

## Behind the Scenes of Bank Negara Malaysia's Monetary Policymaking

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At some point, you may have come across these types of headlines when browsing the news or social media. The topic could have also surfaced during a chat with your family and friends, and you may have wondered – Who and what is the 'MPC'? Why are they making these decisions? Why would they raise the interest rates when the cost of living is already high? These are all valid questions, and this article aims to shed some light on these and related issues. In particular, we'll look into what Bank Negara Malaysia's Monetary Policy Committee (MPC) is and what they do, in addition to a 'behind the scenes' look at MPC meeting preparations.

### Part I: The MPC – What is it and what do they do?

Let's start with the big picture. Bank Negara Malaysia (BNM) is tasked with promoting monetary and financial stability, and fostering a sound and progressive financial sector to achieve sustainable economic growth. Simply put, monetary stability means keeping prices in check so the economy can steadily grow over time. Stable prices create a reliable environment for investment and spending, which are crucial for long-term growth and job creation. However, while stable prices are important, they're just one ingredient towards a strong and healthy economy. For BNM, a dedicated committee is charged with this mandate of promoting monetary stability – the Monetary Policy Committee (MPC). The MPC sets monetary policy<sup>1</sup> by adjusting the Overnight Policy Rate (OPR).<sup>2</sup> The refresher box explains in more detail why price stability is important and what happens when the OPR is changed.

<sup>1</sup> Monetary policy is the action that BNM takes to influence interest rates in the economy.

<sup>2</sup> The OPR is BNM's policy interest rate that influences, among others, banks' lending and financing rates, as well as deposit rates. This means that even if you do not have loans, changes in the OPR could still affect you through changes in returns for deposits and savings, among others. Changes in the OPR affect economic activity and overall price level changes, typically by influencing interest rates in the economy.



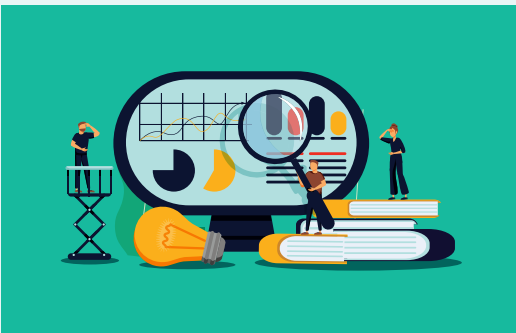
## Let's refresh our memories on some key monetary policy concepts.

### Why is price stability important?

- When inflation is low and stable, it means that changes in the overall level of prices are stable and predictable. This is important because if prices keep changing and are hard to predict, it is difficult for households and businesses to plan how much they can spend, save or invest. This will then affect economic activity and growth.
- When prices increase rapidly or significantly, it hurts our purchasing power. High and unstable inflation affects everyone, but it hurts lower-income households the most. Compared to the higher-income group, a larger share of their spending is on essential purchases like food and housing.
- High inflation also makes it harder for businesses, which may face higher costs to produce goods and services, or lower sales if the high prices affect consumers' demand. This can then affect business sales and profits. When prices keep changing, businesses also find it difficult to plan and invest for the future. For savers and retirees, high inflation eats into their savings. Rapid increases in prices will quickly erode the purchasing power of savings.
- Conversely, having a long period where overall prices are falling is not good either. This is known as deflation, which is bad when it is due to a collapse in demand. When this happens, many people lose their jobs and there is more uncertainty and financial stress. As a result, there would be lower investment and spending. Businesses would have to cut prices to attract consumers, but people would not spend as their finances are uncertain and they wait for prices to come down even more. Like high inflation, deflation is also harmful to the economy.



### What happens when the MPC changes the OPR?



- When the MPC decides to raise the OPR, higher interest rates on savings and loans will influence people to save more and spend less. For example, when the demand for goods and services in the economy is more than the supply available, prices will keep rising. The higher OPR will help to slow demand down. This brings demand more in line with supply and prices would increase more slowly.
  - The reverse happens when the MPC decides to reduce the OPR. Lower interest rates on loans and savings will get people to save less and spend more. This spurs economic activity and avoids a situation of falling price levels due to weak demand, which will hurt the economy.
- It's important to understand that the OPR is a 'blunt tool'. Even though the MPC tries to maintain stable prices and keep the economy growing steadily over time, its actions do not affect everyone in the same way. Monetary policy cannot target specific parts of the economy precisely, but it is needed to set the overall interest rate conditions.

Source: Adapted from BNM's Monetary Policy Frequently Asked Questions (FAQs)  
(<https://www.bnm.gov.my/monetary-stability#mpfaq>)



The MPC is chaired by the Governor and the members comprise the Deputy Governors and up to seven other members. The composition of the MPC aims to ensure a broad range of technical expertise and perspectives in monetary policy discussions, rather than representing specific interest groups. Since 2015, individuals outside BNM have also made up the MPC, known as external MPC members. Having external members is highly beneficial as they bring diverse viewpoints, specialised knowledge, and additional insights to the table when it comes to making decisions about monetary policy. This gives a more well-rounded and informed view on various issues that complement the expertise of the internal MPC members.

## Part II: What goes into an OPR decision?

To understand how a decision on the OPR is made, it's helpful to look at it in two key parts: i) **the analysis** – the areas the MPC analyses and forecasts and ii) **the process** – the step-by-step journey from gathering information to arriving at the final policy decision.

### The analysis

At the heart of it all, the standard questions the MPC has in mind for each MPC meeting are:



In pursuit of maintaining low and stable prices while fostering a steadily growing economy over the long term, the MPC's guiding 'north star' in terms of economic variables is growth and inflation. Importantly, the MPC always looks ahead when setting monetary policy. This is because the full effects of OPR changes on economic activity and inflation do not happen right away. According to some estimates, it can take up to two years for monetary policy to have the most effect on the economy.<sup>3</sup> This is why understanding the growth and inflation outlook (where the economy is heading) is crucial for the MPC.

<sup>3</sup> For example, the European Central Bank has said that tighter monetary policy can take almost two years to have the most effect on inflation, which is the same case for Malaysia.

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**A key part of assessing the outlook is having a grasp of how the economy is currently performing.** The MPC looks at areas that span the latest economic, monetary, and financial market developments and outlook. They tap into a range of information and insights, which cover in-house data and information, expertise of BNM staff, engagements with various economic players – from households to SMEs to large corporates, and academic research. These sources are used in tandem with data and information from Government agencies like Malaysia's Department of Statistics, on top of analyses and forecasts from other central banks, international institutions, and private sector economists.

Diagram 1 provides a broad overview of the surveillance areas that BNM staff<sup>4</sup> look at. The economic growth assessments start with the global economy, which matters as Malaysia is a small and open economy, affected by what happens beyond our borders. For the domestic economy, staff would cover areas spanning consumption, investment, and trade, among others.

Inflation, the rise in the overall price level of goods and services, is another crucial aspect to assess. Understanding the dynamics of inflation is key as it directly influences purchasing power, and how people spend their money. For businesses, it would determine how much it would cost to produce goods and services. In our surveillance, a broad range of indicators are monitored. These include key price measures like the Consumer Price Index and Producer Price Index, factors influencing demand and supply, as well as inflation expectations gauged through BNM's Consumer Sentiment Survey (CSS).<sup>5</sup>

**Diagram 1: Broad Overview of Main Surveillance Areas and Selected Key Indicators Used**



Note: This list is not exhaustive

Source: Bank Negara Malaysia

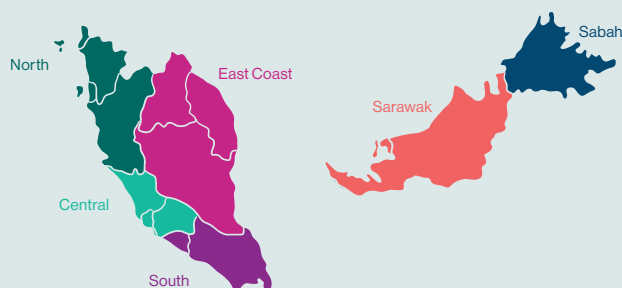
<sup>4</sup> These staff are mainly from the departments that focus on monetary policy, economics, and investment operations and financial markets in BNM.

<sup>5</sup> The CSS, which commenced in 2013, captures how households feel about economic growth, inflation, wages and borrowing costs. This is important to know, because expectations may influence people's spending decisions, which affects the economy.

Financial market assessments also come into the picture as markets and financial institutions are important channels through which monetary policy affects the economy. Their performance is closely linked to global economic trends and conditions, influencing liquidity, interest rates, and credit availability, which are essential for businesses and consumers. Staff also assess domestic financing conditions, including lending rates, the availability of credit for borrowers, and the presence of financial imbalances.

**While these developments provide insights into how the economy is doing, they also feed into the question of where the economy is heading through forecasting exercises.** These forecasts, developed by staff with the help of technical models and judgement, project what would happen next. For example, there would be numbers for what inflation and economic growth are estimated to be in the next few quarters or years ahead. However, projections can never always be spot on. They are frequently updated to reflect new information, especially when there is a lot of uncertainty. Yet, while never 100% accurate, forecasts provide a good guide for MPC members to form their views on what monetary policy should do.

The main assessments are indeed based on data and models. However, integrating on-the-ground insights is crucial for gaining early and better understanding of the outlook. These insights are sourced by BNM's Regional Economic Surveillance team. They are stationed in major economic hubs across the country,<sup>6</sup> covering surveillance in the surrounding regions. The BNM economic liaison officers engage regularly with industry players and businesses, delving into their economic and inflation outlooks, sentiments, and business strategies. The surveillance enables the MPC to grasp how evolving developments and domestic policies are impacting various sectors of the economy. Such reliance on firsthand insights is a vital bridge connecting us with timely, forward-looking, and qualitative information that fills in the gaps left by statistics alone.<sup>7</sup>



Lastly, staff put together the relevant information to inform a monetary policy strategy. This involves assessing the balance of risks to growth and inflation and conducting scenario analyses. Staff also highlight aspects of the monetary policy communication strategy.

Ultimately, each of these assessment areas serves as a puzzle piece. They contribute to the formation of a comprehensive picture of the Malaysian economic landscape, where it's headed, and how monetary policy should respond. Depending on the circumstances, some MPC meetings might dive into specific issues or research.

**After piecing together the puzzle, the MPC would come to a decision, which is made autonomously.** Although the process is far more nuanced, it boils down to the balance of risk to domestic growth and inflation.

### The Monetary Policy Committee makes monetary policy decisions autonomously

Recall that the MPC is guided by its goal of stable prices and sustainable economic growth. If inflation is likely to be too high for a long time while signs point to strong growth, the MPC would typically tighten monetary policy by increasing the OPR. In assessing the inflation outlook, what's crucial for the MPC are its drivers – whether the forecasted higher inflation stems from higher consumer demand or because the cost of making goods has gone up. Understanding the root cause is key because monetary policy is most effective in tackling demand-driven inflation.<sup>8</sup> Meanwhile, looser monetary policy (i.e. lower policy rates) would be essential in a situation of weak growth and low inflation. This would help spur growth and ward off deflation (which is also not desired). There are also risks of keeping the OPR too low for too long. Doing so when

<sup>6</sup> Namely Johor Bahru, Kuala Terengganu, Pulau Pinang, Kota Kinabalu, and Kuching.

<sup>7</sup> For more details, see the box article from the 2013 Annual Report titled 'Broadening Economic Surveillance through Bank Negara Malaysia's Regional Offices' ([https://www.bnm.gov.my/documents/20124/830154/cp01\\_002\\_box.pdf](https://www.bnm.gov.my/documents/20124/830154/cp01_002_box.pdf)).

<sup>8</sup> There are times when higher costs set off a ripple effect, leading to a series of other price increases across the economy (including instances where workers demand higher wages). In this case, monetary policy would be effective in addressing the higher inflation.

the economy is healthy can lead to higher inflation. It can encourage excessive borrowing by individuals and businesses, potentially causing financial imbalances.

**The OPR adjustments following the economic recovery in 2022 offer a real-life example of the MPC's considerations.** During the COVID-19 crisis in 2020, the MPC cut the OPR from 3.00% to a historic low of 1.75% to help the economy stay afloat. By 2022, more material signs of recovery had appeared as the lockdown was lifted. It became clear to the MPC that the economy was on a firmer footing.

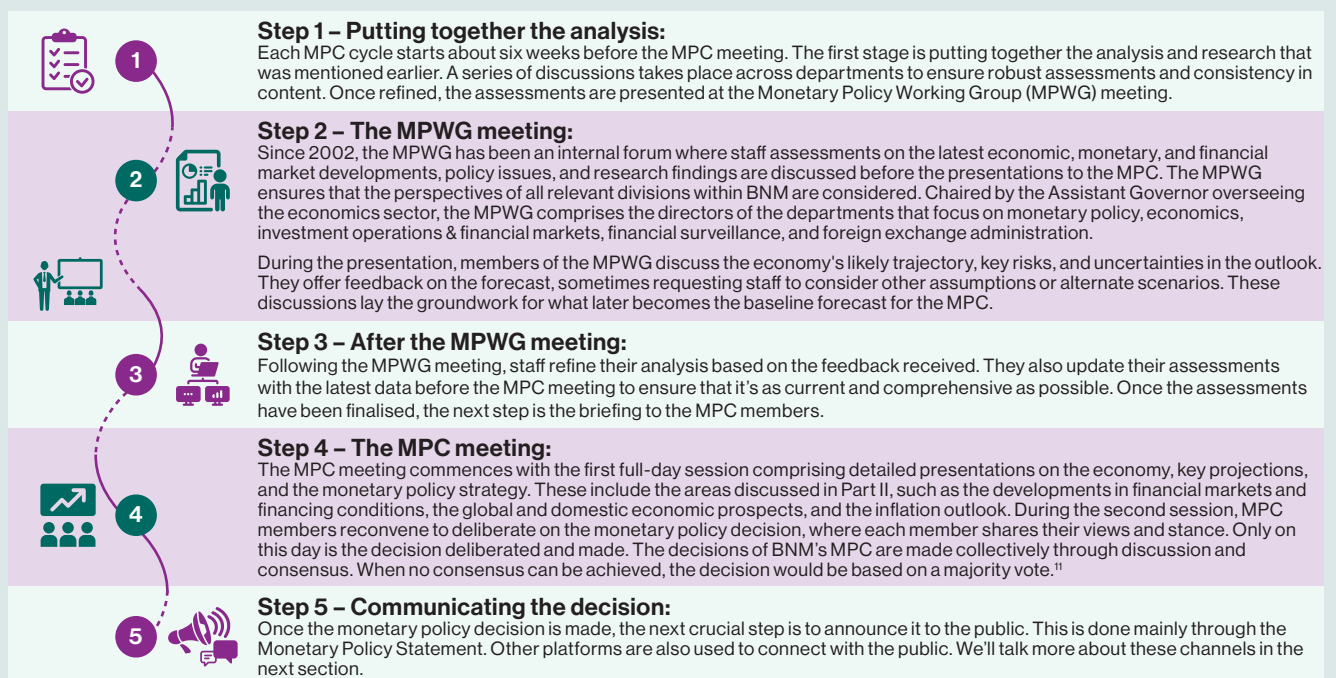
The MPC judged that it was the right time to remove the large monetary policy support provided during the COVID-19 crisis. The MPC gradually raised the OPR to reach 3.00%, a move which would also curb risks of financial imbalances from prolonged low rates. Amid the environment of high costs, the MPC also started seeing early signs of inflation caused by rising demand. Thus, the MPC viewed that the OPR hikes were also needed to prevent price pressures from building up and hurting households and businesses.

There are times when making monetary policy decisions is often far from black and white. The economy might face periods of low growth and high inflation, posing a dilemma where reducing the OPR could lift growth but also risk fueling inflation further. In such cases, the MPC has to navigate the delicate balance between stimulating growth and controlling inflation.<sup>9</sup> In addition, coordination with fiscal policy is crucial. Both monetary and fiscal policies should complement each other to ensure a more effective and coordinated approach to achieving a healthy economy.<sup>10</sup>

### The process

Now that we've explored the content of MPC assessments, let's now see how it all comes together. The MPC meets at least six times a year to discuss and decide on monetary policy. These sessions are scheduled and announced in advance, with the dates for the next year's meetings disclosed to the public at the end of each year.

### Diagram 2: Bank Negara Malaysia's MPC Decision-Making Process



Source: Bank Negara Malaysia

<sup>9</sup> Moreover, there could be times when a monetary policy decision impacts BNM's other mandates, like financial stability, which could pose another tradeoff. For more details about such tradeoff, see the box article from the 2014 Annual Report titled 'Financial Imbalances and Policy Responses in Malaysia' ([https://www.bnm.gov.my/documents/20124/829724/cp03\\_001\\_box.pdf](https://www.bnm.gov.my/documents/20124/829724/cp03_001_box.pdf)).

<sup>10</sup> To learn more about this topic, see the box article in the 2023 Economic and Monetary Review titled 'Navigating Economic Cycles: Interactions Between Monetary and Fiscal Policy'.

<sup>11</sup> For more details, see the box article from the 2015 Annual Report titled 'Evolution of the Monetary Policy Committee of Bank Negara Malaysia: Key Milestones over the Years' ([https://www.bnm.gov.my/documents/20124/829207/cp03\\_001\\_box.pdf](https://www.bnm.gov.my/documents/20124/829207/cp03_001_box.pdf)).

### Part III: How does the MPC communicate its monetary policy decisions to its stakeholders?

Now that we have unpacked the different assessment areas that the MPC looks at, let's shift to what happens after an OPR decision has been made. The crucial next step is communicating this decision to the public. Such communication is key because it will also shape how households, businesses, and investors view the future of the economy, which affects their spending and investment choices. When people have a better sense of the economy and monetary policy, they can make more informed financial choices. This helps achieve the outcomes the MPC aims for.

The MPC communicates its decisions primarily through the Monetary Policy Statement (MPS, Diagram 3). The MPS is a press release from the MPC, informing the stakeholders of the monetary policy decision taken by the MPC and why. This statement sets out the MPC's assessments of how the economy is doing, both globally and domestically, and provides insights into their expectations for Malaysia's future inflation and economic growth. The MPS is released on BNM's website following an MPC meeting.

**Diagram 3: Breaking Down the MPS**



**See also:**  
 1. Monetary Policy Statement (MPS) Snapshot: July 2023  
 2. Frequently Asked Questions

**Bank Negara Malaysia**  
**6 July 2023**

Source: Bank Negara Malaysia

Beyond the MPS, the information on monetary policy is conveyed to a wider universe of audiences through various other channels. These include press conferences, typically held after key report releases such as the Quarterly Bulletin and the Annual Report. In these sessions, BNM fields questions on monetary policy to provide clarity and further explanations. BNM also engages with analysts, media, and Government officials as part of the communication approach. For instance, briefings with analysts, industry practitioners and academics are held after most MPC meetings. These interactions offer deeper insights into the nuances of monetary policy decisions and the economic outlook. They help cultivate an open dialogue, fostering trust and transparency between the MPC and its stakeholders.

Given that monetary policy affects everyone, the MPC is committed to making its decisions easier to understand. To achieve this, several steps have been taken. One example is the Monetary Policy Statement Snapshot (MPSS), released alongside the MPS. It breaks down the key factors behind the monetary policy decisions into concise points. The Monetary Stability page on the BNM website<sup>12</sup> also explains monetary policy in simple terms, covering the factors behind monetary policy decisions and frequently asked questions on relevant topics. Through the transparency of its monetary policy decisions, the MPC is thus accountable to the public for its decisions and the outcomes.

## Conclusion

As a final word, through careful analysis and deliberations, the MPC ensures that its policies are focused on delivering the mandate of maintaining price stability while giving due regard to economic developments. At the end of the day, the MPC remains steadfast in its role as guardian of the nation's economic well-being.

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<sup>12</sup> <https://www.bnm.gov.my/monetary-stability>