

ECONOMIC REVIEW | January 2016 BNM MPC

BNM Cut SRR by 50 Basis Points

- *Monetary Policy Committee cut the Statutory Reserve Requirement (SRR) by 50 basis points to 3.50% in January as to ensure ample liquidity in the financial institutions.*
- *The loan to deposit ratio in the financial system is beginning to tighten as it reached 91.0% level November 2015, significantly higher than 86.6% in November 2014. We estimate this will lead to an additional liquidity in the banking system by approximately RM6.18 billion. Bank Negara Malaysia (BNM) reminded that SRR is not a signal of monetary policy, and OPR remains as the sole used to signal the stance of monetary policy which is maintained at 3.25%.*
- *For now, we maintain the expectation that BNM will keep its interest rate at 3.25% in the first half of 2016. However, there may be downward pressure on the interest rate in the second half if the global economy continues to slow while domestic demand is not supporting the economy as expected by BNM.*

Higher risk of global economic slowdown. BNM is seeing higher downside risk in the global economy due to the volatility and uncertainties in the financial market. In the real economy, recovery of advanced economies is slower than expected, while the emerging economy is expected to experience further slowdown. Recently, IMF cut its 2016 growth forecast for both the global economy and emerging economies by 0.2%, while the advanced economies were cut by 0.1%. Furthermore, trade volume growth was cut by 0.7%, 0.5% and 1.0% for the world, advanced and emerging market economies respectively. BNM is also expecting the economy to moderate lower this year after 5.0% growth in 2015.

BNM sees domestic demand remaining strong. BNM is of the opinion that domestic demand is supported by continued growth in income and employment. However, moving forward, we are expecting that domestic demand will continue to moderate due to slower income growth and employment, particularly in the oil and gas sector. We believe that the current recovery of income, employment and investment in the manufacturing sector was due to the rebound in exports activity in the second half of 2016. However, looking at the global economic condition and latest indicators, it is unlikely that the positive momentum will continue.

Headline inflation will spike in the first quarter of 2016 and moderate thereafter. In line with our expectation, BNM is expecting inflation rate will be higher in 2016, partly due to the weaker Ringgit and adjustment in the pump price mechanism which began in January 2015. Despite that, the overall economy is expected to experience slower inflationary pressure in 2016, as global inflation is expected to remain subdued and domestic demand may continue to moderate.

BNM cut its SRR by 50 basis points, but remain OPR at 3.25%. The cut in (SRR) by 0.5% will release approximately RM6.18b into the banking system which can be lent out by banks to borrowers. Our approximation of the additional liquidity released is based on the new SRR rate of 3.5% times total eligible liabilities in the banking system of RM1.236t as of November 2015. We opine that the amount of additional liquidity to be released will be small (circa 0.37% to the total deposits in the banking system of RM1.66t as of November 2015). Nevertheless, the improved liquidity in system after looking the tighter LD ratio of 91.0% as at end November 2015 compared to 86.6% in November 2016, is expected to improve funding cost, hence exerting slightly pressure on banks' NIM. Based on total loans in the system of RM1.43t, total deposits of 1.66t and statutory reserves to be placed with BNM based on SRR rate of 3.5% (RM49.45b), total excess liquidity in the system is estimated to be circa RM180b.



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