

Monetary Policy

In the first eight months of 1998, monetary policy was conducted in a difficult economic environment caused by the deflationary contagion effect of the region's financial crisis on domestic financial markets and the real economy. Priority continued to be accorded to restoring macroeconomic stability and thereby stability in the domestic financial markets. In responding to changes in the economic environment, monetary policy remained flexible. At the start of the year, a tight monetary policy stance was adopted with the view to strengthen further economic fundamentals and the financial system as well as to contain inflationary pressures due to ringgit depreciation. However, when it became evident that the prolonged crisis and slowdown in external demand had affected the economy adversely resulting in a 4.8% contraction in real Gross Domestic Product (GDP) in the first half of the year, monetary policy was eased and new measures introduced to support the recovery process. At the same time, improving the efficiency and functioning of the money market and the intermediation process of the banking system was given emphasis to ensure the availability of financing at reasonable costs.

In the first quarter of 1998, the annualised growth of the key monetary aggregates M1, M2 and M3 moderated significantly to -11.3%, 15.7% and 13.7% respectively as at end of March 1998 (4.3%, 22.6% and 18.5% respectively at the end of 1997). The primary reason for the slowdown was the significant moderation in loan growth in the period due to weak business expectations, higher interest rates and more cautious lending by financial institutions. The sharper than anticipated moderation in credit growth among the banking institutions in an environment of slowing economic growth was a cause of concern as the effective allocation of resources to productive

activities remained important in efforts to stimulate growth. Liquidity in the banking system was tight partly as a result of inefficiencies in the money market which resulted in smaller financial institutions facing difficulties in securing interbank funds. The competition for funds subsequently led to a significant increase in interest rates, particularly for short-term money of a few institutions which became reflected in overall higher interest rates for the banking system.

Following the sharp depreciation of the ringgit and the subsequent volatility in the financial markets as well as the need to rationalise the term structure of interest rates, Bank Negara Malaysia (BNM) raised the 3-month intervention from 10% to 11% in February to prevent capital outflows and to moderate inflationary expectations. In addition, BNM lowered the Statutory Reserve Requirement (SRR) from 13.5% to 10% of eligible liabilities of the banking system effective February 16, to promote liquidity flow and enhance the efficiency of the intermediation process. To ensure the SRR reduction was not expansionary and inflationary, the funds released was offset by the non-rollover of funds previously lent by BNM to financial institutions. Reflective of the tight liquidity, the one and three-month interbank rates ranged from 10% - 11.30% and 9.80% - 11.0% to 10.85% respectively in March. Reflecting the developments in the money market, the average base lending rates (BLR) of commercial banks and finance companies was higher at 11.96% and 14.23% respectively at the end of March 1998 (10.33% and 12.22% at end-1997).

The moderation in monetary growth continued into the second quarter of 1998, with the annual growth in M3 slowing down to 7.3% as at end-June on account of continued slowdown in lending activities as financial institutions undertook adjustments to strengthen their balance sheets

given rising non-performing loans (NPLs). Continued weak aggregate demand and negative expectations about near term economic prospects in an environment of high interest rates also dampened demand for bank credit. Liquidity remained tight and interest rates firm with the 3-month interbank rates stable at around 11%. As part of efforts to enhance transparency and promote efficient liquidity management, a new procedure for market operations was introduced by BNM on April 30, whereby forecasts of cash flows of the financial system were to be provided at regular intervals to assist market participants to assess the liquidity situation in the system. Meanwhile, the average BLR of commercial banks and finance companies increased to 12.27% and 14.70% as at end-June 1998 respectively from 11.96% and 14.23% respectively at end-March.

Given the sharp deterioration in growth of the real sectors of the economy and the banking system due to the sharper-than-anticipated decline in economic activities and aggregate demand, BNM continued to implement measures to address these concerns focussed on reducing the cost of funds to the banking sector in order to enable them to lower their lending rates. Effective May 1, 1998 the band for permissible daily variation in the average balances that was required to meet the SRR was widened to $\pm 2\%$ of the prescribed SRR rate from the previous band of $\pm 0.5\%$ to allow banking institutions greater flexibility in managing their daily liquidity operations and lower the cost of operations. On July 1, the SRR was again reduced by a further 2 percentage points from 10% to 8% to improve liquidity in the system. BNM also relaxed the hire purchase guidelines for the financing of passenger cars effective July 28 to revitalise the motorcar industry. The margin financing for cars was raised from 70% to 85% and the restriction on maximum repayment period was removed. This was to address the sharp contraction in sales of passenger cars faced by the motor vehicle industry, as a result of stricter hire purchase lending guidelines imposed earlier.

In August, a deceleration in the rate of inflation, absence of demand pressures and a relatively stable ringgit allowed BNM to adopt a cautious easing of monetary policy as part of overall efforts to support the economic recovery process. The 3-month intervention rate was reduced from 11% to 10.5% and further to 10% which resulted in lower lending rates. The average BLR of

commercial banks declined from 12.27% at end-June to 9.05% as at September 9, 1998. As part of the overall easing of the monetary stance, BNM also exercised flexibility in ensuring compliance with credit plans by allowing individual institutions with lending capacity to exceed their respective credit ceilings.

In late August, against a backdrop of a 6.8% contraction of real GDP growth in the second quarter of 1998, new measures were introduced to ease liquidity. They included a further reduction in the SRR to 6% from 8% effective September 1, 1998 and a reduction in the intervention rate from 10% to 9.5% effective August 28. In addition, as a move to enable faster transmission of changes in monetary policy on interest rate levels, the BLR framework was revised. The calculation of the BLR was subsequently based on the BNM 3-month intervention rate instead of Kuala Lumpur Interbank Offered Rate (KLIBOR), while the administrative margin of financial institutions that is allowed in BLR computation was reduced to 2.25% from 2.50%. In addition, the maximum margin over the quoted BLR was reduced from 4.0 percentage points to 2.5 percentage points effective October 1, to lower the cost of funds to borrowers.

In September, the Government adopted additional new measures to reduce interest rates and improve liquidity to expedite the economic recovery process. With effect from September 3, the BNM intervention rate was further reduced to 8.0% from 9.5%. This reduction aimed at effectively reducing the maximum BLR of the commercial banks and finance companies to 9.06% and 10.76% respectively. As a further measure to ease liquidity, commercial banks were no longer required to maintain vostro balances of foreign banking institutions with BNM. Greater flexibility was also accorded to banking institutions in their asset-liability management. In line with measures announced to establish a new liquidity framework in July, the liquid asset requirement for commercial banks was revised downwards to reduce the cost of holding liquid assets held by banking institutions. Effective September 3, the liquid asset requirement of commercial banks was reduced from 17% to 15%, while the SRR was further reduced to 4%. However, the liquid asset requirements of finance companies and merchant banks were retained at 10% (12.5% if they issued negotiable instruments of deposit (NIDs)). In addition, lending to the broad property sector was liberalised as financing

for construction and purchase of residential properties costing RM250,000 and below was exempted from the 20% limit. To ensure that there were sufficient loanable funds to finance the economic recovery process, banking institutions were required to achieve a minimum annual loan growth rate of 8% by the end of 1998. This credit target was necessary given that annualised loan growth achieved as at end-July 1998 had decelerated from a peak of 30.4% at end June 1997 to 7.5% at end-August 1998 and there was need to ensure that banking institutions fulfilled their intermediation role in the recovery of the economy. Effective October 5, the BNM intervention rate was reduced further to 7.5% from 8%.

The issue of rising NPLs of the banking system became important as the slowdown in economic growth increasingly affected the ability of debtors to service their debts. NPLs of the banking system had risen steadily from 4.7% (3-month net basis) at end 1997 to 6.6% as at end-February 1998. However, the risk-weighted capital ratio (RWCR) continued to remain high at 10.8% at the end of February 1998, above the minimum of 8% set by the Bank of International Settlements. To safeguard the soundness of the banking institutions and enhance its ability to adjust to the more challenging business environment, the Government had initially introduced measures in March 1998 to enhance the existing prudential regulatory and supervisory framework. However, as the impact of the financial crisis became increasingly felt, the Government introduced new measures to ensure that the economic slowdown and further increases in NPLs of the banking system would not erode the lending base of banking institutions.

In May 1998, the Government of Malaysia announced the creation of a national asset management company. *Pengurusan Danaharta Nasional Berhad* (Danaharta), Malaysia's national asset management company was established in June 1998 and commenced full operations at the beginning of September 1998. The *Pengurusan Danaharta Nasional Berhad Act 1998* that confers on Danaharta special statutory powers to facilitate its activities came into force on September 1 1998. Its main activities comprise acquiring, managing and disposing of NPLs and its underlying collateral. The primary objectives of Danaharta are to remove the NPL distractions facing the financial institutions in Malaysia. By selling NPLs to Danaharta in

return for Government guaranteed bonds/cash, the financial institutions can refocus on their main business of lending to viable businesses and customers. This would aid the national economic recovery effort. Danaharta will also pursue the objective of maximising the recovery value of acquired assets (NPLs).

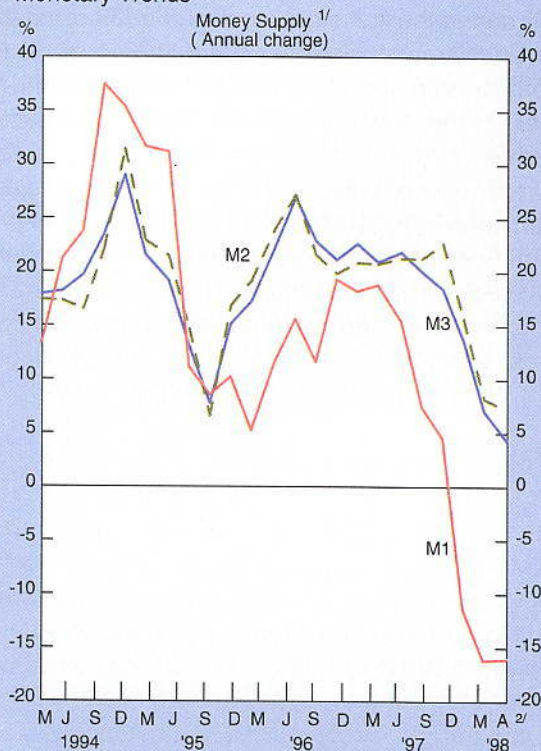
In addition, *Danamodal Nasional Berhad* (Danamodal) which began operation in August, was also established to spearhead the recapitalisation and consolidation of domestic banking institutions in order to increase their resilience and enhance their ability to generate new lending activities. This would enable them to continue to play a leading role in stimulating economic development. Since its establishment, Danamodal had undertaken one such recapitalisation exercise and is expected to complete this exercise between end-September and October 1998. At the end of August 1998, the net NPLs of the banking system was 11.4% and the RWCR, 11.1%.

Money Supply

Monetary expansion slowed down significantly during the first eight months of 1998 partly due to the impact of the contraction of the real economy. The slower growth in monetary aggregates was also attributed to the monetary tightening in the early part of the year to contain inflationary pressures, the tight liquidity position of a number of banking institutions as well as the reluctance of some banks to lend due to excessive concerns about rising NPLs. Reflecting slower monetary expansion, growth of the broader monetary aggregate, M3, decelerated to 4.3% by end of August from 18.5% as at end of 1997. The slower growth was mainly due to decreased lending to the private sector given weaker business expectations, relatively high interest rates and more cautious lending policies of the banking institutions in response to a marked increase in NPLs during the same period.

Narrow money, M1, which is defined to include currency and demand deposits of the private sector, declined by annual rate of 16.0% as at the end of August 1998, compared with a growth of 4.3% as end of 1997. The decline in M1 mirrored the reduced demand for both currency in circulation and demand deposits, as a result of the reduction

Chart 8.1
Monetary Trends



1/ End of March, June, September and December including Repurchase Agreements (Repos)

2/ As at end of August 1998

in economic activities. Demand deposits declined by 27.7% during the first eight months of 1998, as compared to the negative growth of 4.4% for the corresponding period of 1997 following higher interest rates and weak sentiments on the stock market. Meanwhile, currency in circulation recorded a negative growth of 6.0%, as compared with a positive growth of 6.1% for the corresponding period in 1997.

M2, comprising M1 and narrow quasi money (constituting private sector holdings of fixed and savings deposits with commercial banks and BNM, net NIDs and repurchase agreements (repos) registered a slower growth of 7.2% as at the end of August 1998, (growth of 22.6% as at end 1997). The slowdown was largely due to the relatively slower growth in narrow quasi-money of 2.7% during the first eight months of 1998 (January-August 1997: 16.1%), due mainly to declines in savings deposits, NIDs and repurchase agreements (repos). However, fixed deposits continued to expand by 7.5% during the period due to attractive interest rates, thereby, contributing to 72.4% of the narrow quasi-money as at end of August 1998.

The sharp deceleration in growth of the broad monetary aggregate, M3, which comprises M2 and private sector deposits (including repos) placed with other banking institutions, namely, finance companies, merchant banks, discount houses and Bank Islam, but excluding the placement of funds among these institutions, from an annual rate of 18.5% as at end 1997 to 4.3% as at end-August 1998 was due to slower growth of private sector deposits placed with the banking institutions. These deposits, excluding interplacements, declined by 0.9% from the end of 1997 to RM387,179 million at end-August 1998 (12.5% in the corresponding period of 1997).

During the first eight months of 1998, lending to the private sector slowed down significantly to grow marginally by 0.9% or RM4,015.2 million, as compared to RM66,232.5 million or 14.8% in the same period for 1997. The tight liquidity position of some banking institutions as well as the more cautious and prudent approach of the banking system, given the increase in NPLs from 4.7% (3-month net basis) at end-1997 to 11.4% at end of August 1998 were factors that contributed to the slowdown of lending by the banking system to the private sector. Loans to priority sectors of the economy, that is the manufacturing, agriculture and financial services stood at RM110,118.5 million as at end of August 1998, indicating an increase of 2.9% only from end of 1997, compared to a 8.0% growth during the corresponding period of 1997. Similarly, total loans extended by the banking system to the broad property sector as well as for consumption grew marginally, at 2.7%, during the first eight months of 1998 to RM198,578 million at the end of August 1998 compared with 20.9% in the same period for 1997.

The financial operations of Government were contractionary on money supply, reflecting largely the decline in the holdings of Government papers by BNM as well as accumulation of Government deposits. In the first eight months of 1998, net domestic claims on Public Sector declined by 70.5%, as compared to a decline of 16.4% in the corresponding of 1997.

The external sector exerted an expansionary impact of RM15,459.1 million on money supply during the first eight months of 1998, compared with a contractionary impact of RM9,636.7 million in the corresponding period of 1997. Net

international reserves of BNM during this period declined by RM1,267.1 million to RM57,855.7 million at the end of August 1998. Simultaneously, the banking system reversed their external position from having net external liabilities of RM15,638.6 million at end-1997 to record a net external asset position of RM1,087.6 million at end-August 1998.

"Other influences", which comprise residual factors (including undistributed profits, provision for bad and doubtful debts, paid-up capital and reserves of the banking system and maturing Bank Negara Bills held by non-bank private sector) were contractionary on money supply by RM16,729.6 million during the first eight months of 1998.

Bank Liquidity and Money Market

Liquidity in the banking system declined marginally in the first half of 1998, due to the adverse developments in the foreign exchange and capital markets as well as some inefficiencies in the intermediation process that emerged in early 1998. Monetary policy was, therefore, directed at the management of liquidity to ensure that in an environment of negative economic growth, there was adequate liquidity in the banking system to facilitate economic recovery. In this regard, BNM introduced a number of measures during the first nine months of 1998 to enhance efficiency in the intermediation process and the flow of liquidity in the system. These measures included lowering the SRR of commercial banks, finance companies and merchant banks progressively from 13.5% in February to 4% in September. To enhance transparency and promote efficient liquidity management by banking institutions, BNM also introduced a new procedure for its market operations so that market participants can effectively assess the liquidity situation. Beginning April 30, 1998, BNM will announce information on its daily operations in the money market as part of its efforts to enhance transparency and to promote a better understanding of the BNM's money market operations and its impact on domestic liquidity. In addition, BNM's intervention rate was lowered while steps were taken to ensure that the calculation of BLR be based on the intervention rate instead of KLIBOR. All these measures were aimed at enhancing the liquidity position of the banking system so that more loanable funds can be made available to borrowers at lower interest for the purpose of financing economic activities.

Total deposits (including repos) mobilised by the banking system declined by RM10,665.8 million or 2.5% during the first eight months of 1998 compared with an increase of RM48,404.8 million or 13.5% during the corresponding period of 1997 reflecting the impact of the financial crisis on the financial sector. The bulk of the decline in deposits was due to a decline in deposits placed with the commercial banks, which accounted for 48.1% or RM5,131.0 million of the total decline in deposits, while finance companies and merchant banks accounted for 37.0% and 14.9% respectively. On an annual basis, growth in total deposits increased by 4.1% at the end of August 1998, compared with 21.2% at the end of 1997.

Total loans and advances of the banking system increased only by RM990.8 million or 0.2% during the first eight months of 1998, compared with an increase rise of RM59,545.2 million or 17.9% during the corresponding period of 1997, reflecting partly the impact of the contraction in domestic spending. As at end-August 1998, the bulk of the outstanding credit was extended to finance the broad property sector (35.1%), manufacturing (15.5%) and consumption credit (12.0%). On an annual basis, loan growth was significantly lower at 7.5% at the end of August 1998 (August 1997: 28.9%). The decline in domestic demand and the contraction of real economy had adversely affected the capability of debtors to service loans. As a result, the net NPL of the banking system had increased although the RWCR of the banking system improved in the first eight months of 1998. The increase in NPL was due largely to the loans granted to the broad property sector and for share financing which had NPL ratios of 15.6% and 29.3% respectively as at end-August 1998. With deposits declining relative to loans, the banking system experienced a resource-gap of RM11,374.3 million during the first eight months of 1998, compared to a resource gap of RM8,302.0 million during the corresponding period of 1997. Consequently, the loan-deposit ratio increased from 92.7% at the end of 1997 to 95.2% at the end of August 1998.

Transactions in the **interbank money market** was active during the first eight months of 1998, underpinned by the unequal distribution of liquid funds among the financial institutions. The monthly volume of funds transacted in the market averaged about RM151,175.7 million during the first eight months of 1998, compared with an average of about

RM114,365.6 million during the corresponding period in 1997. The funds transacted were mainly short-term funds, with overnight money accounting for RM82,131.9 million of the total volume of transactions in August 1998.

Overall, interbank rates increased with slight fluctuations in the first eight months of 1998. The average interbank rate for the 7-day to 6-month maturities in August ranged from 9.19% - 10.09% (8.30% - 10.57% in December 1997). This was a continuation of the trends established in the second half of 1997. The average 3-month interbank interest rates surged from 7.67% in May 1997 to 8.60% at end 1997 to 11.00% in April 1998 before peaking at 11.07% in June. It subsequently dipped to 10.14% in August 1998. Similarly, the overnight rates increased from 8.30% at end 1997 to a peak of 10.59% in April, before dipping to 9.19% in August 1998. In line with movements in the interbank rates, the mode fixed deposit rates of the commercial banks and finance companies across the maturity spectrum ranged between 9.00% - 9.50% (end 1997: 7.50%-9.50%) and 10.00% - 10.50% (end 1997: 9.50%-11.50%) respectively at the end of August 1998. In the case of savings deposit, the rate for the commercial banks and finance companies increased slightly from 3.50% and 5.00/6.00% at end-1997 to 3.28/3.50/3.70% and 6.00% respectively at the end of August 1998. Reflecting higher costs of funds, the BLR of the commercial banks and finance companies increased to 11.70% and 14.17% respectively by end of August 1998, as compared to 10.33% and 12.22% at the end of 1997.

Commercial Banks

Total resources of commercial banks, which included 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, contracted by 6.4% or RM31.0 billion during the first seven months of 1998, compared with an increase of 17.1% or RM61.6 billion during the corresponding period of 1997. The decrease in total resources was mainly due to the decline in deposits and interbank placements. **New deposits**, including NIDs, New Investment Fund (NIF), special deposits and repos mobilised by the commercial banks contracted by 2.6% or RM7,672.1 million during the first seven months

Table 8.1
Commercial Banks: Deposits

	Change During Period				As at end July 1998
	1997 January-July		1998 January-July		
	RM million	%	RM million	%	
					RM million
Demand deposits	45.9	0.1	-11,553.3	-26.4	32,293.1
Savings deposits	-1,734.6	-6.2	-2,357.5	-9.1	23,496.9
Fixed deposits	12,398.8	9.7	9,762.1	5.9	174,892.7
NIDs ¹	7,903.3	29.2	-2,751.9	-6.9	36,908.7
Repos	2,958.3	24.6	-2,549.1	-16.9	12,511.8
Others ²	2,326.6	38.6	1,777.5	-16.2	12,782.8
TOTAL	23,898.3	9.8	-7,672.1	-2.6	292,886.0

¹ Negotiable instruments of deposit

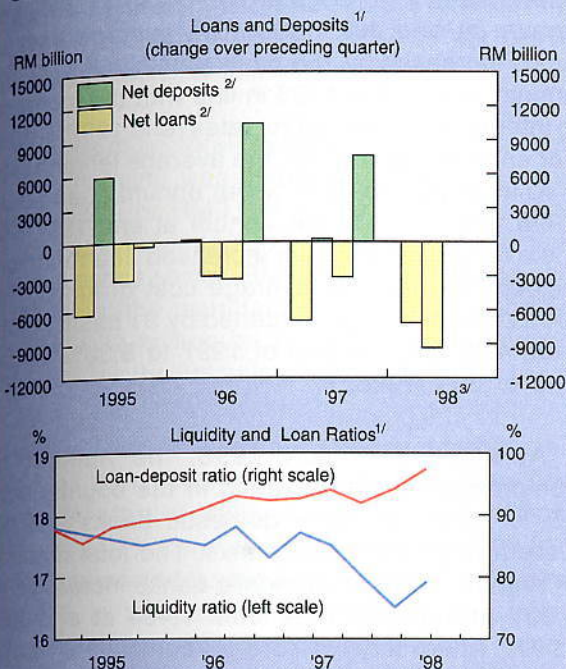
² Include New Investment Fund and special deposits.

Source: Bank Negara Malaysia.

of 1998 (January-July 1997: increase of 9.8%) as a result of the contraction of the real economy as well as decline in disposable incomes (January-July 1997: increase of 9.8%), as indicated in Table 8.1. Deposits placed with the commercial banks accounted for 69.3% of the total deposits placed with the banking system.

The bulk of commercial banks' resources (63.3%) was utilised for the financing of loans during the first seven months of 1998. Reflecting the weaker demand for credit by the private sector as well as tight liquidity faced by a number of banks, **total new loans and advances** extended by commercial banks grew at a slower rate of 3.3% to RM285,145.5 million (excluding loans sold to Cagamas Bhd) as at end of July 1998, compared with a growth of 15.1% to RM250,757.4 million as at end of July 1997. A major proportion of the new loans (65.7% or RM 6,328.7 million) during the first seven months of 1998 was channelled to the broad property sector, followed by the manufacturing sector (26.9% or RM2,594.3 million) and the general commerce sector, (13.8% or RM1,334.06 million). As at end July-1998, the proportion of loans to the broad property sector remained high at 35.9% of total lending due to

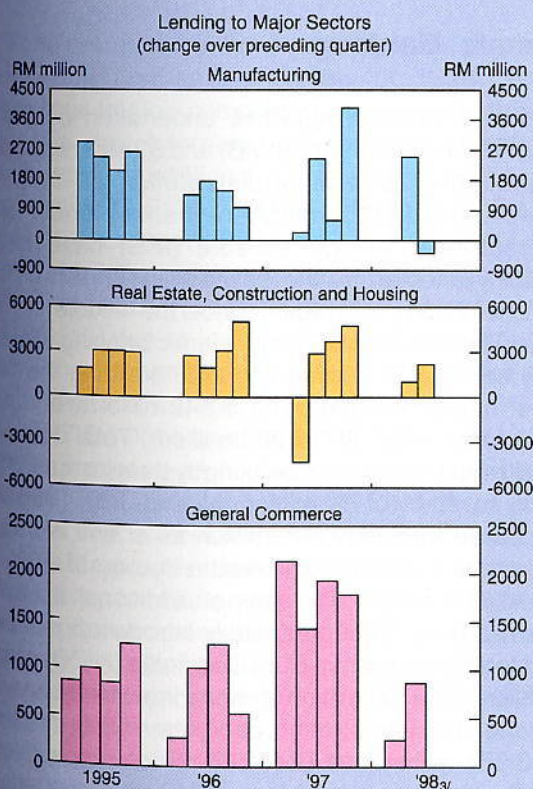
Chart 8.2
Commercial Banks



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 June 1998.



earlier commitments (end-July, 1997: 34.2%). Loans for housing constituted 13.9% of the total loans extended to the broad property sector as at end of July 1998 (end-July 1997: 12.7%). However, due to the decline in disposal incomes and measures introduced in early part of 1998 to curb consumption spending, consumption credit declined significantly by 11.3% or RM1,090.52 million during the review period (January-July 1997: RM4,197 million).

Loans provided by the commercial banks included those to the **priority sectors**, namely the Bumiputera Business Community, housing and small-scale enterprises under the New Principal Guarantee Scheme (NPGS) of the Credit Guarantee Corporation (CGC). As required by the Lending Guidelines, commercial banks had 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 1998, lending to Bumiputera borrowers increased marginally by 0.5% or RM336.6 million, compared with a decline of 8.0% in the corresponding period of 1997. As at end of July 1998, total loans extended to the Bumiputera community amounted to RM75,608.8 million or 32.8% of the loan base, which is above the target requirement of 30% set out by the BNM 1998 Lending Guidelines, beginning April 1998. Of these loans, RM12,673.8 million or 18.5% was extended for construction, while RM8,461.1 million or 12.3% was extended to the manufacturing sector and RM6,255.2 million or 9.1% were extended to the residential property sector. As at end July 1998, the commercial banks financed the purchase of 19,703 units of houses costing RM100,000 and below or 39.4% of the target (at least one-half of 100,000 units of such houses by end of March 1999). In terms of credit with guarantee cover under the NPGS of the CGC, the commercial banks as a whole extended loans amounting to RM4,495.3 million. In terms of new loans of RM500,000 and below approved and disbursed to the small and medium-sized enterprises under the BNM 1998 Lending Guidelines, the commercial banks as a whole extended loans amounting to RM174.5 million.

The overall liquidity position of the commercial banks was tight during the first seven months of 1998. The liquidity ratio of commercial banks stood at 16.7% at end July 1998 compared with 17.0% at end 1997.

Table 8.2**Commercial Banks: Direction of Lending**

	Change During Period				As at end July 1998
	1997 January-July		1998 January-July		
	RM million	%	RM million	%	RM million
Agriculture	1,072.0	24.2	387.73	6.6	6,305.3
Mining and quarrying	31.0	5.1	349.79	44.5	1,136.6
Manufacturing	2,000.0	4.2	2,594.30	4.7	57,546.3
Finance, insurance and business services	2,234.0	9.1	489.01	1.7	28,747.3
Construction	5,192.0	26.4	1,656.59	5.7	30,813.4
General commerce	2,331.0	9.7	1,334.06	4.5	30,812.1
Transport and storage	1,750.0	39.7	1,267.64	14.7	9,884.4
Real estate	-1,279.0	-9.7	-424.98	-3.4	11,955.5
Housing ¹	2,143.5	11.2	3,223.27	11.7	27,650.1
Miscellaneous	17,463.0	28.8	-1,848.52	-2.3	80,294.4
TOTAL ¹	32,936.8	15.1	9,028.9	3.3	285,145.5

¹ Excluding loans sold to Cagamas Berhad.

Source: Bank Negara Malaysia.

The 2.6% decline in deposits placed with the commercial banks, against a loan growth of 3.3%, resulted in the commercial banks registering a loan deposit-gap of RM16,701 million during the first seven months of 1998 (January-July 1997: RM9,038.5 million). This resulted in the loan-deposit ratio of commercial banks rising to 97.4% at the end of July 1998, against 91.9% at end-1997.

The mode interest rate of commercial banks' fixed deposits registered an increase of 100 to 300 basis points during the first seven months of 1998, reflecting the liquidity conditions. The mode fixed deposits rates for 1-month, 3-month, 6-month and 12-month maturity increased from 7.50%, 9.40%, 9.50% and 9.50% per annum respectively at the end of 1997 to 10.5%, 10.75%, 10.30%-11.00% and 10.50% per annum as at end July 1998. The mode savings deposit rate increased to 4.36% per annum in July 1998 compared with a range of 3.25% to 3.35% per annum at end 1997. The daily weighted average

interbank money market rates for most maturities rose from a range of 8.81% to 9.33% per annum at end 1997 to a range of 10.75% to 11.30% per annum at end July 1998. The average cost of funds increased by 165 basis points to 8.17% per annum at end July 1998 in line with the increase in interbank money market rates (end 1997: 6.52% per annum). Meanwhile, the average lending rate also increased to 13.47% per annum at end-July 1998 from 11.51% per annum at end-1997. As the average lending rate increased at a relatively higher rate than the average cost of funds, the gross interest margin widened by 31 basis points from 4.99% at the end of 1997 to 5.30% at the end of July 1998.

At the end of July 1998, 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 to 1,557 at end-July 1998 from 1,484 at end-July 1997, while that of foreign-controlled banks remained unchanged at 144. As at end-July 1998, the number of commercial banks accorded Tier-1 status remained unchanged at 10, as was the case at end-1997.

Islamic Banking

Islamic Banking activities undertaken by Bank Islam Malaysia Berhad (BIMB) and 52 other financial institutions (25 commercial banks, 22 finance companies and 5 merchant banks) under the interest-free banking scheme (IBS) have been similarly affected by the deflationary impact of the crisis besetting the region since the middle of last year. The total assets of the Islamic banking system (IBS and BIMB) declined by 24.3% during the first seven months of 1998 to RM13,542 million at end July 1998 (July 1997: RM12,983 million). Total deposits mobilised by the Islamic banking system increased by 2.8% to RM10,172 million at end-July 1998 as compared with RM9,895 million as at end of 1997, while total financing registered a decline of 0.8% to RM10,660 million. The bulk of additional deposits was mobilised through a newly introduced product, the Negotiable Islamic Debt Certificate (NIDC) which mobilised RM703 million, general investment as well as specific investment deposits which totalled RM3,574 million and RM1,588 million respectively. NIDC was made available by BIMB to all customers

since March 1998. Savings deposits and demand deposits during the first seven months of 1998, however, declined by 2.2% and 23.9% respectively, reflecting the impact of the decline in per capita income and reduced economic activities.

In terms of sectoral breakdown, a major portion of the financing was channelled to the housing sector (29% or RM3,094 million of total), while 17.2% was extended to the other construction and real estate sector (RM1,835 million). Financing extended to the manufacturing sector accounted for RM1,092 million or 10.2% of total financing provided by the Islamic banking system.

In the Islamic Interbank Money Market, the value of transactions recorded during the first seven months of 1998 was RM68,745 million. This was 24.7% lower when compared to RM97,333 million transacted during the corresponding period of 1997. In the case of Islamic BAs, the value of transactions recorded during the first seven months of 1998 was RM1,339 million while the value of Green BAs was RM7,747 million.

Finance Companies

Total resources of finance companies declined during the first seven months of 1998. **Total resources** (mainly comprising capital and reserves, deposits and borrowings from other financial institutions) mobilised by finance companies declined by 11.9% to RM134,305.2 million at end-July 1998, compared with an increase of 17.9% to RM141,233.4 million during the corresponding period of 1997. The decline in total resources was mainly due to lower deposits and borrowing from other financial institutions. **Total deposits** of the finance companies declined by 1.8% to RM4,567.3 million as at end-July 1998, compared with an increase of 17.1% in the corresponding period of 1997, reflecting primarily lower disposable incomes and a slowdown in economic activities. The **lending operations** of finance companies also contracted during the first seven months of 1998, in consonance with the decline in resources. **Total loans** extended to the various sectors of the economy declined by 10% to RM92,320.8 million at the end of July 1998 compared with a positive growth of 18.2% during corresponding period of 1997.

New deposits mobilised by finance companies declined by RM1,944.4 million during the first seven months of 1998, compared with an increase of RM15,500.1 million during the corresponding period of 1997. The major depositors were 'individuals' (48.4%), financial institutions (13.7%), business enterprises (11.2%) and the Government and statutory authorities (8.3%). In terms of kind of new deposits mobilised, only fixed deposits and IBS deposits registered increases during the period. Savings deposits, NIDs issued, repos and others all registered declines during the period. Fixed deposits increased by 8.0% from the end of 1997 to RM80,802.5 million at end-July 1998, due largely to the relatively higher interest rates offered for such deposits. Savings deposits declined by 17.0% or RM522.8 million during the first seven months of 1998, compared with a decrease of 6.8% during the corresponding period of 1997. NIDs issued by the finance companies decreased significantly by 22.4% during the first seven months of 1998, compared with an increase of 3.1% during the same period of 1997. As at end July 1998, total outstanding deposits of finance companies amounted to RM104,567.3 million, representing 16.9% of total resources of the banking system. As a percentage of total outstanding deposits, 78.1% was in the form of fixed deposits, while NIDs and savings deposits represented 13.8% and 2.9% respectively of the total outstanding deposits at the end of July 1998.

Table 8.3
Finance Companies: Deposits

	Change During Period				As at end July 1998
	1997 January-July		1998 January-July		
	RM million	%	RM million	%	
Savings deposits	-375.0	-6.8	-522.8	-17.0	3,070.3
Fixed deposits	13,308.5	19.8	5,967.8	8.0	80,802.5
IBS deposits ¹	233.4	25.6	306.3	24.8	1,539.2
NIDs ²	470.2	3.1	-4,196.7	-22.4	14,555.2
Repos	910.2	30.3	-3,472.5	-44.1	4,404.9
Others	14.7	6.3	-26.6	-12.0	195.2
TOTAL	15,500.1	17.1	-1,944.4	-1.8	104,567.3

¹ Interest-Free Banking Scheme

² Negotiable instruments of deposit.

Source: Bank Negara Malaysia.

In line with a more cautious and prudential approach to lending given rising NPLs, **lending activities** of finance companies contracted during the first seven months of 1998. Consequently, total new loans and advances decreased by 10.0% or RM10,225 million to RM92,320.8 million during the first seven months of 1998, compared with an increase of 18.4% during the same period of 1997. Loans extended for housing increased by 9.2% (RM599.5 million) while loans to general commerce decreased by 2.6% (RM102.8 million) and real estate decreased by 2.2% (RM80.6 million). As the decline in loans extended was larger than the contraction in deposits in the first seven months of 1998, the finance companies recorded a larger resource surplus of RM12,994.5 million at the end of July 1998 (1997: RM4,729.8 million). Consequently, the loan-deposit ratio declined to 87.7% at the end of July from 95.6% at end-1997.

The mode fixed deposit rates of finance companies for all maturities increased during the seven months of 1998, reflecting the liquidity situation. The mode rates for one-month, three-month and six-month deposits increased by 30 basis points to 11.30% per annum for the period January to July 1998 (end-1997: 10.50%, 10.80% and 10.50% respectively). Meanwhile, the twelve-month rate increased by 80 basis points to 11.30% (end-1997 : 9.80%). The mode savings deposit rate also increased to a range of 6.00% to 7.00% per annum at the end of July 1998 from a range of 4.00% to 5.00% per annum at end-1997.

In line with the increase in fixed deposit rates, the **average cost of deposits** of finance companies increased from 8.28% in December 1997 to 10.48% per annum at end-July 1998. Similarly, the average lending rate registered an increase of 91 basis points to 13.07% per annum at end-July 1998 from 12.16% per annum at end of 1997. With the average cost of deposits increasing at a slower rate than the average lending rate, the gross interest margin was 2.59% at end-July 1998. In tandem with the rising average cost of deposits, the mode BLR of finance companies rose to 14.49% per annum at the end of July 1998 from 12.22% per annum at end-1997.

In terms of financing to the **priority sectors** as prescribed by the BNM 1998 Lending Guidelines, beginning April 1998, lending to the Bumiputera community was RM33,766.8 million (40.3%) of

Table 8.4

Finance Companies: Direction of Lending

	Change During Period				As at end July 1998
	1997 January-July		1998 January-July		
	RM million	%	RM million	%	RM million
Agriculture	122.0	11.9	-170.8	-13.2	1,123.7
Mining and quarrying	126.0	44.2	-56.9	-12.3	404.6
Manufacturing	564.0	14.7	-513.8	-9.3	5,023.1
Construction	2,042.0	38.8	-470.8	-5.6	7,912.5
Real estate of which:	555.0	16.6	-80.6	-2.2	3,639.1
Consumption credit	-47.0	-1.4	-497.9	-14.6	2,904.0
Purchase of stocks/ shares	2,385.0	30.8	-1,406.0	-14.1	8,578.3
Housing*	-289.1	-3.9	599.5	9.2	7,121.5
General commerce	757.0	30.4	-102.8	-2.6	3,918.1
Miscellaneous	8,235.2	17.3	-7,012.3	-11.9	51,695.8
TOTAL	15,153.8	18.4	-10,225.0	-10.0	92,320.8

* Excluding loans sold to Cagamas Berhad.

Source: Bank Negara Malaysia.

the total outstanding loans at end of July 1998. As for lending to individuals for the purchase of houses priced at RM100,000 and less, the finance companies, as a group, are required to finance at least one-half of 40,000 units by the end of March 1999. By July 1998, the finance companies, as a group, had extended financing for the purchase of a total of 3,657 units of such houses or 18.3% of the target.

In view of the fragmented nature of the finance company industry, plans to merge the finance companies were first mooted in the late 1980s. The onset of the regional crisis and the need to strengthen the industry provided an impetus to realise the merger plan. BNM had identified four Tier-1 finance companies and one or two others as anchor finance companies to merge with the small and medium-sized finance companies. March 31 1998 was set as the deadline for the finance companies to identify their merger partners and agree in principle to the terms and conditions of

the merger. As at September 16, 1998, only one merger had been completed, that of RHB Bank Berhad absorbing its subsidiary, RHB Finance Berhad. The other proposed mergers under the absorption method are, however, in the final stages. In the case of small finance companies merging with anchor companies, the majority of the companies involved have either completed their due diligence or are in the final stages. Additionally, two Tier-1 finance companies, namely Arab-Malaysian Finance Berhad and Maybank Finance Berhad have signed the Sales and Purchase agreements with their respective merger partners that is Abrar Finance Berhad and Amanah Finance Berhad. However, no concrete plans for approval have been submitted for finance companies under the strategic alliance method.

With RHB Bank Berhad absorbing its subsidiary, RHB Finance Berhad, there are currently 38 finance companies operating in the country, of which ten are wholly-owned subsidiaries of domestic commercial banks and four are subsidiaries of locally-incorporated foreign commercial banks. As at end-July 1998, there were 1,103 branches of Malaysian-owned finance companies and 13 branches of foreign-owned finance companies. There were four Tier-1 finance companies at end-July 1998.

Merchant Banks

During the first seven months of 1998, the financial intermediation activities of merchant banks slowed down significantly. Total resources mobilised by merchant banks from **fund-based activities** declined by RM6,346.9 million to RM37,953.2 million at end July 1998, compared with an increase of RM9,531.9 million during the corresponding period of 1997 due primarily to a decline in interbank borrowing and deposits. The new resources generated were from placements by corporations and NIDs issued by the merchant banks. **New deposits** placed by financial institutions had declined significantly by 46.5% or RM2,623 million to RM3,015.1 million as at end of July 1998, compared with an increase of 11.6% or RM522.7 million in the same period of 1997. The bulk of the total deposits continued to be concentrated in short-term fixed deposits of maturity period of up to six months. **Total deposits** (including repos) mobilised by the merchant banks declined by 5.3% or RM1,399.7 million at the end

of 1997 to RM24,990.0 million as at the end of July 1998. The share of deposits mobilised by merchant banks to the total outstanding deposits of the banking system also decreased marginally from 6.09% at the end of 1997 to 5.92% at end of July 1998.

In terms of the **lending operations**, total loans extended by merchant banks declined 2.2% or RM516.8 million during the first seven months of 1998, compared with an increase of 11.5% during the corresponding period of 1997. This was mainly due to decreased lending to the private sector, that is by RM484.5 million, and a decline in lending to the public sector by RM3.1 million. The decline in lending to the private sector was due to lower lending for the purchase of securities, real estate and construction compared with the corresponding period of 1997. This was however, balanced with increased lending for the property sector, other than residential, agriculture and the financial services, insurance and business sectors in the same period. Loans to the private sector accounted for 98.0% of total loans extended by the merchant banks as at end-July 1998 while loans to the public sector accounted for 0.5% with the remaining 1.5% being loans to foreign customers. As at end-July 1998, the bulk of the loans was in the form of term loans amounting to RM10,765.5 million or 47.8% of total outstanding loans of the merchant banks.

In view of the larger decline in deposits (-5.3%) as compared with the decline in loans (-2.2%), the merchant banks recorded a resource gap of RM2,454.8 million in the first seven months of 1998 (1997: RM3,339 million). Consequently, the **loan-deposit ratio** of the merchant banks increased to 90.2% at end-July 1998 as compared with the end-1997 position of 87.3%. With the increase in fixed deposits rates, the average cost of deposits of merchant banks increased from 9.35% at the end of 1997 to 10.97% at the end of July 1998, while the average lending rate fell from 16.34% at the end of 1997 to 15.23% at the end of July 1998. Thus, the gross interest margin narrowed by 273 basis point to 4.26% at the end of July 1998 from 6.99% at the end of 1997.

Due to the abolition of the minimum fee income requirement effective December 1996 for Tier-1 merchant banks, the fee income of merchant banks declined as the **fee-based activities** of merchant banks contracted during the first seven months

Table 8.5

Merchant Banks: Deposits And Lending

	Change During Period				As at end July 1998
	1997		1998		
	January-July		January-July		
	RM million	%	RM million	%	RM million
Deposits					
Fixed deposits	3,648.8	25.7	1,424.1	9.3	16,695.0
IBS deposits ¹	0.8	—	80.6	29.2	355.7
Foreign exchange deposits	2.5	2.1	-188.1	-55.1	153.2
Repos	282.3	11.9	-1,678.3	-42.7	2,255.4
NIDs	-458.1	-7.6	-1,023.3	-15.6	5,529.7
Others ²	-14.6	-48.8	-14.7	-100.0	0
TOTAL	3,461.8	15.0	-1,399.7	-5.3	24,990.0
Loans					
Term loans	1,598.7	17.9	-16.9	-0.1	10,765.5
Revolving credit facilities	156.5	1.8	-342.0	-3.3	10,144.3
Others	412.2	35.5	-158.0	-8.9	1,625.4
TOTAL	2,167.5	11.5	-516.8	-2.2	22,535.2

¹ Interest-Free Banking Scheme.

² Includes merchant banks and other financial institutions.

Source: Bank Negara Malaysia.

¹ Interest-Free Banking Scheme.

² Includes merchant banks and other financial institutions.

Source: Bank Negara Malaysia.

of 1998. Total income from fee-based activities declined by 53.8% to RM113.6 million, compared with a decline of 61.6% during the corresponding period of 1997. Total fees derived from portfolio management activities undertaken by the merchant banks fell to RM3.6 million during the first seven months of 1998, compared with RM20.7 million earned during the same period of 1997. The bulk of the fee-based income was generated mainly from their activities in corporate advisory services (RM28.8 million or 25.4%), underwriting (RM28 million or 24.6%) and the syndication of consortium loans (RM25.3 million or 22.3%).

The number of merchant banks operating throughout the country remained at 12 with 24 branch offices as at end-July 1998. Six merchant banks have been accorded Tier-1 status. **Total assets** of the merchant bank declined by 14.4%

from the end of 1997 to RM37,953.2 million at end-July 1998, compared with an increase of 30.0% during the same period of 1997.

Discount Houses

The overall performance of the discount houses declined during the first seven months of 1998. Total deposits (including repos) mobilised by discount houses declined by 11.7% to RM17,586 million during the first seven months of 1998, compared with an increase of 13% registered during the corresponding period of 1997. Of the total deposits, 39.3% was placed by the commercial banks, while the balance was placed by the other financial institutions.

Total investment of discount houses registered a marginal decrease of 1% from the end of 1997 to RM12,660 million at end-July 1998, compared with an increase of 11.8% during the corresponding period of 1997. In terms of components, investment in Private Debt Securities (PDS), increased by 0.1% to RM11,883 million (January-July 1997: +24.3% or RM2,227 million) while investment in BAs declined by 44.7% to RM2,376 million (January-July 1997: -4.7% or RM200 million). Investment in Malaysian Government Securities (MGS) increased by 26.1% to RM392 million (January-July 1997: -27.7% or RM175 million). Cagamas bonds declined by 18% during the first seven months of 1998, compared with a decline of 18.6% during the corresponding period of 1997. NIDS on the other hand, increased by 40.6% during the first seven months of 1998, compared with a decline of 24.3% during the corresponding period of 1997.

Development Finance Institutions

The Malaysian Industrial Development Finance Berhad (MIDF), Bank Industri Malaysia Berhad (Bank Industri), Bank Pembangunan Malaysia Berhad (Bank Pembangunan), Sabah Development Bank (SDB) and Bank Pertanian Malaysia (Bank Pertanian) are five principal development finance institutions (DFIs) specially set up by the Government to provide medium and long-term loans for the purpose of financing capital investment in the industrial sector. Total outstanding resources of these DFIs increased marginally, that is by 0.5%, during the first six months of 1998 from

Table 8.6

Development Finance Institutions (as at end of period)

Institution	1997	June 1998
Total Resources¹ (RM million)		
Bank Pertanian Malaysia	4,425	4,500
Bank Pembangunan Malaysia Bhd.	2,207	2,238
Malaysian Industrial Development Finance Bhd.	2,514	2,630
Bank Industri Malaysia Bhd.	2,150	2,377
Sabah Development Bank Bhd.	1,568	1,177
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.	10.35	11.56
Malaysian Industrial Development Finance Bhd.	11.70	13.70
Bank Industri Malaysia Bhd.		
Ship repairing	6.00	6.00
Ship building	9.00	11.50
Dockyard infrastructure	9.00	11.50
Sabah Development Bank Bhd.	14.00	17.50

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

² Base Lending Rate

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

million at end-June 1998 (January - June 1997: 9.5%). However, total resources of both Bank Pertanian and Bank Pembangunan only increased marginally at 1.7% and 1.4% to RM4,500 million and RM2,238 million respectively (January - June 1997: 10% and -0.3%), while the resources of SDB declined sharply by 24.9% to RM1,177 million as at end of June 1998 (January - June 1997: 6.7%), due to substantial losses incurred and a decline in deposits during the first half of 1998.

During the first half of 1998, **total new loans** extended by the five DFIs, declined further by 52.2% to RM595 million, against a decline of 35.3% during the corresponding period of 1997, reflecting the impact of a slowdown in economic activities (please see Table 8.7). In terms of lending by sector, loans to the shipping industries increased sharply by 434% to RM155 million as at end of June 1998 from RM29 million during the corresponding period of 1997. On the other hand, new loans to the other sectors namely the agriculture and manufacturing sectors declined by 82.2% and 44.2%, respectively to RM42 million and RM314 million, while loans to the real estate and construction sectors registered a significant decline of 90.4% to RM16 million during the period.

As in previous years, the lending activities of individual DFIs varied. New loans approved by Bank Industri increased significantly, that is by RM268 million to RM306 million during the first six months of 1998 from RM37 million during the same period of 1997, in line with the increase in the resources of the bank. On the other hand, new loans approved by Bank Pembangunan declined by 48.2% to RM209 million, during the first six months of 1998, compared with RM404 million in the corresponding period of 1997. During the review period, credit approved by Bank Pertanian and MIDF registered declines of 82.2% and 86.4% to RM42 million and RM42 million respectively (January-June 1997: RM238 million and RM312 million respectively). On the other hand, no new credit was approved by SDB (-RM4.3 million) in the first half of 1998 as against RM252 million provided during the same period of 1997. Meanwhile, total outstanding loans of the DFIs stood at RM6,928 million at the end of June 1998, compared with RM6,804 million at end 1997. The average interest rates charged by the individual DFIs varied within a range of 4.00% to 17.5% per annum.

RM12,864 million as at end 1997 to RM12,922 million as at end-June 1998. The increase during the corresponding period of 1997 was 8.5%.

The resource position of individual DFIs varied as illustrated in Table 8.6. Reflecting the increase in total shareholder's funds (1.3%), total resources of the Bank Industri rose by 10.5% to RM2,377 million as at end June 1998 compared with 16% in the corresponding period of 1997. Similarly, total resources of MIDF grew by 4.6% to RM2,630

Table 8.7
Direction of Lending by DFIs

	1997	1998 ^a	Change During Period %
	January-June RM million	January-June RM million	
Manufacturing	563	314	-44.2
Shipping	29	155	+434
Agriculture	238	42	-82.2
Real estate and construction	173	16	-90.4
Mining and Quarrying	0	0.75	+100
Others	241	67	-72.3
TOTAL	1,245	595	-52.2

^a Preliminary data

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

A number of specialised assistance schemes are implemented by DFIs. One such scheme is the **Fund for Food** scheme which was launched on January 4, 1993 with an initial allocation of RM300 million. This was increased to RM700 million in 1997. During the first seven months of 1998, 176 applications amounting to RM59.6 million were approved (1997: 29 applications amounting to RM9.4 million). As at July 31, 1998, the number of applications approved totalled 1,225 applications with a value of RM359.4 million while the value of disbursements was RM310.8 million. Several loan criteria were amended this year to increase the effectiveness of the scheme. They include the following:

- The minimum loan for a qualified borrower was reduced from RM50,000 to RM10,000 per borrower on February 23, 1998;
- The scope for the qualified food sector under this scheme was widened on May 5, 1998 to include quail, prawn, sheep, deer, rabbit and ostrich farming, as well as planting of padi;

- Bank Islam Malaysia Berhad is now allowed to participate in this scheme, using an Islamic financing method with the concept of "*Al-Wadiah Yad Dhamanah*" (savings with guarantee).

The **Enterprises Rehabilitation Fund (ERF)** was established to provide financial assistance to ailing but viable Bumiputera enterprises in 1988, given the financial problems faced by a number of them as a result of the recession in 1985/86. The total amount approved during the first seven months of 1998 increased by RM2.0 million compared with an increase of RM2.6 million during the corresponding period of 1997. As at end-June 1998, 237 applications with a total value of RM652.8 million had been approved, while drawdowns amounted to RM607.2 million. A major proportion of the loans was extended to the housing sector (RM392.6 million), followed by the property sector (RM60.3 million), the "Skim Rundingan Terus" sector (RM49.4 million) and the construction sector (RM41.1 million).

Administered by Bank Pertanian, Bank Industri, Bank Pembangunan and MIDF, the **ASEAN - Japan Development Fund (AJDF)** aims at assisting the development of small and medium-scale industries. Launched in January 1989, this revolving fund was set up with an initial funding allocation by the Overseas Economic Cooperation Fund (OECF) and the Export-Import Bank of Japan. During the first seven months of 1998, the implementing DFIs approved a total of 4 applications amounting to RM665 million, as against an increase of 315 applications (RM223,820 million) during the corresponding period of 1997. Thus, as at July 31, 1998, total loans approved amounted to RM 1,921,222 million for 4,450 projects. Out of this, RM1,531,406 million was sourced from OECF's allocation, while the balance was from Export-Import Bank of Japan's allocation.

The **Export-Import Bank of Malaysia Berhad (EXIM Bank)**, a wholly owned subsidiary of Bank Industri was given the task of managing the Export Credit Refinancing Facility (ECR) in January 1998. The EXIM Bank was previously managed by BNM. The ECR scheme provides refinancing at a competitive rate of interest to eligible direct and indirect exporters via commercial banks, aimed at promoting the export of manufactured and agricultural products and selected primary commodities that have significant value-added

and utilise local resources. Total ECR financing declined by 18.1% or RM2,726 million during the first six months of 1998 (of which RM1,177 million was for pre-shipment and RM1,548 million for post-shipment), as compared with RM3,330 million registered during the corresponding of 1997. A substantial amount of the credit was for rubber products (18.9%), palm oil (18.1%) followed by mechanical and electrical products (13.7%). The current ECR rate (including the interest-free scheme) increased to 10.80% as at end-June 1998.

The taking over of the management of ECR scheme will enhance the overall role of the EXIM Bank in facilitating the export of manufactured goods and diversification of exports as well as in assisting the Government in the promotion of reverse investments in resource-based manufacturing and processing of agricultural products and the promotion of high value-added, capital-intensive and technologically sophisticated industries. Aside from the ECR scheme, new loans provided by EXIM Bank associated with its original activities amounted to RM209 million during the first half of 1998, a decline of 57.2% over the RM488 million new loans provided in the corresponding period of 1997. The Buyer Credit Guarantee Facility and the Overseas Investment Credit Facility remained EXIM Bank's core activities which contributed about 76.3% of the total operating income of RM17 million for the EXIM Bank.

Another assistance scheme aimed at encouraging more small and medium-scale Bumiputera entrepreneurs to venture into business is the **New Entrepreneurs Fund (NEF)**. This fund was launched on December 1989 with an allocation of RM750 million. As the NEF is a revolving fund, the long repayment period resulted in the Fund's balance being insufficient to meet demands. The NEF allocation was, therefore, increased by an additional RM500 million on July 15, 1998 to RM1.25 billion. To reflect the prevailing interest rates, the rate of interest under NEF was simultaneously raised from 5% per annum to 8% per annum for all applications submitted after July 15, 1998. The implementing agencies of the Fund include MIDF, Bank Pembangunan, Bank Industri and 11 other commercial banks. During the first seven months of 1998, a total number of 28 applications were approved, amounting to RM39 million (1997: 56 applications valued at RM24.3 million). This brings the total number of

applications approved to 2,097 as at end-July 1998, valued at RM1,012 million. Of this, RM910.6 million had been disbursed.

No new applications were approved for the **Industrial Adjustment Fund (IAF)** which was launched on in 1991, with a total allocation of RM500 million, aimed at rationalising and restructuring companies existing before December 31, 1990 in three selected industries (namely machinery and engineering, wood-based and textile industries) through mergers, takeovers, relocation and diversification. As such, the number of approved applications received remained at 26, with an aggregate value of RM106.1 million at end-July 1998, while drawdowns amounted to RM91.7 million.

The **Special Fund for Tourism (SFT)** set up by the Government in March 1990 with the aim of financing the development of tourism-related projects with an allocation of RM200 million ceased as a revolving fund on December 31, 1997. As such, no new application were approved and as at end-July 1998 the number of application remained at 211 with a value of RM239.0 million. Of this, RM196.7 million had been disbursed as at end-July 1998.

Other Financial Institutions

National Savings Bank

Underpinned by strong increases in deposits, **total resources** of the National Savings Bank (NSB) increased by 5.3% or RM397 million to RM7.9 billion as at end June 1998 compared with a decline of 0.9% in the corresponding period of 1997. **Deposits** mobilised by NSB during the first half of 1998 rose by 6.4% to RM6,939 million at the end June 1998, as compared with the 1.6% decline during the same period of 1997. The increase in deposits was attributed to an increase in deposits from the corporate sector of 128.9% during the first half of 1998 to RM993 million at end June 1998, from RM434 million at end 1997. However, other deposits namely GIRO, save-as-you-earn, premium savings, fixed deposits and savings schemes mobilised by the NSB decreased by 2.3% to RM5,919 million as at end June 1998 from end 1997. Depositors fund accounted for 87.3% of total resources. With withdrawals amounting to RM11,445 million, the total net

deposits with NSB declined by RM226 million during the first half of 1998.

The **GIRO** Savings scheme remained the core product of the NSB mobilising a total value of RM9,912 million. This scheme accounted for 88.3% of the total new deposits mobilised by the NSB during the first half of 1998 (January-June 1997: RM11,399 million). On the other hand, withdrawals from this scheme was 11% lower at RM10,134 million during the first half of 1998, compared with RM11,383 million during the same period of 1997. With regard to the Guaranteed Giro Order (GGO) facility which is similar to a cashier's order for the purchase of new public share offerings, a total of 377 GGO's were issued during the first half of 1998 with a total value of RM0.91 million. This indicated a sharp decline when compared to 236,710 GGO's valued at RM841.1 million issues during the corresponding period of 1997. The decline reflected poor investor sentiments in the stock market as well as reduced numbers of new issues of shares. Meanwhile, the **save-as-you-earn** scheme continued to record net withdrawals of RM3.4 million (January-June 1997: RM0.7 million) as deposits (RM7.0 million) were lower than withdrawals (RM10.4 million). Similarly, the **premium savings certificates** scheme recorded a bigger net outflow of RM38 million (January-June 1997 inflow of RM63.0 million), as redemption declined by 26.5% to RM172 million. Similarly, purchases of premium certificates also declined by 61.5% to RM135 million (January-June 1997: RM183 million). The net withdrawal from GIRO savings and premium savings certificates reflected private individual liquidity being affected by the deflationary impact of the region's financial crisis.

In consonance with the increase in growth of total resources, investment rose by 7.7% to RM5,117 million at end-June 1998 from end-1997 (January-June 1997: RM4,486 million). This was mainly due 59.5% increase in short and long-term deposits placed with the banking system to RM1,090 million during the first half of 1998 compared with RM270 million during the corresponding period of 1997. Investments in stocks and shares (includes trustee, non-trustee shares and warrants) rose marginally by 0.1% to RM1,345 million (January-June 1997: RM1,220 million). However, investment in Government-guaranteed securities (comprising MGS, Cagamas bonds and Treasury bills) declined by 7.0% to RM1,939 million, with MGS accounting for 67% of the total.

Table 8.8

National Savings Bank
(as at end of period)

	1997	June 1998 ^p
Deposits ¹ (RM million)		
Savings	1,585	1,477
Fixed	1,751	1,896
Save-As-You-Earn	22	18
GIRO	2,550	2,328
Premium Savings Certificates	584	546
Investments at book value (RM million)		
MGS	2,087	1,939
Stocks and shares ²	1,343	1,345
Others ³	1,091	1,434
Loans (RM million)		
Individuals	941	1,068
Corporate	158	154
Visa Cards	24	25
Hire Purchase	897	859
Number of NSB branches ⁴	468	458
Number of post offices with NSB facilities	621	624
Number of depositors ('000)	8,438	8,520
Savings	3,051	2,817
Fixed	109	122
Save-As-You-Earn	19	17
GIRO	5,259	5,564

¹ Includes interest credited.

² Includes trustee and non-trustee shares and warrants

³ Includes long and short-term deposits.

⁴ Includes mini and sub-branches.

^p Preliminary data.

Source: National Savings Bank.

Loans provided by the NSB increased by 3.0% or RM60 million during the first six months of 1998 to RM2,019 million as at end-June 1998, compared with RM202 million during the corresponding period of 1997. This was mainly due to the 13.5% increase or RM127 million in credit granted to individuals bringing the total to RM1,068 million as at end-June 1998, compared with RM799 million in the same period of 1997. Similarly, loans granted for Visa Cards rose by 4.1%. However, loans extended to the corporate sector and hire-purchase decreased by 2.5% and 4.2% to RM154 million and RM859 million respectively (January-June 1997: RM161 million and RM742 million).

The total number of NSB branches declined from 471 in June 1997 to 458 in June 1998 due to the merging of some branches. This led to a reduction in NSB's automated teller machines (ATMs) from 592 ATMs as at end-June 1997 to 590 ATMs throughout the country as at end June 1998.

Provident and Pension Funds

The provident and pension funds continued to play a major role in mobilising national savings for the purpose of financing long-term development projects initiated by the public sector. The amount of financial resources mobilised by the four principal provident and pension funds in the country namely, the Employees Provident Fund (EPF), the Social Security Organisation (SOCSO), the Pensions Trust Fund (PTF) and the Armed Forces Fund (AFF) amounted to RM9.3 billion during the first half of 1998, an increase of 6.1% when compared with RM11.2 billion mobilised during the corresponding period of 1997. As a result, the outstanding amount mobilised by these four principal provident and pension funds rose from RM151.8 billion as at end-1997 to RM161.2 billion at end-June 1998, as shown in Table 8.9.

The EPF remained the largest provident and pension fund in the country. Total resources of the EPF expanded 5.1% in the first half of 1998 to RM139.1 billion as compared with growth of 7.8% during the corresponding period of 1997. Total resources continued to expand due mainly to the 1.6% (135,346 members) increase in new contributors during the first half of 1998 to 8,410,312 members as at June 30, 1998 from 8,274,966 at end 1997. Total investment of the EPF expanded

moderately by 4.6% during the first six months of 1998 to RM135.4 billion (January-June 1997: 7.4%), accounting for 97.3% of total outstanding resources. Investment in loans and debentures increased significantly by 27.7% from the end of 1997 to RM23.5 billion at end-June 1998 compared with an increase of 29.2% during the same period of 1997. Similarly, investments in NIDs, fixed deposits and short-term deposits rose by 9.7% to RM33.6 billion (January-June 1997: 11.7%). However, investment in corporate securities declined 1.7% during the first six months of 1998 to RM39.3 billion at end-June 1998 compared with an increase of 22.2% during the corresponding period of 1997. EPF's holdings of MGS continued to decline by 0.4% during the January-June 1998 period to RM37.9 billion at end of June 1998, compared with a 3.6% decline during the corresponding period of 1997. As a result, investment in MGS accounted for a share of 28.0% of the total outstanding investment of the EPF at end of June 1998 (end of 1997: 29.4%) which was below the mandatory requirement of the cumulative investment in MGS of 50.0%.

Gross contributions to the EPF increased by RM7.7 billion during the first six months of 1998, compared with an increase of RM7.4 billion during the same period of 1997. However, total withdrawals declined to RM4.6 billion at end June 1998 from RM6.0 billion at end 1997. As a result, the total outstanding balance of contributors' accounts (including interest credited) increased by 5.4% from RM131.5 billion at end-1997 to RM138.5 billion at end-June 1998 (January-June 1997: 4.4%).

From August 1, 1998, foreign workers (excluding domestic maids) were required to contribute to the EPF at a rate of 11% of their income, while their employers were required to contribute RM5 per employee. However, both employers and employees could choose to voluntarily contribute more than the required rate.

SOC SO, established under the Employee Social Security Act 1969 to provide social security benefits to workers through the Employment Injury Scheme and Invalidity Pension Scheme, mobilised a total of RM1,095 million during the first six months of 1998. The outstanding resources mobilised by SOCSO increased by 21.5% from RM5,089 million as at end of 1997 to RM6,184 million at end-June 1998. The bulk (44.6%) of SOCSO's outstanding

Table 8.9

Provident and Pension Funds
(as at end of period)

	<i>Total Resources (RM million)</i>		<i>Malaysian Government Securities (RM million)</i>		<i>Number of Members (‘000)</i>	
	1997	June 1998 ^p	1997	June 1998 ^p	1997	June 1998 ^p
EPF	132,402	139,131	38,067	37,922	8,274	8,410
SOCSSO	5,089	6,184	2,053	2,759	8,252	8,604
AFF	4,451	4,547	5	5	99	97
PTF	9,922	11,338	0	0	—	—
TOTAL	151,864	161,200	40,125	40,686	16,625	17,111

^p Preliminary data.

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

resources was invested in MGS, while 38.2% was placed with the banking system as deposits and 9.0% was invested in corporate securities. As at end-June 1998, the number of registered employees stood at 8,604,616 persons, an increase of 351,936 persons from the end of 1997 (December 1996 : 7,613,635 persons).

The **PTF**, which was established under the Pensions Trust Fund Act 1991 to take over the Government's obligations in meeting the cost of payments of pension, gratuity and other pension benefits to retired public servants, mobilised RM1,416 million during the first half of 1998. As a result, PTF resources rose by 14.3% to RM11,338 million as at end-June 1998 from RM9,922 million at end 1997. The increase was largely to the substantial increase in the funds contributed by the Government annually (initially set at 5% of the annual civil service emolument bill), as well as by Statutory and Local Authorities (set at a rate of 17.5% of the salaries of pensionable officers). Refunds of employer's contributions to the EPF and other approved funds established for retired public officials as well as income from

investments approved by the Minister of Finance also contributed to the PTF's financial resources. The bulk of these resources was channelled to investments (61.4%), while cash as well as deposits with the banking system (particularly in the money market account of BNM) accounted for 30.3%.

The **AFF**, established in 1973, provides superannuation benefits to servicemen in the armed forces. Total resources of the AFF increased by RM96 million or 2.1% from RM4,451 million at end-1997 to RM4,547 million at end-June 1998 (January-June 1997: 4.1%). The slower expansion in total resources was mainly due to the decline in contributors balances given the lower number of registered members as at end-June 1998 compared with the end 1997 and a decline in returns from investment.

The contributors' balances declined by 2.3% from RM3,420 million as at end-1997 to RM3,342 million as at end-June 1998. The number of registered members, however, declined to 97,290 persons as at end-June 1998 from 99,360 persons at end-1997. The AFF invested 83.7% of its total

outstanding resources in corporate securities (RM3,806 million), while 12.3% was placed with the banking system (RM561.6 million). AFF's investments in MGS however, remained unchanged from the end 1997 figure of RM5 million at end-June 1998.

Insurance Companies

The combined premium income of the life and general insurance sectors increased by 14.4% (1996: 20%) to RM11.1 billion in 1997, with more than half of the income (53.5%) being derived from life business. Premium income of the industry as a percentage of nominal Gross National Product increased to 4.2% in 1997, compared with 4.1% in 1996. Total benefits and net claims paid out by the industry increased by 28.1% to RM3.6 billion, representing 32.8% of the premium income. The industry's insurance fund assets increased by 13% to RM35 billion as at end 1997 to account for 3.1% of the total assets of the financial system.

Despite the economic slowdown, new premiums and sums insured grew by 11.8% and 16.5% to RM1.6 billion and RM88.6 billion respectively. All classes of business recorded favourable growth rates in new premiums, except for temporary policies. Temporary policies which had experienced a relatively high growth in the past increased only marginally by 0.1% in 1997 (1996: 18.9%) due to lower demand for credit-related term policies by borrowers of financial institutions. Sums insured terminated increased by 24% (1996: 16.9%) to RM47.3 billion, involving annual premiums of RM0.6 billion. Despite the increased termination rate, life insurance business in force in 1997 continued to expand with total sums insured in force and aggregate annual premiums in force increasing by 14.7% and 13.4% (1996: 14.8% and 14%) respectively to RM324 billion and RM6 billion.

Total income of the industry increased at a slower rate of 11.5% (1996: 20.1%) to reach RM7.7 billion, while total outgo expanded significantly by 53.6% (1996: 4.9%) to RM5.1 billion. The lower growth in income was largely attributable to a decline in other income of 33.9% (1996: +126.8%), mainly due to reduction in profit on sale of assets. On the other hand, outgo increased significantly, mainly caused by additional provision for diminution in value of investments and losses on sale of assets which accounted for 28.8% (1996: 0.01%)

of total outgo. Premium income, which accounted for 77.5% of total income, increased by 14.1% (1996: 14.5%) to RM 5.9 billion in 1997. Investment earnings, the second largest component (17.9%) of total income, grew by 20.9% (1996: 20.5%) to RM1.4 billion in 1997. The operating cost guidelines which was implemented in January 1996 helped to curb commissions further by 13% to account for 30.3% of total outgo. As a result, the excess of income over outgo for the industry decreased by 27.6% (1996: +38.7%) to total RM2.6 billion in 1997.

Total assets of life funds grew by 12.4% (1996: 18%) to RM23.3 billion as at end 1997. Investment in Government securities and Government guaranteed loans decreased significantly to account for 15% of the total assets. Corporate securities remained the largest category of assets, constituting 29.6% (1996: 28%) of the assets of the life funds in 1997. Cash and deposits increased sharply by 52.8% to RM5.3 billion, mainly because most insurers chose to adopt a cautious investment policy. Policy loans also increased substantially by 24.1% to account for 8.5% of the total life assets. More policy owners took advantage of the financing provided by insurers in the wake of the higher cost of borrowing from financial institutions.

During the first half of 1998, the insurance industry recorded a combined premium income of RM5.2 billion, a slower increase of 3.4% compared with 19.3% in the corresponding period in 1997. The combined assets of life and general insurance funds only managed to register a smaller growth of 6.5% to RM36.4 million at the end of the first half of 1998 (December 1997: RM34.2 billion).

The current economic slowdown has affected the sale of new life business which recorded negative growth in the first half of 1998. New business premiums and new sums insured decreased by 1.8% (January-June 1997: +21.4%) and 18.1% (January-June 1997: +31.1%) respectively to RM0.7 billion and RM44.6 billion. All categories of policies registered either negative or slower growth in new business premiums. Despite the unfavourable performance of new business, annual premiums in force and total sums insured in force increased by 15.1% and 17.45% (January-June 1997: 13.4% and 12.2%) respectively.

Table 8.10

Life and General Insurance Business

	1997 ^{1/}	1998 ^{2/}
Life insurance (RM million)		
New Business:		
Number of policies ('000 units)	1,106.9	532.3
Sums insured	88,618.1	44,554.5
Total premiums	1,591.3	679.8
Business in force:		
Number of policies ('000 units)	5,919.5	6,040.1
Sums insured	324,018.1	337,929.1
Annual premiums	5,961.7	6,166.0
Premium Income	5,943.2	2,870.2
Benefit payments:		
Total	1,511.6	845.4
Maturity	467.2	234.1
Death & disability	565.8	198.8
Surrender	306.9	207.2
Cash bonuses	171.8	70.9
Others	—	134.3
Annuity	—	0.1
General Insurance (RM million)		
Premium Income:		
Written Premium ^{3/}	6,093.8	2,764.4
Net Premium	5,116.3	2,299.7
Reinsurance Placed Outside Malaysia	927.5	464.7
Retention Ratio (%)	84.8	83.2
Number of Insurance Companies		
Direct:		
Life	7	7
General	40	40
Composite	11	11
Reinsurance:		
Life	1	8
General	8	1
Takaful	2	2

^{1/} As at calendar year end^{2/} As at 31, March 1998^{3/} From 1997 onward, written premium is replaced with gross direct premium.

Source: Director General of Insurance

Total income of the industry grew at a lower rate of 13.5% (January-June 1997: 15.6%) to RM3.9 billion, while total outgo increased at a higher rate of 35.9% (January-June 1997: 15.5%) to RM2.2 billion in the first half 1998, mainly due to higher provisions for diminution in the values of quoted stocks. In the first half of 1998, the realised and unrealised losses arising for equity investments increased to RM362.5 million and RM67.1 million compared with only RM0.8 million and RM32.1 million in the corresponding period in 1997. With slower growth in aggregate income, the excess of income over outgo of the industry registered a decline of 7.1% to RM1.7 billion in the first half 1998 (January-June 1997: +28.6% to RM1.8 billion). Total assets of the life funds increased by 5.9% to reach RM24.3 billion as at end of June 1998. Corporate securities continued to remain the largest portfolio, constituting 29.4% of the life fund assets.

Reflecting the economic slowdown, the general insurance sector recorded a substantially slower growth of 7.5% in written premiums to RM6.1 billion in 1997, compared with 19% in 1996. Efforts to improve the national retention level were further supported by the greater utilisation of local reinsurance capacity. The amount of premiums ceded overseas showed a reduction of 20.4% from RM1,164.7 million in 1997 to RM927.4 million in 1996. Accordingly, the net retention ratio further improved from 79.5% in 1996 to 84.8% in 1997, the highest level achieved since 1980. During the year, the claims ratio deteriorated marginally from 56.8% in 1996 to 57.5% in 1997.

In line with the slower business growth, total assets of the general insurance funds grew at a slower rate of 14.4% to RM11.6 billion in 1997. Cash and deposits continued to be the largest component of the insurance fund assets in 1997, accounting for 40.8% share of total assets, followed by Malaysian Government securities and Government guaranteed loans, which totalled RM2,203 million or a share of 18.9%.

As at end-1997, there were 67 insurers, comprising seven life insurers, 11 composite, 40 general insurers, eight general reinsurers and one life reinsurer. Of the total, 53 were Malaysian-incorporated and the remaining foreign incorporated. As at same date, there were 37 licensed brokers and 43 licensed loss adjusters.

Table 8.11

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

	Life insurance (RM million)			General insurance (RM million)		
	1996	1997 ^{1/}	1998 ^{2/}	1996	1997 ^{1/}	1998 ^{2/}
Fixed assets	127.3	262.4	337.7	389.6	431.2	473.2
Loans	4,443.1	5,224.2	5,483.6	293.5	564.6	594.5
Government securities	5,000.3	3,367.6	3,103.1	2,549.8	2,183.0	2,139.9
Government guaranteed loans	180.8	122.3	101.1	32.2	20.0	17.5
Corporate securities	5,797.3	6,900.5	7,152.2	1,846.3	1,987.7	1,981.8
Investment properties	957.6	1,042.4	1,089.1	37.0	158.5	149.1
Cash and deposits	3,494.2	5,337.7	5,487.1	3,754.7	4,759.2	5,209.1
Foreign Assets ^{3/}	—	—	352.1	—	—	7.8
Other assets	728.8	1,040.1	1,216.2	1,293.9	1,558.7	1,547.1
Total	20,729.4	23,297.2	24,322.2	10,197.0	11,662.9	12,120.0

^{1/} As at calendar year end.

^{2/} As at 31 June 1998

^{3/} Foreign assets are included under other assets for 1996

Source: Director General of Insurance

During the first half of 1998, the general insurance sector's written premiums declined by 8.3% to RM2.7 billion (January-June 1997: +17.5%). The total assets of the general insurance industry increased marginally by 7.6% to RM12,112.0 million at the end of the first half of 1998 (December 1997: RM11,256.3 million).

In a move to help revitalise the insurance industry which has been affected by the economic downturn, BNM announced a series of measures on October 2, 1998 to assist the industry. The measures are as follows:

- the minimum capital requirement for direct insurers will be RM35 million instead of RM50 million by December 31, 1998. The requirement remains unchanged for the other insurers;
- the minimum margin of solvency for each class of business will be RM30 million beginning January 1, 1999 instead of RM50 million;
- for financial year ending in 1998, insurers are allowed to maintain a minimum of 70% of the aggregate of the insurance fund liabilities and margin of solvency in the form of admitted assets. The balance 30% of the liabilities and margin of solvency can be supported by other assets. This ratio will be increased to 80:20 for financial year ending in 1999;
- insurers will be allowed to continue holding unsecured bonds which have been downgraded below A or P2, but such bonds will no longer qualify as admitted assets.

However, insurers are prohibited from new investments in bonds which fall below the minimum rating;

- insurers may also continue to hold bank guaranteed bonds issued by corporations which have been granted protection by the Court under section 176 of the Companies Act as well as bonds issued by corporations that have sought assistance from the Corporate Debt Recovery Committee. The bonds will remain as admitted assets during the period that debt restructuring is taking place;
- the period for which an insurer is required to obtain additional security for credit facilities where the value of the security has fallen, is now extended from 90 days to one year, subject to conditions to be specified by the Bank; and
- low risk assets have been extended to include securities, bills, certificates or other papers guaranteed by the Government and BNM. This is to encourage insurers to increase their participation in and contribute towards the development of the capital market as well as enable them to match their longer term liabilities with long-term investments.

Companies which are still unable to meet the financial requirements will be monitored closely by BNM. BNM will require companies to furnish concrete plans to rectify their position by end 1998 and insurers were encouraged to consolidate themselves through mergers. BNM remains fully committed to the policy that insurers should be well capitalised to remain viable and competitive. As such, the higher capital and solvency margin requirements will continue to be enforced by BNM when the economy improves.

Takaful business or Islamic insurance in Malaysia underwritten by two takaful operators, namely Syarikat Takaful Malaysia Berhad (STMB) and MNI Takaful Sdn. Berhad (MNIT), continued to expand in 1998. Total assets of takaful funds increased by 21.3% to RM 686 million at the end of the 1998 financial year compared with a growth of 55.3% in the previous financial year. Assets of the family takaful funds accounted for 57.9% of the total assets, while general takaful funds

	<i>Financial Year 1997</i>	<i>Financial Year 1998^u</i>
Assets (RM million)	565.7	686.0
Malaysian Investment Certificates	99.5	113.9
Investment in Bank Islam Malaysia Bhd.	76.1	9.9
Others ¹	390.1	562.3
Family Takaful		
New Business:		
Total contribution (RM million)	79.2	119.8
Sums participated (RM million)	2,317.8	6,292.7
Number of certificates	50,005.0	66,037.0
Business in Force:		
Total contribution (RM million)	162.3	312.0
Sums participated (RM million)	7,892.2	13,287.0
Number of certificates	112,605.0	185,934.0
General Takaful Business		
Gross contributions	92.1	122.6
Net claims paid	16.1	17.5

^u Unaudited data

¹ Includes shares, cash and balances and other assets

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

accounted for another 23.6% with the balance of 18.5% being assets of shareholders funds. Investment in Malaysian Investment Certificates amounted to RM113.9 million or 16.6% of total assets, followed by investment in Bank Islam Malaysia Berhad of RM9.9 million or 1.4% of total assets.

New takaful business grew steadily in the 1998 financial year with a total of 68,037 new certificates sold under family takaful business, an increase of 32.1% with total participation of RM6,292.7 million. Total contributions received on new certificates increased by 51.3% to RM119.8 million in 1998.

Business in force continued to expand in tandem with the steady pace of growth of new business in 1998 with the number of certificates in force increasing by 65.1% to reach 185,934 units (1997: 112,605). Total contributions and total participation in force rose by 92.3% and 68.4% to reach RM312 million and RM13,287 million respectively at the end of the 1998 financial year (1997: RM162.3 million and RM7,892.2 million respectively).

General takaful business, comprising marine, motor, fire, group personal accident and engineering coverages, continued to record a strong growth of 33.1% in gross contribution to RM122.6 million in financial year 1998, after registering a growth rate of 37.5% in 1997. On the other hand, total net claims paid during the year increased marginally by 8.5% from RM16.1 million to RM17.5 million compared with a sharp increase of 11.8% in 1997.

The strong growth of takaful business was partly attributable to the expansion of the distribution network arising from the opening of more branch offices and takaful desks throughout the country to promote the sale of takaful products nationwide. As at June 30, 1998, there were 59 takaful desks and 36 takaful branch offices throughout the country.

Capital Market

Net long-term funds raised by both the public and private sectors through the capital market during the first eight months of 1998 declined significantly by 89.1% to RM2.5 billion from RM23 billion mobilised during the corresponding period of 1997, as indicated in Table 8.13. The decline was largely due to a 88.6% decline in the funds mobilised by the private sector to RM3.1 billion as a result of slower economic activity and weak market sentiment in the equity market. The public sector meanwhile, recorded a net redemption of RM546 million in the first eight months as compared with a redemption of RM3.8 billion for the corresponding period of 1997.

During the first eight months of 1998, the public sector raised funds through the issuance of MGS and Khazanah Bonds. The Federal Government floated RM4.5 billion worth of MGS during the period mainly to offset the redemption of the securities as well as to meet the demand of banking institutions to fulfil their liquid asset requirements. Khazanah Berhad also raised a total of RM1.3 billion through the issuance of Khazanah Bonds. During the same period, a total of RM4.7 billion worth of MGS and RM924 million worth of Malaysia Savings Bonds were redeemed by holders.

The decline in the net funds raised by private sector during the first eight months of 1998 was largely due to a decline in the issuance of shares. Total gross funds raised by the private sector through the equity market was lower by 88.8%, that is RM1.6 billion during the eight months of 1998 compared with RM14.2 billion during the corresponding period of 1997. Of this, a total of RM657 million was raised through public issues, RM627 million through rights issues and RM300 million through private placements.

Similarly, total gross funds raised from the PDS market declined significantly by 61% to RM5.5 billion compared with RM14.1 billion raised during the corresponding period of 1997. The new issues of PDS were channelled primarily to cater for the financing needs of the manufacturing and construction sectors. These funds were raised through issues of Cagamas bonds (RM3 billion), straight bonds (RM2 billion), Islamic bonds (RM345 million) and convertible bonds (RM55 million). A total of RM4 billion was redeemed, resulting in net funds of RM1.5 billion being raised from the PDS market during the first eight months of 1998. Thus, after adjusting for redemption and repayments, net funds raised by the private sector declined by 88.6% to RM3 billion during the first eight months of 1998, compared with RM26.7 billion in the corresponding period of 1997.

Cagamas Berhad, the national mortgage corporation, mobilised a total of RM10,935 million and RM2,970 million from 14 issues of Cagamas notes and 8 issues of Cagamas bonds respectively during the first eight months of 1998 (January-August 1997: a total of RM7,630 million and RM2,215 million from 12 issues of Cagamas notes and 6 issues of Cagamas bonds respectively).

Table 8.13

Funds Raised in the Capital Market

	1997 January-Aug. RM million	1998 ^P January-Aug. RM million
By Public Sector		
Debt Securities	0.0	5,827
Malaysian Government Securities	0.0	4,500
Khazanah Bonds	0.0	1,327
Less: Redemptions	3,756	6,374
Malaysian Government Securities	2,320	4,700
Government Investment Issues	1,400	750
Malaysia Saving Bonds	36	924
Net funds raised	-3,756	-546
By Private Sector		
Shares	14,175	1,582
Public issues	3,505	656
Rights issues	6,078	626
Special issues ¹	1,510	0
Private placements ²	3,081	299
Debt Securities ³ (gross)	14,111	5,503
Straight bonds	3,473	2,033
Convertible bonds	1,992	54
Islamic notes	4,021	345
Bond with warrants	2,410	100
Cagamas bonds	2,215	2,970
Less: redemptions	1,541	4,034
Net issues of debt securities	12,570	1,468
Net funds raised	26,745	3,051
Total	22,989	2,505

^P Preliminary data.¹ Refers to special issues to Bumiputera and selected investors.² Includes restricted offer for sales.³ Refers to securities with maturities of more than one year.

Source: Bank Negara Malaysia.

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 1998, Cagamas Berhad purchased a total of RM4,375 million of housing loans, compared with RM4,429 million during the same period of 1997. Out of this, 77.1% (RM3,374 million) was purchased from the financial institutions, while 22.9% (RM1,001 million) was from the Housing Loans Division of the Ministry of Finance.

During the first eight months of 1998, the **Rating Agency Malaysia Berhad (RAM)** only completed one corporate debt rating valued at RM300 million (January – August 1997 : 32 issues valued at RM10,354 million). This reflected decisions by many corporations to reduce or defer capital expenditure in an environment of rising interest rates and economic uncertainty during the period. Total number of issues rated by RAM up to end August 1998 since its inception in 1990 was 400 corporate ratings, amounting to RM65.8 billion. During the first eight months of 1998, there were no bank-guaranteed issues, compared with 16 issues valued at RM1,404 million during the corresponding period of 1997. RAM has to date rated 15 financial institutions comprising 7 commercial banks, 5 merchant banks, 2 finance companies and one DFI. The second rating agency, the Malaysian Rating Corporation Berhad, which was established in September 1996, rated 5 corporate debt issues worth RM1,637 million during the first nine months of 1998.

The Kuala Lumpur Stock Exchange

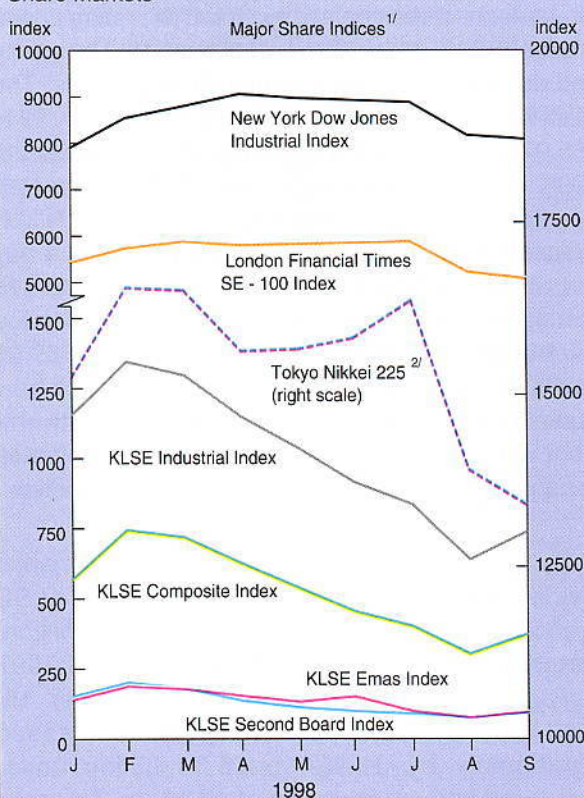
The Kuala Lumpur Stock Exchange (KLSE) began 1998 on a weak note, a carry over from the bearish sentiments prevailing in the second half of 1997. It was subject to downward pressure exerted by depreciating regional currencies as well as concerns about the health of the domestic corporate sector. Sentiments recovered somewhat in March in response to announcements by the Government on stabilisation and equity liberalisation measures. This upward trend was, however, reversed in May on renewed concerns about possible recession, social unrest in Indonesia and the depreciation of the Japanese yen. Sentiments on the KLSE worsened in July and August mainly due to concerns over the political and financial developments in Japan, sharper than anticipated contraction of the second quarter real GDP

and the financial health of the corporate sector. The market barometer, the Kuala Lumpur Composite Index (KLCI) declined to a 11 year intra-day low of 261.33 points on September 1, 1998. The KLCI has, however, recovered since then to 389.08 points on September 15, 1998. The recovery was influenced by positive sentiments following the introduction of selective capital controls by BNM to insulate the economy from the contagion effect of the regional and global financial crisis, through the introduction of new measures by the KLSE to ensure an orderly and fair market in the trading of Malaysian securities and measures to improve market transparency and protect investors as well as the fixing of the ringgit exchange rate at RM1=US\$0.2632 on September 2, 1998.

Market sentiment on the KLSE was mixed in the first quarter of 1998. In early January, amid the downward spiral in regional currencies and a weakening ringgit which breached the RM4 to a US dollar level on January 5, 1998 and adverse reports on Malaysia's external loan position due to ringgit depreciation the KLCI fell to 491.60 points on January 9, 1998, below the 500 points level for the first time in seven and a half years. The KLCI rebounded in mid-January before closing at 569.51 points at the end of the month. The bullish streak spilled over into early February on positive trends in regional markets and a stronger ringgit and the KLCI recorded a rise of 131.80 points to 701.31 points on February 3, 1998, that is 18.0% higher than the index of at the end of 1997. The market stabilised in response to liberalisation of foreign equity participation in the telecommunications sector from 30% to 49%, announcements by Government on stabilisation measures and encouraging news on the merger of finance companies. Reflecting this, the KLCI ended higher to close at 719.52 points at the end of March (end 1997: 594.44 points).

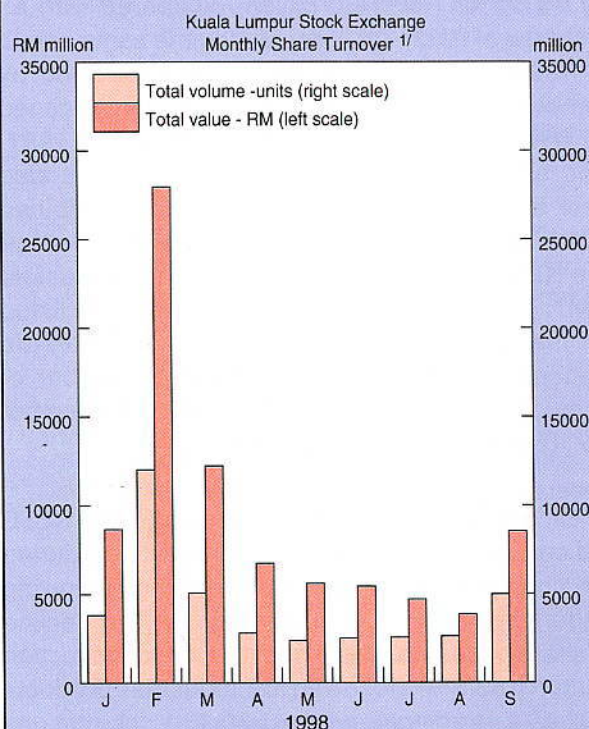
In the second quarter of 1998, bearish sentiments prevailed again in the KLSE, with the market tracking the performance of other regional bourses and weighed down by concerns over the health of the corporate sector, stockbroking companies and deteriorating domestic economic conditions. The KLCI continued its downtrend in April, May and June to close the quarter at 455.64 points. While the market subsequently reacted positively to the establishment of Danaharta, there were on going concerns about the contraction of Malaysian economy, the sliding yen and Japan's deteriorating economy and continuing

Chart 8.3
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

social unrest in Indonesia. In July and August sentiments continued to worsen undermined by volatile movements of the yen against the US\$, rating downgrades, contraction in the real sectors of the economy and downward revisions of growth projections. The KLCI which fell below the 400-point level on July 29 to 385.97 points closed at 302.91 points on August 28, 1998, a level last touched in April 1988, aggravated by sharp declines in the Dow Jones and Nikkei indices. On September 1, it dropped to an intra day low of 261.33 points. However, sentiments turned around with the KLCI gaining 28.4% compared to the level registered at end of August 1998 to touch 389.08 points on September 15, 1998 in response to new capital control measures introduced by the Government and new measures by the KLSE to enhance transparency in the trading of Malaysian securities.

Reflecting the downward trend in the main market indices, total market capitalisation of the KLSE declined significantly by 32.2% or RM120.9 billion, that is from RM375.80 billion at the end of 1997 to RM255 billion at the end of September 15, 1998. Similarly, total turnover volume decreased significantly by 31.9% to 38.08 billion units, compared with an increase of 17.4% in the same period of 1997. The value of turnover also declined by 76.4% to RM81.50 billion, compared with an increase of RM31.28 billion during the same period of 1997. Thus, market liquidity as measured by turnover value to market capitalisation declined 42.9% compared with the same period of 1997. The first eight and a half months of 1998 also saw a total of 26 companies with a combined nominal capital of RM1.3 billion newly listed on the KLSE (January-August 1997: 61 companies, RM7.3 billion). Of this, 5 companies were listed on the Main Board and another 21 were on the Second Board. This brings the total number of companies listed on the KLSE to 734 by September 15, (September 15, 1997: 681).

On a sectoral basis, the movement of the KLSE indices registered a double-digit declines during the first nine and a half months of 1998, following underlying weak market sentiments. The decline in share prices was the highest for the construction sector (-33.3%), followed by industrial products (-32.3%), trading/services (-30.1%), plantations (-28.5%), properties (-28.2%), finance (-27.4%), consumer products (-27.2%) and mining (-25.0%).

Table 8.14
Kuala Lumpur Stock Exchange:
Key Indicators

	1997	1998 September 15
Price Indices¹		
Composite	594.44	389.08
Emas	151.21	101.70
Second Board	162.93	93.41
Industrial	1,107.59	749.59
Finance	3,273.22	2,375.54
Property	760.90	546.70
Plantation	1,837.22	1,313.50
Mining	172.32	129.22
Price-Earning Ratio ¹	10.3	14.6
Market capitalisation ¹ (RM billion)	375.8	255
Number of listed companies ¹	708	734
Turnover²		
Volume (billion units)	72.77	38.08
Value (RM billion)	408.55	81.50

¹ As at end of period.

² For market transactions only.

Source: Kuala Lumpur Stock Exchange.

Several regulatory and legislative measures were instituted by the Securities Commission (SC) and the KLSE in the first nine months of 1998 aimed at enhancing investor protection, ensuring systemic stability, promoting innovation and competition and providing a fair and orderly environment for the trading of securities. These measures include:

- (i) **Introduction of new provisions or amendments to the Securities Industry Act 1983 (SIA)** to increase the range and level of enforcement options, protection of investors and promotion of market integrity. The amendments to the SIA and the introduction of new provisions, which

became effective on April 1, 1998, were as follows.

— **Insider trading**

The insider trading amendments broaden the definition of persons that can be caught for insider trading. Firstly, any person who possesses inside information is prohibited from trading in the relevant securities. Secondly, a person who possesses inside information is also prohibited from communicating that information.

Insiders are no longer defined as persons with fiduciary duties such as Chief Executive Officers (CEOs) or directors but could include all persons who have in their possession information that is not generally available. Such persons may include a member of a director's family, a body corporate which is associated with that director, or a substantial shareholder. In addition, a person who communicates inside information to enable another person to use it for his advantage, the second-mentioned person, known as a "tippee", can also be charged for insider trading. In the previous definition under sections 89 and 90, the definition only applied to an officer, agent or employee of a corporation or officer of a stock exchange.

— **Civil powers**

New sections have been added to the SIA, giving the SC or any person who has suffered loss or damage from market manipulation practices and insider trading to bring civil action against the offenders to recover losses. A case may be brought against the offender even if he has not been charged or proven guilty of any charge under criminal law.

Civil penalties would allow for full compensation for loss or damages, and the full range of orders available under section 100 of the SIA as well as under the inherent powers of the

Malaysian courts. The criminal penalty is imprisonment for a term not exceeding 10 years and a fine of not less than one million ringgit.

— **Power over company directors**

A new section has been added to the SIA giving SC the power to require a CEO or director of a public company to disclose their interest in a listed corporation and its associates. In addition, under the Securities Industry (Reporting of Substantial Shareholding) Regulations which came into force on 1 May, 1998, a substantial shareholder in a company is now required to give notice to the SC of the particulars of his interest. These disclosure requirements together with civil remedies prescribed will collectively act as a major deterrent to market manipulation and insider trading practices. The SC is also empowered to apply to the High Court to remove any CEO or director of a listed company who has been declared bankrupt or who has contravened provisions of securities laws or who has been convicted by a court of law for a criminal offence. In addition, the SC has the power to go behind nominee accounts relating to dealings in securities of listed and unlisted public companies.

(ii) **Tightening of rules on related-party and interested-party transactions** in recognition of the considerable potential for abuse in such transactions. The SC undertook a review of the rules on related-party/interested-party transactions in the Listing Requirements of the KLSE and subsequently strengthened the rules in the interest of investor protection. Existing rules were enhanced to:

- Include transactions involving interests of persons connected with directors and substantial shareholders;
- Require enhanced disclosure in the announcements of such transactions on circulars to shareholders;

- Require the appointment of corporate advisors to ensure that such transactions are fair and reasonable;
- Require boards of directors to state that such transactions are in the best interest of the company; and
- Prevent the persons interested in such transactions from voting.

(iii) **Enhancing standards of corporate governance.**

A key component in facilitating the move towards a disclosure-based system of regulation is the strengthening of corporate governance mechanisms in companies and transparency of these mechanisms. Towards this end, a high level Finance Committee on Corporate Governance comprising both public and private sector representative and chaired by the Secretary General of the Finance Ministry, was established in March, 1998 aimed at developing a framework for corporate governance and setting best practice standards for the securities industry.

(iv) **Facilitation and enhancement of investor compensation schemes**

- **The Compensation Fund** administered by KLSE was increased and administrative measures were introduced to ensure that claims for compensation are efficiently dealt with;
- **An Investor Reimbursement Scheme** was introduced by the SC, whereby SC will identify companies which met the qualitative and quantitative criteria set by SC and determine their interest in acquiring any member company under trading restrictions to take over liabilities owed to bona fide clients. Through the Reimbursement Scheme, any willing stockbroker having been deemed fit by the SC will be required to contribute a certain sum to the Scheme in return for approval to set up a branch or branches as deemed appropriate.

(v) **Primary market and capital raising**

Given the current economic difficulties, the SC had, among others, taken the following measures to alleviate some of the problems faced by listed companies to raise funds in the capital market:

- Removal of most of the restrictions on submissions for new listings, capital-raising exercises and restructuring schemes imposed on December 5, 1997;
- Liberalisation of rules in relation to warrants and convertible securities as follow:
 - (a) The limit on issuance of convertible securities, which was previously set at 50% of the company's issued and paid-up capital, was removed;
 - (b) The attachment of warrants with rights shares was allowed; and
 - (c) The issuance of naked warrants was allowed under specific circumstances.
- ; and
- Allowing dilution in earnings per share resulting from acquisition exercises and granting dispensations of profit forecasts and projections in public documents.

(vi) **New measures to enhance transparency and curb offshore trading of Malaysian securities.**

In addition to measures introduced by the SC, new measures were undertaken to increase transparency in the KLSE, and to curb offshore trading of securities listed on the KLSE. Initiated through changes in rules, regulations and procedures of the KLSE, the Securities Automated Network Services Sdn. Bhd. (SCANS) and the central depository, Malaysian Central Depository Sdn. Bhd. (CDS), measures instituted effective September 1, 1998 are as follows:

- **Trading of KLSE-listed securities:** all dealings in securities listed on the KLSE must be undertaken through

KLSE or recognised stock exchanges only; all dealings in KLSE securities must be through the KLSE's trading system (except otherwise permitted); stockbroking companies must ensure that they are not assisting any person to create another market for Malaysian securities;

- **New disclosure requirements:** know your client rule; name and particulars of beneficiary to be disclosed; each CDS account operated by a nominee can only have one beneficiary;
- **Off-market business and its clearing and settlement :** limited to crossings and married deals only; cleared and settled through SCANS.
- **New rules by MCD include:**

New Issues of Securities : all new issues of securities by public listed companies must be made by way of crediting the securities into the CDS accounts of the securities holders; Mandatory deposit: holders of share certificates must deposit them with the CDS. Withdrawal: all withdrawals are prohibited (except for circumstances allowed in the notice issued by KLSE); Transfers: restricted.

Consequent to these measure, all trading of Malaysian securities on the Central Limit Order Book International (CLOB) ceased on 15 September 1998 and with effect from 16 September 1998, all shares held in CDS accounts of stockbroking companies and other financial intermediaries acting as agents to facilitate trading on CLOB will no longer be good for all CDS transactions until the migration of CLOB shares have been formalised and effected.

The **Kuala Lumpur Options and Financial Futures Exchange (KLOFFE)** saw a substantial increase in the trading of the KLSE CI futures contract in the first eight months of 1998, reflecting the need for hedging activities given the greater

volatility in the equity market and increased uncertainties in the foreign exchange market in the review period. KLOFFE achieved an average monthly volume of 78,240 contracts during the first eight months of 1998, representing an increase of 145% from the average monthly volume of 31,914 contracts in the corresponding period of 1997. The daily average volume in the period was 3,888 contracts, a significant increase of 152% from the comparative figure at the end of 1997 (1,544 contracts). The trading volume of the KLSE CI futures contract was highest in the month of August 1998 with a record daily average volume of 4,646 contracts. As in previous years, foreign institutions still ranked the highest in terms of trading volume on the KLSE CI futures contract, with a market share of 54% during the eight months of 1998. Transactions by domestic retail participants accounted for 29% of the volume, followed by local members (14%), proprietary (2%) and foreign retail (1%) participants.

The trading volume of the 3-month KLIBOR futures on the **Malaysia Monetary Exchange (MME)** recorded a moderate turnover of 21,824 contracts valued at RM21.8 billion during the first nine months 1998, against 67,216 contracts valued at RM67.2 billion during the corresponding period of 1997. The lower turnover reflected the uncertainty about the direction of interest rates. As investors preferred to hedge against interest rates over the longer term, the most actively traded contracts were the June 1998 (5,219 contracts), September 1998 (5,194 contracts) and December 1998 (4,057 contracts), which together accounted for 66.3% of the total turnover during the period under review. Since its launch, market-makers who accounted for 47.0% of the total volume transacted, remained the most important players in the market. However, the market makers scheme was removed in July 1998. For the period of July to September 1998, domestic banks were the most active players who accounted for 70.0% of the total volume transacted, followed by foreign corporations (20.0%), retailers (4.0%), locals (3.3%), foreign banks (0.8%), domestic corporations (0.6%) and others (0.5%).

The **unit trust industry** grew moderately during the first eight months of 1998 in line with the softer market conditions. Another nine new units of trust funds were launched with a total approved fund size of 3,150 million units (January – August 1997: 5 unit trust funds, 1,300 million units). The total net asset

value of the funds increased by 12.4% from RM33.6 billion at the end of 1997 to RM37.7 billion at the end of August 1998. The net asset value of the funds as compared to the market capitalisation of the KLSE stood at 18.8% during the same period. Among the new funds launched during the period were the Amanah Saham Angkasa, BHLB Pacific Dana-Ihsan, Commerce-BT Lifetime Trust (comprising three funds namely Future Goals Fund, Balanced Returns Fund and Income Plus Funds), Amanah Saham Wanita, PB Balanced Fund, OSK-UOB Small Cap Opportunity Unit Trust and Pacific Dana Aman.

Kuala Lumpur Commodity Exchange

During the first eight months of 1998, the only active futures contract in the Kuala Lumpur Commodity Exchange (KLCE) was the crude palm oil (CPO) futures contract. There was no trading registered for the other contract markets, namely, Crude Palm Kernel Oil (CPKO), Cocoa and Tin, reflecting the lack of liquidity.

Trading in CPO futures in the first eight months of 1998 declined by 17.7% to 268,340 lots of 25 tonnes each, compared to 326,227 lots during the same period in 1997. One reason for the lower volume traded was the high price volatility experienced throughout the period. The price volatility had created great uncertainties making the market more cautious, causing both turnover and open position to fall. Another reason was the higher margin imposed by the clearing house to provide for the higher volatility. The higher margin and the high interest rates experienced in the period from November 1997 to August 1998 accounted for the increased cost of hedging and trading at the KLCE. As a result, many have turned to the physical market to hedge. In the first eight months of 1998, 6.71 million tonnes of CPO have been traded which is 26.8% higher than what has been produced (5.29 million tonnes) in the same period. The average daily turnover in the period declined from 2,001 lots or 50,025 tonnes in 1997 to 1,656 lots or 41,400 tonnes per day traded in 1998. The average settlement price for the first quarter of 1998 was RM2,301 per tonne while for the second quarter it was RM2,376 per tonne.