

Easing of Monetary Policy

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In early August, Bank Negara Malaysia initiated a monetary policy easing following fundamental trends indicating that there was an absence of inflationary pressures. Latest indicators confirm the absence of a build-up in demand pressures and the inflation rate has shown some degree of moderation. Ringgit rates have also remained relatively stable with fluctuations in rates reflecting mainly external developments. In July, monetary growth moderated further primarily due to further declines in outstanding loans as repayments exceeded disbursements. Under these circumstances and given the need to support the recovery process, monetary policy is eased further.

In line with the stance of monetary policy to support the economic recovery, Bank Negara Malaysia today announces the following additional measures.

- (i) With immediate effect, the Bank Negara Malaysia intervention rate (3-month interbank rate) will be reduced to 9.5% from 10%.
- (ii) Effective September 1, 1998, the Statutory Reserves Ratio (SRR) of commercial banks, finance companies and merchant banks will be reduced to 6% from the current level of 8%.
- (iii) Effective September 1, 1998, the BLR framework is revised to allow a faster transmission of changes in monetary policy on interest rate levels . The calculation of the BLR will be based on the Bank Negara Malaysia 3-month intervention rate instead of the KLIBOR, while the administrative margins of financial institutions that are allowed in the BLR computation will be reduced to 2.25% from 2.50%.

The combined impact of the reduction in SRR and the Bank Negara Malaysia intervention rate will ease liquidity in the banking system, making available more loanable funds to borrowers, and at a lower rate. The maximum BLR of the commercial banks and finance companies is expected to moderate to 10.34% and 12.36%, respectively. With the revision in the BLR formula, the lower lending rates would be effected almost immediately following the reduction in the intervention rate and the SRR.

Details on Revisions to the BLR Framework

Under the existing framework, the maximum base lending rate (BLR) which banking institutions are allowed to quote ("computed BLR") is computed based on the 3-month weighted average interbank rate of the previous month and a flat administrative margin of 2.5 percentage points.

It is currently observed that the computed BLR is not responsive enough to changes in interest rates. In fact, changes in the computed BLR consistently lag behind changes in interest rates which reduces the effectiveness of changes in direction of monetary policy. Hence, to improve the responsiveness of the computed BLR and to ensure an immediate transmission of changes in the direction of monetary policy into the BLR of banking institutions, the computed BLR will be determined based on the prevailing BNM intervention rate. Banking institutions will be given up to one week to adjust their BLR following changes in the BNM intervention rate.

It is also observed that the level of operational efficiency within the industry has improved since the introduction of the new base lending rate framework in October 1995. This is reflected in the lower average administrative cost for the whole industry. To ensure that borrowers benefit from the higher efficiencies, the flat administrative margin of 2.5 percentage points will be reduced by 25 basis points to 2.25 percentage points. The reduction also serves to promote greater operational efficiency among banking institutions.

In this regard, with effect from 1 September 1998, the formula for computing the BLR would be revised as follows :

Commercial banks

Computed BLR = Intervention rate x 0.8 + 2.25%

1 - SRR

Finance companies

Computed BLR = Intervention rate + 2.25%

1 - SRR

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