MALAYSIA OPR UNCHANGED - ECONOMIC GROWTH DOMINATES

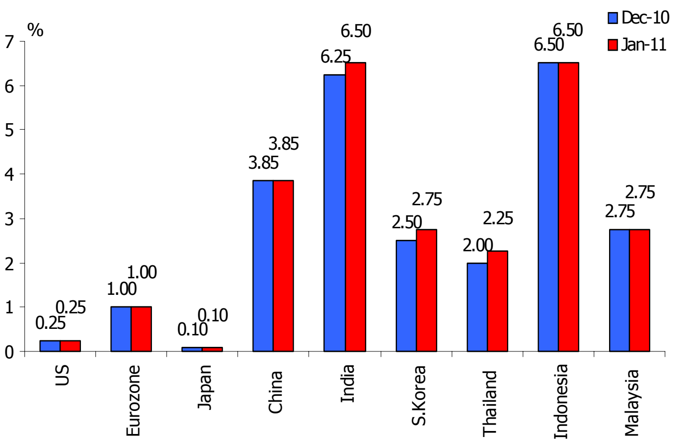
28 JANUARY 2011
2011/03

BNM MONETARY POLICY MEETINGS 2011

No.	Date	%
1st	27 January 2011 (Thursday)	2.75
2nd	11 March 2011 (Friday)	2.75f
3rd	5 May 2011 (Thursday)	2.75f
4th	7 July 2011 (Thursday)	3.00f
5th	8 September 2011 (Thursday)	3.25f
6th	11 November 2011 (Friday)	3.25f

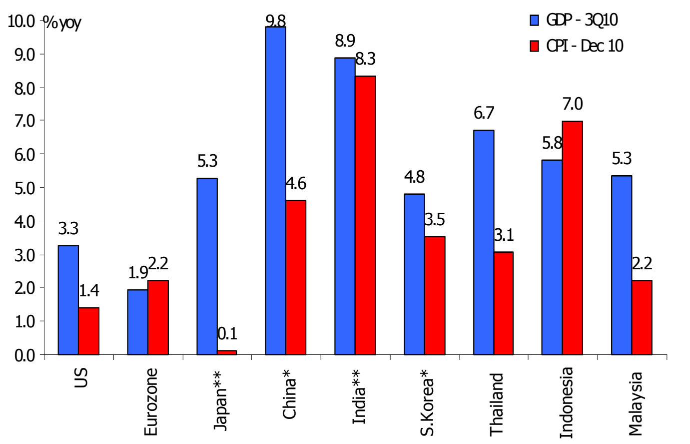
Source : BANK NEGARA MALAYSIA
f - RESEARCH DIVISION FORECAST

MALAYSIA VS GLOBAL INTEREST RATES (%)



Source : BLOOMBERG LP

GDP VS CPI FOR SELECTED COUNTRIES (% YOY)



Source : BLOOMBERG LP
** for 4Q10 GDP, ** for Nov10 CPI*

- **Meeting expectations.** As widely expected, Bank Negara Malaysia (BNM) left its Overnight Policy Rate (OPR) unchanged at 2.75% on January 27. This was the third consecutive meeting which left the interest rate unchanged after the third hike in July 2010.

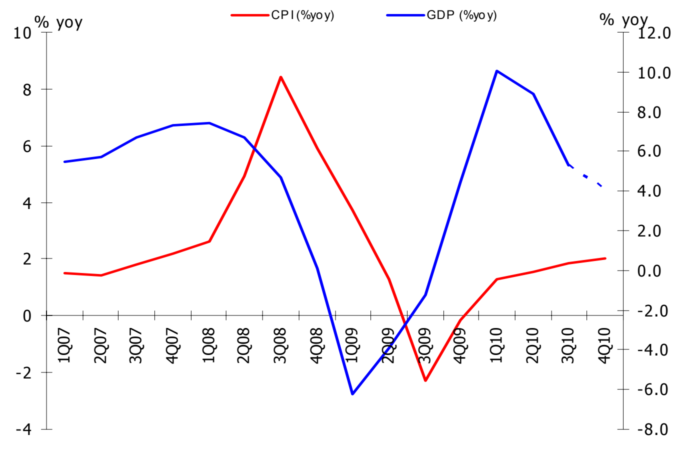
- **Bucking regional trend.** The decision made by BNM was opposed to the monetary tightening being carried out by some Asian central banks. Bank of Thailand and Bank of Korea raised their interest rates by 25 basis points (bps) to 2.25% to 2.75% respectively in mid- January this year. This was followed by the Reserve Bank of India which hiked interest rates by 25 bps on January 26, pushing its repo rate to 6.5% and the reverse repo rate to 5.5%. Both the repo and reverse repos are instruments of the bank's liquidity adjustment facility.

- **Rising global food inflation**. Regional inflation rates are moving upwards driven by a spike in global food prices and on higher commodity prices. This has prompted central banks to raise interest rates to curb further price increases and lower inflationary expectations. To a certain extent, the strong economic recovery particularly in emerging economies has also provided support for higher interest rates. China, for instance, has expressed the need to extend interest rate increases to control rising inflation after the economy recorded a stronger than expected GDP growth during 4Q10.

- **Maintaining domestic interest rates.** On the domestic front, concerns over a sustained global recovery appear to continue influencing BNM in its monetary policy decision. This was evidenced by the recent MPC statement which stated "a more moderate external demand" going into 2011. The current mild domestic inflation rates also supported for a loose and accommodative OPR. BNM, in its statement, viewed the latest CPI growth of 2.2% as "low" and expected to increase at a "modest pace" in 2011. The current stance of the MPC notes which stated "monetary policy continues to remain accommodative and supportive of economic growth" also signals BNM continues to favour growth above inflation.

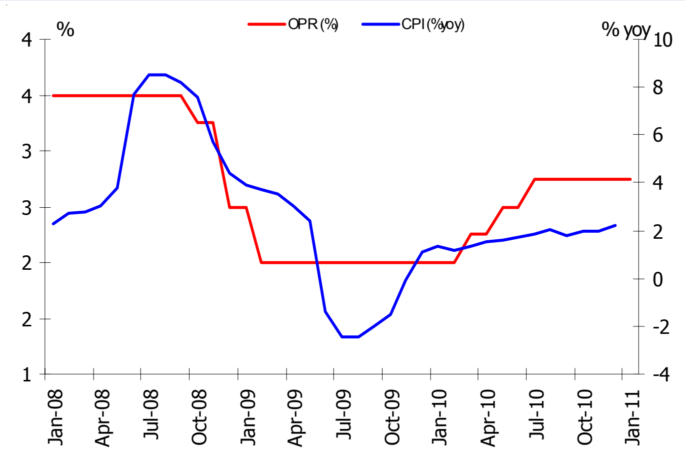
- **Increasing chances of a higher SSR on liquidity buildup.** In its statement, Bank Negara also reiterated its concerns over capital flows into emerging economies which have brought risks to macroeconomic and financial stability. Though this has led to a build up in the domestic financial system, in which the impact has been manageable, the additional policy tools such as the statutory reserve requirement (SRR) and macroeconomic lending measures could be employed to prevent

MALAYSIA GDP VS CPI (% YOY)



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

MALAYSIA CPI (% YOY) VS OPR (%)



Source : BANK NEGARA MALAYSIA,

the risks of macroeconomic and financial imbalances. The absence of such measures in previous MPC statements not only indicates the growing concerns of BNM on the impact of external capital flow but also reflects the flexibility that BNM has in dealing with the liquidity problems.

- **Less pressure on BNM for now**. The recent upward trend in the regional benchmark interest rates is not expected to drive local interest rates higher. In fact, BNM was slightly ahead of the curve compared to regional peers when the OPR was first raised on March 10, as part of the effort to normalize and prevent the risk of financial imbalances. Furthermore, the low-interest rate environment in developed countries, amidst further monetary tightening by emerging economies, will lead to continuing issues related to capital inflows.

- **Remaining silent before moving upward in 2H11.** At this juncture, we continue to believe that BNM will hold the OPR at the current level until 1H11. As previously mentioned in our CPI report, the rate of inflation was driven mainly by rising cost following the government subsidy rationalization that would not necessarily lead to a monetary tightening by the central bank. This is in line with the BNM assessment on inflation that it will be "driven by supply side factors with limited evidence of excess demand exerting pressure on prices". On the back of rising global food and commodity prices, the government is expected to continue with the subsidy rationalization and thus is expected to increase consumer prices moderately. In addition, the government is also expected to announce a slower 4Q10 GDP growth in mid-February, which could support for the case of unchanged policy rates. We, however, expect BNM to resume its OPR hike during the second part of the year on the back of a stronger domestic demand and sustained improvement in the global economy. The pick-up in domestic private sector activities, in particular, would provide a boost for overall consumer spending and hence, exert an increase in demand-pull inflation. On that note, we are maintaining our forecast of a 25-50 bps hike in 2H11, taking the overall 2011 year-end OPR target to 3.25%.

BANK NEGARA MONETARY POLICY COMMITTEE MEETING (MPCM) STATEMENT

27 JANUARY 2011

At the Monetary Policy Committee (MPC) meeting today, Bank Negara Malaysia decided to maintain the Overnight Policy Rate (OPR) at 2.75%.

The recovery of the global economy is continuing, although the growth performance differs markedly across regions. While the advanced economies continue to register modest growth, most emerging economies have experienced strong growth. For the Asian region, while growth has moderated amid weaker external demand, domestic economic activity continues to provide strong support to the growth momentum. However, shifts in global liquidity have resulted in significant capital flows into the emerging economies, in particular, into the Asian region, and have brought with it risks to macroeconomic and financial stability. The region is also being affected by global inflationary pressures arising from the higher commodity and food prices.

In the domestic economy, recent indicators point towards a sustained expansion in private sector activity in the fourth quarter of 2010. External demand, however, was affected by the slower global growth. Going forward, the Malaysian economy is expected to grow at a steady pace in 2011, underpinned by continued firm expansion in domestic demand amid more moderate external demand. Private consumption will be supported by sustained employment and income growth, while the favourable outlook in the domestic-oriented sectors and the expansion of new growth industries will provide support for continued private investment activity.

While domestic headline inflation rose towards the end of 2010, it has remained low at 2.2%. The increase was mainly on account of higher food and energy prices. Prices are expected to increase at a modest pace in the coming months, driven primarily by rising global commodity and food prices. The assessment is that inflation will continue to be driven by supply factors with limited evidence of excess demand exerting pressure on prices.

At this stage, the MPC considers the current monetary policy stance as appropriate and consistent with the current assessment of the economic growth and inflation prospects. The stance of monetary policy continues to remain accommodative and supportive of economic growth. However, the large and volatile shifts in global liquidity are leading to a build up of liquidity in the domestic financial system. While the liquidity in the financial system has been manageable, going forward, additional policy tools such as the statutory reserve requirement and macroprudential lending measures may be considered to avoid the risks of macroeconomic and financial imbalances.

12 NOVEMBER 2010

At the Monetary Policy Committee (MPC) meeting today, Bank Negara Malaysia decided to maintain the Overnight Policy Rate (OPR) at 2.75%.

Growth in the global economy has moderated in the third quarter, with a sustained divergence in the growth performance of the advanced and emerging economies. In the region, the recovery continues, although the pace of economic growth has moderated arising from a weakening of external demand. International financial market conditions have become more volatile with increased capital flows to emerging markets. This shift in global liquidity has brought with it risks to macroeconomic and financial stability in the emerging market economies.

In the Malaysian economy, recent indicators on exports and external-related sectors affirmed the earlier expectations for growth to moderate in the third quarter. Nevertheless, domestic demand has provided strong support to growth. Going forward, overall growth will continue to be well supported by domestic economic activity. Private consumption will benefit from the favourable employment conditions, firm commodity prices and accommodative financing environment, while the expansion in private investment is expected to be driven by increased capital spending in the domestic-oriented sectors.

Domestic headline inflation moderated in September to 1.8%. Prices are expected to rise at a modest pace in the coming months in view of the rising global commodity and food prices. Inflation is however expected to remain moderate going into 2011.

The MPC considers the current level of OPR as appropriate and consistent with the latest assessment of the economic growth and inflation prospects. The stance of monetary policy continues to remain accommodative and supportive of economic growth. While domestic financial conditions remain orderly, greater vigilance will be accorded to the potential risks arising from large and volatile capital flows.