The Bank's Policy Considerations

HIGHLIGHTS

- The MPC kept the Overnight Policy Rate unchanged in May and July, maintaining the degree of monetary accommodation amid the positive domestic demand outlook.

The OPR remained accommodative

In May and July 2018, the Monetary Policy Committee (MPC) maintained the Overnight Policy Rate (OPR) at 3.25%.

The Malaysian economy continued to expand in the first half of 2018, supported by private sector activity. In terms of growth prospects, the MPC assessed that growth of the domestic economy is expected to remain firm. Private consumption will be underpinned by continued wage and employment growth, with an additional lift from higher household spending due to the zerorisation of the GST. Investment activity is projected to be supported by capacity expansion mainly in the export-oriented industries and ongoing infrastructure projects. The external sector will continue to benefit from the continued expansion in global growth, despite emerging risks amid escalation of trade tensions.

Headline inflation in 2018 is projected to be lower compared to the forecast earlier in the year. This revised forecast has taken into account the anticipated impact of recent policy measures, including the zerorisation of the GST and the fixing of retail fuel prices, on domestic cost factors. However, the low inflation environment is expected to be transitory, reflecting the one-off impact of the policy measures that would lapse from the second half of 2019. Core inflation is nevertheless expected to remain relatively stable in line with sustained private sector spending.

The MPC will continue to monitor key risks from any material shifts in the prospects for domestic growth and inflation. Risks to the global outlook have tilted to the downside from more balanced prospects earlier in the year, reflecting the escalating trade tensions, and spillover effects from global liquidity shifts in an environment of monetary policy normalisation. Domestically, the growth outlook will be further supported with greater certainty in policy in the coming months. The inflation outlook is subject to uncertainties from the extent of pass-through from the policies on consumption tax to prices.

The positive domestic demand outlook, sound financial sector and improving current account surplus of the balance of payments will continue to support Malaysia's fundamentals. Domestic financial markets have remained resilient through heightened volatility caused by non-resident portfolio outflows. The ringgit exchange rate would be more reflective of the underlying fundamentals of the economy when the external and domestic uncertainties recede. The domestic monetary and financial conditions remain supportive of economic growth. Monetary operations will continue to ensure sufficient liquidity to support the orderly functioning of money and foreign exchange markets and intermediation activity.

Domestic financial stability remain preserved

Domestic financial stability continued to be preserved, while overall level of risks remain contained and unchanged. Domestic financial institutions remain resilient with banks continuing to be well-capitalised, and having sufficient liquidity to support the financing needs of the real economy. Households continue to record low impairment levels amid sustained debt servicing capacity. Overall risk outlook for the business sector remains stable. Direct risks from exposures to the non-residential property segment, where certain segments continue to face an oversupply situation, remain low as banks maintain sound underwriting standards. A more comprehensive assessment on risks to financial stability will be published by the Bank in September.

Other policy highlights in the second quarter of 2018

Development financial institutions (DFIs) play a crucial role in developing strategic sectors in the economy. To enable DFIs to pursue such development mandates sustainably, it is important that DFIs continue to provide credit intermediation in a prudent manner. As part of the Bank's continued efforts to enhance financial institutions' risk management practices, DFIs have been encouraged to adopt relevant standards and practices set out in the credit risk policy document issued to financial institutions. Concurrently, the Bank will continue to engage closely with DFIs in establishing prudential standards on credit risk management that is tailored to reflect their roles and mandates.

In line with the increasing depth and breadth of Islamic finance, the Bank issued two policy documents that specify the Shariah and operating requirements relating to Ijarah and Bai' al-Sarf (currency exchange) contracts. The policy documents highlight salient features of the respective contracts and outline regulatory expectations on governance, risk management, disclosure and business conduct for both contracts.

The Bank has also published two exposure drafts to further develop the takaful sector in Malaysia. The Trade Credit Insurance and Trade Credit Takaful exposure drafts are intended to position insurance and takaful products to better meet the protection needs of businesses. Proposed revisions to the current Takaful Operational Framework have also been issued for public consultation. The revisions are aimed at spurring greater innovation in the takaful sector while safeguarding the best interests of takaful participants.

In view of the increasing frequency and ferocity of cyber-attacks, PayNet, the operator of shared payments infrastructures for Malaysia, issued guidelines on cyber resilience for participants of its services. The guidelines seek to provide PayNet's participants, including financial institutions, with guidance to assess and improve their ability to prevent, detect and respond to cyber-attacks. The guidelines also include protective measures to mitigate cyber risks relating to PayNet and the ecosystem as a whole.