

VIEWPOINT

By Shahrudin Ismail

WE HAVE seen healthy growth in car sales in the country over the last decade, with interests in both national and non-national makes. Apart from first-year zero-interest promotions by certain auto-makers, the current interest rate charged by banks for automobile hire purchase is hovering around 4 per cent.

Some of the more financially savvy motorists are wondering if banks could offer them better packages and trim monthly payments further. The answer lies in the way the interest is calculated and repaid.

Let's consider a fixed rate instrument like the existing hire purchase loan.

In a fixed rate hire purchase, the bank simply charges the interest rate for the whole loan amount over the entire repayment period even though the amount owed by the customer continues to shrink over time with every instalment paid.

In fact, for a hire purchase loan, about half of the instalment for the first two years goes towards paying the interest and the interest itself is calculated on a flat rate for the full amount throughout the loan period.

For example, if you borrow RM50,000 for five years and the interest is 4 per cent per annum, then you are charged RM2,000 per year for five years, which brings the total amount repayable to RM60,000. Almost half of the monthly instalment of RM1,000 would go towards servicing the interest.

When more is less



Banks emphasise that the variable interest rate loan is offered as an option and is not the only way of financing a car purchase.

The situation is very different for a housing loan with interest rates that are tied to the Base Lending Rate (BLR) where the interest is calculated on a monthly balance, which means that with every month, the borrower is paying less and less on interest.

Hence, if the total amount repayable falls, then the monthly instalments should also become smaller.

Based on the average prevailing industry interest rate (3.85 per cent), a hire purchase loan of RM50,000 for five years should incur monthly repayments of RM994 while a variable rate loan for the

same amount and tenure with interest charged at BLR +0.5 per cent would require monthly commitments of RM986 (assuming a BLR of 6.3 per cent). A savings of RM8 per month that sums up to almost RM500 for the five-year tenure.

With a variable rate loan, like a housing loan that is linked to the BLR, banks calculate the interest rate on the actual balance. There is no honey without bees and there is no profit without risk-taking so those who want to take advantage of variable rate hire purchase loans should be aware of the advantages that they afford.

The BLR is based on the prevailing OPR (Overnight Policy Rate) which is adjusted by Bank Negara Malaysia (BNM). With an increase in BLR, the total amount due would also rise accordingly but many analysts believe that it is unlikely for banks to increase the BLR to the 1998 levels, given that the Malaysian economy is now more resilient and able to better absorb the effects of a financial crisis.

Furthermore, the Financial Sector Master Plan, launched by BNM, ensures that banks are better capitalised, going forward. Correspondingly, if the BLR should drop,

the amount due will also decrease, making it more cost-effective for customers.

Under the proposed mechanism for variable rate hire purchase, the customer can enjoy the same monthly repayments regardless of the interest rate or they can choose to lower or increase the instalments according to the prevailing interest rate and maintain the same repayment period.

For those who want the stability of a fixed monthly commitment, the banks will reduce or increase the loan tenure to match the total amount repayable.

In the late 1970s, Malaysia's BLR hovered around 8.5 per cent, it spiked to 12.25 per cent in November 1984 and again to 12.27 per cent in 1998. Since 1999, the base rate has hovered around the 6 per cent mark and rose to 7.05 per cent between 2006 and 2008.

While some view variable rates as less attractive, customers should be aware of the increased cost-effectiveness that accompanies any decrease in the BLR.

Banks understand this and emphasise that the variable rate is offered as an option and not the only way of financing a car purchase. Fixed rate hire-purchase will remain as an additional option to customers.

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AmBank is Malaysia's premier auto financier and has won both the prestigious Excellence in Automobile Lending Award from the Asian Banker and the Frost & Sullivan's Asean Automotive Award for Automotive Financial of The Year.