Malaysia: BNM to tap on the brakes and our forecasts

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- **Malaysian GDP growth is significantly exceeding BNM's forecast for 2026, driven by strong energy, palm oil and electronics exports. While the economy is running strong, it is not running hot. Current headline and core inflation remain below 2%, near the centre of BNM's 2026 forecast band.**

- **Inflation pressures are building due to strong growth and sustained increases in global commodity prices linked to the Strait of Hormuz closure as well as AI-driven demand for Malaysia's electronics exports. However, the pass-through to domestic inflation so far remains modest and the labour market is softening, limiting wage growth.**

- **We are changing our OPR forecast from BNM being on hold in 2026 and 2027 to a one-off 25bp rate hike in Q426, taking the OPR to 3.00%. Such a move would reverse the one-off rate cut from a year ago and represent a light tap on the brakes rather than a full hiking cycle. The OPR would move into modestly restrictive territory. Future policy will depend on how long the Strait of Hormuz remains closed and on the sustainability of the AI boom.**

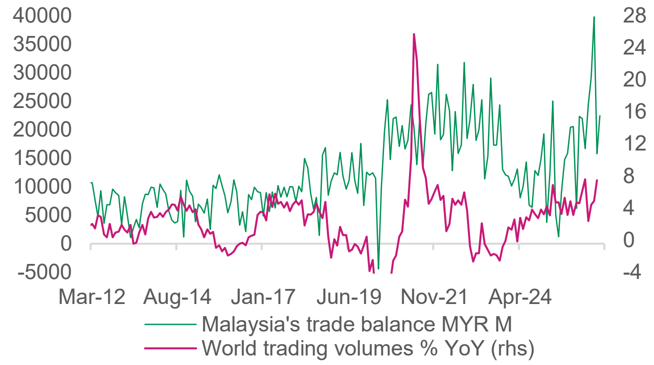
- **A one-off 25bp rate increase is unlikely to significantly affect the MYR, as USD/MYR is trading close to fair value. The exchange rate is more heavily influenced by US rates as well as gold, metal, food prices and domestic political uncertainty. Our USD/MYR forecast remains at 4.02 for Q4, with gradual weakening to 3.95 by end-2027.**

What's in a word?

At its September meeting, BNM left its OPR unchanged at 2.75% as widely expected. But a single word change has signalled that a rate hike is on the table at the upcoming meetings. In the section on bias, the word "appropriate" was dropped from the phrase "appropriate and consistent" when describing BNM's current policy setting relative to the goals of price stability and sustainable economic growth. So, the MPC no longer sees its current neutral policy setting as appropriate for the economy.

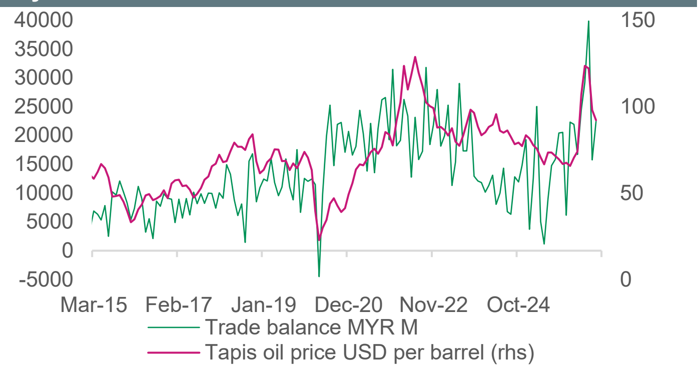
Despite the conflict in the Middle East, global trading volumes remain strong, boosting Malaysia's trade balance along with high energy prices (Figures 1 and 2). Malaysia's gas, oil and crude palm oil (CPO), exports, which make up about one-fifth of total exports, benefit from higher global energy prices.

Fig 1. Strong global trade is supporting Malaysia's trade balance



Source: Bloomberg, Crédit Agricole CIB

Fig 2. Elevated energy prices are also supporting Malaysia's trade balance



Source: Bloomberg, Crédit Agricole CIB

Malaysia's electronics exports, another about two-fifths of total exports, are being lifted by the AI boom (Figure 3). These factors, together with stable local consumption and investment, have pushed Malaysian GDP growth significantly above BNM's forecast band for 2026 (Figure 4). And high-frequency indicators point to sustained strong growth going forward (Figure 5). Consumption in Malaysia is being supported by strong tourism.

Fig 3. The AI boom and demand for Malaysia's electronic exports is boosting growth

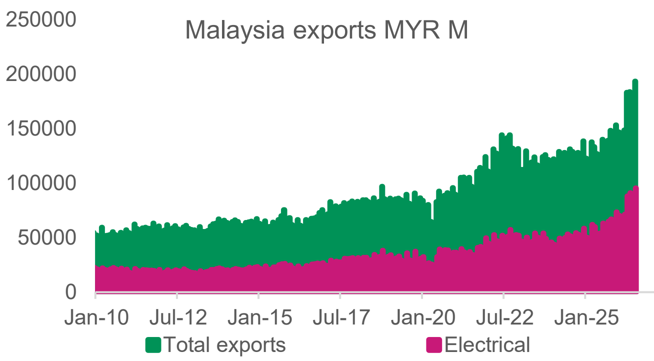


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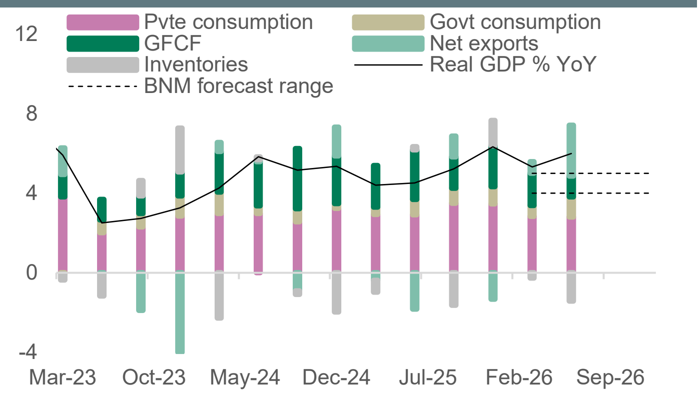
Fig 4. Malaysian growth is running above BNM's forecasts



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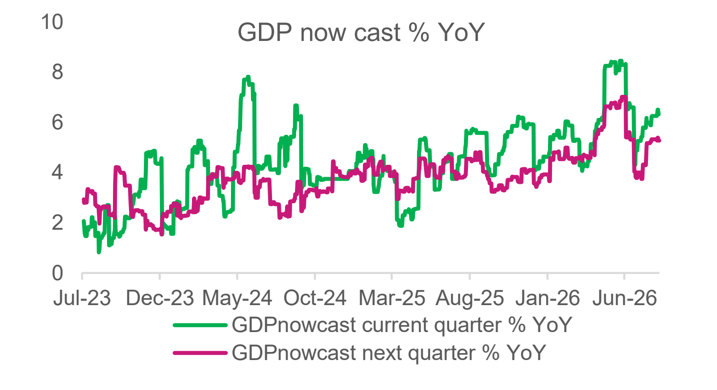
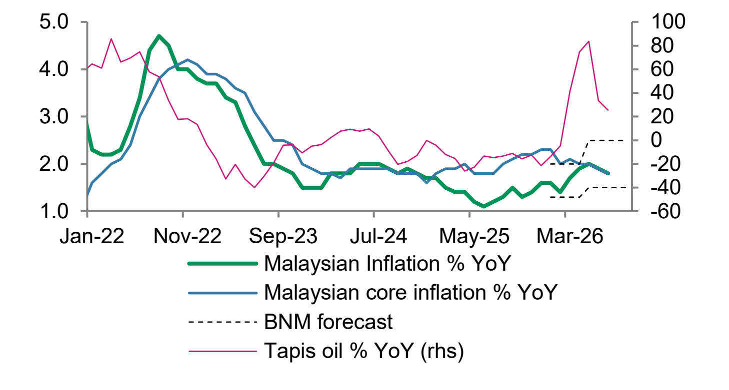
Despite strong growth, there are few signs that this is spilling over into significantly higher inflation. Headline and core inflation have dipped recently on the retreat in global energy prices and remain near the centre of BNM's forecast band for 2026 (Figure 6). The passthrough onto domestic inflation from higher global commodity prices is so far small. Importantly, the booming export sector on the back of strong demand for Malaysia's semi-conductors has not spilled over into stronger manufacturing wage growth (Figure 7). As we have noted ahead of the BNM meeting, the labour market has softened recently, and this is restricting wages growth (Figure 8).

Fig 5. High frequency indicators point to sustained strong growth



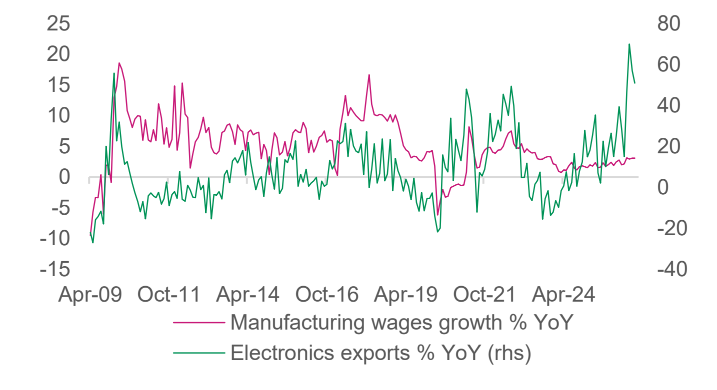
Source: CEIC, Crédit Agricole CIB

Fig 6. Higher oil prices have not spilled over into significantly higher inflation



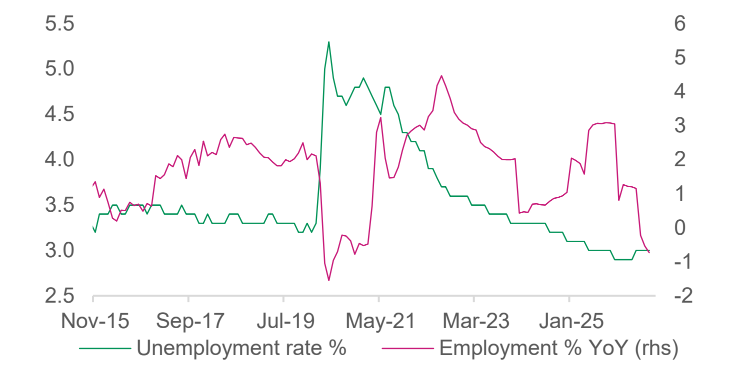
Source: Bloomberg, Crédit Agricole CIB

Fig 7. Strong growth in electronics exports has not yielded the usual strong growth in manufacturing wages



Source: Bloomberg, Crédit Agricole CIB

Fig 8. A softening labour market is holding back wages growth

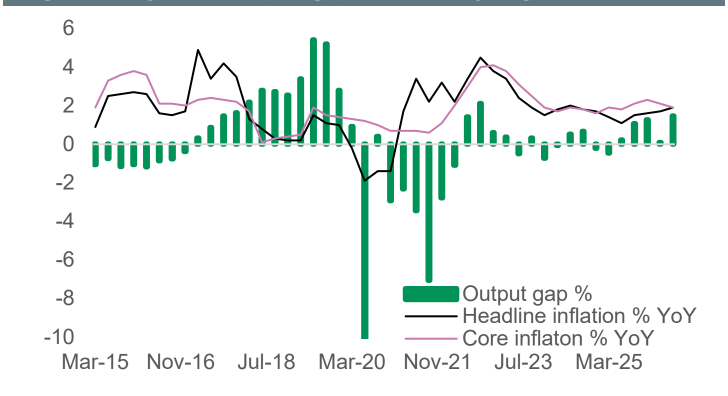


Source: Bloomberg, Crédit Agricole CIB

A light tap on the brakes

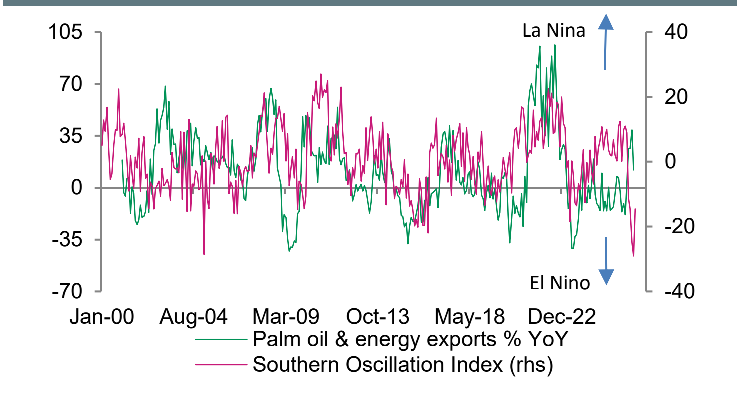
We do not expect a large adjustment by BNM or a rate hiking cycle. Instead, the central bank will likely want to move the OPR into modestly restrictive territory to offset the inflation pressures building from strong growth and a sustained increase in global commodity prices due to the ongoing closure in the Strait of Hormuz as well as the AI boom. Malaysia's output is not very high and the labour market is looking soft (Figure 9). And, with El Niño already leading to softer growth in CPO exports, BNM will likely have to only lightly tap on the brakes (Figure 10). So we look for just one 25bp rate hike in Q4 reversing the one-off rate cut a year ago. Beyond Q4, BNM's policy setting will depend on how much longer the Strait of Hormuz remains closed as well as the sustainability of the AI boom.

Fig 9. Malaysia's output gap is not very high



Source: Bloomberg, Crédit Agricole CIB

Fig 10. El Niño threatens weaker CPO exports

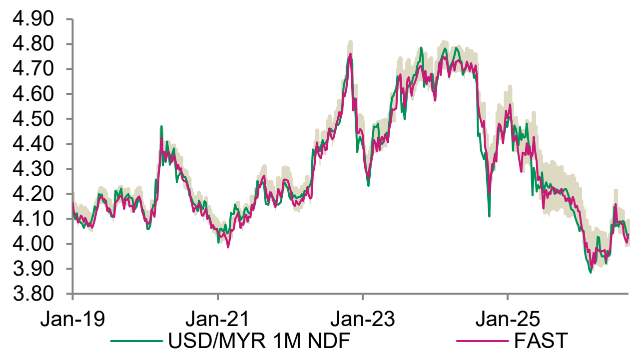


Source: Bloomberg, Crédit Agricole CIB

What does this mean for the MYR?

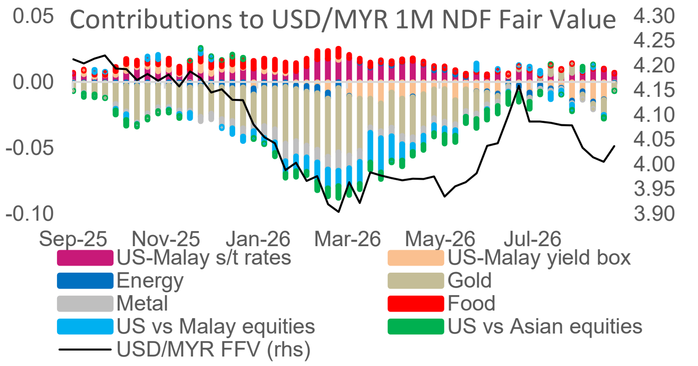
We think a one-off 25bp rise in the OPR is unlikely to make much of a difference to the MYR. Our FAST FX model for the USD/MYR 1M NDF shows that the NDF is trading close to its fair value (Figure 11). The larger driver of USD/MYR is likely to be the US side of the relative rates equation. Gold, metal and food prices are also strong drivers of the exchange rate (Figure 12). We also note that domestic political uncertainty continues weighing on the MYR. The next potential flash point between PM Anwar Ibrahim's PH party and its national coalition partner BN is around 16 September, when the two sides are supposed to have agreed on a seat-sharing arrangement for the upcoming Melaka state election. So we are currently inclined to leave our Q4 USD/MYR forecast at 4.02 and expect gradual weakening in the exchange rate to 3.95 by end-2027.

Fig 11. The USD/MYR 1M NDF is trading close to fair value



Source: Bloomberg, Crédit Agricole CIB

Fig 12. Along with relative rates, gold, metal and food prices are strong drivers of the USD/MYR 1M NDF



Source: Bloomberg, Crédit Agricole CIB

Conclusions

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