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Interest rates and the market

INTEREST rates are the topic of the moment, and not just locally it appears. In Malaysia, there has been speculation that Bank Negara would soon cut its intervention rate, which is what it charges the country's banks for funds and currently standing at 5.5 per cent. Then there is the news that Malayan Banking Bhd, Malaysia's biggest commercial bank, has reduced deposit rates for various tenures, with many market players taking it as confirmation that lending rates are indeed edging south. In Washington, the US central bank, Federal Reserve, on Tuesday trimmed short-term interest rates, the third time this year, by half a percentage point to 5.0 per cent in an effort to ease "persistent pressures on profit margins (that) are restraining investment spending", including "declines in equity wealth, consumption". A day earlier, the Bank of Japan decided to "throw money at the banks" by reinstating a zero interest rate policy.

But rather than seeing interest rate adjustments for what they are, an economic management tool - albeit a key one - used to tweak policies to ensure the smooth running of the economy and achievement of objectives, investors have tended to react to them singularly as "stock market events". Granted that interest rates, perhaps more than any other single factor, determine how well-oiled a country's commerce and industry is, they are rarely reviewed and adjusted on their own, and not accompanied by a host of other measures deemed necessary to point the economy in the desired direction. Yet, on Wall Street for example, players are chiefly, if not only, concerned about how the availability of funds for stock trading is affected, when the intention of the Fed is to ensure that American businesses are not stymied by cash flow problems in the face of slowing demand. As a result, the Dow Jones Industrial Average plunged 238.35 points, or 2.4 per cent to 9,720.76. The market was disappointed that the rate had not been cut by 0.75 per cent as hoped.

At home, comments on the possibility of cheaper funds, likewise, were mostly confined to its impact on the stock market; whether such a move would do anything for share prices, which have been in the doldrums, notwithstanding yesterday's last-minute spurt of 16.74 points or 2.55 per cent to 673.24 by the Kuala Lumpur Stock Exchange's Composite Index (KLCI). What is also disturbing is that, like it or not, the stock market has come to be accepted as the main barometer of economic health, and sometimes worse, of political and social stability, and of corporate governance and corruption even, depending on the issue of the day. This is a "lazy" approach, as Prime Minister Datuk Seri Dr Mahathir Mohamad pointed out. One might add, foolhardy. Share prices can be manipulated, very easily, as can be seen at the height of the Asian financial crisis in 1997-98, the Prime Minister stressed at a seminar on Tuesday.

In the case of Maybank, news of its move to reduce deposit rates was received, in an all too common knee-jerk fashion, by share investors to mean that the bank's margins are under pressure, and that it was acting pre-emptively in anticipation of a fall in lending rates. The counter fell sharply on opening yesterday, but recovered later in the day to close at RM13.00, up 30 sen. People who unloaded their shares dismissed the fact that Maybank's margins have immediately widened, and will stay that way as long as lending rates remain the same, which is more than likely as Finance Minister Tun Daim Zainuddin has indicated that he feels there is no real need to make funds any cheaper than they are now. And even if

lending rates eventually decline, any shaving of the banking sector's overall margins, not just Maybank's, can be made up for by increased business volume. In fact, in the larger scheme of things, narrower margins are not a bad thing. The product or service provider will try harder to be efficient and competitive, and the consumer receives the best value for his ringgit.

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