

**ECONOMIC REVIEW | January 2019 BNM MPC****BNM Holds Rates at 3.25% - Still Optimistic on Domestic Activity**


- *Overnight Policy Rate maintained at 3.25%. In line with our expectation, overnight policy rate is left unchanged at 3.25%. The decision is widely expected and timely as macroeconomic indicators are reflecting moderating signs especially at the global front. We observed slowdown in external trade, industrial production and manufacturing sales performances in the first eleven months of 2018 as compared to 2017.*
- *GDP growth in 3Q18 missed market expectations. Malaysia's GDP growth expanded by 4.4%yoy in 3Q18 which came in slightly above our forecast of 4.2%yoy but below market expectation of 4.6%yoy. We have expected the GDP performance to moderate during the quarter, highlighting strong domestic demand and contraction in commodity-based sectors such as agriculture and mining & quarrying. It was the weakest growth in 7 quarters.*
- *OPR to stay at 3.25% in 2019. As core inflation rate remains low, we opine change in monetary stance is not required at this juncture as it would affect the trajectory of domestic growth. Furthermore, the US has indicated that their interest rate is nearing the neutral rate, suggesting that the central bank is preparing to slow down its normalization exercise. Since there will be less pressure from both domestic and external fronts, we anticipate that BNM will maintain the OPR at 3.25% in 2019 barring any surprises in domestic economic growth.*

**Overnight Policy Rate maintained at 3.25%.** In line with our expectation, overnight policy rate is left unchanged at 3.25%. The decision is widely expected and timely as macroeconomic indicators are reflecting moderating signs especially at the global front. We observed slowdown in external trade, industrial production and manufacturing sales performances in the first eleven months of 2018 as compared to 2017. The moderating external trend is anticipated to continue into 2019. Nevertheless, we expect Malaysia's GDP growth to remain solid this year, buoyed by robust domestic spending, continuous pick-up in commodity prices, steady business confidence and stable labour market. We estimate GDP growth for 2019 at 4.9%.

**GDP growth in 3Q18 missed market expectations.** Malaysia's GDP growth expanded by 4.4%yoy in 3Q18 which came in slightly above our forecast of 4.2%yoy but below market expectation of 4.6%yoy. We have expected the GDP performance to moderate during the quarter, highlighting strong domestic demand and contraction in commodity-based sectors such as agriculture and mining & quarrying. It was the weakest growth in 7 quarters. From the demand side, tax holiday and stable retail fuel prices supported the growth. It is notable that domestic demand contributed about 5% of the total growth during the quarter. From the supply side, services and manufacturing sectors contributed 3.9% and 1.2% respectively. We opine the continuous slowdown in GDP growth was mainly due to external factors particularly escalating trade war effects and poor performances of commodity-based sectors. Moderating inflationary pressure, strengthening domestic demand and accommodative economic policies as well as strong re-exports growth are expected to be major drivers for GDP performance in the last quarter of 2018.

**Moderating trade activities amid global trade spat.** Malaysia's external trade performance expanded at a slower rate in the first eleven months of 2018. Up to date, growth of exports moderated to 7%yoy (2017: 19.3%yoy). In fact, the export growth was mainly generated by re-exports which grew 43.3%yoy for the first eleven months of 2018. Oppositely, domestic exports remained stagnant with growth below 1% so far this year. Meanwhile, business environment as reflected in global and emerging economies PMIs were indicating expansionary direction. Both PMIs for global and emerging economies were recorded at 51.5 and 50.3 points respectively in Dec-18. Nevertheless, the global economic indicators have been pointing downwards since mid-18. Among others, ongoing trade tension, Brexit, political instability in EU and geopolitical stress in the Middle East are pressuring global economic confidences. We forecast Malaysia's exports growth at 3.6%yoy in 2019.

**Headline inflation averaged at 1% in 2018.** Consumer price index increased 0.2%yoy in the final month of 2018, same as in Nov-18 and the lowest since Aug-18. The figure was slightly below market consensus of 0.4%yoy. The low inflation was mainly attributed to transport prices which continued to drop by 2.0%yoy in Dec-18. Meanwhile, core inflation went down to a neutral rate (Nov-18: 0.5%yoy). For the full year of 2018, inflation moderated to a nine-year low of 1.0%yoy as costs rose at a slower pace for most of the components. Similarly, core inflation rate eased sharply to 0.8%yoy in 2018 (2017: 2.3%yoy). As for 2019, we foresee inflation to increase to 2.2%yoy amid lower base effects. We anticipate inflationary pressure mainly from fuel-related items to increase, consistent with our expectation on crude oil price to average at USD75pb for 2019 (2018: USD72pb) and given that RON95 subsidy will be targeted to only B40 group. However, core inflation rate is expected to remain steady in 2019, hovering around 2018's level of 1.0%yoy.

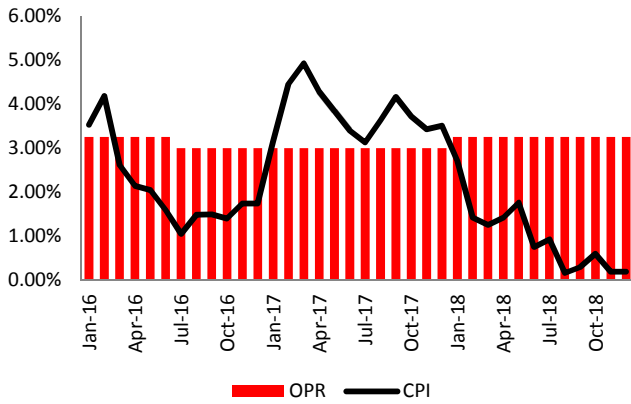
**OPR to stay at 3.25% in 2019.** As core inflation rate remains low, we opine change in monetary stance is not required at this juncture as it would affect the trajectory of domestic growth. Furthermore, the US has indicated that their interest rate is nearing the neutral rate, suggesting that the central bank is preparing to slow down its normalization exercise. Since there will be less pressure from both domestic and external fronts, we anticipate that BNM will maintain the OPR at 3.25% in 2019 barring any surprises in domestic economic growth. 

**Table 1: Central Bank Policy Rate (%) by Selected Countries**

	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19
Malaysia	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
Indonesia	4.75	5.25	5.25	5.50	5.75	5.75	6.00	6.00	6.00
Singapore	Neut.	Neut.	Neut.	Neut.	Neut.	Neut.	Neut.	Neut.	Neut.
Philippines	3.00	3.25	3.25	4.00	4.50	4.50	4.75	4.75	4.75
Thailand	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.75	1.75
Vietnam	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25
Korea	1.50	1.50	1.50	1.50	1.50	1.50	1.75	1.75	1.75
China	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35
Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
United Kingdom	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75
EU	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
United States	1.75	2.00	2.00	2.00	2.25	2.25	2.25	2.50	2.50

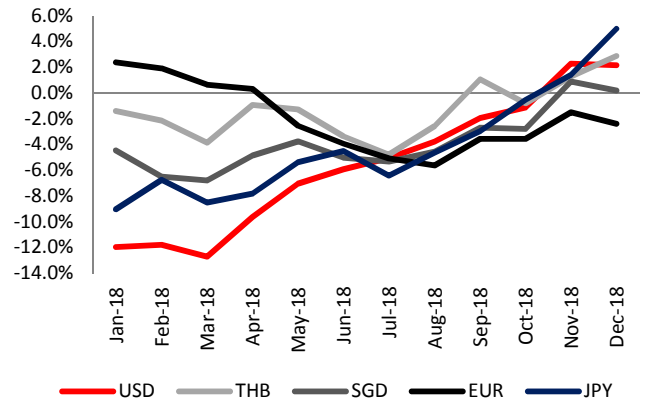
Source: CEIC, MIDFR

**Chart 1: Monetary Policy (%) vs CPI (YoY%)**



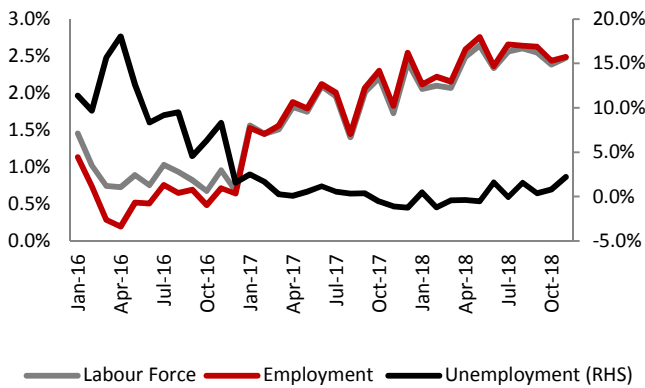
Source: CEIC, MIDFR

**Chart 2: MYR Against Selected Currencies (YoY%)**



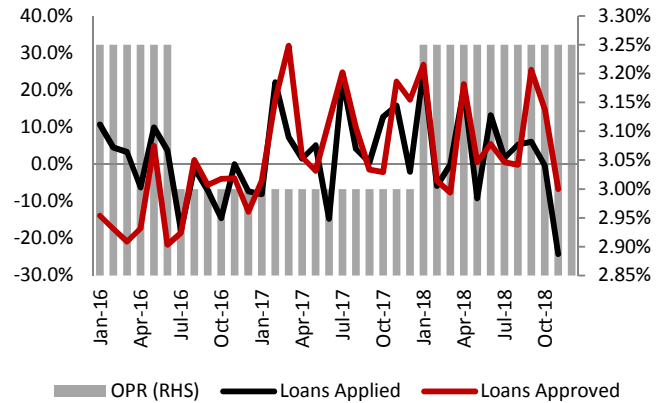
Source: CEIC, MIDFR

**Chart 3: Labour Market Performance (YoY%)**



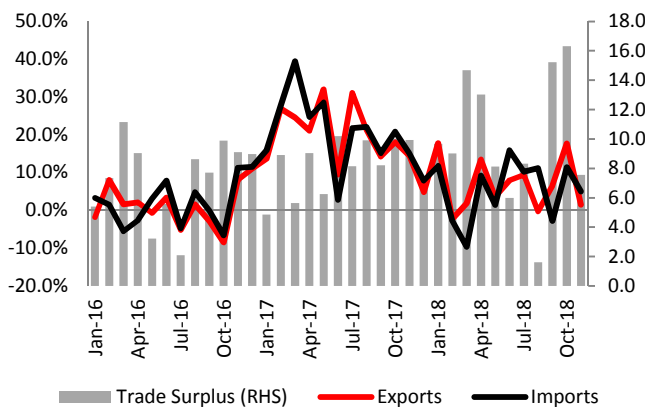
Source: CEIC, MIDFR

**Chart 4: OPR (%) vs Loans Growth (YoY%)**



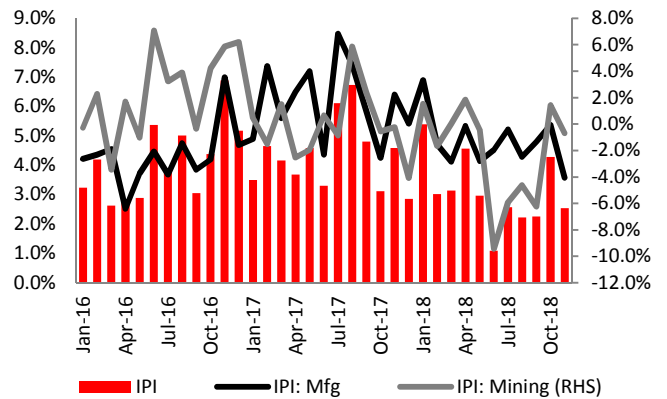
Source: CEIC, MIDFR

**Chart 5: External Trade Performance (YoY% & RMb)**



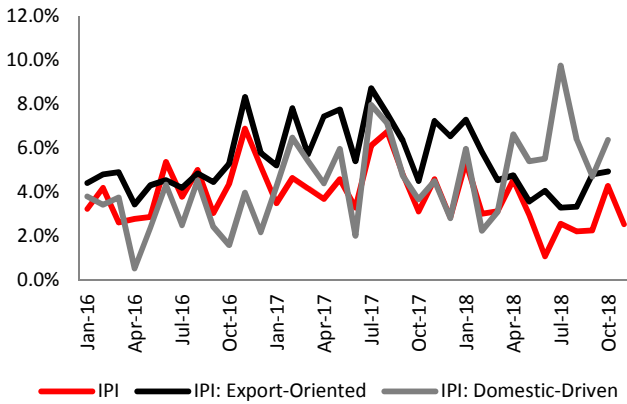
Source: CEIC, MIDFR

**Chart 6: Industrial Productions Performance (YoY%)**



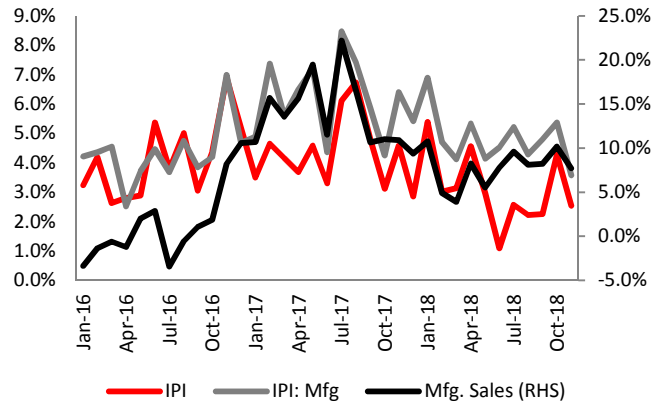
Source: CEIC, MIDFR

**Chart 7: IPI Performance (YoY%)**



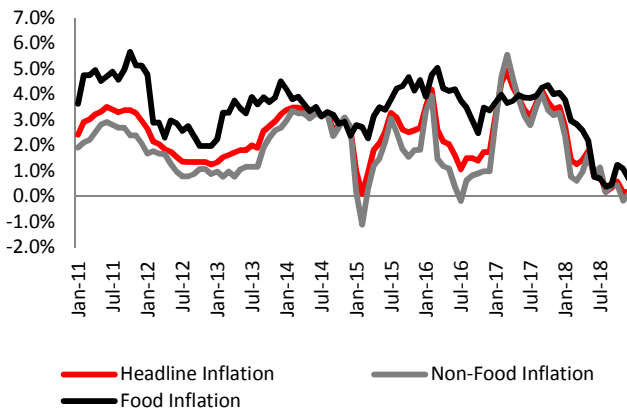
Source: CEIC, MIDFR

**Chart 8: IPI vs Manufacturing Performances (YoY%)**



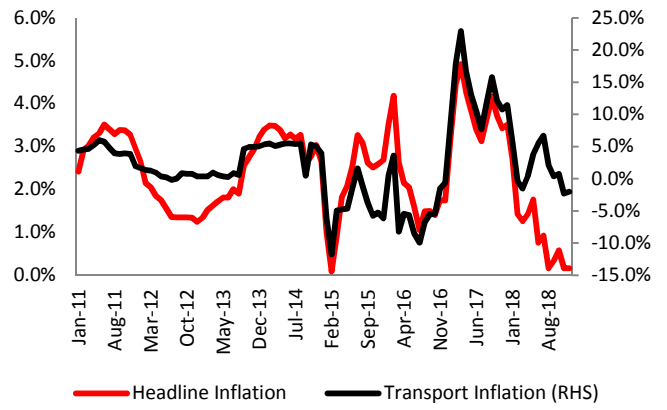
Source: CEIC, MIDFR

**Chart 9: Headline vs Food & Non Food Inflation (YoY%)**



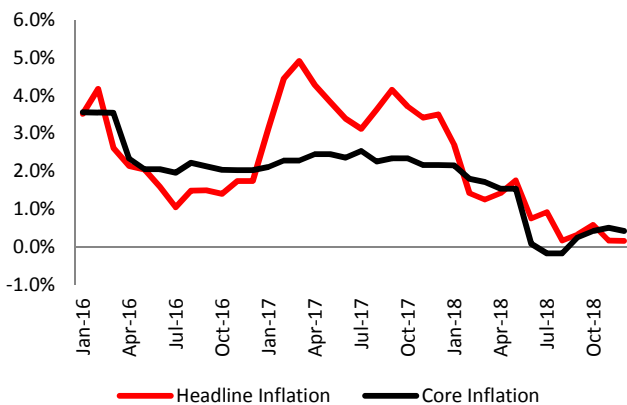
Source: CEIC, MIDFR

**Chart 10: Headline vs Transport Inflation (YoY%)**



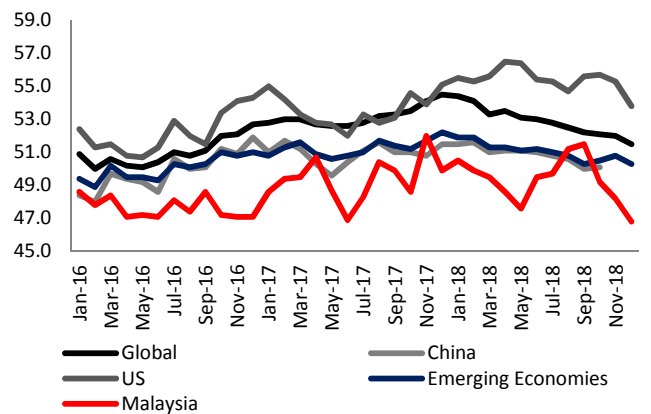
Source: CEIC, MIDFR

**Chart 11: Headline vs Core Inflation (YoY%)**



Source: BLOOMBERG, MIDFR

**Chart 12: Economic Confidence Level**



Source: CEIC, MIDFR  
 \*(>50:Expansionary, <50: Contractionary)

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