May 7, 2019

Monetary Policy Loosened in Malaysia

- **Bank Negara Malaysia lowered its benchmark interest rate by 25 basis points to 3.00% following today's monetary policy meeting.**
- **We expect the central bank to adopt a wait-and-see stance for the foreseeable future in order to assess the impact of the cut on the economy's growth prospects.**

Malaysia's monetary policy cycle has turned. Following today's monetary policy meeting, Bank Negara Malaysia (BNM) lowered the Overnight Policy Rate by 25 basis points to 3.00%, marking the first cut since July 2016 and reversing the January 2018 hike (chart 1). We expect the BNM to keep the benchmark interest rate on hold over the coming quarters as monetary authorities assess the health of domestic and global economic growth momentum and the need for further policy support.

In our view, the BNM's decision to loosen monetary policy is a pre-emptive move to provide support to the domestic economy, given that global growth prospects face downside risks due to persisting trade uncertainties. The BNM pointed out that the rate cut is intended to preserve the accommodative monetary policy stance following some recent tightening in financial conditions. In addition, given that inflation is expected to rebound in the second half of 2019, monetary policymakers likely concluded that there was a narrowing window of opportunity to provide support to the economy.

Malaysian inflationary pressures remain contained. Reflecting changes to consumption tax policies and lower energy prices, headline inflation has eased significantly, hovering at 0.2% y/y in March. Nevertheless, the impact of the tax rate changes will start fading away in the second half of 2019, prompting a rebound in inflation. We expect the headline inflation rate to approach 2% y/y by the end of the year (chart 2). Nevertheless, strong demand-driven price pressures remain absent, allowing the central bank to maintain its accommodative monetary policy stance over the foreseeable future.

The Malaysian economy has maintained solid growth momentum in recent quarters in contrast to most of its regional peers. The country's real GDP grew by 4.7% y/y in the fourth quarter of 2018, following a 4.4% gain in the prior quarter. Nevertheless, output growth will likely decelerate over the coming quarters on the back of weaker demand conditions globally, which will be reflected in Malaysia's export sector performance. Meanwhile, economic activity will likely be driven by domestic demand; favourable employment and income developments will continue to support household spending prospects while multi-year projects in both export- and domestically-oriented industries will underpin investment activity. We expect Malaysia's real GDP growth to average 4⅓% y/y in 2019–20.

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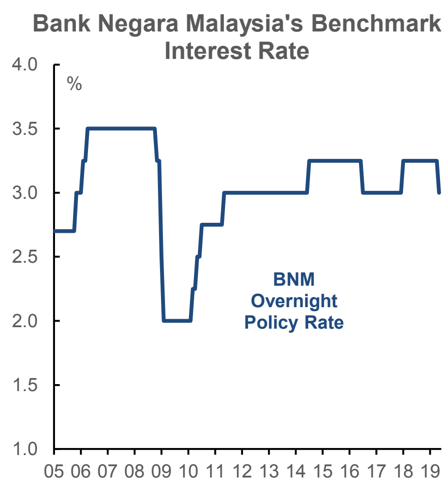
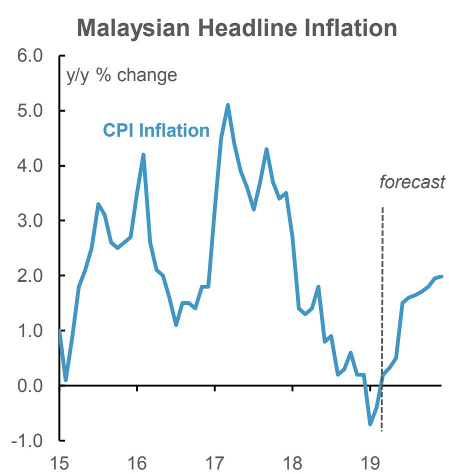
Chart 1



Sources: Scotiabank Economics, Bloomberg.

Chart 2



Sources: Scotiabank Economics, Bloomberg.