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Incremental gains

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AFTER months of seeing interest rates move up, the trend seems to have reversed. Leading banks such as Malayan Banking Bhd, Bank Bumiputra Malaysia Bhd, RHB Bank and Public Bank have all reduced their base lending rates (BLRs) in recent weeks. Maybank, the benchmark indicator, reduced its BLR to 10.9 per cent on Aug 17.

The reduction in interest rates is not surprising. Over the past few months, there have been vehement calls by the public and private sectors for rates to be eased to help relieve the pressure on the highly leveraged private sector. Prime Minister Datuk Seri Dr Mahathir Mohamad has openly expressed his preference for a lower interest rate regime.

However, unlike normal supply-demand circumstances, the decline in interest rates does not mean there is ample liquidity in the system nor there is no demand for funds. In this case, the decline in lending rates is to reduce the costs of funds and to correct earlier market perceptions. Indications that downward pressure was building up on interest rates were Bank Negara's decisions to reduce the statutory reserves requirement (SRR) of banks from 13.5 per cent to 10 per cent in February and again in July by a further eight per cent. According to the National Economic Action Council (NEAC), based on an average interbank interest rate of 11 per cent, the reductions in the SRR consequently capped the BLR for commercial banks and finance companies at 12.04 per cent and 14.42 per cent respectively for the month of August.

Besides the reductions in the SRR, efforts by the authorities these past few weeks to reduce the benchmark three-month Klibor rates also helped interest rates fall. The three-month intervention rate reduced by one percentage point early August, reducing the BLR by 0.8 percentage points for commercial banks and one percentage point for finance companies. Anthony Dass, the economist at TA Research, says the tapering off of the inflation rate also plays a role in reducing interest rates. Up until July private economists had predicted the inflation rate to hit double digits, mainly because of the falling ringgit. However, the inflation rate is now expected to settle at six per cent for the year and not higher as earlier feared.

'The real interest rate is coming down with the expectation of a lower inflation rate. So with the reduction in the real interest rate, there is some room to manoeuvre to bring down the BLR,' says Dass.

Before the economic problems began, the real interest rate was about three per cent but shot up lately to nearly five in anticipation of a higher inflation rate.

Dass also says that the notion that high interest rates keep the exchange rate steady no longer holds water, at least in the case of the ringgit. 'The interest rate no longer influences the exchange rate. The exchange rate is now driven by speculation, (market) sentiment and also developments in Japan and China,' he says.

The International Monetary Fund advocates high interest policies to attract capital and reduce the outflow of funds. However, this has proved inadequate in international capital markets in dealing with currency manipulators. A case in point is Hong Kong which, despite its high interest rates, still comes under speculative attacks.

As for currencies in Southeast Asia, the main concerns at present are whether the yen will fall further or whether China will devalue the

renminbi to boost its exports. Although China has stressed several times that it will not devalue its currency, the concerns are still there. But an economist with a foreign research house feels that the effect of reducing interest rates on the ringgit should not be discounted yet. 'The lower interest rates could still put the ringgit under pressure. Another point to note is that the lower rates do not reflect the liquidity situation in the system or that more money is being channelled to the real sectors of the economy. Domestic demand must improve,' he says. Banks are still cautious about giving loans while some manufacturers are still not keen on taking loans due to their high cost and the drop in domestic and international demand for goods and services. New loan approvals in the banking system dropped from an average of RM17.4 billion a month in the first half of last year to an average RM4.7 billion a month in the first four months of this year. Dass says that it will take time for the lower interest rates to translate into flows of funds to the real sectors of the economy. 'A decline in interest rates is good as it eases pressure on the highly leveraged private sector to service its loans. But the economy as a whole still has a long way to go before it gets out of the woods,' says the economist.

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