

Bad Loan Jitters

While the Malaysian banking system remains resilient, a recent build-up in non-performing loans is causing some anxiety.

By Bhupinder Singh

THE fear of non-performing loans (NPLs) besieging the banking system is beginning to grip investors. They are becoming jittery over the recent rise in non-performing hire purchase loans for commercial transport vehicles that have shot up almost three-fold from June to September, due possibly to escalating oil prices.

Many worry that home mortgage NPLs could follow suit as such NPLs in the banking system rose 15.8% year-on-year (y-o-y) to RM10.1 billion last December after going up some 26% at end-2002 to RM8.74 billion.

The fear over rising NPLs was sparked off by the default on a syndicated loan by independent power producer Northern Utility Resources Sdn Bhd. Meanwhile, Affin Bank had turned the screws on PSC Industries Bhd to settle its borrowings.

Banking analysts say while the jump in commercial vehicle NPLs was a surprise, there is little reason to get worried about home loans for now.

'Consumer banking has become a much more strategically sought-after segment and the single-customer risk for home loans is much lower as compared to a corporation,' says Promod Dass, manager, Financial Institutions Ratings, at Rating Agency Malaysia Bhd.

'The loan growth for home mortgages has been rising by about 15-20% y-o-y. The rate of default in home mortgages for the commercial banking industry is still fairly stable at 7-8% for the last two years. Therefore, we do not find it alarming at present,' he says.

Bank Negara Malaysia figures for September indicate that overall, the banking system's net NPLs ratio based on the six-month classification declined to 6.1% in September from 6.2% in August, the lowest since the Asian crisis.

Loan and private debt security issues for September were the highest for the year at RM47 billion. On a net basis, total financing grew at an annual rate of 7.6% that month. The banking system posted a pre-tax profit of RM3.3 billion as of end-June.

Promod says the more pressing issues facing banks centre on the increasing competition that is eating away at margins, the need to offer greater product diversity and increase fee-based incomes and a possible further consolidation of the sector.

The good days, based on the banking sector's leading indicators, look set to continue into 2005 on the momentum in place. According to the Asian Strategy and Leadership Institute (Asli), the economy is set to post a growth rate of at least 7.6% this year, which is above the official forecast of 7%. The expansion rate, however, is expected to be slower in 2005.

'What is certain is there will be a slowdown but what is not certain is the degree. That will depend on oil prices and the impact on the United States' and China's economies,' says Tan Teng Boo, managing director of Capital Dynamics, a local research house.

China and the US are Malaysia's two largest trading partners and play a big role in the world economy. The US has been the export market of choice while China's growing consumption of raw material from across the world has had a broad-based impact on the global economy.

That has come at a price. World oil prices have shot up, fuelled partly by China's industrialising economy. If oil prices remain in the US\$45-US\$55 a barrel region, Tan believes the impact on the global economy and Malaysia will not be that serious.

The impact of the high oil prices will begin to show after six to nine months. The effect so far has been mild and the labour market has not seen upside wage pressure, which has allowed employers to absorb or pass on the higher cost to consumers.

But if oil prices continue to rise and inflationary momentum builds, that would put pressure on wages and lead to further pressure on prices and inflation. Monetary authorities would then begin a cycle of

funds into ringgit deposits and financial instruments may lead to a bubble effect in the stock market as foreign funds look for opportunistic assets.

Sungei Way Group adviser Tan Sri Ramon Navaratnam believes the ringgit peg needs to be adjusted but he doesn't doubt the growth potential of the Malaysian economy.

'The economy should grow by about 7% next year. The outlook is pretty good relative

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tightening, as recent hikes in interest rates in some economies show.

Rising costs would derail any sustainable recovery, which would lead to a global slowdown. A weaker global economy remains a strong possibility as large economies like the US and Germany have large fiscal deficits that need to be reigned in.

The US' fiscal and trade deficits are a major concern at this juncture. Any rapid adjustment of the imbalances could trouble financial markets and derail economic stability. The falling US dollar is leading foreign exchange markets to speculate that the ringgit peg may change.

According to Tan, increased inflow of

to neighbouring economies. The balance of payments is healthy and the budget deficit is being managed. The only concern is the exchange rate. For the structural health of the economy, I think we should follow a market-oriented policy,' he says.

Navaratnam, who is also a director of Asli, adds that while the undervalued currency has short-term benefits, the business community must not be lulled into complacency as a change in policy could happen anytime.

The other major concern of the local economy has been the budget deficit. Tan believes the ability of the government to control the deficit would depend on exports. Should exports fall significantly, the government may need to provide an expansionary stimulus.

How the business community has been taking all this is difficult to judge. Some economic indicators are giving mixed signals. The industrial production index (IPI) for September expanded at its slowest pace in 2004, up 9.8% to 233.5 as compared to 212.6 the previous year. On a month-on-month basis, the index rose 1.7%, while the stock market has performed well enough.

The key fundamental issue would be to become more competitive, which will require more reforms. 'The biggest concern now is reform. They are not coming fast enough but then again, it could be worse,' says Tan, who believes productivity must be the yardstick of competitiveness rather than an undervalued currency. **mb**



As the NPL for hire purchase of commercial transport vehicles rose, there were fears that home loans might follow suit