The Bank's Policy Consideration

HIGHLIGHTS

- **At the current level of the OPR, the stance of monetary policy is accommodative and supportive of economic activity.**
- **Current macroprudential and other measures to manage financial imbalances in the household sector and property market remain adequate, as associated risks are largely contained.**

The MPC maintained the OPR at 3.00%

At the January and March Monetary Policy Committee (MPC) meetings, the MPC maintained the Overnight Policy Rate (OPR) at 3.00%. At the most recent meeting in May, the MPC also maintained the OPR at 3.00%. At this level of the OPR, the stance of monetary policy is accommodative and supportive of economic activity.

The Malaysian economy is expected to perform better in 2017 compared to the 4.2% growth in 2016, driven by domestic demand growth and positive contribution from the external sector. The growth in exports is expected to continue to provide support to overall growth, due in part to expectations for faster global growth. Headline inflation is also projected to be higher in 2017, reflecting primarily the pass-through impact of the increase in global oil prices on domestic retail fuel prices. The decision by the MPC to maintain the OPR was based on the assessment that the recent increase in inflation would be transitory. Monetary policy is not the appropriate tool to address cost-push inflation. Going forward, the MPC will monitor closely the degree of spillover of the higher costs to the broader price trends and overall demand conditions.

Bank's Financial Stability Committee (FSC) assessed that domestic financial stability remains preserved

During the quarter, the FSC observed that key sources of risks to domestic financial stability continue to stem from high levels of domestic debt, elevated property prices in some segments of residential property and an oversupply of commercial property, and persistent volatility in financial markets. The FSC assessed that risks associated with household debt and corporate sector leverage are largely contained and current macroprudential and other measures are adequate. Credit conditions and supply remain conducive to economic needs. The FSC opines that increased vigilance is required over commercial property developments, loan performance in some business segments and lending activities of non-bank financial institutions.

Given the anticipated persistent volatility in global financial markets and investor sentiments, the Bank will further assess the impact of foreign participation in the local bond markets on domestic financial stability. In April 2017, the Financial Markets Committee, together with the Bank, also announced a number of initiatives to promote a fair and effective financial market, improve bond market liquidity, ease hedging activities and enhance market transparency. In the coming quarters, the Bank will continue to monitor the progress and assess the potential effects of the removal of tariffs for all existing motor products (except motor third party products), and the transition towards mandatory PIN verification for payment cards, both of which come into effect from 1 July 2017.

Macroeconomic Outlook

HIGHLIGHTS

- **Global growth to expand at a faster pace in 2017, supported by improvements in both advanced and emerging market economies.**
- **The Malaysian economy on track to register higher growth in 2017.**
- **Inflation may have peaked in the first quarter, outlook remains contingent upon movements in oil prices.**

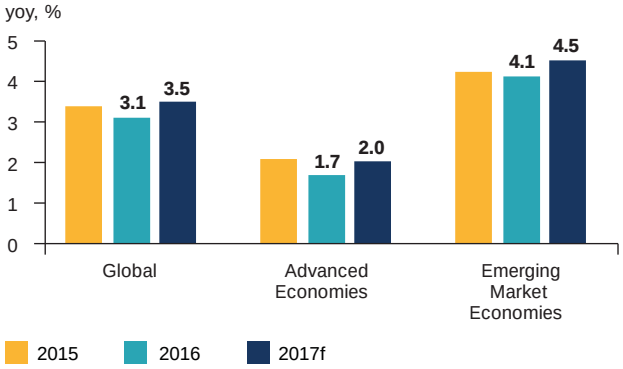
Global growth to expand at a faster pace, supported by improvements across regions

Global growth enters the year 2017 on a stronger footing with positive economic data releases across regions. In the advanced economies, private consumption continues to support domestic activity amid improvement in the labour market conditions and recovery in household wealth. Recent data suggests a more favourable outlook for investment compared to 2016, which will translate into stronger global trade. Growth in the emerging market economies is benefiting from the recovery in commodity prices as external demand improves. This outlook is reinforced by sustained domestic demand against a supportive policy environment. Against this backdrop, global growth is expected to expand at a faster pace in 2017.

Despite these developments, the balance of risks to global growth remain tilted to the downside. Of immediate concern are the developments in Europe which are generating policy uncertainties, as indicated by the higher reading in the economic policy uncertainty index in the first quarter. The short-term impact is likely to be felt more in the financial markets. However, over a longer term, changes in financing conditions will affect real economic activity. The threat of protectionism and negative developments in the prices of key commodities are also risk factors that the Bank is monitoring.

Chart 44: Real GDP Growth

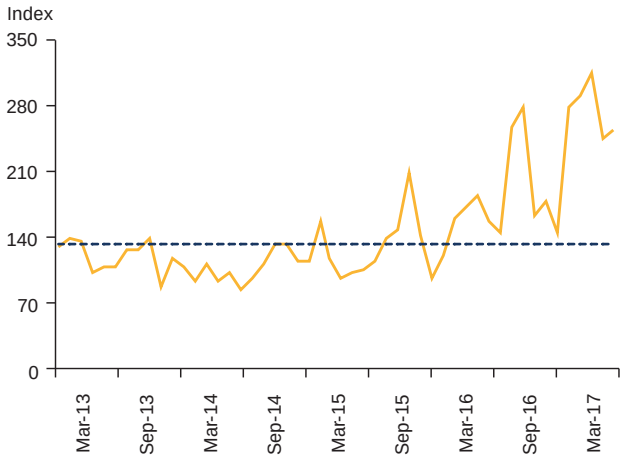
Growth Improvements Projected Across Regions in 2017



Source: International Monetary Fund

Chart 45: Global Economic Policy Uncertainty Index

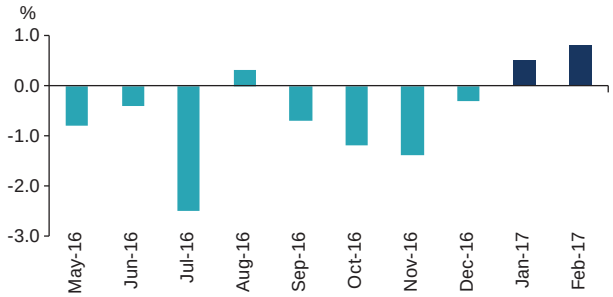
Heightened Global Economic Policy Uncertainty



Source: Baker, Bloom and Davis

Chart 46: Composite Leading Index

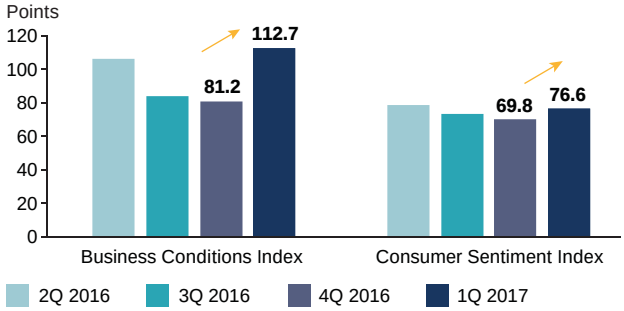
Leading Indicator Points to Continued Expansion in the Domestic Economy



Source: Department of Statistics, Malaysia

Chart 47: MIER Business Conditions and Consumer Sentiment Indices

Sentiment Indicators Improved in 1Q 2017



Source: Malaysian Institute of Economic Research

The Malaysian economy on track to register higher growth in 2017

The Malaysian economy continued to expand in the first quarter of 2017, driven mainly by domestic demand activity. Looking ahead, leading indicators such as the Department of Statistics Malaysia's composite leading index, MIER Business Conditions Index and MIER Consumer Sentiments Index, point to continued expansion of the domestic economy. Private consumption will be sustained by continued wage and employment growth, with additional lift coming from various policy measures to raise disposable income. Investment activity is projected to expand, driven mainly by the implementation of new and ongoing projects in the manufacturing and services sectors. The stabilisation of commodity prices is also expected to lend support to investment activity in the mining sector. On the external front, exports are expected to benefit from the improvement in global growth, especially among Malaysia's key trading partners. Overall, the economy remains on track to expand as projected in 2017.

On the supply side, the improvement in external trade will benefit the export-oriented industries in the manufacturing and services sectors, particularly the E&E industry and trade-related services. The agriculture sector will continue to recover as CPO yields improve post-El Niño. Growth in the mining sector is projected to be supported by output from the ramping up of production in new oil and gas facilities. In the construction sector, new and existing civil engineering projects will drive the sector going forward.

Inflation expected to moderate from second quarter onwards

Inflation increased to 4.3% in the 1Q 2017 driven by higher costs, but is expected to moderate in the second quarter onwards. However, compared to the forecast at the beginning of the year, the upside risks to global oil prices have increased given the rising geopolitical tensions in the Middle East and the possibilities of an extension to OPEC's output cut agreement. While the impact of these developments on global oil prices remain limited at this juncture, if they persist, inflation could average higher than forecasted.