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THE EFFECT OF AN OVERNIGHT POLICY RATE (OPR) HIKE ON HOME LOAN IN MALAYSIA

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Abstract

Bank Negara Malaysia (BNM) has employed numerous monetary policies to reduce inflation and ensure financial stability. It includes the change in the Overnight Policy Rate (OPR), which is the benchmark interest rate at which banks borrow and lend cash overnight. The purpose of this research was to explore the implementation of OPR and the effect of OPR hike towards home loans. This was achieved through a qualitative research design involving interviews with representatives (bankers) from Bank Negara Malaysia as well as conventional and Islamic banks. The results revealed that OPR implementation is conducted by Bank Negara Malaysia through the Monetary Policy Committee (MPC), which is in charge of developing policies for conducting monetary activities. While the OPR hike inflicts an impact on the interest rates of home loans, statistics from BNM showed an increase of home loan borrowers during the third quarter of this year compared to the second quarter across both conventional and Islamic banks. These findings offer critical insights into the effects of OPR increase on Malaysian home loans. Therefore, financial institutions should establish risk management measures while simultaneously providing home buyers with reasonable and accessible financing choices.

Keywords: Overnight Policy Rate (OPR), Home Loan.

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INTRODUCTION

A home loan is an amount of money borrowed by an individual from a financial institution to finance the purchase of a house or invest in real estate. The individual who owns the property (the borrower) gives a title to the lender with the understanding that it will be returned to the owner once the last loan payment is completed and all other mortgage terms are satisfied (Julia, 2022). Often, a home loan is the largest loan that most individuals would subscribe to satisfy their needs for a house or invest in real estate.

However, the overnight price rate (OPR) in the monetary policy can have an impact on home loans. OPR is an interest rate that is applied when a depository institution loans or borrows cash in the overnight market from a different depository institution. It is commonly established by the central bank of a nation for the purpose of monetary policy. In Malaysia, the OPR is set by Bank Negara Malaysia (BNM) as the central bank (James, 2022). Since banks count on lending as an essential commercial activity, maintaining their accessible cash reserves is critical to satisfy BNM's liquidity criteria. Bank interest rates, as determined by OPR, provide the foundation for national monetary policy to ensure that banks have a steady supply of accessible cash.

Changes in the OPR set in motion a chain of events that affect the base lending rate (BLR), basis rate (BR), fixed deposit rates, short-term interest rates, long-term interest rates, foreign exchange rates, and ultimately, a variety of economic variables such as employment, goods and services prices (inflation), and economic growth. When the OPR rises, banks pass on the cost to consumers in the form of a higher base rate (BR). This means that it is now more expensive for buyers to take out a home loan because the loan tenure will increase regardless of whether the monthly home loan instalment is higher or remains similar.

RESEARCH BACKGROUND

Overnight Policy Rate is the rate of interest that a depository institution (usually a bank) loans or borrows cash in the overnight market from another depository institution (James, 2022). Malaysia's borrowing costs rose again for the fourth time this year, with Bank Negara Malaysia raising the OPR by 25 basis points to 2.75% during the sixth and last Monetary Policy Meeting (MPC) for 2022 held on 3 November 2022 (Priyatharisiny, 2022).

Central bank policy rate for selected countries (%)

COUNTRIES	MONTHS, 2022			
	AUGUST	SEPTEMBER	OCTOBER	NOVEMBER
Malaysia	2.25	2.50	2.50	2.75
Indonesia	3.75	3.75	4.25	4.75
Philippines	3.75	4.25	4.25	4.25
Thailand	0.75	1.00	1.00	1.00
Vietnam	4.00	5.00	6.00	6.00
India	5.40	5.90	5.90	5.90
Japan	–0.10	–0.10	–0.10	–0.10
Euro area	0.50	1.25	1.25	2.00
UK	1.75	2.25	2.25	3.00
US	2.25–2.50	3.00–3.25	3.00–3.25	3.75–4.00

Figure 1: Overnight Policy Rate for selected countries including Malaysia.
Source: Priyatharisiny (2022)

According to the Malaysian Industrial Development Finance Berhad (MIDF) Research, the new sales prognosis for property demand is sluggish due to negative consumer mood caused by rising OPR. Loan applications for property transactions declined by 7.3% month-on-month to RM43.95 billion in October (Azanis, 2022). The two consecutive reductions in loan applications might be attributed to Bank Negara Malaysia's September OPR boost, which reduced buyers' interest and affordability. Loan applications dropped by 10% year-on-year in October after three months of strong growth, indicating that demand for real estate is moderating. Nonetheless, MIDF Research stated that the reduction in property overhang was modestly beneficial for the sector, since additional reductions in property overhang in the future may alleviate worries about the oversupply in the housing industry (Azanis, 2022).

The decline in applications for loans and approvals began in August 2022, owing to banks tightening lending rules, monetary policy normalisation, and growing living expenditures (Sharen, 2023). Other factors impacting loan growth in the real estate business include the OPR, trust among consumers, and inflation forecasts. Higher OPR will inflict more cost on loan money, which can have a major impact on the housing industry. BNM has kept the OPR rate at 2.75% as of the beginning of 2023, which is a 0.25% increase from the prior rate of 2.50% in September 2022 (Kathy, 2023).

OPR Decision and Statement			
Date	Change in OPR (%)	New OPR Level (%)	Monetary Policy Statement
09 Mar 2023	0	2.75	View Statement
19 Jan 2023	0	2.75	View Statement
03 Nov 2022	+0.25	2.75	View Statement
08 Sep 2022	+0.25	2.50	View Statement

Figure 2: The current OPR decisions set by Bank Negara Malaysia.
Source: Bank Negara Malaysia (2023)

Many people are worried about the health of their family finances because BNM is expected to raise the OPR again at the end of the month. Maybank Investment Bank (Maybank IB) expects another 25-basis point (BPS) rise to return OPR to the pre-COVID-19 level of 3.00%, with its eyes placed upon the next three Monetary Policy Committee (MPC) discussions this year, which are scheduled for 2 to 3 May, 5 to 6 July, and 6 to 7 September (Kathy, 2023). Economists anticipate that BNM will continue to raise the OPR to at least 3.00% this year in accordance with the improving economic performance. Following the beginning of COVID-19 in Malaysia in early 2020, the OPR was reduced to a record of 1.75%. It was hiked four times last year by a total of 100 basis points to 2.75%, which is still lower than the pre-COVID-19 rate of 3.25% observed in March 2019.

LITERATURE REVIEW

Overnight Policy Rate (OPR)

OPR is a gauge of the BNM's monetary policy stance and acts as a target rate for BNM on a daily liquidity operation. Any shift in the MPC's monetary policy stance would be signalled by a shift in the OPR. Additionally, OPR stands as the principal reference rate used to calculate other market rates (Noor, Tzeng, & McGowan, 2014). According to Dieter and Jan (2011), OPR can be defined as signalling the desired rate of interest level and monetary policy perspective. Central banks have adjusted their monetary policy tools in recent years to guarantee that the overnight rate closely matches their primary policy rate and that volatility is kept to a minimum. The mean and variance of policy spreads, such as the divergence of the overnight rate in relation to the policy-intended level, are sometimes seen as indications of monetary policy's efficacy.

If the policy spread persists for a prolonged period, the long-term impact of shocks would limit the overnight rate's signalling role and the central bank's control over interest rates. Jasmin, Eduard, and Veronica (2012) stated that over the last 30 years, most central banks have turned to use overnight policy interest rates as the main monetary policy weapon due to their clarity in signalling monetary policy stance. Its usage as the primary policy tool coincides with central banks' transition towards monetary aggregate targeting and other monetary policy frameworks incorporating control over short-term rates of interest. In conclusion, OPR describes the main monetary policy that signals the desired rate of interest level. Central banks' use of policy rates demonstrates their reliance on indirect monetary management, which is consistent with rising financial growth.

Factors Affecting Overnight Policy Rate

1. Inflation

Inflation refers to the rate at which prices rise over a specific time period (Oner, 2017). The term is often defined as a broad metric, such as the whole rise in prices or the rising cost of living in a country. However, it may also be computed more precisely—for instance, specific items such as food or services like haircuts. In any context, inflation reflects how much costlier a specific set of products and/or services has gotten over a specific time period, most typically a year (Oner, 2017). The cost of living for consumers is determined by the costs of various products and services, as well as the proportion of every item in the spending plan for the family. Government agencies undertake home surveys to establish a basket of regularly purchased commodities and track the expenses of buying this basket over time to determine the typical consumer's cost of living. In Malaysia, housing expenditures, including rent and mortgages, form the biggest part of the consumer basket (Oner, 2017). Nonetheless, Bank Negara has concerns regarding the core inflation rate as data from the Department of Statistics Malaysia (DoSM) showed a rise to 4% year-over-year at the end of September compared to 1.6% in January (Lukman, 2022). The rise will serve to control demand pressures, allowing inflation expectations to be handled without increasing inflation.

However, since the interest rate is currently below the neutral rate, it is anticipated that the central bank will continue to normalise, considering that the interest rate fluctuated between 3.25% and 5% prior to the pandemic (Lukman, 2022). The central bank may continue to press for hiking interest rates to the neutral rate. Naturally, the magnitude and rate will be determined by current inflation and growth momentum. Bank Negara's decision to begin raising the

OPR benchmark can potentially reduce the substantial spike in inflation or prices for commodities, hence strengthening the Malaysian Ringgit (MYR) against the US Dollar (USD). As shown in January 2018, when the OPR raised the cost of services and goods, the index for consumer prices fell to 2.7% year-on-year, down from 3.6% prior (Mikail, 2022). Furthermore, after the country's bond market reported a net international inflow of RM4.5 billion and international local equities investors became net purchasers of RM3.4 billion in January 2018, the rise in OPR is projected to accelerate foreign capital inflows towards Malaysia (Mikail, 2022).

2. Sustainability of Economic Growth
Economic growth can be defined as a rise in the production of economic products and services in one period of time over another. It can be identified in nominal or real (inflation-adjusted) terms (Potters, 2021). Aggregate economic growth is commonly measured through Gross Domestic Product (GDP) or Gross National Product (GNP) while other measures are occasionally employed. The pace at which the economy is able to grow is referred to as sustainable growth. For some, increasing economic growth today above the sustainable rate might appear to be an appropriate move (Bank Negara Malaysia, 2023).

Good economic growth can cause the OPR to rise, whereas slow growth in the economy can cause the OPR to fall. A robust economy often results in higher inflation and more credit demand, necessitating tighter monetary policy. The responsibility of creating and implementing monetary policy in Malaysia is vested on BNM as the country's central bank. According to the Central Bank of Malaysia Act 2009, one of the primary objectives of BNM is to foster monetary stability that is favourable to the Malaysian economy's long-term growth (Bank Negara Malaysia, 2023). In promoting monetary stability, BNM is mandated to pursue a monetary policy which serves the country’s interests with the primary objective of maintaining price stability while giving due regard to developments in the economy. It is crucial to have sustainable economic growth that does not cause other issues. Past years have witnessed how excessive growth or growth fuelled by cheap credit harmed the economy as evidenced in nations with excessively high inflation. When this occurs, the people, particularly future generations, bear the consequences and are left impoverished. Sustaining growth helps to mitigate such a boom-bust cycle.

3. Monetary Policy Stance
Comprehensive knowledge, sound analysis, and excellent judgment are required for effective judgements. The actions of central banks are often based on the evaluation of their monetary policy stance, which may be characterised as monetary policy's contribution to financial, economic, and monetary

developments (European Central Bank, 2010). Assessing such a stance entails determining whether the contribution is consistent with the central bank's aim. Monetary policy refers to the actions taken by BNM to regulate economic interest rates. As the central bank of Malaysia, the purpose of BNM is to encourage monetary and financial stability (Bank Negara Malaysia, 2023). This is intended to create the circumstances for Malaysia's economy to thrive sustainably. Furthermore, the MPC determines monetary policy to maintain inflation low and stable while promoting economic development for achieving monetary stability.

According to Bank Negara Malaysia (2023), the Monetary Policy Committee (MPC) is responsible for creating monetary policy and policies for the implementation of monetary policy operations under the Central Bank of Malaysia Act 2009. The MPC makes monetary policy decisions by assessing the balance of risk to the forecast for domestic inflation and GDP. They also monitor risks of destabilising financial imbalances given its implications for the prospects of the economy. The MPC meets at least six times each year to deliberate on the OPR and issues concerning the Monetary Policy Statement (MPS) to explain what has been decided (Bank Negara Malaysia, 2023).

The MPC is formed by the Governor and Deputy Governors as well as three to seven additional members, including external members selected by the Minister of Finance following the proposal of the Bank's Board Governance Committee. The MPC membership aims to bring together a range of skills and experience that is essential for good monetary policy decision-making. BNM will provide optimal circumstances for the Malaysian economy through its role in supporting financial stability. As a result, if the inflation rate becomes excessively high, the OPR will be raised to calm the economy.

4. Exchange Rate

An exchange rate is the rate upon which one currency is exchanged for another which influences commerce and money flow between countries (James, 2022). Both the local and foreign currency values influence exchange rates. In June 2023, the exchange rate from MYR to USD was RM 4.67. The exchange rate between two currencies is generally decided by each country's market interest rates, unemployment rate, economic activity, and GDP. It is set in the global financial marketplace where banks and other financial organisations trade currencies around the clock depending on these criteria. This can be referred to as market exchange rates (James, 2022).

A rise in the OPR can swiftly result in a comparable appreciation of a currency's foreign exchange rate. This is because since everything else is comparable, investing in a nation with a greater rate of interest will increase demand for that currency, causing its exchange rate to rise (John, 2014). Changes in the rate of exchange can have an impact on the economy's inflation rate, thus affecting the OPR. For instance, more inflation may emerge if the exchange rate falls, hence necessitating a rise in OPR by BNM. According to Bank Negara Malaysia (2022), the MYR rate suffered a persistent fall with USD in 2022. While slight changes in the ringgit currency exchange rate are typical, major moves can have long-term consequences for businesses, consumers, and the economy. MYR, in opposition to USD, was hovering at values last seen throughout the Asian Financial Crisis (AFC) in Figure 3, hence became an issue of concern.

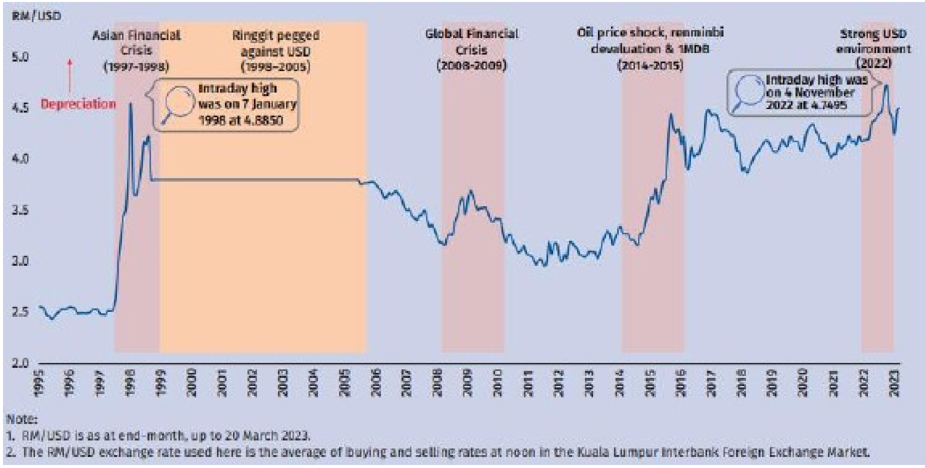

Figure 3: The performance of the Malaysian Ringgit against the US Dollar.
Source: Bank Negara Malaysia, 2022.

RESEARCH METHODOLOGY

In this research, qualitative research design in the form of interviews was employed to attain a better comprehension and understanding about industry-specific references, such as economic theories or financial terms. Since Bank Negara Malaysia is the only entity eligible for OPR, the interview session was deemed the most accurate approach to obtain data regarding OPR. Additionally, findings from previous studies were also gathered for further support.

A review of past studies led to the proposal of a conceptual framework to achieve the aims of this investigation. As shown in Figure 4, the proposed conceptual framework comprises inflation, sustainability of economic growth, monetary policy stance, exchange rate, and global economic condition as the independent variables (IV) and OPR hike on home loans as the dependent variables (DV).

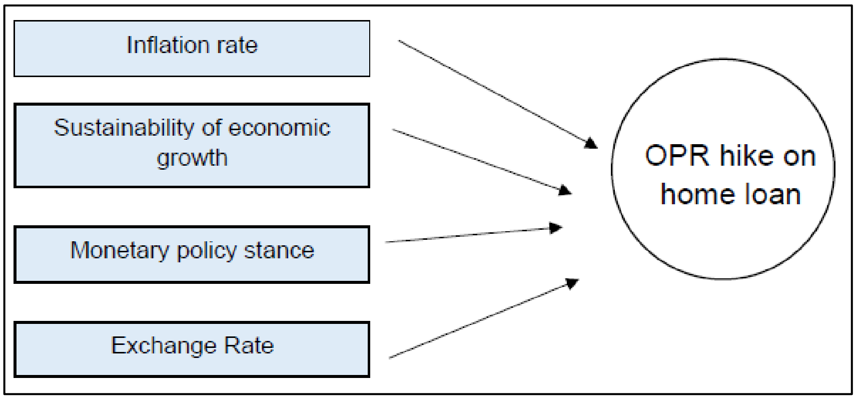

Figure 4: Conceptual Framework
Source: Author's (2023)

DATA ANALYSIS AND FINDINGS

The interview sessions involved several persons in charge from the central bank and commercial banks with work experience concerning financing and loans. The purpose of the interview was to explore the effect of OPR increase on commercial and Islamic bank home loans. All respondents were codenamed as R1, R2, and R3 while the banks were referred to based on their respective names.

Table 1: List of respondents from the central bank, commercial bank, and Islamic bank.

Respondents' Background		
Respondent	Bank	Location
R1	Bank Negara Malaysia (BNM)	Kuala Lumpur
R2	Malayan Banking Berhad (Maybank)	Johor Bahru
R3	Bank Islam Malaysia Berhad (Bank Islam)	Selangor

Source: Author's (2023)

The diverse responses obtained amidst the rise in OPR could inflict significant difficulty to obtain loans from banks. R1 said that the increase in the OPR rate will also increase the home loans. However, the data suggests that it is not difficult for people to apply for home loans because the OPR rate in Malaysia is still low. The data also showed that there is an increase in home loans and household loan applications, indicating that loan demand improved up to 4.1% during the third quarter of this year than 2.5% in the second quarter. BNM further reported that the rate of home loan borrowers rose at the end of 2023, indicating that it is not difficult for individuals to obtain home loans even if the OPR is raised to 3%.

Table 2: Loan application data for households in the second and third quarters.

Loan Indicator for households	2023			
	During Period (RM Billion)		Annual Change (%)	
	Q2	Q3	Q2	Q3
Loan application	RM 231.70	RM 231.70	2.5 %	4.2%

Source: Bank Negara Malaysia (2023)

Meanwhile, R2 said that higher OPR will result more expensive cost to borrow money, which can have a significant influence on the housing sector. The extent of such impact will depend on whether borrowing is tied more to short- or long-term rates.

This demonstrates the difficulty for people to obtain a loan depending on whether they want a short-term or long-term loan because the rates for both are different and rely on a person's financial status. According to R3, an increase in OPR could inflict significant difficulty for some Malaysians to obtain home loans from Islamic banks. This is because banks commonly price their home lending products using the base rate, which is related to the OPR. Subsequently, the rise in OPR will increase the base rate, resulting in larger monthly payments for borrowers. This demonstrates that an increase in OPR will affect home loan borrowers. Both respondents agreed that such an increase in borrowing rates can make it more difficult for certain people to finance a home loan, particularly those with lower salaries or high debt-to-income ratios since they may have to cut back on other spending or postpone their home purchase plans. Several commercial bankers highlight the effects faced by conventional and Islamic banks following the BNM's announcement of increasing the OPR rate. R2 said that such a condition will result in borrowers having to pay more for the loan to the lending bank. While there are cases of individuals pleading for lower rates, such a decision is not within the bankers' capability. R2 further stated that "no one had withdrawn from the loan", thus implying that borrowers are still opting to take out loans from this particular lending bank despite the increased interest rates. This might be attributed to various circumstances. For instance, borrowers may still regard this bank as a legitimate and dependable source of money lending. It is also probable that they could not find alternative entities offering better credit arrangements. Additionally, the borrowers may have pressing financial circumstances that necessitate fast access to cash and they are willing to pay a higher interest rate in exchange for the simplicity and rapidity of the loan procedure.

According to R3, banks earn profit by charging greater interest rates on loans than they do on deposits. Such a condition is referred to as the spread or the net interest margin (NIM). When the OPR rises, the profit margins decrease because banks must offer lower interest rates for loans to remain competitive. The increased OPR also indicates that the central bank is tightening monetary policy to keep inflation under control. This will result in more alternatives for borrowers to choose and banks may cut their loan rates to remain competitive in the market. It also reduces the difference between loan and deposit rates, which could result in lesser bank profit margins. Therefore, banks will need to identify new sources of income or cost-cutting initiatives to compensate for decreased profit margins.

CONCLUSION

In conclusion, our findings showed that the implementation of OPR in Malaysia is governed by BNM through the MPC, which is responsible for developing policies for monetary activities. Furthermore, BNM's decision to increase the OPR has inflicted an impact on existing home loans in Malaysia. However, statistics by BNM revealed a rise in home loans, thus implying that the OPR hike does not affect the demand for home loans. This is further supported by the significant increase in home loan applications in the third quarter of this year than the second quarter.

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