Another Interest Rate Cut in Malaysia

- **Bank Negara Malaysia lowered its benchmark interest rate by 25 basis points to 2.50% following today's monetary policy meeting, reflecting rising concerns regarding the coronavirus and its impact on the global economy.**
- **We expect the Malaysian central bank to monitor economic developments carefully over the coming months, being prepared to ease monetary policy further if need be.**

Malaysia's monetary conditions continue to ease as a response to uncertain economic growth prospects that reflect the Covid-19 outbreak. Following today's monetary policy meeting, Bank Negara Malaysia (BNM) lowered the Overnight Policy Rate by 25 basis points to 2.50%, marking a second consecutive cut; the policy rate was lowered by the same magnitude in January 2020 (chart 1).

We anticipate the BNM to keep the benchmark interest rate on hold over the coming quarters, assuming that that the coronavirus outbreak peaks by the end of the first quarter and starts stabilizing from the second quarter onwards. Nevertheless, we assess that the BNM has monetary policy space left should the economy need further support.

The MPC highlighted that the decision to loosen monetary policy was intended to provide a more accommodative monetary environment to support the economy's recovery while maintaining price stability. Nevertheless, the uncertain global economic environment is a concern for the monetary authorities, who pointed to the downside risks of a prolonged virus outbreak and continued weakness in commodity-related sectors. Meanwhile, they acknowledged that the government's fiscal stimulus efforts will provide support to economic activity, complementing the BNM's monetary efforts.

The coronavirus outbreak is a significant downside risk to the Malaysian economic outlook for 2020, which will depend on sustained momentum in household spending, as well as the realization of approved private investment projects. Moreover, we assess that Malaysia is among the regional economies that are the most exposed to demand fluctuations in China, given its proximity to the vast Chinese market and the tightly integrated supply chains. Meanwhile, fiscal outlays will support the Malaysian economy; the government unveiled a MYR 20 bn (USD 4.7 bn) fiscal stimulus package on February 27 to assists the businesses and individuals affected by the Covid-19 outbreak. We expect the Malaysian economy to weaken in the first quarter followed by a recovery once the outbreak stabilizes. The country's real GDP is expected to grow by 3½% in 2020, compared with our prior estimate of 4.2%, yet we note that risks remain on the downside.

Malaysian inflationary pressures remain contained despite a modest pickup in January. Headline inflation accelerated to 1.6% y/y in January from 1.0% at end-2019. We assess that demand-driven price pressures will remain largely absent, with headline inflation remaining below 2% over the coming quarters, allowing the central bank to focus on stimulating the economy.

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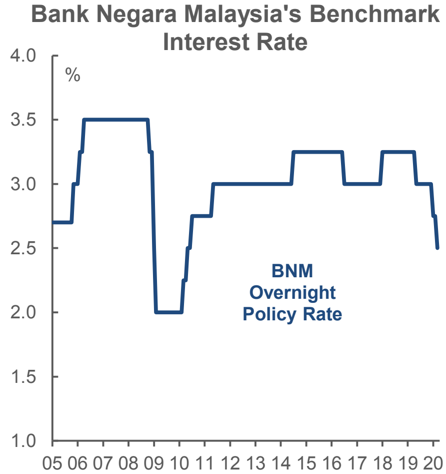
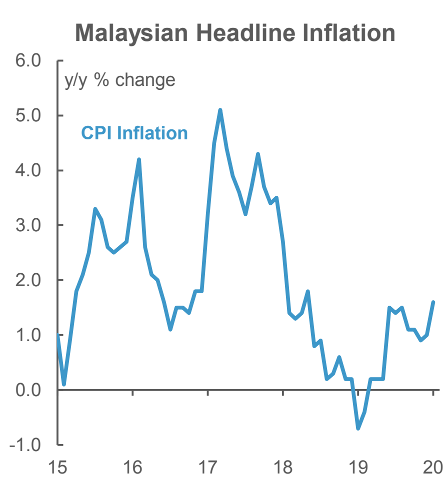
Chart 1



Sources: Scotiabank Economics, Bloomberg.

Chart 2



Sources: Scotiabank Economics, Bloomberg.