

16/10/2002

Govt's warning of higher SRR a good wake-up call

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EVER since the last recession, the Government has been trying to get banks to lend more money so Malaysian companies can spend to get the economy back on its feet.

The trouble is, ever since the last recession, banks have been wary about lending, not least because they were heavily blamed for some suspect lending practices that resulted in a collective non-performing loans ratio of 27 per cent at the peak.

The Government wants banks to increase their lending by at least 8 per cent per year, but banks collectively only managed 2.8 per cent loan growth for the last 12 months from August 2001 to July 2002.

To break the stalemate and to encourage banks to relax and free up their coffers, the Government gave a thinly-veiled ultimatum - that unless banks meet the 8 per cent loans growth, they may have to put more money into a non-interest account with Bank Negara.

Banks now have to put 4 per cent of their funds into the statutory reserve requirement (SRR) but Prime Minister Datuk Seri Dr Mahathir Mohamad hinted that the bar could be raised if banks fail to meet the loan growth target.

The Government's threat to raise the requirement seems justified since it cut the SRR from 6 per cent to 4 per cent in September 1999 just so banks will have more funds to increase lending at the height of the effects of the 1997-98 Asian financial crisis. The SRR stood as high as 13.5 per cent in June 1996.

While banks choose to remain silent on the SRR issue, bankers privately complain that they are between a rock and a hard place.

The 1997 currency crisis pushed companies to default highlighted bad loan decisions that had the national non-performing loans ratio spiralling to 27 per cent in 1998, which the country is still unwinding.

"Having burnt our fingers then, we have learnt our lesson," said one banker. "We have become prudent."

But being prudent has its own set of problems. The slow rate of loans growth has increased banks' deposit-to-loans ratios beyond profitability, but shows that banks have excess capacity that the Government is keen to tap.

Excess capacity, not just apparent in Malaysia but in the region, has caused weak demand for loans in the corporate sector, the main contributor of loan growth during the boom years.

"As long as excess capacity exist coupled with a modest growth in the economy, loan growth is expected to be unexciting. The thrust will continue to focus on consumer loans namely hire purchase, credit cards and housing/mortgage," a senior fund manager said.

Corporate loans are also taking up less space in the banks' books because companies are repaying their loans, yet banks are not lending them new money because the world economic situation has become riskier.

"It is unfair to blame the banks for the slow loan growth as they are answerable to shareholders ... being prudent is one them. The current business environment is tough on everyone," a local fund manager said.

OUB-TA Asset Management Sdn Bhd's general manager Mohd Hasnul Ismar Mohd Ismail believes the Government's warning to raise SRR is a good wake-up call to the banking industry to be more serious in boosting their loan growth but added that an increase in SRR is not expected to have a

significant impact on banks' bottom lines.

"A one per cent increase in SRR would only have a 0.5 per cent impact on a bank's earning per share," Mohd Hasnul said. A report from AmResearch said that a 1 per cent increase in SRR and assuming no change in the base lending rate will have a less than 1.5 per cent dilution impact on earnings of most banks, except for RHB Capital Bhd at 3.3 per cent. Still bankers are not taking chances, and the side-effect of the SRR warning is their renewed interest in corporate bonds as banks accumulate debt papers that would count as loans in their books.

"The bankers hope that an increase in loan growth would help ease some tension between the Government and banks in relation on the unsatisfactory loan growth," a bond manager said.

He said banks are now buying higher rated debt papers, namely, AAA and AA and they are not choosy.

The drop in Kuala Lumpur interbank rates last week due to weak demand for money has also caused banks to switch some investments to bonds, according to bond traders.

"Under the finance report, banks can include investment in corporate bonds in their loan portfolio. As such, they (banks) are using this as one means to boost their loan growth and ease the Government's concern on loan growth," a treasury manager in a leading local bank said.

He said the buying of these bonds has been done gradually so as not to cause a rally in prices, thus making investment in these debt papers more attractive.

In the calculation of loan growth, banks are allowed to use private debt securities (PDS) except for bonds issued by Khazanah Nasional Bhd, Pengurusan Danaharta Nasional Bhd, Pengurusan Danamodal Nasional Bhd, and Cagamas Bhd.

However, industry players said the move is more of a knee-jerk reaction by the PDS industry, adding that banks will still have to grapple with increasing loans through lending to companies and corporation. "Banks can invest only so much in corporate bonds. At the end of the day, loan growth will still depend on traditional lending to companies," a bond trader said.

Industry observers believe the Government's strategy is to exert pressure on banks to do more lending and thus be a more active participant in the country's economic recovery.

The threat of an increase in the SRR may be causing a stir but the impact is arguable if the increase is between 1 per cent and a high of 4 per cent.

A bond trader estimated that a 4 per cent increase in SRR would wipe about RM11 billion from the banking system, currently estimated at between RM50 billion and RM52 billion.

In Rating Agency Malaysia Bhd's (RAM) recent report on the banking sector, it said liquidity remained flushed with the banking system's ratio of net loans and advances to total deposits standing at about 86 per cent as at May 2002.

This was partly due to the policies implemented by Bank Negara since September 1998. In addition, deposits continued to outpace loan growth, RAM added.

RAM's senior manager Meor Amri Meor Ayob told Business Times that he was not surprised by banks' recent move to accumulate corporate bonds, adding that it is a natural progression of their businesses.

"Generally speaking in a credit risk perspective, I am more comfortable with a bank that has a bond book rather than loans ... the former is less riskier. Bonds have a tradeable market which makes that a liquid asset.

"In comparison, a bank cannot dispose of a loan so readably as there is

no market or a price mechanism as in the bond market," Meor Amri added.

On the converse, industry players said there are frictions of goals between the Government and the banks, and these differences will have to be narrowed. It is likely to be gradual. But some see that a drastic move to increase the SRR might be necessary.

Analysts said any increase in the SRR would be negative for interest margins and banks will be under pressure to take on more riskier business.

An increase in the SRR, the amount banks have to deposit with Bank Negara, will definitely be more costly to them than maybe forgoing some profits by boosting lending activities, they said.