KERATAN AKHBAR

TARIKH : 5 JULAI 2023

AKHBAR : NEW STRAITS TIMES

MUKA SURAT : 23

OPR hikes unneeded for now

PROFESSOR GEOFFREY WILLIAMS

STABLE RINGGIT

OPR HIKES UNNEEDED FOR NOW

LAST week, the Financial Markets Committee (FMC) at Bank Negara Malaysia made very clear that the current weakness in the ringgit against the US dollar does not reflect economic fundamentals. It is right.

A lot of the negative sentiments in the markets reflect the underperformance of the ringgit relative to the other currencies for most of the year. However, Bank Negara correctly stood on its position that this weakness was driven by external factors outside of the control of Malaysian policymakers, as well as by news and sentiment in the financial markets.

The ringgit has performed slightly worse than other countries due to many reasons, including the lower interest rates. Even the recent rate hikes did not impact the ringgit much.

Therefore, factors outside of Malaysia are more important than the country's policy stance.

There is clearly a mismatch between financial market sentiment and the underlying economic fundamentals.

The ringgit and stock market performances should not be taken as barometers of the economy and the underlying value of ringgit should be stronger if we were to look at the strength of those economic fundamentals.

The economy grew 8.7 per cent last year and 5.7 per cent in the first quarter. It is forecast to grow by four to five per cent for the full year.

Inflation has also slowed to around 2.8 per cent and is expected to fall to below 2.5 per cent in the next few months.

The Overnight Policy Rate (OPR) is now in the normal range of around three per cent, while the monetary policy remains accommodating to growth.

This success is due in large part to Bank Negara sticking to its mandate and using the OPR to maintain price and financial stability rather than to chase market sentiments on the ringgit.

Policymakers in Singapore and Hong Kong have been using active exchange rate intervention to protect their currencies, even if it means a loss of economic growth. This is because they have different economic structures where the exchange rate has a much bigger influence through trade and financial flows.

But raising interest rates to defend their currencies has proved very costly for Hong Kong and Singapore.

Hong Kong had raised rates by 500 basis points (bps) since March last year and yet fell into a recession. Its gross domestic product (GDP) shrank by 3.5 per cent overall last year.

Singapore's GDP contracted in the first three months of this year and now risks a technical recession due to hikes of 320bps since March last year to defend the Singapore dollar.

If Bank Negara had matched every rate hike by the United States Federal Reserve, the OPR would be 6.75 per cent now instead of three per cent. This would crush borrowers, risk recession and collapse the ringgit.

Market speculators and those calling for a hike in the OPR to defend the ringgit must learn those lessons. Bank Negara has done a good job setting the OPR according to domestic conditions, which are strong enough to balance the volatility in the exchange rate without the need to raise interest rates too much.

The FMC statement has done its job ahead of the Monetary Policy Committee statement tomorrow and stopped the decline in the ringgit, which has been stable at around 4.66-4.68 versus the US dollar.

It emphasised that Bank Negara would intervene only in line with its mandate if movements in the exchange rate were excessive. This means that intervention is only justified if it affects the mandate of price stability, financial sector stability and sustainable growth.

Although it has acknowledged that the current movements in the ringgit are excessive when compared to economic fundamentals, it does not appear that this will necessarily affect its mandate as inflation is falling, the financial sector is stable and the economy is expected to grow four to five per cent this year.

It also noted the consensus among financial analysts for the ringgit to strengthen to around 4.50 versus the greenback by the end of the year. Separately, some put their estimates at around 4.20-4.30 to more closely reflect long-term norms.

Interestingly, Bank Negara also noted that many exporters and corporations are holding lots of foreign reserves.

Encouraging these firms to buy ringgit with their foreign currency reserves will help strengthen the local note in the short-term as a market-driven response. They could lose that opportunity if they wait.

This clearly signals that the market itself can help correct the mismatch between the current spot rate and the underlying economic fundamentals. So things are not that bad and actually, the ringgit strengthened slightly after the statement and has remained stable for a full week.

Apart from this, Bank Negara can do very little, if anything, to systematically influence the ringgit in the short term, as seen from recent OPR hikes that have only a minimal impact. Keeping the OPR high could damage the ringgit in the long-term.

Malaysia's foreign currency reserves are too low for Bank Negara to intervene for long.

It is also important to note that intervention by Bank Negara does not necessarily mean hiking the OPR. Based on the economic fundamentals and the stable ringgit, there is less need to raise the OPR now.

Therefore, we can safety pause any OPR hike at the next MPC meeting.

> *Encouraging these firms to buy ringgit with their foreign currency reserves will help strengthen the local note in the short-term as a market-driven response.*

The writer is an economist at the Malaysia University of Science and Technology. The views expressed are his own.