OPR VERDICT – BNM REMAINS GUARDED

8 JULY 2021

ECONOMIC RESEARCH

DR. MOHD AFZANIZAM ABDUL RASHID
ADAM MOHAMED RAHIM
SHAFIZ BIN JAMALUDDIN
NOR JANNAH ABDULLAH
RAJA ADIBAH RAJA HASNAN

OPR HELD STEADY AT 1.75%

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BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

1.75%

4 March 2021 MPC Meeting

1.75%

8 July 2021 MPC Meeting

Next MPC Meeting

9 September 2021

Bank Negara Malaysia (BNM) has decided to keep the Overnight Policy Rate (OPR) unchanged at 1.75% during the Monetary Policy Committee (MPC) meeting on 8 July 2021 (Consensus: 1.75%, Bank Islam: 1.75%).

Global

- ✓ According to the accompanying statement, global economic activities continued to gain its momentum mainly fuelled by the pick up in manufacturing and services activities. Nevertheless, the recovery remained uneven across the world.
- ✓ Meanwhile, sizeable fiscal stimulus alongside with accommodative monetary stance continued to support economic recovery in several advanced economies while some of the economies were heavily affected by tighter Covid-19 related measures. In light of this, balance of risks to the growth prospects remains tilted to the downside amid the uncertainty over path of Covid-19, as well as potential risks of heightened financial market volatility.

Domestic

- ✓ On the domestic front, the better-than-expected economic activity in the 1Q2021 has continued into April, as demonstrated by latest indicators, particularly on exports, retail spending and labour market conditions. However, series of the movement control order (MCO) extension is expected to have severe impact to growth as human mobility and business operation are highly restrictive. Be that as it may, announcement of various fiscal packages accompanied by improving external demand would cushion the brunt from Covid-19 crisis. Going forward, rapid vaccination efforts, easing lockdown measures, as well as stronger external demand would drive the economic recovery into 2022.
- ✓ The BNM has reckoned that the sudden surge in inflation is transitory, mainly underpinned by low base effect that is expected to diminish in the near term. For 2021, the headline inflation is forecasted to average closer to the lower bound of the forecast range (between 2.5% and 4.0%) while core inflation is likely to remain subdued, ranging between 0.5% and 1.5% in 2021. This was in view of continued spare capacity in the economy. Nonetheless, the inflationary pressures would remain subject to global commodity price movement.

The MPC considers the stance of monetary policy to be appropriate and accommodative. BNM remains committed to utilise its policy levers as appropriate to foster enabling conditions for a sustainable economic recovery.

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

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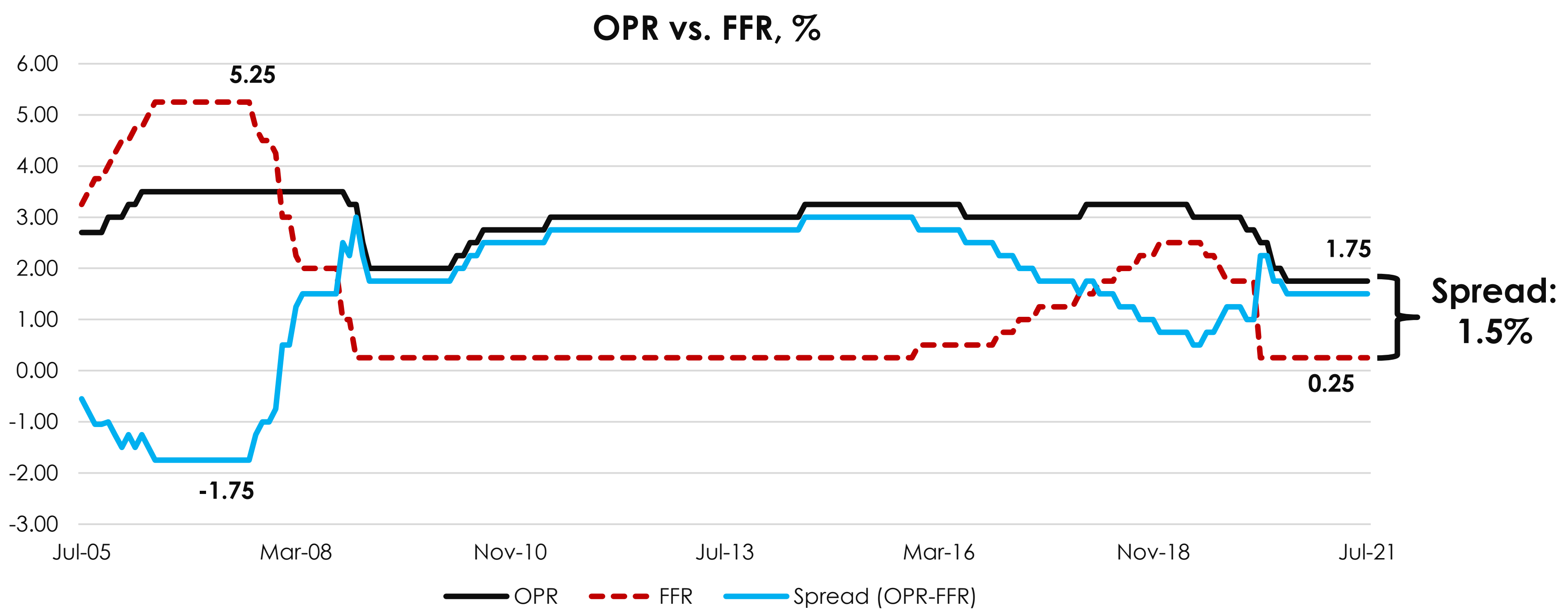

Sources: CEIC, Bank Islam

- ✓ At the moment, the difference between Malaysia's OPR and the U.S. FFR stood at 150 basis points (bps) (1.75% minus 0.25%).
- ✓ This would mean Bank Negara Malaysia (BNM) would have room for a possible OPR reduction if such decision would be entirely based on the interest rate differentials with the U.S. FFR.
- ✓ Be that as it may, the BNM is not expected to further cut the OPR until the end of the year as we believe the government has provided various fiscal supports to rejuvenate the economy. Recently, the Malaysia's government has broadened the fiscal responses in June 2021 by introducing "PEMULIH" amounting RM150.0 billion to mitigate the severe impacts caused by the Covid-19. Since 2020, Malaysia has issued 7 stimulus packages worth RM530.0 billion which includes RM83.0 billion of direct fiscal injections.

CENTRAL BANK POLICY RATES

Policy rates	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21	July-21*
Advanced countries													
US (Fed Fund Rate)	0.25	0.25	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)	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Canada (ON Lending Rate)	0.25	0.25	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)	5.00	4.50	4.25	4.25	4.25	4.25	4.25	4.00	4.00	4.00	4.00	4.25	4.25
Brazil (Selic Rate)	2.25	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.75	2.75	3.50	4.25	4.25
Argentina (LELIQ 7D Notes Rate)	38.00	38.00	38.00	36.00	38.00	38.00	38.00	38.00	38.00	38.00	38.00	38.00	38.00
Eastern Europe													
Russia (Key Rate)	4.25	4.25	4.25	4.25	4.25	4.25	4.25	4.25	4.50	5.00	5.00	5.50	5.50
Ukraine (Discount Rate)	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.50	7.50	7.50	7.50	7.50
Turkey (1W Repo Rate)	8.25	8.25	10.25	10.25	15.00	17.00	17.00	17.00	19.00	19.00	19.00	19.00	19.00
Asia													
China (1Y Loan Prime Rate)	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85
India (Repo Rate)	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
Indonesia (7D Repo Rate)	4.00	4.00	4.00	4.00	3.75	3.75	3.75	3.50	3.50	3.50	3.50	3.50	3.50
Thailand (1D Repo Rate)	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
South Korea (Base Rate)	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Philippines (O/N Lending Rate)	2.25	2.25	2.25	2.25	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Australia (Cash Rate)	0.25	0.25	0.25	0.25	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
New Zealand (Cash Rate)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Malaysia (OPR)	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75

As at 8 July 2021

Source: Bloomberg

- ✓ Accommodative monetary policy stance is needed to strengthen the ongoing economic recovery, enabling expansion of output. Thus far, many central banks have decided to keep their benchmark interest rate lower, aiming to support economic growth, reduce unemployment rate and stabilize the inflation rate amid the impact from the Covid-19 pandemic .
- ✓ Recently, the Reserve Bank of Australia (RBA) left its cash rate unchanged at a record low of 0.1% during its meeting on 6 July 2021. Apart from that, the policymakers decided to extend its current bond purchase programme until mid-November, but would reduce the amount purchases to AUD4.0 billion a week starting September, from the current AUD5.0 billion. Policymakers has also reiterated that they will not increase the cash rate until actual inflation is sustainably within the 2.0% to 3.0% target range.

OUR VIEW – INFLATION IS LIKELY TO BE TRANSITORY

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- ✓ Malaysia's inflation rate stood at 4.4% y-o-y in May, moderating from 4.7% in the previous month as the low base effect from last year continues to dissipate especially for fuel prices.
- ✓ Latest data shows that the double-digit y-o-y increases for average fuel prices of RON95, RON97 and Diesel remain prevalent in June. However, this represents a moderation compared to the preceding month.
- ✓ Looking ahead, the low base factor for fuel should wears off as retail prices for RON95, RON97 and Diesel were gradually on the rise in the 2H2020.
- ✓ Furthermore, the government has decided to cap the RON95 and Diesel prices at RM2.05 per litre and RM2.15 per litre respectively in February 2021. Therefore, inflationary pressures should be contained as fuel prices beyond the cap level will be subsidised by the government.

Year-on-year changes (%) in average fuel prices

Month	Price (RM per litre)			Year-on-year change (%)		
	RON95	RON97	Diesel	RON95	RON97	Diesel
Apr-21	2.05	2.55	2.15	60.8%	61.9%	44.2%
May-21	2.05	2.60	2.15	57.1%	62.1%	48.3%
Jun-21	2.05	2.65	2.15	32.8%	43.8%	25.5%

Source: CEIC

- ✓ In relation to bottleneck issues amid restricted working capacity for manufacturing sectors under the full scale lockdown and closures for some factories under the areas affected by the enhanced movement control order (EMCO), we posit that the supply and demand dynamics would normalize in the later part of the year. The is premised on the ramping up of vaccination program for factory workers that would pave the way for higher working capacities as outlined under the National Recovery Plan (NRP).
- ✓ Additionally, the manufacturing workers will be vaccinated under the Public-Private Partnership Covid-19 Industry Immunisation Programme between July and September at 49 designated industry vaccination centres.
- ✓ This would mean the supply bottleneck is likely to be temporary and it is expected to be reversed once the manufacturing workers would be able to return to work in normal hours.

OUR VIEW – OPR TO REMAIN AT 1.75% FOR THE REST OF THE YEAR

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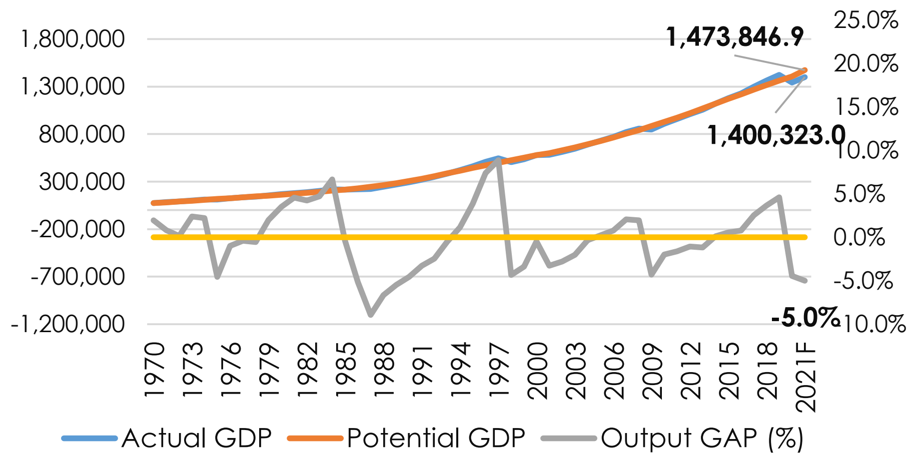
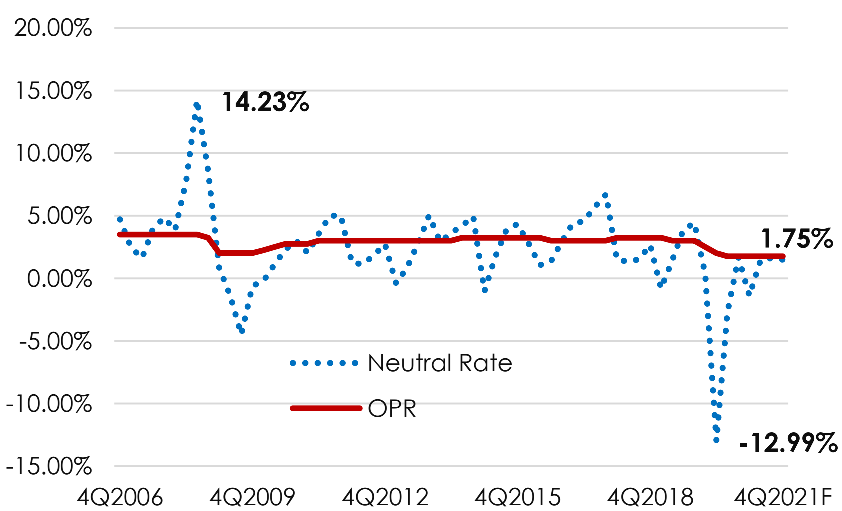
- ✓ While Malaysian economy is expected to record 4.2% growth this year after falling into recession in 2020 (2020 GDP: -5.6%), we opine that the country's output gap (the difference between actual and potential GDP) is estimated to be around -5.0%.
- ✓ This would mean the available resources (labour, capital & total factor productivity) have not been fully utilized. In short, the economy is still fragile and requires support from the government.
- ✓ Combined with transitory nature of inflation, the case for keeping the OPR low is strong. Moreover, the country is still grappling with high Covid-19 infections. Today's tally showed new cases have reached 8,688, a level not seen since 29 May (9,020 cases).

Actual and Potential GDP, RM million



Sources: Bloomberg, CEIC, Bank Islam

OPR vs. Neutral Rate, %



Sources: Bloomberg, CEIC, Bank Islam

- ✓ On the flip side, one would argue that the BNM may want to cut the OPR due to risks from the pandemic.
- ✓ Our estimates showed that the Taylor's neutral rate (a rate that is neither expansionary nor contractionary) is hovering between 1.50% and 1.60% in 2021. Judging from this, BNM may want to cut the OPR by 25 basis points if the decision is solely on ruled-based monetary policy.
- ✓ However, the expansionary fiscal policy alongside with robust external demand would mean the BNM can afford to keep the OPR steady at 1.75% throughout the year, at least for now.

OUR VIEW – OPR HIKE COULD HAPPEN IN 2022

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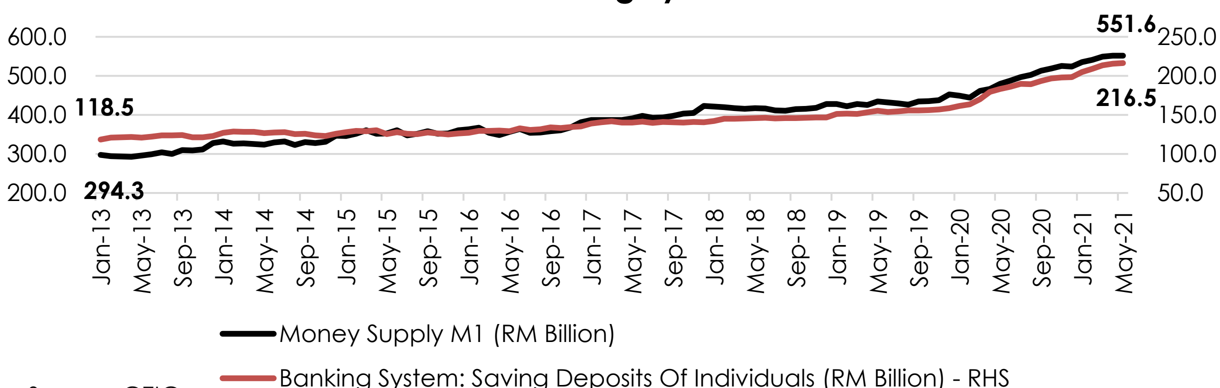
- ✓ Our analysis indicates that the nation's aim to vaccinate 80.0% of Malaysia's population by year end is possible. Once this goal is reached, a full reopening of the social and economic sectors is something that can be reasonably expected.
- ✓ In the meantime, states such as Kelantan, Pahang, Perlis, Perak, Terengganu and Penang have already entered Phase 2 of the NRP. Against such a backdrop, business activities could slowly resume and contribute to the country's economic output.
- ✓ We opine that the full reopening of the economy will be accompanied by a strong propensity to consume. The reason being is that the avenues for consumer to spend on services such as travel and leisure is limited for now. So once the travel and leisure sector reopens, we can expect to see an influx of spending for this sector.
- ✓ On further scrutiny, Malaysia's M1 money supply growth has been increasing by a double-digit growth since May last year (May 2021: 15.1% y-o-y vs. April 2021: 18.3%), suggesting that there is a lot of cash circulating in the country's economy. Likewise, the amount of saving deposits held by individuals in the country's banking system reached RM216.5 million in May this year (April: RM215.5 million) which is higher compared to RM170.0 billion in March last year when the pandemic outbreak happened.
- ✓ Therefore, a higher OPR in 2022 would be more plausible once the herd immunity is achieved, allowing the reopening of the economy to be more consistent. Perhaps, the demand-pulled inflation could be more prevalent next year, necessitating the BNM to raise the OPR in order to anchor the inflation expectation.

Money Supply M1 vs. Demand Deposits Of Individuals In The Banking System



Source: CEIC

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APPENDIX - MONETARY POLICY STATEMENT

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- ✓ 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 economic recovery has strengthened further, supported by improvements in manufacturing and services activity. The pace of recovery, however, varies across countries. Economies making better progress in their vaccination programmes have been able to ease containment measures, enabling a swift recovery in domestic activity. In several advanced economies, sizeable fiscal and monetary measures are also supporting a stronger recovery momentum, although activities in some economies are disrupted by tighter containment measures to curb COVID-19 resurgences. Financial conditions remain supportive of growth. Overall, the balance of risks to the growth outlook remains tilted to the downside, due mainly to uncertainty over the path of the pandemic as well as potential risks of heightened financial market volatility.
- ✓ For the Malaysian economy, better-than-expected economic activity in the first quarter of 2021 continued into April, as reflected by latest indicators, particularly on exports, retail spending and labour market conditions. The re-imposition of nation-wide containment measures to curb the resurgence in COVID-19 cases, however, will dampen the growth momentum. The degree of impact to the economy is highly dependent on the stringency and duration of containment measures. Nevertheless, continued allowances for essential economic sectors to operate, albeit at a reduced capacity, and higher adaptability to remote work, automation and digitalisation will partly mitigate the impact of restrictions. The various policy support packages will alleviate some of the financial burdens of households and businesses. Favourable external demand conditions will continue to provide a lift to growth. Going forward, the gradual relaxation of containment measures, alongside the rapid progress of the domestic vaccination programme and continued strength in external demand will provide support for the growth recovery into 2022. The growth outlook, however, remains subject to significant downside risks, due mainly to factors that could lead to a delay in the easing of containment measures or imposition of tighter containment measures, and a weaker-than-expected global growth recovery. The materialisation of these risks could undermine the growth recovery.
- ✓ As expected, headline inflation spiked recently due mainly to the base effect from low fuel prices in the second quarter of last year. This spike is transitory and headline inflation is projected to moderate in the near term as this base effect dissipates. For 2021 as a whole, headline inflation is projected to average closer to the lower bound of the forecast range. Underlying inflation, as measured by core inflation, is expected to remain subdued, averaging between 0.5% and 1.5% for the year, amid continued spare capacity in the economy. The outlook, however, is subject to global commodity price developments.
- ✓ The MPC considers the stance of monetary policy to be appropriate and accommodative. In addition, fiscal and financial measures will continue to cushion the economic impact on businesses and households and provide support to economic activity. Given the uncertainties surrounding the pandemic, the stance of monetary policy will continue to 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 foster enabling conditions for a sustainable economic recovery.