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SNAPSHOT

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BNM normalises OPR

In line with SME Bank's expectation, Bank Negara Malaysia (BNM) raised its key Overnight Policy Rate (OPR) by another 25 basis points (bps) to 2.25%, after its earlier hike in May 2022. This is the first consecutive rate hike since 2010. Despite a total 50bps hikes thus far, the OPR rate of 2.25% remained below its pre-pandemic normalised rate of 3.10%.

BNM's stance is to ensure sustainable economic growth in an environment of price stability. Malaysia's economy expanded by 5.0% y-o-y in 1Q 2022, accelerating from 3.6% y-o-y in the previous quarter. Growth performance has been supported by improving domestic demand as economic activity picks up amid easing of Covid-19 restrictions. Recent key economic indicators also point towards a firm recovery. Retail sales – a proxy for consumer spending – surged 29.9% in May 2022, a continuation of its record strong double-digit growth of 20.9% from the previous month. In the labour market, unemployment rate declined further, with higher labour participation and improving income prospects.

Monetary policy normalisation is currently a global phenomenon as the low interest rates environment is no longer needed as economies embark on recovery path. Normally, central banks around the world will cut interest rates during periods of crisis to stimulate economic growth. It will then roll back these accommodative monetary policies i.e. raise interest rates during periods of strong growth momentum to alleviate inflationary pressure and prevent overheating in the economy.

Compared to global peers, Malaysia has been more cautious in taking this normalisation exercise. The US had so far raised its Federal Funds Rate by 150bps this year to tame inflation (May 2022: 8.6%). Upward pressure on prices of goods and services are mainly due to supply side disruptions and pent-up demand post reopening of the economy. Singapore, which uses an exchange rate-based monetary policy, had also tightened for the third time in 6 months. Although Indonesia and Vietnam have yet to hop on the bandwagon, their key interest rates of 3.50% and 4.00%, respectively, are far above Malaysia's 2.25%.

A higher OPR rate would be favourable to our exchange rate, to prop up the currently weak Ringgit (RM4.43 to USD1). Besides preventing capital outflows from Malaysia, a stronger Ringgit could reduce cost of imports. This in turn will benefit businesses that rely on foreign-sourced supplies and raw materials. SMEs that are planning to expand via purchases of machinery and equipment from abroad should stand to gain.

With the higher OPR rate, financing costs will become more expensive while interest or profit rates on deposit will rise. However, higher deposit rates are only likely applicable to new deposits. Existing customers whose financing contract is based on variable profit rate would see an increase in their monthly instalments.

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At present, high prices of commodities and other raw materials are being cushioned by Government subsidies and price controls. While headline inflation had been stable thus far as a result of these interventions by the Government, prices of some components especially food related items have been escalating. The impending removal of blanket fuel subsidy for a more targeted subsidies plan, alongside the removal of price subsidy for bottled cooking oil and higher ceiling prices of standard chicken and eggs, could exert upward inflationary pressures. However, the Government is taking steps to combat shortages of food supplies. Examples include the removal of Approved Permits for certain agro-food commodities and temporary halt in exports of chicken to secure sufficient supplies locally.

BNM has reaffirmed that the OPR normalisation process will be done in a measured and gradual manner so that it would not be detrimental to economic growth. SME Bank anticipates another 25bps hike in September before a pause to allow for the effects to filter through the economy. However, should inflation remain elevated with continuously large capital outflow due to the rising interest rate differential with the US Treasury, it is possible that BNM could raise OPR by another 25bps in November to end the year at 2.75%.