Dr Mohd Afzanizam Abdul Rashid
Chief Economist

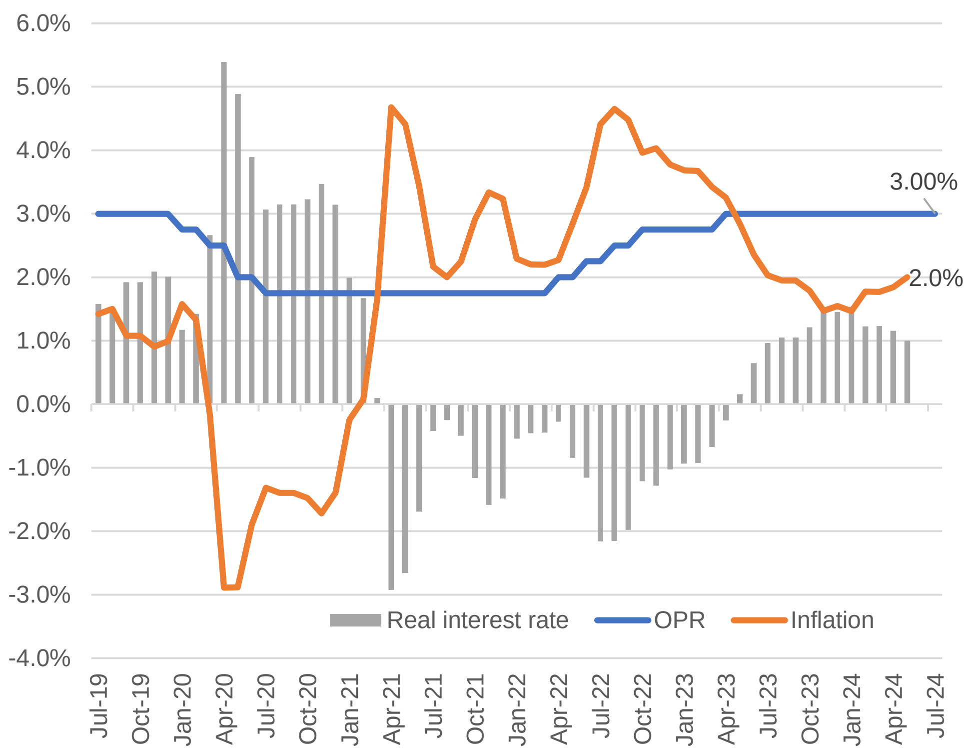
12 JULY 2024

Overnight Policy Rate (OPR) maintained at 3.00%

The BNM's Monetary Policy Committee (MPC) has decided to maintain the OPR at 3.00% during its recent meeting. This decision aligns with the consensus forecast. Based on the committee's statement, the MPC members are satisfied with both global and domestic economic trajectories, with balanced upside and downside risks since the start of the year. This indicates that the current monetary policy is well-suited to support the economy while minimizing the risk of rising inflation. On the inflation front, inflation rates are anticipated to increase in the second half of the year, influenced by potential changes in fuel subsidies and their impact on overall price levels.

As of May 2024, the real interest rate, which is the difference between the nominal OPR and the inflation rate, stands at 1.00%. This rate has decreased from 1.5% between November 2023 and January 2024, and 1.2% between February 2024 and April 2024. With the recent fuel subsidy for Diesel announced on June 10, 2024, and the upcoming announcement for RON95, we can expect the inflation rate to rise in the second half of 2024, consequently lowering the real interest rate further. By maintaining the nominal OPR, the decline in the real interest rate effectively increases the monetary policy accommodation.

OPR, inflation rate & real interest rate



Sources: Bloomberg & CEIC

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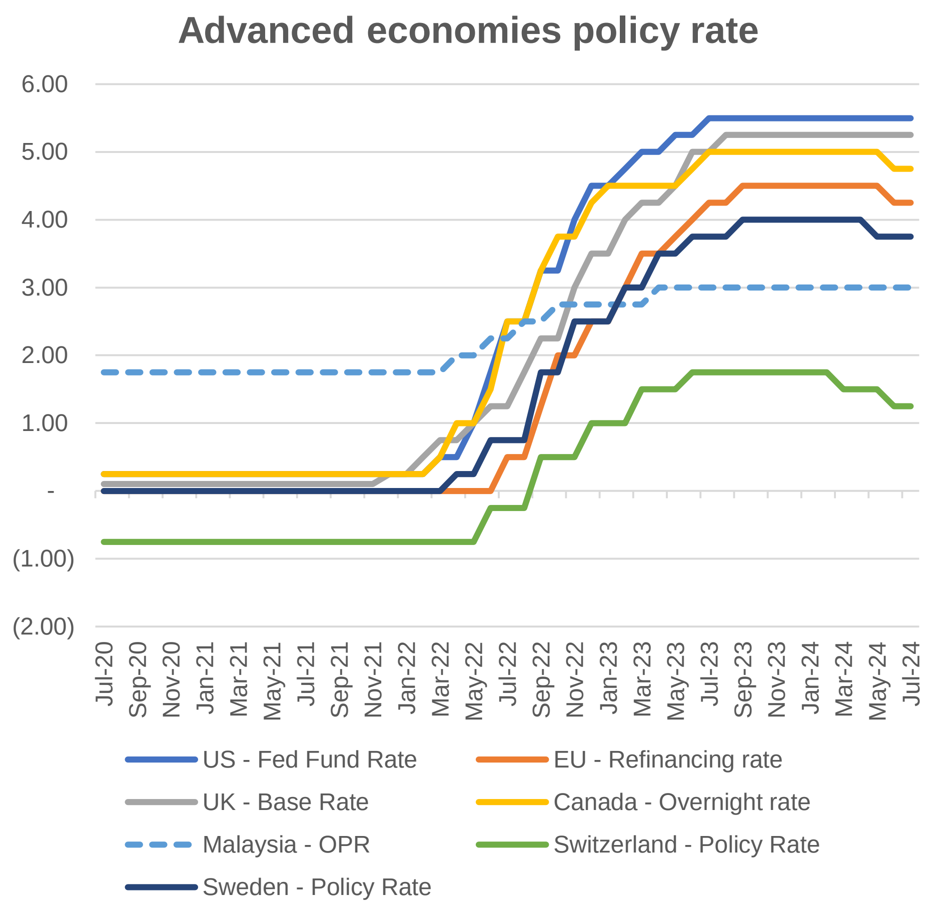
Interest rate differentials with the developed world would narrow

Regarding the ringgit, BNM continues to emphasize that its fluctuations are primarily due to external factors, such as monetary policy decisions of major economies and ongoing geopolitical tensions. However, coordinated efforts among GLCs and GLICs, as well as corporate engagement, have helped minimize currency volatility. In summary, it appears that BNM is likely to maintain the OPR at its current level for the remainder of the year, aiming to balance inflation and growth trajectories. On a global scale, interest rates seem to be on a downward trend. Major economies like Canada, Switzerland, Sweden, and the EU have recently reduced their benchmark interest rates. It is anticipated that the US Fed will follow suit, likely in September.

However, we do not anticipate that BNM will follow the same path as other central banks, as they will consider local factors such as the country's inflation outlook, particularly with the impending fuel subsidy rationalization. **As such, we maintain our OPR call at 3.00% throughout 2024**. In the broader context, the wide interest rate differentials with developed economies are expected to narrow, enhancing the ringgit's appeal. Positive reviews from Credit Rating Agencies (CRAs) like S&P and Fitch Ratings, along with improving assessments by foreign investment banks on Malaysia, are likely to attract more foreign funds. This influx would boost the value of the ringgit and help mitigate imported inflation. **On that score, we retain our year-end target for USDMYR at 4.65.**



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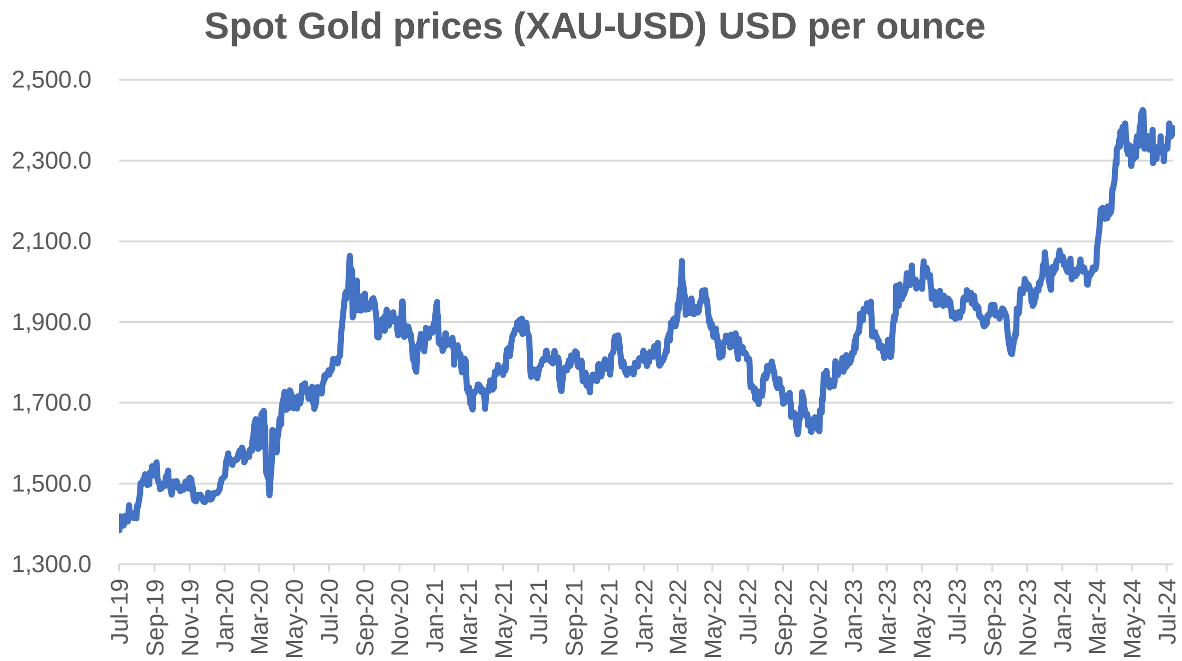
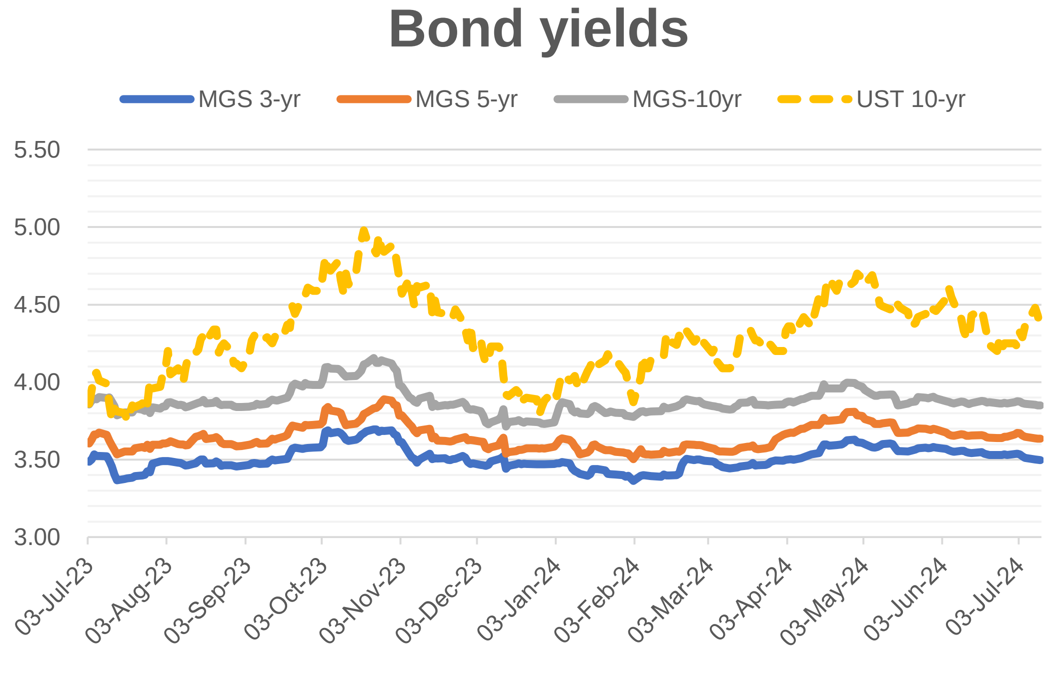
Lower global interest rate prospect is good for bonds and gold





Sources: Bloomberg & CEIC

Gold prices are expected to remain well supported due to their inverse relationship with the 10-year US Treasury yields (Correlation = -77.8%). Currently, spot gold prices are around USD2,400 per ounce and may test the previous record high of USD2,425.31 per ounce, achieved on May 20, 2024. Similarly, Malaysian Government Securities (MGS) yields are expected to decline if the 10-year US Treasury yield falls further. The positive correlation between MGS and the 10-year US Treasury yields will be the primary driver for lower yields (Correlation with the 10-year US Treasury yield: MGS 3-yr = 69.4%, MGS 5-yr = 70.9%, and MGS 10-yr = 71.5%). In summary, the anticipated US rate cut will have a significant impact on global markets.