

SPECULATION is rife that Bank Negara Malaysia (BNM) will raise its key interest rate by 0.25% in its upcoming Monetary Policy Committee meeting on July 28.

The investment fraternity sees the move as coinciding with the US Federal Open Market Committee (FOMC) decision to raise its intervention rate to 5.25%, its 17th hike since it started its monetary tightening.

The move is unpopular with many investors as it puts a dampening effect on businesses and the economy. A hike in interest rates raises the cost of doing business as borrowings become more expensive. It also stifles consumer spending.

There are also negative implications for the stock market as investors see a rate hike

judging from the current economic situation where the hike in electricity tariff has put pressure on prices, and to narrow the interest differential with the US.

However, he adds, the rate hike is expected and has been factored in by the investment fraternity. 'Judging from past hikes, the economy is robust enough to absorb the increases which I believe would not be very significant.'

Imran believes the increase would not damage investor confidence much, but says if the central bank decides to keep the old rates, then it would be positive for investors' sentiments, as it would be a pleasant surprise. He is looking at BNM raising rates by another 50 basis points to push the OPR to 4% by year-end.

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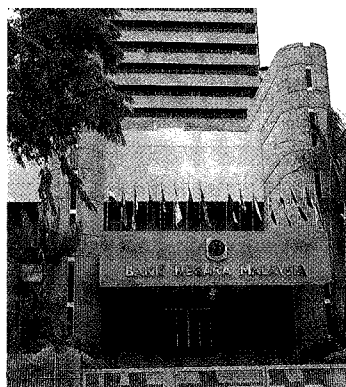
countries, namely the US, which has just recently raised its policy rate by 25 basis points,' he adds.

The interest rate differential gap puts pressure on the value of the ringgit and investment flows into the country. This is evident when the ringgit appreciated in recent months after BNM started to raise rates, which saw a huge inflow of funds to Malaysia.

Another factor why rates could be raised, Yeah adds, is the need to balance the negative real returns of deposit rates. 'Deposit rates are currently at about 3% while inflation rates are between 3.5% and 3.8%. This penalises savers as higher inflation figures eat into their deposit returns,' he says.

Yeah sees interest rate hikes as inevitable.

ANOTHER RATE HIKE?



The investment fraternity believes Bank Negara Malaysia will raise interest rates soon to keep up with the latest US hike.

By *Ishak Ahmad*

as dampening corporate earnings and pushing down bond prices as their yields become less attractive.

So, why should Bank Negara increase rates? One argument is that it is an effective tool to fight inflationary pressure. The other is to narrow the rate differential between other countries, especially the United States.

BNM has increased its rate by 25 basis points three times since last November, with the overnight policy rate (OPR) currently at 3.5%. The last time it raised rates was in April, citing concerns of inflationary pressure as the reason.

MIDF Sisma economist Imran Nurginias Ibrahim says he expects BNM to raise rates

chief economist and managing director Dr Yeah Kim Leng says: 'Despite the easing of inflation, as measured by the Consumer Price Index, to 3.9% in May from a record high of 4.6% in April, we believe BNM's interest rate policy decisions in the coming months would continue to be dictated by inflationary concerns and the need to address the negative real interest rates for depositors and the widening differentials with foreign interest rates.'

He says raising rates is an unlikely option this time around due to moderating growth which is expected to reduce external demand and increase the need for domestic demand to take up the slack.

'If the central bank sees growth is not that robust to take another interest rate hike, it will probably take a wait-and-see attitude. However, if BNM decides to increase rates, it is likely because it wants to reduce the interest rate differential between the

'It is a timing issue. If not this time around, maybe at the next meeting in September,' he says.

On the converse, BNM may likely raise rates by 25 basis points in its goal to maintain price stability, rather than to ensure economic growth remains robust, judging from the gross domestic product growth of 5.3% and 5.4% in the first and second quarter respectively.

At the end of the day, says the investment fraternity, the decision to raise or maintain rates would fall on BNM's reading of the economy. If it sees inflationary as a more pressing problem, it would raise rates, while an economic slow-down reading would see it delaying rate hikes.

'It is all a very delicate balancing act to maintain the right mix of growth and inflation,' says a bond trader. 'You can't have both at all times. One must be sacrificed for the other.' 