Move to ease banks' lending constraints

Analysts say Bank Negara may reduce SSR soon

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PETALING JAYA: With the banking system's loan to deposit (LD) ratio on the rise and squeeze on net interest margin (NIM), analysts and industry observers say Bank Negara may reduce the statutory reserve requirement (SRR) from the current 4% soon to ease lending constraints.

The industry's LD ratio, according to Maybank IB Research, was a far cry from the average 78% that it recorded in 2009. The ratio continued to climb and crossed the 90% mark to 90.4% at end-August.

NIM spreads (i.e. the spread between average lending rate and average deposit rate) had narrowed further in August to 1.32% from 1.35% in July, being the lowest in recent times due to declining lending rates, the research house noted.

Malaysian Rating Corp Bhd (MARC) head of banking Sharidan Salleh told *StarBiz* that given the current LD ratio level and tightening of NIM, the likelihood of reduction in SRR may have increased.

In the past, the central bank had reduced the SRR to as low as 1% and therefore, the current SRR of 4% provide sufficient buffer for further reduction, he noted.

The SRR has stood at 4% since July 2011.

"Central banks have the option to cut the SRR to add liquidity to the banking system to spur lending activities.

"We have seen China recently undertake a big cut to its reserve requirement and Bank Negara has used this approach during the economic crisis in 1998 and 2008 for this purpose," he added.

UOB Kay Hian, in a recent note, said it expected potential reduction in the SRR in the upcoming Budget 2016 to help enhance system liquidity and maintain a stable interbank interest rate environment in light of rising system LD ratio.

Affin Hwang added that with this ratio on an uptrend, it signals constraints in lending, noting that the brokerage believed there would be further constraints in lending in the remaining year.

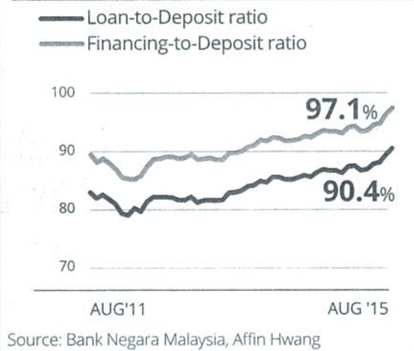
Despite the latest loan application data showing an expansion of 3.1% year-on-year (yoy) in August, loan approval declined 9.0% yoy. Loan approval rates declined to a nine-year low of 41% in August compared with 48% in the first eight months of this year and a high of 65% in 2007.

The higher rejection rates were largely seen in household loans where loan approval declined 15.2% yoy in August while business loan approval remained flattish. Total loan growth yoy for August stood at 10.2% compared with 9.7% in July.

Sharidan said the rating agency was more comfortable with LD ratio of between 80% and 90% as it provides a balance between the banks ability to continue growing its loans, and maximise its return.

The ratio of close to 100% maximises the bank's ability to generate higher net interest income, but limited its ability to further lend out using cheap funding sources, he said.

However, a higher ratio of above 100% means the bank is financing its lending activities via the more expensive funding sources. Sharidan expects loan growth to be about 8% to 9% yoy this year and the next.



Teoh: 'Customer deposits, on the other hand, have decreased since the first quarter of this year.'

OCBC Bank (M) Bhd chief financial officer Teoh Yin Meng said the bank expected the industry LD ratio to continue its upward trend for the next few months before settling down to around 90%-92% by year-end.

In the light of current economic conditions, it is only natural that banks would be more cautious in their lending decisions, she pointed out.

"Whilst outstanding loans have continued to increase, this is mainly on the back of drawdowns on facilities approved previously and the loan growth will likely taper down in line with the slower loan approvals since early this year.

"Customer deposits, on the other hand, have decreased since the first quarter of this year with capital outflows but these should stabilise as corporates lock in profits on their investments abroad and those investment profits as well as foreign currency export proceeds move from offshore to onshore," Teoh noted.

However, she said the bank did not expect lowering of the SRR this year as a lower SRR is usually used as a tool to stimulate loans growth. Given the political and currency volatility in recent months, the slowdown in spending and investment is likely to extend beyond the normal 12-month goods and services tax gestation period and a lower SRR would have minimal positive impact other than to cushion the banks' NIM compression, Teoh said.

Wong says the rating agency also examines the Basel III liquidity coverage ratio.

Meanwhile, RAM Ratings co-head of financial institution ratings Wong Yin Ching said while the LD ratio has risen quite steeply on the back of slower deposit growth, it was not the only indicator to look at.

She said the rating agency also examined the Basel III liquidity coverage ratio (LCR) which measured the amount of high quality liquid assets held by banks to meet the potential cash outflow in a stressed scenario over a 30-day horizon.

As of end-August, banks liquidity profiles were still sound as reflected by the industry's average LCR of 124%, which was higher than the Basel III requirement of 100% to be achieved by 2019, Wong noted.

RAM is projecting a loan expansion of 7% for this year and 6% next year after recording 9.3% last year.