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Economic Research

SNAPSHOT

27 JANUARY 2023

BNM surprisingly paused OPR at 2.75%

Bank Negara Malaysia (BNM) has paused its tightening cycle during the first Monetary Policy Committee (MPC) meeting of 2023 by maintaining its Overnight Policy Rate (OPR) at 2.75% after four consecutive hikes totaling 100bps between May to Nov 2022. This decision will relieve entrepreneurs particularly SMEs to evaluate their financial health and build cash reserve, especially in preparing for a potential economic slowdown this year, arising mainly from external fronts. The pause was a surprise move as market (94% of economists surveyed on Bloomberg) expected a 25bps hike amidst a relatively solid economic data.

Domestic demand as reflected by high frequency data such as retail sales (*Fig. 1*) and industrial production continued expanding in recent months albeit at moderating pace but remained above pre-pandemic levels in 2019. Furthermore, consumers' excess savings built up during the pandemic years stayed comfortably above its long-term trend (*Fig. 2*).

Nonetheless, BNM justified its decision to maintain the OPR at 2.75% by citing the need to assess the impact of past cumulative OPR hikes on the economy. Given that monetary policy transmission via OPR has lag effects (12 – 18 months), we welcome the pause to allow its effect to filter through the economy. **Our base expectation is for OPR to stay at 2.75% throughout this year** in anticipation that headline and core inflation will continue to ease, barring unforeseen shocks or major policy shifts.

While core inflation is still above its historical average, headline inflation has slowed to 3.8% in December 2022 *(Fig. 3*). Knocked on effects from China re-opening, global commodity price developments and changes in domestic subsidy policies may put pressure on inflation. As such, **any further OPR hikes will be data-driven.**

Figure 1: Retail Sales

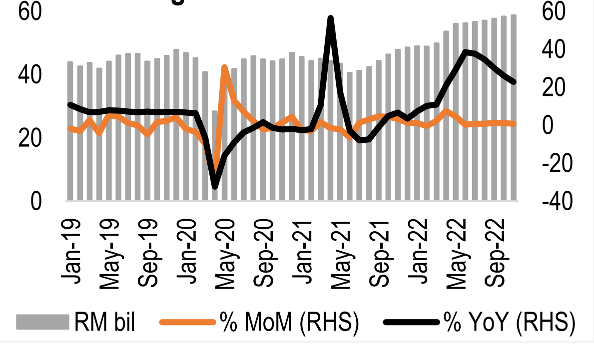


Figure 2: Savings: Total: Individuals

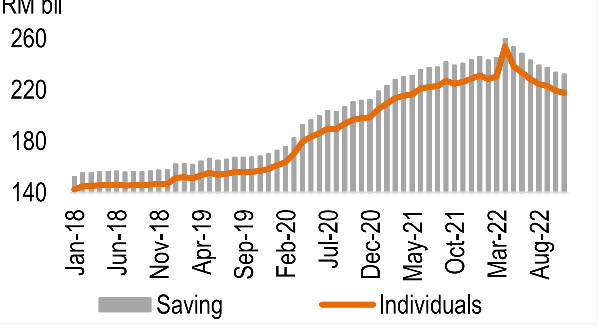
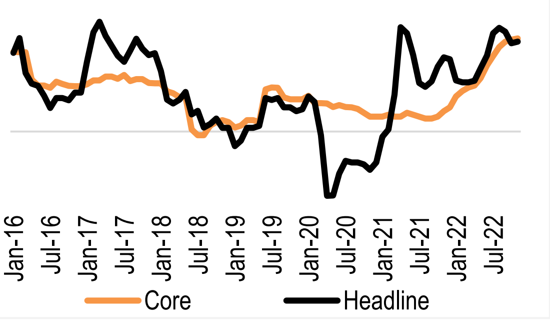


Figure 3: Inflation (%)



Source: CEIC, Bloomberg and SME Bank Economic Research

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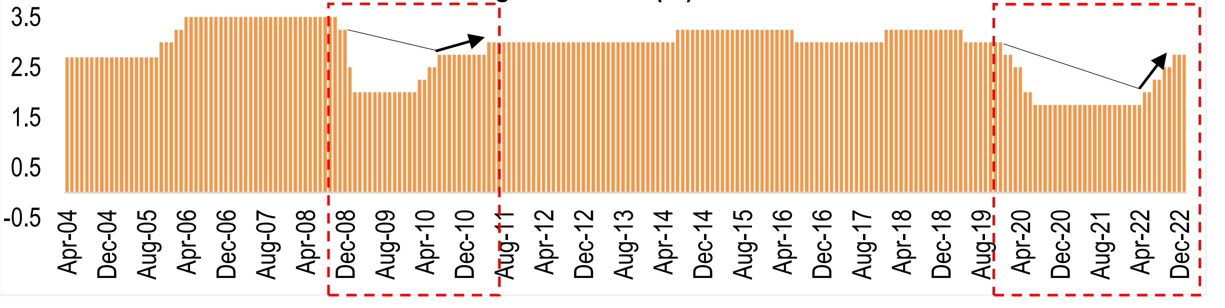
Based on observation from the past, BNM slashed its OPR rate by 150bps to 2.00% between 2008/09 and started its tightening cycle in 2010 to 2.75%. It then paused for 10 months before normalising by another 25bps in May 2011 to 3.00%. The OPR remained unchanged for 38 months before a 25bps hike to 3.25% in July 2014 (*Fig. 4*). Taking cue from BNM, we opine that the **OPR has not peak at 2.75% and there is still room for further tightening in the future.** Key events to look out for are 1) potential changes to subsidies mechanism which remain largely uncertain over the "right timing" amid concerns over the impact on cost of living, and 2) China's full economy reopening which has spill over effect to Malaysia's growth and inflation.

Figure 4: OPR (%)



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