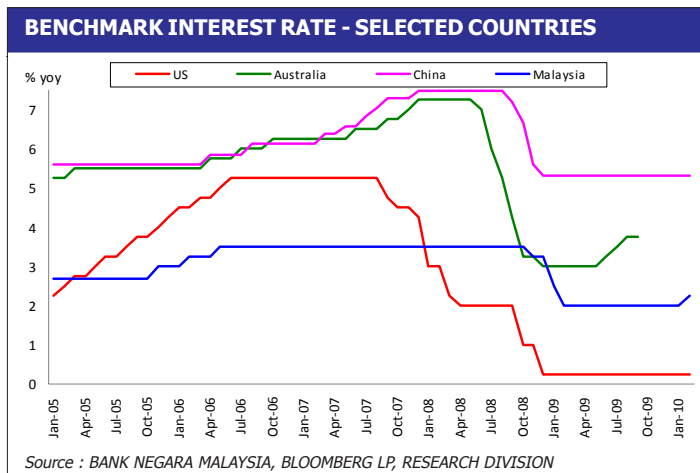
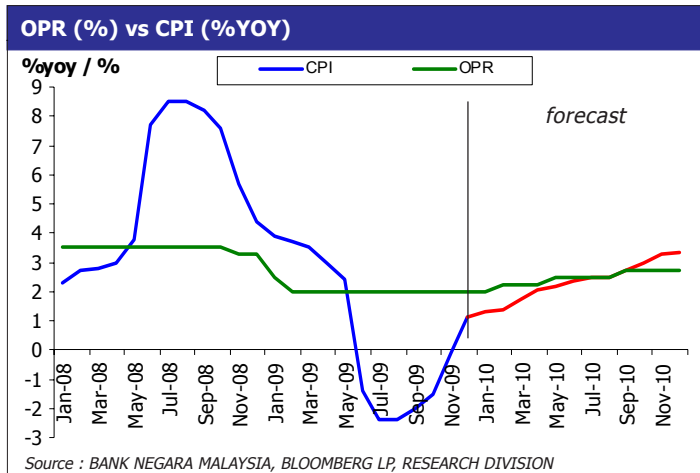


## MALAYSIA: The 'normalisation' begins...

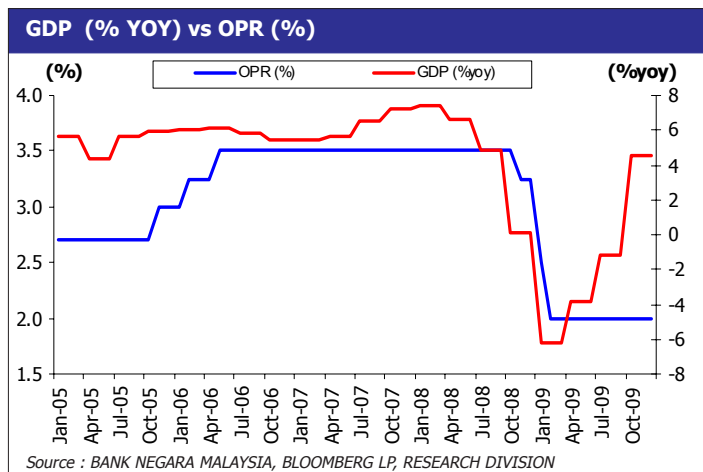
5 MARCH 2010  
2010/013



BNM MPCM for 2010 (%)		
No.	Date	%
1st	26 January 2010 (Tuesday)	2.00
2nd	4 March 2010 (Thursday)	2.25
3rd	13 May 2010 (Thursday)	2.50f
4th	8 July 2010 (Thursday)	2.50f
5th	2 September 2010 (Thursday)	2.75f
6th	12 November 2010 (Friday)	2.75f

Source : BANK NEGARA MALAYSIA, BLOOMBERG LP, RESEARCH DIVISION

- As widely expected, BNM in its latest Monetary Policy Committee (MPC) meeting increased the overnight policy rate (OPR) by 25 basis points (bps) to 2.25%, after keeping it at a historical low of 2.00% since February 2009. The move was made on the back of a faster than expected GDP growth in 4Q09, which provided some comfort and flexibility for the central bank to begin normalising the benchmark rate. However, the overall stance of monetary policy remains accommodative.
- In its assessment of the economy, BNM sent a more confident tone on the growth outlook with both the external and domestic economies are seen to be on the path to recovery and growth momentum expected to be sustained or even strengthen as in the case of the domestic economy. In addition, the latest MPC statement had also left out any reference to 'uncertainties' in the outlook which was made in the previous statements.
- On inflation, the central bank expects prices to rise gradually, reflecting both the recovery and also hikes in administered and commodity prices. With output likely to stay near potential in 2010, there should be restricted demand side inflation pressures to emerge in 2010 and thus inflation would be less of a significant policy consideration for BNM this year.
- The decision by BNM has made Malaysia as the first country in Asia to hike its benchmark policy rate. The limited option of monetary tools had attached the local central bank to follow countries such as Australia to raise interest rates, while others such as China and India had resorted to other liquidity tightening measures, despite having much faster GDP growth and higher inflationary pressures.
- There are yet any signs of price and financial imbalances emerging, thus the gradual increase in OPR is seen as a pre-emptive measure by BNM to avoid such occurrence as the recovery momentum gathers pace. With GDP growth expected to accelerate in 1H10, thanks to the depressed base in 1H09, the normalisation process by BNM is likely to continue in the next meeting in May with another small hike by 25 bps.
- Beyond the May 13 MPC meeting, further moves would be dependent on the performance of the economy in the second half. As we expect a growth moderation in 2H10, after the



probability of a peak in annual GDP growth at above 8.0% in 1Q10, BNM could temporarily pause on the normalisation of the OPR. But should growth, demand inflation pressures or household credit surprise on the upside, a further 25 bps in 2H10 could not be ruled out, given that BNM had begin raising interest rate early in the year.

- Our concern however lies on the impact of these rate increases on private consumption and investment spending going forward. Notwithstanding BNM's argument of a sustained domestic demand, 4Q09 GDP showed that the overall growth was mostly driven by external demand, public sector expenditure and reduced inventory drawdown while the pace of growth in the private sector spending remained substantially below trend. Any increase in borrowing costs would then be detrimental to the recovery of the private sector, and given the ongoing uncertainties in the developed economies and also waning effect of the government stimulus packages, GDP growth in the 2H10 and 1H11 could be at risk.
- At this juncture, the local economy is expected to chart a growth of 6.0% to 6.5% this year while inflation would range between 2.5% to 3.0%, both which are close to the pre-crisis levels. As such, we expect the OPR to be raised by another two times by 25 bps each to take the end of the year OPR target to 2.75%.