CHAPTER 6
CONCLUSION & RECOMMENDATIONS

6.1 Conclusion

This paper examined Malaysia's banking sector problems which occurred in mid 1997. There were multiple factors that caused the banking crisis. Over the seven years period preceeding the crisis, there were massive capital inflows especially the private short-term capital which increased significantly with an average of 232% per year between 1990-1993. This led to increase in high powered money in the banking system and subsequently encourage high credit growth. As a result, there was over extension of lending and imbalance of lending portfolio, in other words, lending are skewed to certain sectors, especially to the BPS and purchase of shares. This unhealthy lending condition of the banking system is very vulnerable to any external shock. Hence, when the contagion effect of Baht currency crisis spread to Malaysia in mid 1997, foreign investors pulled out their investment from Malaysia and this was followed by the public. As a result, the stock market crashed and this led to the banking problems.

Was the Malaysian banking crisis different from those happened in other countries? Going by the literature review in Chapter 2; there is not much difference. Recall the earlier cited empirical studies, there were several common factors. Among the common factors were excessive loan growth, weak supervisory and regulatory banking system and external shock (for example, currency attack in the case of East Asian crisis).

The measures taken to curb the depreciation of Ringgit Malaysia was a sharp contraction of money supply between July 1997 to September 1998. This resulted in liquidity squeeze and hike in interest rate. Borrowers could not service their loans because of the high interest rate. In addition, BNM has revised its NPL policy from 6 months previously to 3 months. Combination of all these factors aggravated the banking problems.

Subsequently in September 1998, the Government of Malaysia relaxed the contractionary monetary policy via reducing the Statutory Reserve Ratio, liquid asset requirement and base lending rate of the banking system. The Statutory Reserve Ratio was gradually reduced from 13.5% (in end of 1997) to 4% (in September 1998) and the liquid asset requirements for commercial banks was reduced to 15%. The base lending rate administrative margins were reduced from 2.5% to 2.25%.

Besides that, the default period for non-performing loans classification was reverted back from three to six months. In addition, banks were required to achieve a minimum annual loans growth of 8% by the end of 1998 (BNM Annual Report, 1998:89). These new policies followed the imposition of capital and exchange controls, where the Ringgit's exchange rate to the Dollar was fixed at RM3.80 per US$1.

On the other hand, the Government has a four-pronged strategy to address the NPLs problem and emerging weakness in some banking institutions. The strategy involved are the merger programme, the setting-up of an asset management company, Danaharta, the setting up of a special purpose vehicle, Danamodal, and establishment of a joint public and private Committee, the CDRC.

As a result of the recovery measures, the banking system recorded a pre-tax profit of RM5.3 billion in 1999 (1998: pre-tax loss of RM2.3 billion). Asset quality has strengthened, with NPL ratio based on 6-months classification declining from 9% to 7% between December 1998 and December 1999. The banking system also well-capitalised with the RWCR increasing by 0.7% to 12.5% over the same period. Appendix: Table A10 in page xi summarised the causes, recovery measures taken and the effectiveness of these measures on banking system.

6.2 Recommendations

Although banks are demonstrating signs of recovery, it is still at the very early stages of recovery and the role of Government is undeniable very vital in continue monitoring the recovery path of the banking system. To further enhance and strengthen the banking system performance, some recommendations are made as follows:-

a. Separation of Malaysia's financial services regulator from the Central Bank

The Central Bank of Malaysia, BNM is responsible for the supervision, regulation and development of the banking industry. It is also responsible for the monetary stability of the country. As a result, there seems to be some conflict of interest in between these two roles. For example in the recent banking crisis, as a monetary policy regulator, the Central Bank should raise the interest rate. However, as the management of the banking sector and realising that increase in interest rate would potentially cause further stress on banks, this action was not finally executed (Malaysian Business June 1, 1999). Conversely, interest rate was gradually reduced with the intention to enlighten the burden of interest servicing.

As such, the supervision of the banking sector should be separated from monetary policy as in the United Kingdom where the supervision of the banking sector was taken out of the Bank of England and put it into the Financial Supervisory Authority (Malaysian Business June 1, 1999). This will enable the central bank to evaluate a situation more objectively.

b. Enhancing transparency and Corporate Governance

BNM should improve transparency through disclosure of more reliable and updated information to the public. The information disclosed should consist of financial position including capital, solvency and liquidity; risk exposures including credit risk, liquidity risk, currency risk, interest rate risk and other risk; accounting policies; and bank loan portfolio (Punyanitya, 1999).

In addition, BNM and the Ministry of Finance should frequently release monetary and economic data to the public. In the United Kingdom, the minutes of the Bank of England board meetings are released to the public, while the United State Treasury releases economic data at a regular and timely manner (National Economic Recovery Plan, 1998).

To enhance the corporate governance, BNM should increase private sector ownership of banking sector. Based on the prevailing ownership regulation, private individuals and corporations may not own more than 10% and 20% respectively of the shares of any banking institutions (Appendix: Table A5, page vi). It is recommended that this capping ratio should be relaxed to a certain extent, to have a more balance of shareholding between both public and private in the banking industry.

c. Improving the regulations

Since the banking crisis, BNM has imposed several measures to limit the extension of credit to the BPS and purchase of shares. However, regulation should not be too stringent until it will result in restriction of competition. Conversely, it should aim at creating incentives for banks, markets and regulators to provide and use information efficiently and act prudently' (Narayanan et al. 1997:108).

In addition, all banks are advised to seek credit ratings from local and international agency to have a better understanding of their creditworthiness in the banking industry, with particular against the benchmarking to the international banking institutions, and hence to further enhance the regulatory discipline.

To reduce moral hazard, the Government should not implicitly guarantee the depositor funds. Instead, deposit insurance scheme should be introduced. This would serve the purpose of spreading the risks and reduce the burden of the Government in providing guarantee to depositors.

d. **Development of a credit rating for all credit applications**

Credit ratings should be assigned to all credit applications to reflect the asset quality of the applicants. Credit model which incorporates objective criteria would assist in arriving at a more unbiased decision making. This would further enhance the transparency of credit approvals.

In short, the banking sector plays an important role in the development of our country. Lessons should be learnt from this banking crisis. It is the duty of every Malaysian to ensure the development of a more resilient banking sector to face the challenges of the impending liberalization and globalization.

To other researchers who which to further study the same topic, there are several aspects that can be considered. They are, for example:

- research on the effectiveness of the Malaysian restructuring programmes in strengthening the banking system.
- comparable research on the banking restructuring by the East Asian governments.