Our Role

Bank Negara Malaysia (BNM) is Malaysia's central bank. Our principal objective is to promote monetary stability and financial stability conducive to the sustainable growth of the Malaysian economy. BNM derives its mandate and powers from the Central Bank of Malaysia Act 2009 and other laws that it administers.[1]

In our role to promote monetary stability, BNM formulates and conducts monetary policy to keep inflation low and stable, while ensuring that it is supportive of sustainable economic growth. We are also mandated to promote an exchange rate regime consistent with the fundamentals of the economy.

To promote financial stability, BNM regulates and supervises financial institutions to promote their safety and soundness. We oversee money and foreign exchange markets to promote their integrity and orderly functioning. We also exercise oversight over payment systems to foster safe, efficient and reliable payment systems and payment instruments. In addition, we regulate the conduct of financial institutions and intermediaries in order to provide appropriate protection to financial consumers.

BNM plays a key role in promoting a progressive and inclusive financial system. This takes into account the changing needs of the Malaysian economy and its people, and the central role of finance in the nation's economic and social progress. Our pursuit to develop and deepen both the conventional and Islamic financial system also recognises that a well-developed financial system is one that can help absorb shocks, and therefore contributes to the country's resilience.

BNM carries out a number of other important functions. These include issuing currency, and holding and managing the country's foreign reserves. BNM is also the financial adviser, banker and financial agent of the Government. Together with other government and law enforcement agencies, we play a role in helping to prevent the criminal abuse of financial services. Additionally, BNM has been responding to climate risk, firstly through appropriate regulation and supervision of financial institutions, to support an orderly transition to a low-carbon economy; and secondly by embedding sustainable practices in our own operations.

In all BNM does, it does in the best interest of the nation.

[1] Other key legislation includes the Financial Services Act 2013; Islamic Financial Services Act 2013; Development Financial Institutions Act 2002; Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001; Money Services Business Act 2011; and the Currency Act 2020.

Promoting Monetary Stability

Bank Negara Malaysia (BNM) Monetary Policy Committee (MPC) sets monetary policy to maintain price stability while giving due regard to economic developments in Malaysia. To achieve this goal, the MPC decides on the Overnight Policy Rate (OPR) based on its assessment of domestic inflation and economic growth prospects.

Monetary Policy in 2023

In 2023, the global economy continued to face a series of challenges. High interest rates, elevated inflation, slowing global trade, and geopolitical tensions created a high level of uncertainty and weighed down on global growth during the year. Despite initial positive signs early in the year with the reopening of China's economy post-COVID-19, the optimism and momentum of China's recovery were short-lived. In addition, the global technology downcycle, shifts in consumer spending from goods to services, and ongoing trade restrictions dampened global trade activity.

Although inflation came down from its peak in 2022 for many countries, it remained at high levels. This prompted many central banks to keep a tight monetary policy stance, with some even continuing to raise their policy rates. Global financial conditions tightened during the year. Expectations of prolonged high interest rates in the US also resulted in continued US dollar strength in 2023. The strong US dollar was further contributed by safe-haven flows following concerns about banking sector stress in advanced economies and escalating geopolitical tensions. The continued US dollar strength affected other major and emerging market currencies, including the ringgit.

Despite the challenging global conditions, Malaysia's economy continued to expand, growing by 3.7% in 2023 (2022: 8.7%). The more moderate growth also reflected normalising conditions following the economic rebound in 2022, which was supported by the reopening of the economy and sizeable policy measures.[1] During the year, Malaysia's economy was supported by resilient domestic demand and further recovery in tourism activities. Labour market conditions improved as the unemployment rate declined to its pre-pandemic level. Employment continued to grow amid ongoing economic expansion. These improvements, along with policy measures such as targeted cash transfers, provided a lift to Malaysian household spending. Rising tourist arrivals also boosted Malaysia's tourism sector and supported domestic businesses. Continued progress in large investment projects throughout the year further contributed to domestic growth.

Like other economies in the region, the slower global demand affected Malaysia's export activities. Nevertheless, Malaysia's diverse export products and destinations helped to partly lessen the impact of external shocks. Despite the volatile global financial and foreign exchange markets, Malaysia's sound financial system served as strong buffers against the external shocks. This helped ensure that domestic financial conditions remained conducive to financial intermediation and sustained credit growth, supporting the economy.

After reaching its peak in the second half of 2022, headline inflation trended lower, averaging 2.5% in 2023 (2022: 3.3%). Although the continued US dollar strength against the ringgit led to higher costs of imported materials for domestic production, overall cost pressures eased during the year. This was mainly due to the lower global commodity prices and improving global supply chain conditions. Existing domestic price controls and subsidies on fuel and key food items (e.g. fresh eggs)

[1] These measures included cash transfers, Employees Provident Fund (EPF)-related measures, and the implementation of a higher minimum wage, which supported household spending in 2022.

also helped to partly contain the upward pressures on prices. In addition, domestic demand stabilised in 2023 following the heightened demand since the reopening of the economy in 2022.

Meanwhile, underlying inflation, as measured by core inflation,[2] also trended lower in the second half of 2023 and averaged at 3% for the year (2022: 3%). The pace of decline in core inflation during the year was more gradual, partly reflecting persisting demand pressures, particularly during the first half of 2023.

After four consecutive OPR increases in 2022, the MPC[3] decided to keep the OPR unchanged at 2.75% in the January and March 2023 meetings. This allowed the MPC to review the cumulative impact of the previous OPR increases in 2022 on Malaysia's economy. This was because monetary policy changes take some time to fully influence economic activity. The assessment showed no signs of excessive tightening in the economy. Rather, the domestic economy continued to expand, with moderating unemployment and continued expansion of household spending. Considering all these together amid resilient domestic growth prospects in 2023, the MPC decided to further normalise the OPR, increasing it by 25 basis points at the May meeting. This brought the OPR to the pre-pandemic level of 3.00%. With that, the MPC had totally withdrawn the monetary policy stimulus provided during the COVID-19 crisis to support the economic recovery.

It was crucial for the MPC to ensure that monetary policy was aligned with the health of Malaysia's economy. Although domestic inflation had been moderating during the year, there were still concerns about potential upward pressures on prices, particularly coming from resilient domestic demand. As such, the increase in the OPR was also aimed at pre-emptively safeguarding against the upside risks to inflation. High inflation, if left unchecked, would be damaging to the welfare of all Malaysians, especially the lower-income group.[4] Conversely, if the OPR is kept too low as the economy strengthens, this could lead to excessive spending and borrowing by households and businesses. This would not only fuel higher inflation, but also pose financial risks for both households and businesses in the future.

Following the cumulative OPR adjustments since May 2022,[5] lending rates increased broadly in line with the OPR increases. For borrowers, the impact of the higher OPR on loan repayments depended on the type of loan. Existing fixed-rate loans, like most car loans, remained unchanged. Meanwhile, borrowers with floating-rate loans, mainly housing loans, faced increased monthly instalments. Nevertheless, targeted assistance, such as debt restructuring and advisory arrangements, remained available for borrowers who continued to experience financial difficulties. For new loans, interest rates also increased broadly in line with the OPR adjustments. Similarly, returns to depositors, especially fixed deposits, also trended higher.

Throughout the year, BNM's monetary operations continued to focus on ensuring sufficient liquidity in the banking system.[6] This enabled the orderly functioning of domestic financial markets and financial intermediation in the economy.

Diagram 1: 2023 Key Domestic Figures at a Glance

Real GDP grew by

3.7%

(2022: 8.7%)

Headline inflation averaged at

2.5%

(2022: 3.3%)

Overnight Policy Rate (OPR) increased to

3.00%

back to its pre-pandemic level

Source: Bank Negara Malaysia and Department of Statistics, Malaysia

[2] Core inflation is computed by excluding price-volatile items (e.g. fresh meat, vegetables and eggs) and price-administered items (e.g. electricity, road tolls and sugar).

[3] The MPC meets six times a year to decide on monetary policy. More information on Malaysia's monetary policy and the MPC can be found in the 'Governance' section of this report and in the 'Monetary Stability' section of the BNM's website (https://www.bnm.gov.my/monetary-stability).

[4] High inflation erodes people's purchasing power and savings, especially affecting those in the lower-income group. High inflation is also detrimental for businesses as they face increased costs to produce goods and provide services, or lower sales due to reduced demand. These would then lead to slower economic activity and growth.

[5] The OPR was increased by a total of 125 basis points through five 25-basis point adjustments.

[6] BNM conducts monetary operations using a range of instruments. More information on the various instruments used can be found in the 'Monetary Operations' section of the BNM's website (https://www.bnm.gov.my/web/guest/overview).

The Ringgit Exchange Rate

In 2023, the ringgit continued to face depreciation pressures against the US dollar and other major trading partners. These were largely due to global developments. Investors favoured US dollar-denominated assets amid expectations of prolonged high interest rates in the US, which were higher than the prevailing interest rates in Malaysia. Ongoing geopolitical conflicts led to financial market participants' preference for holding the US dollar as a safe-haven asset. Uncertainties over China's economic growth prospects also dampened investor sentiments in the region.

The movements in the ringgit exchange rate did not reflect Malaysia's sound economic fundamentals in 2023 despite the challenging global environment. Nevertheless, these external factors would be short-term in nature. As global financial conditions improve and volatility eases in the future, these would ease the pressure on the ringgit.

BNM's foreign exchange operations also provided necessary support to smoothen excessive volatility in the movements of the ringgit exchange rate.[7] We did so by our presence in the foreign exchange market to buy and sell ringgit when necessary. This ensures sufficient two-way liquidity in the ringgit exchange rate market. We continued to deepen the foreign exchange market through ongoing efforts by BNM's Financial Markets Committee and banks operating in Malaysia, thus enabling businesses to meet their funding needs more effectively. We also continued to promote access to hedging instruments for businesses to better manage their foreign exchange risks.[8]

In 2023, we continued to engage large investors and corporates, including exporters, on their foreign exchange activities. We also closely monitored the conversion of export proceeds to ringgit by the large resident exporters. More recently, the Government and BNM have also been taking coordinated actions to encourage Government-Linked Companies (GLCs) and Government-Linked Investment Companies (GLICs) to bring back and convert their realised foreign investment income into ringgit more consistently. These collective actions will contribute to greater and sustained inflows, lending support to a firmer ringgit. Meanwhile, the ongoing structural reforms should bring in more investment flows into Malaysia, and thus provide more enduring support for the ringgit in the long run.

Analysis and Research

BNM's economic analysis and policy research in 2023 focused on assessing Malaysia's economic resilience, especially amid external challenges, and further understanding domestic inflation drivers. Through a scenario analysis, we assessed how the strength of the recovery in China's economy might impact Malaysia's GDP growth due to the close trade ties. We also studied how Malaysia could be affected by the banking sector stress in advanced economies, and slower global growth in the medium term. In addition, we analysed Malaysia's economic resilience post-pandemic, including recovery in economic sectors and labour market, and exports resilience.[9] On inflation, we looked deeper into whether price changes in Malaysia were driven by economy-wide or sector-specific factors,[10] and the different approaches to measuring underlying inflation.[11] Our research also investigated how firms set prices and wages amid elevated inflation and ringgit exchange rate movements.

Throughout the year, we continued to closely monitor the impact of past OPR changes on the broader economy. In particular, we closely monitored for signs of overtightening that could hinder domestic economic growth. This assessment covered the effects on credit, financing, and consumption activities. To further strengthen our analytical surveillance and research, we continued to integrate ground-level insights from BNM's regional offices. These insights from industry players, including businesses, were essential in helping us gain a better understanding of the economy, including how evolving developments and domestic policies affect different sectors of the economy. We also improved our economic surveillance tools during the year. This included refining methods for measuring the output gap, developing an indicator to better assess interest rate conditions, and creating an index to gauge sentiment in domestic financial markets.

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7 More information on the ringgit can be found in the 'Ringgit Exchange Rate Policy' section of the BNM's website (https://www.bnm.gov.my/monetary-stability/ringgit).

8 More information on financial market development initiatives can be found in the 'Market Development Initiatives' section of the BNM's website (https://www.bnm.gov.my/committees/fmc#devt).

9 More information can be found in the BNM 3Q 2023 Quarterly Bulletin Box Article titled 'Malaysia's Economic Resilience: A Post-pandemic Analysis'.

10 More information can be found in the BNM 2Q 2023 Quarterly Bulletin Box Article titled 'Understanding Inflation Drivers: Differentiating Common and Idiosyncratic Dynamics in Malaysia'.

11 Further discussion on underlying inflation can be found in the BNM Economic and Monetary Review 2023 Box Article titled 'Underlying Inflation at its Core'.

As the financial and economic advisor to the Government, BNM continued to actively contribute to several policy groups focusing on economic priorities. These included policies related to the cost of living, investment, labour, public finance, and social protection. We provided policy advice on the Government's subsidy rationalisation plan from a macroeconomic perspective, including the potential impact on domestic inflation and growth. Our input also covered potential strategies for implementing the subsidy rationalisation, as well as potential measures to minimise its impact on households and businesses. We also contributed to the formulation of the Public Finance and Fiscal Responsibility Act 2023 which was passed by Dewan Negara in November 2023. This Act is important to enhance accountability and transparency in the management of public finances. This would ultimately serve towards preserving macroeconomic stability and protecting the welfare of Malaysians.

We also supported policies that would facilitate the country's transition to a high-income nation. This included advocating for a mission-based approach to industrial planning and promoting cross-industry collaboration in the formulation of the New Industrial Master Plan 2030 (NIMP 2030).[12] We also supported the initiatives to improve investor relations practices in Malaysia, aimed at enhancing the country's attractiveness as a business and investment destination. We continued to advocate for a more comprehensive and efficient social protection system in Malaysia to ensure the well-being of the people in the long term. This included to streamline social assistance programs to ensure those who need the support receive it. We also advocated for extending the coverage of the Malaysian private retirement savings scheme to all individuals, including workers in the informal sector (e.g. self-employed individuals).

We also continued to advocate for structural reforms aimed at boosting household incomes, especially amid the rising cost of living issues. This included generating opportunities for high-skilled jobs through quality investments in new growth areas, and supporting initiatives to improve wage growth via upskilling and enhanced labour productivity.

Communication and Outreach

Throughout 2023, BNM continued to share insights on our monetary policy decisions, and the latest developments on inflation and ringgit. By doing so, we aimed to improve public understanding and address concerns surrounding these topics. Given the economic issues and the interplay with many factors, we sought to communicate in a simpler and more engaging way for a wider audience. For instance, we have published explanations to dispel common misconceptions about the OPR, as well as a short video explaining how the OPR works on our social media platforms (see Diagram 2). We also continued our active engagement with the public, analysts, investors, media, and Government representatives during the year.[13]

We also maintained ongoing collaborations with academia through various initiatives. These included the Visiting Research Fellowship (VRF)[14] and Research Support Initiative (RSI)[15] programmes. Through the RSI programme, we provided support to academics in their research on areas relevant to BNM. The VRF programme also helped to expand our research on monetary and financial economics, with ongoing joint studies in areas such as the labour market, inflation, and investment. Ultimately, these collaborations aimed to incorporate diverse perspectives, enriching our understanding of complex economic issues for informed policy-making.

[12] The NIMP 2030 was launched on 1 September 2023.

[13] More information on the BNM's public engagements throughout the year can be found in the 'Engaging Malaysians' chapter of this report.

[14] The VRF was launched in October 2020. The programme aims to produce joint research publications between academics and BNM staff. More information can be found on the BNM's website (https://www.bnm.gov.my/research/vrf).

[15] The RSI was launched in October 2020. This program is designed for post-graduate and post-doctorate candidates specialising in econometrics, macroeconomics, monetary and financial economics, machine learning, and data science. More information can be found on the BNM's website (https://www.bnm.gov.my/research/rsi).

Diagram 2: Snippets of Information Shared on Social Media

Source: Bank Negara Malaysia

Going Forward

In 2024, the Malaysian economy is poised for continued expansion. In addition to resilient domestic expenditure, the sustained global growth and rebound in trade activity will benefit our exports. These would lend support to Malaysia's economic growth. At the same time, inflation is also expected to remain moderate. These favourable economic conditions in 2024 provide a window for the implementation of structural reforms as announced by the Government. Pursuing these reforms, such as subsidy rationalisation, is necessary for strengthening the economy post-crisis, ultimately benefitting Malaysia in the long run.

As the domestic policies related to subsidies and price controls undergo review and potential adjustments, they would affect the inflation path going forward.

Beyond domestic policies, there could also be global headwinds and emerging challenges that may pose risks to Malaysia's economic outlook. As such, BNM remains vigilant to the ongoing domestic and global developments. We will ensure that the monetary policy stance remains conducive to sustainable domestic economic growth in the long term amid price stability. Foreign exchange and monetary operations will also continue to ensure sufficient liquidity in the foreign exchange, money, and Government bond markets. They will complement our other policies to ensure the smooth functioning of domestic financial markets and financial intermediation. BNM is committed to collaborating closely with our stakeholders on relevant policy measures, especially structural reforms. These efforts would not only address immediate economic challenges, but also enhance Malaysia's economic resilience in the years ahead.

Behind the Scenes of Bank Negara Malaysia’s Monetary Policymaking

[The Star] *‘Bank Negara raises OPR by 25bps to 2.75%’* – 3 Nov. 2022

[Sinar Harian] *‘Jawatankuasa Dasar Monetari (MPC) Bank Negara Malaysia (BNM) mengumumkan dasar semalaman (OPR) meningkat dua puluh lima perpuluhan kepada tiga peratus’* – 3 May 2023

[Harian Metro] *‘OPR tidak naik, masih 3.0%’* – 7 Sep. 2023

[Malay Mail] *‘Bank Negara Malaysia maintains OPR at 3pct’* – 24 Jan. 2024

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[1] by adjusting the Overnight Policy Rate (OPR).[2] The refresher box explains in more detail why price stability is important and what happens when the OPR is changed.

[1] Monetary policy is the action that BNM takes to influence interest rates in the economy.
[2] 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:

How is the economy doing?	Where is the economy heading?	How should monetary policy respond?
		
Growth and inflation developments	***Outlook on growth and inflation***	***Monetary policy strategy***

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. [3] This is why understanding the growth and inflation outlook (where the economy is heading) is crucial for the MPC.

[3] 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.

The MPC always looks ahead when setting monetary policy. This is because the effects of OPR changes on economic activity and inflation do not happen right away.

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[4] 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).[5]

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

Global economy
- Growth and inflation
- Financial Conditions Index
- Country/region-specific indicators

Labour market
- Unemployment
- Job Placement Index
- Wages
- Labour force participation
- Productivity per worker

Trade
- Gross exports/imports
- Regional exports
- Global container throughput
- Semiconductor sales

Inflation
- Headline inflation
- Core inflation
- Pervasiveness
- Household inflation expectations
- Business pricing

Production
- Manufacturing Industrial Production Index
- Manufacturing orders
- Purchasing Managers' Index

Consumer sentiment
- Passenger car sales
- DOSM Composite Leading Index
- Credit card spending

Financing conditions
- Loan disbursements for businesses and households
- Loan applications
- Lending rates

Financial markets
- FTSE Bursa Malaysia Kuala Lumpur Composite Index (KLCI)
- MGS spreads
- KLCI Forward Earnings Per Share
- 1M USD/MYR implied volatility

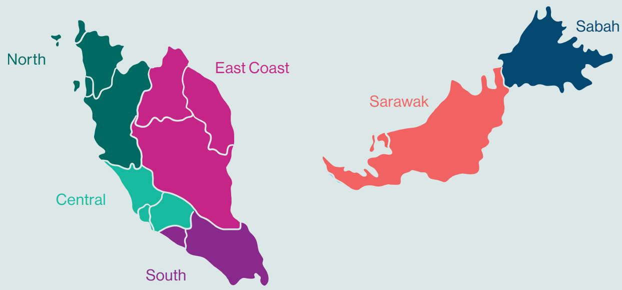
Note: This list is not exhaustive

Source: Bank Negara Malaysia

[4] These staff are mainly from the departments that focus on monetary policy, economics, and investment operations and financial markets in BNM.
[5] 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, [6] 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.[7]

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.[8] 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

[6] Namely Johor Bahru, Kuala Terengganu, Pulau Pinang, Kota Kinabalu, and Kuching.
[7] 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).
[8] 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.[9] 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.[10]

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

Step 1 – Putting together the analysis:
Each MPC cycle starts about six weeks before the MPC meeting. The first stage is putting together the analysis and research that was mentioned earlier. A series of discussions takes place across departments to ensure robust assessments and consistency in content. Once refined, the assessments are presented at the Monetary Policy Working Group (MPWG) meeting.

Step 2 – The MPWG meeting:
Since 2002, the MPWG has been an internal forum where staff assessments on the latest economic, monetary, and financial market developments, policy issues, and research findings are discussed before the presentations to the MPC. The MPWG ensures that the perspectives of all relevant divisions within BNM are considered. Chaired by the Assistant Governor overseeing the economics sector, the MPWG comprises the directors of the departments that focus on monetary policy, economics, investment operations & financial markets, financial surveillance, and foreign exchange administration.

During the presentation, members of the MPWG discuss the economy's likely trajectory, key risks, and uncertainties in the outlook. They offer feedback on the forecast, sometimes requesting staff to consider other assumptions or alternate scenarios. These discussions lay the groundwork for what later becomes the baseline forecast for the MPC.

Step 3 – After the MPWG meeting:
Following the MPWG meeting, staff refine their analysis based on the feedback received. They also update their assessments with the latest data before the MPC meeting to ensure that it's as current and comprehensive as possible. Once the assessments have been finalised, the next step is the briefing to the MPC members.

Step 4 – The MPC meeting:
The MPC meeting commences with the first full-day session comprising detailed presentations on the economy, key projections, and the monetary policy strategy. These include the areas discussed in Part II, such as the developments in financial markets and financing conditions, the global and domestic economic prospects, and the inflation outlook. During the second session, MPC members reconvene to deliberate on the monetary policy decision, where each member shares their views and stance. Only on this day is the decision deliberated and made. The decisions of BNM's MPC are made collectively through discussion and consensus. When no consensus can be achieved, the decision would be based on a majority vote.[11]

Step 5 – Communicating the decision:
Once the monetary policy decision is made, the next crucial step is to announce it to the public. This is done mainly through the Monetary Policy Statement. Other platforms are also used to connect with the public. We'll talk more about these channels in the next section.

Source: Bank Negara Malaysia

[9] 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).

[10] 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'.

[11] 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).

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

Monetary Policy Statement
Embargo : Not for publication or broadcast before 1500 on Thursday, 6 July 2023

At its meeting today, the Monetary Policy Committee (MPC) of Bank Negara Malaysia decided to maintain the Overnight Policy Rate (OPR) at 3.00 percent.

The decision

What's happening globally along with the outlook

The global economy continues to expand, driven by resilient domestic demand supported by strong labour market conditions. Global growth, however, remains weighed down by persistent core inflation and higher interest rates. While China's reopening remains supportive of the global economy, its pace of recovery has slowed in recent months. Globally, headline inflation continued to moderate, but core inflation remains above historical averages. For most central banks, the monetary policy stance is likely to remain tight. The growth outlook remains subject to downside risks, mainly from a slower momentum in major economies, higher-than-anticipated inflation outturns, an escalation of geopolitical tensions, and a sharp tightening in financial market conditions.

Following a strong outturn in the first quarter of the year, the Malaysian economy expanded at a more moderate pace in recent months as exports were weighed down by slower external demand, as expected. Growth for the remainder of the year will continue to be driven by resilient domestic demand. Household spending continues to be underpinned by favourable labour market conditions, particularly in the domestic-oriented sectors. Tourist arrivals have been steadily improving, and are expected to continue rising, thereby lifting tourism-related activities. Investment activity would be supported by continued progress of multi-year infrastructure projects. Domestic financial conditions also remain conducive to financial intermediation amid sustained credit growth. While the growth outlook is subject to some downside risks stemming from weaker-than-expected global growth, upside risks mainly emanate from domestic factors such as stronger-than-expected tourism activity and faster implementation of projects.

What's happening in the domestic economy along with the outlook

Inflation developments and outlook

Headline inflation has continued to ease amid lower cost factors. While core inflation has also moderated, it remains elevated relative to the long-term average amid lingering demand and cost factors. For the second half of 2023, both headline and core inflation are projected to trend lower, broadly within expectations. Risks to the inflation outlook remain highly subject to the degree of persistence in core inflation, changes to domestic policy on subsidies and price controls, as well as global commodity prices and financial market developments.

At the current OPR level, the monetary policy stance is slightly accommodative and remains supportive of the economy. The MPC continues to see limited risks of future financial imbalances. The MPC remains vigilant to ongoing developments, and will continue to monitor incoming data to inform the assessment on the outlook of domestic inflation and growth. The MPC will ensure that the monetary policy stance remains conducive to sustainable economic growth amid price stability.

The rationale behind the decision, and indications on the monetary policy outlook (if any)

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[12] 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.

[12] https://www.bnm.gov.my/monetary-stability

Promoting Cross-border Local Currency Settlement (LCS)

Over the last two decades, Malaysia's trade, investment and financial linkages within the region have deepened. As a result, trade with China and ASEAN as a percentage of Malaysia's total trade has increased from 13% and 25.6% in 2009 to 17.1% and 27.3% in 2023 respectively, while at the same time, trade with the United States (US) has declined from 11.1% in 2009 to 9.5% in 2023.[1]

Despite the shift, the bulk of trade continued to be settled in US dollars (2023: 82.1%, 2009: 82.9%) (Table 1a). Even for intra-regional trade within ASEAN, the trade settlements in the US dollar remain dominant (Figure 1b). Only 13.1%[2] of trade within ASEAN was settled in regional currency pairs. Based on Bank Negara Malaysia (BNM)'s engagements with major exporters, some companies have stated that their preference to settle their trade in US dollars is to ensure that their US dollar income matches their exposure to US dollar-denominated external debt. Multinational corporations with strong presence in the global supply chain, like those in the Electrical and Electronics (E&E) industry, also commonly use the US dollar to implement a more centralised treasury management system to manage the flow of funds across countries. Malaysia's commodity exporters and importers also transact in US dollars as the majority of commodities are invoiced in such terms. As such, the prevalence of trade settlement in US dollars is not a unique phenomenon to Malaysia. The transactional dominance of the US dollar in global trade, investment and financial activities is a structural feature of the global economy primarily due to its standing as a global settlement currency.

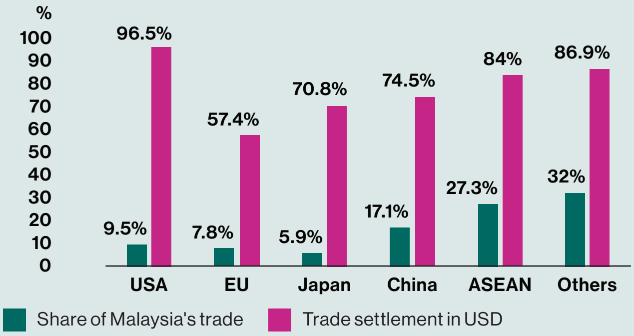
Chart 1: The Dominance of the US Dollar as the Settlement Currency for Trade Activities

Table 1a: Percentage of Malaysia's Total Trade Settled in Respective Currencies

Top Currency	% (2009)	% (2023)
USD	82.9	82.1
EUR	5.0	4.3
MYR	1.3	3.6
CNY	0.0	2.9
SGD	3.7	2.6
JPY	3.4	1.9
Others	3.7	2.5

Source: Bank Negara Malaysia

Chart 1b: Breakdown of Malaysia's Trade by Trading Partners Vis-à-Vis Percentage of Trade Settlement in USD with These Trading Partners in 2023



Source: Bank Negara Malaysia and Department of Statistics, Malaysia

As a small open economy,[3] the settlement of trade in US dollars may appear to be a given. However, there are costs involved, and these are particularly evident when relying on the US dollar for regional trade purposes. Consider the example of a Malaysian firm importing from an Indonesian supplier. Rather than being able to conduct the trade with just both their local currencies, the importer has to convert ringgit to US dollars while the supplier has to convert from US dollars to Indonesian rupiah. The additional step adds to business costs, while also increasing both firms' exposure to volatility in the US dollar. Additionally, regional countries have to hold high US dollar-denominated reserves to match the prevalent choice of currency settlement. Given these factors, efforts to encourage more intra-regional trade in local currencies could help to increase business efficiency and reduce cost.

In this regard, BNM has gradually introduced flexibilities to our foreign exchange policy (FEP) since 2001, allowing both trade and investment to be settled directly using ringgit through licensed onshore bank (LOB). The ringgit settlement flexibility was further expanded in 2010 through the Appointed Overseas Office (AOO) framework[4] to cover banks

[1] Source: Department of Statistics, Malaysia
[2] Source: Bank Negara Malaysia
[3] Malaysia is an open economy but it is relatively small compared to the rest of the world given that we do not have much control over the prices of goods and services in the global market.
[4] For further information on AOO, please refer to Financial Markets Investor Portal (https://financialmarkets.bnm.gov.my/Foreign-Exchange-Market).

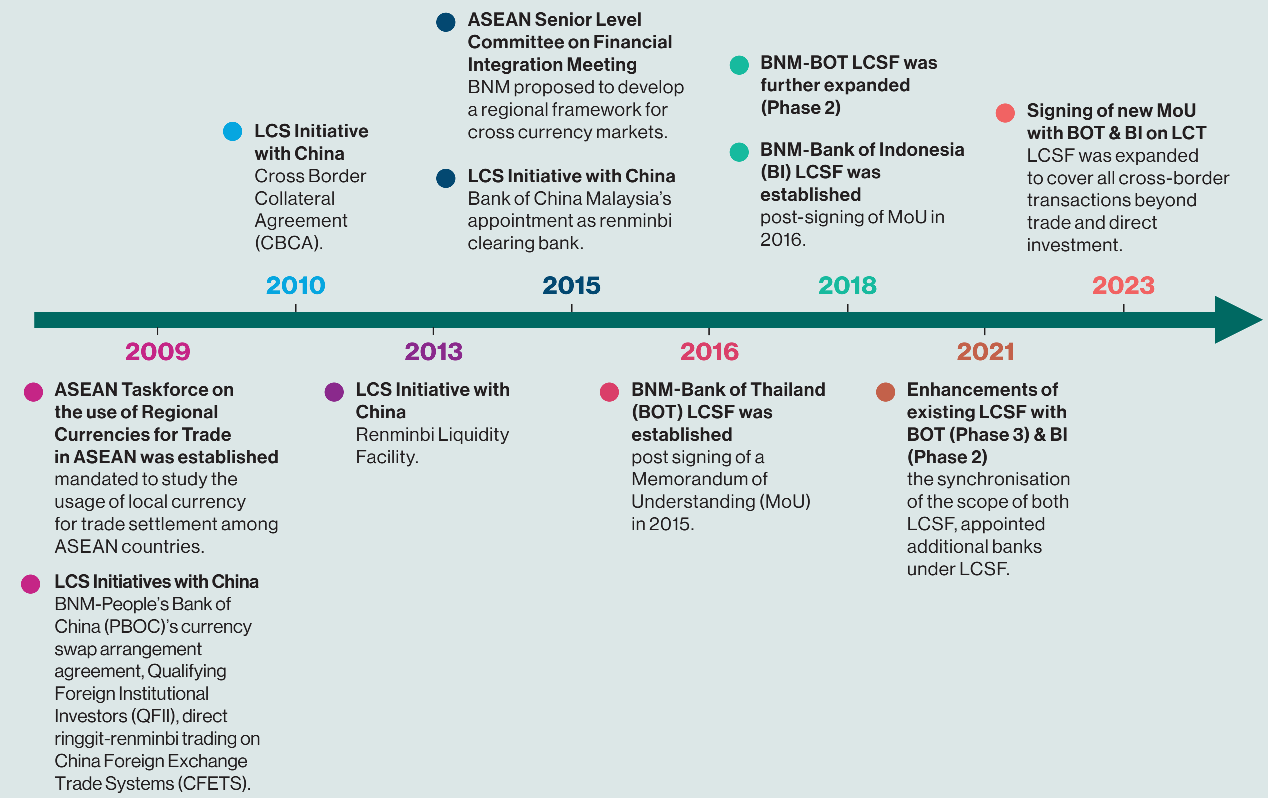
outside of Malaysia within the LOB's group. Through the AOO, foreign companies and investors outside Malaysia can now settle cross-border transactions in ringgit from abroad.

In parallel, BNM has also enhanced financial cooperation with Malaysia's key regional trading partners to promote the use of local currency for cross-border settlement. These regional collaborations endeavour to overcome the underlying challenges hindering wider use of regional local currencies for cross-border settlement. These challenges include the relatively underdeveloped local currency markets that have resulted in higher business costs.

One of the success stories has been the cooperation with China, Malaysia's largest trading partner. Many initiatives[5] have been put in place since 2009 to facilitate and encourage more local currency settlement by increasing access to renminbi which includes the Renminbi Liquidity Facility introduced in 2013 and the appointment of Bank of China Malaysia as a renminbi clearing bank in 2015. As a result, the value of bilateral trade settled in renminbi and ringgit has increased from 1.2% of trade settlement (RM0.5 billion) in 2009 to 24.4% of trade settlement (RM57.8 billion) in 2023 (Figure 3a).

Additionally, the lack of harmonisation of foreign exchange regulations across regional countries also constrains access to local currencies and domestic assets. To address these issues, BNM has established the Local Currency Settlement Framework (LCSF) with the Bank of Thailand[6] (BOT) (2016) and Bank Indonesia[7] (BI) (2018) to introduce more harmonised and flexible foreign exchange rules for bilateral transactions, while taking into account each country's circumstances. This framework provides flexibilities in foreign exchange regulations for the participating banks[8] to offer

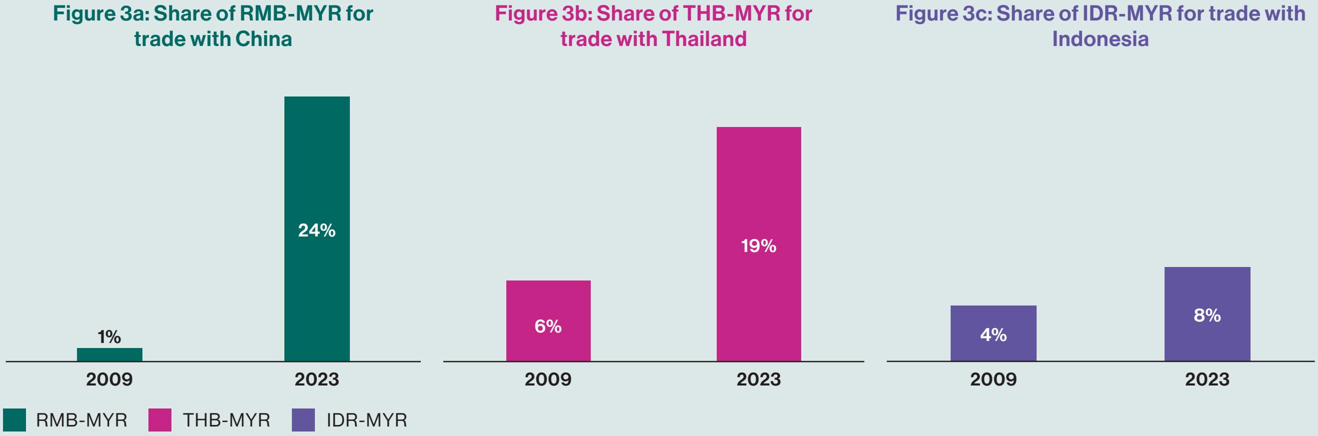
Chart 2: Key Developments on Advancing LCS Involving Malaysia



Source: Bank Negara Malaysia

[5] Other initiatives includes bilateral currency swap arrangement agreement, Qualifying Foreign Institutional Investors (QFII) and direct ringgit-renminbi trading on China Foreign Exchange Trade System (CFETS) in 2009 and the Cross Border Collateral agreement (CBCA) in 2010.
[6] For further information on the LCSF with Thailand, please refer to Further Expansion of The Local Currency Settlement Framework Between Bank Negara Malaysia and the Bank of Thailand - Bank Negara Malaysia (https://www.bnm.gov.my/-/further-expansion-of-the-local-currency-settlement-framework-between-bank-negara-malaysia-and-the-bank-of-thailand).
[7] For further information on the LCSF with Indonesia, please refer to Expansion of Local Currency Settlement Framework between Bank Negara Malaysia and Bank Indonesia - Bank Negara Malaysia (https://www.bnm.gov.my/-/expansion-local-currency-settlement-framework-bnm-bi).
[8] Also known as the Appointed Cross-Currency Dealers (ACCDs).

Chart 3: Increasing Share of Local Currencies Used for Trade with Regional Countries



Source: Bank Negara Malaysia

competitive financial services for market players to settle their cross-border transactions in local currencies. Local currency settlements with Thailand and Indonesia have gained traction since the LCSF was established. Overall trade with Thailand settled in local currencies (the ringgit and Thai baht) has increased from 6.4% of trade settlement (RM1.9 billion) in 2009 to 18.6% of trade settlement (RM11 billion) in 2023 (Figure 3b). At the same time, trade with Indonesia settled in local currencies (the ringgit and Indonesian rupiah) grew from 4.5% of trade settlement (RM1.2 billion) in 2009 to 7.6% of trade settlement (RM5.9 billion) in 2023 (Figure 3c). Notwithstanding the progress achieved on this front, on 25 August 2023, BNM signed a Memorandum of Understanding (MoU) with BI and BOT to broaden the LCSF's scope to cover cross-border transactions beyond trade and direct investment activities such as portfolio investment.

In our pursuit of a more conducive ecosystem for promoting the use of local currencies, initiatives to address demand-side structural issues are equally important and would require a more coordinated approach with market players. Recently, BNM has stepped up engagements with stakeholders including the market players to better understand the operational challenges faced by companies. A common issue raised by most companies was the difficulty persuading clients to settle in local currency, particularly when this would require companies to reconfigure processes and systems.

The advancement of financial technology may also help to promote local currency within the region, especially for consumers. Of significance on this front is the establishment of cross-border payment linkages,[9] such as the ones with Indonesia, Singapore and Thailand for QR payments as well as person-to-person (P2P) fund transfer with Singapore. These initiatives not only promote efficiency in term of faster, cheaper, and more seamless cross-border payments, but also encourage greater usage of local currencies.

Moving forward, BNM and the Government will continue to encourage the use of local currencies for trade and investment. Priorities will include expanding local currency settlement and cross-border payment linkages with other countries in tandem with stepping up promotional efforts to increase awareness of market players on these initiatives. These efforts will provide an alternative avenue for companies and investors to better manage their exposure to movements of the exchange rate, reduce overdependence on US dollar, and ultimately, strengthen the region's financial resilience against external shocks.

[9] For further information, please refer to the 'Promoting Safe and Efficient Payment and Remittance Services' chapter.

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