

**Bank Negara hikes interest rates to 2.5%**  
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Bank Negara has hiked its key rate by 25 basis points to 2.5 percent today, in line with market expectations to unwind emergency measures from the global downturn after growth surged to a 10-year high.

Today's move brought interest rates back to where they were in January 2009 and was announced after data showed the Southeast Asian country's economy grew by a faster than expected 10.1 percent in the first quarter of 2010 from a year earlier.

The central bank maintained its policy stance that the move was part of its "normalisation" of rates, although it did appear to suggest that policy was "dynamic" depending on any contagion from Europe's debt crisis.

Bank Negara governor Zeti Akhtar Aziz again stressed that the key Overnight Policy Rate, still well below its record peak of 3.50 percent, was "accommodative" for further economic growth and that the central bank saw no inflation risks.

"I think the key point she wanted to make is that it is domestic growth that is going to take the lead on rate movements. Rates would remain on hold only if there are massive effects from European contagion, any kind of financial crisis, which would have strong implications for domestic numbers growth," said Rahul Bajoria, regional economist at Barclays Capital in Singapore.

"I think moving in clips of 25 bps is about right as the central bank has been suggesting it wants to normalise policy and anything above 25 bps might suggest a hawkish stance," he said.

Malaysia has now hiked interest rates twice this year off a record low of 2.00 percent, following in the footsteps of India with two hikes and a much more aggressive Reserve Bank of Australia, which has raised its policy rate six times since October.

Many of its Southeast Asian peers - Thailand and Indonesia - have left rates unchanged at levels adopted to fight the global financial crisis.

Bank Negara Malaysia said it expected growth in Asia's third most trade dependent country relative to the size of its economy, to be even stronger in the second quarter of this year, despite concerns over economic and financial contagion from a European debt crisis.

Malaysia's Prime Minister Najib Razak forecast the economy would grow 6 percent this year, more than the 4.5-5.5 percent forecast by the central bank.

"The Malaysian economy is now firmly on path to economic recovery - it continues to improve," Zeti told a press conference after the rate decision.

More rate hikes on the way?

Prior to the rate rise, the three-month interbank rate was at 2.67 percent while forward starting swaps showed the 3-month rate moving to 2.75 percent by mid August.

While that meant the market was pricing in less than 8 bps of rate rises by August, the KLIBOR itself has been trending upwards in the past few weeks in anticipation of a rate rise.

"This is a continuation of interest rate normalisation in Malaysia and we continue to look forward to a gradual increase in the benchmark policy rate in the quarters ahead. The OPR should end the year at 3 percent," said Irvin Seah, an economist at DBS.

Malaysia is not the only Asian country to have reported double-digit growth for the first quarter as the region leads the worldwide recovery from the global downturn.

China's economy expanded close to 12 percent in the first quarter over a year earlier and Malaysia's neighbour Singapore grew over 13 percent.

For Malaysia, the strong pace of economic growth may give the government more breathing room to implement difficult economic reforms such as reducing subsidies aimed at bringing down its 20-year high budget deficit.

In recent months, the government had delayed or postponed plans to hike petrol prices, electricity tariffs and implement a goods and services tax.

Najib however promised that subsidy cuts for items such as fuel, electricity and food would be introduced gradually although he said that they would be "as painless as possible".

Subsidies are planned to account for RM20.9 billion this year, down from RM24.5 billion in 2009, out of total federal government operating spending of RM148.4 billion for 2010.

Najib stressed on today that he would stick to plans to cut the budget deficit to 5.6 percent of gross domestic product this year from 7.4 percent in 2009.

- Reuters

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