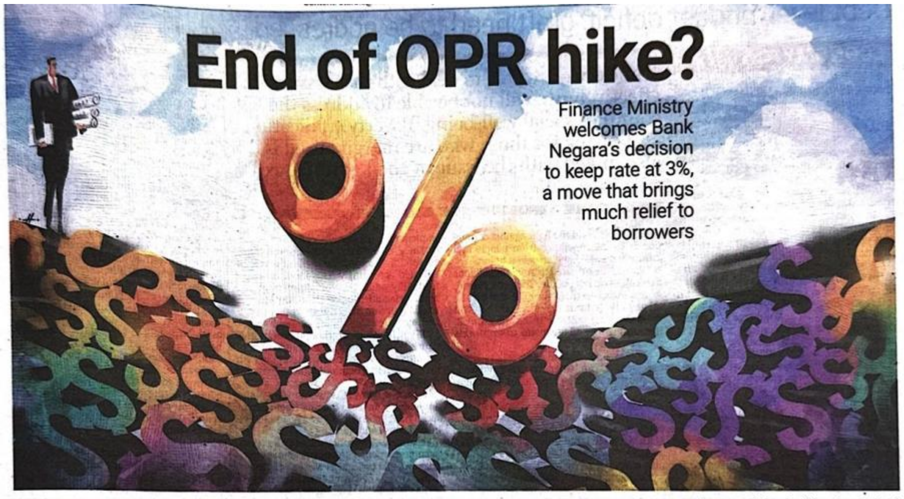
KERATAN AKHBAR

TARIKH : 7 JULAI 2023

AKHBAR : THE STAR

MUKA SURAT : 1 & 2 (Starbiz)

End of OPR hike?



ECONOMY

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PETALING JAYA: Has the new governor of Bank Negara brought the central bank's monetary tightening to an end, amid public pressure and slower growth concerns?

About two weeks after central banks in Indonesia and the Philippines kept borrowing costs unchanged, Bank Negara has also retained its overnight policy rate (OPR) at 3% as expected, bringing much relief to borrowers.

In a rare move yesterday, the Finance Ministry welcomed Bank Negara's decision to keep the OPR unchanged.

Malaysia's falling inflation that hit one-year low in May and the expectation of an economic slowdown in the second half of 2023 (2H23) are among the prime reasons for the latest OPR decision.

> "The current level of OPR is appropriate. After the OPR was raised to 3% in May, our real interest rate has turned positive, which is good. Judging from its latest statement, Bank Negara seems to be somewhat positive on the economy."
> Lee Heng Guie

Economist Geoffrey Williams said the unchanged OPR was good news to borrowers, but at the same time, has no "particular downside" for savers.

"I was checking savings rates and retail fixed-deposit rates recently and they are very low. So, recent hikes are not passed on much to savers," he told *StarBiz*.

At 3%, the benchmark interest rate is already at the pre-pandemic level.

The Monetary Policy Committee (MPC), chaired by governor Datuk Shaik Abdul Rasheed Abdul Ghaffour, said the current OPR level is "slightly accommodative" and remains supportive of the economy.

Nevertheless, some economists believe the risk of one more rate hike this year remains, perhaps by 25 basis points (bps) to 3.25%.

Globally, there are strong signals that major central banks like the Federal Reserve (Fed), Bank of England and European Central Bank could continue their rate hikes to combat stubborn inflation.

So far, Bank Negara has raised the OPR by 125 bps since May 2022, bringing the rate from 1.75%.

Meanwhile, Socio Economic Research Centre executive director Lee Heng Guie told *StarBiz* that the risk of a further rate hike is "quite small".

"The current level of OPR is appropriate. After the OPR was raised to 3% in May, our real interest rate has turned positive, which is good.

"Judging from its latest statement, Bank Negara seems to be somewhat positive on the economy," said Lee.

MIDF Research said in a note that Bank Negara is likely to raise the OPR to 3.25% by year-end, following the "stronger-than-expected domestic economy".

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Headline inflation continues to ease amid lower cost factors

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"In addition, Bank Negara may optimise its monetary arms through normalising its statutory reserve requirement (SRR) from 2% to 3% this year. The SRR rate was reduced to 2% in March 2020.

"However, the decision will be subjected to the stability of economic growth, the pace of price increases and further improvement in macroeconomic conditions, particularly a continued recovery in the labour market and growing domestic demand.

"From a medium-term perspective, the policy rate normalisation is needed to avert risks that could destabilise the future economic outlook such as persistently high inflation and a further rise in household indebtedness," the research house said.

Meanwhile, the Finance Ministry said the decision to maintain OPR was in line with the global economic developments as well as the inflation rate in Malaysia, which shows a downward trend and remains stable.

It added that the government is confident the Malaysian economy will continue to grow in 2023, supported by the declining unemployment and increasing economic activities, especially tourism.

Furthermore, the implementation of government projects will continue to be expedited to drive economic activities.

"Banks should always be aware of the difficulties faced by individual borrowers and small and medium enterprises and immediately provide restructuring and rescheduling facilities for their troubled loans," recommended Prime Minister and Finance Minister Datuk Seri Anwar Ibrahim.

The eight-member MPC said in a statement yesterday that it continued 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," it said.

The committee noted that the Malaysian economy expanded at a more moderate pace in recent months as exports were weighed down by slower external demand.

Growth for the remainder of the year will continue to be driven by resilient domestic demand.

Meanwhile, 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, the MPC said upside risks mainly emanate from domestic factors such as stronger-than-expected tourism activity and faster implementation of projects.

On headline inflation, the MPC said it 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 2H23, 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," it said.

According to Williams of Malaysia University of Science and Technology, inflation is already falling of its own accord.

He argued that the current interest-rate level is consistent with maintaining inflation close to normal just under 2% in the long term.

"The decision to hold rates is the right decision for the right reasons. All sectors will benefit from this.

"Holding rates steady around the normal level will be positive for the economy, especially since there are some headwinds from global growth.

"It will help businesses and consumers to be more confident and more stable and will allow policy attention to switch to long-term structural issues," he said.

There are views that a higher OPR will strengthen the ringgit against the US dollar. Since February, the ringgit has weakened by over 9.3% against the greenback.

MIDF Research said the differential between the OPR and the United States federal funds rate (FFR) is currently at the lowest level ever recorded.

The gap widened as the Fed increased its benchmark interest rate more aggressively than Bank Negara since the middle of last year.

"At this current juncture, the OPR-FFR differential is at negative 2.25%.

"We opine the widening OPR-FFR differential is one of the major factors contributing to the strong US dollar," according to MIDF Research.

However, Williams pointed out that the ringgit has stopped depreciating over the last week.

"Based on fundamentals, it should improve over the rest of the year.

"Reminding the markets to focus on fundamentals will strengthen the ringgit throughout the year.

"Unless there are major shocks, there should be no need to raise interest rates for the rest of the year," he added.

Lavanya Venkateswaran, OCBC Bank's senior Asean economist, also foresees Bank Negara to hold the OPR unchanged for the rest of the year.

"We believe that Bank Negara is now more sanguine about the growth and inflation outlooks but has stopped short of sounding less hawkish.

"This is justified, in our view, not just by external factors including the continued hawkish drumbeat of global central banks but also domestic factors including sticky core inflation pressures and the inflationary impact of potential changes to the government's subsidy policies," she said.