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Developments in the Financial System

Monetary Policy

In the conduct of monetary policy in the first eight months of 1997, priority continued to be accorded to achieving price stability aimed at ensuring that prospects remain favourable for sustainable economic growth. An important element of the policy was also to ensure stability in the money and foreign exchange markets so as to create a predictable environment for the private sector to conduct business and investment. The developments during the period that was of concern were a continued high rate of growth of money supply primarily due to the strong increase in lending by banking institutions to less productive sectors of the economy as well as the volatility in the financial markets, triggered by developments in the region.

Strong monetary expansion remained an issue of concern which required policy addressal during 1997 in order to contain inflationary pressures. Although monetary expansion moderated in the first quarter of 1997 with M1, and M2 relatively constant at 18.9% and 20.8% respectively at the end of March (18.3% and 20.9% respectively at the end of 1996) on an annual basis and M3 moderating to 21.0% (22.7% at the end of 1996), monetary expansion remained strong when compared to the nominal growth of Gross National Product estimated at 10.3% for 1997. Monetary growth continued to be driven by strong growth in bank lending to the private sector especially to the less productive sectors of the economy such as property and shares. Increased access to bank financing could contribute to further increases in prices, therefore raising concerns about asset inflation and its potential destabilising effects on the economy. Given these concerns, Bank Negara Malaysia (BNM) introduced measures, effective April 1, 1997, to ensure that the stability of the banking system was not undermined by

excessive exposure to the relatively more volatile sectors of the economy. These measures include limiting credit facilities extended to the property sector (excluding the purchase of owner-occupied residential properties, the construction of residential properties costing RM150,000 and below and infrastructure projects and industrial buildings and factories) to not more than 20.0% of outstanding loans; and redefining existing limits of commercial banks, finance companies and merchant banks for the purchase of stocks and shares to cover credit facilities granted for the purchase of stocks and shares and unit trusts. The imposition of these measures resulted in some slowdown in credit extended to these sectors in June and July with M3 moderating to an annualised growth of 20.8% at the end of July 1997.

In the first quarter of 1997, liquidity in the banking system was ample as reflected in the stable interest rates. The interbank rates remained relatively stable with the 3-month rate trading in the range of 7.27% to 7.46%. However, liquidity contracted and tight liquidity conditions prevailed intermittently in the May-July period following the pressure on the ringgit as a result of the contagion effects of developments in Thailand. Interbank rates rose sharply across the board and the overnight rates fluctuated sharply in line with contractions in liquidity following bouts of speculative activity which occurred especially in July. Reflective of the fluctuations in liquidity, the 1 and 3-month interbank rates ranged from 7.23% to 16.50% and 7.40% to 8.60% respectively in July. Reflecting developments in the money market, the average base lending rates (BLR) and deposit rates of the commercial banks and finance companies edged upwards in the first seven months of the year. In a move to reduce the effects of external developments on interest rates, BNM, on 31 July 1997, issued guidelines to the banking institutions

to cap their BLR in August at the July ceiling. On 4 August, BNM introduced a US\$2 million limit for banks in non-commercial related ringgit offer swap transactions with foreign customers to insulate domestic interest rates from external developments. Following this, interbank rates eased but remained above the levels before the excessive volatility in the currency market. The moderation in interest rates reflected efforts to reduce wide adjustments in interest rates and to establish stability in the domestic money market.

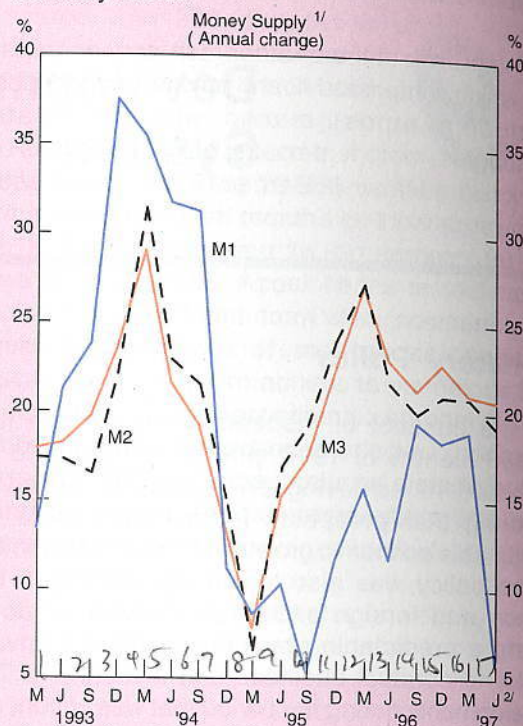
Given that the recent measures introduced by BNM especially to contain monetary expansion and loan growth to the less productive sectors of the economy will take time to yield results, the stance of monetary policy for the remaining part of this year will continue to be one of restraint. At the same time, BNM will continue to promote financial market stability to provide an environment conducive for private sector economic activity.

Money Supply

Monetary expansion slowed down in the first seven months of 1997. During this period, the broad monetary aggregate M3 grew at an annual rate of 20.8%, lower than the rate of growth of 22.7% at the end of 1996. Lending to the private sector continued to provide the main impetus to growth, increasing by 17.1% in the first seven months of 1997 (26.5% in 1996). Both the external sector and Government budgetary operations were contractionary on monetary supply.

Narrow money, M1, which is defined to include currency in circulation and demand deposits of the private sector, declined by 2.5% in the first seven months of 1997 as compared with an increase of 8.9% recorded in the corresponding period of 1996. The decline in M1 was largely caused by a decline of RM1,585 million in demand deposits (demand deposits constituted 68.1% of M1 at end-July 1997) as compared with the end of 1996 position as a result of poor performance of the stock market during the second and third quarter and higher interest rates. Meanwhile, currency in circulation which accounted for 31.9% of M1 increased marginally by 0.2% (2.2% in corresponding period) to RM19,079 million at end of July 1997 from RM19,033 million at the end of 1996. On an annual basis, the growth of M1 decelerated significantly from 18.3% at end of 1996 to 5.9% at the end of July 1997.

Chart 9.1
Monetary Trends



1/ End of March, June, September and December including Repurchase Agreements (Repos)
2/ As at end of July 1997

The cumulative growth of broad money, M2 which consists of M1 and narrow quasi-money (comprising private sector holdings of fixed and savings deposit with the commercial banks and BNM, net negotiable instruments of deposit (NIDs) and repurchase agreements (repos) moderated to 7.6% or RM258,786 million at the end of July 1997, compared with an increase of 9.1% during the corresponding period of 1996. This increase is attributed to 11.1% or RM19,896 million increase in quasi-money to RM198,895 million at the end of July 1997 (9.2% during the corresponding period of 1996). The rise in quasi-money was largely due to a substantial RM10,857 million or 40.3% increase in NIDs and repos compared with 6.9% in the corresponding period in 1996, while fixed deposits increased by 8.6% (January-July 1996 : 9.9%) and savings deposits declined by 5.5%. Despite the lower rate of increase of fixed deposits, these deposits remained the leading contributor to the increase in quasi money (53.4% of the cumulative increase in quasi-money), followed by NIDs (27.3%) and repos (15.9%). On an annual basis, the growth of M2 moderated to 19.2% at

the end of July, compared with a rate of growth of 20.9% at the end of 1996.

The growth of the broader monetary aggregate, M3, which comprises M2 and private sector deposits (including repos) placed with the finance companies, merchant banks, discount houses and Bank Islam Malaysia Berhad (BIMB) increased at a slower rate of 9.6% during the first seven months of 1997 compared with an increase of 11.4% during the corresponding period of 1996. Although the expansion in M3 continued to be driven by continued strong domestic credit to the private sector, the measures introduced in early April 1997 to moderate credit extension for the purchase of property and shares resulted in some slowdown to the sectors in June and July. Similarly, the growth of private sector deposits placed with other banking institutions excluding inter-placements rose moderately by 14.7% from end 1996 to RM106,927 million at the end July 1997, compared with 17.4% in the corresponding period of 1996.

Lending to the private sector expanded by RM61,675 million or 17.1% during the first seven months of 1997 (RM41,319 million or 14.5% during the same period in 1996). Loans extended by the banking system to the broad property and finance, insurance and business services and consumption as a group absorbed an increase of 19.1% during the first seven months of 1997 to RM200,851 million at the end of July 1997 compared with 17.4% in the corresponding period of 1996. Loans to the manufacturing sector in the meantime recorded a higher increase of 7.5% to RM59,836 million at the end of July 1997 (January-July 1996 : 7.1%).

The **external sector** exerted a contractionary impact on money supply by -RM8.6 billion during the first seven months of 1997, compared with a contractionary impact of -RM1.7 billion in the corresponding period of 1996. During the period, net international reserves of BNM recorded a decline of RM8,638 million to RM61,376 million at the end of July 1997. At the same time, the banking system increased its net external liabilities marginally by RM20 million during the first seven months of 1997 to RM10.9 billion.

The financial operations of Government were contractionary on money supply, reflecting largely the decline in the holdings of Government papers

by the banking institutions and BNM (-RM2.9 billion). With the healthy financial position of the Government, domestic borrowing from the banking system in terms of sale of Government papers was not significant. "Other influences", which comprise residual factors (including undistributed profits, paid-up capital and reserves of the banking system and maturing Bank Negara Bills (BNBs) held by non-bank private sector) were contractionary on money supply by -23.8% during the first seven months of 1997.

Bank Liquidity and Money Market

Liquidity in the banking system fluctuated during the first seven months of 1997, influenced by developments in the foreign exchange and capital markets. Monetary policy was, therefore, directed at the management of liquidity to ensure an environment of price stability. To insulate domestic interest rates from external developments, BNM introduced limits on non-commercial related ringgit offer side swap transactions with foreign customers and issued guidelines requiring institutions to cap their BLR in August at the July ceiling level. In order to effectively manage liquidity, the Central Bank's liquidity operations were conducted through a combination of traditional measures and market based instruments, including direct money market intervention and issuance of BNBs.

Liquidity conditions in the banking system contracted during the first seven months of 1997. Holdings of excess liquid assets by the banking institutions (i.e. holdings in excess of the mandatory requirement of 17.0% for the commercial banks and 10.0% to 12.5% for finance companies and merchant banks) were lower at RM2,404 million at the end of July 1997 from RM2,646 million at the end of 1996.

Total deposits (including repos) mobilised by the banking system increased by RM41,859 million or 11.7% during the first seven months of 1997, compared with RM36,596 million or 12.9% during the corresponding period of 1996. The bulk of the new deposits was mobilised by the commercial banks, which accounted for 58.3% or RM24,396 million of the total new deposits, while the finance companies and the merchant banks accounted for 34.5% and 7.2%, respectively. By type, fixed deposits accounted for the largest portion

(RM30,125 million or 72%) of the total increase in deposits. On an annual basis, growth in total deposits increased by 25.3% at the end of July 1997, compared with 24.9% at the end of 1996.

Total loans and advances of the banking system rose by RM50,262 million or 15.7% during the first seven months of 1997, compared with RM35,028 million or 13.9% during the corresponding period of 1996. The bulk of the outstanding credit was extended mainly to finance the broad property sector (25.4%), manufacturing (16.2%) and finance, business and insurance services (15.9%) at the end of July 1997. On an annual basis, loan growth was higher at 28.8% at the end of July 1997 (July 1996 : 27.4%). With the faster growth in loans extended by the banking system vis-a-vis the growth in deposits, the banking system experienced a **resource-gap** of RM8,403 million during the first seven months of 1997, compared with a loan-deposit surplus of RM1,568 million during the corresponding period of 1996. This resulted in the loan-deposit ratio increasing from 89.1% at the end of 1996 to 92.3% at the end of July 1997.

Transactions in the **interbank money market** remained active, with the continued demand for credit by the private sector. The unequal distribution of excess funds among the financial institutions also added to the active transactions in the interbank market. Thus, the monthly volume of funds transacted in the market averaged about RM109,226 million during the first seven months of 1997, compared with an average of about RM77,950 million during the corresponding period in 1996. The funds transacted were mainly short-term funds, of which overnight money accounted for 64.2% of the total volume of transactions in July.

Interbank rates remained relatively stable in the first four months of 1997, with the average interbank rate for the 7-day to 6-month maturities in April in the range of 7.22%-7.41% (7.28%-7.35% in December 1996). However, interbank rates rose sharply in May following speculative pressure on the currency. On 16 May, the 3-month interbank rate increased sharply to 8.62%. Interbank rates subsequently adjusted downwards with the 3-month rate recording 7.51% at the end of May as the liquidity conditions improved. The rate continued to remain at 7.50% at the end of June. Interest

rates rose again in mid-July, following a second round of speculative activity on the ringgit. The interbank rates increased sharply across the board on 10 July with the overnight rate and 3-month rate rising to 40.43% and 8.60% respectively from 7.52% and 7.90% the day before. Thereafter, the rates eased, and by 29 July, the overnight and 3-month interbank rates had declined to 8.55% and 8.38% respectively. In line with movements in the interbank rates, the mode fixed deposit rates of the commercial banks and finance companies across the maturity spectrum were higher by 20 - 80 and 25 - 120 basis points, ranging between 7.50% - 8.00% and 7.60% - 8.50% at the end of July 1997. The average savings deposit rate for the commercial banks and finance companies also increased slightly by 4 and 10 basis points to 4.14% and 5.12% respectively at the end of July 1997. Reflecting the higher cost of funds, the BLR trended upwards. The average BLR of the commercial banks increased from 9.18% at the end of 1996 to 9.58% at the end of July 1997, while that of the finance companies rose from 10.65% to 11.21% over the same period.

Commercial Banks

During the first seven months of 1997, **total resources** (inclusive of capital and reserves, deposits, borrowings from other financial institutions, bankers' acceptances (BAs) and other liabilities such as interest-in-suspense, provision for bad and doubtful debts and borrowings from and bills discounted with BNM) of commercial banks continued expand in tandem with the growth of the Malaysian economy. Total resources continued to expand strongly at 17.8% or RM62.6 billion, compared with an increase of RM30.9 billion during the corresponding period of 1996. The increase in total resources emanated mainly from the increase in deposits while the bulk of the increase in resources was utilised for financing loan operations. At the same time, the commercial banks mobilised 67.0% of the total deposits placed with the banking system and extended 67.8% of total loans granted by the banking system at the end of July 1997.

With the continued expansion in the economy and the firming of interest rates, **new deposits**, including NIDs issued, New Investment Fund (NIF), special deposits and repos mobilised by the

Table 9.1

Commercial Banks: Deposits

	Change During Period				As at end of July 1997
	1996 January-July		1997 January-July		
	RM million	%	RM million	%	
Demand deposits	4,625	12.7	-60	-0.1	44,475
Savings deposits	2,159	9.2	-1,504	-5.2	27,290
Fixed deposits	10,310	10.1	11,824	9.1	142,436
NIDs ¹	1,371	5.6	7,515	27.4	34,982
Repos	1,587	16.5	3,144	26.6	14,962
Others ²	-4	-0.5	1,224	164.9	1,966
TOTAL	20,049	10.2	24,396	10.0	268,364

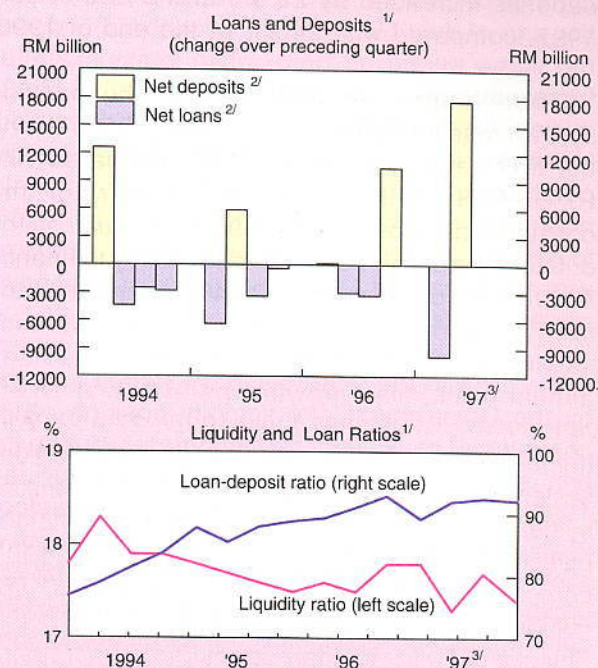
¹ Negotiable instruments of deposit.

² Include New Investment Fund and special deposits.

Source: BNM.

commercial banks registered a growth of 10.0% or RM24,396 million during the first seven months of 1997, compared with an increase of 10.2% during the corresponding period of 1996, as indicated in Table 9.1. The expansion in individual incomes and corporate earnings led to the higher increase in deposits (including repos) placed by individuals as well as business enterprises and financial institutions (which rose by RM10.3 billion, RM3.0 billion and RM7.1 billion respectively).

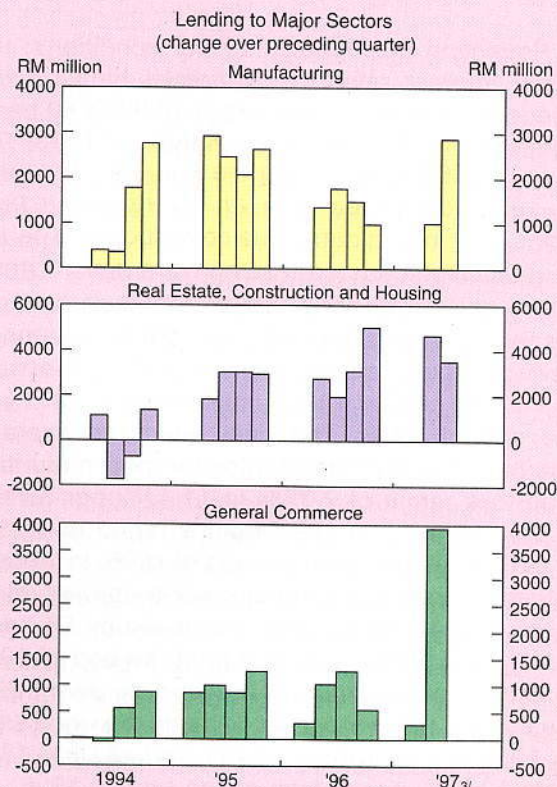
Reflecting the momentum of continued strong economic activity and the strong demand for credit by the private sector, **loans and advances** of the commercial banks continued to grow during the first seven months of 1997. Total new loans and advances extended grew by 15.1% to RM250,757 million (excluding loans sold to Cagamas Bhd) compared with a growth of 13.5% to RM198,558 million during the same period of 1996. In terms of new loans, a major proportion was channelled to the finance, insurance and business services sector (constituting 27.9% or RM9,196 million of the new loans), followed by the broad property (25.1% or RM8,274 million) and manufacturing sectors (8.6% or RM4,139 million) during the first seven months of 1997, compared with 26.0%,

Chart 9.2
Commercial Banks

1/ Including Repos.

2/ Net deposits refer to the excess of commercial bank deposits over loans in each quarter while net loans refer to excess of loans over deposits

3/ As at the end of July 1997.



19.8% and 7.0% respectively during the same period of 1996. Total loans extended for general commerce rose by 18.3% to RM26,259 million at the end of July 1997 compared with 8.2% during the same period of 1996, while loans extended for consumption declined by 3.3% to RM7,834 million (January-July 1996 : RM1,382 million). However, loans extended to individuals for the purchase of stocks/shares decreased marginally during the first seven months of 1997 by 12.0% to RM10.9 billion at the end of July 1997, compared with an increase of 12.2% during the corresponding period of 1996.

In line with the tight monetary stance adopted by the Government, the liquidity position of the commercial banks declined moderately during the first seven months of 1997. At the end of July 1997, the liquidity ratio of commercial banks stood at 17.4%, compared with 17.8% at the end of 1996. Reflecting the faster growth in loans (15.0%) compared to growth in deposits (10.0%), the commercial banks registered a loan deposit -gap of RM8,469 million during the first seven months of 1997, compared with RM3,501 million during the corresponding period of 1996. As a result, the loan-deposit ratio of commercial banks rose to 93.4% at the end of July 1997 (end of 1996: 89.3%).

Reflecting the tighter liquidity conditions, the mode interest rate of commercial banks' fixed deposits registered an increase of 20 to 80 basis points during the first seven months of 1997. The mode fixed deposits rates for 1-month, 3-month, 6-month and 12-month maturity increased from 7.20%, 7.20%, 7.25% and 7.30% per annum, respectively at the end of 1996 to 8.00%, 7.80%, 7.50% and a range of 7.50% to 7.60% per annum, respectively as at the end of July 1997. The mode savings deposit rate increased to 3.50% per annum at the end of July 1997 compared with 20.0% at the end of 1996. The daily weighted average interbank money market rates for most maturities rose to a range of 7.75% to 11.44% per annum at the end of July 1997 from a range of 7.15% to 7.37% per annum at the end of 1996. In tandem with the increase in interbank money market rates, the average cost of funds increased by 55 basis points from 5.30% per annum at the end of 1996 to 5.85% per annum at the end of July 1997. Meanwhile, the average lending rate also increased to 10.85% per annum at the end of July 1997 from 10.20% per annum at the end of 1996. As

Table 9.2

Commercial Banks: Direction of Lending

	Change During Period				As at end of July 1997
	1996 January-July		1997 January-July		
	RM million	%	RM million	%	
Agriculture	548	14.2	907	19.9	5,457
Mining and quarrying	274	30.9	66	11.0	677
Manufacturing	2,978	7.0	4,139	8.6	52,089
Finance, insurance and business services	6,170	26.0	9,196	27.1	43,089
Construction	2,586	18.4	5,518	28.6	24,814
General commerce	1,566	8.2	4,068	18.3	26,259
Transport and storage	500	16.7	2,013	48.4	6,174
Real estate	1,830	11.5	1,364	6.5	22,449
Housing ¹	238	1.4	1,392	7.5	19,931
Miscellaneous	6,861	19.3	4,274	9.4	49,828
TOTAL	23,551	13.5	32,937	15.1	250,757

¹ Excluding loans sold to Cagamas Berhad.

Source: BNM.

the average lending rate grew faster relative to the growth in the average cost of funds, the gross interest margin widened by 10 basis points from 4.90% at the end of 1996 to 5.00% at the end of July 1997

The commercial banks continued to provide credit to the **priority sectors** of the economy, namely the Bumiputera Business Community, housing and to small-scale enterprises under the New Principal Guarantee Scheme (NPGS) of the Credit Guarantee Corporation (CGC). As required by the Lending Guidelines, commercial banks have to secure at least RM1 billion guarantee cover from CGC on loans below RM500,000 each, of which at least one half of the allocated quota has to be extended to Bumiputera borrowers. During the first seven months of 1997, lending to Bumiputera borrowers decreased by 2.3% or RM1,440 million, compared with an increase of 14.3% in the corresponding period of 1996. As at end of July 1997, total loans extended to the

Bumiputera community amounted to RM67,707 million or 38.3% of the loan base, exceeding the target requirement of 30.0% set out by the Guideline. The loans were extended mainly for purchase of stocks and shares (RM46,467 million or 18.5%), followed by the loans extended to broad property sector (RM8,698 million or 3.4%) and to the finance and business sector (RM3,096 or 1.2%). As at end of July 1997, the commercial banks financed the purchase of 69,198 units of houses costing RM100,000 and below or 69.2% of the target (at least 100,000 units of such houses). In terms of credit with guarantee cover under the NPGS of the CGC, the commercial banks as a whole extended loans amounting to RM1.8 billion as against the requirement of RM1 billion to be complied with by 31 March 1998.

At the end of July 1997, the number of commercial banks operating in the country was 35, of which 22 were domestic banks and 13 were foreign-controlled banks. The total number of branch offices of domestic banks increased from 1,442 at the end of July 1996 to 1,480 at the end of July 1997, while that of foreign-controlled banks remained unchanged at 144. As at end of July 1997, 10 commercial banks have been accorded Tier-1 Status and allowed to undertake a number of activities subject to prudential limits and conditions determined by BNM (end - 1996: 11 banks). These activities include issuing NIDS up to five times of their capital funds; participating in equity derivatives; undertaking securities borrowing and lending activities subject to Securities Commission approvals; and expanding their operations through setting up of branch offices, representative offices, subsidiaries or on joint venture basis.

The commercial banks continued to extend financing for export under the **Export Credit Refinancing (ECR) Scheme**. The Central Bank provides refinancing at a competitive rate of interest to eligible direct and indirect exporters via commercial banks, aimed at promoting the exports of manufactured products and agricultural products and selected primary commodities that have significant value-added and utilise local resources. Total ECR financing decreased by 45.0% or RM3,330 million during the first seven months of 1997 (of which RM1,626 million was for pre-shipment and RM2,431 million for post-shipment), as against RM7,388 million during the corresponding period of 1996. The bulk of the

credit was for mechanical and electrical products (39.6%), followed by rubber products (17.6%) and palm oil (13.7%). The current ECR rate (including the interest-free scheme) remains unchanged at 7.70% per annum, effective 1 April 1996.

Islamic Banking

Islamic banking saw yet another year of significant growth with an increasing number of financial institutions offering Islamic banking services. At the end of July 1997, apart from BIMB, a total of 24 commercial banks, 22 finance companies and 5 merchant banks were offering Islamic banking services under the interest-free banking scheme (IBS) as compared with the end of July 1996 position when there were 24 commercial banks, 19 finance companies and 3 merchants banks. Total assets of the Islamic banking system surged by 29.6% to RM13,132 million at the end of July 1997, while total deposits mobilised rose by 26.3% to RM9,175 million. Total financing extended by the Islamic banking system grew by 22.0% to RM7,492 million. The bulk of the deposits was in the form of general investment deposits of RM3,451 million and specific investment deposits RM1,402 million. In the same period, savings deposits and demand deposits rose by 23.5% and 69.7% respectively. In terms of sectoral breakdown, 35.6% or RM481 million of the new financing was extended to the construction and real estate sectors, 22.8% or RM307 million to the housing sector and 14.2% or RM192 million to the transport and storage sector. In the first seven months of 1997, transactions in the Islamic Interbank Money Market amounted to RM91,028 million during the period compared to RM27,071 million in the corresponding period of 1996. The transactions of Islamic Bankers Acceptances amounted to RM1,367 million at the end of July 1997, while Green BAs amounted to RM11,878 million.

The National Syariah Advisory Council (SAC) for Islamic Banking and Takaful was established in May 1997. The primary objectives of the SAC are to act as the sole authoritative body to advise BNM on Syariah issues pertaining to Islamic banking and takaful operations, to review the Syariah-compatibility of new Islamic products submitted by BIMB, banks participating in the IBS and takaful companies as well as to harmonise the application of Islamic concepts for existing

Islamic financial products. The SAC comprises 10 members, including one foreign Muslim scholar to enhance the credibility and recognition of the SAC internationally. In October 1996, BNM introduced a new specimen of financial statements for banking institutions which incorporated the disclosure of Islamic banking operation as a subset to principal financial statements drawn up on conventional principles. The objective of the guideline is to exhibit transparency and disclosure of Islamic banking operations. In line with this, BNM has changed the policy of income recognition from a cash basis to an accrual basis for IBS operations with the view to promote a consistent approach in the accounting treatment between the IBS operations with their parent banking institutions. BIMB, nonetheless, has been allowed to continue with its existing cash accounting convention for the income recognition. Eligible IBS banking institutions are now allowed to set up full-fledged Islamic banking branches. Prior of this, the facilities and the products of Islamic banking were offered through Islamic banking 'windows' within the conventional branches. Under this full-fledged branch set-up, it is envisaged that the IBS banking institutions will be more focused and commit more resources towards the development of the Islamic banking. This move is expected to generate a larger pool of banking personnel equipped and conversant in Islamic banking.

Finance Companies

During the first seven months of 1997, total resources of finance companies increased in tandem with the momentum of sustained growth of the economy. **Total resources** (mainly comprising capital and reserves, deposits and borrowings from other financial institutions) mobilised by finance companies increased significantly by 18.2% to RM141,326 million at the end of July 1997 from RM119,610 million at the same period of 1996. The increase in total resources was mainly due to the strong growth in deposits which was utilised largely to finance loan operations. **Total deposits** of the finance companies increased by 15.9% to RM105,237 million as the end of July 1997, compared with 16.9% in the corresponding period of 1996, reflecting primarily the higher interest rates offered for fixed deposits (see Table 9.3). In tandem with the increase in resources, the **lending operations** of finance companies also expanded during the

first seven months of 1997. **Total loans** extended to the various sectors of the economy grew by 18.4% to RM97,651 million at the end of July 1997 compared with a growth of 14.8% during the same period of 1996.

New deposits mobilised by finance companies rose by RM14,465 million during the first seven months of 1997, compared with RM11,814 million during the corresponding period of 1996, with the major depositors comprising "other" customers (41.8% of total outstanding deposits), business enterprises (16.3%), financial institutions (12.3%) and the Government and statutory authorities (11.0%). A major proportion (92.0%) of the new deposits which was in the form of fixed deposits increased by 19.8% from the end of 1996 to RM80,597 million as at end of July 1997. This was due to the relatively higher interest rates offered for such deposits.

However, savings deposits declined by 6.8% or RM375 million during the first seven months of 1997, compared with an increase of 0.9% during the corresponding period of 1996. NIDs issued by the finance companies increased at the slower rate of 3.1% at the first seven months of 1997, compared with an increase of 42.7% during the same period of 1996. As at end of July 1997, total outstanding deposits of finance companies amounted to RM105,307 million, representing

Table 9.3
Finance Companies: Deposits

	Change During Period				As at end of July 1997
	1996		1997		
	January-July		January-July		
	RM million	%	RM million	%	RM million
Savings deposits	44	0.9	-375	-6.8	5,117
Fixed deposits	7,212	13.3	13,309	19.8	80,597
Special deposits	1	1.6	15.1	172.4	238
NIDs ¹	3,724	42.7	470	3.1	15,444
Repos	833	44.6	910	30.3	3,911
TOTAL	11,814	16.9	14,465	15.9	105,307

¹ Negotiable instruments of deposit.

Source: BNM.

26.3% of total resources of the banking system. Of this, 76.5% was in the form of fixed deposits, while NIDs and savings deposits represented 14.7% and 4.8% respectively of the total outstanding deposits at the end of July 1997.

In line with the rising demand for financing by the private sector, the **lending activities** of the finance companies continued to expand during the first seven months of 1997. Consequently, total new loans and advances increased further by 18.4% or RM15,154 million during the first seven months of 1997, compared with 14.8% during the same period of 1996, as indicated in Table 9.4. Loans extended to general commerce increased by 63.0% (RM1,426 million), construction and real estate by 15.7% (RM2,373 million) and the manufacturing sector by 7.4% (RM372 million) of total new loans. Lending to private individuals rose by 19.6% or RM8,854 to RM54,114 million at the end of July 1997. Of this, 25.7% (RM8,224 million) was for consumption purposes and 15.3% (RM899) for the purchase of stocks and shares. With the growth in loans continuing to outpace the growth in deposits, the **loan-deposit ratio** of the finance companies stood 92.8% at the end of July 1997 (end 1996 : 90.8%).

Reflecting the liquidity situation, the mode fixed deposit rates of finance companies for all maturities increased during the first seven months of 1997. The mode rate for one-month increased by 120 basis points to 8.50% per annum, three-month deposits by 70 basis points to 8.00% per annum at the end of July 1997 (July 1996 : 7.35% and 7.40%). Similarly, both the six and twelve-month rates increased by at the same rate of 25 basis points to 7.60% (end-1996 : 7.35%). The mode savings deposits rate increased to a range of 5.00% to 6.25% per annum at the end of July 1997 from a range of 4.00% to 5.50% per annum at the end of 1996.

In line with the increase in fixed deposit rates, the **average cost of deposits** of finance companies increased from 7.08% in December 1996 to 7.59% per annum at the end of July 1997. Similarly, the average lending rate registered an increase of 51 basis points to 12.00% per annum at the end of July 1997 from 11.49% per annum at the end of 1996. With the average lending rate increasing at a same rate as the average cost of deposits,

Table 9.4

Finance Companies: Direction of Lending

	Change During Period				As at end of July 1997
	1996		1997		
	January-July		January-July		
	RM million	%	RM million	%	RM million
Agriculture	136	14.2	-18	-1.5	1,149
Mining and quarrying	3	1.4	107	35.2	412
Manufacturing	409	10.2	372	7.4	5,371
Construction	1,093	25.0	1,752	31.6	7,305
Real estate	794	23.5	603	11.2	5,965
Private individuals of which:	3,943	11.0	8,854	19.6	54,114
Consumption credit	3,930	17.0	8,224	25.7	40,180
Purchase of stocks/ shares	-235	-4.5	899	15.3	6,781
Housing*	248	3.4	-269	-3.6	7,153
General commerce	224	14.5	1,426	63.0	3,689
Miscellaneous	2,676	21.3	2,058	11.7	19,646
TOTAL	9,278	14.8	15,154	18.4	97,651

* Excluding loans sold to Cagamas Berhad.

Source: BNM.

the gross interest margin was at 4.41% at the end of July 1997. Reflecting the rising average cost of deposits, the mode BLR of finance companies rose to 11.02% per annum at the end of July 1997 from 10.80% per annum at end of 1996.

In terms of financing to the **priority sectors** as prescribed by the Central Bank's Lending Guidelines, lending to the Bumiputera community was RM33,876 million (52.4%) of the total outstanding loans as at end of July 1997. As for lending to individuals for the purchase of houses priced at RM100,00 and less, the finance companies, as a group, complied with the minimum requirement of financing at least one-half of 40,000 units by the end of March 1997. By July 1997, the finance companies, as a group, had extended financing for the purchase of a cumulative total of 34,058 units of such houses.

The two-tier regulatory system which was introduced for the commercial banks (December

1994) and merchant banks (December 1995) was extended to finance companies in April 1996. To be classified under Tier-1 group, finance companies must have a minimum shareholders' funds of RM300 million. In addition, finance companies were also required to increase their shareholders' funds to RM600 million by the end of 1998 and achieve a minimum paid-up capital of RM600 million by the end of 2000. Subject to prudential limits and conditions imposed by BNM, Tier-1 finance companies are allowed to undertake a wider range of activities including providing factoring services; providing remittance services within Malaysia, including bankers cheques, demand drafts, payment orders and telegraphic transfers. However, a finance company is only allowed to use the cheques of the commercial banks belonging to the same group, or the cheques of Tier-1 commercial banks; participating in special funds established by BNM (such as Fund for Food, Special Fund for Tourism, New Entrepreneurs Fund and Bumiputera Industrial Fund); granting unsecured business loans up to a maximum of RM500,000 except for personal loans which will be subject to existing limit of RM10,000; participating in venture capital (VC) financing through the subsidiary company, or in the case of a finance companies of a Group with a VC subsidiary company, the Group's VC subsidiary; and issuing NIDs up to five times of their capital funds. As at the end of July 1997, four finance companies have been accorded Tier-1 status.

The number of finance companies operating the country as at the end of July 1997 declined to 39, of which 11 were wholly-owned subsidiaries of domestic commercial banks and four were subsidiaries of locally-incorporated foreign commercial banks. During the first seven months, finance companies established another 23 branches.

Merchant Banks

Financial intermediation activities of merchant banks continued to expand during the first seven months of 1997. Total resources mobilised by merchant banks from **fund-based activities** rose by RM9,597 million to RM43,601 million at end of July 1997, compared with an increase of RM1,958 million during the same period of 1996. The new resources were mainly generated from placements by corporations and NIDs issued by the merchant

banks. During the first seven months of 1997, **new deposits** placed by financial institutions rose at the slower rate of RM519.8 million or 5.1%, compared with an increase of RM2,778 million or 46.9% in the same period of 1996. The bulk of the total deposits continued to be concentrated in short-term fixed deposit of maturity period of up to six months. Thus, **total deposits** (including repos) mobilised by the merchant banks increased by RM2,998 million at the end of 1996 to RM26,529 million as at the end of July 1997. As at the end of July 1997, the share of deposits mobilised by merchant banks to the total outstanding deposits of the banking system increased marginally to 6.6% from 6.5% at the end of 1996.

In terms of the **lending operations**, total loans extended by the merchant banks increased at a slower rate of 11.5% or RM2,170 million during the first seven months of 1997, compared with an increase of 15.6% during the same period of 1996. This is mainly due to increased lending to the private sector, that is by RM2,121 million, while lending to public sector declined by RM92 million. Loans to the private sector, however, accounted for 98.4% of total loans extended by the merchant banks as at end of July 1997, while loans to the public sector accounted for 0.4%.

The bulk of the loans was in the form of term loans, amounting to RM11,039 million or 52.4% of total outstanding loans of the merchant banks at the end of July 1997. The bulk of new credit was channelled to the broad property sector, amounting to RM1,697 million or 78.2% of new loans, general commerce (RM77.1 million or 11.1%), followed by the finance, insurance and business sectors (RM592 million or 8.1%). Meanwhile, loans to the manufacturing sector declined by RM331 million or 12.2% to RM2,375 million at the end of July 1997 compared with an increase of 3.9% at the same period of 1996.

As growth in deposits (12.7%) outpaced the growth in loans (11.5%), the **loan-deposit ratio** of the merchant banks stood at 79.4% at the end of July 1997, marginally lower than the end 1996 position of 80.3%. The **average liquidity ratio** of the merchant banks increased to 15.8% as at the end of July 1997 from 15.2% as at the end of 1996. With the increase in fixed deposits rates, the average cost of deposits of merchant banks increased to 8.12% at the end of July 1997 from 7.18% at the end of 1996, while the average

Table 9.5

Merchant Banks: Deposits And Lending

	Change During Period				As at end of July 1997
	1996 January-July		1997 January-July		
	RM million	%	RM million	%	RM million
Deposits					
Fixed deposits	3,797.4	37.8	3,174.2	20.9	18,330.2
Commercial banks	421.7	74.4	-223.2	-19.9	900.3
Finance companies	-101.4	-32.5	20.7	8.5	264.2
Corporations	2,731.7	36	2,207.9	19.9	13,283.7
Others ¹	690.2	48.8	952.9	38.3	3,442.3
NIF	55.2	31.3	216.2	96.7	439.7
Repos	-802.5	-30.1	282.3	11.9	2,656.2
NIDs	1,737.4	51.4	-458.1	-7.6	5,542.7
TOTAL	4,732.4	29.4	2,998.4	12.7	26,529.1
Loans					
Term loans	1,494.5	19.4	1,417.2	14.7	11,039.5
Trade bills (including BAs)	-106.8	-14.6	26.5	4.3	636.8
Others	811.8	14.3	727.2	8.4	9,386.9
TOTAL	2,199.5	15.6	2,170.9	11.5	21,062.2

¹ Includes merchant banks and other financial institutions.

Source: BNM.

lending rate rose from 10.86% at the end of 1996 to 12.43% at the end of July 1997. Thus, the gross interest margin widened by 63 basis points to 4.31% at the end of July 1997 from 3.68% at the end of 1996.

The fee-based activities of merchant banks continued to expand rapidly during the first six months of 1997 in line with the increase in demand for intermediation services. Total income from fee-based activities rose by 51.4% to RM308 million, compared with 31.4% during the same period of 1996. With the capital market expanding, the merchant banks underwrote 155 issues of securities with an aggregate value of RM4.4 billion compared with 108 issues of securities valued at RM13.1 billion during the corresponding period of 1996. At the same time, merchant banks acted as corporate advisers on acquisitions, take-overs

and mergers and undertook feasibility studies for a total of 237 corporate clients. Total fees derived from portfolio management activities undertaken by the merchant banks rose to RM19 million during the first six months of 1997, compared with RM10 million earned during the same period of 1996. The bulk of the fee-based income was generated mainly from their activities in managing the syndication of consortium loans (RM81 million), corporate advisory services (RM56 million), and underwriting (RM54 million). As at end of July 1997, the number of merchant banks operating in the country remained at 12 with 24 branch offices operating in the country as at end of July 1997. **Total assets** of the merchant bank increased by 28.2% from the end of 1996 to RM43,605 million at the end of July 1997, compared with 7.2% during the same period of 1996.

The two-tier regulatory system introduced for commercial banks was extended to merchant banks, with effect from December 1995. Merchant banks which satisfy the criteria of ratings in terms of capital, assets, management, earnings and liquidity (CAMEL), having a minimum shareholders' funds of RM250 million and actively participate in fee-based activities would be classified as Tier-1 merchant banks. The Tier-1 merchant banks are allowed to undertake several activities subject to prudential guidelines issued by BNM, including foreign exchange activities for their own accounts and to offer foreign exchange services to eligible customers, participating in the domestic and global derivatives markets, invest in all non-trustees shares listed on the Kuala Lumpur Stock Exchange (KLSE) and other exchanges in the ASEAN countries subject to a prescribed limit, accept fixed deposits from individuals subject to a minimum amount of RM1 million, issue NIDs up to five times their capital funds and expand their operations regionally through the establishment of a branch, a subsidiary company or a joint-venture. As at the end of July 1997, four merchant banks have been accorded Tier-1 status.

Discount Houses

The overall performance of the discount houses moderated during the first seven months of 1997. **Total resources** of discount houses rose by 13.0% from the end of 1996 to RM19,384 million at the end of July 1997. Total deposits (including repos)

mobilised by discount houses increased by 13.0% during the first seven months of 1997, compared with 20.9% registered during the corresponding period of 1996. The bulk of the new deposits was placed by commercial banks amounting to RM840.2 million of total new deposits, while deposits of other financial institutions totalled RM1,547 million.

Total investment of discount houses recorded a smaller increase of 5.7% from the end of 1996 to RM17,038 million at the end of July 1997, compared with an increase of 30.3% during the corresponding period of 1996. In terms of components, investment in Private Debt Securities (PDS) increased by 24.0% to RM11,373 million (January-July 1996: RM3,427 million) while investment in BAs declined by 4.0% to RM4,284 million (January - July 1996: +RM160 million). Investment in Malaysian Government Securities (MGS) continued to decline by 27.0% (January-July 1996:-RM33 million) due to a shift in investment to higher yielding papers such as PDS. Investment in Cagamas bonds and NCDs also declined by 18.4% and 24.3%, respectively during the first seven months of 1997, compared with an increase of 29.1% and 19.3% respectively during the corresponding period of 1996.

Development Finance Institutions

Development finance institutions (DFIs) are government agencies specialising in the provision of medium and long-term loans to finance capital investment of new industries as well as entrepreneurs in the industrial sector. The five principal DFIs in the country comprise the Malaysian Industrial Development Finance Berhad (MIDF), Bank Industri Malaysia Berhad (Bank Industri), Bank Pembangunan Malaysia Berhad (Bank Pembangunan), Sabah Development Bank Berhad (SDB) and Bank Pertanian Malaysia (Bank Pertanian). As at end of June 1997, **total resources** of the DFIs rose by 7.6% to RM12,249 million from end-1996, as against an increase of 6.0% during the corresponding period of 1996. This was mainly due to the 7.0% growth in borrowings which was the largest category of funding, amounting to RM4,611 million or 37.6% of the DFIs' total resources.

With the exception of Bank Pembangunan, the total resource performance of individual DFIs

increased as indicated in Table 9.6. The total resources of Bank Industri rose by 10.9% during the first six months of 1997 to RM1,936 million (January-June 1996: 6.9%), largely due to the 50.1% increase in shareholders' funds. Similarly, total resources of both Bank Pertanian and MIDF increased by 10.1% and 9.3% to RM4,514 million and RM2,224 million respectively (January-June 1996: 3.1% and 20.0% respectively), while that of SDB rose by 6.7% to RM1,426 million (January-June 1996: 23.8%). However, total resources of Bank Pembangunan declined further by 0.8% to RM2,150 million, compared with 10.0% during the corresponding period of 1996.

Table 9.6
Development Finance Institutions
(as at end of period)

<i>Institution</i>	<i>1996</i>	<i>June 1997</i>
Total Resources¹ (RM million)		
Bank Pertanian Malaysia	4,098	4,514
Bank Pembangunan Malaysia Bhd.	2,167	2,150
Malaysian Industrial Development Finance Bhd.	2,035	2,224
Bank Industri Malaysia Bhd.	1,746	1,936
Sabah Development Bank Bhd.	1,336	1,426
Average Interest Rates (%)		
Bank Pertanian Malaysia		
Concessional rate	4.00	4.00
Commercial rate	0-4 above BLR ²	0-4 above BLR ²
Bank Pembangunan Malaysia Bhd.	7.43	7.75
Malaysian Industrial Development Finance Bhd.	9.75	9.75
Bank Industri Malaysia Bhd.		
Ship repairing	6.00-9.45	6.00-9.45
Ship building	6.00-9.45	6.00-9.45
Dockyard infrastructure	9.00	9.50
Sabah Development Bank Bhd.	11.30	11.55

¹ Include shareholders' funds, short and long-term borrowings and deposits mobilised.

² Base Lending Rate

Sources: Bank Pertanian Malaysia, Bank Pembangunan Malaysia Berhad, Malaysian Industrial Development Finance Berhad, Bank Industri Malaysia Berhad and Sabah Development Bank Berhad.

Total **new loans** extended by the DFIs declined further by 24.9% to RM1,448 million, compared with a decline of 13.5% during the same period of 1996. In terms of lending by sector, loans to the manufacturing sector recorded a significant increase of 34.5% to RM635 million. However, loans to all the other sectors such as the mining and quarrying (-100.0%), agriculture (-56.5%) and shipping industries (-32.8%) declined from the corresponding period of 1996. The bulk of DFIs' loans was extended to the manufacturing (43.9%), agriculture (15.8%) and construction and real estate (11.9%) sectors, while 10.8% was utilised by the shipping industries, with the balance of 17.6% being extended to the other sectors (comprising trade credit and miscellaneous) as indicated in Table 9.7.

The lending activities of the individual DFIs declined during the first half of 1997 from the corresponding period of 1996. New loans approved by Bank Pertanian declined significantly by 53.9% to RM229.0 million during the first six months of 1997 (January-June 1996: RM496.9 million), while that of SDB declined by 39.4% (January-June 1996: RM416.5 million). Similarly, credit approved by MIDF declined 6.9% to RM311.1 million, compared with RM334.1 million during the same period of 1996. Meanwhile, loans approved by Bank Industri amounted to RM250.2 million, while approvals by Bank Pembangunan totalled RM405.0 million, reflecting a decline of 4.4% and 3.1% respectively. The total outstanding loans of the DFIs stood at RM6,773.3 million at the end of June 1997, compared with RM6,544.5 million at the end of 1996. As indicated in Table 9.6, the average rate of interest charged by the DFIs varied within a range of 4.00% to 11.55% per annum.

The DFIs continued to serve as the implementing agencies for various specialised assistance schemes. One such scheme is the **Industrial Adjustment Fund (IAF)** which was launched on 5 February 1991, with a total allocation of RM500 million. The IAF was established with the aim of rationalising and restructuring companies existing before 31 December 1990 in three selected industries (namely machinery and engineering, wood-based and textile industries) through mergers, takeovers, relocation and diversification. During the first seven months of 1997, five applications amounting to RM32.3 million was approved (no new applications were approved during the same period of 1996). Consequently, a total of 26

Table 9.7
Direction of Lending by DFIs

	1996	1997 ^P	Change During Period %
	(January-June) RM million		
Manufacturing	472	635	+34.5
Shipping	232	156	-32.8
Agriculture	527	229	-56.5
Real estate and construction	246	173	-29.7
Mining and Quarrying	12	0	-100.0
Others	439	255	-41.9
TOTAL	1,928	1,448	-24.9

^P Preliminary data

Source: Bank Pertanian Malaysia, Bank Pembangunan Malaysia Berhad, Malaysian Industrial Development Finance Berhad, Bank Industri Malaysia Berhad and Sabah Development Bank Berhad.

applications with an aggregate value of RM106.1 million was approved as at end of July 1997, while drawdowns amounted to RM68.7 million.

The **Enterprises Rehabilitation Fund (ERF)** which was established in 1988, aimed at providing financial assistance to ailing but viable Bumiputera enterprises facing financial problems as a result of the recession in 1985/86. Given repayments of five previously approved applications, the total amount approved during the first six months of 1997 declined by RM8.2 million compared with an increase of RM60,519 during the corresponding period of 1996. As at end of June 1997, 121 applications with a total value of RM421.6 million had been approved, while drawdowns amounted to RM399.1 million. A substantial amount of the loans was extended to the housing sector (RM274.0 million), followed by the construction sector (RM56.9 million), the property sector (RM53.0 million) and the manufacturing sector (RM30.2 million).

The **ASEAN-Japan Development Fund (AJDF)** is another scheme aimed at assisting the development of small and medium-scale industries, administered by the Bank Pertanian, Bank Industri, Bank Pembangunan and MIDF. This revolving fund was launched in January 1989, with initial

funding allocated by the Overseas Economic Cooperation Fund (OECF) and the Export-Import Bank of Japan (EXIM). During the first half of 1997, the implementing DFIs approved a total of 382 applications amounting to RM71.3 million, as against a decline of 254 applications with the approved amount increasing by RM158.5 million during the same period of 1996. Thus, as at 30 June 1997, total loans approved amounted to RM1,759.1 million for 4,513 projects. Out of this, RM1,372.2 million was derived from OECF's allocation, while the balance was from EXIM's allocation.

The **Export-Import Bank of Malaysia Berhad (EXIM Bank)**, a wholly owned subsidiary of Bank Industri was incorporated on 29 August 1995 with the objective of providing institutional support to facilitate the export of manufactured goods and diversification of exports, assisting government in promoting reverse investments in resource-based manufacturing and processing of agricultural products and assisting in promoting high value-added, capital-intensive and technologically sophisticated industries. Since its establishment, EXIM Bank has approved loans and guarantees for 49 projects amounting to RM1,157 million as at end of June 1997. For the year ended 31 December 1996, the Bank earned an operating income of RM7.96 million which is equivalent to 56.5% of the total income of RM14.1 million. During the first half of 1997, Exim Bank's operating income totalled RM6.65 million. The Buyer Credit Guarantee Facility remains the largest revenue earner, contributing about 55.6% of the total operating income for the EXIM Bank during the first six months of 1997.

The **Special Fund for Tourism (SFT)** was set up by the Government in March 1990 with the aim of financing the development of tourism related projects with an allocation of RM120 million. The implementing agencies for SFT include the commercial banks, merchants banks and DFIs. Due to the overwhelming response as well as to cater for the increasing number of new applications, the implementing agencies have allocated funds exceeding the initial allocation amounting to a total of RM241.7 million during at the end of July 1997. During the first seven months of 1997, 17 applications with a total value of RM22.8 million were approved (January-July 1996 : 6 applications with a total value of RM7.3 million). This brings the total number of applications approved as at

end of July 1997 to 212, with a value of RM241.7 million. Of this, RM180.4 million has been disbursed as at end of July 1997. The bulk of the approvals was extended for the construction and renovation of budget hotels (62.6%) and chalets (25.0%).

The total amount of loans approved under the **Fund for Food** scheme has also increased. During the first seven months of 1997, 15 applications amounting to RM6.2 million were approved (1996: 276 applications amounting to RM34.5 million). This brings the number of applications approved to 1,049 applications, valued at RM299.8 million as at 30 July 1997, with RM273.9 million having been disbursed. The majority of the approvals was for animal husbandry (RM162.9 million), followed by cultivation of fruits and vegetables (RM54.8 million) and food processing (RM35.7 million). Recently, the Government announced the approval of an additional allocation of RM300 million to the existing RM300 million under the Fund and BNM has issued a new guideline regarding the additional allocation on 1 August 1997.

The **New Entrepreneurs Fund (NEF)**, with an allocation of RM750 million, was launched in December 1989 with the aim of encouraging more small and medium-scale Bumiputera entrepreneurs to venture into various fields of business at a reasonable cost. The Fund has been fully utilised to date. The implementing agencies of the Fund include MIDF, Bank Pembangunan, Bank Industri and 11 other commercial banks. During the first seven months of 1997, a total number of 56 applications were approved, amounting to RM24.3 million (1996: 101 applications valued at RM74.7 million). This brings the total number of applications approved to 2,055 as at end of July 1997, valued at RM958.9 million. Of this, RM854.3 million has been disbursed.

Other Financial Institutions

National Savings Bank

Total resources of the National Savings Bank (NSB) declined by 0.6% or RM44 million from end-1996 to RM6,889 million as at end of June 1997, compared with an increase of 9.1% or RM553 million during the corresponding period of 1996. This was mainly due to a decline of 1.6% in

deposits during the first half of 1997 to RM5,827 million at the end of June 1997, compared with an increase of 5.0% during the same period of 1996.

During the first half of 1997, **new deposits** (including premium savings certificates) mobilised by the NSB totalled RM1,387 million, reflecting a slower growth of 12.5% to RM12,521 million, against an increase of 25.6% during the same period of 1996. On the other hand, total withdrawals increased by 15.3% to RM12,462 million, against an increase of 22.9% during the corresponding period of 1996, resulting in smaller net deposits of RM59 million (January-June 1996: RM323 million).

The **GIRO** savings scheme continued to be the core product of the NSB. The bulk of the new deposits mobilised by the NSB emanated from the Giro savings scheme, accounting for 90.7% or RM11,355 million of the total new deposits (January-June 1996: 88.6% or RM9,870 million). Similarly, withdrawals also expanded by 16.9% to RM11,344 million (January-June 1996: 25.7%), resulting in significantly lower net deposits of RM11 million (January-June 1996: RM166 million). The Giro Guarantee Orders (GGOs) introduced by the NSB in August 1993 to facilitate applications by the NSB account holders and members of the public for new share issues by MIDF Consultancy and Corporate Services Sdn. Bhd. as well as the Malaysian Issuing House proved to be popular. During the first half of 1997, a total of 226,703 GGOs valued at RM801.6 million were issued, compared with a total of 144,574 GGOs valued at RM456.8 million during the corresponding period of 1996. Meanwhile, the **Save-As-You-Earn** scheme recorded a net withdrawal of RM0.7 million (net withdrawal of RM0.8 million during the corresponding period of 1996) as deposits (RM8.2 million) continued to decline and lagged behind withdrawals (RM8.9 million). However, the **premium savings certificates** scheme recorded a smaller net inflow of RM63 million during the first six months of 1997 (January-June 1996: RM93 million), as redemption of certificates rose by 21.9% to RM120 million, while purchases of certificates declined by 4.0% to RM183 million.

In tandem with the decline in total resources of the NSB, **investments** declined 5.2% during the first six months of 1997 to RM4,798 million at the end of June 1997, compared with an increase

Table 9.8

National Savings Bank
(as at end of period)

	1996	June 1997 ^P
Deposits ¹ (RM million)		
Savings	1,682	1,624
Fixed	1,164	1,208
Save-As-You-Earn	23	22
GIRO	2,561	2,572
Premium Savings Certificates	469	532
Investments at book value (RM million)	5,062	4,798
MGS	1,957	1,636
Stocks and shares ²	1,191	1,278
Others ³	1,914	1,884
Loans (RM million)	1,448	1,658
Individuals	663	732
Corporate	157	161
Visa Cards	15	22
Hire Purchase	613	743
Number of NSB branches ⁴	479	471
Number of post offices with NSB facilities	614	616
Number of depositors ('000)	9,133	9,230
Savings	3,288	3,059
Fixed	91	96
Save-As-You-Earn	21	20
GIRO	5,733	6,055

¹ Includes interest credited.

² Includes trustee and non-trustee shares, private debt securities and warrants.

³ Includes long and short-term deposits.

⁴ Includes mini and sub-branches.

^P Preliminary data.

Source: National Savings Bank.

of 9.4% during the same period of 1996, as indicated in Table 9.8. This was mainly due to the decline of 15.6% in short and long-term deposits placed with the banking system during the first half of 1997 to RM582 million at the end of June 1997. Similarly, investments in the Federal Government Securities, such as MGS, Cagamas bonds and Treasury bills rose by 13.0% from the end of 1996 to RM2,408 million, while investments in stocks and shares increased at a higher rate of 7.3% to RM1,278 million, compared with 2.9% during the same period of 1996.

The **lending** activities of the NSB, however, increased significantly by 14.5% to RM1,658 million during the first six months of 1997 (January-June 1996: 8.4%). This was mainly due to the increase in the credit granted for Visa Cards and hire-purchase, which rose significantly by 46.7% and 21.2% respectively. Similarly, loans granted to individuals increased by 10.4% from the end of 1996 to RM732 million at the end of June 1997, compared with a decline of 10.5% during the same period of 1996, while loans extended to the corporate sector rose by 2.5% to RM161 million (January-June 1996: 6.4%).

The total number of NSB branches declined from 479 in June 1996 to 471 in June 1997 as some of the branches were merged as centralised branches based on the concept of 'profit-centres'. However, the NSB installed four additional automated teller machines (ATMs) during the first six months of 1997. In total, the NSB has 592 ATMs throughout the country as at end of June 1997.

Provident and Pension Funds

The principal provident and pension funds, comprising the Employees Provident Fund (EPF), the Social Security Organisation (SOCSO), the Armed Forces Fund (AFF) and the Pensions Trust Fund (PTF), continued to be the largest source of long-term domestic financing for the public sector. **Total resources** of these four funds expanded by 8.4% from the end of 1996 to RM 145.5 billion as at end of June 1997, compared with an increase of 8.3% during the same period of 1996, as indicated in Table 9.9.

The **EPF** with total resources of RM126.9 billion as at end of June 1997 remained the largest

provident and pension fund in the country. Total resources expanded 8.2% in the first six months of 1997 as compared with growth of 7.7% during the same period of 1996. The continued growth of total resources was mainly due to higher returns from its various investments as well as the increase in the number of contributors. Total investments of the EPF increased by 7.9% during the first six months of 1997 to RM124.3 billion (January-June 1996: 8.5%), accounting for 97.9% of the total outstanding resources. Investment in loans and debentures rose significantly by 28.5% from the end of 1996 to RM13.4 billion at the end of June 1997, compared with an increase of 9.4% during the same period of 1996. Similarly, investments in corporate securities increased by 16.2% to RM36.6 billion as at end of June 1997 (January-June 1996: 25.0%), while investments in NIDs, fixed deposits and short-term deposits rose by 11.6% to RM31.7 billion (January-June 1996: 18.9%). However, the EPF's holdings of MGS continued to decline by 1.9% during the first six months of 1997 to RM38.0 billion at the end of June 1997, compared with a decline of 0.4% during the corresponding period of 1996. As a result, investment in MGS accounted for a share of 30.0% of the total outstanding investment of the EPF at the end of June 1997 (end of 1996: 33.0%), which was well below the mandatory requirement of the cumulative investments in MGS of 50.0%. This was mainly due to shortages in Government papers resulting from the decline in Government borrowings in view of its strong overall financial position as well as EPF's objective of diversifying into higher revenue-earning investments.

The total membership of the EPF increased by 162,243 persons during the first half of 1997 to 8,212,981 contributors at the end of June 1997 from 8,050,738 at the end of 1996. Thus, gross contributions to the EPF increased by RM5.6 billion during the first six months of 1997, compared with an increase of RM4.5 billion during the same period of 1996. However, withdrawals declined to RM2.6 billion at the end of June 1997 from RM3.6 billion at the end of 1996. As a result, the total outstanding balance of contributors' accounts (including interest credited) increased by 4.9% from RM114.2 billion at the end of 1996 to RM119.8 billion at the end of June 1997 (January-June 1996: 4.6%).

The **PTF** was established under the Pensions Trust Fund Act 1991 on 1 June 1991, with the

Table 9.9
Provident and Pension Funds
(as at end of period)

	Total Resources (RM million)		Malaysian Government Securities (RM million)		Number of Members (‘000)	
	1996	June 1997 ^p	1996	June 1997 ^p	1996	June 1997 ^p
EPF	117,335	126,863	38,754	38,028	8,051	8,213
SOCSCO	5,233	5,486	2,572	3,033	7,614	7,917
AFF	4,120	4,288	10	10	99	105
PTF	7,522	8,847	0	0	-	-
TOTAL	134,210	145,484	41,336	41,071	15,764	16,235

^p Preliminary data.

Source: Employees Provident Fund, Social Security Organisation, Armed Forces Fund and Pensions Trust Fund.

objective of developing into a self-financing fund to take over the Government's obligation to meet the cost of payments of pension, gratuity and other pension benefits to retired public servants. Funds are derived from the annual contribution by the Government (initially set at 5.0% of the annual civil service emolument bill), monthly contributions made by employers under the Statutory and Local Authorities Pension Act 1980 (set at a rate of 17.5% of the salary of their pensionable officers), refund of employers' contributions to the EPF and other approved funds established for the retired public officials, income from investments and other sources approved by the Minister of Finance. Total resources of the PTF rose by 17.6% during the first six months of 1997 to RM8,847 million at the end of June 1997, compared with an increase of 21.6% during the same period of 1996. A major proportion of the total outstanding resources was channelled to investments (73.7%), with the balance (26.3%) comprising cash and balances placed in the banking system (including BNM).

SOCSCO was established in 1971 under the Employees Social Security Act, 1969 to provide

social security benefits to workers through the Employment Injury Insurance Scheme and Invalidity Pension Scheme. Reflecting the continued expansion in net contributions and returns from its investment, total resources of SOCSCO increased by 4.8% during the first six months of 1997 to RM5,486 million at the end of June 1997, compared with an increase of 4.0% during the corresponding period of 1996. The bulk (55.3%) of the total outstanding resources was invested in MGS, cash and deposits with the banking system (23.6%), while 11.3% was invested in corporate securities. The number of registered employees stood at 7,916,995 as at end of June 1997, reflecting an increase of 303,360 persons from the end of 1996 (7,613,635).

The **AFF** which was established in 1973 aimed at providing superannuation benefits to servicemen in the armed forces. During the first half of 1997, total resources of the AFF increased more rapidly by 4.1% to RM4,288 million, compared with an increase of 1.8% during the same period of 1996. This was mainly due to the growth in returns from its investment (4.1%) which more than offset the

decline in contributors' outstanding balance (1.1%). The contributors' outstanding balance (including interest credited) declined from RM3,194 million at the end of 1996 to RM3,160 million as at end of June 1997, reflecting a lower net contribution deficit amounting to RM34 million during the first six months of 1997 (January - June 1996 : RM71 million). The number of registered members increased to 105,040 persons as at end of June 1997 from 99,380 persons at the end of 1996. The AFF invested 75.2% of its total outstanding resources in corporate securities (RM3,226 million), while 19.7% was placed in the banking system (RM846 million). Investments in MGS, however, remained unchanged at RM10 million as at end of June 1997.

Insurance Companies

The combined premium income of the life and general **insurance sectors** grew at a slower rate of 17.7% in 1996 (1995: 22.0%) to RM9.3 billion, as indicated in Table 9.10. Premium income of the industry as a percentage of nominal Gross National Product (GNP) increased further to 4.0% in 1996, compared with 3.8% in 1995. Total benefits and claims paid out by the industry increased by 21.1% to RM2.7 billion (1995: 14.0%), representing 26.0% of the premium income (1995: 28.5%). The industry's insurance fund assets increased by 20.1% to RM30.0 billion at the end of 1996 (1995: RM25.0 billion), to account for 3.3% of the total assets of the financial system.

New business of the **life insurers** in terms of new premiums and sums insured declined by 9.1% and 3.7% respectively to RM1.4 billion and RM72.8 billion in 1996. This decline in new business was a temporary phenomenon as the industry underwent some adjustments following the implementation of BNM's guidelines on Rationalisation of the Operating Costs of Life Business. Sums insured terminated during the year increased by 25.4% (1995: 32.5%) to RM38.2 billion, involving annual premiums of RM488.2 million. In line with the decline in new business, life insurance business in force expanded at a slower rate, with the number of policies in force increasing by 7.6% (1995: 14.3%) to 5.3 million policies in force as at the end of 1996. Similarly, total sums insured and aggregate annual premiums in force also recorded slower growth of 13.5% and 14.1% (1995: 23.2% and 23.6%) respectively to RM275.8 billion and RM5.2 billion.

Table 9.10
Life and General Insurance Business

	1995	1996 ^P
Life Insurance (RM million)		
New Business:		
Number of policies ('000 units)	1,029.5	897.7
Sums insured	75,599.5	72,775.2
Total premiums	1,495.0	1,358.8
Business in Force:		
Number of policies ('000 units)	4,949.5	5,323.4
Sums insured	1,242,965.0	275,840.0
Annual premiums	4,559.8	5,201.2
Premium Income	4,506.4	5,098.5
Benefit Payments:		
Total	1,077.5	1,221.1
Maturity	379.6	392.7
Death and disability	428.4	486.2
Surrender	191.5	228.2
Cash bonuses	77.7	113.7
Annuity	0.3	0.3
General Insurance (RM million)		
Premium Income:		
Written	4,634.3	5,378.0
Net	3,412.6	4,218.6
Reinsurance Placed Outside Malaysia	1,222.0	1,159.4
Retention Ratio (%)	73.6	78.4
Number of Insurance Companies		
Direct:		
Life	5	5
General	40	40
Composite	13	13
Reinsurers	4	7

^P Preliminary data.

Source: Director General of Insurance.

The overall income and outgo position of the industry showed a significant improvement in 1996. Total income of the industry increased by 19.4% (1995: 4.1%) to reach RM6.8 billion, while outgo expanded by 4.6% (1995: 24.7%) to RM3.3 billion. Premium income, which accounted for 75.3% of total income, increased by 13.1% (1995: 23.3%) to reach RM5.1 billion in 1996. Investment earnings, the second largest component (16.8%) of total income, grew by 22.2% (1995: 17.7%) to RM1.1 billion in 1996. The industry experienced a slower increase in the operating expenses of only 0.6% (1995: 29.0%), mainly due to lower growth in commissions. Commission payments, which accounted for 47.0% of total outgo, registered a lower growth of 5.7% (1995: 25.8%), mainly due to the implementation of the operating cost guidelines effective 1 January 1996 and the slowdown in new business growth. Consequently, the excess of income over outgo for the industry increased by 37.5% (1995: -13.4%) to RM3.5 billion in 1996.

The total assets of life funds grew by 17.8% (1995: 16.9%) to reach RM20.5 billion as at the end of 1996. There was a slight change in the distribution pattern of the assets of the life insurance industry in 1996. For the first time, corporate securities overtook MGS and Government Guaranteed Loans to become the largest category of the assets, constituting 27.7% (1995: 23.8%) of the assets of the life funds in 1996. Investment in MGS and Government Guaranteed Loans became the second largest component, accounting for 25.6% of the life funds (1995: 26.9%), as indicated in Table 9.11.

In 1996, the **general insurance** sector continued to consolidate, with a slower rate of growth in total written premiums, which increased by 16.0% to RM5,378 million (1995: 17.6%). In line with the Government's policy of optimising national retention and with increased local capacity, the amount of premiums ceded overseas showed a reduction of 5.1% from RM1,221.8 million in 1995 to RM1,159.4 million in 1996. Accordingly, the net retention ratio improved to 78.4% (1996: 73.6%). During the year, all sectors, except the compulsory class of motor business, registered increases in claims, resulting in the overall claims ratio deteriorating to 58.2%, compared with 55.7% in 1995. Total assets of the general insurance funds increased by 25.4% to RM9,581.7 million in 1996, as compared with 26.5% in 1995. Cash and deposits

which amounted to RM3,522.9 million remained the largest investment portfolio, accounting for a share of 36.8% of total assets, followed by MGS and Government Guaranteed Loans, which totalled RM2,543.5 million or a share of 26.5%.

The insurance industry is expected to maintain its pace of growth in 1997. For the period of January until June 1997, the combined premium income for both the life and general insurance business increased by 19.3% to RM4,999.7 million (January-June 1996: RM4,191.2 million). The combined total assets for both the life and general insurance business recorded an increase of 11.4% amounting to RM33,481.2 million (December 1996: RM30,051.5 million).

New business growth improved during the first half of 1997 compared with the corresponding

Table 9.11
Life and General Insurance Funds
(as at end of period)

	<i>Life Insurance</i> (RM million)		<i>General Insurance</i> (RM million)	
	1995	1996 ^p	1995	1996 ^p
Fixed assets	109.3	115.6	276.0	353.2
Loans	3,527.8	4,360.0	155.9	226.8
Government securities	4,344.4	5,048.1	2,074.0	2,509.7
Government guaranteed loans	339.6	182.3	59.5	33.9
Corporate securities	4,133.2	5,675.6	1,125.3	1,650.8
Investment properties	800.7	938.9	37.7	31.4
Cash and deposits	3,501.4	3,437.5	3,038.0	3,522.9
Other assets	618.3	709.2	877.3	1,253.0
TOTAL	17,374.6	20,467.2	7,643.7	9,581.7

^p Preliminary data.

¹ Includes Treasury bills and Government securities issued abroad.

Source: Director General of Insurance

period a year ago, with new business premiums and sums insured increasing by 21.9% (January-June 1996: -2.4%) and 29.7% respectively (January-June 1996: 20.0%) to RM695 million and RM44.9 billion respectively. Annual premiums in force increased by 13.4% (January-June 1996: 19.2%) to RM5.4 billion, while sums insured grew by 13.4% (January-June 1996: 17.9%) to RM290.9 billion. Total income recorded a growth of 15.6% (January-June 1996: 19.9%) to RM3.5 billion, while total outgo increased by 15.5% (January-June 1996: 10.0%) to RM1.7 billion. During the period, the industry's excess of income over outgo improved by 15.8% (January-June 1996: 31.1%) to RM1.8 billion. As at the end of June 1997, total assets of the life funds reached RM22.3 billion, 8.3% higher than that at the end of December 1996, with corporate securities remaining as the largest category, constituting 31.8% of the life fund assets.

During the first half of 1997, total written premiums of the general insurance sector rose markedly by 17.5% to RM3,017.9 million (January-June 1996: 18.9%). The total assets of the general insurance industry increased by 16.6% to RM11,172.6 million at the end of first half of 1997 (December 1996: RM9,581.7 million).

As at end of June 1997, there were 66 insurers, comprising five life insurers, 13 composite insurers, 40 general insurers, seven general reinsurers and one life reinsurer. Of this, 53 were Malaysian-incorporated and the remaining 13 were foreign-incorporated. As at the same date, there were 38 licensed brokers and 44 licensed loss adjusters.

Takaful or Islamic insurance, provided by two takaful operators, namely, Syarikat Takaful Malaysia Berhad (STMB) and MNI Takaful Sdn. Berhad (MNIT), continued to expand strongly with the main business indicators recording double-digit growth rates in 1997 financial year ending 30 June. Total assets of takaful funds increased significantly by 58.0% to reach RM575.5 million at the end of the 1997 financial year, compared with a growth of 68.8% in the previous financial year. Assets of the family takaful funds accounted for 39.8% of the total assets, while general takaful funds accounted for another 36.0% with the balance of 24.2% being assets of shareholders funds. Investment in Malaysian Investment Certificates amounted to RM99.4 million or 17.3% of total assets and followed by investment in Bank Islam Malaysia Berhad of RM76.1 million or 13.2% of

total assets. During the financial year under review, new takaful business grew steadily by 42.1% with a total of 55,949 new certificates sold under the family takaful business amounting to RM3,166.5 million (1996: RM1,947.1 million). Total contributions received on new certificates increased by 84.0% to RM101.2 million in 1997 financial year. Business in force continued to expand strongly in tandem with the growth momentum of new business in 1997 financial year. The number of certificates in force increased by 67.9% to reach 128,244 units in the period under review. Total contributions and total participation in force

Table 9.12
Family and General Takaful Business

	<i>Financial Year 1996</i>	<i>Financial Year 1997^P</i>
Assets ¹ (RM million)	364.3	575.5
Malaysian Investment Certificates	80.8	99.4
Investment in Bank Islam Malaysia Bhd.	49.2	76.1
Others ²	234.3	400.0
Family Takaful		
New Business:		
Total contribution (RM million)	55.0	101.2
Sums participated:		
(RM million)	1,947.1	3,166.5
Number of certificates	39,366	55,949
Business in Force:		
Total contribution (RM million)	83.8	229.6
Sums participated (RM million)	4,563.4	8,557.6
Number of certificates	76,393	128,244
General Takaful Business		
Gross contributions	67.0	93.0
Net claims paid	7.6	19.0

^P Preliminary data.

¹ As at end of period, 30 June.

² Includes shares, cash and balances and other assets.

Source: Syarikat Takaful Malaysia Berhad and MNI Takaful Sdn. Berhad.

rose significantly by 174.0% and 87.5% to reach RM229.6 million and RM8,557.6 million respectively at the end of the 1997 financial year.

The general takaful business, which offered marine, motor, fire, group personal accident and engineering coverages, recorded a higher growth of 38.8% in gross contribution to RM93.0 million in 1997 financial year, after registering a moderate growth rate of 15.7% in 1996 financial year. However, total net claims paid during the 1997 financial year also increased sharply by 150.0% from RM7.6 million to RM19.0 million compared with a decline of 8.4% in 1996 financial year. The strong growth of takaful business was partly attributable to the expansion of the distribution network with the opening of several new branch offices throughout the country to promote the sale of takaful products nationwide. As at 30 June 1997, there are 63 takaful desks and 35 takaful branch offices throughout the country.

Capital Market

The capital market continued to support economic growth in the first seven months of 1997. Total funds raised from the capital market by both the public and private sectors during the first seven months of 1997 increased by 9.3% to RM20,717 million, compared with RM18,957 million mobilised during the corresponding period of 1996, as indicated in Table 9.13. The private sector continued to dominate the capital market with total gross funds raised amounting to RM25,487 million or 123.0% of the total net funds raised in the capital market, representing an increase of 22.9% during the first seven months of 1997 (January-July 1996 : RM20,742 million). In contrast, the public sector recorded a net repayment of RM3,749 million during the first seven months of 1997, compared with net funds of RM360 million raised during the same period of 1996, in consonance with the shift in the financing of development from previously by the public to the private sector.

There were no new issues of MGS by the Government during the first seven months of 1997, compared with a floatation of one issue of MGS amounting of RM2,000 million during the corresponding period of 1996. However, a total of RM2,320 million of MGS and RM29 million

worth of Malaysia Savings Bond were redeemed by the respective holders during the first seven months of 1997, while that of the Government Investment Issues amounted to RM1,400 million. Khazanah Nasional Berhad, the Government's investment arm, issued zero-coupon bonds worth RM1 billion with a maturity of three years on 18 September 1997 in order to build up a benchmark yield curve for the ringgit bond market. The RM1 billion benchmark bonds have been oversubscribed, with total bids amounting to RM2.262 billion. For the face value of RM100, purchasers paid RM79.44 for the bonds which will mature in September 2000.

During the first seven months of 1997, the net funds raised by the **private sector** increased by 31.6% due largely to the issuance of PDS to tap funds. Total gross funds raised from the PDS market registered an increase of 14.0% to RM13,027 million during the first seven months of 1997, compared with RM11,428 million during the corresponding period of 1996. These funds were raised through conventional bonds (RM5,396 million), Islamic papers (RM4,022 million) and convertible bonds (RM2,084 million). Meanwhile, a total of RM1,021 million was redeemed, resulting in net funds of RM12,006 million raised from the PDS market. This accounted for 49.1% of the total net funds raised by the private sector in the capital market (January-July 1996 : 49.9%).

In the equity market, total funds raised by the private sector increased by 33.8% to RM12,460 million during the seven months of 1997, compared with RM9,314 million during the corresponding period of 1996. A recent development which underpinned the growth of the market has been the liberalisation of rules to allow infrastructure companies to tap funds from the equity market. The amount raised from the equity market comprised of RM3,160 million from public issues, RM5,209 million from rights issues and RM2,836 million from private placements were issued during the period under review. Thus, after adjusting for redemptions and repayments, net funds raised by the private sector increased by 31.6% to RM24,466 million during the first seven months of 1997, compared with RM18,597 million during the same period of 1996.

Table 9.13

Funds Raised in the Capital Market

	1996 January-July RM million	1997 ^p January-July RM million
By Public Sector		
Government Securities ¹ , gross	2,000	0
Less: Redemptions	1,323	2,320
Equals: Net issues	677	-2,320
Less: Government holdings	0	0
Equals: Net Federal receipts	677	-2,320
Malaysia Savings Bond, net	-17	-29
Investment certificates, net	-300	-1,400
Net funds raised	360	-3,749
By Private Sector		
Equity market		
Shares ²	9,314	12,460
Public issues	1,183	3,160
Rights issues	3,256	5,209
Special issues ³	1,786	1,255
Private placements ⁴	3,089	2,836
Warrants	0	0
Debt Securities ⁵ (gross)		
Conventional bonds	5,602	5,396
Convertible bonds	681	2,084
Islamic notes	2,200	4,022
Cagamas bonds	2,945	1,525
Less: redemptions	2,145	1,021
Net issues of debt securities	9,283	12,006
Net funds raised	18,597	24,466
TOTAL	18,957	20,717

^p Preliminary data.¹ Refers to Federal Government securities, excluding Treasury bills.² Refers to corporate shares issues by companies listed on the Kuala Lumpur Stock Exchange.³ Includes special issues to Bumiputera and selected investors.⁴ Includes restricted offer for sales.⁵ Refers to securities with maturity of more than one year.

Source: BNM

Cagamas Berhad, the national mortgage corporation, raised a total of RM9,845 million from 18 issues of Cagamas notes during the first eight months of 1997 (January-August 1996 : a total of RM6,470 million from 20 issues of Cagamas notes). The notes with maturities ranging from the three to nine months were mainly issued to meet short-term funding needs. During the first eight months of 1997, Cagamas Berhad purchased a total of RM4,238 million of housing loans, compared with RM4,283 million during the same period of 1996. Out of this, 98.7% (RM4,183 million) was purchased from the financial institutions, while 1.3% (RM55 million) was from the Housing Loans Division of the Ministry of Finance.

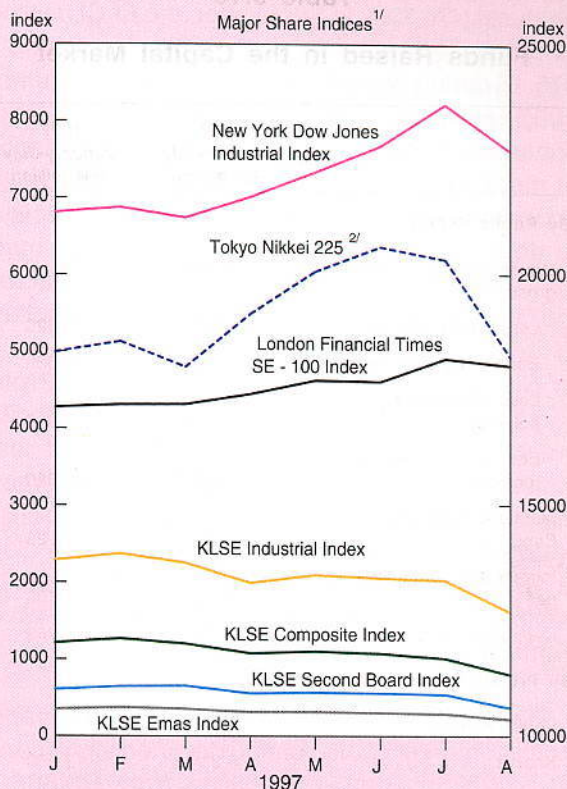
In consonance with the robust development in the capital market, the **Rating Agency Malaysia Berhad (RAM)** completed 33 corporate debt ratings valued at RM10.2 billion during the first eight months of 1997. A total of 58 corporate debt ratings valued at RM8.9 billion was completed during the corresponding period of 1996. As at end of August 1997, an aggregate of 399 corporate ratings amounting to RM65.5 billion had been rated by RAM since its establishment. As for the bank guaranteed issues which were based on PDS, there were 16 issues valued at RM1.6 billion during the first eight months of 1997, compared with 26 issues worth RM3.6 billion during the same period of 1996. As at end of August 1997, RAM had rated 37 institutions comprising 18 commercial banks, 12 merchant banks, three finance companies and four DFIs. RAM had also entered into a joint-venture agreement with Duff & Phelps Rating Company (DCR) of the United State of America to set up a rating company which will provide credit rating services for companies in the Asian region. It will also assist companies in the region to enhance their credit rating through asset or future flows securitisation. Thus, the joint-venture will enlarge RAM's product lines beyond the current rating of domestic corporate debt securities and financial institutions. The second rating agency, the Malaysian Rating Corporation Berhad (MARC), which was recently established in September 1996 rated 17 corporate debt issues worth RM7.4 billion as at end of August 1997.

The Kuala Lumpur Stock Exchange

Sentiments on the KLSE which began the year on a bullish note were adversely affected by the contagion effects of speculative activity on the Thai baht since mid-May 1997. The performance of the local bourse was encouraging during the first quarter of 1997 due to the release of positive macroeconomic data which enhanced the economy's growth prospects including data indicating a slower growth and favourable trade figures. While the Kuala Lumpur Composite Index (KLCI) was marginally lower at 1,203.10 (end 1996: 1,237.96), the Second Board Index performed well reaching an all time high of 680.25 on 19 March 1997 before closing at 656.38 at the end of the month, that is 13.9% higher than the index of 576.31 at the end of 1996. The broad-based Emas Index rose marginally by 1.1% to 351.42 (end-1996: 347.67) in the same period. The performance of the stock market weakened during the second quarter of 1997 partly due to the introduction of credit control measures by BNM effective 1 April as well as developments in Thailand which led to a consequential outflow of short-term capital. The KLCI and the Emas Index declined significantly by 13.0% and 12.7% from the end of 1996 position to 1,077.30 and 303.46 respectively at the end of June 1997, with the Second Board Index declining 2.4% to 562.66.

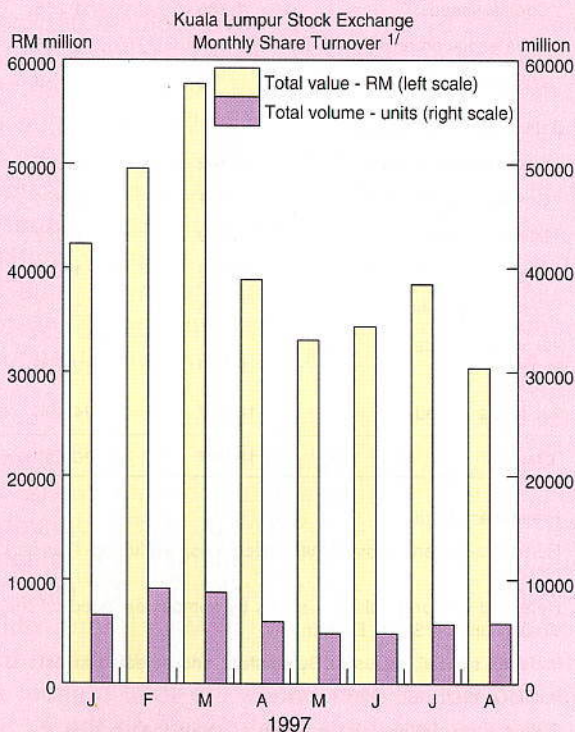
Reflecting developments in the foreign exchange market and other regional bourses, the stock market began its sharp downward trend in the month of July as the KLCI broke through the psychological level of 1,000 points to trade at an intra-day low of 777.96 on the 29 August 1997 before rebounding to close the day at 804.40, the lowest level touched since 19 August 1993. At the close of the first eight months of 1997, the KLCI had declined significantly by 35.0% from the end of 1996 position to 804.40 and the Emas Index had plunged 36.9% to 219.48. The Second Board Index which registered impressive gains during the early part of the year declined 35.1% from 576.31 at the end of 1996 to 373.74 at the end of August 1997, the lowest level recorded since 15 February 1996. Similarly, the movements of the KLSE indices on a sectoral basis registered a double-digit declines during the first eight months of 1997, reflecting the underlying weak market sentiments. The fall in share prices was most significant in the construction sector (-47.9%), followed by mining

Chart 9.3
Share Markets



1/ End of period closing indices

2/ Right scale



1/ Refers to the Main Board and Second Board of the Kuala Lumpur Stock Exchange

(-40.3%), trading/services (-38.0%), finance (-37.8%), properties (-37.5%) and the industrial products (-36.2%). In September, the KLCI declined to touch its lowest level since 20 April 1993 of 675.15 during the intra-day trading on 4 September 1997. However, sentiments picked up strongly subsequent to the announcement of a number of measures to improve the fundamentals of the economy. These measures included the decision to defer or reschedule a number of large major infrastructure projects, to undertake a 2.0% across the board cutback in the Government's expenditure, to review the purchases of large foreign goods by Government agencies, to provide only Proton cars to members of the administration and eligible public officials, to increase the usage of local content in privatised projects as well as to remove the designated status of the 100 CI-component counters. The KLCI rebounded strongly to close at 814.57 on 30 September 1997, up 20.7% compared with the lowest level of 675.15 on September 4.

Reflecting the movement of the main market indices, market capitalisation declined significantly by 31.2% or RM251.92 billion from RM806.76 billion at the end of 1996 to RM554.84 billion at the end of August 1997. Similarly, total trade as measured by the total turnover volume declined substantially by 22.4% to 51.6 billion units, compared with a significant increase of 89.1% during the same period of 1996. The value of turnover also declined significantly by 29.9% to RM324.6 billion at the end of August 1997 from RM463.3 billion at the end of 1996 (January-August 1996: RM294.3 billion). However, market liquidity as measured by the turnover value to market capitalisation increased from 57.4% at the end of 1996 to 58.5% at the end of August 1997.

During the first eight months of 1997, 61 new companies involving a total nominal capital of RM7.29 billion were listed on the KLSE (January-August 1996: 54 new companies with a total nominal capital of RM3.04 billion). Of this, 20 companies were listed on the Main Board, while the remaining 41 companies were listed on the Second Board. This brings the total number of companies that have been listed on the KLSE to 681 by the end of August 1997 (end-August 1996: 583).

Table 9.14
Kuala Lumpur Stock Exchange:
Key Indicators

	1996	1997 August
Price Indices ¹		
Composite	1,237.96	804.40
Emas	347.67	219.48
Second Board	576.31	373.74
Industrial	2,356.91	1,619.23
Finance	10,284.93	6,397.44
Property	2,538.80	1,586.64
Plantation	2,864.17	2,274.77
Mining	587.87	350.96
Price Earning Ratio ¹	28.56	16.40
Market capitalisation ¹ (RM billion)	806.76	554.84
Number of listed companies ¹	621	681
Turnover ²		
Volume (million units)	66,461	51,555
Value (RM million)	463,265	324,606

¹ As at end of period.
² For January-August only.
Source: Kuala Lumpur Stock Exchange.

Several regulatory and legislative measures were also instituted during the first eight months of 1997 to further strengthen, deepen and broaden the activities of the capital market. These include:

(i) Amendments to the Listing Requirements

- (a) with effect from 1 April 1997, the minimum paid up capital requirements for the Main Board was increased to RM50 million from RM40 million previously, while that of the Second Board to at least RM10 million but less than RM50 million (previously at least RM10 million but less than RM40 million);
- (b) the qualifying historical profit performance of companies to be listed on the Main Board was changed to

either a track record of three financial years, with an after-tax profit of not less than RM4 million per annum and an aggregate after-tax profit of not less than RM25 million over the said three financial years or a track record of five financial years, with an after-tax profit of not less than RM2 million per annum and an aggregate after-tax profit of not less than RM25 million over the said five financial years (previously a track record of five financial years, with an after-tax profit of not less than RM2 million per annum and an average after-tax profit of not less than RM5 million per annum over the said five financial years).

(ii) The Listing of Subsidiary or Associated Companies

The threshold level of after-tax profits and/or net tangible assets contribution for the listing of subsidiary or associated companies was raised from 35.0% to 50.0%.

(iii) Promoters of the Second Board Applicant Companies

All promoters of the Second Board applicant companies for direct listing are required to provide a profit guarantee, which is to be supported by a bank guarantee, instead of being given the option of either profit guarantee or moratorium on disposal of shares.

(iv) Settlement System

The KLSE's T+5 rolling settlement system, to replace the T+7 system, was implemented on 18 August 1997. This system reduces the time between the execution of a trade and settlement, which in turn reduces the risk and market exposure. The system is in line with other developed stock exchanges and brings it closer to the international standards, which will encourage greater foreign investors involvement in the market. Furthermore, it creates greater liquidity and confidence in the market, enhances operational procedures and takes advantage of new technologies.

(v) Security Broking Services

To enable local brokers to compete with foreign brokers, local security broking firms have been permitted to set up unit trusts, undertake fund management and underwriting activities and to issue call warrants.

(vi) Scriptless Trading of Securities

The system for electronic transfer of funds and securities (SPEEDS) was enlarged to include unlisted corporate bonds, and this will increase the liquidity in the bond market since the trading and settlement of corporate bonds can now be done electronically through SPEEDS.

(vii) Malaysian Exchange of Securities Dealing and Automated Quotation (MESDAQ)

To complement the Government's efforts to make Kuala Lumpur a regional capital centre, MESDAQ, a new exchange for high growth and technology companies which have yet to show a profit record is expected to be launched by the end of 1997. MESDAQ will emphasize nine priority technology areas for the listing of technology companies on the new exchange. The areas are advanced electronics and information technology; equipment/instrumentation, automation and flexible manufacturing systems; biotechnology, bioconversion and genetic engineering; electro-optics, non-linear optics and optoelectronics; advanced materials; energy source; aerospace; transportation; and services.

(viii) Benchmark Bond

The Government has introduced a programme to issue a series of bonds aimed at creating a benchmark yield curve for the ringgit bond market. Khazanah Nasional Berhad, a wholly owned subsidiary of Minister of Finance Incorporated, has been identified as the benchmark issuer. The main features of the Khazanah Benchmark Bond issuance programme are:

- zero-coupon based on the concept of *murabahah*;
- fully guaranteed by the Government of Malaysia;

- issued on a quarterly basis;
- issue size will not be less than RM500 million per issue;
- will not qualify for liquid asset status;
- maturities will start at the shorter end of the term structure and be progressively extended out to longer maturities;
- competitive bidding on the basis of price through the Principal Dealers; and
- traded on the Scripless Securities Trading System (SSTS).

The first benchmark issue of size RM1 billion and maturity three years was issued on 18 September 1997. With the introduction of the Khazanah Nasional Berhad Benchmark Bonds, the secondary markets for bonds will become more efficient and active, apart from assisting the development of bond futures and options to add breadth and depth to the financial derivatives market.

(ix) **Developing an Islamic Share Index**

An Islamic Share Index will be introduced on the KLSE with the aim of making Kuala Lumpur a regional Islamic financial centre. The SAC of the Securities Commission has approved an initial list of 371 companies listed on the KLSE as approved securities on 18 June 1997. As these companies are listed on the Main Board and the Second Board of the KLSE, an index will be developed by the KLSE for each of these Boards.

(x) **Financial Reporting Foundation and Malaysian Accounting Standards Board**

Following the announcement in the 1997 Budget that the Malaysian Accounting Standards Board (MASB) would be established under a new legislation, the Financial Reporting Foundation (FRF) and MASB has been established under the Financial Reporting Act 1997 as a new framework for financial reporting in Malaysia. Both the FRF and MASB have been in operation since July 1997. The FRF and MASB are responsible for the

establishment of financial accounting and reporting standards in Malaysia, and have been established as a "two-tier" arrangement to segregate the oversight and funding function from the technical function so as to ensure independence of standard setting.

(xi) **Listing of Foreign-based Companies on the KLSE**

Following the Finance Minister's announcement in August 1996 to allow foreign companies to list on the KLSE, the **Guidelines for the Public Offering of Securities of Foreign-based Companies with Listing and Quotation on the KLSE** were officially released on 1 April 1997. Under these guidelines, only foreign-based companies with substantial Malaysian interests will be allowed to be listed initially, whilst other categories of foreign companies will be considered at a later stage. Only primary listings denominated in ringgit will be considered. In addition the listings will be expected to meet the high standards of disclosure. The move to promote the listing of foreign-based companies on the KLSE is consistent with the objective of developing the KLSE as a regional financial center. It is also to encourage the development of the financial services industry and contribute to the Government's objective and commitment to promote the growth of the services sector of the economy.

At the end of 1996, the Malaysian Central Depository (MCD) Sdn. Bhd. had successfully mobilised all the companies listed on the Main Board and the Second Board into the **Central Depository System (CDS)** via the 'Accelerated Conversion Plan' by rescheduling and expediting deposition of shares into the CDS. During a 15-month period (October 1995 to December 1996), the MCD had included 341 companies on the Main Board into the CDS. Apart from the ordinary securities, the Transferable Subscription Rights, warrants and loan-stocks have also been included in the system since March 1997 and the process was successfully completed before 30 June 1997. As at end of August 1997, a total of 1,766,539 CDS accounts were opened, while the number of participants in the CDS totalled 106, comprising 61 Authorised Depository Agents and 45 Authorised

Depository Members. Thus, 688 companies involving 100,171 million shares have been mobilised into the CDS as at end of August 1997.

Since the **Kuala Lumpur Options and Financial Futures Exchange (KLOFFE)** commenced its operations on 15 December 1995, trading of the KLSE CI futures contract increased significantly. During the first eight months of 1997, KLOFFE achieved an average monthly volume of 20,362 contracts, representing an increase of 218.2% from the average monthly volume of 6,400 contracts in 1996. The daily average volume for the same period in 1997 is 999 contracts, a 220.2% increase from the figure at the end of 1996 (312 contracts). The trading volume for the KLSE CI futures contract achieved a record high daily average volume of 2,115 during the month of August 1997. As in previous year, foreign institutions still rank the highest in terms of trading volume on the KLSE CI futures contract with a market share of 41.0% during the first eight months of 1997, followed by domestic retail (32.0%), local members (18.0%), proprietary (5.0%), domestic institutions (3.0%) and foreign retail (1.0%).

The three-month KLIBOR futures on the **Malaysia Monetary Exchange (MME)** which was launched on 28 May 1996 recorded an encouraging turnover of 61,579 contracts with a notional value of RM61,579 million during the first eight months 1997 (end-1996: 40,933 contracts, RM40,933 million). As investors preferred to hedge against interest rates over the longer term, the most actively traded contracts were the March, June and September 1997 contracts, which accounted for 52.0% of the total turnover during the period under review. Market-makers (50.4% of the total volume transacted) remained the most important

players in the market, followed by domestic financial institutions which were not market-makers and corporations (23.3%) and foreigners (8.4%).

The **unit trust industry** registered a growth of 11.5% in units in circulation during the first seven months of 1997. However, due to the weaker market conditions, the total net asset value of the funds decreased by 5.4% from RM59.96 billion at the end of 1996 to RM56.74 billion at the end of July 1997. As at 31 July 1997, the net asset value of the funds accounted for 7.7% of the market capitalisation of the KLSE. Three new funds with a total approved fund size of 700 million units were approved in the seven months of 1997. The new funds launched (including one approved in 1996) during the period were Kuala Lumpur Ittikal Fund, MBF Equity Index Fund, Pacific Pearl Fund and SBB Retirement Balanced Fund.

Kuala Lumpur Commodity Exchange

Except for crude palm oil futures, trading in the Kuala Lumpur Commodity Exchange (KLCE) in 1997 remained inactive. In the first six months of 1997, CPO futures traded increased by 2.1% with a total turnover of 237,847 lots of 25 tonnes each, compared with 232,942 lots during the same period of 1996. The turnover is equivalent to 5.9 million tonnes of crude palm oil, which is higher than the level of Malaysia's crude palm oil production of 4.1 million tonnes for the first six months of 1997. The average daily turnover in the period increased to 1,982 lots or 49,550 tonnes in 1997, compared with 1,957 lots or 48,925 tonnes attained in 1996 with average settlement price of RM1,253 during the first quarter of 1997 and RM1,304 during the second quarter of the year.