

# Promoting Monetary Stability

A key role of the Bank is to implement a monetary policy that maintains a low and predictable pace of increase in the prices of goods and services, taking into consideration existing economic developments. Decisions on monetary policy are made autonomously by the Monetary Policy Committee (MPC), which meets six times a year.<sup>1</sup> The Bank undertakes monetary operations to implement the decisions of the MPC.

## Monetary policy in 2019

2019 was a challenging year. Globally, there were unresolved trade tensions, a slowdown in investments and trade activity, heightened financial market volatility, country-specific risks and geopolitical uncertainties. As a highly open economy, the Malaysian economy was affected by these global developments. In addition, weakness in investment activity and supply disruptions in the commodities sector also affected domestic economic activity. Economic growth thus expanded by 4.3% in 2019 (2018: 4.7%), driven by private sector spending. In particular, household spending was supported by continued income and employment growth, as well as Government measures. Meanwhile, price pressures were subdued throughout the year. Headline inflation averaged at 0.7% in 2019 (2018: 1.0%). The low inflation was due mainly to policies on retail fuel

prices and festive price controls, as well as the changes in consumption tax policy in 2018, which resulted in lower price pressures.

At each meeting, the MPC decides on whether the current level of the Overnight Policy Rate (OPR) – the indicator of the monetary policy stance – is at an appropriate level to safeguard price stability while supporting economic activity. As the effect of monetary policy takes at least two or three quarters to be felt in the economy, the MPC, in making its decisions, assesses and deliberates on the outlook for both domestic economic growth and inflation. Our staff facilitate this process by presenting their surveillance analysis, simulation results, research findings and forecasts to the members. The MPC also takes into consideration the risk that financial imbalances may pose to the broader economy. In 2019, the MPC decided to lower the OPR by 25 basis points at the May MPC meeting. This brought the OPR to 3.00%, where it remained for the rest of the year. The decision to lower the OPR was made in view of providing a conducive monetary environment for a steady growth path amid price stability.<sup>2</sup>

Monetary operations are undertaken by ensuring an appropriate level of liquidity is in the banking system to influence the average overnight interbank rate to remain around the OPR. This in turn sets guidance for other interest rates in the economy, so that monetary policy decisions have the ultimate intended impact on economic activity. We also use various instruments in our monetary operations such as unsecured borrowings and repos of various short-term tenures to ensure there is sufficient liquidity in the domestic financial markets to support financial intermediation in the economy. One of the monetary instruments is the Statutory Reserve

<sup>1</sup> More information on Malaysia's monetary policy and the MPC can be found in the 'Governance' section of this report.

<sup>2</sup> Greater detail on the analysis underpinning the MPC's decisions can be found on the BNM website in the Monetary Policy Statements, and the BNM Quarterly Bulletins, and also Chapter One of the Economic and Monetary Review 2019.

Requirement (SRR), which is an instrument to manage liquidity typically when the excess liquidity in the banking system is large and long-term in nature. In November 2019, the SRR ratio was reduced from 3.50% to 3.00% to continue supporting the efficient functioning of the domestic financial markets.

## The ringgit exchange rate

The ringgit exchange rate plays an important role in the economy, as it affects the price of our exports, imports and level of foreign currency debt. One of our roles is to maintain the efficient and effective functioning of the foreign exchange market. Malaysia maintains a flexible exchange rate policy for ringgit. This flexibility in the ringgit exchange rate has played an important role in ensuring that the economy is able to withstand external shocks. Nevertheless, as an open economy that faces large cross-border capital flows, this flexibility can at times lead to volatility in ringgit movements, particularly when investor sentiments are strongly affected by global developments. In this regard, we continue to ensure that volatility in the exchange rate is not excessive so as not to disrupt domestic economic activity such as trade and investments. This is achieved by providing sufficient liquidity at all times in the domestic foreign exchange market, including through our two-way foreign exchange interventions.

## Analysis and research

Throughout the year, the Bank continued to strengthen analytical surveillance and research including from our regional offices to support the MPC in its monetary policy decisions. In an environment of ongoing trade tensions, we continually updated our initial assessment of the impact of trade tensions on the global and Malaysian economy.<sup>3</sup> To improve understanding on inflation dynamics, we studied the relationship between imported food inflation and the exchange rate,<sup>4</sup> and how households form their inflation expectations,<sup>5</sup> as well as enhanced indicators

<sup>3</sup> Refer to the Second Quarter 2019 BNM Quarterly Bulletin box article entitled 'Unresolved Trade Disputes One Year On' on the BNM website for the analysis.

<sup>4</sup> Refer to the Third Quarter 2019 BNM Quarterly Bulletin box article entitled 'Food Imports and the Exchange Rate: More Than Meets the Eye' on the BNM website for the analysis.

<sup>5</sup> Refer to Bank Negara Malaysia's Annual Report 2018 box article entitled 'When the Future Starts Today: Inflation Expectations of Malaysian Households' on the BNM website for the analysis.

for the measurement of underlying inflation in the economy. Important insights were made in understanding the trends and behaviour in bank lending.<sup>6</sup> We also constructed internal capital flows-at-risk and global growth-at-risk surveillance tools, similar to that of the International Monetary Fund (IMF). These tools aim to assess and quantify the downside risks to future capital flows and global growth, respectively.

We also conducted research on longer-term and structural issues confronting the economy. Research emphasis during the year was on ways to reinvigorate private investments in the country. This led to collaborative work with the World Bank to improve the overall investment ecosystem in Malaysia. Work focused on three key areas of reform including establishing national investment objectives, streamlining investment promotion and investor services as well as improving the efficiency of tax incentive administration. We also provided advisory support to the Government on reviewing national investment policy through participation in key working groups such as for the New Industrial Masterplan and for the Twelfth Malaysia Plan (*Rancangan Malaysia Kedua Belas*, RMKe-12). As a financial advisor to the Government, we are a member of the Fiscal Policy Committee (FPC) and Debt Management Committee (DMC), providing input on strategies to strengthen the country's fiscal framework.

## Communication and outreach

In 2019, the Bank intensified efforts to widen our outreach on monetary and financial economics. We hosted our sixth Monetary Policy Conference, centred on the theme of current challenges facing monetary policy. The conference, which brought together representatives from central banks, academia, and international policy institutions, discussed the narrowing of monetary policy space, distributional effects of monetary policy, and whether new insights from other disciplines can offer fresh perspectives to monetary policy.<sup>7</sup> The keynote address was delivered by Professor Barry Eichengreen who touched on the challenges of macroeconomic stabilisation in an environment

<sup>6</sup> Refer to the Third Quarter 2019 BNM Quarterly Bulletin box article entitled 'Banking on Banks: Are They Lending Enough?' on the BNM website for the analysis.

<sup>7</sup> The Conference materials can be found on the BNM website.



Assistant Governor Marzunisham Omar delivering his presentation at the Monetary Policy Conference in 2019.

of low interest rates, and the spillovers from central bank actions to fiscal and climate change abatement policies.

The Tun Ismail Ali Chair, established by the Bank at the University of Malaya in 2001 to enhance expertise in monetary and financial economics, organised public lectures and a research workshop for academics, the private sector and policymakers, and issued research grants. This year also brought about the second installment of the Tun Ismail Ali Challenge, where undergraduates showcased their solutions to address cost of living issues.

We strive to continue to communicate with the wider public on monetary policy and economic analysis. The Monetary Policy Statement provides the MPC's assessment on the economic outlook and the rationale behind the committee's decisions.<sup>8</sup> The Monthly Highlights provides monthly updates on economic, monetary and financial developments. Further in-depth economic analysis is published in



The three young undergraduates who emerged as champions in the second Tun Ismail Ali Challenge in 2019.

<sup>8</sup> The Monetary Policy Statements can be found on the BNM website.

the Bank's Quarterly Bulletins.<sup>9</sup> For wider and easier accessibility, we incorporate infographics in the Bank's Annual Reports and Quarterly Bulletins, which are also disseminated on social media platforms.

## Going forward

With the world facing the outbreak of COVID-19, the Bank will focus on managing the impact of this unprecedented global health crisis on the Malaysian economy. In this regard, the MPC will

continue to assess all relevant data as well as economic and monetary developments in arriving at the appropriate monetary policy response. Monetary operations will continue to be directed at ensuring sufficient liquidity in the foreign exchange, bond and money markets to ensure uninterrupted financial intermediation. We will also continue to provide independent and professional advice to the Government on appropriate policy measures to see Malaysia through these challenging times.

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<sup>9</sup> The Monthly Highlights and BNM Quarterly Bulletins can be found on the BNM website.