FUNDAMENTAL FLASH

Rate Lift-off by Bank Negara Malaysia

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BNM Hike Rates as Recovery Gains Momentum

In a surprise move, Bank Negara Malaysia (BNM) raised the Overnight Policy Rate (OPR) by 25bps to 2.00% on 11 May 2022, the first rate hike since January 2018.

A more positive view on Malaysia's economic growth outlook as seen in 1Q'2022 industrial production that grew 4.5% y-o-y and a steady fall in unemployment rates indicate a more sustained recovery.

On inflation, BNM's projection for headline inflation is at 2.2%-3.2%, while core inflation is at 2.0%-3.0%. This is more aggressive compared to its view in March, where the central bank expected core inflation to normalise to its long-term average (i.e. below 2%).

We believe global factors such as a more aggressive rate hike cycle by the US Federal Reserve (Fed) and other global central banks was also a consideration in BNM's decision.

Lastly, the central bank believes it is also timely to start unwinding its pandemic-related cumulative rate cuts of 125bps. However, it has that guided that policy normalisation will be 'measured and gradual'.

Flashpoints

- BNM's decision to raise interest rates came as a surprise in terms of timing.
- However, it is seen as a pre-emptive move amidst continued domestic recovery and the Fed's hawkish stance.
- BNM is expected to continue its path towards normalising monetary policy in the 2H'22.
- Though, the pace would be 'measured and gradual' as downside risks to growth stemming from the Russia-Ukraine conflict and COVID lockdowns in China remain.
- Local bond yields have moved higher this year, though investors remain on the side-lines as they await for catalysts.

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We expect BNM to continue normalising monetary policy in the 2H'2022 with 2 more 25bps rate hikes bringing the OPR to 2.50%; as well as a further 2 rate hikes in 2023 lifting it to 3%.

This is of course subject to recovery momentum continuing as downside risks to growth remain. These include the continued Russia-Ukraine military conflict as well the strict COVID containment measures in China that could worsen commodity price shocks and supply chain disruptions.

MGS yields saw a knee-jerk response to the unexpected news by moving 3-15 bps higher post-OPR hike decision with shorter tenures moving the most on thin trading liquidity seen. Meanwhile, corporate bond yields were less impacted and remained steady.

In the near-term, we expect investors to remain on the side-lines while waiting for catalyst amid heightened external driven volatility and poor local sentiment stemming from concerns over the EPF withdrawal scheme which saw local bond yields moving higher by 80-100bps on a YTD basis. We believe at this level, the bond market has already priced in 4-5 further rate hikes.

Portfolio Positioning

Our Fixed Income portfolios including Affin Hwang Bond Fund and Aiiman Income Plus Fund have shifted to a more defensive positioning over the past few months. We have reduced the portfolio duration and increased the cash level to 10%-12%.

Although, the risk-reward dynamic has actually turned attractive, we are still mindful of volatile UST, potential foreign outflows and a high government bond supply in the near-term.

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