

Malaysia: Kicking Off Interest Rate Normalisation

Bank Negara hiked its benchmark OPR by 25bps to 2.25% on Thur, making it the first central bank in Asia outside Australia to start normalising interest rates. It was a close call with half of the market expecting the move yesterday following comments from the Governor last month that rates have to be normalized to prevent imbalances in the markets. Still, we felt the rate hike came a bit too early for Malaysia which registered mild inflation so far (Jan: 1.3%/y) and where asset prices appeared to be well-contained. In its statement, the central bank said it expects economic growth to strengthen further while inflation will be moderate. We expect the headline inflation rate to trend above 2% y/y in 2Q10 and average around 2.3% for the full-year from 0.6% in 2009. Our growth forecast for Malaysia remains unchanged at 4.9% for this year vs a contraction of 1.7% in 2009.

Despite the move yesterday, we expect BNM to hike rates gradually this year with only another 50bps at the May and July meeting, and then stay on hold at 2.75% for the rest of the year. This is still in line with our call for a more moderate pace of rate normalisation in Malaysia compared with other Asian countries where interest rates were slashed more deeply during the financial crisis.

On the currency front, MYR strengthened to a high of 3.3575/USD at the opening today from 3.3685/USD yesterday in response to the rate hike which was announced after markets closed. The currency pair traded mostly in the range of 3.360-3.368 today. The faster-than-expected start to the rate normalisation in Malaysia would support MYR in the near-term but given that the quantum of rate hike will probably stay more moderate than other Asian central banks as a whole for this year, we are maintaining our forecast for USD/MYR at around 3.32 by year-end.

BNM's Monetary Policy Statement on 4 March 2010

At the Monetary Policy Committee (MPC) meeting today, Bank Negara Malaysia decided to raise the Overnight Policy Rate (OPR) to 2.25 percent. The floor and ceiling rates of the corridor for the OPR are correspondingly raised to 2 percent and 2.50 percent respectively.

The recovery in the global economy is progressing amidst continued policy support and improvements in financial conditions. Economic activity in the advanced economies has improved although growth is expected to remain modest. Emerging economies, however, are recording a stronger recovery. In particular, regional economies expanded strongly in the fourth quarter of 2009 and the growth momentum is expected to be sustained.

In the domestic economy, the stronger growth performance in the fourth quarter of 2009 affirms that the economic recovery is firmly established. Going forward, growth is expected to strengthen further, supported by domestic demand and continued improvement in external demand, particularly from the regional economies.

Prices will gradually increase during the year, reflecting the prevailing economic conditions and taking into account possible adjustments in administered prices. While external factors, including rising global commodity and food prices, may exert some additional upward pressure on domestic prices, inflation is expected to remain moderate in 2010.

The OPR was reduced to historic lows in early 2009 as a key measure to avert a severe and fundamental economic downturn. These conditions no longer prevail. The domestic economy has since improved significantly and is now on a path of recovery. Given this improved economic outlook, the MPC decided to adjust the OPR towards normalising monetary conditions and preventing the risk of financial imbalances that could undermine the economic recovery process. At the new level of the OPR, the stance of monetary policy continues to remain accommodative and supportive of economic growth.

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