Monetary Policy

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Bank Negara Malaysia announces today the implementation of a number of policy measures. These measures aim to improve the efficiency of the intermediation process in providing financing to productive economic activities as well as to enhance the efficiency of the operations of the money market to allow interest rates to reflect underlying liquidity conditions. These measures also aim to reinforce the fundamental thrust of policy to achieve the objectives of monetary and financial stability.

Since the onset of the turbulence in the financial markets in July 1997, monetary policy has been tightened progressively through a combination of interest rate policy, prudential measures and quantitative restrictions. The 3-month interbank rates have been raised during this period, from 7.5% in July 1997 to 10% currently. Prudential guidelines on exposure to properties and stocks and shares were introduced in March 1997 as pre-emptive measures to ensure that any downward trend in asset prices would not threaten the strength and stability of the financial institutions in particular and the financial system in general. The measures are also aimed at encouraging available financial resources to be channelled for productive activities. While these measures have contained lending to the property and share markets, overall lending growth continued to remain high. Hence, in October 1997, these measures were strengthened further with credit plans which are aimed at slowing down the overall credit growth to levels that are more consistent with the growth in economic activities. At the same time, several prudential regulatory measures were introduced to further strengthen individual banking institutions. These measures include more stringent disclosure requirements, higher general provisions and a shorter period for recognising non-performing loans.

While the above policy measures have been effective in slowing down growth of credit and money supply some inefficiencies have emerged in the intermediation process as well as in the functioning of the money market. Under these circumstances, **Bank Negara Malaysia finds it necessary to introduce additional monetary measures** to meet the following objectives:

- Maintain a tight monetary policy
- Rationalise the term structure of interest rates to reflect the liquidity conditions
- Improve the efficiency of the intermediation process in terms of greater reliance on the market mechanism to facilitate access to funding and extension of credit; and
- Create conditions to enable banking institutions to prioritise credit facilities to support more productive activities.

These objectives will be achieved through the following policy measures :

1. **Maintain tight monetary policy.** Despite a slowdown in growth, it is essential to maintain a tight monetary policy to contain inflationary pressures arising from the depreciation of ringgit. This policy is intended to strengthen the foundation on which the prospect for sustainable growth in the medium and longer term would be enhanced.

2. **The interest rate structure will be streamlined** to reflect liquidity conditions in the market. Arising from recent developments, the term structure of interbank and lending rates is no longer reflective of prevailing market conditions. The shorter end interbank rates tend to reflect the exceptionally tight liquidity situation of a small number of banking institutions. However, because of current uncertainties, there has been a tendency for lending rates to be based on these short-term rates on a cost plus basis. The measures being announced today aim at improving the flow of liquidity in the system and, therefore, generate a more orderly term structure of interest rates that would better reflect the liquidity in the financial system. For this purpose, the 3-month Bank Negara intervention rate, currently at 10%, would under present conditions, be adjusted upwards to 11%.

3. **Reduce the statutory reserve requirements (SRR)** of commercial banks, merchant banks and finance companies from the current level of 13.5% to 10% of their eligible liabilities, effective 16 February 1998. This is aimed to enhance the efficiency of the intermediation process and not to provide additional liquidity to the system. The Bank will in effect neutralise the additional liquidity to the banking system arising from the reduction in the SRR by reducing its direct interbank lending, thereby slowing down base money growth. The reduction in SRR from 13.5% to 10% would release about RM14 billion of funds to the banking institutions. However, the simultaneous reduction in central bank lending to the interbank market would result in a neutral impact on liquidity.

Banking institutions should channel their resources to productive activities to support the economic recovery of the country. Banking institutions should also be more transparent in their loan pricing mechanisms. In this regard Bank Negara Malaysia would like to emphasise that given current circumstances, banking institutions should not charge excessively high lending rates on a cost-plus

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