

Thursday, 22 January 2009

Flash Notes

Malaysia: Surprisingly Large Rate Cut Signals Deep Economic Concerns

Bank Negara surprised market with a large 75bps cut to its Overnight Policy Rate (OPR) at its scheduled meeting on Wed (Jan 21) while market was just expecting a 25bps easing. This brings the OPR to 2.50%, the lowest since the central bank started to target the rate in April 2004. The Statutory Reserve Requirement (SRR) was also reduced from 3.50% to 2.00% with effect from Feb 1. The aggressive moves following the 25bps rate cut in November suggests concerns over the rapid deterioration in the incoming economic data and reassures investors that the BNM is ready to take more aggressive steps if necessary. Our 2009 GDP growth forecast of 0.9% for Malaysia incorporates expectation of a 'technical' recession in 1Q09. At the same time, domestic inflation has started to drop at a faster pace from November. Headline inflation nearly halved to 4.4%/y in December from a peak of 8.5% in August last year. With prices expected to come under more pressure from weakening demand, we expect Malaysia's inflation rate to drop significantly to 1.2% this year from an average 5.4% in 2008.

Growth concerns and falling inflation will see the BNM continue to cut rates further this year. We expect another 50bps cut in the OPR at the next monetary policy meeting on 24 February. In fact, many in the market are already expecting the policy rate to fall below 2% this year if the economic environment remains tough. On the fiscal front, there is also speculation that the government will be coming up with a second stimulus package soon but that will be somewhat constrained by the already large budget deficit of around 5% of GDP this year.

The MYR was little-moved by the monetary policy decision last evening. USD/MYR traded a tad lower to 3.6100 this morning from Wed's close of 3.6172. However, growth risks should put upward pressure on the pair in the near-term, probably pushing it to around 3.64 in the coming weeks.

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