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ECONOMIC REVIEW | November 2016 BNM MPC

Benchmark Interest Rate End the Year at 3.0%

- *In line with all economists' expectation, BNM keep its interest rate unchanged at 3.00% in November MPC meeting. The strong year-on-year GDP growth and the volatile and relatively weak Ringgit make it very unlikely for BNM to cut its interest rate in its last MPC meeting of 2016.*
- *Rising uncertainty coming from the risk of protectionism and financial market volatility are among BNM's key considerations for its decision. Protectionism is not a new issue; in fact we have been cautious by it ever since the end of last year, particularly when imports substitution has become an agenda among many high-population countries – leading to the global trade activity slowdown.*
- *We think BNM will continue to be accommodative in 2017, hence we do not rule out a rate cut next year. While the headline 3Q16 GDP grew better than our expectation at 4.3%, we were right in forecasting that the economy had yet show to solid recovery during the quarter. Thus, for 2017, we opine that a rate cut by 25bps is in the offing unless it meets the two conditions that we have aforementioned.*

BNM benchmark interest rate unchanged in the last meeting of 2016. In line with all economists' expectation, BNM keep its interest rate unchanged at 3.00% in November MPC meeting. The strong year-on-year GDP growth and the volatile and relatively weak Ringgit make it very unlikely for BNM to cut its interest rate in the November meeting. However, at the moment we are maintaining our view that BNM will cut its interest rate by 25 bps in 2017 in two conditions: i) there is no improvement in the quarterly growth momentum of GDP and ii) there is a stability in the Ringgit movement.

Rising uncertainty coming from the risk of protectionism and financial market volatility. Protectionism is not a new issue; in fact we have been cautious by it ever since the end of last year, particularly when imports substitution has become an agenda among many high-population countries – leading to the global trade activity slowdown. Things could turn for the worse if Trump continues with his protectionism manifesto, in which he was planning to hike tariff of up to 45% for products from China. China has warned that they are going to retaliate should that happen, which could cause a trade war and adversely affect exports-dependent economy including Malaysia.

Financial market volatility could push BNM to wait and see attitude. Without any improvement in the financial market volatility, BNM may conduct a wait and see attitude for its monetary policy. The current weakness of Ringgit caused by continuous fund outflow is unlikely to reverse for the time being, making it difficult for Ringgit to experience a sharp rebound in the short term. Though the previous July cut had seen a strengthening of Ringgit rather than weakening – on the assumption that it would boost the stock market, it is unlikely to happen if the same action is taken this time around. Foreign investors currently have a huge appetite for US stock market; as such a cut in OPR could cause further fund outflow rather than an inflow. Additionally, the almost certain probability of Fed rate hike in December meeting as well as elevated inflation expectation in US have put pressure on Ringgit.

Despite weakening Ringgit, an interest rate hike is unlikely. There were talks in the news of a possibility of an increase in OPR, in which we opine would be very unlikely. Looking into the market behaviour, it is very unlikely that increasing the interest rate could lead to a fund inflow into Malaysia capital market. In fact, a combination of weakening Ringgit and higher interest rate could hurt the economy, which we think would be very unlikely for BNM to conduct such a move.

Table 1: Global Monetary Policy (%p.a.)

Country	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16
Australia	2.000	2.000	1.750	1.750	1.750	1.500	1.500	1.500	1.500
China	4.350	4.350	4.350	4.350	4.350	4.350	4.350	4.350	4.350
EU	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
India	6.750	6.500	6.500	6.500	6.500	6.500	6.500	6.250	6.250
Indonesia	6.750	6.750	6.750	5.250	5.250	5.250	5.000	4.750	4.750
Japan	-0.100	-0.100	-0.100	-0.100	-0.100	-0.100	-0.100	-0.100	-0.100
Korea	1.500	1.500	1.500	1.250	1.250	1.250	1.250	1.250	1.250
Malaysia	3.250	3.250	3.250	3.250	3.000	3.000	3.000	3.000	3.000
Philippines	4.000	4.000	4.000	3.000	3.000	3.000	3.000	3.000	3.000
Singapore	Grad.	Neut.	Neut.	Neut.	Neut.	Neut.	Neut.	Neut.	Neut.
Taiwan	1.500	1.500	1.500	1.375	1.375	1.375	1.375	1.375	1.375
Thailand	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.500
United Kingdom	0.500	0.500	0.500	0.500	0.500	0.250	0.250	0.250	0.250
United States	0.500	0.500	0.500	0.500	0.500	0.500	0.500	0.500	0.500
Vietnam	6.500	6.500	6.500	6.500	6.500	6.500	6.500	6.500	6.500

*Red indicates easing policy while yellow indicates contractionary policy
Source: Bloomberg, CEIC; MIDF Research

We think BNM will continue to be accommodative in 2017, hence we do not rule out a rate cut next year. While the headline 3Q16 GDP grew better than our expectation at 4.3%, we were right in forecasting that the economy had yet show to solid recovery during the quarter. High trade balance gave the vital push for the higher GDP figure but it was weaker demand from imports particularly from tourism which highly suggest households are facing tighter financial conditions, stemming from lacklustre job market and moderating economy. Thus, for 2017, we opine that a rate cut by 25bps is in the offing unless it meets the two conditions that we have aforementioned.

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