Rate)	6.50	6.50	6.50	6.50	6.50	6.50	6.25	0.00
Indonesia (7D Repo Rate)	5.25	5.75	5.75	6.00	6.00	6.00	6.00	0.25
Thailand (1D Repo Rate)	1.50	1.50	1.50	1.50	1.75	1.75	1.75	1.75
South Korea (Base Rate)	1.50	1.50	1.50	1.75	1.75	1.75	1.75	0.25
Philippines (O/N Lending Rate)	4.00	4.50	4.50	4.75	4.75	4.75	4.75	0.25
Australia (Cash Rate)	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.75
New Zealand (Cash Rate)	1.75	1.75	1.75	1.75	1.75	1.75	1.75	0.00
Malaysia (OPR)	3.25	3.25	3.25	3.25	3.25	3.25	3.25	0.00

Source: Bloomberg

Our view

Central banks across the globe have become more dovish these days as the current global economic conditions are not forthcoming (declining PMIs, rising populists politics & volatility in commodities markets). Thus far, the Reserve Bank of India (RBI) has been at the forefront when they decided to cut its policy rates by 25 basis points from 6.50% to 6.25% in February 2019. While others have kept their current policy rates such as Reserve Bank of Australia (1.50%), Bank of Korea (1.75%), Bank of Thailand (1.75%) and Bangko Sentral Ng Pilipinas (4.75%) but their stands have shifted on the loose side.

Essentially, the case for monetary policy accommodation is building up in the current context. Lower rates tend to benefit the private investment as this would reduce their cost of borrowings. We reckoned that most of the major players in the export-oriented industries are now seeking opportunities to expand their production and to invest in technological development in order to remain competitive. To some degree, lower cost of funds would entice businesses to gear up their balance sheet. Notwithstanding that, business owners need to strike the right balance between expanding their production capacity and the threat of weak demand. In particular, measures of business sentiment has been anything but weak in most cases. The likes of RAM's Business Confidence Index (BCI), MIER's Business Condition Index (BCI) and DOSM's Business Tendency Index (BTI) were all pointing to one direction: heightening pessimism.

In that sense, the BNM would weigh the cost and benefits of having lower rates and its intended effect. Bear in mind, that the ringgit outlook and its association to dwindling current account surplus balance may not bode well should the latter is expected to remain low in the foreseeable future. Nonetheless, the expected long pause in the US Federal Fund Rate (FFR) hike is certainly make the case for OPR cuts a compelling one. This is especially true when the FFR futures seems to suggest that the Fed is likely to deliver a rate cuts in November 2019 and January 2020 meetings. As such, we would wait for further clarity from BNM during the tabling of their 2018 annual report sometime this month. **For now, we maintain our OPR call at 3.25% throughout 2019.**