

Monetary and Financial Developments

ECONOMIC REPORT

5

Overview

Monetary conditions support private sector activities, complemented by an active capital market...

The monetary stance remains supportive of economic growth in 2004. Low inflation combined with stronger fundamentals accorded flexibility in maintaining an accommodative monetary policy. Low and stable interest rates amidst ample liquidity continue to support business activities and consumer spending. There was strong demand for bank financing in tandem with improving business and consumer confidence. Higher bank financing was reflected in double-digit increases in loan disbursements to the business, small and medium enterprises (SMEs) and household sectors.

The strong position of the banking system has helped increase its resilience to withstand shocks, as well as support the financing needs of the economy. Islamic banking made further inroads in Malaysia, with the entry of two domestic banks and a foreign bank into full-fledged Islamic banking. This has placed the Islamic banking system on firmer footing to capture a bigger share of domestic banking assets, deposits and financing, as well as to attract international customers, especially from West Asia.

Private debt securities (PDS) raised from the capital market in the first half of 2004 were mainly used to finance new activities, reversing the trend in previous years of PDS utilisation for restructuring and refinancing purposes. This positive development is an indicator of a strengthening corporate sector following financial sector and corporate debt restructuring. Financial restructuring in Malaysia achieved another significant milestone with the closure of Danamodal in February 2004, less than two years

after the winding up of the Corporate Debt Restructuring Committee (CDRC). Danamodal was a special purpose vehicle set up to recapitalise financial institutions during the Asian financial crisis, while CDRC was established as a platform for the resolution of corporate debts.

The stock market was more active in 2004 on improved investor sentiment following the stronger performance of the economy. The derivatives market recorded better performance, particularly the Kuala Lumpur Composite Index (KLCI) futures, which were fuelled by the better performance of the stock market and crude palm oil (CPO) futures in tandem with rising CPO prices. The year 2004 also marks the beginning of the implementation of Phase 2 of both the Financial Sector Master Plan (FSMP) and the Capital Market Master Plan (CMP) following the completion of several key recommendations of Phase 1 in 2003. Meanwhile, efforts are ongoing to further enhance the efficiency and liquidity in the capital market.

Monetary Policy

Monetary policy remains supportive of economic growth...

Monetary policy continued its seventh year of low interest rate regime in 2004, supported by ample liquidity to facilitate economic activities and sustain the growth momentum. Low inflation reinforced by strengthening macroeconomic fundamentals and a stronger banking system continue to provide flexibility in pursuing an easier monetary stance. A significant development was the implementation of the new interest rate framework on 26 April 2004 by Bank Negara Malaysia (BNM), reflecting a move towards a more market-based approach in interest rate determination. The new framework is aimed at

TABLE 5.1

Key Interest Rates of Selected Countries

Country	End 2003	End August 2004	Change (basis points)	Effective Date
	(%)			
US (Federal funds)	1.00	1.25	+25	30.6.04
		1.50	+25	10.8.04
UK (Repo)	3.75	4.00	+25	5.2.04
		4.25	+25	6.5.04
		4.50	+25	10.6.04
		4.75	+25	5.8.04
Japan (Official discount)	0.10	0.10	0	19.9.01
Australia (Cash rate target)	5.25	5.25	0	3.12.03
Malaysia (Overnight policy)	-	2.70	-	26.4.04
Thailand (14-day repurchase)	1.25	1.50	+25	25.8.04
Indonesia (1-month discount)	8.31	7.34	-97	16.6.04
Philippines (Overnight call)	6.75	6.75	0	2.7.03

Source: Central Bank Websites.

enhancing the effectiveness of monetary policy transmission and promoting more efficient pricing by banking institutions. Under the new interest rate framework, the overnight policy rate (OPR) replaced the 3-month intervention rate as the indicator of the monetary policy stance.

The OPR was set at the prevailing interbank overnight rate of 2.7% and allowed to fluctuate within a narrow range of ± 25 basis points. Banking institutions can now determine their own base lending rates (BLRs) based on their cost structures and business strategies. Since the introduction of the OPR, the interbank overnight range has moved within a tight range of 2.68%-2.74%, with an average of 2.7%.

On the international front, there has been a gradual rise in interest rates, as shown in *Table 5.1*. The US raised the federal funds rate for the first time since January 2001 by 25 basis points to 1.25% in June 2004 and by another 25 basis points to 1.5% in August. The United Kingdom (UK) increased interest rates four times this year to 4% in February, 4.25% in May, 4.5% in June and 4.75% in August. The prevailing low and stable interest rates are, however, expected to remain unchanged in Malaysia, given the

excess liquidity and low inflation as well as the need to sustain the growth momentum.

Since 2 September 1998, the ringgit has remained pegged at RM3.80 to the US dollar. With volatility still prevalent in the foreign exchange markets, the ringgit peg continues to provide an environment of predictability and stability to support economic activities. The ringgit peg remains supported by increasingly strong economic fundamentals, such as low inflation and unemployment, rising international reserves, manageable external debt, as well as a sound and well-capitalised banking system.

Monetary Developments

Money supply and loans expanded strongly...

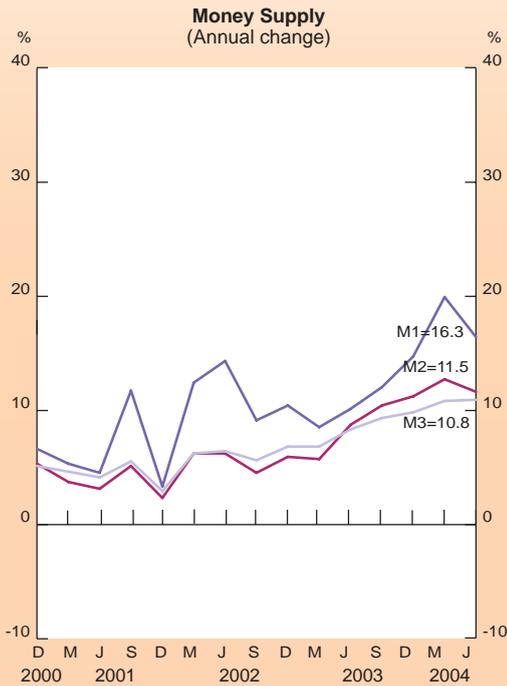
Driven by robust domestic economic activities and an improving external sector, all three monetary aggregates expanded. The growth in **M1**, **M2** and **M3** was 16.3%, 11.5% and 10.8%, respectively at end-June 2004 (end-2003: 14.6%; 11.1%; 9.7%), as shown in *Chart 5.1*. The expansion in **M1** reflected stronger demand for transaction balances on account of higher consumer spending, improved business activities and performance in the stock market.

The **broad monetary aggregate or M3** increased by RM29,154 million in the first six months of 2004. The growth was mainly due to higher financing of the private sector by the banking system (RM16,138 million), as well as expansionary net external operations (RM39,346 million), reflecting continued repatriation of export earnings and inflows of foreign funds for portfolio investments and direct investments. As of June this year, export proceeds have exceeded import receipts for 80 consecutive months.

Interest rates remained low and stable amidst ample liquidity in the banking system during the first half of 2004. Due to the keen competition among banking institutions, lending rates have eased slightly. The BLR of commercial banks was slightly lower at 5.98% at end-June 2004 (end-2003: 6%), as shown in *Table 5.2*. The

CHART 5.1

Monetary Aggregates



Source: Bank Negara Malaysia.

BLR of finance companies, however, remained unchanged at 6.9%. Average lending rates also declined to a low of 5.99% for commercial banks and 8.76% for finance companies. Savings deposit rates also declined by 10-13 basis points. Fixed deposit rates on 12-month deposits, however, edged upwards marginally due to the prescribed minimum rates to ensure that depositors continue to enjoy a positive real rate of return.

Demand for financing by the private sector was higher in the first six months of 2004, supported by the low interest rate environment and robust domestic demand. Improved business and consumer sentiments also contributed to higher financing. Gross private sector financing through the banking system and the capital market rose by 5.1% to RM246,158 million (January-June 2003: RM234,235 million), as shown in Chart 5.2. Bank lending remained the main source

TABLE 5.2

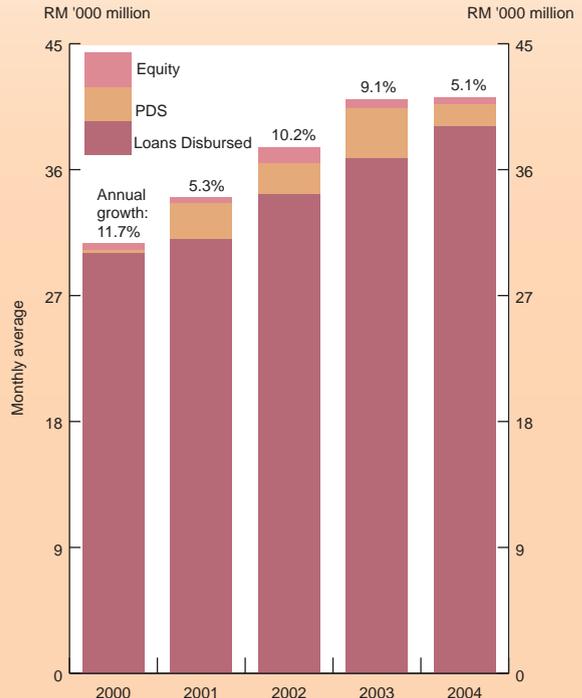
Interest Rates of Commercial Banks and Finance Companies (%)

	End 1998	End 2003	End-June 2004	Change vs End 2003
Commercial Banks				
Base lending	8.04	6.00	5.98	-0.02
Average lending	9.72	6.11	5.99	-0.12
Savings deposit	3.87	1.86	1.73	-0.13
1-month fixed deposit	5.82	3.00	3.00	0.00
12-month fixed deposit	5.74	3.68	3.70	+0.02
Finance Companies				
Base lending	9.50	6.90	6.90	0.00
Average lending	11.76	9.11	8.76	-0.35
Savings deposit	5.01	2.18	1.99	-0.10
1-month fixed deposit	6.35	3.00	3.00	0.00
12-month fixed deposit	6.57	3.68	3.70	+0.02

Source: Bank Negara Malaysia.

CHART 5.2

Gross Private Sector Financing through Banking System Loans and Capital Market



Source: Bank Negara Malaysia.

of financing, accounting for more than 90% of total gross financing. Notwithstanding this, measures taken to promote the PDS market as an alternative source of financing since the financial crisis, particularly for projects with long gestation periods, have been successful. Total PDS outstanding as a percentage to GDP rose to 35.2% at end-June 2004 (end-1998: 16.5%).

All loan indicators recorded double-digit growth, following improved business activities and strong consumer spending. Total loan applications, approvals and disbursements by the banking system rose to RM129,199 million, RM83,748 million and RM234,825 million, respectively in the first six months of 2004 (January-June 2003: RM109,099 million; RM73,717 million; RM204,912 million), as shown in *Table 5.3*.

Household financing remained robust, with a 32.3% increase in loan applications spurred by competitive interest rates, especially for the purchase of residential properties. The higher loan demand for residential properties was also attributed to the various incentives, such as tax relief as well as stamp duty and real property gains tax exemptions provided to house buyers under the Package of New Strategies in May 2003.

Bank lending to the priority sector of SMEs remained strong, with an increase of 10.5% in loan approvals to RM14,016 million (January-June 2003: RM12,680 million) to 40,864 SME accounts (January-June 2003: 38,041 SME accounts). Likewise, loan disbursements to SMEs grew strongly by 20.5% to RM48,470 million (January-June 2003: RM40,221 million). In terms of composition, loans to SMEs accounted for 38.4% of total business loans and 17% of total outstanding loans (end-2003: 38.4%; 17.3%)

To complement the various measures taken to enhance access to financing for SMEs, a Small Debt Resolution Committee (SDRC) was established in November 2003 to facilitate the restructuring of non-performing loans (NPLs) of SMEs with ongoing businesses, as well as to assist their financing requirements. At the same time, a Rehabilitation Fund for Small Businesses

TABLE 5.3

Banking System: Loan Indicators

Indicator	RM million		% annual growth	
	January-June		January-June	
	2003	2004	2003	2004
Total				
Loan applications	109,099	129,199	2.2	18.4
Loan approvals	73,717	83,748	10.3	13.6
Loan disbursements	204,912	234,825	0.1	14.6
Loan repayments	197,658	222,805	0.4	12.7
of which:				
SMEs				
Loan applications	22,548	25,035	n.a	11.0
Loan approvals	12,680	14,016	n.a	10.5
Loan disbursements	40,221	48,470	n.a	20.5
Loan repayments	n.a	n.a	n.a	n.a
Other businesses				
Loan applications	39,737	43,645	n.a	9.8
Loan approvals	25,383	26,770	n.a	5.5
Loan disbursements	99,382	112,543	n.a	13.2
Loan repayments	n.a	n.a	n.a	n.a
Households				
Loan applications	44,953	59,451	14.1	32.3
Loan approvals	34,146	42,096	4.4	23.3
Loan disbursements	53,462	62,260	4.3	16.5
Loan repayments	44,073	52,369	7.5	18.8

Note: Data on loan indicators for SMEs is only available from January 2003.

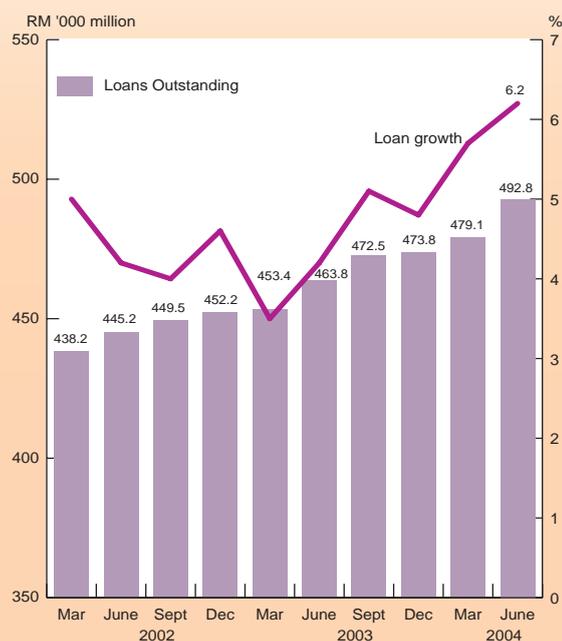
Source: Bank Negara Malaysia.

was also established with an allocation of RM800 million to provide new financing to viable SMEs undergoing debt restructuring. Since its inception to June 2004, SDRC has received 129 applications for the restructuring of SME NPLs totalling RM114 million, of which 50 applications worth RM41 million were approved.

Total outstanding loans of the banking system rose by 6.2% to RM492,772 million at end-June 2004 (end 2003: 4.8%; RM473,776 million), as shown in *Chart 5.3 and Table 5.4*. Loans to the household sector expanded by 13.6% to RM245,137 million (end-2003: 12.8%; RM231,075 million), mainly for purchase of residential properties and passenger cars to account for a significant 49.7% of total loans outstanding at end-June 2004. Loans to the business sector accounted for RM218,523 million or 44.3% of loan outstanding, (SME share of 17%), and were channelled mainly to the manufacturing, wholesale and retail trade, restaurants and hotels and construction sectors.

CHART 5.3

Banking System: Loans Outstanding and Growth



Source: Bank Negara Malaysia.

The exchange rate of the ringgit strengthened in 2004 in tandem with the US dollar, after depreciating against most major and regional currencies in 2003, as shown in *Chart 5.4*. The firmer US dollar was supported by improved economic conditions in the US, as well as expectations of further interest rate hikes. However, the pound sterling appreciated against the US dollar on anticipation of larger interest rate increases to mitigate inflationary pressures in the UK.

The ringgit strengthened against most regional currencies in the range of 0.8%-10.6% in the first eight months of 2004, as shown in *Table 5.5*. This was mainly due to concerns on the impact of rising oil prices, uncertain political developments in specific countries and further interest rate increases in the US. The Korean won appreciated against the ringgit, supported by strong exports and equity inflows.

TABLE 5.4

Banking System: Direction of Lending¹

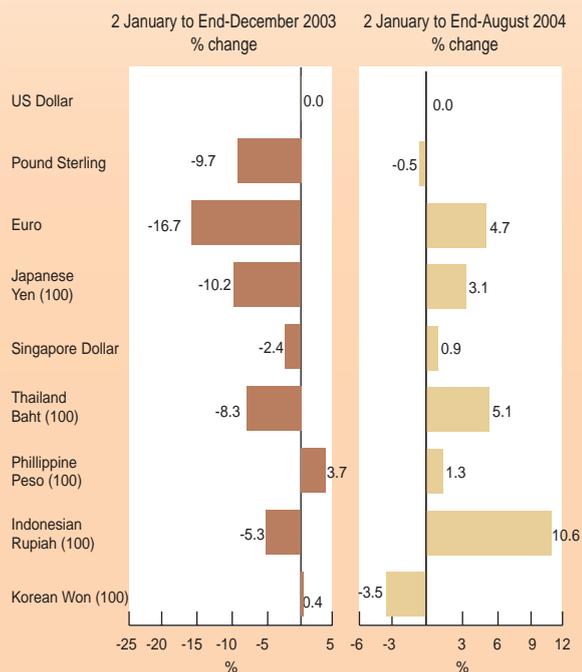
Sector	RM million		Change	% share End-June 2004
	December 2003	End-June 2004		
Agriculture, hunting, forestry and fishing	10,514.1	11,472.3	958.2	2.3
Mining and quarrying	1,096.1	1,025.7	-70.4	0.2
Manufacturing	61,083.2	63,350.3	2,267.2	12.9
Electricity, gas and water	5,066.0	5,386.3	320.3	1.1
Wholesale and retail trade, restaurants & hotels	39,161.8	40,426.9	1,265.1	8.2
Broad property sector	188,713.7	197,390.1	8,676.4	40.1
Construction	29,482.6	29,560.2	77.6	6.0
Residential property	116,552.9	124,437.3	7,884.4	25.3
Non-residential property	28,798.0	29,719.4	921.4	6.0
Real estate	13,880.2	13,673.2	-207.0	2.8
Transport, storage and communication	10,727.8	11,729.0	1,001.2	2.4
Finance, insurance and business services	29,527.4	29,725.7	468.3	6.0
Consumption credit	89,277.5	94,961.9	5,684.4	19.3
of which:				
Credit cards	12,236.5	12,671.1	434.6	2.6
Purchase of passenger cars	61,491.1	65,841.2	4,350.1	13.4
Purchase of securities	19,806.6	19,490.6	-316.0	4.0
Purchase of transport vehicles	3,304.2	2,554.0	-640.2	0.5
Community, social and personal services	4,968.6	5,174.8	206.2	1.1
Others	10,799.7	9,974.4	-825.3	2.0
Total loans outstanding²	473,776.5	492,772.2	18,995.7	100.0

¹ Including Islamic banks.² Including loans sold to Cagamas.

Source: Bank Negara Malaysia.

CHART 5.4

Performance of Ringgit Against Selected Currencies



Source: Bank Negara Malaysia.

Health of the Banking System

Stronger banking system, with improving capital base and NPLs declining...

The health of the banking system remained robust, as reflected in the improving asset quality. NPLs based on 6-month classification fell by RM1,847 million from RM54,798 million at end-2003 to RM52,951 million at end-June 2004. The decline in NPLs was due to better loan recovery in line with the more favourable economic conditions, as shown in *Chart 5.5*. Likewise, the net NPL ratio also improved to 6.2% in June 2004 (end-2003: 6.8%).

The increased strength of the banking system was also reflected in its growing capital base, from RM71,533 million at end-2003 to RM75,296 million in June 2004, due to improved earnings and capital raising by some banking institutions. Similarly, the risk-weighted capital ratio (RWCR) and core capital ratio (CCR) continue to be sustained above 13% and 10%, respectively since June 2002. The RWCR and CCR of the banking system, which stood at 13.7% and 11.1%, respectively in June 2004 (end-2003:

TABLE 5.5

Performance of Ringgit against Selected Currencies

RM per foreign currency ¹	2 September 1998	End 2003	End-August 2004	% change vs	
				2 September 1998	End 2003
US Dollar	3.8000	3.8000	3.8000	0.0	0.0
Pound Sterling	6.3708	6.7678	6.8007	-6.3	-0.5
Euro ²	-	4.7783	4.5621	-	4.7
Japanese Yen (100)	2.7742	3.5546	3.4478	-19.5	3.1
Singapore Dollar	2.1998	2.2342	2.2166	-0.8	0.8
Thailand Baht (100)	9.3713	9.5947	9.1182	2.8	5.2
Philippine Peso (100)	8.8302	6.8431	6.7559	30.7	1.3
Indonesian Rupiah (100)	0.0354	0.0449	0.0406	-12.8	10.6
Korean Won (100)	0.2827	0.3180	0.3294	-14.2	-3.5

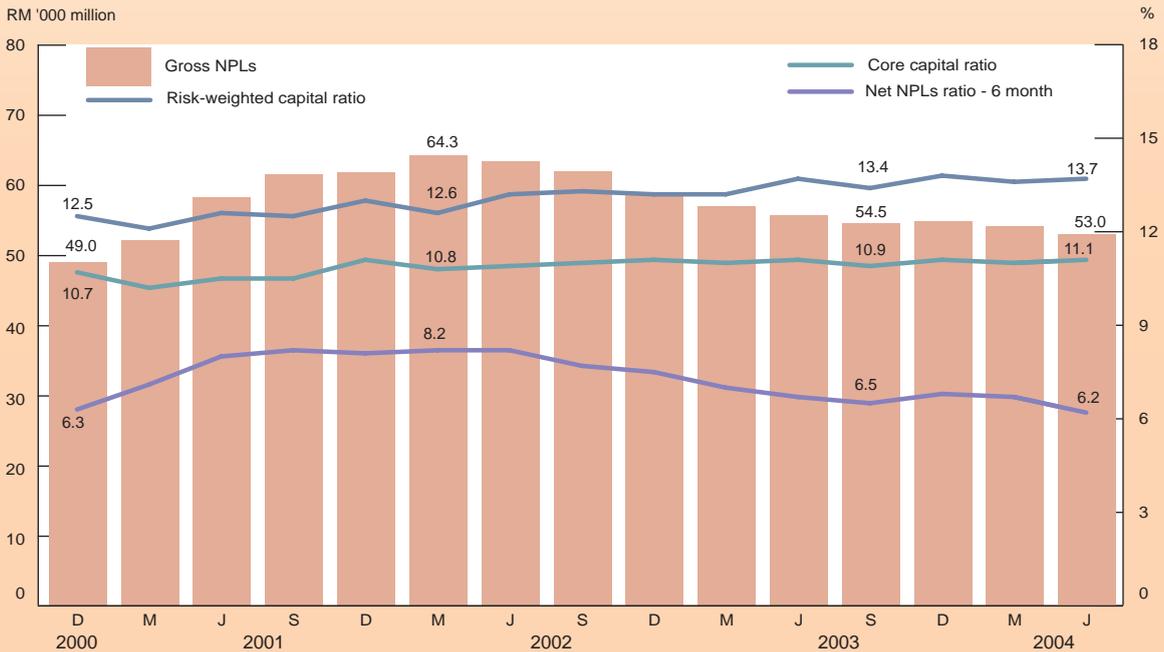
¹ Interbank rates at 12.00 noon in Kuala Lumpur are an average of the highest buying and lowest selling quotes.

² Euro was introduced in January 1999.

Source: Bank Negara Malaysia.

CHART 5.5

Banking System: Gross NPLs, Net NPLs Ratio, Risk-Weighted Capital Ratio and Core Capital Ratio



Source: Bank Negara Malaysia.

13.8%; 11.1%) remained significantly higher than the respective Basel minimum requirements of 8% and 4%.

Financial Sector Restructuring

Danamodal ceased operations, while Danaharta is on track, redeeming its bonds on schedule...

Financial sector restructuring in Malaysia reached another important milestone, with the cessation of operations in February 2004 by **Danamodal**, one of three institutions set up to address the problems of the banking system during the Asian financial crisis. Danamodal was a special purpose vehicle, which was set up to recapitalise the banking institutions. Established with a definite objective and finite life, Danamodal was the second institution to wind up after the closure of the CDRC in August 2002. During its five-

year life span, Danamodal had recapitalised ten banking institutions totalling RM7,590 million, far lower than the initial estimated requirement of RM16,000 million. Danamodal had also redeemed its entire RM11,000 million bonds in October 2003, issued in 1998 to fund the recapitalisation of banking institutions.

Danaharta, the national asset management company, is also making good progress towards winding up its operations by end-2005. As at end-June 2004, Danaharta had successfully redeemed eight tranches of bonds with a face value of RM8,647 million as scheduled, which accounted for 78% of total bonds issued. There remains seven tranches of bonds worth RM2,493 million to be redeemed at quarterly intervals until 31 March 2005. Danaharta had issued a total of RM11,140 million bonds in 15 tranches between November 1998 and March 2000 to finance the acquisition of NPLs during the financial crisis. As at end-June 2004, Danaharta expects

to recover RM30,990 million from its NPL portfolio of RM52,440 million (loan rights acquired plus accrued interest), representing a recovery rate of 59%.

Progress of the Financial Sector Master Plan

Enhancing the resilience and stability of the financial sector...

The FSMP, which was launched in March 2001, sets out the strategies for the development of the financial sector over a 10-year period. Comprising a total of 119 recommendations, the FSMP is to be implemented in three phases from 2001 to 2010. In line with the objective of the FSMP in evolving a more competitive, resilient and dynamic financial system, initiatives that were undertaken during Phase 1 were focussed on enhancing the capacity and capability of domestic financial institutions to improve their level of effectiveness and competitiveness. Measures were also targeted at strengthening the regulatory and supervisory framework, promoting a secure and efficient payments system, as well as developing the framework on consumer education and protection.

Phase 1 of the FSMP has yielded positive results, which saw further improvements in the domestic banking industry in terms of capitalisation, profitability and costs, as shown in *Table 5.6*. Likewise, the insurance industry witnessed further improvements in Phase 1. The capital position of the general insurance industry strengthened, with average capitalisation increasing by 54.4% from RM92 million in 2000 to RM142 million in 2003. Domestic insurers maintained their dominance in the market, capturing 73.3% of gross general insurance premiums at end-2003. Employee productivity measured by gross premiums generated per employee grew significantly by 60% to RM797,923 in 2003 from RM498,857 in 2000. Overall profitability also improved, with domestic insurers achieving a higher return on equity at 24.7% against 20.4% for foreign insurers in 2003.

TABLE 5.6

Selected Banking Indicators

	End-2001	End-2003
Average total assets (RM million)	18,096 ¹	47,921 ²
Shareholders' funds (RM million)	1,437 ¹	4,033 ²
Return on assets (%)	0.7	1.2
Return on equity (%)	8.4	13.4
Pre-tax profit per employee (RM)	50,196	108,728
Cost to income ratio (%)	41.2	40.1

¹ As at end-1999.

² As at end-June 2004.

Source: Bank Negara Malaysia.

Moving forward, in Phase 2 of the FSMP, more initiatives will be directed towards levelling the playing field between domestic and foreign players in the financial system. At the same time, efforts will continue to be directed towards further strengthening the resilience, stability, efficiency and effectiveness of the financial system. The implementation of the FSMP is on track. As at end-June 2004, a total of 33 recommendations of the FSMP has been fully implemented, with an additional 24 recommendations being implemented on an on-going basis.

Islamic Banking

Liberalisation of Islamic banking earlier than envisaged...

Islamic banking further expanded in the first six months of 2004, sustaining its market share in terms of assets and deposits at 2003 levels and increasing its market share of financing. Islamic banking assets increased to RM89,077 million to garner 9.9% of total banking assets at end-June 2004 (end-2003: RM82,182 million; 9.7%),

as shown in *Table 5.7*. Islamic financing rose 11.3% to RM54,108 million to account for 11% of total financing by the banking system (end-2003: RM48,612 million; 10.3%). The growth in Islamic financing was largely due to higher consumer loan financing demand for passenger cars and residential properties. Islamic banking deposits increased to RM63,922 million, accounting for 10.4% of total banking deposits (end-2003: RM60,212 million; 10.4%).

Further measures were taken to strengthen and promote the Islamic banking industry in Malaysia during the first half of 2004. On the domestic front, these measures include issuing the Guidelines on New Product Approval Requirements for Islamic Banking Institutions to provide greater clarity, transparency and speedier product approval. The Credit Card-i Guideline was also issued to enable Islamic banking institutions to offer credit cards based on *bai'inah* (sell and buy back arrangement) or *bai'bithaman ajil* (deferred payment sale) contract.

BNM also issued the Guidelines on Directorship in Islamic Banks, which outline the duties and

main responsibilities of directors of boards of Islamic banks, aimed at enhancing transparency and corporate governance. In addition, amendments were made to the Central Bank of Malaysia Act, 1958 to enhance the Syariah Advisory Council (SAC) of BNM as the sole authority on *syariah* matters for Islamic banking and financial institutions that fall under the purview of BNM. The SAC will also serve as the reference point for the court or arbitrator in dispute resolutions involving *syariah* issues in Islamic banking and financial cases.

A significant development was the liberalisation of Islamic banking three years earlier than envisaged under the FSMP, following the approval in May 2004 for the establishment of a new foreign Islamic bank in Malaysia. In addition, two domestic commercial banks were also granted approval-in-principle in July this year to operate full-fledged Islamic banks. The move is expected to further drive the growth of Islamic banking.

On the international front, Malaysia remains at the forefront in the development of Islamic banking and finance. The Islamic Financial Services Board (IFSB), which was set up in Kuala Lumpur in November 2002 with Malaysia as the secretariat, has gained prominence and attracted the participation of international multilateral agencies such as the International Monetary Fund, World Bank, Bank for International Settlements and Asian Development Bank as associate members. Malaysia has also signed a Memorandum of Understanding (MOU) with the Islamic Development Bank in June 2004, paving the way for greater cooperation among countries in the Organisation of Islamic Conference (OIC) in key economic and financial activities. Among others, the MOU will strengthen financing arrangements to promote trade and investment as well as the development of Islamic financial markets.

Development Financial Institutions

DFIs increase lending to priority sectors...

Development financial institutions (DFIs) play an important role in complementing the banking

TABLE 5.7

Islamic Banking: Key Indicators

	RM million		% change
	End 2003	End-June 2004	
Assets	82,182	89,077	8.4
Deposits	60,212	63,922	6.2
of which:			
Investment	35,228	36,100	2.5
Savings	6,866	7,674	11.8
Demand	10,973	11,629	6.0
Others	7,145	8,519	19.2
Financing	48,612	54,108	11.3
of which:			
Residential property	14,344	15,322	6.8
Passenger cars	11,815	13,692	15.9

Source: Bank Negara Malaysia.

system through the provision of financial and advisory services to identified priority sectors, such as agriculture, infrastructure, *Bumiputera* entrepreneurs, shipping, capital-intensive and high-technology industries, manufacturing and exports. Meanwhile, the state-based DFIs contribute towards promoting home ownership and property development at the state level, namely in Sabah and Sarawak. Total loans outstanding of the ten DFIs surveyed expanded by 7.9% to RM33,052 million at end-June 2004 (end-2003: RM30,646 million), as shown in *Table 5.8*. Loan growth was driven by lending to infrastructure projects under the transport and storage sector, with an increase of RM812 million or 18.3%. Growth of 15.9% was recorded in the manufacturing sector, contributing 11.8% to total loans outstanding of the DFIs.

The micro-credit scheme of Bank Pertanian Malaysia (BPM) and Bank Simpanan Nasional (BSN) continues to receive overwhelming response. Since its introduction in June 2003 and up to June this year, both institutions have received 156,567 applications and approved

RM926 million, benefitting 91,000 individuals and small enterprises.

Total resources of DFIs rose by 3.7% to RM63.9 billion at end-June 2004 (end-2003: RM61.7 billion). The increase reflected higher borrowings from the Government to RM10.7 billion (end-2003: RM9.1 billion), accounting for 18.3% of total resources of DFIs. These borrowings were mainly to fund the infrastructure projects of Bank Pembangunan dan Infrastruktur Malaysia Berhad (BPIMB). The DFIs were also funded by shareholders' funds totalling RM8.1 billion or 15.4% of total resources.

Insurance Industry

Strong growth driven by investment-linked and endowment policies...

The insurance industry continues to play an important role in the economy by facilitating economic risk transfers and mobilising long-term savings to support economic growth. The industry, comprising life insurance and general insurance business, continued its strong growth momentum in the first six months of 2004, supported by the improving economy. Combined insurance premium income rose 21.5% to RM10,626 million (January-June 2003: 11.6%; RM8,748 million), largely contributed by the life sector, as shown in *Table 5.9*. Strong demand for investment-linked and endowment products was the major contributor to new business growth in life insurance, reflecting the shift in consumer preference for investment instruments over pure protection policies.

Total benefits and claims paid by the insurance industry increased by 19.2% to RM4,384 million (January-June 2003: 4.3%; RM3,677 million). The higher benefit payouts was due to increase in medical claims and cancellation of investment-linked units by policyholders as a result of profit-taking to capitalise on the improved equity market performance in the first quarter of 2004.

With its substantial asset pool, the insurance industry continued to provide an important source of funds for economic activities. Insurance fund

TABLE 5.8

Direction of Lending of DFIs¹

Sector	RM million		% share	
	End 2003	End June 2004	End 2003	End June 2004
Manufacturing	3,379.3	3,916.7	11.0	11.8
Agriculture	3,242.1	3,014.1	10.6	9.1
Real Estate & Construction	8,118.3	8,151.2	26.5	24.7
General Commerce	392.4	292.3	1.3	0.9
Transport & Storage	4,432.2	5,244.1	14.5	15.9
Others	11,081.8	12,433.3	36.1	37.6
Total	30,646.1	33,051.7	100.0	100.0

¹ Comprising Bank Industri & Teknologi Malaysia Berhad, Bank Pembangunan dan Infrastruktur Malaysia Berhad, Bank Simpanan Nasional, Bank Kerjasama Rakyat Malaysia Berhad, Export-Import Bank of Malaysia Berhad, Bank Pertanian Malaysia, Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad and Borneo Development Corporation (Sarawak) Sendirian Berhad.

Source: Bank Negara Malaysia.

TABLE 5.9

Life and General Insurance Business

	End 2003	End-June 2004 ^P
Life insurance business (RM million)		
New business:		
Number of policies ('000 units)	1,602	713
Sums insured	168,594.4	85,176.1
Total premiums	4,852.0	3,175.2
Business in force		
Number of policies ('000 units)	9,230	9,468
Sums insured	538,779.3	562,438.6
Annual premiums	10,246.0	10,675.7
Premium income	12,374.4	7,224.4
Benefit payments		
Death & disability	4,593.9	2,533.6
Maturity/vesting	662.3	352.3
Surrender/net cancellation of units	927.5	492.9
Cash bonuses	1,440.0	810.2
Medical	582.3	329.8
Others	448.8	279.5
	533.0	268.9
General insurance (RM million)		
Premium income:		
Gross direct premiums	8,186.3	4,407.2
Net premiums	6,437.9	3,401.1
Reinsurance placed outside Malaysia	1,084.1	542.0
Retention ratio ¹ (%)	85.6	86.3
Number of insurance companies		
Direct:		
Life	43	43
General	7	7
Composite	27	27
Reinsurance:	9	9
Life	10	10
General	1	1
Composite	8	8
	1	1

^P Preliminary data.

¹ Net premiums to gross direct and reinsurance accepted premiums less reinsurance within Malaysia.

Source: Bank Negara Malaysia.

assets expanded by 6.4% to RM81,757 million at end-June 2004 (end-2003: RM76,807 million), mainly contributed by the 8% growth in life fund assets, as shown in *Table 5.10*. Investments of insurance funds in corporate and debt securities remained dominant, amounting to RM35,699 million at end-June 2004 and accounting for the largest share of 43.7% (end-2003: 45.1%) of total fund assets of the industry. Malaysian Government Securities (MGS) held by insurance companies amounted to RM12,952 million to account for 15.6% of total MGS as at end-June 2004.

New business premiums of life insurance rose significantly by 53.7% to RM3,175 million in the first six months of 2004 (January-June 2003: 24.5%; RM2,066 million). The increase was largely due to higher sales of investment-linked and endowment products amounting to RM1,186 million and RM940 million in premiums, respectively (January-June 2003: RM584 million; RM505 million). In tandem with the growth,

TABLE 5.10

Assets of Life and General Insurance Funds (RM million)

	Life Insurance		General Insurance	
	End 2003	End June 2004 ^P	End 2003	End June 2004 ^P
Fixed assets	439.3	401.2	734.3	726.4
Loans	7,619.6	8,321.1	242.4	220.4
Government securities	10,004.3	11,121.2	1,922.1	1,830.5
Government guaranteed loans	-	-	30.2	10.1
Corporate and debt securities	29,249.5	30,121.1	5,370.8	5,578.4
Investment properties	2,661.1	2,748.8	454.6	435.4
Cash and deposits	8,258.0	10,575.6	6,010.4	6,045.8
Other assets*	1,963.7	1,739.6	1,846.7	1,881.6
Total	60,195.5	65,028.6	16,611.5	16,728.6

^P Preliminary data.

* Includes other investments and foreign assets.

Source: Bank Negara Malaysia.

investment-linked and endowment products accounted for a significant share of 37.4% and 29.6%, respectively in the first six months of 2004 (2003: 28.0%; 31.2%). Medical and health insurance recorded strong growth of 20% to RM774 million (January-June 2003: 27.8%; RM645 million) in line with increasing demand by consumers for better hospitalisation and medical protection. Market penetration, measured in terms of total number of policies in force to total population, rose to 37% in June 2004 (2003: 36.7%), indicating huge potential for further market penetration.

The strong new premium growth coupled with improved investment conditions, particularly in the equity market during the first quarter of 2004, boosted the overall profitability of the life sector. As a result, excess of income over outgo increased by 49.1% to RM5,792 million in the first six months of the year (January-June 2003: RM3,884 million). Total assets of life insurance funds continued to grow, increasing by 8% to RM65,029 million at end-June 2004 (end-2003: RM60,196 million).

Growth in the **general insurance sector** moderated in the first six months of 2004, with slower growth rates observed in most classes of business, including the two major classes of motor and fire business. Total gross direct premiums increased by 4.1% to RM4,407 million (January-June 2003: 11.5%; RM4,233 million). Motor insurance business remained the largest category, contributing 42.8% to total gross direct premiums.

The overall retention ratio for general insurance business increased to 86.3% in the first six months of 2004 (January-June 2003: 83.3%) following the higher retention registered by both direct insurers and professional reinsurers, particularly in the fire class of business. With the increase in net premiums retained and positive investment results, operating profits in the general insurance sector reached RM674 million (January-June 2003: RM638 million). Total general insurance fund assets increased marginally to RM16,729 million at end-June 2004 (end-2003: RM16,612 million).

Takaful

Sustained growth reflects increasing acceptance...

The *takaful* industry expanded further in tandem with the improving economy and the increasing popularity of Islamic financial products. Combined contributions of family and general *takaful* increased by 6.8% to RM557 million in the first six months of 2004 (January-June 2003: 23.1%; RM522 million), accounting for 5.5% of total insurance sector contributions, as shown in *Table 5.11*. Similarly, total assets of *takaful* funds rose 16.5% to RM4,734 million (January-June 2003: 22.1%; RM4,065 million), accounting for 5.6% of total assets of the insurance sector.

TABLE 5.11

Family and General *Takaful* Business

	Financial Year 2003	End June 2004
Assets¹ (RM million)	4,429.1	4,733.7
Government Investment	426.8	487.1
Issues		
Investment deposits:		
Bank Islam Malaysia Bhd.	105.4	180.8
Others	1,434.0	1,442.8
Islamic PDS and equities	2,047.7	2,266.7
Cash and bank balances	103.7	39.6
Financing	97.6	59.5
Fixed assets	108.3	107.5
Others	105.6	149.7
Contributions² (RM million)	1,014.0	557.2
Family <i>Takaful</i> Business		
New Business:		
Total contributions (RM million)	511.0	258.0
Sums participated (RM million)	18,330.0	14,525.6
Number of certificates	265,035	132,077
Business in Force:		
Total contributions (RM million)	394.2	418.5
Sums participated (RM million)	63,573.8	85,157.1
Number of certificates	1,128,446	1,184,844
General <i>Takaful</i> Business		
Gross contributions (RM million)	403.0	256.7
Net claims paid (RM million)	78.7	37.5

¹ Assets of family and general *takaful* funds.

² Net contributions of family and general *takaful* funds.

Source: Bank Negara Malaysia.

New business contributions of *family takaful* declined 8.9% to RM258 million in the first six months of 2004 (January-June 2003: 25.5%; RM283 million). The contributions were mainly generated from mortgage reducing term *takaful*, supported by the growth in Islamic mortgage financing of Islamic financial institutions and the provision of Islamic financing facility by the Government to civil servants. New business contributions of annuity *takaful* plans recorded a total of 260 certificates involving RM1 million (January-June 2003: 455 certificates; RM2 million). Likewise, investment-linked *takaful* plans introduced in 2003, expanded further with 1,170 certificates and contributions of RM5 million. Market penetration of the *takaful* industry, measured by the number of certificates in force to total population increased to 4.6% in June 2004 (2003: 4.5%).

General *takaful* business continued to grow, with gross contributions increasing by 21.2% to RM257 million in the first six months of 2004, surpassing the RM212 million contributions recorded in the same period of 2003. Gross contributions from the fire sector grew 7.8% to RM103 million (January-June 2003: RM96 million) and remained the dominant sector with 40.3% of total gross contributions. The motor vehicle sector with RM71 million in gross contributions and 27.5% share was the second top sector. Net claims paid by the industry amounted to RM37 million, an increase against RM32 million in the corresponding period of 2003. The increase in net claims was due mainly to third party and bodily injury claims under the motor vehicle sector.

Capital Market

Lower funds raised due to more subdued PDS issuance...

Total gross funds raised in the capital market were lower at RM43,777 million in the first six months of 2004 (January-June 2003: RM60,818 million), as shown in *Table 5.12*. The Government raised RM25,764 million through the issuance of MGS, marginally lower than the RM25,862 million in the corresponding period of 2003. In line with the announcement in Budget 2004,

TABLE 5.12

Funds Raised in the Capital Market January-June (RM million)

	2003	2004 ^P
By public sector		
Government securities		
Malaysian Government Securities	25,861.6	25,763.5
Khazanah Bonds	1,739.6	0.0
Government Investment Issues	1,729.4	1,440.1
Merdeka Savings Bonds	0.0	1,000.0
New Government securities	29,330.6	28,203.6
Less: Redemptions		
Malaysian Government securities	11,800.0	15,200.0
Khazanah Bonds	1,000.0	1,000.0
Government Investment Issues	0.0	2,000.0
Merdeka Savings Bonds	4.4	457.7
Net funds raised	16,526.2	9,546.0
By private sector		
Shares¹		
Initial public offerings	409.5	736.0
Rights issues	332.9	797.6
Private placements	234.6	437.0
Special issues	73.1	16.2
Warrants	120.7	47.7
New share issues	1,170.8	2,034.6
Debt securities² (gross)		
Straight bonds	20,056.9	889.4
Convertible bonds	769.8	2,220.2
Islamic bonds	6,815.0	890.9
Asset-backed bonds	510.0	1,402.5
Bonds with warrants	0.0	0.0
Medium term notes ³	-	3,896.0
Cagamas bonds	2,165.0	4,240.0
New debt securities	30,316.7	13,539.0
Less: Redemptions		
Private debt securities ⁴	8,480.6	11,316.0
Cagamas bonds	3,297.0	4,170.0
Net issues of debt securities	18,539.1	(1,947.0)
Net funds raised	19,709.9	87.5
Total net funds raised	36,236.1	9,633.6

^P Preliminary data.

¹ Excludes funds raised by the exercise of Employees Share Option Scheme, Transferable Subscription Rights and Irredeemable Convertible Unsecured Loan Stocks.

² Includes bonds issued by banking institutions since July 2000.

³ Classified as instrument of PDS since January 2004.

⁴ Includes straight bonds, bonds with warrants, convertible bonds and Islamic bonds.

Source: Bank Negara Malaysia.

BNM issued Merdeka Savings Bonds amounting to RM1,000 million to provide a higher annual return of 5% for pensioners not employed on a full-time basis and retired military personnel.

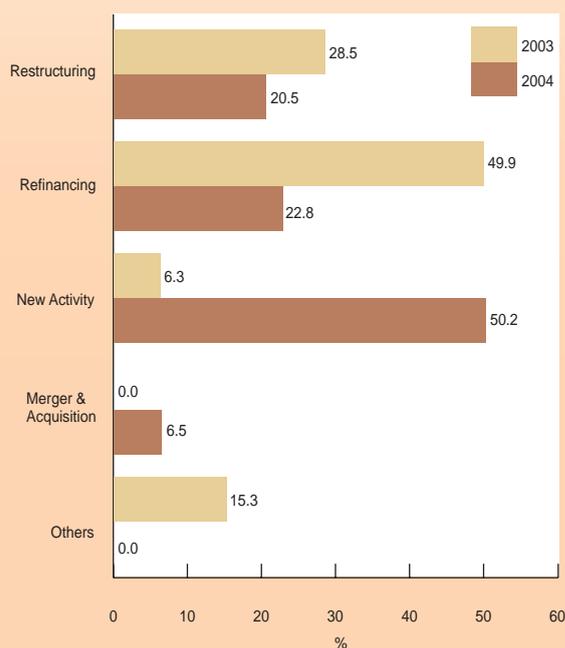
The decline in total funds raised was largely due to a sharp fall of 55.3% in the issuance of PDS by the private sector to RM13,539 million (January-June 2003: RM30,317 million). The decrease in PDS issuance can be attributed to the high base year effect in 2003, as well as concerns of a possible rise in bond financing cost following expectations of interest rate hikes in the US and improved investor sentiment in the equity market. In addition, the corporate sector preferred bank borrowing due to the prevailing low short-term interest rates. Encouraged by the more favourable performance of the equity market, funds raised from initial public offerings (IPOs) and rights issues rose significantly by 79.7% and 139.6%, respectively to RM736 million and RM798 million (January-June 2003: RM410 million; RM333 million). Consequently, net funds raised after accounting for redemptions were lower at RM9,634 million (January-June 2003: RM36,236 million).

A positive development was the utilisation of the bulk of PDS proceeds for new activities, amounting to RM4,669 million or half of total new PDS in the first six months of 2004, as shown in *Chart 5.6*. Funds raised for restructuring accounted for RM1,906 million or 20.5%. Since the financial crisis, the bulk of PDS raised had been used for restructuring and refinancing activities. The reversal in trend suggests a restructured and strengthened corporate sector, following financial and debt restructuring measures, which is poised to undertake capacity expansion and new activities. Bonds raised were predominantly in the construction sector, accounting for RM4,622 million or 49.7% of total new PDS issuance, as shown in *Table 5.13*.

Cagamas, the National Mortgage Corporation, remains the leading PDS issuer in the capital market, with ten issues valued at RM4,640 million in the first seven months of 2004 (January-July 2003: 18 issues; RM8,490 million), despite the generally more subdued PDS market. The bulk of issuance was in fixed rate bonds with nine

CHART 5.6

New Issues of PDS by Purpose January-June



Source: Bank Negara Malaysia.

TABLE 5.13

New Issues of PDS by Sector¹ January-June

Sector	2003		2004 ^P	
	RM million	% share	RM million	% share
Agriculture	410.3	1.5	-	-
Manufacturing	8,776.3	31.2	1,031.8	11.1
Electricity, gas and water supply	987.0	3.5	1,000.0	10.8
Construction	1,621.0	5.8	4,621.7	49.7
Transport, storage and communication	5,455.3	19.4	50.0	0.5
Financing, insurance, real estate and business services	5,433.8	19.3	2,540.6	27.3
Government and others	5,468.0	19.4	55.0	0.6
Total	28,151.7	100.0	9,299.1	100.0

¹ Excluding Cagamas bonds.^P Preliminary.

Source: Bank Negara Malaysia.

issues valued at RM4,240 million (January-July 2003: six issues; RM2,255 million) to fund the company's purchase of loans and debts. Investor demand for Cagamas bonds remained firm with a weighted average over-subscription rate of 2.66 times.

Trading in Cagamas bonds rose 95.4% to RM27,412 million (January-July 2003: RM14,026 million) due to the larger issuance of Cagamas fixed rate bonds during the period. Cagamas continues to be an important player in the PDS market, with Cagamas outstanding bonds amounting to RM25,668 million or 15.9% of the PDS market at end-June 2004 (end-2003: RM26,503 million; 15.6%). Banking institutions remained the dominant holder of Cagamas bonds, with RM15,096 million or 56.8% of the total as at end-June 2004 (end-2003: RM15,648 million; 59%), as shown in *Table 5.14*.

The purchase of loans and debts declined by 20.1% to RM3,592 million during the first seven months of 2004 (January-July 2003: RM4,498 million) amidst an environment of continued excess liquidity and stable interest rates. The financial institutions preferred to source funds from the money market and were generally less inclined to sell their adjustable rate housing loans to Cagamas. The purchase of hire purchase and leasing debts, however, increased by 17.5% to RM2,275 million (January-July 2003: RM1,935 million) as expectations of future interest rate hikes prompted financial institutions to be more active in hedging their fixed rate portfolios.

The two credit rating agencies continue to play an important role in the bond market by providing objective and impartial opinions on the ability of issuers to make full and timely payments of financial obligations. Despite the generally subdued PDS market, the number of credit ratings undertaken by **Rating Agency Malaysia (RAM)** and **Malaysian Rating Corporation (MARC)** increased to 86 issues valued at RM26,346 million in the first seven months of 2004 (January-July 2003: 57 issues RM20,822 million). Notwithstanding the increase in the number of rated bond issuance to 57 (January-July 2003: 46 issues), the value was, however, significantly lower at RM11,942 million (January-July 2003: RM25,800 million), due to the smaller number of larger-sized issues. The PDS market had benefitted from several large infrastructure projects in 2003, including Syarikat Prasarana Negara, Kuala Lumpur International Airport and YTL Power Generation.

In terms of tenure, there was a preference for longer dated PDS of more than five years, with 69 issues or 80.2% of total credit ratings, as issuers sought to lock in financing at low interest rates. Credit ratings on Islamic PDS and asset-backed securities (ABS) rose to 36 and 21 issues, respectively in the first seven months of 2004 (January-July 2003: 18 issues; 8 issues), with higher value of RM14,913 million and RM5,936 million, respectively (January-July 2003: RM2,725 million; RM3,452 million). The growth augurs well for efforts to develop Islamic PDS and ABS. During the period, RAM rated 49 bond issues worth RM10,373 million while MARC conducted 37 credit ratings valued at RM15,973 million, mostly involving utilities, construction and engineering, as well as property and real estate.

TABLE 5.14

Distribution of Cagamas Bonds

Holder	End-2003		End-June 2004	
	RM million	% share	RM million	% share
Banking institutions	15,648	59.0	15,096	56.8
Insurance companies	2,442	9.2	2,759	10.4
Provident and pension funds	7,700	29.1	7,101	26.7
Other investors	713	2.7	1,617	6.1
Total	26,503	100.0	26,573	100.0

Source: Cagamas.

Bursa Malaysia

Improved performance on positive investor sentiment...

The Kuala Lumpur Stock Exchange (KLSE) officially converted its name to **Bursa Malaysia** on 20 April 2004 following the demutualisation of the exchange. Subsequently, all subsidiaries with the exception of Labuan International

Financial Exchange (LFX), which previously had their own identity received new names incorporating “Bursa Malaysia” for branding purpose.

Bursa Malaysia was the best performing exchange in the region in the first quarter of 2004, supported by better economic growth prospects, improved corporate earnings and the Government’s landslide victory in the 11th general election. The KLCI breached the 900-point level to close at 901.85 points at end-March 2004, registering a sharp gain of 107.9 points or 13.6% (end-2003: 793.94 points). Market capitalisation rose to RM724.2 billion (end-2003: RM640.3 billion). Similarly, daily average turnover volume was higher at 651 million units during the first three months of 2004 compared with 214 million units in the first quarter of 2003.

The upward trend was, however, not sustained as investor sentiment was dampened by concerns

including the impact of a slower Chinese economy on regional economies, hike in US interest rates and higher global oil prices. The KLCI eased to 819.86 points at end-June 2004 with market capitalisation at RM653.9 billion. Daily average turnover volume was also lower at 331 million units during the second quarter of 2004. The KLCI edged up to 842.04 points at 2 September, registering an increase of 6.1% year-to-date. The performance of Bursa Malaysia was mixed compared with other major and regional bourses, as shown in *Chart 5.7*.

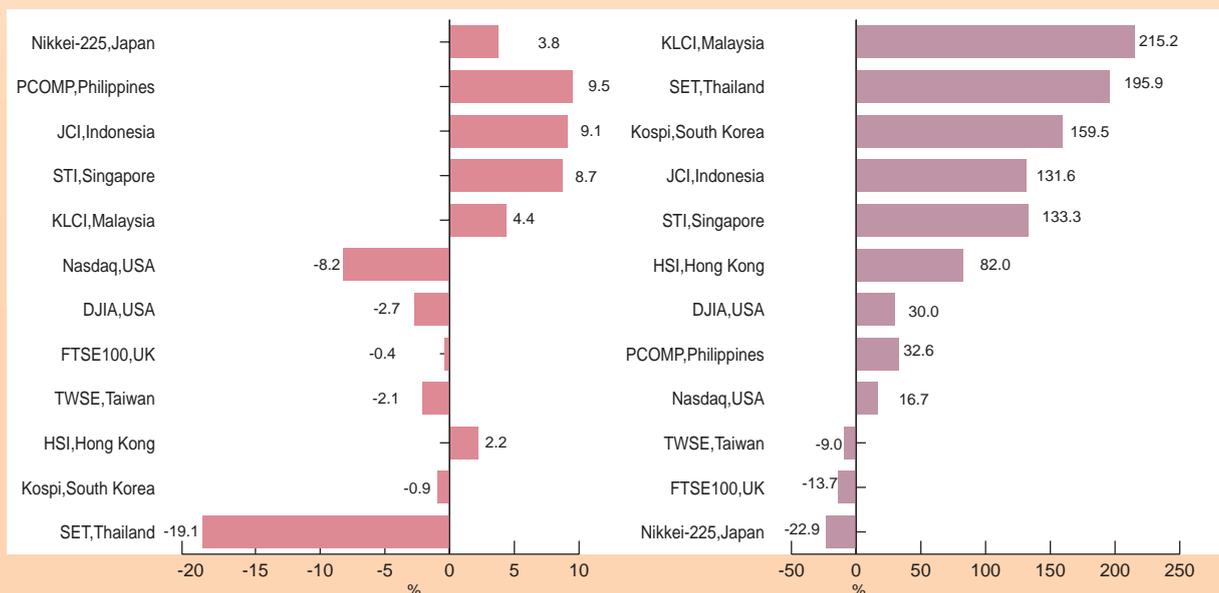
In terms of sectoral indices, the best performing index was the Mining Index, up 19.7% on the back of corporate restructuring undertaken by some companies within the sector, which spurred buying interest, as shown in *Table 5.15*. The Malaysian Exchange of Securities Dealing and Automated Quotation (MESDAQ) Market Index declined by 16.9% on profit-taking after registering strong gains of 82.9% in 2003, compounded by

CHART 5.7

Performance of Selected Indices

End 2003 vs end-August 2004.

1 September 1998 vs end-August 2004.



Source: Bloomberg.

TABLE 5.15

Bursa Malaysia: Performance of Selected Indices

	End-December 2003	End-July 2004	% change
Composite	793.94	833.97	5.0
EMAS	195.57	200.32	2.4
Second Board	140.64	117.87	-16.2
MESDAQ Market	152.25	126.52	-16.9
Industrial	1,772.39	1,827.60	3.1
Consumer Products	216.29	227.61	5.2
Industrial Products	81.39	81.83	0.5
Construction	187.97	165.87	-11.8
Trading/Services	115.34	119.43	3.5
Finance	6,472.17	6,957.32	7.5
Property	750.70	735.98	-2.0
Plantation	2,180.93	2,211.23	1.4
Mining	338.7	405.29	19.7
Syariah	122.86	125.19	1.9
Technology	60.3	44.87	-25.6

Source: Bursa Malaysia.

a less favourable outlook for the global technology sector.

Trading on Bursa Malaysia was more active during the first seven months of 2004, supported by higher retail and institutional investors as well as foreign participation. Turnover rose significantly in terms of volume and value, posting increases of 41.8% and 85.4%, respectively, as shown in *Table 5.16*.

The better market performance prompted a larger number of firms to raise funds in the equity market. The number of IPOs and total funds raised in the equity market increased to 42 issues and RM3,574 million, respectively (January-July 2003: 25 IPOs; RM1,770 million). The 42 new listings comprised eight on the Main Board and 17 each on the Second Board and MESDAQ Market. Prices of 37 new listings also traded at a premium at the end of the first day of trading supported by improved market sentiment.

TABLE 5.16

Bursa Malaysia: Selected Indicators January-July

	2003	2004
Price indices¹		
Composite	720.6	834.0
Emas	178.9	200.3
Second Board	118.9	117.9
MESDAQ Market	118.9	126.5
Total turnover²		
Volume (million units)	46,523	65,951
Value (RM million)	73,063	135,486
Average daily turnover²		
Volume (million units)	325.3	461.2
Value (RM million)	510.9	947.5
Market capitalisation ¹ (RM million)	562,739	664,672
Market capitalisation ¹ / GDP (%)	1.60	1.62
Total no. of companies listed¹		
Main Board	570	613
Second Board	290	280
MESDAQ Market	24	49
Market liquidity¹		
Turnover value/market capitalisation (%)	13.0	20.4
Turnover volume/no. of listed securities (%)	18.8	23.6
Market concentration¹		
10 most highly capitalised stocks/market capitalisation (%)	31.8	33.8
Average paid-up capital of stockbroking firms ¹ (RM million)	167.3	174.7

¹ End period.

² Based on market transactions during period.

Source: Bursa Malaysia.

The total number of listed companies on Bursa Malaysia stood at 942 at end-July 2004, the second largest number of listed companies on a stock exchange after Hong Kong in East Asia.

Unit Trust Industry

NAV rises, following the strong performance of the stock exchange...

The unit trust industry expanded further in the first six months of 2004 in tandem with new funds launched coupled with an increase in the volume of units in circulation. During the period, 33 new funds were launched, of which eight were Islamic funds, as shown in *Table 5.17*. The volume of units in circulation grew by 8.7% to 106,129 million units. In line with the strong performance of Bursa Malaysia, the net asset value (NAV) of the unit trust industry rose 6.7% to RM74,893 million. The ratio of NAV to market capitalisation of the stock exchange was 11.5% at end-June 2004 compared with the level of 40% for developed countries, indicating scope

for further development and growth of the unit trust industry.

Derivatives Market

Higher trading volume, spurred by KLCI and CPO futures...

Turnover of derivatives traded on Bursa Malaysia Derivatives increased sharply by 46.6% to 1,599,539 contracts in the first seven months of 2004 (January-July 2003: 1,091,009 contracts), fuelled by trading in KLCI and CPO futures. Following the launch of palm kernel oil futures in February this year, the derivatives exchange now has eight products to provide a wider choice of derivatives investment options to investors. CPO futures maintained its dominance on the exchange, with turnover of 790,683 contracts or 49.4% of total turnover (January-July 2003: 792,332 contracts; 72.6%). Average CPO futures prices rose 16.8% to RM1,788 per tonne in the first seven months of 2004 (January-July 2003: RM1,531 per tonne), due to tight supply of global

TABLE 5.17

Unit Trust Industry: Selected Indicators

	End-2003			End-June 2004		
	Government Supported Funds	Private Funds	Total	Government Supported Funds	Private Funds	Total
Number of unit trust management cos.	10	26	36	10	26	36
Number of unit trust funds ¹	35	179	214	35	212	247
Units in circulation (million)	49,112	48,554	97,666	49,406	56,723	106,129
Number of accounts (million)	8.708	1.590	10.298	8.714	1.649	10.363
Net asset value (NAV) (RM million)	41,912	28,260	70,172	43,534	31,359	74,893
NAV/Bursa Malaysia market value (%)	6.55	4.14	10.96	6.66	4.80	11.46

¹ Refers to funds already launched.

Source: Securities Commission.

vegetable oils and fats and continuing strong demand from China and the European Union. The outlook for CPO prices remains positive on expectations of depleting domestic and world CPO stocks and production during the second half of 2004, while demand is expected to rise, especially during the coming festive season from markets such as India and China.

The performance of KLCI futures was impressive with a more than four-fold increase in turnover to 698,986 contracts (January-July 2003: 126,420 contracts). Similarly, the market share of KLCI futures also expanded significantly to 43.7% (January-July 2003: 11.6%). The better performance of KLCI futures was underpinned by the more favourable performance of Bursa Malaysia. Trading in the 3-month Kuala Lumpur Interbank Offered Rate (KLIBOR) futures also improved, up by 25.7% to 91,515 contracts (January-July 2003: 72,793 contracts). The higher turnover was attributed to expectations of interest rate increase and the shift in market preference from the bond market to short-term money market and interbank market instruments. Trading activity in 5-year MGS futures was, however, more subdued with turnover down to 14,204 contracts (January-July 2003: 99,464 contracts). Financial institutions were less inclined to participate in the underlying bond markets and its futures contracts, due to the spill-over effect of the sudden increase in volatility in the bond market in July 2003.

Progress of the Capital Market Master Plan

Completion of Phase 1, moving on to Phase 2...

The first phase (2001-2003) of the implementation of the CMP was completed in 2003. The CMP, which was launched in 2001, is a 10-year plan to chart the strategic development of the

Malaysian capital market. Measures undertaken in Phase 1 of the CMP essentially focussed on strengthening domestic market players, building market capacity, as well as developing strategic sectors of the capital market. Among the more significant measures implemented include the development of an efficient corporate bond market, as reflected in the growing PDS issuance and increased efficiency of fund raising, with a 50% reduction in turnaround time of various regulatory processes. Another important achievement was the exchange consolidation, resulting in the merger of two stock exchanges (KLSE and MESDAQ) and three derivatives exchanges (KLOFFE, COMMEEX and MDEX). Efforts to further enhance liquidity in the stock exchange were also intensified in Phase 1, especially the standardisation of board lot sizes at 100 shares and reduction in transaction costs.

Measures undertaken during the second phase of the CMP (2004-2005) will be directed towards further strengthening key sectors and gradual liberalisation of market access. Emphasis will be on enhancing liquidity, including the free float of public listed companies (PLCs) through divesting of Government-owned shares and increasing market access. Current initiatives being pursued include the introduction of a common trading platform for equities and bonds and the joint development and establishment of a cross-trading linkage for securities between Bursa Malaysia and the Singapore Exchange (SGX).

Another priority is on value creation of market intermediaries in the progress towards liberalisation and further deregulation of the market. Phase 2 will also focus on enhancing the position of Malaysia's capital market, including allowing increased foreign participation in the domestic market, as well as facilitating the participation of domestic intermediaries in international markets.

Key Capital Market Measures

Continuing efforts to enhance the efficiency and competitiveness of the capital market...

Capital market measures introduced by the Securities Commission (SC) and Bursa Malaysia in the first seven months of 2004 were aimed at further enhancing market liquidity and efficiency, as well as investor protection and corporate governance. The key measures are as follows:

Demutualisation of the Exchange

- On 5 January 2004, the Kuala Lumpur Stock Exchange (KLSE) completed the demutualisation exercise, converting into a public company limited by shares from a company limited by guarantee. With the conversion, three equal shareholders, namely the Capital Market Development Fund, Minister of Finance Inc and licensed stock broking companies, now hold a 30% stake each in the demutualised entity. The remaining 10% stake was given to remisiers. The demutualisation marked the completion of a key recommendation of the CMP towards further strengthening the competitiveness of market institutions.

Strengthening Licensing Framework

- On 5 January, amendments to the Securities Industry Act (SIA) 1983 to clarify the definition of investor adviser became effective. With the amendments, any person who acts as or represents himself as a financial planner is required to be licensed as an investment adviser by the SC. The requirement is aimed at enhancing professionalism and credibility of financial planners, as well as to benefit investors who use financial planning services.

Enhancing Civil and Administrative Powers

- Effective 5 January, the scope of civil and administrative action for breach of any securities laws and any other laws under the purview of the SC was further enhanced. The expanded scope now allows SC to take action and penalise actual and prospective abuses of power by directors and chief executive officers (CEOs), including removal of a director and barring him from becoming a director of any PLC. At the same time, investors who suffer losses as a result of a breach of the laws can also make use of the new civil remedies provision.

Strengthening Clearing and Settlement

- Effective 5 January, a new provision was introduced under the amended SIA 1983 aimed at better ensuring the systemic integrity of the clearing and settlement arrangements of the clearing house. Under the provision, settlement of trades executed on the exchange is not compromised in the event of insolvency of any market participant who is a party to the trade.

Strengthening Investor Protection and Corporate Governance

- Effective 5 January, client asset protection will be enhanced through provisions requiring fund managers to appoint third party custodians to hold client assets. Other safeguarding measures include the transfer of client assets to a trustee, if such assets are deemed to be in jeopardy.

- Whistle blowing provisions were also introduced aimed at curbing corporate abuses and promoting better corporate governance in PLCs. The provisions impose a mandatory duty on auditors to report breaches of securities laws and rules of the exchange to the relevant authorities, and provide an auditor with statutory protection from any court action, when a report is made in good faith. Statutory protection is also available to officers of the company such as CEOs, chief financial officers and internal auditors for reporting wrongdoings by the company, although no mandatory obligation is imposed on them.
- With effect from 1 April, PLCs which are late in submission of financial statements to Bursa Malaysia for a period exceeding three months, will face suspension in the trading of their securities. The objective of the measure is to disseminate information in a timely manner.
- On 19 May, the SC released the Prospectus Guidelines for Listing of Foreign-Incorporated Companies. The new guidelines mandate additional disclosure requirements for foreign corporations seeking listing in Malaysia. The prospectus must disclose information such as differences in enforceability of laws, corporate information and risks associated with being regulated by other jurisdictions. The new guidelines are aimed at helping investors make informed decisions.

Enhancing Fund Raising Efficiency

- Effective 9 February, PLCs undertaking bonus issues, employee share schemes and employee share option schemes (ESOS) will no longer require the approval of the SC under amendments to the Securities Commission Act 1993. Bonus issues and ESOS by PLCs are now administered by Bursa Malaysia through amendments to the Listing Requirements (LRs). The amendments also introduce certain liberalisations. These include the option under the LR and the MESDAQ Market Listing Requirements for PLCs to extend ESOS to non-executive directors. Under the LR, the percentage of shares that may be issued under an ESOS is increased from 10% to 15%.
- In cases where bonus issues are undertaken from the capitalisation of reserves arising from the revaluation of land and buildings, the LR and the MESDAQ Market Listing Requirements require property valuation reports to be prepared in compliance with the SC's Guidelines on Asset Valuation.

Enhancing Clarity on Take-overs and Mergers

- On 25 March, the amended Malaysian Code on Take-overs and Mergers and its practice notes came into effect, aimed at ensuring greater clarity of various provisions in the Code. A new provision makes it mandatory for every director of the offerer to state that he had taken reasonable care to ensure that both facts and opinions expressed in the offer document were fair and accurate, and that no material facts were omitted. The offer document must also state that each director accepts responsibility accordingly.

Promoting Growth of PDS

- On 26 July, the SC released the Guidelines on the Offering of Islamic Securities (IS Guidelines). The IS Guidelines introduce an "umbrella" framework for Islamic securities, enabling and facilitating the development of a more innovative and sophisticated Islamic capital market in Malaysia. The Guidelines would facilitate the introduction of a wider range of Islamic instruments, particularly those issued under the syariah principles of *mudharabah* or *musyarakah* (profit-and-loss sharing) to meet different risk-return profile of investors. With the IS Guidelines, the offering of Islamic securities is no longer subject to the Guidelines on the Offering of PDS (PDS Guidelines).

- On 28 July, the SC released Practice Note 2 to clarify the application of PDS Guidelines on the issuance of ringgit denominated bonds in Malaysia by multilateral development banks (MDBs) or multilateral financial institutions (MFIs). Practice Note 2 facilitates issuance of ringgit bonds by MDBs and MFIs by dis-applying various requirements in the PDS Guidelines. The relaxations are accorded based on the high credit stature of such issuers and developmental objectives that they bring along to the markets in which they raise funds.

Promoting Growth of Unit Trust Industry

- On 28 April, the SC issued Guidance Note 1 to the Guidelines on Unit Trust Funds. The note is aimed at further promoting the growth of the unit trust industry by allowing a larger pool of Malaysian incorporated licensed banks and merchant banks to act as guarantors for capital guaranteed funds. The minimum long-term rating requirement for a guarantor was liberalised from a rating that indicates highest safety for timely repayment of financial obligations and have favourable credit profile to a rating that indicates adequate safety for timely payments of financial obligations and have adequate credit profile, which can be obtained from either a domestic or international rating agency.
- On 7 July, several liberalisations were made under Guidance Note 2 to the Guidelines on Unit Trust Funds. Under the revised provisions, the management company must be a subsidiary of a company involved in the financial services industry in Malaysia, except where it is an entity licensed by the SC. Foreign equity participation was also enhanced from 30% to 49%. Activities undertaken by the management company were also widened to include management of investment portfolio other than unit trust funds as well as investment advisory services. At the same time, the shareholders' funds requirement for a management company was increased from RM5 million to RM10 million.
- Guidance Note 3 on the Guidelines on Unit Trust Funds issued on 7 July 2004 extended the initial offer period for close-ended unit trust funds from 21 to 45 days.

Preventing Money Laundering and Terrorism Financing

- On 31 March, the SC issued the Guidelines on Prevention of Money Laundering and Terrorism Financing for Capital Market Intermediaries. The aim is to facilitate capital market intermediaries such as dealers, fund managers, futures brokers and futures fund managers in complying with the provisions of the Anti-Money Laundering Act 2001.

Outlook 2005

Monetary policy to support growth, complemented by a resilient capital market ...

The Malaysian economy is projected to grow by 6% in 2005 in line with the moderation in world growth. Strong private consumption and steadily rising private investment will drive domestic economic activity, while public spending gradually consolidates. Monetary policy will

continue to support domestic growth by ensuring low and stable interest rates to facilitate economic activities, whilst maintaining a positive real rate of return for savers. Notwithstanding the anticipated gradual rise in global interest rates, Malaysia's increased economic resilience and strong macroeconomic fundamentals will continue to accord flexibility in undertaking a supportive monetary stance.

The healthier banking system is on stronger footing to withstand shocks and support the economy's higher financing needs. DFIs will

continue to complement the banking system as niche providers of medium and long-term financing of projects with higher risks due to the longer investment tenure. The insurance industry is set to expand, fuelled by the growth of invest-linked and endowment inclusive of education, as well as medical and health insurance products.

Growth of Islamic banking is poised to further accelerate, following the earlier liberalisation in allowing a foreign bank to commence Islamic banking in Malaysia, with another two new licences to be issued to qualified foreign Islamic banking players in the pipeline. In addition, the recent approval for two domestic banking institutions to start full-fledged Islamic banking is also expected to further spur the expansion of the industry. Apart from developing Islamic financial products in line with efforts towards becoming a regional Islamic financial hub, Malaysia is also well placed to exploit other potential areas. In this regard, Malaysia will position herself as a leading educational centre for Islamic banking and finance of international

standing, as well as offer Islamic banking and *takaful* consultancy services, particularly through the Islamic Banking and Finance Institute Malaysia (IBFIM), an industry-owned institute. Likewise, the role and activities of Malaysia's financial institutions can be expanded regionally and globally by mobilising their existing overseas outfits to provide Islamic banking products and services.

The stronger capital market is also well positioned to complement the banking system in financing private sector initiatives. PDS issuance is anticipated to increase, albeit more moderately, with the bulk to be utilised for funding of business expansion and new investments, a trend seen since the first half of 2004. Meanwhile, efforts to further broaden and deepen the capital market are expected to accelerate, supported by recent key measures. Among these initiatives include the automatic approval for private placements up to a limit of 10% of issued capital, the securitisation of housing loans of civil servants, as well as allowing the issuance of ringgit denominated bonds by MDBs and MFIs.