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Turning up the heat on banks with SRR issue

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THERE is this saying that when the US sneezes, Malaysia (and the rest of the world) will catch a cold. Tweak it, and the saying could go like this: When the Prime Minister hints, a sonic boom will be felt.

That was what exactly Datuk Seri Dr Mahathir Mohamad did when he tabled the Budget in Parliament.

He criticised banks for not lending enough to companies and individuals, and that they prefer to invest in "safe" financial instruments. Then he hinted that the Government would be compelled to use the SRR (statutory reserves ratio) tool.

The very mention of the SRR was enough to send a sonic boom throughout the local banking industry, shaking the bank stocks on the KLSE last week, which some analysts called a "knee-jerk" reaction.

Firstly, banks do not like the SRR as it would mean locking up part of their funds, for which no interest is paid, with Bank Negara.

(The SRR is the amount of money that a financial institution keeps with Bank Negara as a statutory requirement for liquidity. It carries no interest, and is based on the financial institutions' eligible liabilities, mainly deposits.)

Secondly, raising the SRR would eventually squeeze their margins if all other rates are not raised accordingly to compensate for the rise in SRR. This would mean lower profits - something that banks definitely don't like.

Hence, the SRR is a part of the formula used to calculate the BLR (base lending rate) - the minimum rate to which most lending rates is pegged.

Changing the SRR would mean changing the BLR. And any move to up the BLR would be suicidal under the present economic scenario.

It would mean interest rates moving up, thus stifling borrowings for investment - a move that is in turn contrary to one of the main objectives of the Budget, that is to boost the growth of small- and medium-sized industries.

Currently, the SRR is four per cent, having been last adjusted on Sept 16, 1998 and is the lowest since January 1990. For every percentage point increase in the SRR, some RM3 billion cash would be mopped up from the banking system.

Banks are saying that one percentage point rise in the SRR would have a minimal effect on them. Even the impact on the net interest income of the bigger banks would average only a minimal 0.9 per cent according to one calculation.

The RM3 billion is minute given that the current overhang in terms of money saved and not spent is RM50-RM55 billion according to official sources, while the market is talking of RM60-RM65 billion.

The normal size of the overhang is usually RM20-RM25 billion according to some analysts, which means the banking system is flush with cash. Last Monday, the day after the previous Friday's Budget, the KLSE finance index dropped 1.80 per cent or 97.51 points with 11.5 million shares changing hands.

For the following two days after that, the finance index continued its free-fall into what seemed a bottom-less pit.

Each day the index fell at almost the same percentage points (1.97 per cent on Tuesday and 1.90 per cent on Wednesday), on high volume (60.98 million on Tuesday and 27.49 million on Wednesday).

Only on Thursday did the selling pressures abate.

When many saw the performance of the bank stocks, their conclusion was that the local banks were shivering in their pants over what Dr Mahathir had announced in his Budget speech.

But were these banks really fearful of what the Prime Minister had said? Or was there a sinister motive behind the plunge in bank share prices, and thus the finance index?

Chartists will tell you that generally the market was already in a downtrend days (or even weeks, as some would claim) before the Budget on Sept 20, except that the slide was slower and more agonising, of course.

The Budget merely nudged the slide into a free-fall.

If that was the reasoning, then fund managers could have seen a window of opportunity to dump all the bank stocks they had, hoping that with the sharp drop in prices, they could pick the stocks up later at lower prices, making a bundle, thanks to the Budget.

Last week's few days of share price plunge in bank stocks had made this argument more credible. Of course, other fund managers holding stocks other than bank stocks would be silly not to follow suit.

The result, throwing out not only bank stocks but also other index component stocks.

Added to this were rumours that local institutions were not supporting the market for one reason or another.

But as some would say, market players were just waiting for an excuse to bring the market down. The Budget provided that excuse with bank stocks opening that window of opportunity.

Even more fascinating was the heavier part of the day's selling came in the afternoon, suggesting that the selling was exacerbated when the European markets opened (European markets open when the KL market is trading in the afternoon).

Bringing the finance index way down, and subsequently the whole KLCI substantially lower, an over-sold situation would be reached where a strong technical rebound would occur, so the chartists would say.

In another perspective, Dr Mahathir's words on the SRR had also created a stir on another front - the continued role of Bank Negara as a pro-active pacesetter in the management of the country's financial system.

Many said this was the first time that the Prime Minister had mentioned the SRR in the Budget. And what's more, he cautioned that the SRR would be used should banks fail to change their lending 'attitude'.

Some asked: Shouldn't what the Prime Minister had said should have come from Bank Negara Governor Tan Sri Dr Zeti Akhtar Aziz?

Others argued the Prime Minister was speaking as Finance Minister when he presented the Budget, and that Bank Negara comes under the Finance Ministry.

Some asked: Could the fact that the Prime Minister threatened to use the SRR on financial institutions mean that Bank Negara had been ineffective in getting the financial institutions to have a 'proper attitude' towards lending?

The talk in banking circles these days is that the central bank does not strike the fear of God in many of the bankers.

This is unlike the days of the late Tun Ismail Ali whose authority and the respect he commanded went far beyond the confines of the financial services sector.

Zeti could be good at her work (or not, as her critics would say), but she still needs to have the stature of a central banker. Many have said she lacks industry experience, that she is more an academic, and that she should play a more pro-active role as Bank Negara Governor.

Former Bank Negara staff would say that the central bank these days no

longer has the dynamism of the yesteryears, especially during the days of Tun Ismail, the late Tan Sri Jaffar Hussein, Tan Sri Dr Lin See Yan, Andrew Sheng and Dr Zainal Aznam Yusof.

Many say Zeti should regain for the central bank the respect that it once commanded.

But then others would argue that the Bank Negara Governor today is operating in a politico-economic environment unlike the governors in those days.

Today, the hands of the politicians are stronger than the hands of the professionals in setting monetary and banking policies.

In this context, it is unfortunate that foreign financial circles view Bank Negara as a tiger without teeth.

But just as before, there is a divergence of views between Bank Negara and the powers-that-be over the use of interest rates to stimulate the economy.

In the past, SRR was seldom used as a policy instrument. Bank Negara in those days preferred to "play around" with the money market than use the SRR.

In a way, some commented that the Budget 2003 is turning the SRR into a "monetary weapon", besides being used as a monetary policy instrument.