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STRUCTURAL REFORMS
BUILDING A RESILIENT MALAYSIA

Workshop 3

A Guide to Bank Negara Malaysia's Monetary Policymaking

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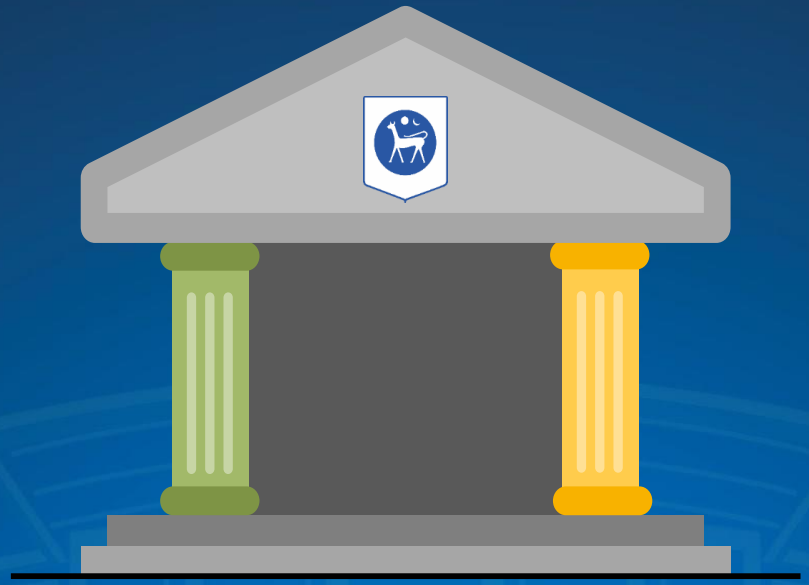
Part I
Back to basics – What is the MPC and what do they do?

BNM's mandate is to promote monetary and financial stability conducive to the sustainable growth of the Malaysian economy



Monetary Stability

Monetary stability means keeping prices in check so the economy can steadily grow over time

Financial Stability

Financial stability means that the financial system, including banks and markets, is working well and people have confidence in its ability to operate efficiently and reliably

The MPC is a dedicated committee charged with the mandate of promoting monetary stability

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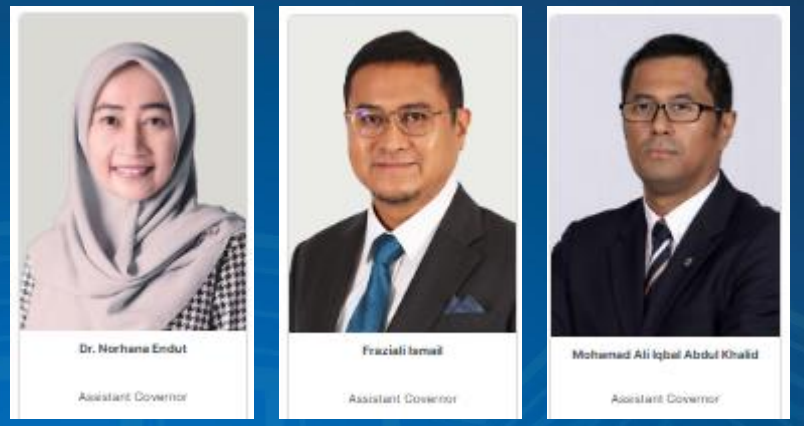
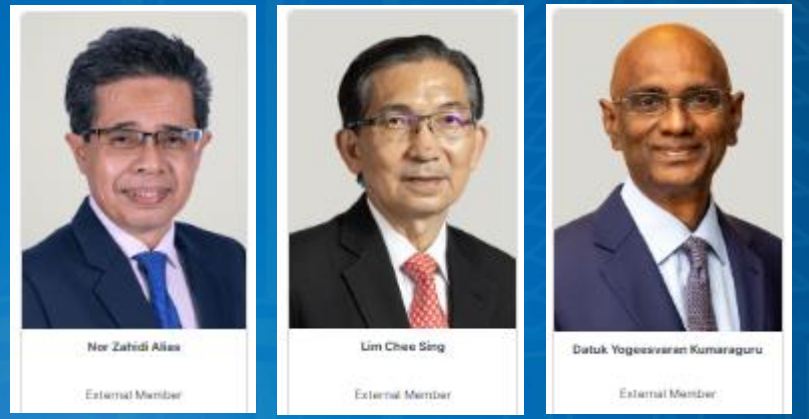
Chaired by the Governor of BNM
Members comprise the Deputy Governors and up to seven other members.

External members also comprise the MPC
Bringing diverse viewpoints, specialised knowledge, and additional insights to the table when making decisions about monetary policy.

The MPC sets monetary policy by adjusting the Overnight Policy Rate (OPR)
The OPR is BNM's policy interest rate that influences, among others, banks' lending and financing rates and deposit rates.







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Part II
What goes into a monetary policy decision?

The standard questions the MPC has in mind for each MPC meeting

How is the economy doing?



Growth and inflation developments

Where is the economy heading?



Outlook on growth and inflation

How should monetary policy respond?



Monetary policy strategy

In deciding on the OPR, the MPC looks at areas that span the latest economic, monetary, and financial market developments and outlook

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Global economy
- *Growth and inflation*
- *Country/region specific indicators*

Global financial conditions
- *Financial conditions Index*
- *Global monetary policy*
- *Global bonds, equities and FX markets*

Domestic financial conditions
- *Interbank liquidity*
- *Foreign exchange flows*
- *Local bond, equity and forward markets*

Domestic financing conditions
- *Lending rates*
- *Credit demand and supply for businesses and households*

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

Labour market
- *Employment and labour force participation*
- *Wage data for formal and informal sectors*
- *Productivity*

Consumer sentiments
- *Passenger car sales*
- *Credit card spending*
- *DOSM Composite Leading Index*
- *Business Conditions Index*

Inflation
- *Headline and core CPI*
- *Pervasiveness and persistence*
- *Household inflation expectations*
- *Business pricing*

Note: This list is not exhaustive

These then feed into the question of where the economy is heading through forecasting exercises



A suite of technical models are used
These provide numbers for what inflation and economic growth, among other variables, are projected to be in the next few quarters or years ahead.

Judgement
Judgment is essential in forecasting to handle uncertainty, incorporate qualitative factors, adjust for model limitations, interpret results, leverage experience, and plan for multiple scenarios.

Forecasts are never 100% accurate
But they provide a good guide for MPC members to form their views on what monetary policy should do.

Monetary policy strategy

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Balance of risks to growth and inflation

Scenario analyses

Risk analysis

Topical issues

Timing considerations

Communication strategy



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.

It can take up to two years for monetary policy to have most of its full effect on the economy.

For example



Decrease in OPR

1. Changes cost of borrowing and returns on savings

Lower interest rates on loans and savings

2. Influences decision to spend or save

People **spend more** and **save less**

3. Changes the overall demand

Supports demand for goods and services

4. Changes the overall economic activity and price level

Demand improves to be more in line with supply while prices would **increase at a faster pace**

Before an OPR decision is made and communicated to the public, multiple rounds of assessments and discussions take place to ensure sound decision-making

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Step 1 – Putting together the analysis
About six weeks before each Monetary Policy Committee (MPC) meeting, a series of discussions takes place across departments to ensure robust assessments and consistency in content.

Step 2 – The Monetary Policy Working Group (MPWG) meeting
The MPWG, chaired by the Assistant Governor overseeing the economics sector, discusses the economy's likely trajectory, key risks and uncertainties in the outlook. This lays the groundwork for the baseline projections and scenario analyses at the MPC.

Step 3 – After the MPWG meeting
Staff refine and update their assessments with the latest data before the MPC meeting to ensure the assessments are current and comprehensive.

Step 4 – The MPC meeting
The MPC meets over two sessions. The first session covers presentations on the economy, key projections, and the monetary policy strategy. In the second session, MPC members reconvene to deliberate on the monetary policy decision.

Step 5 – Communicating the decision
Once the monetary policy decision is made, the Monetary Policy Statement is published.

The OPR adjustments during the COVID-19 crisis offer a real-life example of the MPC's considerations



1 **2020: COVID-19 crisis**
The MPC cut the OPR from 3.00% to a historic low of 1.75% to help the economy stay afloat

2 **2021: Stabilising economy**
OPR was unchanged

3 **2022-23: Road to recovery**
The OPR was gradually normalised as more material signs of recovery had appeared amid the lifting of lockdowns

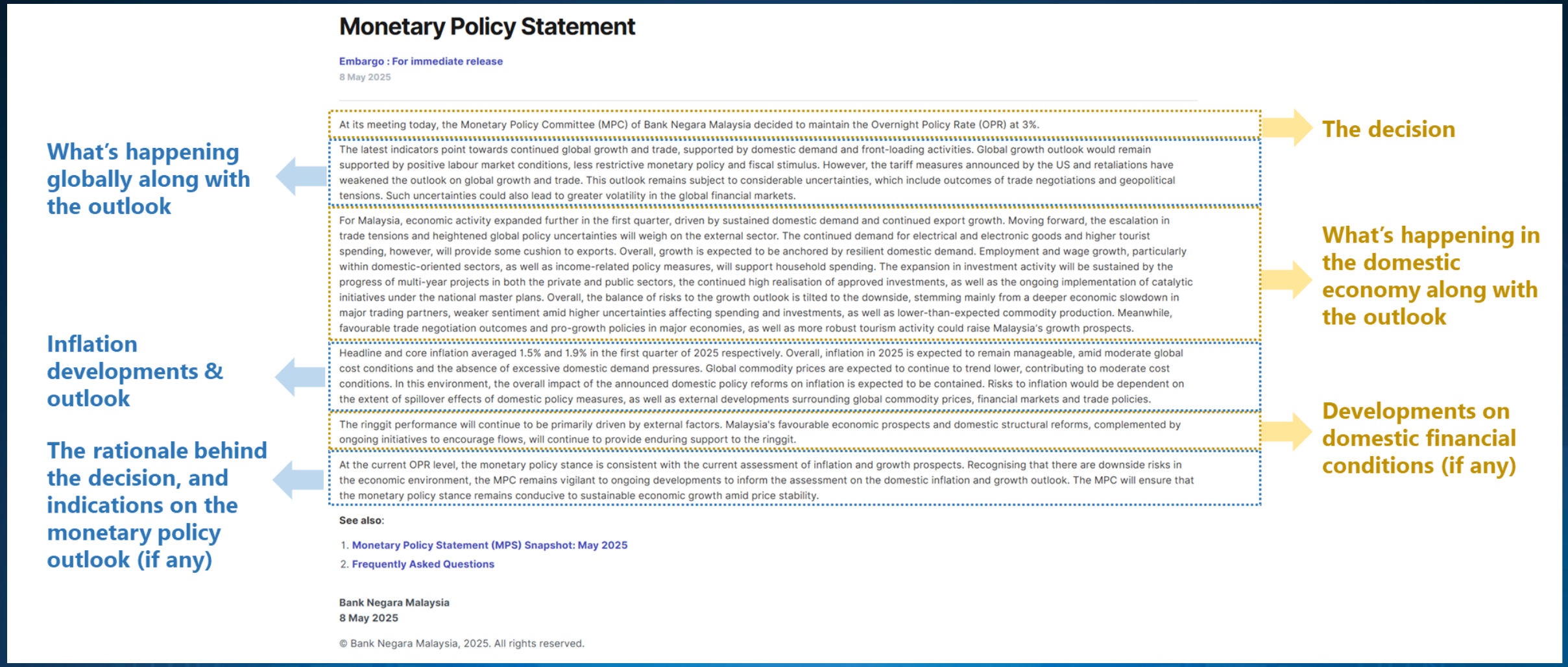
4 **2024 - present**
OPR remained unchanged at 3.00%

Source: Bank Negara Malaysia

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

The MPS is the key MP communication tool

The Monetary Policy Statement (MPS) is a press release from the MPC after each meeting, informing the stakeholders of the monetary policy decision taken by the MPC and why



The MPS drafting undergoes a robust process involving multiple deliberations before public release

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Pre-MPC

The MPS and MPS Snapshot are drafted ahead of the MPC meetings

- Includes versions to consider different OPR scenarios
- Reflects the staff's assessment and presentations
- Drafting is anchored by the MPC Secretariat, and is a collective effort which leverages a wide-range of expertise

Decision Day

- Once a decision is made, the MPC members collectively edit/draft the MPS
- A final review of the MPS takes place where subject matter experts step in to be the sounding board/provide any additional technical clarifications if needed
- Each MPC member signs off on the final draft, before other logistics are set in motion (e.g., BM translation, publication on website at 3pm)

MPC’s considerations when drafting the MPS



Economic outlook assessments

Provide insights into economic developments and outlook, as well as the MPC’s judgment on the balance of risks underpinning the OPR decision

Monetary policy stance

Communicate the MPC’s current view on monetary policy and factors that the MPC could be looking out for going forward, crucial in anchoring expectations on the future course of monetary policy

Overall tone of the statement

Ensure the tone is consistent with the monetary policy action and stance, minimising the risk of misinterpretation of the MPS

Getting the message across - the MPC consistently monitors how the MPS is perceived

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Analytical tools (both qualitative and quantitative) provide key insights on how the MPS is perceived, in terms of clarity and consistency with the monetary policy stance

1. Model-based MPS sentiment measure
2. Historical lexicon
3. Financial market data and surveys
4. Qualitative analyst reports
5. Social and conventional media coverage

Snippets of the change in MPS language in early 2020 as the COVID-19 crisis unfolded

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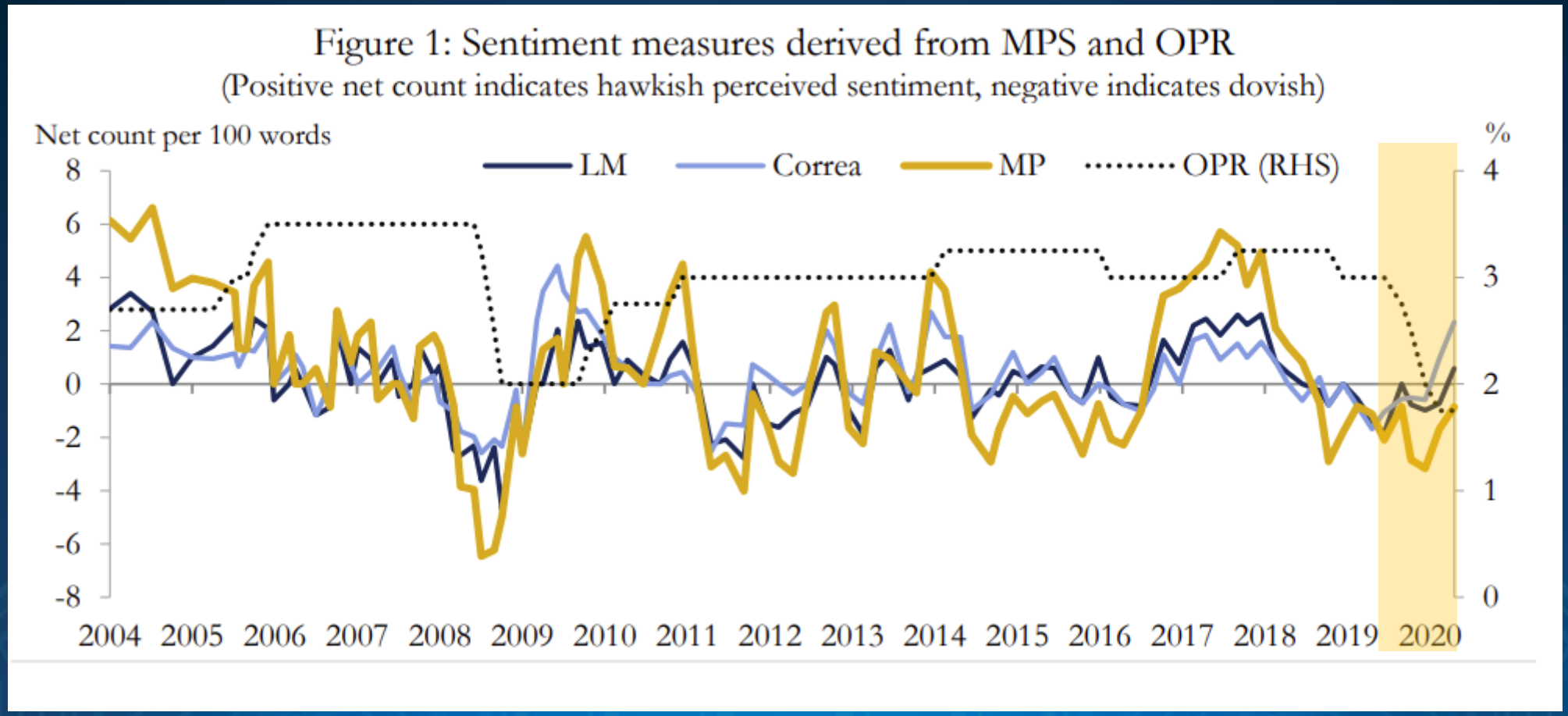
More subdued tone to describe the economic and inflation outlook as the pandemic worsened

Jan 2020	Mar 2020	May 2020
For 2020, growth is expected to gradually improve, with **continued support from household spending** and better export performance.	Household spending is expected to **grow at a slower pace** amid **moderate employment and income growth**.	The Movement Control Order, while necessary to contain the spread of the virus, has also **constrained production capacity and spending**. Labour market conditions are also expected to **weaken considerably.**
Underlying inflation is expected to **remain broadly stable**, reflecting the **continued expansion in economic activity** and the **absence of strong demand pressures.**	Underlying inflation is expected to be **more moderate**, amid **limited demand pressures** despite the **continued expansion in economic activity**.	Underlying inflation is expected to be **subdued given the projections of weaker domestic growth prospects and labour market conditions.**

Decline in the derived sentiment measures moved in line with the imminent OPR reductions during the COVID-19 crisis



Source: BNM Working Paper "Measuring Text-Based Sentiments from Monetary Policy Statements", October 2023. This paper is available on the BNM website (https://www.bnm.gov.my/documents/20124/826852/chong-ho-2023-bnmwp523.pdf).

Snippets of the change in MPS language in early 2022 as the economy recovered from the COVID-19 crisis

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More sanguine tone to describe a more entrenched recovery in Malaysia's economy

Jan 2022	Mar 2022	May 2022
Looking ahead, growth is expected to **gain further momentum** in 2022. This will be driven by the expansion in global demand and **higher private sector expenditure** amid **improvements in the labour market** and continued policy support.	Looking ahead, the **growth recovery will strengthen** in 2022, driven by the expansion in global demand and **higher private sector expenditure,** amid **improvements in the labour market** and continued targeted policy support. The expected reopening of international borders would also **provide further support to economic recovery.**	For the Malaysian economy, latest indicators show that **growth is on a firmer footing,** driven by **strengthening domestic demand** amid sustained export growth. The **labour market is further lifted** by a lower unemployment rate, higher labour participation and better income prospects. The transition to endemicity on 1 April 2022 would **strengthen economic activity**, in line with further easing of restrictions and the reopening of international borders.
Underlying inflation, as measured by core inflation, is expected to **edge upwards** as **economic activity normalises** amid the environment of high input costs.	Underlying inflation, as measured by core inflation, is expected to **normalise to around its long-term average** as **economic activity continues to pick up** amid the environment of high input costs.	Given the **improvement in economic activity** amid lingering cost pressures, underlying inflation, as measured by core inflation, is expected to **trend higher** to average between 2.0% - 3.0% in 2022.

Beyond the MPS, the information on monetary policy is conveyed to a wider universe of audiences through various other channels

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- Press conferences



- Media/ analyst briefings



- Publications



- Interviews, speeches



- Engagements with Government officials



- Social media



Take home messages

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1. One of BNM's mandate is to promote monetary stability, which means keeping prices in check so the economy can steadily grow over time.

2. The Monetary Policy Committee (MPC) is a dedicated committee charged with this mandate, chaired by the Governor of BNM.

3. The MPC sets monetary policy by adjusting the Overnight Policy Rate (OPR). The MPC makes monetary policy decisions autonomously.

4. In deciding on the OPR, the MPC looks at areas that span the latest economic, monetary, and financial market developments and outlook.

5. Before an OPR decision is made and communicated to the public, multiple rounds of assessments and discussions take place to ensure sound decision-making (working level → MPWG → MPC).

6. The Monetary Policy Statement (MPS) is the key communication tool for monetary policy and is crafted through a robust internal process. Beyond the MPS, monetary policy information is conveyed to a wider universe of audiences through various other channels (e.g., press conferences, analyst briefings).

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THANK YOU

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