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ASSET MANAGEMENT

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FUNDAMENTAL FLASH

BNM Raises OPR to 3.00%

Prepared by AHAM Asset Management

What Happened?

Bank Negara Malaysia (BNM) has hiked the overnight policy rate (OPR) by 25bps to 3.00% at its monetary policy committee (MPC) meeting this week.

The decision was a surprise as market players expected BNM to continue to pause. Nonetheless, the decision was in line with our expectations.

We had expected BNM to normalise the OPR to a more neutral rate as Malaysia's economic growth remains strong and inflation remains elevated. Steady domestic demand and the prospects of potential subsidy rationalisation in the 2H'23 are other likely factors that weighed in its decision.

The meeting saw BNM withdrawing the monetary stimulus intended to address the COVID-19 crisis by fully reversing the pandemic rate cuts in the past.

BNM judged that despite downside risks to global growth, most central banks' monetary policy stance is likely to remain tight in the near term supported by strong labour market conditions and still sticky core inflation.

BNM pointed to further expansion in Malaysia's economic momentum in the first quarter of 2023 whereby consumption and investment activities were not affected by the past 100bps hikes in the OPR.

Flashpoints

- In a surprise move, BNM has hiked the OPR by 25 bps to 3.00% at its recent policy meeting.
- BNM pointed to resilience in domestic demand adding that despite downside risks to global growth, it was appropriate to normalise the OPR.
- Headline and core inflation are expected to moderate, between 2.8% – 3.8%.
- However, inflation risks could be tilted towards the upside as core inflation remains sticky amidst potential changes to subsidies.
- BNM is expected to pause from hereon due to a more challenging global growth outlook in the 2H'2023.

As such, domestic financial conditions remain conducive. Meanwhile, Malaysia's March headline CPI and core CPI eased to 3.4% (February: 3.7%) and 3.8% (February 3.9%). As domestic growth prospects remain resilient, BNM decided that it was timely to further normalise the degree of monetary accommodation.

Market Implications & Outlook

Although exports are expected to moderate, domestic demand is projected to remain the key growth driver for Malaysia's economy underpinned by improving labour market. Further support could come from a pick-up in tourism activity and the implementation of various infrastructure projects outlined in Budget 2023.

Headline and core inflation are expected to moderate, between 2.8% – 3.8%. However, BNM expects risk to the inflation outlook to be tilted towards the upside as core inflation remains at elevated levels due to firm demand and potential changes to subsidies.

We expect BNM to pause the OPR at 3% for the remainder of 2023 as we expect a more challenging global growth outlook in the second half of the year. BNM noted that at the current OPR level, the monetary policy stance is still slightly accommodative and remains supportive of the economy.

We see risks of further tightening should there be changes to the policy on subsidies which could lead to price pressures and resilient economic growth above BNM's 4-5% target. Although, this is not our base case.

Portfolio Positioning

We saw muted reaction in the bond market following the OPR announcement while the MYR rallied slightly. We forecast yields to trade range bound in the near term. Demand for bonds continue to be robust as real money investors return to the market as demand supply dynamics continue to be favourable in the near term.

We remain positive on the bond market as we believe the monetary policy hiking cycle approaches its peak and anticipate inflation to moderate albeit gradually. The expected slowdown in global growth or perhaps a potential recession in the developed market could serve as a catalyst for yields to move lower in the medium term.

On portfolio strategy, we maintain our preference for slightly long duration positioning for our fixed income portfolios. Due to the strong performance on year-to-date basis, we aim to selectively take profit on some of our positions and look for switching opportunities especially from the corporate bond primary market for yield pick-up.
