Economic Beat
midf RESEARCH

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MALAYSIA

BNM MPC - Less pressure to tighten for now but inflation is not the only factor going forward

BNM had its third Monetary Policy Committee (MPC) meeting for the year yesterday in which the committee had decided to leave the Overnight Policy Rate (OPR) at 3%. The decision was widely expected, particularly on the back of stabilizing inflation and less pressure to tighten across EM given the recent USD weakness. We expect inflation may have peaked at 3.5% and would start to trend lower in the 3Q period; barring any further upward adjustments to prices of controlled items. That would help narrow the negative real interest rate margin going forward. However, as we had highlighted earlier, other fragilities on the financial conditions may need some tightening. This was clearly signaled by BNM when its stated that "..the degree of monetary accommodation may need to be adjusted to ensure that the risks arising from the accumulation of these imbalances would not undermine the growth prospects". We expect BNM to tighten by 25bps in the second half of the year.

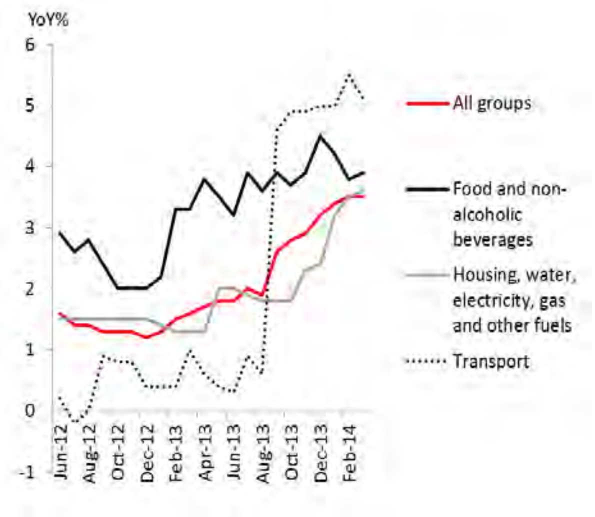
BNM expects inflation to stay above long-term average although still well contained. In its statement, BNM stated that "Inflation has stabilised in recent months amid the more favourable weather conditions and as the impact of the price adjustments for utilities and energy moderate." Nonetheless, due to higher domestic cost factors, it will remain above long-term average. BMM did not state the long-term average inflation it was referring to, but over the past 10 years the Consumer Price Index (CPI) has averaged at 2.5%. We expect inflation may have peaked at 3.5% and would start to trend lower in the 3Q period; barring any further upward adjustments to prices of controlled items, bringing the overall CPI to average at 3.0 – 3.25 for the year.

Risks on inflation smaller, so is risk of much slower growth, but risk of instability building up. Our earlier prognosis and concern are clearly spelled out by the central bank in its recent statement – "Amid the firm growth prospects and inflation remaining above its long-run average, there are signs of the continued build-up of financial imbalances. While the macro and micro prudential measures have had a moderating impact on the growth of household indebtedness, the current monetary and financial conditions could lead to a broader build up in economic and financial imbalances"

As we highlighted earlier, inflation may not be the only factor determining the rate decision. While inflation may stabilize and trend lower this year, the trend may reverse course next year. This is line with the expectation of adjustments to prices of controlled items would continue to sustain the pace of reforms in subsidy rationalization. However, with inflation staying around 3% and OPR at 3% that would imply monetary policy continuing to be loose when there is risk of inflation expectation building up. That set against the all-time high household debt and weakening external position - bigger short-term debt against smaller FX reserves that needs Ringgit to be stronger to ensure the burden does not swell much further, it can pose risk on financial stability. At the moment, we are the only few Asian ex-Japan countries with sizeable negative real interest rates, with perhaps only Philiipines in the league but the country has raised its Reserve Requirement Ratio (RRR) by 100bps to 19% in March. Consensus is expecting the Central Bank of Philippines to tighten further in the coming months, with interest rate finally being raised.

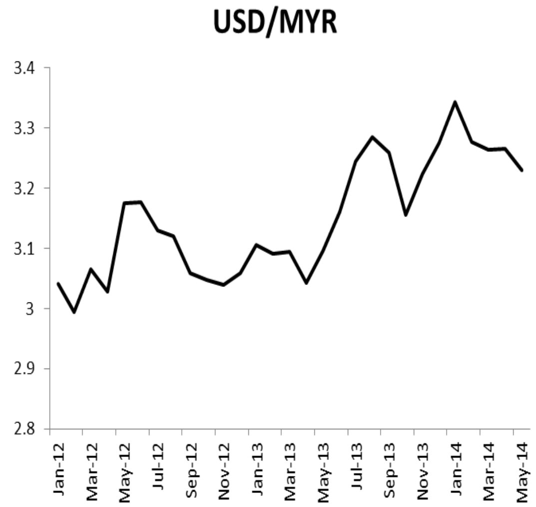
Overall, we took the MPC statement as giving guidance of the possible hike in OPR as clearly signaled by its statement that "..the degree of monetary accommodation may need to be adjusted to ensure that the risks arising from the accumulation of these imbalances would not undermine the growth prospects". Nonetheless, given that there will only be another 3 meetings for the year, we expect BNM would only tighten by 25bps this year. Predicting the timing can be quite tricky but e expect it to be in 4Q 14 (November 5 – 6 meeting)

Chart 1: Inflation has stabilized



Source: DoS, BNM.

Chart 2: So is Ringgit..



Source: Bloomberg.

Table 1: Monetary policy too loose? Rising household debt

	2009	2010	2011	2012	2013
HH Debt (RM bn)	516.1	594.2	674.2	765.0	854.3
HH Financial assets (RM bn)	1241.1	1399.5	1519.6	1711.8	1904.3
HH Debt-to-GDP ratio	72.4	74.5	76.2	81.3	86.8
HH FA-to-HH debt ratio	2.41	2.36	2.25	2.24	2.23
HH Liquid FA-to-HH debt ratio	1.68	1.66	1.59	1.60	1.60
Impaired Loans ratio	3.1	2.3	1.8	1.5	1.3

Source: BNM

Table 2: FX reserves in various measurements

	Absolute level		In multiples of		
	RM bn	US$ bn	Retained imports	Short-term debt	As a % of NGDP
2008	317.50	91.5	7.4	4.0	41.2
2009	331.30	96.7	9.2	4.3	46.5
2010	328.65	106.5	8.6	4.1	41.2
2011	423.33	133.6	9.6	4.1	47.9
2012	427.20	139.7	9.5	4.6	45.4
2013	441.85	134.9	9.5	3.4	44.9
1Q 14	424.60	130.2	9.2	3.3	39.5
15-Apr-14	427.40	131.1	9.4	3.3	39.8

Source: BNM

Table 3: External vulnerability

	CA balance (% of GNI)	Short-term debt (% of NGDP)	FX reserves (as a % of NGDP)
2008	17.1	10.4	41.2
2009	15.5	10.9	46.5
2010	10.9	10.0	41.2
2011	11.6	11.7	47.9
2012	6.1	9.9	45.4
2013	3.8	13.0	44.9
15-Apr-14	3.0	12.1	39.8

Source: BNM, MIDFR estimates

Table 4: EM current inflation and policy rates

	Last date of change	Amount of change (bps)	Current benchmark interest rate (%)	Real interest rate (%)	Amount of change since May 2013 (bps)
India	28-Jan	25	8.00	-0.30	+75
Indonesia	12-Nov - 13	25	7.50	-0.20	175
Thailand	13-Mar	-25	2.00	-0.10	-50
South Korea	8-May - 13	-25	2.50	1.20	0
Brazil	26-Feb	25	10.75	4.55	275
Turkey	29-Jan	550	10.00	1.60	550
South Africa	30-Jan	50	5.50	-0.50	50
Russia	25-Apr	25	7.50	0.60	200

Source: Bloomberg, official statistics, MIDF Research estimates.

Table 5: Consensus on likely direction of OPR

95) Chart Analysts | 96) Forecast Histogram | Bond Yield Forecasts: Analysts

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Market Yield 3.00

Recent Updates

E. Wee Kok Lee

	Q2 14	Q3 14	Q4 14	Q1 15	Q2 15	Q3 15
Bloomberg Wgt Avg	3.00	3.13	3.25	3.25	3.38	
Median Forecast	3.00	3.13	3.25	3.25	3.50	
Average Forecast	3.08	3.19	3.26	3.28	3.34	
High Forecast	3.25	3.50	3.50	3.50	3.50	
Low Forecast	3.00	3.00	3.00	3.00	3.00	
Responses	12	12	17	9	8	
Feb. Survey Median	3.00	3.13	3.25	3.25	3.50	
Nov. Survey Median	3.00	3.25	3.25	3.00		
Change in Medians	0.00	-0.13	0.00	0.25		

Firm Name	Analyst	As of	Q2 14	Q3 14	Q4 14	Q1 15	Q2 15	Q3 15
1) Banco Bilbao Vizcaya Argent	S. Schwartz	02/20			3.25			
2) Bank of America Merrill Lync	H. Chua	02/20			3.25			
3) Capital Economics Ltd	K. Tan	02/20	3.25	3.50	3.50			
4) Citigroup Inc	W. Kit	02/20	3.25	3.50	3.50	3.50	3.50	
5) Credit Agricole SA	D. Kowalczyk	02/20	3.25	3.25	3.25	3.50	3.50	
6) Credit Suisse Group AG	S. Sathirathai	02/20			3.25			
7) DBS Group Holdings Ltd	W. Kwang	02/20	3.00	3.00	3.00			
8) Deutsche Bank AG	D. Del-Rosario	02/20	3.00	3.25	3.25			
9) Goldman Sachs Group Inc/T	M. Tan	02/20	3.00	3.25	3.50	3.50	3.50	
10) HSBC Holdings PLC	S. Lim	02/20			3.50			

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STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	*Negative* total return is expected to be -15% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.