

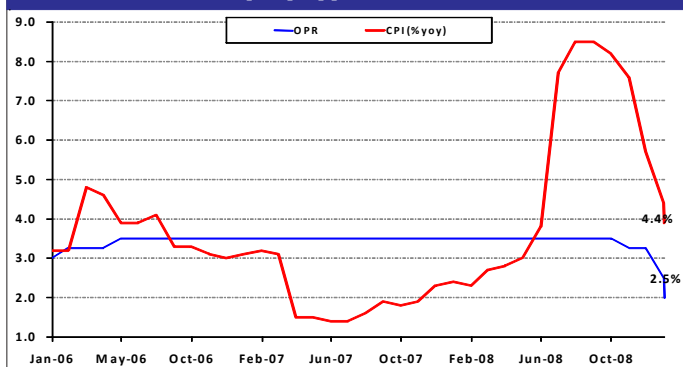
Interest Rates

OPR - 50 bps cuts, further downside risks on growth

26 FEBRUARY 2009

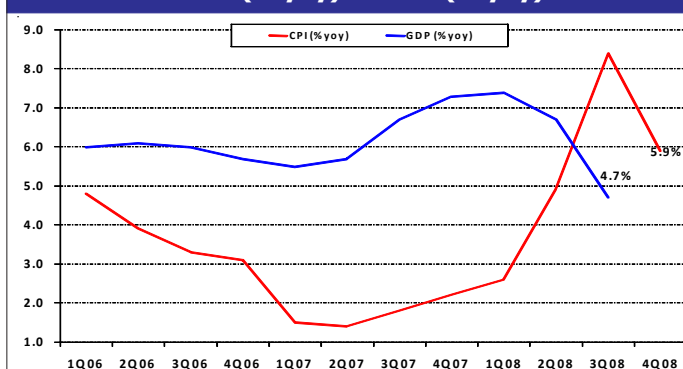
2009/0010

MALAYSIA'S CPI (%yoy) vs OPR



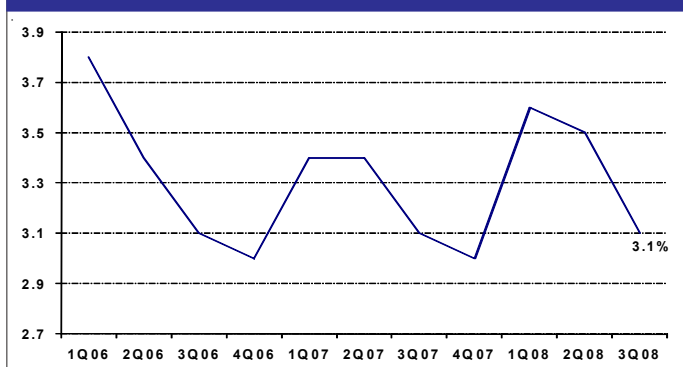
Source: Bank Negara Malaysia & Department of Statistics Malaysia

MALAYSIA'S CPI (%yoy) vs GDP (%yoy)



Source: Bank Negara Malaysia & Department of Statistics Malaysia

MALAYSIA'S UNEMPLOYMENT RATE



Source: Department of Statistics Malaysia

Schedule of BNM Monetary Policy Committee Meetings (2009)

No.	Date	OPR (%)
1st	21 January 2009 (Wednesday)	2.50
2nd	24 February 2009 (Tuesday)	2.00
3rd	29 April 2009 (Wednesday)	
4th	26 May 2009 (Tuesday)	
5th	29 July 2009 (Wednesday)	
6th	25 August 2009 (Tuesday)	
7th	28 October 2009 (Wednesday)	
8th	24 November 2009 (Tuesday)	

- Bank Negara Malaysia (BNM) cuts the key policy rate by 50 basis points to 2.00%, citing the worsening global economic and financial environment in the recent quarter. The decision has come into surprise as most analysts were expecting the central bank to keep the rate on hold. Since Nov 08, the OPR (Official Policy Rate) has been reduced by a cumulative 150 basis points (bps), with the recent cut marked the third interest rate reduction in a row. Together with the Official Policy Rate cuts, Bank Negara slashed its Statutory Reserve Requirement (SRR) to 1.0% from 2.0%, effective from March 1, so as to reduce further the cost of intermediation.
- In its Monetary Policy Statement (MPC), Bank Negara raised its concerns over the continued slump in the major economies and the rapid slowdown experiencing by regional countries. It also conceded over the bleak economic outlook and viewed that the impact of slowing global demand on Asian region, including Malaysia, has intensified. The main interest however was on the central bank's recognition of a possible economic contraction of the local economy, the first since it started to slash interest rates last year. Together with the aggressive rate cuts of 150 bps so far, this underscored our arguments of a strong downside risks to our 0.0%-0.5% forecasts of the 2009 GDP. In the short run, we expect banks to further cut the BLR (Base Lending Rate), currently at 5.90% to 5.95%, as they did following the previous two OPR cuts. Also to follow the same trend will be the fixed deposit rates which were also reduced by an average 50 bps for the year.
- The aggressive and unexpected moves so far by Bank Negara emphasized its commitment to combat further slump of the domestic economy and also in concerted effort with other central banks worldwide. In our view, the reduction in borrowing costs will however have a minimal impact both in terms of loan growth and also economic growth in the broader picture, especially in the short to medium run. The only area that could probably see positive changes is loan refinancing as corporate entities seek to reduce existing borrowing costs. A lower interest rate environment should also help to mitigate rising loan defaults as economic conditions worsen.
- Of significance, the main issue to be tackled is confidence among consumers and businesses and this cut will probably pose a limited impact in doing so. Consumer sentiment is badly hit by the worsening condition of the job markets, which saw the number of people temporarily laid off rose to 80,000 while some 19,000 workers have been retrenched nationwide. The expected declines in earnings by businesses, especially export driven companies, will further escalate the unemployment figures going forward and maintain the lack of demand for funds from the consumer side. From the supply side's perspective, banks are becoming more prudent in giving out loans as the risks of a protracted economic slowdown will possibly induce higher number of delinquencies. This raises the issue of accessibility to loan financing which had been highlighted by Bank Negara in its MPC. Although the reduction of SRR will boost banking system's liquidity, the current risk adverse environment in the system will possibly bring down the loan approval rate. Thus, in attempt to tackle this problem, we expect more measures other than the OPR reductions to be introduced while Bank Negara hold to the current interest rate level for the remaining 1H 2009. In view of the foregoing, we hold to our current assessment on the 2009 economic growth of 0.0% to 0.5% with further downside risks to the forecasts. Lower inflation rate will provide an ample room for further interest rates cuts by Bank Negara should the pace of economic deterioration heightens.