

30 September 2026

BNM: Taking Back the Insurance

Growth has outlasted the insurance cut; one hike to 3.00% in 1Q27, then a long hold

OVERVIEW

- **Normalisation, not tightening.** We expect BNM to hold the OPR at 2.75% on 5 November, then raise it once, by 25 bps to 3.00%, in 1Q27 before a long hold. Growth of 5.7% in 1H26 has outlasted the risks behind the pre-emptive cut in July 2025. **BNM is expected to hike because conditions allow it, not because anything forces it.**
- **Neither classic trigger is present.** Each of BNM's last three normalisation hikes came with explicit language on financial imbalances. Its September 2026 statement has none, and core inflation eased to 1.7% in August. **On current evidence, a 1Q27 hike would lack an inflation or imbalance rationale.**
- **Household debt is high, but not building.** Household debt stood at 84.4% of GDP at end-1Q26. It grew 5.6% in 2025, in line with its pre-pandemic average, and BNM attributes recent moves in the ratio mainly to nominal GDP. **The economy is outgrowing its debt.**
- **The Fed changed our timing, not BNM's mandate.** The prospect of back-to-back Fed hikes prompted our change in call. Yet BNM held through a 250 bps gap to the Fed in 2023-2024. **Growth gives BNM the licence; the Fed sets the clock.**
- **Our model is more hawkish than we are.** Our BNM decision model puts the odds of a hike by end-1Q27 at 80%, against our 55%. We shade lower, mainly because BNM has yet to flag imbalances.
- **FX and fixed income.** We lift our end-2026 USDMYR target to 4.00 from 3.95. One more Fed hike slows ringgit appreciation but does not reverse it. The MGS front end has largely priced in a 1H27 hike, and we keep our end-2026 10Y MGS forecast at 3.88%.

CONTEXT

- **Normalisation, not tightening.** We expect BNM to hold the OPR at 2.75% on 5 November and deliver one 25 bps hike to 3.00% in 1Q27. BNM cut in July 2025 as a pre-emptive move to keep growth steady while inflation was moderate. That insurance has done its job. Growth reached 5.7% in 1H26 (2Q26: 6.0%; 1Q26: 5.4%), which BNM attributes to stronger-than-expected exports and sustained domestic demand. Inflation stays benign, with headline CPI at 1.9% and core at 1.7% in August. Neither inflation nor financial imbalances call for tighter policy. **The case rests on permission, not pressure.**
- **The last three normalisations each carried a warning. This one does not, yet.** BNM framed its hikes in July 2014, January 2018 and May 2023 as normalisation, each with an explicit financial-stability rationale (Table 1). In July 2014, with inflation expected to stay above its long-run average, BNM also aimed to curb the risk of broader economic and

Table 1: Drivers of BNM's Last Three Normalisation Hikes

Hike	Growth backdrop	Inflation	Imbalance language	Fed backdrop
Jul 2014	Firmly on a steady growth path	Above long-run average	Mitigate risk of broader economic and financial imbalances	Near zero
Jan 2018	Firmly on a steady growth path	3.8% in 2017; seen lower in 2018	Prevent build-up of risks from rates too low for too long	Hiking, 1.25-1.50%
May 2023	Resilient	Core to stay elevated amid firm demand	Prevent risk of future financial imbalances	Near cycle peak
1Q27F	GDP 6.0% in 2Q26	Headline 1.9%, core 1.7%	None in September 2026 statement	Hiking again, 3.75-4.00%

Source: BNM, Bloomberg, Kenanga Research

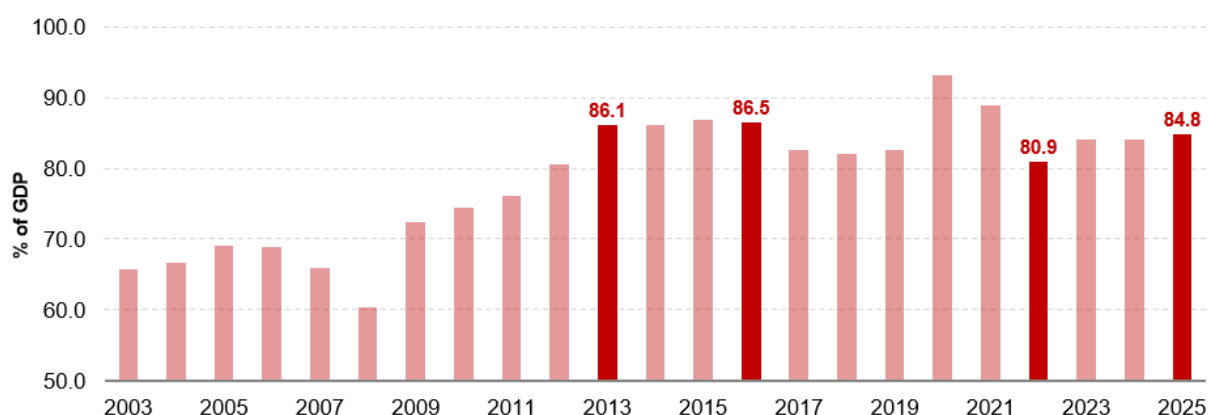
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financial imbalances. In January 2018, after inflation averaged 3.8% in 2017, it moved pre-emptively against the risks of rates staying too low for too long, even as it expected inflation to ease. In May 2023, with core inflation set to stay elevated amid firm demand, it cited the need to prevent future financial imbalances. The Fed backdrop differed each time, from near zero in 2014 to near its peak in 2023. On current evidence, a 1Q27 hike would lack an inflation or imbalance rationale. **If BNM adds imbalance or cost-pressure language in November, as it has before past hikes, we would read it as BNM preparing the ground for 1Q27, which would firm up our call.**

NO IMBALANCES TO CORRECT

- Household debt is high, but it is not building.** Household debt stood at RM1.73t, or 84.4% of GDP, at end-1Q26. The level is high, but BNM's own assessment points away from an imbalance. Household debt grew 5.6% in 2025, in line with its 2015-19 average, and BNM notes that recent moves in the debt-to-GDP ratio came mainly from nominal GDP. Housing anchors the mix: residential property makes up 61.2% of the total, cars 13.9% and personal financing 12.0%. Borrowers can service it. At end-2025, the median debt service ratio held at 33.0%, the median debt-to-income ratio at 1.3 times, and household financial assets covered debt 2.1 times. Riskier borrowers, with a debt service ratio (DSR) above 60% and monthly net disposable income below RM1,000, took only 7.9% of new loan approvals in 2H25. Buy now, pay later balances remain small at 0.3% of household debt. BNM's stress test places 84% of new impairments among borrowers with DSRs above 60%, well within bank capital buffers. **A high but stable level is a structural feature, not a build-up that calls for higher rates.**
- Speed, not level, is what worried BNM before.** What set 2014 apart was the pace of the build-up: household debt rose 25.7 ppt of GDP in the five years to 2013. In the five years to 2025, the ratio fell 8.4 ppt from its pandemic peak (Graph 1, Table 2), and 2026 is extending that trend. Nominal GDP grew 8.5% in 1H26, against 5.3% for household loans and 5.6% for total loans in July. The system can also absorb normalisation: BNM's latest stress test assumes up to 100 bps of OPR hikes alongside a deep recession, yet still projects the banking system's total capital ratio to stay above 15.0%, against an 8.0% minimum. **The economy is outgrowing its debt, which leaves no imbalance for BNM to lean against.**

Graph 1: Household Debt, % Of GDP (End-Year)



Source: Macrobond, Kenanga Research

Table 2: Household Leverage at Each Normalisation

Hike	Household debt/GDP (latest year)	Change over 5 years	BNM imbalance language
Jul 2014	86.1% (2013)	+25.7 ppt	Yes
Jan 2018	86.5% (2016)	+10.4 ppt	Yes
May 2023	80.9% (2022)	-1.8 ppt	Yes
1Q27F	84.8% (2025)	-8.4 ppt	None in Sep-26 statement

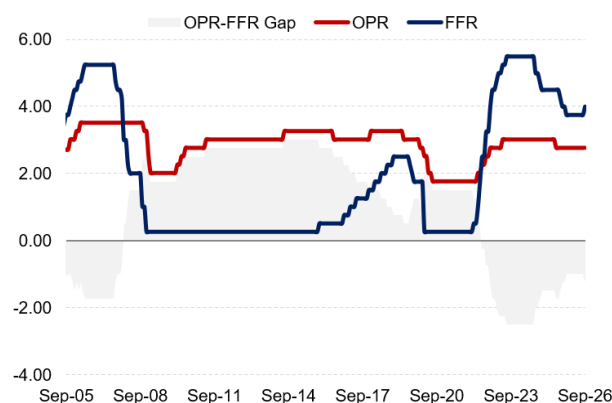
Source: BNM, Macrobond, Kenanga Research

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WHY WE MOVED NOW

- The Fed changed our timing, not BNM's mandate.** We held a no-hike view until September. What changed our call was the prospect of back-to-back Fed hikes. The Fed raised rates to 3.75-4.00% in September, and we now expect one more 25 bps in 4Q26, in line with its median dot, which has climbed from 3.375% in March to 4.125%. The Fed matters for timing only through channels BNM watches: the ringgit, portfolio flows and imported costs. BNM held the OPR at 3.00% while the gap to the Fed's upper bound reached 250 bps from July 2023 to September 2024. In 2018, it stopped at one hike while the Fed kept going (Graph 2, Table 3). The gap is 125 bps today and will widen to 150 bps after our expected Fed hike. Regional hikes reflect different inflation and currency pressures, so we do not read them as a guide for BNM. **Growth gives BNM the licence to act; the Fed sets the clock by raising the cost of staying at an insurance-level OPR.**

Graph 2: OPR vs FFR



Source: Bloomberg, Kenanga Research

Table 3: Fed Tightening Cycles and BNM Response

Fed cycle	Fed hikes	BNM response	Lowest OPR-Fed gap
2004-06	+425 bps	+80 bps (3 hikes)	-175 bps
2015-18	+225 bps	1 hike (Jan 2018), after a cut in 2016	+75 bps
2022-23	+525 bps	+125 bps (5 hikes)	-250 bps
2026 to date	+25 bps	None yet	-125 bps

Source: Bloomberg, Kenanga Research

WHAT OUR MODEL SAYS

- The model puts the odds of a hike by end-1Q27 at 80%.** We extended our BNM decision model with Fed futures, US yields and regional central bank moves, and added a second target: whether BNM hikes within its next three meetings, which from November covers the window to end-1Q27. The model, which already includes global rates, now gives 80% for a hike by end-1Q27, or 90% once local market pricing is added. By end-2Q27, these rise to 90% and close to 100% respectively. All sit well above our house calls of 55% by end-1Q27 and 75% by end-2Q27.
- The odds jumped when global rates turned.** The model's odds stayed below 10% at every meeting from November 2025 to May 2026. They rose to 45% in July and 50% in September, and stand at 80% today. Most of that rise comes from the global rate backdrop (the Fed's expected path, US yields and regional rate moves), with strong exports adding to it. We read this as timing, not motive. BNM's past normalisations tended to coincide with global tightening because both responded to the same strong global demand. The model tells us when conditions line up; BNM's mandate tells us why it would act.
- No imbalance signal in the model either.** Adding the three-year change in household debt-to-GDP worsens the model's forecasts, and its contribution to today's odds is slightly negative. Leverage has not been a reliable trigger for BNM, and it is not one now.
- History rhymes with 2022 and 2017, but 2018 is the warning.** On the model's inputs, the closest past matches since 2012 are March 2022, January 2022, November 2017 and July 2017. Yet the model's clearest false alarm outside the pandemic came in late 2018. The Fed raised rates by 100 bps that year, and the model's odds rose to 40% in November 2018 and 50% in January 2019. BNM held, then cut in May 2019, as growth slowed from 5.8% in 4Q17 to 4.5% in 3Q18. This is the clearest evidence that BNM follows the Fed only while domestic growth allows, and it is why we shade our odds below the model's.

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- **A Taylor rule cross-check.** We set the real neutral rate at 1.0% and the inflation anchor at 2.0%, which puts neutral at 3.00%. The rule adds 1.5 times the inflation gap and 0.5 times the output gap, which we put at 0.6-1.0% from a trend and an HP-filter estimate. That gives 2.85-3.05% on August core inflation of 1.7%, and 3.30-3.50% on the 2Q26 core average of 2.0%. A 3.00% OPR sits inside the first range and below the second: normalisation to neutral, not tightening.

OUR CALL

- **3.00% in 1Q27, then a long hold.** We put the cumulative odds at about 15% for November, 55% by end-1Q27 and 75% by end-2Q27. We shade below the model mainly because BNM has yet to use the imbalance language that came before its last three normalisation hikes. The 2018 precedent, election timing and a small sample of 15 hike windows add to that. That said, the model's largest errors were first hikes it priced at about 5% (July 2014, May 2023), so risks skew earlier. If GE16 is held before the hike window, BNM may wait for the new government's fiscal signals, pushing the hike into 2Q27. For November, our 15% sits below our next-meeting model's 20% (30% with global inputs) and market pricing of about 20%. A November hike would need local rates to reprice, with KLIBOR up by about 30 bps and the 3-year MGS up about 25 bps alongside higher CPI. We see none of this yet. **November is too early, but not off the table.**
- **One move, not a new cycle.** 3.00% is where the OPR sat from May 2023 to July 2025. July 2025 was only the second time BNM cut the OPR below 3.00% outside a crisis, and like the first, in January 2020, it was explicitly pre-emptive. We treat the next phase of RON95 subsidy reform as a post-GE16, 2028 story, so we see no inflation case for a second hike next year. **A second leg would need core inflation above about 2.5% after subsidy reform, a 2028 question.**
- **What would change our view.** On the hawkish side, two Fed hikes in 4Q26 rather than one, Brent above USD110 with local pass-through, and repricing in local rates would pull the hike forward to January. On the dovish side, fading growth would remove the case for normalisation, as in 2018. A one-and-done Fed, or a US-Iran deal that pulls Brent lower, would ease the pressure on timing. Watch growth more closely than the Fed.

MARKET IMPLICATIONS

- **USDMYR: we lift our year-end target to 4.00 from 3.95.** With spot at about 4.08, one more Fed hike slows the ringgit's appreciation but does not reverse it. The trend stays intact, backed by a current account surplus of 2.0% of GDP over the four quarters to 2Q26, a RM198.7b trade surplus in January-August, RM15.9b of foreign bond inflows in August and a BNM tightening bias for 2027. Foreign-currency deposits, elevated at RM336.8b in July, can convert once Fed hikes end, a tailwind that builds into 2027. **If the Fed is one-and-done, 3.95 is back in play.**
- **MGS:** The 3-year MGS trades 70 bps over the OPR, against a 2005-2026 average of 39 bps. 3-month KLIBOR trades 78 bps over the OPR, up from 48 bps at end-January 2026. The 1-year non-deliverable interest rate swap (NDIRS) at 3.74%, against 3-month KLIBOR at 3.53%, prices roughly one hike over 12 months. The current 10-year MGS trades at around 4.09%, up from an October 2025-January 2026 average of 3.50%. We keep our end-2026 forecast at 3.88% as the Fed nears its peak and foreign inflows extend. **With a 1H27 hike largely priced in, we see limited room for further front-end selling unless November surprises.**

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