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MORGAN STANLEY-MALAYSIA

RATES CUT IN MALAYSIA JUSTIFIED, SAYS MORGAN STANLEY

By: Mikhail Raj

KUALA LUMPUR, Aug 24 (Bernama) -- International financial services group Morgan Stanley says Bank Negara's move to again cut its intervention rate by 50-basis points to 10 percent is justified to counter the dangers of shrinking economic activity through deflation.

The firm, in a report issued from Hong Kong today on why Bank Negara eased its monetary policy, maintained that deflation, and not inflation, was what the Malaysian authorities needed to worry about.

Bank Negara cut its intervention rate by 100 points early this month in a bid to ease lending rates and make loans cheaper, thereby stimulating economic activity in the country.

The move, in contrast to calls by the International Monetary Fund (IMF) to raise interest rates, is gradually gaining support. Even foreign economists are now criticising the IMF's policies for doing more harm than good.

Morgan Stanley said the decreasing inflationary pressure was evident from the 0.4 percent decline in the Consumer Price Index for June this year.

In the year to July 1998, inflation was 5.2 percent and "our forecast for inflation for 1998 is 6.0 percent," it said.

In an economy where the stock of private credit is equivalent to 150 percent of Gross Domestic Product (GDP), policies that delivered deflation were not sustainable, Morgan Stanley emphasised.

"Deflation justifies a further 50-basis point cut in Bank Negara's intervention rate, the three-month intervention rate to 10 percent," it said, adding that interest rates in Malaysia are headed towards the 8.0 percent level.

However, it said that "interest rates have a long way to go before they are back to their pre-crisis level of 8.0 percent."

"But in our view that's where they are headed," it stressed.

In view of the changed scenario, Morgan Stanley said it was revising its year-end forecasts for the three-month interbank rate and the base lending rate to 8.0 percent and 9.7 percent respectively from 10.5 percent and 11 percent at present. The prevailing BLR is around 11.5 percent.

Narrow money growth turned sharply negative early this year and deflation broke out after a lag of about half a year. The authorities reversed the country's monetary policy stance in July but it would take some time for the effects of the earlier high interest rate regime policy to wear off.

The firm also forecast a four percent drop in the second quarter GDP following the 1.8 percent fall in the first quarter.

Morgan Stanley said an easier monetary policy and aggressive fiscal expansion -- two fiscal stimulus packages have boosted government spending by 20 percent -- are the only ways for Malaysia to avert a depression-style Gross Domestic Product (GDP) contraction this year.

It believed that Prime Minister Datuk Seri Dr Mahathir Mohamad's call for the people to "have faith in the government" meant that the government "is going to be the engine of growth in an effort to reverse the economy."

While this reversion to the state-led development model of the early 1980s might spook equity investors, Morgan Stanley is convinced that it would be much easier on the Malaysian population than the kind of contraction that the previous policies would have delivered. -- BERNAMA

MR SHY