

# 5

## Monetary and Financial Developments





# Monetary and Financial Developments

## Overview

### *Stronger financial sector developments*

The economy continued to grow, albeit with some moderation, in the second quarter of 2011 following increasing uncertainties in the global environment. As headline inflation recorded the fifth consecutive quarterly increase, the Overnight Policy Rate (OPR) was adjusted upward by 25 basis points (bps) to 3.00% in May 2011 to safeguard price stability. Meanwhile, the Statutory Reserve Requirement (SRR) ratio was raised three times from 1.00% to 4.00% to manage the increased level of liquidity and prevent any financial imbalances, arising from the strong short-term capital inflows. Notwithstanding this, monetary policy remains accommodative to support growth.

Financing through the banking system and capital market remained robust, supporting activities across all sectors of the economy. The resilience and stability of the financial system is underpinned by strong capitalisation and firm asset quality as well as prudent risk management practices. During the first seven months of 2011, loan applications and approvals continued to increase strongly at 23.1% and 20.1%, respectively. Similarly, business loan applications and approvals recorded robust growth of 29.5% and 25.8%, respectively, with lending to small and medium enterprises (SMEs) accounting for more than one-third of total loans to businesses. As at end-July 2011, the risk-weighted capital ratio (RWCR) and core capital ratio (CCR) stood at 14.3% and 12.5%, respectively.

The Capital Market Masterplan 2 (CMP2) was launched on 12 April 2011 based on the theme "Growth with Governance". This strategic blueprint

is set to transform the capital market over the next 10 years, addressing key structural challenges and critical linkages to foster a more diverse and innovative intermediation environment and to nurture new growth opportunities.

Currently, Malaysia has the most established shariah, regulatory and legal infrastructure, which offers a comprehensive coverage of Islamic financial services across banking, takaful and capital market, including innovative products. The Islamic capital market now exceeds RM1 trillion and is growing as rapidly as the conventional capital market. Malaysia remains the leader in sukuk issuance accounting for 62.7% or USD112.3 billion of total global sukuk outstanding as at the end of the first half of 2011. The total value of sukuk listed on Bursa Malaysia as at end-July 2011 stood at RM88.3 billion (USD29.6 billion), confirming the exchange's position as the leading sukuk listing destination in the world.

In June 2011, the Government set another milestone in offering a global sovereign sukuk based on the wakala structure. The dual tranche USD2 billion Wakala Global Sukuk comprising a 5-year USD1.2 billion tranche and a 10-year USD800 million tranche, was very well received by the market and was 4.5 times oversubscribed. The yield for the 5-year tranche was 2.991% and the 10-year tranche, 4.646%, the lowest absolute yield achieved by an Asian sovereign for a new USD-denominated issue.

## Monetary Policy

### *Further normalisation of rates*

**Monetary policy** in 2011 continues to support the growth of the economy, while managing

the risk of inflationary pressures as well as to avoid financial imbalances. As the economy sustained its growth momentum in the first quarter of 2011, the OPR was adjusted upwards on 5 May 2011 by 25 bps to 3.00%. Even with the adjustment in the degree of monetary accommodation, the OPR remained supportive of growth. Meanwhile, the SRR, which was held at 1.00% since March 2009, was raised three times as a pre-emptive measure to manage the significant build-up of excessive liquidity which could lead to financial imbalances. Post-global financial crisis, the emerging economies, including Malaysia experienced large short-term capital inflows, which exerted significant upward pressure on exchange rates and asset prices. Thus, the SRR was raised 100 bps each time, in April, May and July 2011 to 4.00%.

## Monetary Developments

### *Money supply expands further*

Monetary aggregates continued to grow during the first seven months of 2011. **M1 or narrow money** increased 14.5% as at end-July 2011 (end-2010: 11.7%) due to higher demand deposits, which rose 14.6% (end-2010: 12.2%). **M3 or broad money** expanded 11.6% as at end-July 2011 (end-2010: 6.8%) on account of increased bank lending to the private sector and higher net foreign assets.

### *Interest rates remain accommodative*

With the economy firmly on a steady growth path, the degree of monetary accommodation was adjusted. Thus, the OPR, which was held steady at 2.75% since July 2010, was increased 25 bps to 3.00% on 5 May 2011. During the 7 July 2011 policy review, the OPR was left unchanged at 3.00% and remains supportive of growth.

Following adjustment in the OPR, the average base lending rate of commercial banks increased

TABLE 5.1

### Determinants of M3 January – July

	Change (RM million)	
	2010	2011
<b>M3</b>	<b>18,752.0</b>	<b>70,342.4</b>
Net claims on Government	-7,135.8	-19,367.1
Claims on private sector	48,787.6	63,028.6
Loans	50,098.2	57,080.0
Securities	-1,310.6	5,948.5
Net foreign assets	-5,592.3	102,029.9
Bank Negara Malaysia	-19,942.0	80,784.8
Banking system	14,349.7	21,245.1
Other influences	-17,307.5	-75,348.9

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

27 bps to 6.54% as at end-July 2011 (end-2010: 6.27%). Similarly, the average lending rate of commercial banks rose to 5.10% in May 2011 before stabilising at 5.03% as at end-July 2011 (end-2010: 5.05%). Meanwhile, the savings deposit rate rose to 1.09% as at end-July 2011 (end-2010: 1.00%). The fixed deposit rates for the 1-month to 12-month maturities increased to range between 2.95% – 3.23% (end-2010: 2.71% – 2.97%). With inflationary pressures on the upward trend during the first seven months of 2011, the real return for fixed deposits turned negative from March 2011 onwards.

### *Strong private sector financing*

**Gross financing by the private sector** through the banking system and capital market grew 9.3% to RM497.6 billion in the first seven months of 2011 (January – July 2010: 12.1%; RM455.1 billion). This was due to higher issuance of private debt securities (PDS), which surged

90.3% to RM35.8 billion while equity issuance amounted to RM8.2 billion. Loans disbursed by the banking system rose 8.2% to RM453.6 billion (January – July 2010: 15.1%; RM419.1 billion) with disbursements mainly to the household (RM155.1 billion), manufacturing (RM97.1 billion) as well as wholesale and retail trade, accommodation and restaurant (RM76.7 billion) sectors.

Following sustained economic growth, all financing indicators of the banking system expanded during the first seven months of 2011. **Loan applications, approvals and disbursements** posted growth of 23.1%, 20.1% and 8.2% (January – July 2010: 18.8%; 19%; 15.1%), respectively. **Total loans outstanding** expanded 12.9% to RM949.9 billion as at end-July 2011 (end-2010: 12.7%; RM883.3 billion), with the household sector accounting for slightly more than half of the total.

Business loan applications and approvals rose sharply by 29.5% and 25.8% (January – July 2010: 14.4%; 19%), respectively. Loans disbursed to businesses totalled RM298.4 billion and were mainly to finance working capital. The manufacturing sector continued to receive the largest share of the disbursements at 21.4% followed by the wholesale and retail trade, accommodation and restaurant sector (16.9%) and the finance, insurance and business services sector (12%). Similarly, business loans outstanding increased 12.4% to RM354.7 billion as at end-July 2011 with the manufacturing sector accounting for 24.9% of total business loans outstanding (end-2010: 9.4%; RM333.1 billion; 25%).

Financing for SMEs continued to register strong growth with applications, approvals and disbursements increasing 31.4%, 22.4% and 18.8% (January – July 2010: 29.4%; 38%; 2.2%), respectively. Lending to SMEs accounted for 39.6% of total loans to businesses as at end-July 2011 (end-2010: 38.5%). Most of the SME loans were to the wholesale and retail trade, accommodation and restaurant sector (27.9%) as well as the manufacturing sector (21.8%). Total SME loans outstanding grew 14.1% to RM140.6 billion as at end-July 2011 (end-2010: 2.4%; RM128.4 billion).

TABLE 5.2

**Banking System: Loan Indicators  
January – July**

Indicator	RM billion		Change (%)	
	2010	2011	2010	2011
<b>Total<sup>1</sup></b>				
Loan applications	351.7	432.9	18.8	23.1
Loan approvals	191.2	229.5	19.0	20.1
Loan disbursements	419.1	453.6	15.1	8.2
Loans outstanding <sup>2</sup>	841.2	949.9	11.8	12.9
of which:				
<b>Business</b>				
Loan applications	160.4	207.6	14.4	29.5
Loan approvals	86.6	109.0	19.0	25.8
Loan disbursements	281.3	298.4	14.6	6.1
Loans outstanding <sup>2</sup>	315.6	354.7	6.4	12.4
of which:				
<b>SMEs</b>				
Loan applications	73.2	96.2	29.4	31.4
Loan approvals	33.7	41.2	38.0	22.4
Loan disbursements	83.7	99.5	2.2	18.8
Loans outstanding <sup>2</sup>	123.2	140.6	3.1	14.1
<b>Households</b>				
Loan applications	191.3	225.3	22.8	17.8
Loan approvals	104.5	120.6	19.0	15.3
Loan disbursements	137.9	155.1	16.4	12.5
Loans outstanding <sup>2</sup>	465.6	524.9	13.2	12.7

<sup>1</sup> Total includes other sectors (foreign entities, other domestic entities, Government and others).

<sup>2</sup> Outstanding loans as at end-period.

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

Apart from the banking system, financing for SMEs was also sourced from various **special revolving funds** administered by Bank Negara Malaysia (BNM), which totalled RM9.7 billion as

TABLE 5.3

**Loans by Sector**

	Loans Disbursed				Loans Outstanding			
	2010		Jan – July 2011		End-2010		End-July 2011	
	RM billion	Share (%)	RM billion	Share (%)	RM billion	Share (%)	RM billion	Share (%)
<b>Business</b>	<b>483.2</b>	<b>66.7</b>	<b>298.4</b>	<b>65.8</b>	<b>333.1</b>	<b>37.7</b>	<b>354.7</b>	<b>37.3</b>
Large corporations	336.0	46.4	198.9	43.9	204.7	23.2	214.1	22.5
SMEs	147.2	20.3	99.5	21.9	128.4	14.5	140.6	14.8
<i>Selected sectors</i>								
Primary agriculture	24.6	3.4	13.1	2.9	20.0	2.3	20.3	2.1
Mining and quarrying	3.5	0.5	2.6	0.6	3.2	0.4	3.4	0.4
Manufacturing	144.0	19.9	97.1	21.4	83.3	9.4	88.4	9.3
Electricity, gas and water supply	5.3	0.7	3.1	0.7	11.2	1.3	10.9	1.1
Wholesale and retail trade, accommodation and restaurant	122.8	16.9	76.7	16.9	65.2	7.4	70.2	7.4
Construction	42.8	5.9	23.7	5.2	38.3	4.3	38.4	4.0
Real estate	23.7	3.3	17.9	3.9	38.2	4.3	42.6	4.5
Transport, storage and communication	19.7	2.7	10.0	2.2	23.3	2.6	24.4	2.6
Finance, insurance and business services	83.2	11.5	54.6	12.0	71.4	8.1	78.1	8.2
<b>Households</b>	<b>241.4</b>	<b>33.3</b>	<b>155.1</b>	<b>34.2</b>	<b>489.5</b>	<b>55.4</b>	<b>524.9</b>	<b>55.3</b>
Purchase of residential properties	57.8	8.0	36.3	8.0	227.0	25.7	242.7	25.5
Purchase of passenger cars	37.2	5.1	20.3	4.5	112.7	12.8	116.5	12.3
Consumption credit <sup>1</sup>	112.3	15.5	74.4	16.4	71.8	8.1	77.4	8.1
of which:								
Credit cards	83.1	11.5	55.6	12.3	29.8	3.4	30.8	3.2
<b>Others</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>60.7</b>	<b>6.9</b>	<b>70.3</b>	<b>7.4</b>
<b>Total<sup>2</sup></b>	<b>724.6</b>	<b>100.0</b>	<b>453.6</b>	<b>100.0</b>	<b>883.3</b>	<b>100.0</b>	<b>949.9</b>	<b>100.0</b>

<sup>1</sup> Consumption credit = Credit card + personal use + consumer durables.

<sup>2</sup> Total = Business + households + others.

Note: Total may not add up due to rounding.

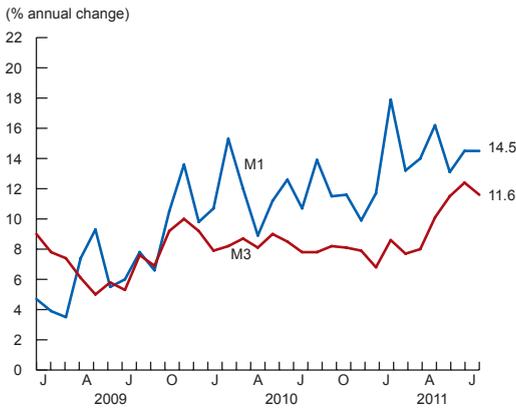
Source: Bank Negara Malaysia.

at end-July 2011. Through the revolving funds, more than 49,000 SMEs have been assisted with total financing approvals of RM20.5 billion. The utilisation rate of the funds remained high at 95.5% (end-2010: 95.5%), with total financing outstanding at RM7.6 billion. During the first seven months of 2011, a total of 2,568 SMEs received loans worth RM542.6 million from these funds.

Micro enterprises continued to receive financing support from 10 participating financial institutions under Skim Pembiayaan Mikro. Demand for **micro financing** remained robust with 25,034 applications during the first seven months of 2011, amounting to RM692.7 million (January – July 2010: 28,839 applications; RM663.1 million) while total financing approved was RM221.9 million for

CHART 5.1

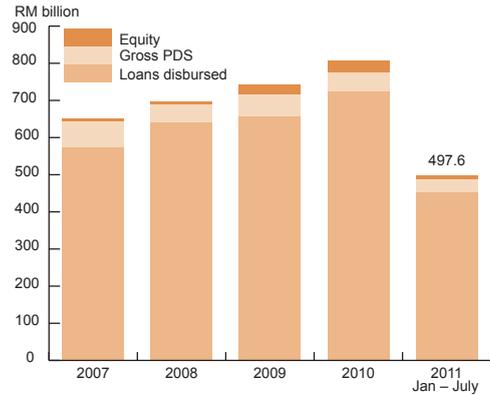
**Monetary Aggregates**



Source: Bank Negara Malaysia.

CHART 5.2

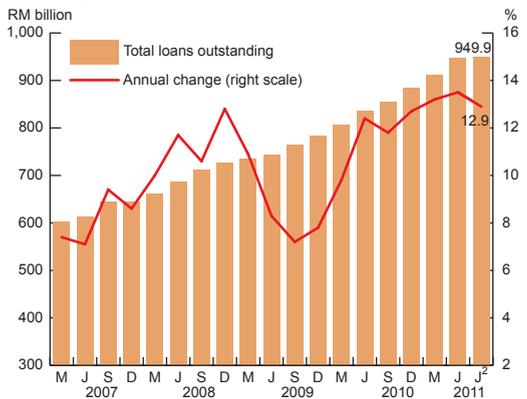
**Gross Private Sector Financing Through Banking System Loans and Capital Market**



Source: Bank Negara Malaysia.

CHART 5.3

**Banking System: Total Loans Outstanding<sup>1</sup>**



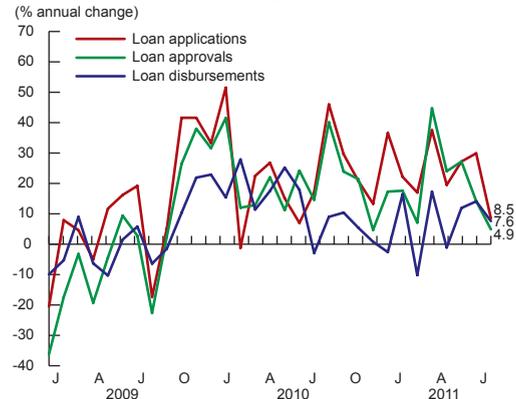
<sup>1</sup> End-period.

<sup>2</sup> End-July 2011.

Source: Bank Negara Malaysia.

CHART 5.4

**Banking System : Lending Indicators<sup>1</sup>**

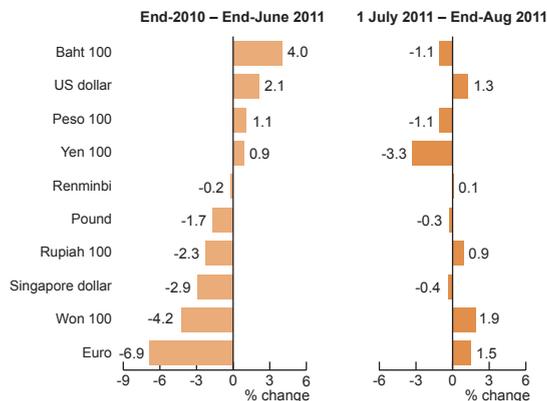


<sup>1</sup> Monthly data.

Source: Bank Negara Malaysia.

CHART 5.5

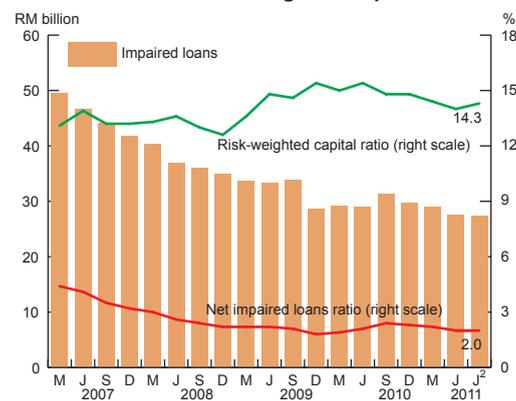
**Performance of Ringgit Against Selected Currencies**



Source: Bank Negara Malaysia.

CHART 5.6

**Banking System: Impaired Loans<sup>1</sup>, Net Impaired Loans Ratio<sup>1</sup> and Risk-Weighted Capital Ratio<sup>1</sup>**



<sup>1</sup> End-period.

<sup>2</sup> End-July 2011.

Source: Bank Negara Malaysia.

11,983 accounts (January – July 2010: RM219.4 million; 13,132 accounts). Total micro financing outstanding expanded 15.5% to RM834.8 million (end-2010: 25.9%; RM776.3 million), benefiting 69,460 micro businesses (January – July 2010: 63,910 micro businesses).

Lending by the banking system to the household sector remained firm, albeit at a slower pace.

Loans applied, approved and disbursed to the household sector grew 17.8%, 15.3% and 12.5% (January – July 2010: 22.8%; 19%; 16.4%), respectively, amid an attractive interest rate environment. Loans disbursed to the household sector were mainly for consumption credit, which totalled RM74.4 billion or 16.4% of total loans disbursed (end-2010: RM112.3 billion; 15.5%). This was followed by the purchase

### **Initiatives to Promote Sound Household Debt Management**

Several initiatives have been undertaken to ensure household indebtedness remains at a prudent level, including:

- Implementing Pengurusan Wang Ringgit Anda (POWER!) programme in February 2011 to promote financial literacy and prudent financial management, especially among young adults and first-time borrowers. This programme provides participants with financial knowledge and skills to make better financial-related decisions. As at end-July 2011, a total of 10,592 individuals have participated in the POWER! programme.
- Revising the eligibility requirements for credit cards, effective 18 March 2011, to instil sound financial and debt management among credit card users, as well as to promote fair and responsible business practices by credit card issuers. The new rules/conditions are:
  - The minimum annual income eligibility for new credit cards is raised to RM24,000 from RM18,000 previously;
  - Cardholders earning RM36,000 per annum and less can only hold credit cards from a maximum of two credit card issuers. (Existing cardholders who hold credit cards from more than two issuers are given up to the end of 2011 to select their preferred issuers and will be given at least two years to service their outstanding debts with the credit cards that have been cancelled);
  - The maximum credit limit is capped at double the monthly income of the cardholder for each issuer;
  - Issuers are not allowed to increase the cardholders' credit limit without their consent;
  - Issuers are also not allowed to offer credit advance in the form of cheque payable to cardholders unless requested;
  - Issuers must provide Product Disclosure Sheet containing key information on the credit card's features, fees and obligations of cardholders to facilitate comparison and informed decision-making;
  - Issuers must also display prominently, alerts on the implications of meeting only minimum and partial repayments; and
  - Effective from December 2011, cardholders should be provided with customised information on the duration to fully settle their outstanding balance and the total interest costs if only minimum repayments are made.
- Ensuring that non-bank financial institutions involved in providing credit and dealing with households, are regulated by similar prudential standards by the relevant authorities.

of residential properties which rose 8% to RM36.3 billion (end-2010: 8%; RM57.8 billion). Total household loans outstanding stood at RM524.9 billion, increasing 12.7% and accounted for 55.3% of total loans outstanding as at end-July 2011 (end-2010: RM489.5 billion; 13.4%; 55.4%).

Total household debt, which included loans provided mainly by the banking system, development financial institutions (DFIs) and Treasury Housing Loans Division, grew 11.6% to RM619.9 billion while the household debt-to-Gross Domestic Product (GDP) ratio stood at 77.2% as at end-July 2011 (end-2010: 12.6%; RM581.6 billion; 75.9%). The household debt level remained manageable as more than half of the debt comprised asset-backed loans for residential properties (45%) and vehicles (19.2%). Household financial assets which increased 14.1% to RM1,476.7 billion, were more than twice the level of household debt, while the ratio of household liquid financial assets to debt remained high at 155.4% as at end-July 2011 (end-2010: 12.4%; RM1,368.4 billion; 153.9%). This provided households with some financial flexibility to manage the changing economic conditions and higher cost of living. In addition, the net impaired loans ratio improved to 2% of total household loans (end-2010: 2.3%).

**Credit card** spending also continued to expand, with transactions increasing 11.8% to RM50.3 billion during the first seven months of 2011 (January – July 2010: 15.9%; RM45 billion). Most of the transactions were for local purchases and purchases from abroad, which together accounted for 95.8% while the balance was for cash advance withdrawals. Following the imposition of the credit card service tax in the 2010 Budget announced in October 2009, total credit cards in circulation has been on the decline, recording 8.3 million cards as at end-July 2011. This represented a 26% decline from the level recorded in October 2009 (end-October 2009: 11.2 million cards).

Credit card debt accounted for 6.1% of total household debt and 3.4% of total loans in the banking system as at end-July 2011 (end-2010: 6.3%; 3.5%). Meanwhile, the impaired loans ratio of credit card debt stood at 1.8% as at end-July 2011 (end-2010: 1.7%). The number of credit card-related cases handled by the Credit Counselling and Debt Management Agency declined slightly to 8,070 in the first seven months of 2011 (January – July 2010: 8,301), accounting for 82.5% of the total cases undergoing the Debt Management Programme with debt valued at RM1.3 billion (January – July 2010: 87.9%; RM1 billion).

### *The ringgit strengthens*

The ringgit continued to appreciate against the United States (US) dollar in line with the performance of regional currencies amid the optimistic growth outlook in the region. The ringgit touched a new 13-year peak at RM2.9615 against the US dollar on 28 April 2011 due to the influx of funds into the region and Malaysia in particular. However, the upward pressure on the ringgit moderated in the second quarter amid increasing concerns over the sovereign debt crisis in Greece as well as the uncertainty in the global economic outlook. As at end-June 2011, the ringgit traded against the US dollar at RM3.0205 and eased against other major and regional currencies in the range of 0.2% and 6.9%.

During 1 July to end-August 2011, the ringgit trended slightly upward by 1.3% against the US dollar as fears over weaker growth and uncertainty surrounding the debt situation in the US weighed down the dollar. Year-to-date to end-August, the ringgit gained 3.5% against the US dollar but eased against the euro by 5.5%, the yen by 2.5% and the pound by 2%. The ringgit also softened against most regional currencies.

## Update on Foreign Exchange Administration Rules

The further liberalisation of foreign exchange administration rules was aimed at enhancing the efficiency of the financial system as well as to support the expansion activities of local companies abroad.

### 4 March 2011

#### General Payments

- Allow resident and non-resident individuals to make:
  - payments in ringgit for any purpose between:
    - non-resident individuals who are immediate family members<sup>1</sup>
    - non-resident and resident individuals who are immediate family members.
  - payments in foreign currency for any purpose between:
    - resident individuals who are immediate family members
    - resident and non-resident individuals who are immediate family members.

#### Foreign Currency Accounts of Residents

- Allow resident individual to open and maintain a joint foreign currency account, for any purpose with a non-resident individual who is an immediate family member, subject to the prevailing rules on investment in foreign currency assets.
- Existing limits on the aggregate overnight balance of foreign currency accounts maintained by residents for education and employment purposes are abolished.
  - the conversion of ringgit into foreign currency to meet the requirement for education or employment abroad will be supported by documentary evidence and justification to the remitting bank.

### 1 June 2011

The liberalisation of direct investment abroad, inter-company loans and trade financing is as follows:

- Direct investment abroad is excluded from the existing RM50 million limit on investment in foreign currency assets. Resident companies that meet the prudential requirements are permitted to undertake direct investment abroad of any amount.
- Resident companies are allowed to borrow any amount in ringgit or foreign currency from their resident and non-resident non-bank related companies.
- The current RM5 million limit imposed on foreign currency trade financing obtained by residents from non-residents will no longer be applicable. In this regard, residents may obtain foreign currency borrowing, including foreign currency trade financing, up to the prevailing aggregate limit of RM100 million for companies on a corporate group basis and RM10 million for individuals.

[<sup>1</sup> Immediate family members comprise parents and children, husband and wife as well as siblings only]

## Financial Sector Developments

### *Banking system stays resilient*

The banking system continued to be resilient, supported by robust capitalisation, steady profitability and strong liquidity buffers during the first seven months of 2011. The regular stress tests conducted on credit, market and liquidity risks confirmed the capacity of the banking system to withstand potential adverse shocks. The banks were also able to provide financial intermediation to support economic activities and sustain growth. As at end-July 2011, the banking system's capital buffer was more than RM62 billion. The CCR and RWCR of the banking system stood at 12.5% and 14.3%, respectively. Approximately 80% of the total capital was in the form of Tier-1 capital, largely made up of paid-up capital and reserves.

During the first seven months of 2011, the banking sector recorded pre-tax profits of RM15.6 billion (January – July 2010: RM13.3 billion), contributed by higher net interest and revenue from services provided relating to financing activities, corporate advisory, money transmission as well as cross-selling of bancassurance and wealth management products. Meanwhile, net gains from treasury activities improved as banks weathered market volatility arising from two-way portfolio investment flows and external challenges from the US and euro area.

The quality of assets in the banking system continued to improve with net impaired loans amounting to RM27.5 billion or 2% of net total loans as at end-July 2011 (end-2010: RM29.7 billion; 2.3%). Loans in-arrears for less than 3 months remained stable at 3.9% of total loans while the overall loan loss coverage was at 97%. On a sectoral basis, the household sector accounted for the highest level of the impaired loans at 37.4% or RM10.3 billion (end-2010: 37.8%; RM11.2 billion). This was followed by the manufacturing sector at 21.5% or RM5.9 billion and the construction sector at 10.1% or RM2.8 billion (end-2010: 19.6%, RM5.8 billion; 10.4%, RM3.1 billion).

Continuous efforts were also undertaken to ensure reasonable fees and charges are imposed by financial institutions, including DFIs. On 16 May

2011, the revised Guidelines on the Imposition of Fees and Charges on Financial Products and Services were issued to ensure fees and charges levied on financial products and services offered to individuals and SMEs are equitable to both the consumer and the financial service provider.

In addition, financial institutions including DFIs are required to adopt sound and effective business continuity management procedures and practices to improve resilience and prepare for any eventualities. In this regard, the revised Guidelines on Business Continuity Management were issued on 3 June 2011, enforcing minimum requirements on the institutions to ensure continuity of critical business functions and essential services within a specified timeframe in the event of a major disruption.

### *Expanding presence of foreign banks*

The presence of foreign banks increased further to complement the current financial sector as Malaysia made progress in its economic transformation to become a high-income nation by 2020. Of the five new commercial banking licences issued in 2010, two banks have commenced operations in April and June 2011. On 15 June 2011, another new international Islamic bank licence was issued to a foreign bank from Bahrain. Currently, more than half of the 20 foreign commercial banks originate from the Asian region, signifying Asia's growing importance in the global economic landscape and Malaysia's strengthened linkages within the region.

Among the liberalisation measures announced in 2009 was to allow existing locally-incorporated foreign banks to establish new branches according to specific distribution ratios (1 market centre: 2 semi-urban: 1 non-urban) to enhance their ability and operational flexibility. As at end-July 2011, 10 new branches have been established nationwide, which included presence in non-urban areas. However, effective 17 August 2011, new and existing locally-incorporated foreign banks that have yet to reach a sizeable scale of operation will no longer be subjected to the ratios to enable the banks to better serve their targeted customer segments and niche areas.

### Investment banks boost bond market growth

As at end-July 2011, the number of investment banks in Malaysia remained at 15, following the transformation and rationalisation of merchant banks, discount houses, stockbroking companies and universal brokers. The investment banks in Malaysia remained resilient with strong RWCR and CCR at 33.4% and 32.9%, respectively (end-2010: 35%; 34.4%). The enhanced role of investment banks as key financial market intermediaries is evident in the growth of Malaysia's bond market to become the largest in Southeast Asia. Several Malaysian investment banks have also emerged as notable players in the regional investment banking industry as part of longer-term growth strategies to diversify sources of income and tap new business opportunities.

### Strengthening the DFIs

The **DFIs** continued to play a significant role in supporting the development of the strategic economic sectors, as evident by the positive growth in DFI financing activities. Total financing outstanding of the DFIs expanded further by 7.4% to RM98 billion as at end-July 2011 (end-2010: 13%; RM94.2 billion), driven mainly by higher financing across all major sectors, particularly consumption credit as well as the construction, maritime and agriculture sectors. As at end-July 2011, total financing for consumption credit, which represented almost half of the DFIs' total financing outstanding grew 12.1% to RM48.4 billion (end-2010: 20.2%; RM45.4 billion) supported by continued strong consumer spending and favourable economic conditions.

Financing to the construction sector recorded a favourable growth of 9.2% to RM15 billion as at end-July 2011 (end-2010: 17.1%; RM13.9 billion). Meanwhile, financing to the agriculture sector turned around to increase 4.9%, with total financing outstanding at RM6.3 billion as at end-July 2011 (end-2010: -1.9%; RM6.1 billion). Lending to the maritime sector also recorded a

TABLE 5.4

#### Development Financial Institutions<sup>1</sup>: Direction of Lending

	RM million		Share (%)	
	End-2010	End-July 2011	End-2010	End-July 2011
Primary agriculture	6,114.6	6,263.2	6.5	6.4
Manufacturing	5,496.5	5,390.8	5.8	5.5
Wholesale and retail trade, accommodation and restaurant	1,794.0	1,828.7	1.9	1.9
Construction	13,935.0	14,995.2	14.8	15.3
Transport, storage and communication	5,693.5	5,509.9	6.0	5.6
Finance, insurance and business services	1,636.3	2,030.5	1.7	2.1
Others	59,531.1	62,027.6	63.2	63.3
<b>Total</b>	<b>94,201.1</b>	<b>98,045.9</b>	<b>100.0</b>	<b>100.0</b>

<sup>1</sup> Refers to Bank Pembangunan Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Bank Pertanian Malaysia, Bank Perusahaan Kecil & Sederhana Malaysia Berhad.

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

significant growth of 25.3% to RM2.1 billion as at end-July 2011 (end-2010: 1.5%; RM1.8 billion) mainly for the purchase of shipping vessels. The DFIs continued to provide financing to SMEs, amounting to RM13 billion or 13.3% of total financing of DFIs as at end-July 2011 (end-2010: RM12.8 billion; 13.6%).

To safeguard the interest of the guarantor of a credit facility extended by DFIs, the Guidelines for Accepting Guarantee as Security for Development Financial Institutions were issued on 28 April 2011. This is to ensure that the guarantor is aware and willing to accept the liability prior to signing the guarantee. The

DFIs are also required to provide updates on the status of the credit facility to the guarantor. In the event of a credit default, the DFIs have to use their best effort to recover the sum in default from the borrower first, before any action can be taken against the guarantor.

### *Insurance industry remains strong*

The **insurance industry** remained resilient and continued to record a positive growth in the first seven months of 2011 with improved premium revenues, strong asset base and sustained profitability. Combined net premium income grew 5.1% to RM18.6 billion (January – July 2010: 11.9%; RM17.7 billion).

For the **life insurance** sector, excess of income over outgo increased 2.9% to RM6.8 billion (January – July 2010: 10.2%; RM6.6 billion) due to higher premium revenue and net investment income. Net premiums from new business and business in force of ordinary life and investment-linked products grew 4.6% to RM12.7 billion (January – July 2010: 12.9%; RM12.2 billion). New business premiums for life insurance were, however, lower by 1% to RM4.7 billion (January – July 2010: 18.1%; RM4.8 billion) following the decline in ordinary life by 8.6% to RM3.4 billion due to lower sales of whole life, endowment and temporary products (January – July 2010: 12.8%; RM3.7 billion). Meanwhile, new premiums for investment-linked products grew 24.3% to RM1.4 billion (January – July 2010: 40.7%; RM1.1 billion). The market penetration rate of life insurance improved to 44.9% as at end-July 2011 (end-2010: 41.5%).

The operating profits for the **general insurance** sector improved to RM1 billion attributed to higher underwriting profits of RM0.5 billion (January – July 2010: RM0.9 billion; RM0.4 billion). Gross direct premiums rose 7.1% to RM8.4 billion (January – July 2010: 9.2%; RM7.9 billion). The motor insurance segment remained the biggest business class, accounting for 44.2% of total premiums. In terms of claims experience, a

TABLE 5.5

### **Life and General Insurance Business**

	2010	Jan – July 2011
<b>Life Insurance (RM million)</b>		
New business:		
Number of policies (units)	1,426,280	860,089
Sums insured	405,658.8	180,489.4
Total premiums	8,659.9	4,726.1
Business in force		
Number of policies (units)	15,322,744	15,332,261
Sums insured	982,002.3	991,359.3
Annual premiums	19,498.7	19,765.7
Premium income	21,854.2	12,709.5
Benefit payments	13,023.4	6,477.1
<b>General insurance (RM million)</b>		
Premium income:		
Gross direct premiums	12,768.3	8,357.9
Net premiums	10,889.8	5,880.2
Reinsurance premiums placed outside Malaysia	714.1	464.6
Retention ratio <sup>1</sup> (%)	85.3	70.0
<b>Number of insurance companies</b>		
Direct:	<b>39</b>	<b>37</b>
Life	8	9
General	24	22
Composite	7	6
Reinsurance:	<b>7</b>	<b>7</b>
Life	1	1
General	5	5
Composite	1	1

<sup>1</sup> Net premiums to gross direct and reinsurance accepted premiums less reinsurances within Malaysia.

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

TABLE 5.6

**Assets of Life and General Insurance Funds**

	Life Insurance (RM million)		General Insurance (RM million)	
	End-2010	End-July 2011	End-2010	End-July 2011
Property, plant and equipment	1,660.5	1,643.1	719.5	635.8
Loans	10,870.2	10,898.3	115.6	94.6
Investments	109,989.8	113,461.3	14,026.5	11,394.4
Government papers	20,205.4	19,932.7	4,910.6	3,016.6
Government guaranteed loans	810.0	1,678.3	30.4	30.3
Corporate securities (equity and debt)	86,050.5	89,074.5	6,973.4	5,981.5
Other investments	2,923.9	2,775.8	2,112.0	2,366.0
Investment properties	2,479.9	2,466.1	222.1	154.0
Cash and deposits	9,184.0	11,234.6	8,181.1	7,298.7
Foreign assets	4,741.6	5,242.8	611.3	502.1
Other assets	2,609.0	2,650.7	2,650.0	2,748.7
<b>Total</b>	<b>141,535.1</b>	<b>147,596.9</b>	<b>26,526.1</b>	<b>22,828.2</b>

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

lower overall loss ratio was recorded at 60.6% (end-July 2010: 63.1%), with losses mainly concentrated in the motor, marine hull as well as oil and gas segments.

Assets of the insurance industry expanded strongly to RM170.4 billion during the first seven months of 2011 compared to RM154 billion in the corresponding period of 2010.

Asset allocation remained concentrated in corporate debt securities and Government securities, accounting for 70.2% of total assets (end-2010: 70.8%). Life insurance business continued to account for a significant portion of the industry's total assets with a share of 84.1%. Meanwhile, the capital adequacy ratio of the insurance industry strengthened to 224.1% following an increase in the capital buffer to RM19.5 billion (end-July 2010: 223.5%; RM18.5 billion).

In line with Malaysia's commitment under the Association of Southeast Asia Nations (ASEAN) Framework Agreement on Services (AFAS), progressive liberalisation was undertaken to enhance the efficiency of the insurance industry. Under the fifth package of AFAS, Malaysia has committed to allow insurance brokers regulated in ASEAN countries to provide cross-border service for insurance broking of international marine, aviation and transit (MAT) risks. An oversight framework has been put in place to ensure orderly cross-border services as well as providing a certain level of protection to Malaysian international MAT risk owners.

Under the framework, ASEAN insurance brokers, who are regulated in the ASEAN countries and do not have any presence in Malaysia are allowed to apply to provide cross-border insurance broking services to Malaysian risk owners for the placement of international MAT risks. They must have a good track record and sound financial position, consent from their respective regulators as well as a valid professional indemnity insurance cover.

Following the greater flexibility offered with regard to foreign equity limits, three foreign parties have increased their shareholding in domestic insurers and a new foreign insurer has entered the insurance industry. The number of insurance companies has decreased to 37 companies as at end-July 2011 following two successful mergers and acquisitions last year.

## The New Motor Insurance Cover Framework

Motor insurance premiums and the scope of coverage of motor insurance policies are determined by the Malaysian Motor Tariff, which is regulated by Bank Negara Malaysia (BNM). The Tariff has not been revised since 1978. However, the profile of associated risks, including increased frequency and escalating costs of motor accidents have changed significantly. This is evident from the claims ratio for third party bodily injury and death cover, which have steadily increased over the years from 166.8% in 2005 to 288.4% in 2010. The resulting pricing misalignment has rendered motor underwriting business unsustainable, which in turn, led to the refusal by some insurers to provide motor cover, especially Third Party policy.

Thus the New Motor Cover Framework was formulated based on extensive consultation with stakeholders during the first half of 2010. The Framework aims to provide enhanced access to motor cover as well as speedier claims assessment and compensation. Currently, claims settlement, which takes 1 to 5 years to be finalised, will be reduced to between 6 and 18 months. The Framework has two broad strategies, namely:

- (1) enhancing the motor insurance claims settlement process to improve overall efficiency in claims management for the benefit of road accident victims; and
- (2) implementing gradual premium adjustments to address misalignment in pricing and ensure the long-term sustainability in the provision of motor cover.

To improve overall efficiency in claims management for the benefit of road accident victims, particularly to secure early compensation, a 24-hour call centre will be established to provide immediate roadside assistance to accident victims, facilitating early and simpler claims notification, shorter timelines to produce police and medical reports, and enhancing public awareness on making prompt motor insurance claims. A Joint Working Committee (JWC), chaired by BNM, was established in April 2011 with a mandate to implement the measures identified. The JWC comprises representatives from key stakeholders involved in the motor insurance claims settlement process.

Pending the implementation of the Framework in 2012, several measures were undertaken in May 2011 to ensure that all motorists will have access to motor cover. Vehicle owners who are presently unable to obtain motor cover from insurers/takaful operators may obtain motor cover from the Malaysian Motor Insurance Pool (MMIP). To increase access to MMIP, all general insurers as well as Pos Malaysia Berhad and their branches can act as agents of MMIP. 'Displaced vehicles', such as private cars exceeding 10 years and motorcycles, seeking cover from MMIP or insurers, would be charged the normal market premium rates and will not be subjected to the loading imposed on high-risk vehicles. In addition, 'displaced vehicles' are no longer required to undergo annual roadworthiness checks unless they are deemed to be high risk.

## Islamic Finance Developments

### *Islamic finance thrives*

Efforts continued to be taken to strengthen Malaysia's position as an International Islamic Financial Centre and contribute towards the internationalisation of Islamic finance by developing shariah-compliant products and services as well as tools to facilitate and support cross-border transactions. This included the establishment of the International Islamic Liquidity Management Corporation (IILM), which began operations on 1 February 2011 in Kuala Lumpur. The IILM is a collaboration of 12 central banks and regulatory agencies as well as two multilateral institutions<sup>1</sup>. IILM is tasked to issue short-term shariah-compliant multi-currency liquidity instruments to facilitate cross-border liquidity management between financial centres, which will in turn enhance Islamic financial interlinkages. This would also contribute to more efficient management of financial flows across borders.

On 1 July 2011, the Shariah Governance Framework was implemented to further strengthen the oversight role, authority, accountability, independence and competency of the Board of Directors, the Shariah Committee and the Management of the Islamic financial institutions on shariah matters. The Framework is to ensure greater shariah observance through end-to-end shariah control mechanisms. Implementation of the Framework will foster greater stakeholders' confidence and enhance the integrity of the Islamic financial industry, thereby reducing shariah non-compliance risk and contribute towards maintaining institutional soundness and financial stability.

Two Islamic indexes were launched in the first half of 2011, namely the Bloomberg Malaysian Foreign Currency Sukuk Index (BMSSUTR), and Bloomberg-AIBIM-Bursa Malaysia Sovereign Shariah Index (BMSSI). The BMSSUTR is a non-ringgit denominated index developed in

conjunction with BNM, which provides a global benchmark for the performance of sukuk and the ability to track movements of foreign currency issuances. The BMSSI index is a collaboration between Bloomberg, Association of Islamic Banks in Malaysia (AIBIM) and Bursa Malaysia, which provides a performance benchmark for shariah-compliant ringgit-denominated Government securities to investors.

The Islamic capital market continues its significant role in providing an alternative source for raising capital. As at end-July 2011, 847 shariah-compliant securities were hosted on Bursa Malaysia, representing 89% of total listed securities with a market capitalisation of RM826 billion or 61.7% of total market capitalisation (end-2010: RM756.1 billion; 59.3%). The trading volume of shariah-compliant securities rose to 111.5 billion units or 59.4% of the total 187.7 billion units traded during the first seven months of 2011 (January – July 2010: 88.5 billion units; 66.4%; 133.9 billion units). Malaysia remains the leader in the global sukuk market, accounting for 62.7% of total global sukuk outstanding as at end of the first half of 2011. Meanwhile, Bursa Malaysia is also the top sukuk listing destination, with 19 sukuk listed totalling RM88.3 billion as at end-July 2011 (USD29.6 billion).

Malaysia is also among the global leaders in the Islamic fund management industry. During the first seven months of 2011, one Islamic fund management licence was approved, bringing the number of full-fledged Islamic fund management companies to 16 (end-2010: 15 companies). During the same period, eight Islamic unit trust funds were launched reaching a total of 160 funds launched with a total net asset value (NAV) of RM26.4 billion as at end-July 2011 (end-2010: 152 funds; RM24 billion). Total Islamic wholesale funds launched stood at 24 with an additional five funds launched during the first seven months of 2011 (end-2010: 19 funds). The size of the Islamic wholesale funds in terms of total NAV was RM7 billion as at end-July 2011 (end-2010: RM4.2 billion). Meanwhile, one Islamic exchange-

<sup>1</sup> The members of IILM are from Indonesia, Iran, Kuwait, Luxembourg, Malaysia, Mauritius, Nigeria, Qatar, Saudi Arabia, Sudan, Turkey, and the United Arab Emirates as well as the Islamic Development Bank and the Islamic Corporation for the Development of the Private Sector.

traded fund (ETF) is listed with a NAV of RM579 million (end-2010: 1 ETF; RM626 million), while Islamic real estate investment trusts (REITs) stood at three with a market capitalisation of RM2.5 billion as at end-June 2011 (end-2010: 3 REITs; RM2.3 billion).

Bursa Suq Al-Sila' (BSAS) continued to facilitate commodity trade to support Islamic liquidity management, deposits, financing and sukuk issuances using the concepts of murabahah and tawarruq. BSAS has seen stronger presence within the local and international markets with its adoption of internationally accepted shariah standards. The daily average value of commodity traded recorded more than 400% increase, equivalent to RM351 million as at end-2010 (end-2009: RM69.6 million). As at end-July 2011, there were 43 commodity trading participants.

### Islamic banking flourishes

The Islamic banking business, which includes DFIs, continued to grow with significant expansion in assets, deposits and financing during the first seven months of 2011. Total assets expanded 15.4% to RM389.3 billion as at end-July 2011 and comprised 21.4% of total banking system assets (end-2010: 15.8%; RM351.1 billion; 20.8%). Total deposits grew 13.5% to RM299.1 billion and accounted for 23.1% of total deposits in the banking system as at end-July 2011 (end-2010: 17%; RM276.1 billion; 22.6%). Islamic financing continued to be in demand with an increase of 16.8% to RM246.8 billion, which represented 23.3% of total loans in the banking system (end-2010: 19.1%; RM222.2 billion; 22.7%).

More than half of the total financing in the Islamic banking system was extended to the household sector (65.8%) totalling RM162.3 billion as at end-July 2011 (end-2010: 66%; RM146.7 billion). This was followed by the manufacturing sector at 6.4% or RM15.9 billion as well as the finance, insurance and business activities sector at 4.8% or RM11.9 billion. Financing to businesses increased 9.4% to RM44.8 billion with SMEs accounting for RM20 billion of total financing to businesses (end-2010: 8.1%; RM40.9 billion; RM19 billion).

TABLE 5.7

### Islamic Banking: Key Indicators

	End-2010		End-July 2011	
	RM million	Change (%)	RM million	Change (%)
<b>Assets</b>	<b>351,104.7</b>	<b>15.8</b>	<b>389,284.4</b>	<b>15.4</b>
<b>Deposits</b>	<b>276,089.3</b>	<b>17.0</b>	<b>299,137.0</b>	<b>13.5</b>
of which:				
Investment	180,544.3	11.8	186,220.3	4.4
Savings	23,741.9	12.4	25,523.2	15.3
Demand	34,142.4	11.0	37,223.9	26.0
Others	37,660.6	66.2	50,169.6	49.9
<b>Financing</b>	<b>222,185.9</b>	<b>19.1</b>	<b>246,757.3</b>	<b>16.8</b>
of which:				
Manufacturing	13,537.9	15.0	15,859.3	24.1
Construction	8,028.7	8.4	8,206.4	14.3
Finance, insurance and business services	9,851.8	26.5	11,890.0	38.6
Education, health and others	8,436.2	117.2	10,459.8	34.0
Household	146,711.2	22.5	162,278.2	17.8

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

In ensuring competitive Islamic banking operations, Islamic banking institutions, which include DFIs, are required to maintain returns to depositors under the mudharabah contract which are comparable to that given to conventional depositors. To facilitate this, BNM issued the revised Guidelines on Profit Equalisation Reserve on 25 April 2011 regarding regulatory requirements to maintain competitive rates of returns or deposit rates while mitigating any downside risk as well as other requirements on governance, financial reporting and disclosures.

In June 2011, a Bahrain-based Islamic bank established a branch and commenced its international Islamic banking business. The bank's presence will further strengthen the economic and financial linkages between Malaysia

and Bahrain as well as contribute further to the development of the domestic Islamic financial system.

### *Takaful industry remains robust*

The takaful industry continued to grow in the first seven months of 2011 underpinned by increased domestic economic activities. Assets of the takaful industry grew 16.8% to RM16.3 billion, accounting for 8.7% of total assets in the insurance and takaful sector (January – July 2010: 19.5%; RM13.9 billion; 8.3%).

Meanwhile, new business contribution for **family takaful** declined slightly by 1.1% to RM1.58 billion (January – July 2010: 25.8%; RM1.59 billion), due to lower contributions in endowment products. However, market penetration rate of family takaful improved to 12.1% as at end-July 2011 (end-2010: 10.9%). During the first seven months of 2011, the net contribution for family takaful rose to RM2.2 billion (January – July 2010: RM2 billion) and contributed to the increase in excess of income over outgo by 6.3% to RM1 billion (January – July 2010: -3%; RM966.5 million). As at end-July 2011, three of the four family takaful operators that obtained licences following the liberalisation announced in 2009, have commenced operations.

For the **general takaful** sector, gross direct contributions increased 18.1% to RM917.5 million (January – July 2010: 27.6%; RM776.7 million) due to higher contributions from motor and medical businesses. However, operating profits for the sector declined 32.7% to RM103.6 million (January – July 2010: RM154 million) due to higher net claims incurred mainly in the motor class business during the period.

During the first seven months of 2011, five new guidelines for takaful operators were issued in efforts to build a robust and efficient takaful sector. They are the Guidelines on Takaful Operational Framework; Valuation Basis for Liabilities of Family Takaful Business; Valuation Basis for Liabilities of General Takaful Business; Financial Reporting for Takaful Operators; and Directorship for Takaful Operators. These guidelines are

TABLE 5.8

### Family and General Takaful Business

	2010	Jan – July 2011
<b>Assets<sup>1,2</sup> (RM million)</b>	<b>14,720.3</b>	<b>16,259.0</b>
Fixed assets	1.8	1.7
Financing	62.3	58.0
Investment	10,538.8	11,734.7
Government securities	2,255.7	2,510.7
Government guaranteed loans	-	87.0
Corporate securities (equity and debt)	7,605.1	8,491.9
Other investments	678.1	645.1
Investment properties	338.1	326.9
Cash and deposits	3,028.3	3,368.9
Foreign assets	21.3	10.9
Others	729.7	757.9
<b>Family takaful</b>		
<b>New business:</b>		
Total contributions (RM million)	2,587.1	1,577.7
Sums covered (RM million)	177,024.8	124,778.9
Number of certificates	906,064	548,201
<b>Business in force:</b>		
Total contributions <sup>3</sup> (RM million)	1,811.8	1,952.0
Sums covered (RM million)	343,632.6	382,658.3
Number of certificates	3,153,875	3,503,867
<b>General takaful</b>		
Gross direct contributions (RM million)	1,341.2	917.5
Net contributions (RM million)	1,030.8	695.2

<sup>1</sup> Assets of family takaful funds, general takaful funds and shareholders' funds.

<sup>2</sup> As at end-period.

<sup>3</sup> In force contributions reported is only for annual contributions.

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

expected to enhance sound risk management practices and foster better conduct of takaful business, thus facilitating the alignment of risk and capital management activities.

### *Post-Financial Sector Masterplan*

The Malaysian financial sector has undergone significant transformation since the 1997/98 Asian financial crisis following capacity and institutional building efforts, particularly under the Financial Sector Masterplan (FSMP) introduced in 2001. The 10-year FSMP was implemented in three phases: first, to enhance domestic capacity; second, to increase the competitive environment; and third, to foster greater international integration. As at end-2010, more than 90% of the FSMP recommendations have been completed or are being implemented. As a result, the financial sector has emerged stronger, more diversified and resilient to effectively support economic growth.

Building on the progress made over the past decade, the stronger financial sector is now well-positioned to take advantage of the opportunities of a more competitive and integrated environment, while serving the more varied and complex needs of the domestic economy. Currently, a new financial sector blueprint is being formulated to chart the future direction of the financial system and ensure that it continues to play a key role as the country transitions into a high-income economy. The new blueprint will outline strategies to develop a financial sector that best serves Malaysia's economic transformation, ensure stability of the financial system and strengthen the key enablers for the robust development of the financial sector.

## Capital Market Developments

### *Strong fund raising*

**Gross funds raised in the capital market** expanded strongly by 31.8% to RM106.2 billion during the first seven months of 2011 (January – July 2010: -26.6%; RM80.6 billion). After adjusting for redemptions, net funds raised increased 28.8% to RM62 billion (January –

TABLE 5.9

### Funds Raised in the Capital Market January – July

(RM million)

	2010	2011
<b>By Public Sector</b>		
<b>Government securities</b>		
Malaysia Government Securities	24,752	36,040
Khazanah Bonds	-	-
Government Investment Issues	15,000	26,179
Merdeka Savings Bond	-	-
Sukuk Simpanan Rakyat	-	-
Sukuk 1Malaysia	2,399	-
<b>New Issues of Government securities</b>	<b>42,151</b>	<b>62,219</b>
<b>Less: Redemptions</b>	<b>14,527</b>	<b>26,288</b>
<b>Net funds raised by Public Sector</b>	<b>27,624</b>	<b>35,931</b>
<b>By Private Sector</b>		
<b>Shares<sup>1</sup>/Warrants</b>		
Initial public offers	5,263	6,652
Rights issues	11,785	1,558
Private placements/ Restricted offer-for-sale	-	-
Special issues	-	-
Warrants	42	6
<b>New issues of shares/ warrants</b>	<b>17,090</b>	<b>8,216</b>
<b>Debt securities</b>		
Straight bonds	1,402	4,453
Convertible bonds	110	-
Islamic bonds	1,578	3,450
Asset-backed bonds	300	-
Bonds with warrants	-	-
Medium-term notes	17,975	27,934
Cagamas bonds	-	-
<b>New issues of debt securities</b>	<b>21,364</b>	<b>35,837</b>
<b>Less: Redemptions</b>	<b>17,940</b>	<b>18,002</b>
<b>Net issues of debt securities</b>	<b>3,424</b>	<b>17,835</b>
<b>Net funds raised by private sector</b>	<b>20,514</b>	<b>26,051</b>
<b>Total net funds raised</b>	<b>48,138</b>	<b>61,982</b>

<sup>1</sup> Excludes funds raised by the exercise of Employee Share Option Scheme, Transferable Subscription Rights and Irredeemable Convertible Unsecured Loan Stocks.

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

July 2010: -29.6%, RM48.1 billion), with the public sector accounting for 58% or RM35.9 billion and the private sector, RM26.1 billion (January – July 2010: 57.4%, RM27.6 billion; RM20.5 billion). Gross funds raised by the public sector rebounded 47.6% to RM62.2 billion (January – July 2010: -36.4%; RM42.1 billion), reflecting ongoing initiatives to transform the structure and performance of Malaysia’s economy through the implementation of the Tenth Malaysia Plan (10MP), Government Transformation Programme and Economic Transformation Programme (ETP). Funds were raised through the issuances of Malaysian Government Securities (MGS) and Government Investment Issues.

Funds raised by the private sector through PDS issuances rose strongly by 67.7% to RM35.8 billion during the first seven months of 2011 (January – July 2010: -32.7%; RM21.4 billion), reflecting higher demand following robust domestic economic activities. While the finance, insurance, real estate and business services sector continued to account for the bulk of the funds raised at RM14.4 billion or 40.3% of total PDS issuances, fund raising activity was more broad-based across more sectors (January – July 2010: RM18.4 billion; 86.1%). Funds raised were mainly used for working capital and to support general business activities. Meanwhile, funds raised in the equity market decreased 51.9% to RM8.2 billion (January – July 2010: 45.9%, RM17.1 billion) mainly due to the much lower rights issuances at RM1.6 billion (January – July 2010: RM11.8 billion). In contrast, funds raised through initial public offerings continued to remain healthy at RM6.7 billion (January – July 2010: RM5.3 billion).

During the first seven months of 2011, domestic sovereign yields were influenced mainly by external factors. In the first three months, heightened global risk aversion and expectations of rising inflationary pressures caused yields to increase. After the first quarter of 2011, there was also an upward pressure on yields for the shorter maturities in response to the OPR increase in May. Subsequently, both long-term and short-

TABLE 5.10

**New Issues of PDS<sup>1</sup> by Sector  
January – July**

Sector	RM million		Share (%)	
	2010	2011	2010	2011
Agriculture, forestry and fishing	140	266	0.7	0.7
Manufacturing	10	640	0.1	1.8
Construction	2,176	3,287	10.1	9.2
Electricity, gas and water	20	6,700	0.1	18.7
Transport, storage and communication	485	800	2.3	2.2
Finance, insurance, real estate and business services	18,384	14,425	86.1	40.3
Government and other services	149	9,370	0.7	26.1
Wholesale and retail trade, accommodation and restaurant	-	349	-	1.0
Mining and quarrying	-	-	-	-
<b>Total</b>	<b>21,364</b>	<b>35,837</b>	<b>100.0</b>	<b>100.0</b>

<sup>1</sup> Includes private debt securities issued by Cagamas and non-resident corporations.

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

term yields declined over sustained demand from non-residents and concerns of slowing global growth. During the first seven months of 2011, yields on 1-year MGS and 5-year MGS rose 6 bps and 10 bps (January – July 2010: 74 bps; -38 bps), respectively. In contrast, yields for 10-year MGS declined 16 bps (January – July 2010: -37 bps). Foreign holding of MGS rose 53.8% to RM95.4 billion, accounting for 34.3% of total outstanding MGS (end-July 2010: 99.8%; RM62 billion; 24.2%).

PDS yields remained stable for higher-rated debt securities of AA and above. However, for lower-rated securities of A and below, yields were on a declining trend, reflecting better credit

conditions in the lower segment of the PDS market following the improved outlook for the domestic economy. The 5-year PDS credit spreads (PDS yields minus MGS yields) for AAA-rated, AA-rated and A-rated debt narrowed 10, 13 and 44 bps (January – July 2010: 19 bps; 11 bps; 40 bps), respectively. This was

largely driven by improved credit conditions and robust corporate results in the first quarter. Meanwhile, MGS term spreads (10-year MGS minus 1-year MGS) declined 22 bps (January – July 2010: -111 bps), reflecting the decline in the 10-year MGS yields following the strong demand.

## Capital Market Masterplan 2

Following the first Capital Market Masterplan (CMP1), which guided the development of the Malaysian capital market during 2001 – 2010, the Malaysian capital market has grown at an annual compounded growth rate of 11% with the size of the capital market expanding from RM718 billion to RM2 trillion in 2010. From a capital market comprising mainly equities and Government debt securities in 2000, significant market segments were successfully nurtured for private debt securities and investment management coupled with the development of a comprehensive and innovative Islamic capital market. As at end-2010, 95% of the 152 recommendations contained in the CMP1 have been completed.

Building on the success of CMP1, the Capital Market Masterplan 2 (CMP2) was launched on 12 April 2011. The CMP2 with the theme “Growth with Governance” maps the strategic directions to transform the competitive dynamics of the capital market over the next 10 years. It outlines growth strategies to address key structural challenges and critical linkages to foster a more diverse and innovative intermediation environment and to nurture new growth opportunities.

Strategies to strengthen the role of the capital market include:

- Promote capital formation
  - Create a conducive intermediation environment to seed emergent companies and industries, nurture the growth of small and mid-cap companies, finance large and high-risk ventures, and promote investments in socially responsible projects.
- Expand intermediation efficiency and scope
  - Address structural constraints to increase the efficiency of savings intermediation and foster an innovative and diverse intermediation environment to expand the supply of assets to meet the needs of investors.
- Deepen liquidity and risk intermediation
  - Broaden the diversity of investment strategies and strengthen market connectivity through risk intermediation products and widen the range of participants.
- Facilitate internationalisation
  - Expand growth boundaries by tapping global opportunities to facilitate expansion in scale and capitalise on hub opportunities in areas of comparative advantage.
- Build capacity and strengthen information infrastructure
  - Strengthen the knowledge base through talent development and acquisition to support the expansion of the capital market into high value-add areas and build a strong information infrastructure to address information asymmetries and promote service innovation and efficiency in a highly electronic environment.

The CMP2 also outlines governance strategies to ensure robust regulatory oversight and active stakeholder participation to enhance confidence in the integrity and soundness of Malaysia's capital market.

Strategies to ensure robust governance arrangements include:

- Enhance product regulation to manage risks
  - Foster a more conducive environment for product innovation and diversity while ensuring that active fund-raising and financial innovation benefits investors.
- Expand accountabilities as intermediation scope widens
  - Create an enabling environment for participants to broaden intermediation activities and strengthen industry capabilities and standards.
- Robust regulatory framework for a changing market landscape
  - Ensure a consistent regulatory approach to a changing market environment and focus on enhancing the quality of markets.
- Effective oversight of risks
  - Expand regulatory coverage, capacity and tools to ensure effective supervisory reach and strengthen oversight of risks to market stability.
- Strengthen corporate governance
  - Strengthen the effectiveness of corporate governance through broad-based approaches to promote greater stewardship, more active shareholder participation and strengthen gate-keeping accountabilities.
- Broaden participation in governance
  - Promote active participation of stakeholders in shaping intermediation and corporate behaviour and to promote a culture of integrity and increased emphasis on socially responsible goals.

### *FBM KLCI continues to climb*

The **equity market** performed relatively well during the first seven months of 2011 despite global market uncertainties and increasing volatilities. In the first quarter of 2011, the Financial Times Stock Exchange (FTSE) Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI) recorded an upward trend bolstered by the strong domestic economic fundamentals and activities generated by the Government's ETP as well as higher capital inflows. This was despite concerns over the political turmoil in the Middle East and North African region, China's monetary policy tightening

measures to curb rising inflationary pressures as well as the massive earthquake, tsunami disaster and the ensuing nuclear power plant problems in Japan, which impacted investors' confidence and markets. The FBM KLCI gained 17% to 1,545.13 points as at end-March 2011 (end-2010: 19.3%; 1,518.91 points).

Investor sentiment remained resilient in the second quarter of 2011 although there were renewed concerns over the European sovereign debt contagion, rising inflation and weak US economic data. The positive performance of the local equity market was supported by continued positive

TABLE 5.11

**Bursa Malaysia: Selected Indicators  
January – July**

	2010	2011
<b>Price indices<sup>1</sup></b>		
FBM KLCI	1,360.9	1,548.8
FBMEMAS	9,212.8	10,682.8
FBM 100	8,953.6	10,459.4
FBM SCAP	11,540.3	12,511.3
FBM-ACE	3,794.8	4,121.8
<b>Total turnover<sup>2</sup></b>		
Volume (million units)	125,097.1	181,160.9
Value (RM million)	188,102.5	261,540.3
<b>Average daily turnover<sup>2</sup></b>		
Volume (million units)	862.7	1,266.9
Value (RM million)	1,297.3	1,829.0
Market capitalisation <sup>1</sup> (RM billion)	1,092.3	1,339.3
<b>Total no. of listed companies<sup>1</sup></b>		
Main Market	846	841
ACE Market	116	119
<b>Market liquidity<sup>1</sup></b>		
Turnover value/ market capitalisation (%)	17.2	19.5
<b>Market concentration<sup>1</sup></b>		
10 most highest capitalised stocks/ market capitalisation (%)	37.8	35.5

<sup>1</sup> As at end-period.<sup>2</sup> Based on market transactions during the period.

Source: Bursa Malaysia.

news such as the rebound in commodity prices, increase in electricity tariff rates, announcement of bank mergers, and further investment by Petroliam Nasional Berhad. Boosted by higher participation of retail investors and strong foreign

buying momentum, the FBM KLCI gained 20.2% to 1,579.07 points, recording a new all-time high as at end-June 2011 (end-March 2011: 17%; 1,545.13 points).

During 1 July to end-August, share prices on Bursa Malaysia recorded a fresh new high of 1,594.74 points on 8 July 2011, accelerated by buying support of selected heavyweight blue chips. However, the upward trend was reversed following the slump on Wall Street as investors were rattled by the failure of US lawmakers to agree on raising the debt ceiling. This was followed by another massive panic sell-off after the US sovereign credit rating was downgraded coupled with fears of the European sovereign debt crisis escalating. The FBM KLCI recorded the lowest close for the year at 1,444.81 points on 26 August 2011 before ending the month slightly higher at 1,447.27 points (end-August 2010: 1,422.49 points).

Market capitalisation grew 22.6% to RM1,339.3 billion as at end-July 2011 (end-2010: 27.6%; RM1,275.3 billion). Total market transactions by volume improved 40.2% to 187.7 billion units during the period (January – July 2010: -14.9%; 133.9 billion units), with favourable participation from local and foreign investors following strong corporate earnings and rising commodity prices. The value of total market transactions increased 34.3% to RM270.9 billion (January – July 2010: 16.6%; RM201.7 billion). Market velocity rose to 35%, but market volatility declined to 8.1% (end-July 2010: 31%, 9.3%). The total number of companies listed on Bursa Malaysia increased to 960 as at end-July 2011 (end-2010: 957 companies) following the listing of 25 new companies (end-2010: 29 companies). The divestment of assets by some Government-linked companies further contributed to liquidity and vibrancy in the market.

During the first seven months of 2011, the capital market continued to record a steady performance with Malaysia being officially elevated to advanced emerging market status from secondary emerging market status in the FTSE Global Equity Index

Series. This development augured well for the market and attracted more foreign portfolio inflows. Malaysia now joins Brazil, Czech Republic, Hungary, Mexico, Poland, South Africa, Taiwan and Turkey in the advanced emerging market category.

On the regional front, four ASEAN exchanges, namely Bursa Malaysia, the Philippine Stock Exchange, Singapore Exchange and the Stock Exchange of Thailand, have made further progress in the establishment of the ASEAN Trading Link by appointing a technology provider to set up the business-to-business intra-ASEAN cross-border order routing and trading platform that will electronically connect the markets of participating exchanges. This will allow investors and broker members to access multiple markets via a single connection. The platform is expected to go 'live' by the end of the first quarter of 2012.

Meanwhile, on 8 April 2011, Bursa Malaysia in collaboration with six stock exchanges in ASEAN (Hanoi Stock Exchange, Hochiminh Stock Exchange, Indonesia Stock Exchange, The Philippine Stock Exchange Inc., Singapore Exchange and The Stock Exchange of Thailand) launched the ASEAN Brand Identity, ASEAN Exchanges website and ASEAN Stars. These initiatives were aimed at promoting the development of ASEAN as an asset class through a collaborative framework with the intent of increasing liquidity to member exchanges.

### **Robust derivatives market**

Trading in the **derivatives market** rebounded strongly by 43.6% to register a turnover of 4.9 million contracts in the first seven months of 2011 (January – July 2010: -11.1%; 3.4 million contracts). The turnover of crude palm oil (CPO) and FBM KLCI futures continued to dominate the derivatives market, accounting for 98.4% of total trading (January – July 2010: 97.8%). Trading in the Kuala Lumpur Interbank Offered Rate (KLIBOR) futures was minimal while the 3-year and 5-year MGS futures as well as the

single stock futures were not traded during the period.

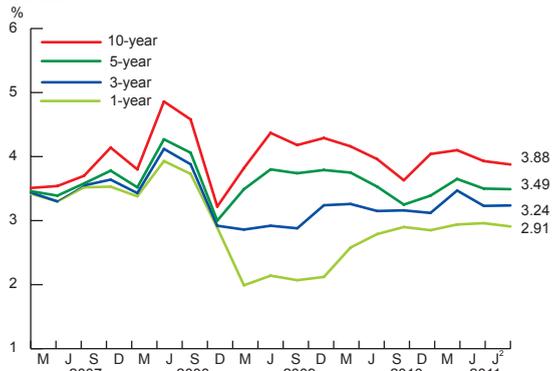
The volume of CPO futures traded, surged 62% to 3.5 million contracts (January – July 2010: -8.7%; 2.1 million contracts) equivalent to 86.8 million metric tonnes of CPO during the first seven months of 2011 (January – July 2010: 53.5 million metric tonnes). The volume of FBM KLCI futures traded also registered a 12.6% increase to 1.3 million contracts (January – July 2011: -15%; 1.2 million contracts).

During the first seven months of 2011, performance in the derivatives market improved considerably. This was partly due to the migration of the derivative products to the Chicago Mercantile Exchange Globex trading platform, giving them greater accessibility and visibility. Meanwhile, in further efforts to promote the derivatives market to retailers who are predominantly equity investors, the Government on 12 April 2011 announced the fast-track programme for dual licences to enable dealer representatives from the equities market to participate in the derivatives industry. Subsequently, on 28 June 2011, the United States Commodity Futures Trading Commission allowed US investors to trade in FBM KLCI futures.

### **Unit trusts remain positive**

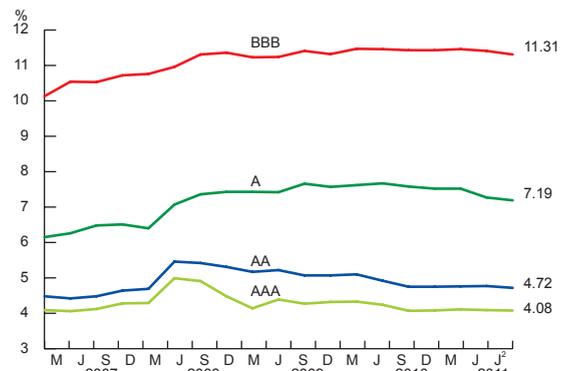
In the first seven months of 2011, the **unit trust industry** recorded the launch of 22 new funds, bringing the total to 586 funds (end-2010: 23 new funds; 564 funds). Total units in circulation grew 6% to 306.3 billion units (end-2010: 5.7%; 289.4 billion units), while the number of accounts increased 5.9% to 15.2 million (end-2010: 3.7%; 14.6 million). The size of the unit trust industry in terms of NAV increased 18% to RM249.9 billion (end-2010: 18.3%; RM226.8 billion). Equity funds were the most preferred funds for investment with net sales of RM16.3 billion in the first seven months of 2011 compared with bond and fixed income funds which recorded RM0.7 billion.

**CHART 5.7**  
**Malaysian Government Securities (MGS) Indicative Yields<sup>1</sup>**



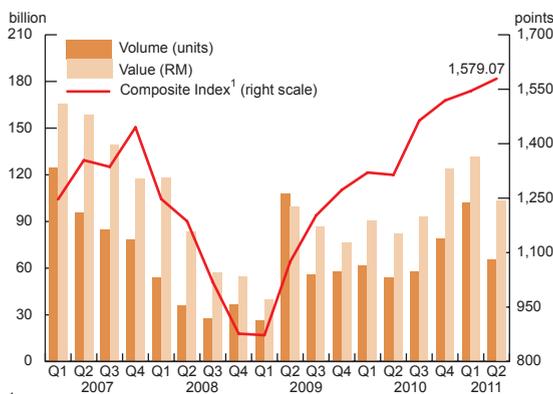
<sup>1</sup> End-period.  
<sup>2</sup> End-July 2011.  
 Source: Bank Negara Malaysia.

**CHART 5.8**  
**Private Debt Securities (PDS) 5-Year Yields<sup>1</sup>**



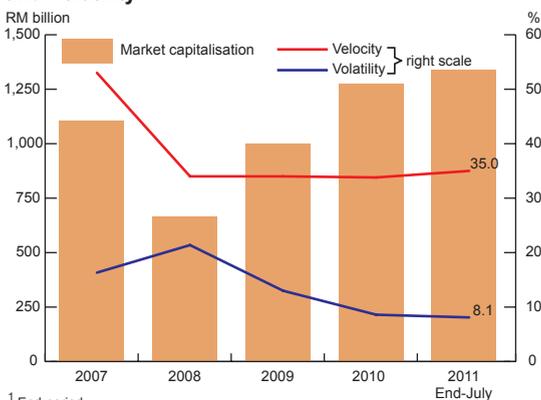
<sup>1</sup> End-period.  
<sup>2</sup> End-July 2011.  
 Source: Bank Negara Malaysia.

**CHART 5.9**  
**Performance of Bursa Malaysia**



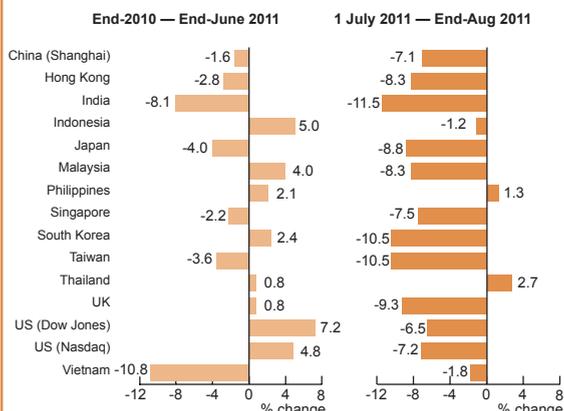
<sup>1</sup> End-period.  
 Source: Bursa Malaysia.

**CHART 5.10**  
**Bursa Malaysia: Market Capitalisation<sup>1</sup>, Velocity and Volatility**



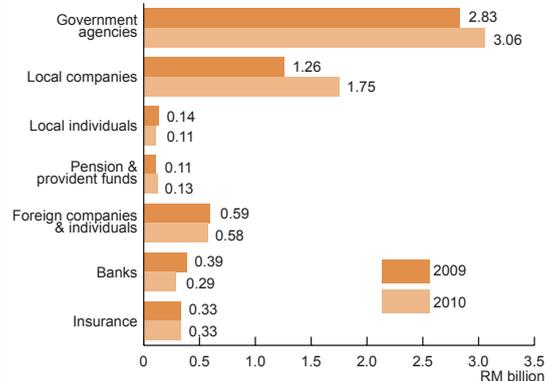
<sup>1</sup> End-period.  
 Source: Bursa Malaysia.

**CHART 5.11**  
**Performance of Selected Stock Markets**



Source: Bloomberg.

**CHART 5.12**  
**Source of Venture Capital Funds**



Source: Securities Commission Malaysia.

TABLE 5.12

**Unit Trust Industry: Selected Indicators**

	End-2010	End-July 2011
Number of unit trust management companies	39	40
Number of unit trust funds <sup>1</sup>	564	586
Conventional	412	426
Islamic	152	160
Units in circulation (million)	289,366	306,262
Number of accounts (million)	14.6	15.2
Net asset value (NAV) (RM million)	226,812	249,875
Conventional	202,768	223,495
Islamic	24,044	26,380

<sup>1</sup> Refers to funds already launched.

Note: Total may not add up due to rounding.

Source: Securities Commission Malaysia.

The first seven months of 2011 saw the launch of 27 new funds for investment in foreign markets, of which 20 funds have invested RM0.8 billion as at end-July 2011. Meanwhile, a total of 272 funds invested RM19.3 billion in foreign markets, representing 7.7% of the industry's total NAV.

In the **real estate investment trusts (REITs) industry**, trading volume rose 4.8% to 687.7 million units during the first seven months of 2011 (January – July 2010: 46.5%; 656.2 million units), with a market capitalisation of RM11.8 billion as at end-July 2011 (end-2010: RM10.5 billion). Similarly, the trading value increased 10.2% to RM803.1 million (January – July 2010: 74.4%; RM728.9 million). As at end-June 2011, the total number of REITs remained at 15 comprising 14 REITs listed on Bursa Malaysia and one unlisted REIT, with the total NAV increasing to RM11.5 billion (end-2010: RM10.7 billion).

The number of **ETFs** listed on Bursa Malaysia stood at five as at end-July 2011. Total market capitalisation amounted to RM1.2 billion as at end-July 2011 (end-2010: RM1.2 billion). During the first seven months of 2011, the volume of transactions increased 259.5% to 147.4 million units while the value rose 245.9% to RM154.8 million (January – July 2010: 6.6%, 41 million units; 47.1%, RM44.8 million).

On 12 May 2011, Nomura Asset Management Co. Ltd., Japan's largest asset manager and a wholly owned subsidiary of Nomura Holdings Inc., listed its NEXT FUNDS FTSE Bursa Malaysia KLCI Exchange Traded Fund on the Tokyo Stock Exchange, marking the first listing of a Malaysia-stock ETF in Japan. NEXT FUNDS FTSE Bursa Malaysia KLCI ETF tracks the movement of 30 of the largest eligible companies by market capitalisation listed on Bursa Malaysia.

### *VC investment expands*

The **venture capital (VC) industry** remains an important source of early stage funding for innovation especially for start-up companies and expansion. As at end-June 2011, the total number of registered venture capital companies (VCCs) and venture capital management companies (VCMCs) stood at 56 and 52 (January – June 2010: 58 VCCs; 55 VCMCs), respectively. Total VC investments rose 31.1% to RM3.4 billion as at end-2010 (end-2009: 34.1%; RM2.6 billion) with the information technology and communication sector accounting for 43%, life sciences 20.9% and manufacturing sector 14.8% of total investments. Meanwhile, total committed funds expanded 11.4% to RM6 billion (end-2009: 17%; RM5.3 billion), with Government agencies being the largest source of VC funds at RM3.1 billion, representing 51.4% of total funds committed (end-2009: RM2.8 billion; 52.9%).

## Key Capital Market Measures

Several measures and initiatives continued to be taken in the first eight months of 2011, aimed at further strengthening the capital market. The key measures include the following:

- On **3 January**, Bursa Malaysia issued a public consultation paper seeking feedback on the proposed amendments to the Rules of Bursa Malaysia Securities Berhad aimed at facilitating greater effectiveness for market regulation and greater efficiency in the business conduct of securities brokers, also known as Participating Organisations.
- On **19 January**, the Securities Commission (SC) launched the Securities Industry Dispute Resolution Centre following the gazetting of the Capital Markets and Services (Dispute Resolution) Regulations 2010.
- On **28 January**, Bursa Malaysia's Listing Requirements on Privatisation of Listed Companies via Disposal of Assets were amended to raise the threshold for shareholder approval to 75%.
- On **28 January**, SC streamlined the categories of sophisticated investors and enhanced the sales practices regime to achieve a better balance between investors' needs for appropriate levels of protection, market growth and product innovation. This is to ensure that complex and high-risk products are offered or marketed only to knowledgeable investors, disclosures are simplified as well as business processes and incentive structures are aligned to investor protection requirements.
- On **28 February**, the Federation of Investment Managers Malaysia (FIMM) was recognised as a Self-Regulatory Organisation for the unit trust industry. This means that FIMM will regulate its own members while also ensuring that investors are protected and public interests upheld. FIMM is tasked to strengthen the professionalism of sales agents and distributors through industry training as well as formulate a robust sales practices regime with adequate supervision and monitoring.
- On **30 March**, SC issued Guidelines on the Registration of Credit Rating Agencies (CRAs) to ensure independent and high quality ratings with appropriate oversight of the CRAs, given their key role in capital markets. The Guidelines are aimed at enhancing the CRAs' standards in key areas such as transparency of rating criteria and policies, objectivity of their rating process, the management of conflicts of interest, and will also enable SC to supervise CRAs in a more vigorous manner.
- On **18 April**, Bursa Malaysia Depository Sdn. Bhd., a subsidiary of Bursa Malaysia, extended its administration fee waiver of RM10 for the registration of eDividend until 18 April 2012 as part of its continuing effort to encourage more shareholders to sign up for the eDividend service.
- On **23 May**, SC revised the Guidelines on Compliance Function for Fund Managers to enhance client asset protection and raise compliance standards to safeguard the interests of investors. The revised guidelines require fund management companies and their representatives to uphold a number of core principles aimed at promoting a culture of compliance, professionalism, ethical standards and responsible conduct among fund management companies, their representatives and employees.

- On **8 July**, the Corporate Governance Blueprint was launched, aimed at promoting excellence in governance. The blueprint covers strategic priorities and recommendations to be implemented over the next five years. These include enhancing the standards of board governance, reviewing ways to further improve shareholder voting rights and access to information, ensuring equitable shareholder treatment, promoting greater diversity on boards of public listed companies, strengthening the role and accountability of gatekeepers and influencers.
- On **12 July**, SC issued the revised guidelines for private debt securities (PDS), sukuk and trust deed to enhance the regulatory framework for fund raising and product regulation in PDS and sukuk markets. The revised PDS and sukuk guidelines streamline the approval process and time-to-market for the issuance of corporate bonds and sukuk. The revisions also facilitate a more informed investment decision-making process with additional provisions to ensure greater disclosure of relevant information to investors.
- On **9 August**, SC revised the Guidelines on Outsourcing for Capital Market Intermediaries, which replaced the Guidelines on Performance of Supervisory Functions at Group Level for Capital Market Intermediaries and Guiding Principles for Outsourcing of Back Office Functions for Capital Market Intermediaries. The revision was made to strengthen investor protection measures and enable intermediaries to focus on their core strengths of intermediation by outsourcing their back office functions to service providers.

## Prospects for 2012

### *Monetary policy continues to support growth*

The economy is projected to sustain a growth of between 5% and 6% in 2012, supported by strong domestic demand and economic activities generated by the ongoing ETP and the 10MP. Inflation is anticipated to moderate from the high levels recorded in 2011. Monetary policy will remain accommodative to support growth and will be determined taking into consideration global developments and their impact on the domestic economy and inflation prospects. At

the same time, macroprudential measures will be implemented to prevent any financial imbalances and preserve financial stability.

Financing through the banking system and capital market is expected to increase to support economic activities, especially with several major long-term projects being implemented as the country transforms into a high-income economy by 2020. Furthermore, with the CMP2 and the second FSMP implemented this year, the financial and capital markets are expected to see greater dynamism and innovation, especially in the internationalisation of Islamic finance, venture capital as well as green and innovative financing.