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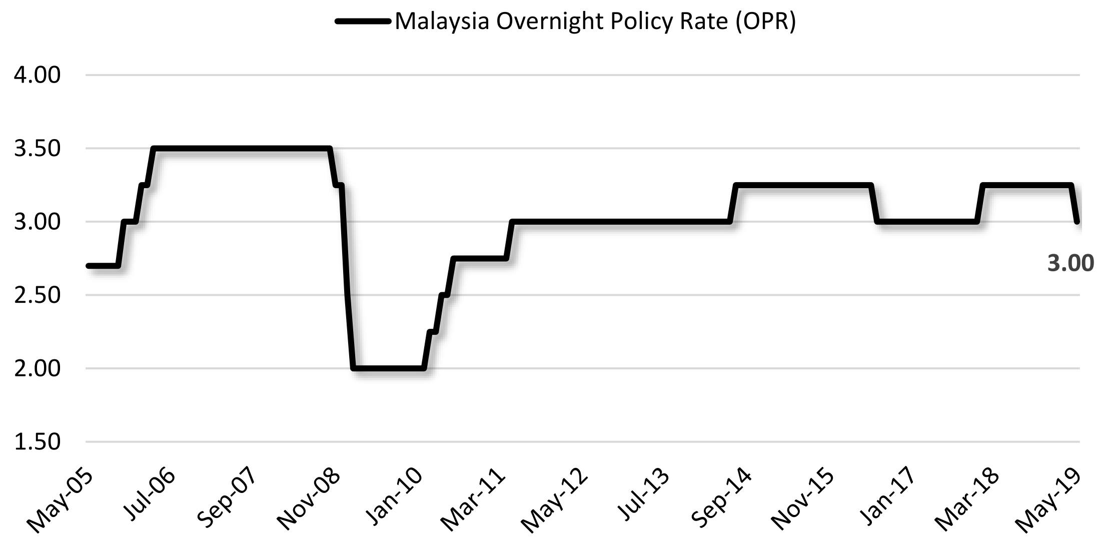
OPR reduced to 3.00%

Facts

- The BNM's Monetary Policy Committee (MPC) decided to cut the Overnight Policy Rate (OPR) by 25 basis points (bps) to 3.00% during its meeting today. At the same time, the floor and ceiling rates of the OPR were reduced to 2.75% and 3.25% respectively. This was the first adjustment since the rate hike in January 2018.
- According to the monetary policy statement, the global economic activities will grow moderately while the downside risks has been quite considerable. Sources of risk will be none other than the escalating trade tensions especially between the US and China as well as country-specific weaknesses in the major economies such as the UK Brexit.
- The BNM is of the view that the Malaysian economy in the first three months of 2019 is likely to be moderate although stable labour market condition and capacity expansions in key sectors will drive household and capital spending. Against such backdrop, the central bank's 2019 Gross Domestic Product (GDP) projection between 4.3% and 4.8% in 2019 has been maintained (Bank Islam: 4.5%).
- The next MPC meeting will be held on 9 July 2019.

Chart 1: Malaysia OPR (%)



Source: Bloomberg

Table 1: Central Bank Policy Rates

Policy rates	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Y-o-Y
Advanced countries							
US (Fed Fund Rate)	2.50	2.50	2.50	2.50	2.50	2.50	0.75
Japan (Policy Balance Rate)	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	0.00
Euro Zone (Main Refinancing Rate)	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	0.25
Canada (ON Lending Rate)	1.75	1.75	1.75	1.75	1.75	1.75	0.50
Latin America							
Mexico (ON Rate)	8.25	8.25	8.25	8.25	8.25	8.25	0.75
Brazil (Selic Rate)	6.50	6.50	6.50	6.50	6.50	6.50	0.00
Argentina (LELIQ 7D Notes Rate)	59.25	53.69	50.13	68.16	73.93	73.93	33.93
Eastern Europe							
Russia (Key Rate)	7.75	7.75	7.75	7.75	7.75	7.75	0.50
Ukraine (Discount Rate)	18.00	18.00	18.00	18.00	17.50	17.50	0.50
Turkey (1W Repo Rate)	24.00	24.00	24.00	24.00	24.00	24.00	7.50
Asia							
China (12M Lending Rate)	4.35	4.35	4.35	4.35	4.35	4.35	0.00
India (Repo Rate)	6.50	6.50	6.25	6.25	6.00	6.00	0.00
Indonesia (7D Repo Rate)	6.00	6.00	6.00	6.00	6.00	6.00	1.25
Thailand (1D Repo Rate)	1.75	1.75	1.75	1.75	1.75	1.75	0.25
South Korea (Base Rate)	1.75	1.75	1.75	1.75	1.75	1.75	0.25
Philippines (O/N Lending Rate)	4.75	4.75	4.75	4.75	4.75	4.75	1.50
Australia (Cash Rate)	1.50	1.50	1.50	1.50	1.50	1.50	0.00
New Zealand (Cash Rate)	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	3.00	-0.25

Source: Bloomberg

Our view

The BNM decision to reduce the OPR was very much in line with our forecast. We believe the OPR reduction is a preemptive measure to ensure the country's economic growth will remain sustainable. This is especially true in the face of global uncertainties brought mainly by the trade tensions. Many would ask whether the latest move would impact the ringgit negatively. In this regard, we need to view the objective of such policy response is to provide support to the economy by making monetary condition very accommodative. This essentially would reduce the cost of funds which can stimulate investment activities among companies. In particular, the revival of mega projects such as the ECRL and Bandar Malaysia would result in higher demand for corporate financing. In addition, lower OPR would also mean slightly lower in monthly commitment for the existing mortgages or any financing contract that has variable rate features. As such, the OPR cut narratives is meant for medium term growth strategy and therefore, ringgit should gain more strength over time. For now, in view of the global uncertainties, **we maintain our USDMYR year-end forecast at RM4.21**.

Thus far, BNM is the second central bank in the Asian region after India to lower the policy rate in 2019. The Reserve Bank of India (RBI) slashed its policy rate by 25bps from 6.25% to 6.00% in April. Others have kept their current policy rates such as Reserve Bank of Australia (1.50%) and Bank of Indonesia (6.00%) unchanged.

The next question would be, is there additional OPR cut in the pipeline? We would like to think the BNM would want to assess their latest policy move on how it can impact investment and consumption decision in the economy. Therefore, we believe the BNM would want to adopt a wait-and-see attitude and as such, **the OPR is expected to remain at 3.00%** subject to the evolving economic outlook for 2019.

Appendix

Monetary Policy Statement

At its meeting today, the Monetary Policy Committee (MPC) of Bank Negara Malaysia decided to reduce the Overnight Policy Rate (OPR) to 3.00 percent. The ceiling and floor rates of the corridor for the OPR are correspondingly reduced to 3.25 percent and 2.75 percent respectively.

The global economy continues to expand moderately. While growth outcomes for several major economies were better than expected during the first quarter, underlying economic conditions continue to suggest moderation going forward. Considerable downside risks to global growth remain, stemming from unresolved trade tensions and prolonged country-specific weaknesses in the major economies, further dampening global trade and investment activities. Although the tightening in global financial conditions has eased somewhat, heightened policy uncertainties could lead to sharp financial market adjustments, further weighing on the overall outlook.

For Malaysia, latest developments point towards moderate economic activity in the first quarter of 2019. Looking ahead, slowing global demand conditions and subdued growth of key trading partners will continue to weigh on the external sector. Domestically, stable labour market conditions and capacity expansion in key sectors will continue to drive household and capital spending. The baseline projection is for the Malaysian economy to grow within the projected range of 4.3% - 4.8%. However, there are downside risks to growth from heightened uncertainties in the global and domestic environment, trade tensions and extended weakness in commodity-related sectors.

Headline inflation increased to 0.2% in March 2019 (February: -0.4%), due mainly to the less negative transport inflation at -3.0% (February: -6.8%). Underlying inflation, as measured by core inflation, remained stable at 1.6% in March 2019. In the immediate term, inflation is expected to remain low mainly due to policy measures. These include the price ceiling on domestic retail fuel prices until mid-2019 and the impact of the changes in consumption tax policy on headline inflation. For 2019 as a whole, average headline inflation is expected to be broadly stable compared to 2018. The trajectory of headline inflation will continue to be dependent on global oil prices. Underlying inflation is expected to remain stable, supported by the continued expansion in economic activity and in the absence of strong demand pressures.

The domestic financial markets have remained resilient, despite periods of volatility primarily due to global developments. While domestic monetary and financial conditions remain supportive of economic growth, there are some signs of tightening of financial conditions. The adjustment to the OPR is therefore intended to preserve the degree of monetary accommodativeness. This is consistent with the monetary policy stance of supporting a steady growth path amid price stability. The MPC will continue to monitor and assess the balance of risks surrounding the outlook for domestic growth and inflation.