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Room to breathe

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AFTER months of agony, interest rates have attenuated to more acceptable levels. The rates seem to have come off their peak of about 18 per cent in the first quarter of this year to more familiar single digit levels of about nine per cent.

The decline in rates has wide ranging effects. For the man-in-the-street it has reduced installments of housing loans while corporate Malaysia gets more breathing space. This is especially so for highly geared companies that have seen their interest cover ratio coming down sharply.

Although the rates have come down as quickly as they went up, the debate on whether it is stimulating the economy is still open.

Under normal circumstances, lower interest rates mean the financial system is flushed with funds. There is less demand for money and subsequently bankers are eager to lend to get a higher return on capital. But in the current scenario, there is a perception that rates have come down basically due to intervention by Bank Negara and Malaysia's move to de-merchandise the ringgit. Therefore, argue market observers, the decrease may not be entirely because of market forces, Thus, the element of confidence seem to be sadly lacking, they say.

'On the other hand, the huge influx of ringgit by the Oct 1 deadline certainly did add to the liquidity and could have helped ease interest rates,' says an analyst. Moreover, interest rates started declining after sharp cuts in the Statutory Reserve Requirement (SRR). The SRR had been slashed from 13.5 per cent since early this year to just four per cent now. Every reduction of two points in the SRR releases about RM8 billion into the system.

Besides slashing the SRR, banks have also undertaken some measures like reducing their spread between deposits and lending rates to reduce the cost of funds. The liquid assets ratio requirement of commercial banks has also been reduced from 17 per cent to 15 per cent of total eligible liabilities.

So how effective have the capital controls been? When they were announced by Prime Minister Datuk Seri Dr Mahathir Mohamad on Sept 1, it was initially estimated that about RM15 billion would return to Malaysia. However, it has been reported that as much as RM11 billion has returned so far.

Although interest rates have tapered off, domestic demand has not increased. Property prices are still going down, car sales have picked up but they are nowhere near last year's levels, consumers are still spending less and there is a marked lack of enthusiasm among banks to lend money.

Jenny Yeow, automobile analyst with Merrill Lynch research house, says the reduction in interest rates has helped boost vehicle sales a little, especially the national cars. 'In fact the increase in car sales as a whole is driven by national cars. Aggressive promotion by national car distributors and relaxed hire-purchase rules have helped boost sales. But there are still concerns among consumers about the state of the economy and job security while finance companies are still conservative in their lending,' she says.

The latest figures by the Malaysian Motor Traders Association (MMTA) substantiates Yeow's contention. It shows that only sales of Proton and Perodua vehicles are picking up while that of non-national cars are still not encouraging. For instance in August, 15,432 vehicles were sold out of

which 80 per cent were Proton and Kancil models.

As for the property sector, the National Housing Price Index report reveals that residential and office property prices are still dropping and are not expected to recover until the second half of next year. That, according to some analysts, is an optimistic view. 'For property prices to recover, buyers must have confidence, banks must be willing to lend and the existing over-supply of office space and residential properties must be absorbed. Unless all these things happen, property prices are unlikely to pick up,' says an analyst. 'Banks cannot be blamed if they are reluctant to lend at the moment. Although their capacity to lend has increased, they are still reeling from the effects of careless lending and rising non-performing loans the last few years.'

Declining interest rates also seem to have little effect on the stock market's performance. In normal circumstances, low interest rates translate into a better stock market as the holding cost of funds is cheaper. But at the time of writing, the Kuala Lumpur Stock Exchange Composite Index was hovering around 360 points.

However, the declining interest rates have, to a great extent, reduced the contraction of the economy and perhaps even averted foreclosures of some businesses. Even the International Monetary Fund (IMF) has admitted that the traditional prescription of high interest rates and tight fiscal policy is not the path out of the current economic turmoil affecting half the world.

This year, Malaysia's gross domestic product (GDP) is expected to contract by about five per cent. The chairman of the Institute of Strategic and International Studies, Tan Sri Dr Noordin Sopiee, was quoted as saying that the economy would have contracted by about 10 per cent if not for measures taken to reduce interest rates and stabilise the ringgit.

He expects to see a GDP growth of more than two per cent next year but private economists say they would be content even if Malaysia pulls out of the negative territory. Compare this with the GDP contraction of 2.8 per cent in the first quarter. It further contracted by 6.8 per cent in the second quarter. In the fourth quarter of last year, the economy grew by 6.9 per cent.

As for corporate Malaysia, the reduction in interest rates has brought a huge dose of relief. The lower interest rates and the ringgit's peg against the US dollar have helped ease cashflows in highly leveraged companies and perhaps even averted foreclosures of some smaller businesses.

Among the highly geared companies that have seen their interest cover dwindle are Hicom Holdings Bhd, Diversified Resources Bhd, Renong Bhd, Southern Steel Bhd, Sistem Televisyen Malaysia Bhd (TV3), Country Heights Holdings Bhd, Malaysia Airlines System Bhd, Berjaya Group Bhd, Kedah Cement Holdings Bhd, Mancon Bhd and Pernas International Holdings Bhd. Their total borrowings is believed to be more than RM36 billion.

Most of these companies have attractive assets and viable businesses but have seen a constriction in cashflow due to the tight liquidity situation and high interest rates. The reduction in interest rates is expected to ease their cashflows considerably.

However, the same cannot be said for companies which have taken court protection from creditors under Section 176 (10) of the Companies Act to undertake restructuring exercises to reduce their borrowings. Among them are Aokam Bhd, Kuala Lumpur Industries Holdings Bhd, Plantations and Development Bhd, Wembley Industries Bhd, Time Engineering Bhd, MBf Holdings Bhd, Wing Teik Bhd, Westmont Industries Bhd and Arab-Malaysian Corporation Bhd.

Total borrowings of these companies are more than RM10 billion with 85 per cent from domestic sources. In such instances, a restructuring or sale of assets is favoured. But a reduction in interest rates while not being sufficient, will certainly lessen their debt servicing burden.

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