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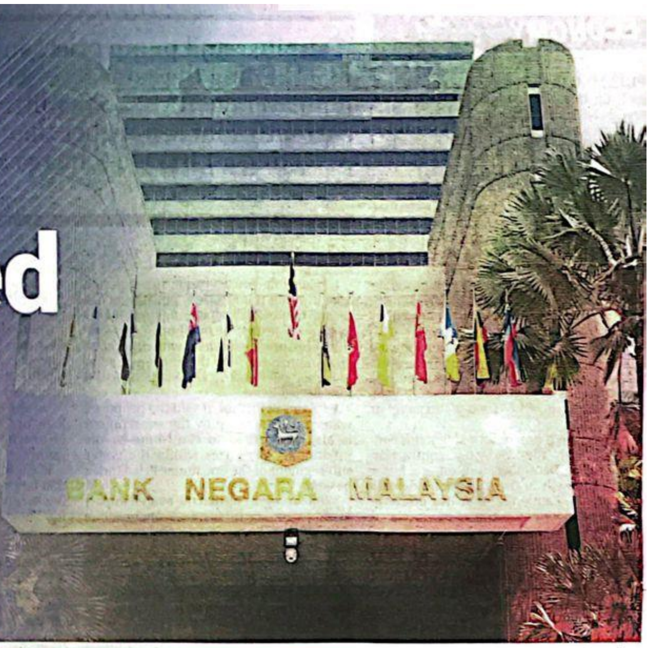
Bank Negara not expected to raise rate ahead of Monetary Policy Committee meeting



ECONOMY

By ELIM POON
elimpoon@thestar.com.my

PETALING JAYA: With inflation easing to its lowest levels since March 2021 and the country's gross domestic product expected to expand at a faster pace this year, economists are projecting that Bank Negara will keep the overnight policy rate (OPR) unchanged at its Monetary Policy Committee (MPC) meeting today.

Malaysia witnessed a sequence of interest rate hikes by the central bank in 2021, reversing the rate from a historic low of 1.75% in 2020. The country started 2023 with the OPR at 2.75%, a level maintained in the majority of the MPC meetings throughout the past year, with the exception of the meeting in May where the OPR was raised to its present rate of 3%.

Prof Yeah Kim Leng, who is one of the recently-appointed finance advisers to Prime Minister and Finance Minister Datuk Seri Anwar Ibrahim, said the current policy stance is deemed to be neutral as the rate remains supportive of growth, evidenced by continuing credit demand.

"Meanwhile, inflation, the other key OPR determinant, has eased as oil price pressures have subsided but remain volatile due to geo-political risks. Inflation risk remains a threat as core inflation stood at 3% last year, although on a monthly basis it had eased to 1.9% in December," he told *StarBiz*.

Yeah said the consumer price index will likely edge above the 20-year average of 2% to between 2.5% to 3% this year, influenced by factors like the increase in service tax from 6% to 8%, higher water tariffs, tax on low value goods, fuel subsidy rationalisation and a weak ringgit that is stoking imported inflation.

> **"With interest rates kept unchanged, there will be an upside for the ringgit as the dollar strength will reverse. There will also be lower imported inflation pressures while the ringgit strengthening will be positive for the import of capital and intermediate goods to expand production capacity and industrial upgrading."**
>
> Prof Yeah Kim Leng

Nevertheless, Yeah noted a recovery in trade, semiconductor industry upcycle, stronger investment and resilient private consumption amidst the improving job market and targeted subsidies are expected to drive the local economy in 2024, leading to better performance compared with last year.

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"There will also be lower imported inflation pressures while the ringgit strengthening will be positive for the import of capital and intermediate goods to expand production capacity and industrial upgrading.

"The expected reversal in US interest rates and dollar value will likely stimulate greater foreign capital flows into Malaysia that will further invigorate the financial sector and the overall economy," he said.

Similarly, Bank Muamalat Malaysia Bhd chief economist and social finance head Dr Mohd Afzanizam Abdul Rashid holds the view that Bank Negara will keep the OPR steady at 3% as the prevailing monetary policy stance is appropriate to promote growth.

"The economic growth is stabilising at 3.3% to 3.4% in the second half of 2023 (2H23) and we believe a similar trajectory would be maintained in 1H24.

"If the OPR remains steady, I believe it could provide some form of stability in terms of the cost of borrowing and would allow better planning for the businesses and households," he said.

However, Mohd Afzanizam noted that real interest rates are already in positive territory at 1.5%, which indicates that the monetary policy stance is quite restrictive as the cost of money is quite expensive in real terms.

"The average real rate of interest stands at 0.6% versus the prevailing level of 1.5%. Hence, the real rate of interest is expensive," he said.

While Universiti Tunku Abdul Rahman economics professor Wong Chin Yoong also concurred that the OPR will likely be maintained at 3%, he projected that there will likely be at least one rate cut before the year ends.

He argued that should inflation continue on its declining trajectory with the OPR remaining unchanged, real interest rates will become too restrictive for economic growth.

"It is crucial to consider the real interest rates in our current economic scenario. With the OPR at 3% and inflation hovering around 1.75% to 1.5%, we likely have a real interest rate of approximately 1.5%.

"This configuration appears reasonable in the context of a growing economy, reflecting a healthy and normal scenario.

"However, if inflation demonstrates a persistent decline, nearing 1% or even approaching zero percent, the dynamics of policy making would undergo a significant shift.

"Therefore, the trajectory of inflation in the upcoming months will play a pivotal role in determining the appropriateness of the current real interest rates," he said.

Nevertheless, Wong said Bank Negara may adopt a wait-and-see approach as inflation rates may make a U-turn and proceed on an upward trajectory with uncertainties in the Red Sea shipping incidence that is affecting global shipping rates and subsidy cuts locally.

Meanwhile, Centre for Market Education chief executive officer Dr Carmelo Ferlito warned that rate cutting cycles in the past has caused problems for the real economy. At the current stage, Ferlito said monetary policy will be quite neutral.

"The US Federal Reserve (Fed) has been the biggest generator of business cycles in the past decades.

"With aggressive rate cuts, they have induced asset bubbles like the dot com bubble in 2001 and the housing bubble that burst in 2008. The Fed's desperate quantitative easings had forced them to aggressive hikes later on to control inflation," he said.

Instead of interest rate adjustments which induce wrong investment decisions and asset bubbles, he said more pro-business and market-friendly reforms are needed to awaken profit expectations and induce investments.