GLOBAL ECONOMICS
| FLASH REPORT

January 25, 2018

Monetary Policy Tightened in Malaysia

- **In line with our expectation, Bank Negara Malaysia raised its benchmark interest rate by 25 basis points to 3.25% following today's monetary policy meeting.**
- **Monetary tightening in Malaysia will likely proceed cautiously; we foresee one more interest rate hike in 2018.**

A monetary normalization phase has commenced in Malaysia. Following today's monetary policy meeting, Bank Negara Malaysia (BNM) increased the Overnight Policy Rate by 25 basis points to 3.25%, marking the first hike since July 2014 (chart 1). We expect the BNM to proceed cautiously with further monetary tightening; indeed, given that the policy rate is already close to its historical ceiling of 3.50%, we foresee only one more interest rate hike (of 25 basis points) in 2018, likely to take place in the second half of the year.

The BNM's decision to tighten monetary policy reflects Malaysia's ongoing strong economic growth that will likely feed demand-driven inflationary pressures over the coming quarters. The policy action was also justified by the central bank's need to prevent the build-up of financial risks that might arise from overly accommodative monetary conditions. Furthermore, we assess that the timing of the rate hike was optimal given that political uncertainty may rise in the coming months; Malaysia's next general elections are due by August 2018, yet they are expected to be called in the near future.

The Malaysian economy continues to grow strongly, driven by both the domestic and external sectors. Household spending is underpinned by rising wages and employment, while fixed investment is boosted by infrastructure projects and private sector capital investment in the manufacturing and services sectors. The external sector is benefiting from higher commodity prices and a pick-up in global demand. We estimate that Malaysian real GDP expanded by 5¾% y/y in 2017 and will continue to register around 5½% y/y gains in 2018.

Strong domestic demand will drive Malaysia's inflation dynamics over the coming quarters. Headline consumer prices increased by 3.5% y/y in December (chart 2). We expect a temporary dip in the headline rate in the first quarter of 2018 on the back of base effects stemming from higher petrol prices in early 2017. Nevertheless, inflation is expected to start reaccelerating in the second quarter, reaching 3½% y/y by the end of 2018. Malaysia's core inflation—at 2.2% at end-2017—remains relatively contained, yet demand-driven price pressures are set to lift the core inflation rate gradually higher as well. Despite such underlying dynamics, the BNM's tighter monetary policy stance, together with the strengthening ringgit, will help keep inflation manageable in the foreseeable future.

CONTACTS

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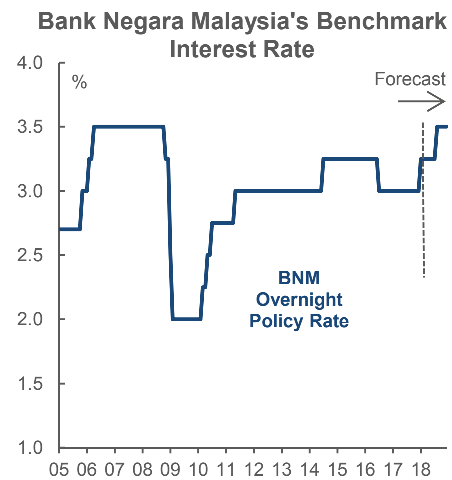
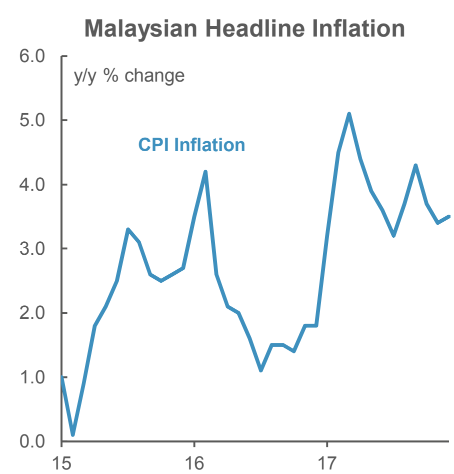
Chart 1



Sources: Scotiabank Economics, Bloomberg.

Chart 2



Sources: Scotiabank Economics, Bloomberg.