Monetary Loosening Continues in Malaysia

- **Bank Negara Malaysia lowered its benchmark interest rate by 25 basis points to 1.75% as the impact of the COVID-19 pandemic continues to weigh on the economy's outlook.**
- **Significant deflationary pressures have created further monetary easing space, if needed.**

Bank Negara Malaysia (BNM) continues to provide support to the Malaysian economy with additional monetary stimulus as significant downside risks to growth persist. Following today's monetary policy meeting, the BNM lowered the Overnight Policy Rate by 25 basis points to 1.75%, taking cumulative cuts to 125 bps since January 2020 (chart 1). The benchmark interest rate has been lowered at four consecutive monetary policy meetings, highlighting monetary authorities' concerns regarding Malaysia's economic outlook.

The Monetary Policy Committee (MPC) assesses that the Malaysian economy has been recovering since early-May when the gradual easing of COVID-19 containment measures began. Nevertheless, policymakers highlight that the outlook remains subject to both domestic and external downside risks, such as possible further COVID-19 outbreaks and re-imposed containment measures, persistent labour market weakness, and weaker-than-expected global recovery dynamics.

We agree with the MPC's view that the Malaysian economy has passed the worst. Nevertheless, real GDP growth will likely prove to be deeply negative in the second quarter of 2020, as the Movement Control Order constrained production and spending while recessionary conditions globally adversely affected the country's exporters. While we expect the economy to recover in the second half of the year, the rebound is unlikely to be strong enough to offset the lost output in the first half. Accordingly, we forecast Malaysia's real GDP to contract by 3.0% in 2020 with significant downside risks. In 2021, economic growth will likely rebound to 5½% y/y on the back of base effects, pent-up demand, and the lagged impact of expansionary fiscal and monetary policies.

Malaysia's inflationary pressures have completely evaporated over the past few months. Headline consumer price index has been in deflationary territory since March, decreasing by 2.9% y/y May (chart 2). Low commodity prices and non-existent demand-driven price pressures amid weakening labour market conditions will likely lead to further price declines. Indeed, the MPC expects the average headline inflation for 2020 to be negative. Persistent deflation over the coming months will keep the benchmark interest rate elevated in real terms, providing the BNM with additional monetary easing space if needed. We assess that one more cut of 25 bps is likely before the end of the year. There are two more scheduled monetary policy meetings in 2020, on September 10 and November 3.

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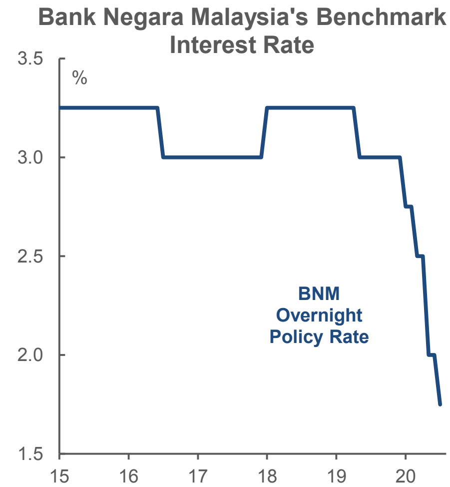
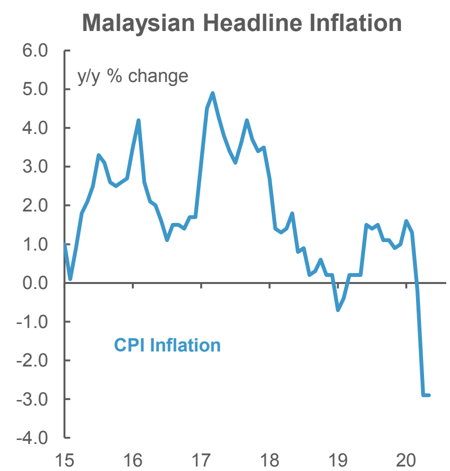
Chart 1



Sources: Scotiabank Economics, Bloomberg.

Chart 2



Sources: Scotiabank Economics, Bloomberg.

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