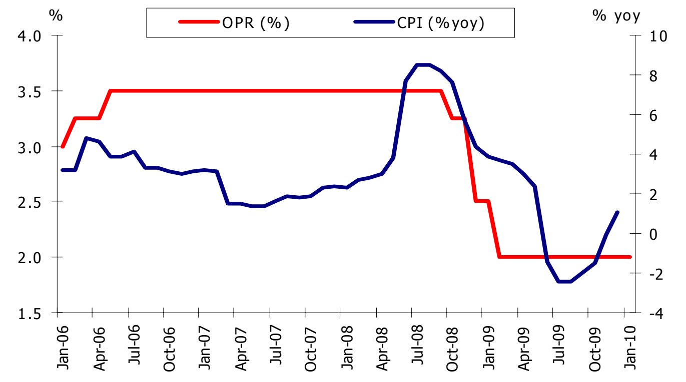
Economy

AMB

MALAYSIA: OPR unchanged, but hinting on exit strategy

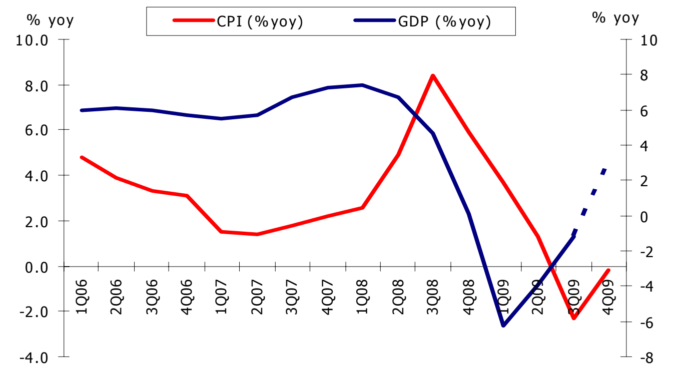
27 JANUARY 2010
2010/004

OPR (%) vs CPI (%YOY)



Source : BANK NEGARA MALAYSIA, BLOOMBERG LP

CPI (% YOY) vs GDP (%YOY)



Source : BANK NEGARA MALAYSIA, BLOOMBERG LP
Dotted Lines : RESEARCH DIVISION FORECAST

BNM MPCM for 2010 (%)

No.	Date	%
1st	26 January 2010 (Tuesday)	2.00
2nd	4 March 2010 (Thursday)	2.00f
3rd	13 May 2010 (Thursday)	2.00f
4th	8 July 2010 (Thursday)	2.00f
5th	2 September 2010 (Thursday)	2.25f
6th	12 November 2010 (Friday)	2.50f

Source : BANK NEGARA MALAYSIA, BLOOMBERG LP
f : RESEARCH DIVISION FORECAST

- **Bank Negara Malaysia, in its first monetary policy meeting held for this year, left the key policy rate unchanged at 2.00%. The rate is at its lowest level since April 2004 and has been unchanged since February, 09.**

- In its statement, the central bank reiterated the view of a firmer recovery in the global economy, supported largely by *'expansionary economic policies, improved financial conditions and strong rebound in emerging economies'.* However, BNM highlighted that the outlook for the advanced economies *'remains uncertain'* as growth was largely depending on *'policy stimulus measures'* and not on *'the sustainability of private sector demand'.*

- BNM was generally optimistic on the domestic economic condition based on its statements *'the economic recovery is gaining momentum'* and *'the economy expanded favorably'.* This was on the back of *'positive developments'* in the real economic activities and financial developments. BNM also reiterated the prospects for the economy during 2010 could be further *'supported by private consumption and improvements in external demand'.*

- As widely expected, the OPR was left unchanged although the December CPI returned to chart an increase. Inflation for December was at 1.1% yoy after 6 months being in a deflationary mode. The central bank is expecting that the *'pace of price increase'* this year will be *'gradual'* and projected *'a positive but modest inflation rate'* for 2010.

- However, Bank Negara cautioned that borrowing costs cannot be kept *'too low'* for too long as the economy strengthens. There is also a need *'to prevent the buildup of financial imbalances'* that could arise from interest rates being too low for a prolonged period of time. This is seen as a signal that BNM is preparing to exit its easy monetary policy.

- The major economies are also preparing to review interest rates and move out of the ultra loose monetary policy. In fact, a few central banks in Asian countries had already raised the borrowing costs or taking steps to remove the excess cash in the banking system to fend off inflationary pressures. The latest was Vietnam, which increased its interest rate by one percentage point to 8.0% late last year. China surprisingly raised its required reserve ratio – the proportion of deposits that banks must set aside as reserves - as credit boom threatens to stoke the country's inflation and creates asset bubbles. India and South Korea are also seen to lead the tightening cycle this year followed by other Asian countries in the later part of the year.

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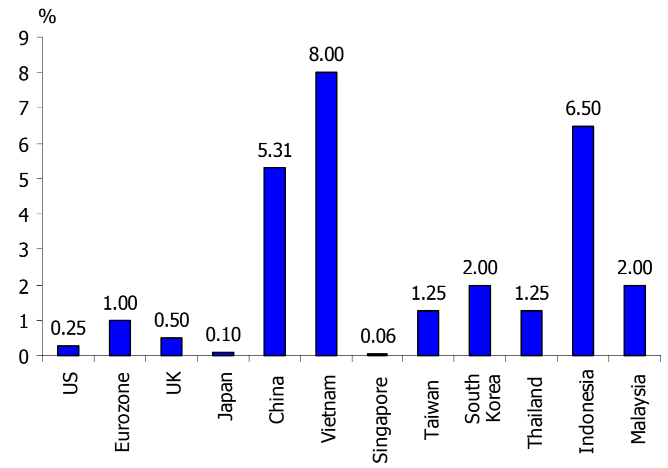
GLOBAL CENTRAL BANK RATE



Source : BANK NEGARA MALAYSIA, BLOOMBERG LP

- Nonetheless, we still believe that BNM will not be embarking on an immediate tightening of monetary policy and raise interest rate given the prevailing uncertainty in global recovery. Risks on domestic inflation and growth, at this time, have also remained well balanced, thus giving more room for BNM to retain the OPR at the prevailing level at least till the end of 1H10. In fact, based on past experience, BNM was always lagging against other central banks in Asia in adjusting interest rates.

- Thus, at this juncture we continue to expect BNM to retain its accommodative policy stance to support economic recovery amidst benign inflation expectations. However, domestic interest rate is likely to be adjusted upward during the later part of 2010 to be in line with global rates (in anticipation of policy tightening in major economies as recovery becomes more entrenched) and rising domestic inflation. Therefore, we expect the OPR to remain unchanged through 1H10 at 2.00% and to be raised gradually by 50 basis points (in two hikes) in the 2H10.

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