

Overview

Enhanced resilience in Malaysian financial and capital markets...

The thrust of monetary policy in 2002 continues to be directed at supporting domestic economic recovery. Low inflation, positive interest rate differentials vis-à-vis the United States (US), a comfortable external payments position and strengthened banking institutions continue to provide flexibility for monetary policy to remain accommodative to stimulate domestic economic activity. Liquidity management was directed at maintaining low and stable interest rates to encourage lending while ensuring that savers continued to enjoy positive rates of return.

The low interest rates and ample liquidity contributed to an expansion in financing to support economic growth. Loan applications, approvals, disbursements and loans outstanding increased during the first seven months of 2002, in tandem with the recovery in domestic economic activity. Higher demand for bank credit was seen in both the household and corporate sectors. Recovery in domestic economic activity is also reflected in the positive expansion of all monetary aggregates.

Notwithstanding the significant volatility in the international foreign exchange market, amidst a weakening of the US dollar rates, the ringgit peg continues to effectively facilitate trade and investment by providing greater certainty and stability. The ringgit peg remains sustainable and is supported by the nation's strong macroeconomic fundamentals.

The banking sector has been further strengthened following the consolidation exercise and the completion of corporate debt resolution by the Corporate Debt Restructuring Committee (CDRC).

The merged and better-capitalised banking entities are now on stronger footing to meet the increased challenges of competition.

Islamic banking grew in parallel with the expansion of the overall banking system. The development financial institutions augmented the banking system with increased lending to priority sectors. The provident and pension funds remain important in mobilising long-term savings in the economy. The performance of the insurance industry was mixed, with life insurance business affected by the termination of the Employees Provident Fund (EPF) annuity scheme, while general insurance business recorded stronger growth on account of higher motor vehicle sales.

The uptrend in the stock market was not sustained following the deterioration of investor confidence in the wake of several accounting scandals in the US, with the US and European markets more adversely affected than regional markets. Nonetheless, the better performance of the stock market prior to its consolidation prompted a record number of initial public offerings (IPOs) in the first half of the year. Funds raised in the capital market were, however, lower on account of higher redemptions of debt instruments. The performance of the derivatives market was mixed, in spite of better performance of crude palm oil (CPO) futures. Measures continued to be taken to increase the efficiency and competitiveness of the capital market, including the promotion of Malaysia as a regional Islamic capital market.

Monetary Policy

Accommodative monetary policy supporting economic growth...

In 2002, **monetary policy** continues to be directed at providing a positive enabling environment to support domestic economic activity. Given the

uncertainty in the external environment, the basic thrust of monetary policy has been directed at sustaining the underlying economic fundamentals to ensure that the domestic sector remains sufficiently flexible to deliver the necessary internal adjustment to sustain the recovery momentum.

The conduct of monetary policy aims to provide a stable and predictable operating environment that will help to maintain confidence in the market. Monetary policy responses have continued to leverage on areas of strong complementarities that exist between fiscal and monetary policies in order to avoid over-dependence on a single policy. The policy has also aimed to ensure that the levels of interest rates remain supportive of economic activities. Liquidity management during the course of 2002 ensured that interest rates remain low and stable, while providing a positive real rate of return on deposits.

On the external front, **international interest rates** have also been generally low due to monetary easing, in particular after the September 11 incident in 2001. With interest rate differentials positive in favour of Malaysia, coupled with the nation's strong macroeconomic fundamentals, the easier global interest rates have further accorded flexibility in maintaining the accommodative monetary stance to support the growth momentum.

The fixed exchange rate regime in place since September 1998, continues to benefit the economy. The ringgit peg provides an environment of certainty and stability to facilitate planning, investment and pricing decisions to support economic activities. The peg is sustainable and is consistent with the fundamentals of the economy, as evidenced by the absence of adverse pressures on the domestic and external sectors of the economy. The strong level of international reserves, low external indebtedness and the well-capitalised banking system are also supportive of the ringgit peg. Consistent macroeconomic policies have further enhanced the sustainability of the peg and increased the ability of the economy to absorb external shocks. The Government is committed to pursuing macroeconomic policies that are supportive of the fixed exchange rate, to ensure that it remains consistent with the economic fundamentals.

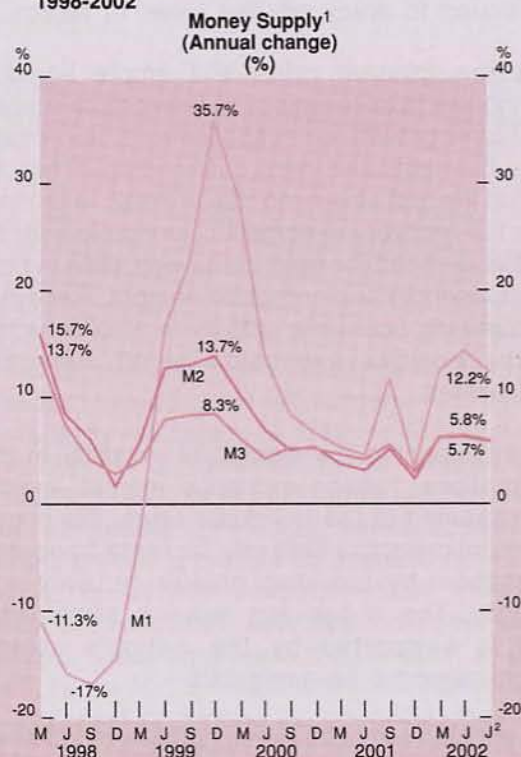
Monetary Developments

Expansion in money supply and loans reflecting improving economy, supported by a softer ringgit...

In tandem with stronger economic growth, money supply expanded further in the first seven months of the year. Reflecting increased demand for transactional balances, **M1 or narrow money**, consisting of currency in circulation and demand deposits, rose by an annualised rate of 12.2% at end-July 2002 (end-2001: 3.2%) or RM1,647 million during the period under review, as shown in *Chart 5.1*. The **broad monetary aggregate, M3** increased by 5.8% at end-July (end-2001: 2.9% at) or RM14,924 million during the same period. The main impetus to monetary expansion emanated from the higher financing of the private sector and expansionary external and Government operations.

CHART 5.1

Monetary Aggregates 1998-2002



Source: Bank Negara Malaysia.

Exhibiting a similar trend, **total deposits** rose significantly by RM9,063 million in the first seven months (January-July 2001: RM3,861 million). Of significance is the RM9,187 million increase in deposits placed by individuals, with the bulk of the increase in total deposits being placed in fixed deposits (48%), Islamic Banking Scheme (IBS) deposits (45%) and savings deposits (22%).

The accommodative monetary policy stance has allowed interest rates to remain low and stable, as shown in *Chart 5.2*. The intervention rate was maintained at 5%, while the base lending rate (BLR) and deposit rates remained stable, as shown in *Table 5.1*. The prevailing ample liquidity situation led to a competitive credit market, prompting the banking institutions to price selective loans below the BLR. Underpinned by the low interest rates, ample liquidity and strengthened banking institutions, monetary conditions continued to improve. Total gross private sector financing raised (loan disbursed, gross private debt securities (PDS) issues and funds raised from the equity market) was higher, amounting to RM253,906 million in the first seven months of 2002 (January-July 2001: RM232,084 million), as shown in *Table 5.2*.

Expansionary policies aimed at stimulating domestic demand were effective in bolstering higher demand for credit from both the household and the corporate sectors. The direction of financing indicated that retail financing was mainly for the purchase of residential properties and passenger cars, while corporate financing was directed mainly into the manufacturing, wholesale and retail trade, restaurants and hotels, construction and finance, insurance and business services sectors, as shown in *Table 5.3*. A positive development has been the continued trend towards deleveraging and debt restructuring exercises that has helped to strengthen the corporate sector balance sheet. Under these circumstances, debt repayments, both in the banking system and bond market remained high. This, together with the reduced need for long-term financing, given the prevailing excess capacity in most industry sub-sectors, moderated the increase in the net financing of the private sector.

TABLE 5.1

Interest Rates of Commercial Banks and Finance Companies (%)

	End-2001	End-July 2002	Difference
Commercial Banks			
Base lending	6.39	6.39	0.00
Savings deposit	2.28	2.25	-0.03
3-month fixed deposit	3.21	3.20	-0.01
Finance Companies			
Base lending	7.45	7.45	0.00
Savings deposit	2.94	2.80	-0.14
3-month fixed deposit	3.22	3.20	-0.02

Sumber: Bank Negara Malaysia.

TABLE 5.2

Private Sector Gross Financing through Banking System and Capital Market (January-July)

	2001		2002	
	RM million	Annual Growth (%)	RM million	Annual Growth (%)
Loan disbursements	215,242	8.2	231,311	7.5
Gross PDS issuance	12,383	37.9	12,976	4.8
Equity	4,459	22.6	9,619	115.7
Total	232,084	9.7	253,906	9.4

Source: Bank Negara Malaysia.

In terms of bank lending, all loan indicators showed expansion in loans extended by the banking system, consistent with increased domestic economic activities. Loan applications rose by 10.2% during the first seven months of 2002. Both loan approvals and disbursements rose by an annual rate of 7.4% and 7.5%, respectively during the same period. Loan repayments were, however, also high, arising from short-term loans taken by corporations to

CHART 5.2

BNM Intervention Rate, 3-month Interbank Rate and Commercial Banks Base Lending Rate

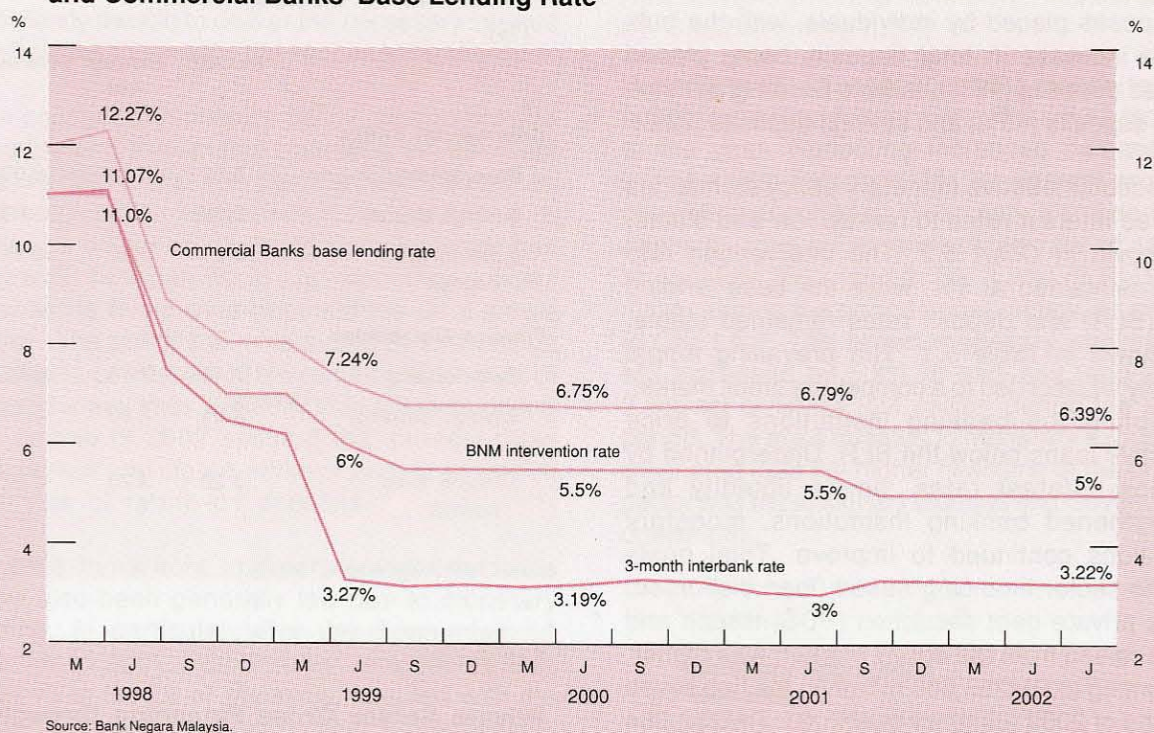


TABLE 5.3

Banking System : Direction of Lending¹

Sector	December 2001	July 2002	Change	End-July 2002 Share
	(RM million)			(%)
Agriculture, hunting, forestry and fishing	12,393.2	11,946.9	-446.3	2.5
Mining and quarrying	1,538.3	1,260.5	-277.8	0.3
Manufacturing	68,466.3	67,507.9	-958.4	14.0
Electricity, gas and water	5,316.8	6,055.6	738.9	1.3
Wholesale, retail, restaurants and hotels	38,896.6	39,256.5	359.9	8.1
Broad property sector	175,860.7	181,479.7	5,619.0	37.5
Construction	40,082.7	38,797.5	-1,285.2	8.0
Residential property	87,055.2	95,139.4	8,084.2	19.7
Non-residential property	29,695.5	29,551.3	-144.2	6.1
Real estate	19,027.3	17,991.5	-1,035.8	3.7
Transport, storage and communications	12,476.2	12,695.4	219.2	2.6
Finance, insurance and business services	35,375.8	34,775.3	-600.5	7.2
Consumption credit of which:	69,436.0	76,561.5	7,125.5	15.8
Credit cards	8,941.8	9,590.1	648.3	2.0
Purchase of passenger cars	45,500.1	51,597.1	6,097.0	10.7
Purchase of securities	30,348.9	30,056.0	-292.9	6.2
Purchase of transport vehicles	2,399.1	3,503.0	1,103.9	0.7
Community, social and personal services	6,201.9	6,461.8	259.9	1.3
Others	11,839.4	11,965.1	125.7	2.5
Total loans outstanding²	470,549.2	483,525.2	12,976.0	100.0

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

Source: Bank Negara Malaysia.

CHART 5.3

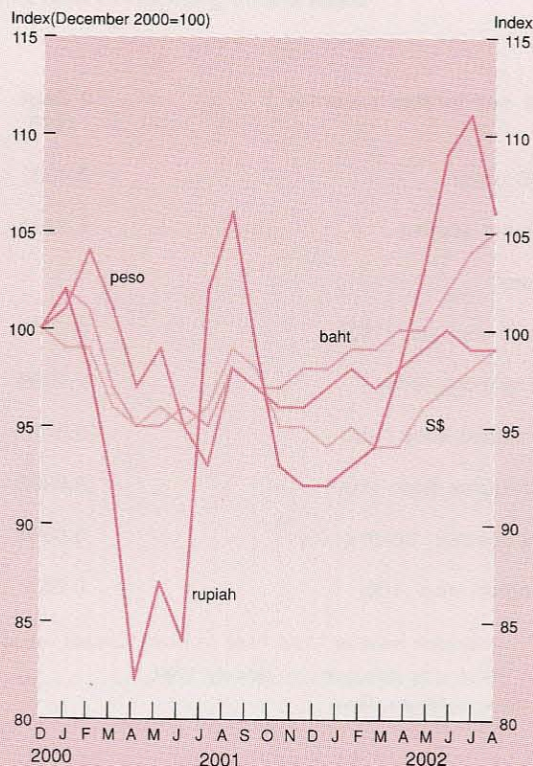
Performance of Ringgit Against Selected Major Currencies



Source: Bank Negara Malaysia.

CHART 5.4

Performance of Ringgit Against Selected Regional Currencies



Note: An increase in the index represent an appreciation of the currency against the Ringgit.

Source: Bank Negara Malaysia.

meet working capital and the ongoing restructuring exercises, resulting in only a moderate increase of 3.3% in loans outstanding at end-July 2002.

Emphasis was also given to improving access to financing of priority sectors, particularly the small- and medium- enterprises (SMEs). In this regard, efforts continued to be directed at enhancing access to credit by the SMEs and developing alternative modes of financing to promote new activities in the higher risk venture capital industry. During the year, efforts to enhance the accessibility to credit by the SMEs continued to build on gains from previous measures aimed at expanding the size and scope of selected funds. These initiatives include the introduction of 12 special funds to finance SMEs since 1998, seven of which are still open for application. Since 2001, the size and scope of selected funds have been expanded, the eligibility criteria

liberalised and the lending rates reduced. A complaints unit and a Bumiputera Development Unit were also established in Bank Negara Malaysia (BNM) to monitor complaints and help develop Bumiputera entrepreneurs. With effect from 3 June 2002, the function and role of the Bumiputera Development Unit has been shifted to ERF Sdn Bhd to serve as a one-stop centre in addressing issues regarding the development of Bumiputera enterprises.

The **exchange rate of the ringgit** remains pegged at RM3.80 to the US dollar, an arrangement that has been in place since 2 September 1998. Since end-2001, the ringgit has, however, depreciated against major currencies due to the weakening of the dollar mainly on market concerns over the US current account deficit and the possible adverse impact of corporate accounting problems on the strength of the US economic

TABLE 5.4

Performance of Ringgit Against Selected Currencies

RM per foreign currency ¹	2 Sept. 1998	End 2001	End August 2002	Change (%)	
				vs. 2 Sept. 1998	vs. end- 2001
US dollar	3.8000	3.8000	3.8000	0.0	0.0
Pound sterling	6.3708	5.5161	5.8822	8.3	-6.2
euro*	-	3.3662	3.7430	-	-10.1
Japanese yen (100)	2.7742	2.8955	3.2213	-13.9	-10.1
Singapore dollar	2.1998	2.0529	2.1733	1.2	-5.5
Thailand baht (100)	9.3713	8.6022	9.0069	4.0	-4.5
Philippine peso (100)	8.8302	7.3644	7.3348	20.4	0.4
Indonesian rupiah (100)	0.0354	0.0365	0.0429	-17.5	-14.9
Korean won (100)	0.2827	0.2883	0.3186	-11.3	-9.5

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

* euro was introduced in January 1999.

Source: Bank Negara Malaysia.

recovery as shown in *Chart 5.3*. The ringgit has depreciated by 10.1% against both the euro and the yen, and 6.2% against the pound sterling, as shown in *Table 5.4*. Similarly, the ringgit has depreciated in the range of 4.5%-14.9% against all regional currencies, except the Philippine peso against which the ringgit has appreciated by 0.4% as shown in *Chart 5.4*.

ratio of 8%, as shown in *Chart 5.5*. Similarly, the core capital ratio (CCR) was sustained at 10.8%, which is higher than the international requirement of 4%. The net non-performing loans (NPLs) ratio, based on a six-month classification, remained stable at 8% in July on account of higher specific provisions and the continuing efforts of the banking institutions in debt restructuring.

Performance of the Banking System

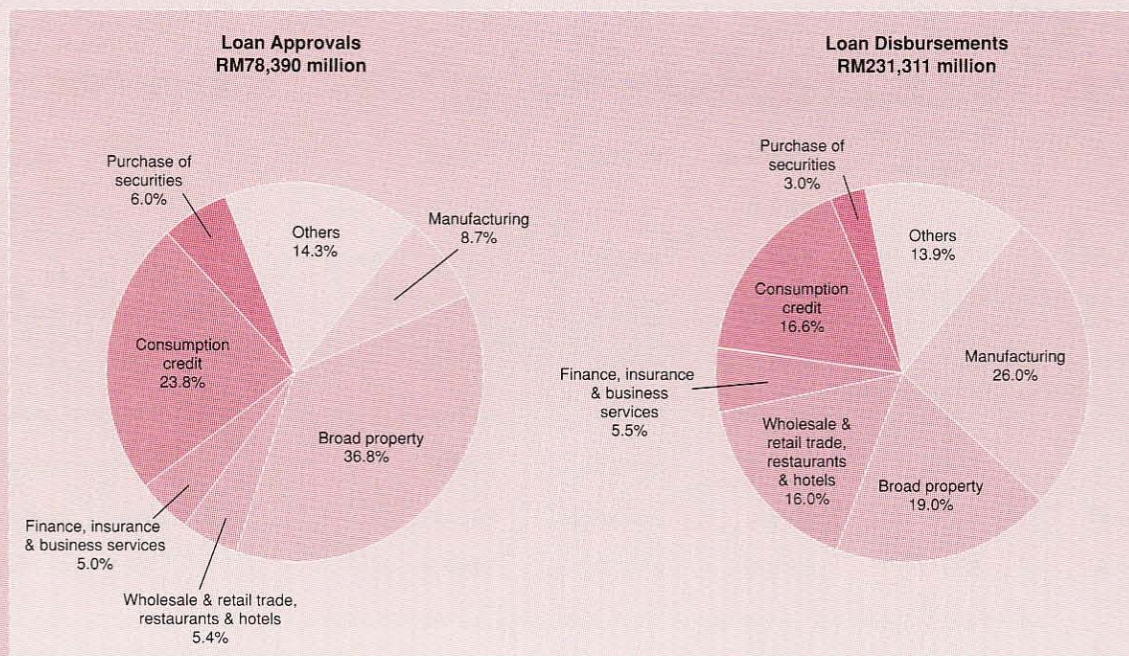
A more resilient banking system with non-performing loans stable and new initiatives...

The banking system strengthened with the risk-weighted capital ratio (RWCR) at 13.1% in July 2002, continuing to exceed the Basle minimum

The implementation of various policy measures further strengthened the banking sector. The banking sector consolidation has resulted in a better-capitalised domestic banking system, with all banking groups having completed their business system integration. Several prudential measures were introduced to ensure the soundness and stability of the financial system. This included the introduction of the Central Credit Reference Information System (CCRIS) which enabled realtime, online access to a comprehensive and up-to-date database of all

CHART 5.6

Loan Approvals and Disbursements January-July 2002



Source: Bank Negara Malaysia.

Financial and Corporate Restructuring

A stronger banking sector...

Progress in financial sector reforms has been significant. The successful consolidation and integration of the ten banking groups has placed the banking sector on firmer footing to support the changing needs of the economy and to meet increasing challenges arising from competition. The merged banking entities are now better capitalised and able to undertake a wider scope of business activities.

There has been further progress in financial and corporate restructuring achieved by Danaharta, Danamodal and the CDRC. **Danaharta** completed its NPL acquisition phase in 2000 and is currently actively focussed on implementing recovery

measures on the NPLs under its purview. As at end-July 2002, recovery action has been initiated on almost all of the RM47,740 million (99.9%) of total loan rights acquired, with recovery expected at RM29,710 million or 57% (after incorporating zero per cent recovery on defaulted loans). A significant development for Danaharta was the embarking on its first asset-backed securitisation (ABS) exercise in December 2001, through a special purpose vehicle, Securita ABS One Berhad. The ABS exercise, involving an issuance of RM310 million "AAA" rated Senior Notes with a coupon rate of 3.875% and maturity in December 2005, marked the first collateral loan obligation securities in Malaysia.

Since 1999, no further addition was made to the initial capital injection of RM7,590 million by **Danamodal** into ten banking institutions in the period 1998 to 1999. To date, repayment of RM5,450 million has been made by seven banking

institutions, while the outstanding recapitalisation in the remaining three banking institutions stood at RM2,140 million at end-July 2002. Danamodal is expected to close its core operations by end-2003.

CDRC has officially ceased operations on 15 August 2002. During its four years' existence from July 1998 to August 2002, the CDRC has successfully resolved 47 cases with debts valued at RM43,971 million. The recovery profile of the resolved cases showed that 83% of the recovery proceeds were in the form of cash, redeemable instruments and rescheduled debts. The progress in corporate debt restructuring has been well received by the market, particularly where revamp of management and operational restructuring took place.

Islamic Banking

Making further strides in Islamic banking, with the IFSB Secretariat in Malaysia...

Islamic banking expanded its market share of the total banking system in terms of assets and deposits to constitute 8.7% and 10.3%, respectively as at end-July 2002. In 2001, Islamic banking assets registered a market share of 8.2%, surpassing the 8% target set by BNM. To date, the Islamic banking system comprises two Islamic banks, namely Bank Islam Malaysia Berhad and Bank Muamalat Malaysia Berhad, with 34 other financial institutions offering Islamic banking services under the IBS.

As at end-July 2002, total assets of the Islamic banking system rose by 8.9% to RM64,164 million (end-2001: RM58,929 million), reflecting a 11% increase in deposits to RM52,299 million (end-2001: RM47,106 million), as shown in *Table 5.5*. Financing extended by the Islamic banking system increased by 17.6% to RM33,164 million during the same period. A significant proportion of financing was channelled for the purchase of houses and passenger cars, increasing by 33.3% and 10.8%, respectively to account for 27.5% and 20.3%, respectively of total financing. Trading

TABLE 5.5

Islamic Banking: Key Indicators

	As at End 2001 RM million	As at End-July 2002 RM million	Change (%)
Assets	58,929	64,164	8.9
Deposits	47,106	52,299	11.0
of which:			
Investment	33,505	36,880	10.1
Savings	4,149	4,881	17.6
Current	6,457	7,305	13.1
Financing	28,201	33,164	17.6
of which:			
Manufacturing	3,073	3,617	17.7
Broad property sector	10,782	13,547	25.6
Residential property	6,846	9,128	33.3
Consumption credit	745	905	21.5
Passenger cars	6,068	6,721	10.8

Source: Bank Negara Malaysia.

in the Islamic interbank money market was active with a monthly average of RM23,009 million (January-July 2001: RM22,700 million), on account of higher demand for short-term Islamic financial instruments.

Several measures were taken to promote Malaysia as an international Islamic financial centre. An important development is the establishment of the Islamic Banking and Finance Institute Malaysia (IBFIM) in February 2001 as a one-stop centre to provide education, training and research on Islamic financial services, which has achieved significant progress. A total of 1,160 persons has been trained in various Islamic banking and *takaful* courses to date. Another milestone was achieved when Malaysia was chosen as the headquarters of the Secretariat to the Islamic Financial Services Board (IFSB). The IFSB, which will be a standard-setting body to develop supervisory and prudential standards for Islamic financial institutions worldwide, is expected to be operational in the fourth quarter of 2002.

Development Financial Institutions

DFIs improved financial accessibility to priority sectors...

Development financial institutions (DFIs) continue to play a significant role in supporting the development of identified priority sectors such as agriculture, manufacturing and infrastructure as well as exports and international trade. The DFIs provide medium-and long-term financing of projects that could carry higher risks due to the longer investment tenure. In 2002, six DFIs were brought under the supervision of BNM under the Development Financial Act, 2002. Total resources of the eight DFIs surveyed, however, decreased by 5.8% to RM42,868 million as at end-June 2002 (end-June 2001: RM45,512 million), due to lower earnings and borrowings. Borrowings declined by 1.7% to RM9,206 million, accounting for a 21.5% share of total resources.

Loans extended by DFIs, however, rose significantly by 17.8% to RM15,710 million (end-June 2001: RM13,330 million), as shown in *Table 5.6*. The prime contributor to the increase in loans was the real estate and construction sector, which expanded by 51.2% due to higher financing of infrastructure projects, such as power lines, ports, railroads, elevated highways and bridges as well as robust demand for residential properties.

TABLE 5.6

Direction of Lending by DFIs (End June)

Sector	RM million		Share %	
	2001	2002 ^P	2001	2002
Manufacturing	3,558.2	3,628.6	26.7	23.1
Agriculture	1,551.2	1,738.9	11.6	11.1
Real Estate & Construction	2,466.7	3,730.5	18.5	23.7
General Commerce	34.7	51.4	0.3	0.3
Transport & Storage	3,808.1	4,690.1	28.6	29.9
Others	1,911.5	1,870.2	14.3	11.9
Total	13,330.4	15,709.7	100.0	100.0

^P Preliminary data

Sources: Bank Pertanian Malaysia, BPIMB, MIDF, Bank Industri & Teknologi Malaysia Berhad, EXIM, Sabah Development Bank, Perbadanan Pinjaman Sabah and Borneo Development Corporation.

Similarly, loans extended to the transport and storage sector increased by 23.2% with Bank Pembangunan dan Infrastruktur Malaysia Berhad (BPIMB) accounting for a hefty 74.4% share of total loans to the sector. The growth in loans to the sector was influenced by the increase in demand for telecommunication infrastructure as well as for land transport and its support services.

In line with the Government's policy to boost the agriculture sector as the third source of growth after manufacturing and services, loans extended to the agriculture sector rose by 12.1%, largely by Bank Pertanian Malaysia in consonance with its objective of financing agriculture development. Meanwhile, loans channelled to manufacturing registered a moderate increase of 2%, with the Export-Import Bank of Malaysia (EXIM) accounting for the bulk at 39% share of total loans to the sector.

Bank Simpanan Nasional

Popular among savers due to convenient access...

Bank Simpanan Nasional (BSN) complemented the banking system in mobilising savings, particularly among the middle and lower income groups. Due to its large network of branches, the BSN provides a convenient and easy access to savers. Total resources of the BSN declined by 5.8% to RM10,657 million at end-June 2002 (end-June 2001: RM11,312 million), mainly due to lower deposits, as shown in *Table 5.7*. Notwithstanding the lower deposits, BSN remained a popular savings institution as mirrored by the 7.6% increase in the number of depositors. Fixed deposits remained the major source of deposit funds with a 44.4% share, despite declining by 16.7% on account of higher redemptions by corporations. GIRO deposits, however, increased by 4.2% and accounted for a 32.7% share of total deposits. Islamic banking deposits rose significantly by 59.7%, pointing to its increasing popularity. Loans extended by the BSN declined by 6.4% to RM2,206 million, mainly due to lower hire-purchase during the period. The bulk of loans was extended to individuals, accounting for 61.5% of total loans, mainly comprising housing loans.

TABLE 5.7

Bank Simpanan Nasional
 (as at end June)

	2001	2002 ^p
Deposits¹ (RM million)	10,593.20	9,977.34
Savings	1,281.52	1,221.26
Fixed	5,317.81	4,427.62
GIRO	3,126.31	3,257.83
Premium Savings Certificates	656.41	739.46
Islamic Banking	194.45	310.58
Others	16.70	20.59
Investments at book value (RM million)	8,080.63	7,452.03
Malaysian Govt. Securities	2,562.23	2,442.59
Shares ²	2,966.85	2,780.27
Others ³	2,551.55	2,229.17
Gross Loans (RM million)	2,356.28	2,206.31
Individuals	1,307.86	1,357.30
Corporates	182.88	196.17
Credit Cards	47.43	48.50
Hire-purchase	818.11	604.34
Number of BSN branches ⁴	434	420
Number of post offices with BSN facilities	482	375
Number of depositors ('000)	8,383	9,016

¹ Includes interest credited.

² Includes unit trust and non-unit trust, private debt securities and warrants.

³ Includes long-term and short-term deposits.

⁴ Includes mini-branches and sub-branches.

^p Preliminary.

Source: Bank Simpanan Nasional.

Discount Houses

Discount houses experienced sharp decline in fee-based activities...

Discount houses remained an important intermediary in the financial system. As at end-July 2002, total resources of discount houses expanded marginally, increasing by 3% to RM24,633 million. As such, total investments of discount houses, also increased slightly by 0.7% to RM20,611 million (end-July 2001: RM20,473 million). The largest proportion of the resources of discount houses was invested PDS which amounted to RM7,072 million or 28.7% of total resources (end-July 2001: RM7,488 million).

During the first seven months of the year, discount houses, however, experienced a large decline in fee-based activities. Discount houses arranged, lead-managed and co-managed the issuance of PDS worth RM695 million (January-July 2001: RM2,389 million) as well as underwriting RM984 million for PDS issues (January-July 2001: RM1,343 million). A significant development affecting discount houses was the extension of the BNM liquidity framework to the industry effective 1 June 2002, aimed at instilling good liquidity management and enhancing its capability in managing liquidity risks.

Provident and Pension Funds

Provident & pension funds continue to play an important role in mobilising funds to support socio-economic development...

Provident and pension funds (PPFs) continue to support socio-economic development by mobilising and channelling medium-to long-term funds to finance public and private sector projects. Total resources of the nine PPFs, comprising the EPF, the Social Security Organisation (SOCSO), the Armed Forces Fund, the Pensions Trust Fund and five other private PPFs, expanded by 8.9% to RM243,295 million as at end-June 2002 (end-June 2001: RM223,331 million), as shown in Table 5.8. Gross contributions to EPF accounted for a major portion of the increase to constitute 84.6% of total gross contributions.

Gross contributions of PPFs during the first half of the year, however, declined by 9.4% in tandem with the lower number of contributors.

During the period, withdrawals were significantly lower amounting to RM7,545 million (January-June 2001: RM14,207 million), resulting in higher net contributions. The bulk of withdrawals was made by EPF contributors through three main withdrawal schemes, namely for government pensionable employees, the purchase of personal computers as well as those leaving the country. The EPF, however, terminated the withdrawal scheme for the purchase of personal computers in August based on the results of a comprehensive study undertaken by the EPF indicating that the "one computer, one home" objective could be achieved without the scheme.

TABLE 5.8

**Provident and Pension Funds:
Selected Indicators
2001-2002**

	2001	2002 ^P
	(RM million)	
As at end June		
Number of contributors ('000)	19,209	18,951
of which: EPF	10,101	10,240
SOC SO	8,873	8,519
Accumulated contributions	199,576	216,660
Total resources	223,331	243,295
of which: EPF	186,940	199,714
SOC SO	9,721	10,641
Investments in MGS	71,327	72,271
During the period (January-June)		
Gross contributions	13,057	11,820
Withdrawals	14,207	7,545
Net contributions	(1,150)	4,275
Investment income	5,920	6,481

^P Preliminary.

Source: Employees Provident Fund, Social Security Organisation, Pensions Trust Fund, Armed Forces Fund and five other private provident and pension funds (Malaysian Estates Staff Provident Fund, MAS Provident Fund, SESCO Employees Provident Fund, Petronas Retirement Benefit Scheme and Jenderata-Bernam Provident Fund).

Investment income of PPFs rose by 9.5% to RM6,481 million, reflecting the improved investment environment. The PPFs shifted their investment strategy to corporate bonds and equities to constitute 52.2% of total investments (end-June 2001: 49.9% share). Investment in MGS registered a smaller increase of 1.3% to account for 47.8% share of total investment, partly due to the lower issuance of Malaysian Government Securities (MGS) in the market.

Insurance Industry

Better performance for general insurance with robust sales in motor vehicles...

The performance of the insurance industry comprising life insurance and general insurance business, was mixed during the first half of 2002. **Life insurance** business was significantly affected by the termination of the annuity scheme by the EPF, with new business premiums of life insurance declining by 55.1% to RM1,660 million (January-June 2001: RM3,694 million), as shown in *Table 5.9*. Excluding single premium annuity business, new business premiums, however, recorded an increase of 28.1% (January-June 2001: 6.5%). New sums insured grew moderately by 4.9% to RM70,376 million (January-June 2001: RM67,061 million). Total assets of life insurance funds expanded by 14.5% to RM47,514 million (January-June 2001: RM41,507 million), as shown in *Table 5.10*. The bulk of assets was invested in corporate and debt securities accounting for 48.4% (January-June 2001: 47.4%).

In contrast, the performance of **general business** was more buoyant with gross direct premiums recording a double digit growth of 18.4% to RM3,798 million in the first half of 2002 (January-June 2001: RM3,207 million), as shown in *Table 5.11*. Motor insurance increased by 12.3%, reflecting higher sales of motor vehicles and continued to account for the largest share at 43.4% of total gross direct premiums. Investments of general insurance funds were dominated by holdings in cash and deposits, accounting for 36.9% of total assets, followed by corporate and debt securities with a 31.7% share.

TABLE 5.9

Life and General Insurance Business

	End 2001	End-June ^P 2002
Life Insurance Business (RM million)		
New Business:		
Number of policies ('000 units)	1,370.0	623.9
Sums insured	129,003.8	70,376.0
Total premiums	5,247.9	1,659.9
Business in force:		
Number of policies ('000 units)	7,891.0	8,137.4
Sums insured	440,005.8	457,065.9
Annual premiums	8,170.0	8,581.8
Premium income	11,684.8	4,945.1
Benefit Payments		
Total	3,311.1	1,933.8
Maturity	703.3	481.4
Death & disability ¹	1,280.0	681.9
Surrender	771.7	445.5
Cash bonuses	509.3	229.1
Annuity	46.8	95.9
General Insurance (RM million)		
Premium Income:		
Gross Direct Premiums	6,404.0	3,797.6
Net Premiums	5,386.7	2,895.1
Reinsurance Placed Outside Malaysia	584.4	580.5
Retention Ratio (%) ²	90.2	83.3
Number of Insurance Companies		
Direct:		
Life	8	7
General	36	34
Composite	8	9
Reinsurance:		
Life	1	1
General	9	9
Composite	1	1

^P Preliminary data.¹ Includes medical and others.² Net premiums over gross premiums.

Source: Bank Negara Malaysia.

TABLE 5.10

Assets of Life and General Insurance Funds

(RM million)

	Life Insurance		General Insurance	
	2001	End-June 2002 ^P	2001	End-June 2002 ^P
Fixed assets	346.8	333.5	675.5	699.0
Loans	6,348.2	6,321.3	222.1	204.5
Govt. securities	6,790.7	6,774.0	1,927.5	1,771.2
Government guaranteed loans	27.8	17.5	1.4	0.9
Corporate and debt securities	21,123.6	22,998.2	4,915.6	4,966.1
Investment properties	2,462.5	2,756.9	427.5	407.9
Cash and deposits	6,080.2	6,513.2	5,258.9	5,789.1
Other assets ¹	1,746.6	1,799.9	1,509.0	1,851.1
Total	44,926.4	47,514.5	14,937.5	15,689.8

^P Preliminary data.¹ Includes foreign assets, other assets and investments.

Source: Bank Negara Malaysia.

TABLE 5.11

**General Insurance:
Premium Growth and Distribution
(January-June)**

	2001	2002	
Sector	(RM million)		Change (%)
Motor	1,466.8	1,647.3	12.3
Marine, aviation and transit	279.5	456.6	63.4
Fire	696.8	765.6	9.9
Miscellaneous	764.0	928.1	21.5
Gross Direct Premium	3,207.1	3,797.6	18.4

Source: Bank Negara Malaysia.

In the light of the changing landscape of the financial sector characterised by increasing competition and sophisticated consumer demands, further efforts have been made to enhance the capacity and competitiveness of the domestic insurance industry. The introduction of higher capital requirements since 30 September, 2001 has resulted in a better capitalised insurance sector as well as facilitated consolidation. Since 1999, 10 mergers and acquisitions (M&As) involving 20 insurers have been completed, while six M&As involving 11 insurers are at various stages of implementation as at end-June 2002.

Islamic Insurance

Vast potential for Islamic insurance...

Islamic or *takaful* insurance offers an alternative to conventional insurance by providing insurance products that are based on Islamic principles. Steps to further enhance the development of the *takaful* industry include promoting competition and accelerating expansion of *takaful* business. In particular, the licensing of a third *takaful* player, which commenced operations in July 2002, will further contribute to the growth of *takaful* business.

The *takaful* industry experienced slower growth, with total contributions for new certificates and total new sums of family *takaful* business recording RM209 million and RM7,695 million, respectively in the first six months (January-June 2001: RM777 million and RM8,319 million, respectively), as shown in Table 5.12. Slower growth was mainly attributed to the discontinuation of the EPF *Takaful* Annuity Scheme in May 2001. General *takaful* business, however, performed better, with total gross contributions expanding by 9% to RM158 million (January-June 2001: RM145 million).

Combined assets of *takaful* funds and shareholders fund increased moderately by 10.5% to RM3,485 million as at end-June 2002 (end-June 2001: 44.8%), in line with the slower growth momentum of *takaful* business. The bulk of *takaful* assets or 80.3% was invested in corporate securities, placed in investment deposits with banks and in Government Investment Issues.

TABLE 5.12

Family and General *Takaful* Business

	Financial Year 2001	As at 30 June 2002 ^P
Assets¹ (RM million)	3,155.0	3,485.5
Government Investment Issues	428.7	195.7
Investment deposits:		
- Bank Islam Malaysia Bhd.	1.5	1.3
- Others	1,268.1	1,250.1
Corporate securities	742.5	1,352.6
Cash and deposits	27.4	14.5
Financing	454.7	137.4
Fixed assets	137.1	136.2
Others	95.0	397.5
Family <i>Takaful</i> Business		
New Business:		
Total contribution (RM million)	1,142.9	209.1
Sums participated (RM million)	19,562.9	7,695.5
Number of certificates	218,394	118,363
Business in Force:		
Total contribution (RM million)	2,293.2	1,831.7
Sums participated (RM million)	50,019.2	57,865.7
Number of certificates	773,054	889,133
General <i>Takaful</i> Business		
Gross contributions (RM million)	266.8	158.2
Net claims paid (RM million)	52.0	44.0

^P Preliminary data.

¹ Assets of family *takaful* funds, general *takaful* funds and shareholders' funds.

Source: Bank Negara Malaysia.

Capital Market

Lower funds raised in capital market due to higher redemption...

The **capital market**, comprising equities and bonds, remains an important source of financing. During the seven months of 2002, gross funds raised in the capital market totalled RM37,671 million, of which RM30,610 million were raised by the private sector with the remaining RM7,061 million by the public sector, as shown in *Table 5.13*. However, due to higher redemptions amounting to RM27,413 million, net funds raised were lower at RM10,258 million (January-July 2001: RM14,395 million). Funds raised by the public sector were mainly through the issuance of MGS amounting to RM6,589 million. This reflected continued Government commitment to establish a benchmark yield for the development of the bond market through regular issuance of MGS as well as raising non-inflationary funding to finance the fiscal deficit. Given the ample liquidity situation, public sector borrowings through MGS issues did not give rise to any crowding-out of private sector financing needs. Redemptions of MGS totalled RM5,900 million, resulting in lower net funds raised by the public sector at RM1,157 million (January-July 2001: RM4,038 million).

In the PDS market, gross funds raised were higher at RM20,991 million in the first seven months of 2002 (January-July 2001: RM16,878 million) as companies issued PDS to take advantage of low interest rates and ample liquidity as well as investors' preference for more stable investment options. This development also reflected the increased recourse to the bond market for longer-term financing and to facilitate the intensified debt restructuring exercise. Islamic bonds were the most popular funding instrument, accounting for 49.3% of total funds raised in the PDS market. The higher redemption during the period was attributed mainly to the redemption of a major infrastructure company's outstanding bonds, which was part of its debt restructuring process. As a result, on a net basis, funds raised by the private sector recorded a net redemption of RM519 million. By sector, funds raised through the PDS market were mainly for the transport,

TABLE 5.13

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

	2001	2002 ^P
By Public Sector		
Debt Securities		
Malaysian Government Securities	11,256.7	6,589.4
Khazanah Bonds	583.3	-
Government Investment Issues	1,805.5	-
Malaysia Savings Bonds	-	471.5
New Government debt securities	13,645.5	7,060.9
Less: Redemptions		
Malaysian Government Securities	6,600.0	5,900.0
Government Investment Issues	2,000.0	-
Malaysia Saving Bonds	7.3	3.6
Khazanah Bonds	1,000.0	-
Net funds raised	4,038.1	1,157.3
By Private Sector		
Shares¹		
Initial Public Offerings	1,565.6	6,541.2
Rights issues	801.4	1,366.6
Private placements	1,651.0	1,454.7
Special issues	32.9	65.7
Warrants	408.0	190.8
New Share Issues	4,458.9	9,619.0
Debt Securities² (gross)		
Straight bonds	3,749.0	1,290.8
Convertible bonds	1,380.2	1,187.7
Islamic bonds	6,490.8	10,347.2
Bonds with warrants	762.8	150.0
Cagamas bonds	4,495.0	8,015.0
New debt securities	16,877.8	20,990.7
Less: redemptions		
Private Debt Securities ³	7,664.5	18,412.3
Cagamas bonds	3,315.0	3,097.0
Net issues of debt securities	5,898.3	(518.6)
Net funds raised	10,357.3	9,100.4
Total net funds raised	14,395.4	10,257.7

^P Preliminary data.

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

² Includes bonds issued by the banking institutions since July 2000.

³ Includes straight bonds, bonds with warrants, convertible bonds and Islamic bonds.

Source: Bank Negara Malaysia.

TABLE 5.14

**New Issues of PDS by Sector¹
(January-July)**

Sector	2001		2002 ^P	
	RM million	Share (%)	RM million	Share (%)
Agriculture	-	-	-	-
Manufacturing	1,601.6	13.2	547.2	4.2
Construction	1,865.5	15.4	598.5	4.6
Electricity, gas and water supply	2,830.4	23.4	819.0	6.3
Wholesale & retail trade, restaurants and hotels	250.0	2.1	285.0	2.2
Transport, storage and communication	2,496.7	20.6	6,197.6	47.8
Financing, insurance, real estate and business services	2,949.6	24.4	1,396.0	10.8
Government and others	99.1	0.9	3,132.5	24.1
Total	12,092.9	100.0	12,975.8	100.0

¹ Excluding Cagamas Bonds.^P Preliminary.

Source: Bank Negara Malaysia.

storage and communication, and financing, insurance, real estate and business services sectors, as shown in *Table 5.14*.

Funds raised through equity issues increased to RM9,619 million in the first seven months of 2002 (January-July 2001: RM4,459 million). Funds were raised mainly through IPOs and private placements. IPOs during the period amounted to RM6,541 million and accounted for more than half of financing acquired through the equity market. Positive signs of domestic economic recovery together with encouraging developments such as the upgrades of Malaysian sovereign

ratings by credit rating agencies, favourable corporate results and positive corporate restructuring developments helped improve market sentiments and attracted the private sector to seek listings on the KLSE to finance their operations and expansion. The listing of two major Malaysian corporations in the telecommunication and infrastructure sectors have further provided interest and significantly improved the depth of the market. The performance of the KLSE fared better compared to other regional and major global bourses. Improved sentiment on the KLSE as a source of financing was also evidenced by oversubscription in many of the IPOs. These IPOs were also traded at a premium over their offer prices at the end of their first day of trading.

Cagamas, the national mortgage corporation remains a prominent player in the capital market, raising 24 PDS issues valued at RM14,820 million during the first seven months of 2002 (January-July 2001: RM11,055 million from 29 issues). Hire-purchase financing and leasing debts purchased by Cagamas increased by 28% to RM4,255 million (January-July 2001: RM3,323 million), mainly due to hedging by finance companies of their fixed interest rate portfolio. Similarly, housing loans purchased by Cagamas increased by 32% to RM3,006 million (January-July 2001: RM2,277 million) as financial institutions took advantage of the prevalent low interest rates to lock in for longer tenures. The increase in the purchase of housing loans also mirrored the more upbeat residential property market with various housing packages offered by financial institutions. A significant development for Cagamas was its first purchase of Islamic Hire Purchase debts valued at RM500 million following its introduction in December 2001, thus enabling Cagamas to access a wider range of assets for securitisation.

During the first seven months of 2002, the number of ratings completed by both **Rating Agency Malaysia (RAM)** and the **Malaysian Rating Corporation (MARC)** increased by 30.5% valued at RM18,967 million (January-July 2001: RM14,538 million), indicating an active bond market. A large proportion of ratings completed was of long-term and medium-term issues, which represented 96% and 97.4% of the total number

and gross issue value, respectively, suggesting a greater preference for longer tenure papers amidst the current low interest rate environment. During the period, RAM completed 42 new ratings valued at RM17,042 million while MARC, 9 new ratings valued at RM1,925 million. The bulk of long-term bonds was in the AA and A categories, pointing to increased recourse to the bond market by companies with good credit quality. The domestic rating agencies continued to enhance the development of the capital market, particularly the Islamic capital market, through a series of briefings to promote greater awareness of Islamic PDS.

Kuala Lumpur Stock Exchange

A record number of IPOs prior to consolidation...

The **Kuala Lumpur Stock Exchange (KLSE)** commenced the year 2002 on renewed optimism, following an upswing in investor confidence as a result of encouraging developments in corporate mergers and restructuring as well as improving prospects for the domestic economy. The benchmark Kuala Lumpur Composite Index (KLCI) closed higher at 718.82 points at end-January (end-2001: 696.09 points). The KLCI continued

its upward trend following an upgrade in rating outlook for Malaysia from stable to positive by international rating agencies, resulting in renewed foreign interest in the KLSE. The KLCI reached its highest level since July 2000 to close at 808.07 points on 23 April 2002, an increase of 16.1% since end-2001. Similarly, turnover rose significantly by 36.1% to 10,278 million units valued at RM20,244 million in April from 7,552 million units valued at RM13,962 million in January. Market capitalisation was high at RM551,830 million at end-April, up 15.2% since end-January.

The upward momentum was, however, not sustained as investor sentiment was affected by the slump in the US markets since May, following the exposure of several fraudulent accounting scandals, the release of weaker economic data and tensions in the Middle East as shown in *Chart 5.7*. The KLCI too underwent some consolidation to close at 711.36 points as at end August 2002. Nonetheless, the KLCI, with an increase of 4.2% since early January, outperformed other selected regional bourses, such as Taipei, Hong Kong, Singapore and Philippines, which declined by 14.9%, 11.5%, 8.4% and 5.7%, respectively, as shown in *Table 5.15*. In terms of market capitalisation, KLSE was ranked 17th among 44 other markets as at end-July 2002.

TABLE 5.15

Performance of Regional Stock Markets

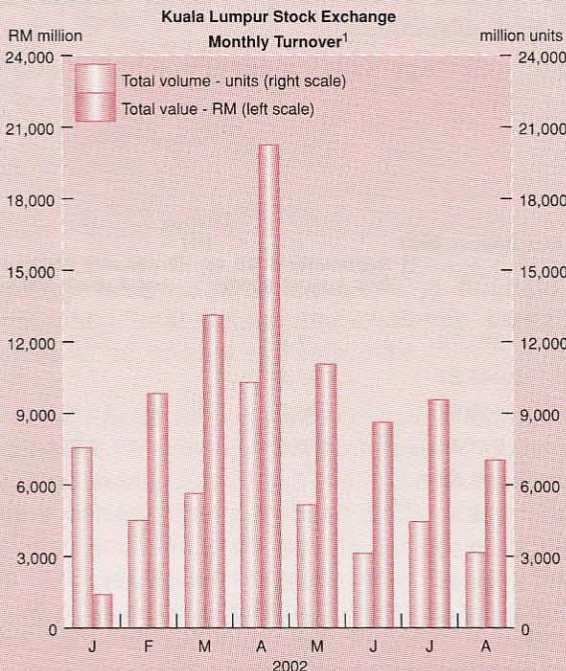
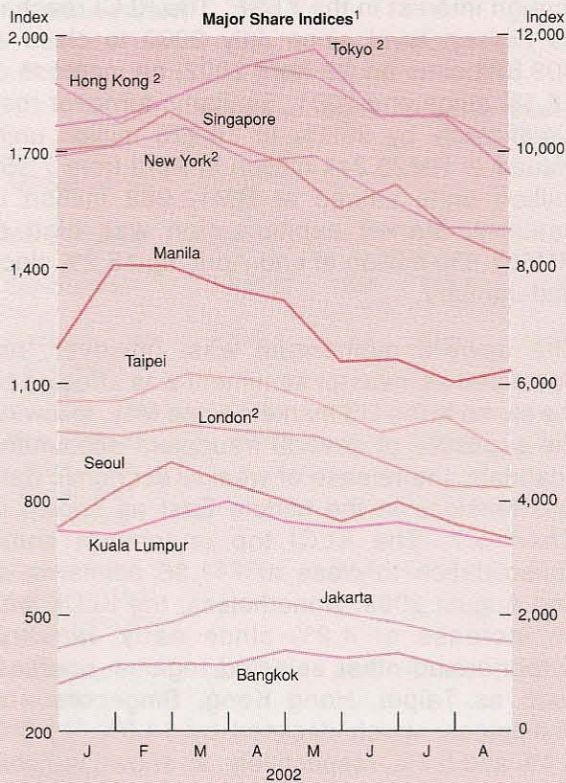
Stock Markets	1 September 1998	2 January 2002	End August 2002	Change (%)	
				(1 September 1998 vs. End August 2002)	(2 January 2002 vs. End August 2002)
Bangkok	211.09	305.19	361.72	71.4	18.5
Hong Kong	7,062.47	11,350.85	10,043.87	42.2	-11.5
Jakarta	325.85	383.46	443.67	36.2	15.7
Kuala Lumpur	262.70	682.83	711.36	170.8	4.2
Manila	1,191.76	1,169.57	1,103.36	-7.4	-5.7
Seoul	309.71	724.95	736.40	137.8	1.6
Singapore	823.33	1,625.69	1,488.50	80.8	-8.4
Taipei	6,335.09	5,600.05	4,764.94	-24.8	-14.9
Tokyo	14,369.63	10,542.62*	9,619.30	-33.1	-8.8

* Closing as at 3 January 2002.

Source: KLSE, Bloomberg

CHART 5.7

Performance of Selected Stock Markets

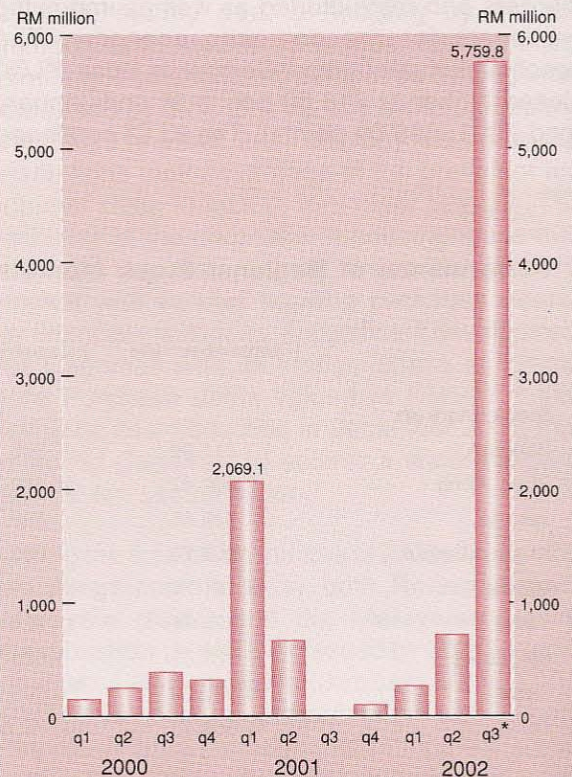


Source: BSKL, Bloomberg.

Total volume transacted on the KLSE rose by 60% to 43,831 million units during the first eight months of 2002 (January-August 2001: 27,431 million units), while average daily turnover surged by 59.3% to 266 million units (January-August 2001: 167 million units), as shown in *Table 5.16*. Improved investor confidence and the positive wealth effect from the better performance of the KLSE saw the number of IPOs soaring to 44 in the first eight months, compared with only 20 for the whole of 2001. Similarly, funds mobilised from the 44 IPOs in the equity market rose sharply to RM 6,740 million compared with RM 2,831 million for the whole of 2001, as shown in *Chart 5.8*.

CHART 5.8

Funds Raised By IPOs



* Up to end-August
Source: KLSE

TABLE 5.16

**Kuala Lumpur Stock Exchange:
Selected Indicators
(January-August)**

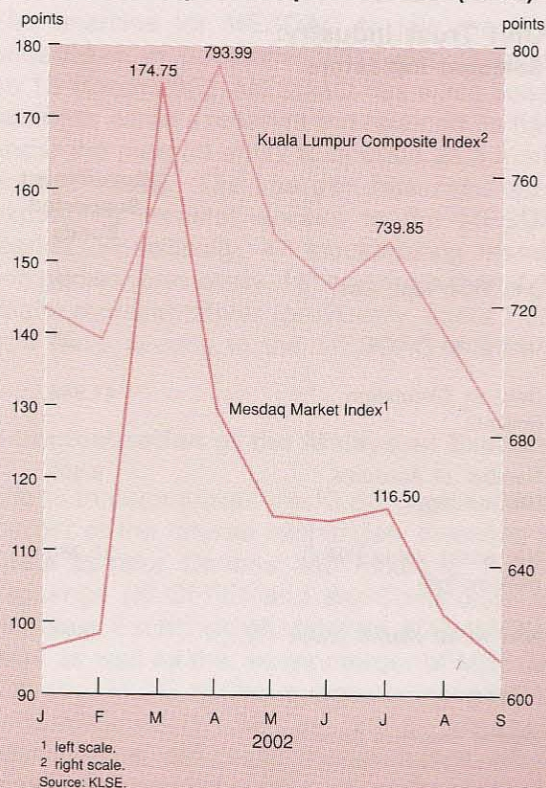
	2001	2002
Price Indices¹		
Composite	687.16	711.36
Emas	164.58	173.50
Second Board	134.65	115.76
Mesdaq Market	-	101.30
Total Turnover²		
Volume (million units)	27,431	43,831
Value (RM million)	49,470	93,386
Ave Daily Turnover²		
Volume (million units)	167.26	256.64
Value (RM million)	301.65	565.98
Market Cap. ¹ (RM million)	466,110	529,528
Market Cap. ¹ /GDP (%)	135.2	149.6
Total Companies Listed¹	807	859
Main Board	513	556
Second Board	294	292
Mesdaq market	-	11
Market Liquidity¹		
Turnover Value/Market Capitalisation (%)	10.6	17.6
Turnover Volume/No. of Listed Securities (%)	14.0	19.6
Market Concentration¹		
10 Most Highly Capitalised Stocks/ Market Capitalisation (%)	36.1	32.7
Ave Pd-up Capital of Stockbroking Firms ¹ (RM million)	141.54	156.26

¹ As at end of period.² Market transactions only.

Source: KLSE.

In line with the recommendation of the Capital Market Masterplan (CMP) for a single Malaysian exchange by 2002, the merger between the Malaysian Exchange of Securities Dealing and Automated Quotation (MESDAQ) with KLSE was successfully completed on 18 March 2002. The launch of the Mesdaq Market on the KLSE witnessed increased activity resulting in improved liquidity and a surge in volume of shares traded, with the Mesdaq Market Index (MMI), previously known as the Mesdaq Composite Index (MCI), closing at 174.75 points as at end-March (end-February 2002: 98.45 points), as shown in *Chart 5.9* due to enhanced investor access to the market. The MMI, however, closed lower at 101.30 points at end-August, in line with the consolidation of the KLSE.

CHART 5.9

**Movement of the Mesdaq
Market Index (MMI) against the
Kuala Lumpur Composite Index (KLCI)**


Unit Trust Industry

Greater product innovation spurs growth of unit trust industry...

The **unit trust industry** continues to provide investors with relatively easy access to a range of investment opportunities. Greater product innovation and increased marketing efforts saw higher growth of the unit trust industry in terms of type and number of unit funds and accounts as well as units in circulation. During the first seven months of 2002, 13 new funds were launched (2001: 30 funds), bringing the total number of unit trust funds to 161, comprising 129 private funds and 32 government-supported funds, as shown in *Table 5.17*. Units in circulation rose 8.8% to 77,679 million units at end-July 2002 (end-2001: 71,392 million units). The net asset value (NAV) of the unit trust industry increased by 14.5% to RM54,206 million (end-2001: RM47,340 million) in line with the positive sentiment in the equity market prior to its

consolidation. The ratio of the NAV of unit trust industry to the KLSE market capitalisation, however, decreased marginally to 10.16% (end-2001: 10.18%).

Malaysia Derivatives Exchange

Higher CPO prices in an otherwise lacklustre futures market...

The performance of the Malaysia Derivatives Exchange (MDEX) was mixed in the first seven months of 2002. Trading in the **Kuala Lumpur Stock Exchange Composite Index (KLSE CI) Futures Contract** was generally lacklustre with a decline of 19.7% to 141,857 contracts (January-July 2001: 176,727 contracts). The lower volume was attributed to the lack of volatility in the KLSE CI, resulting in lower investor participation. Similarly, total trading volume of the **Kuala Lumpur Stock Exchange Composite Index Options (KLSE CI Options)** remained low at

TABLE 5.17

Unit Trust Industry: Selected Indicators

	End-2001			End-July 2002		
	Government Supported Funds	Private Funds	Total	Government Supported Funds	Private Funds	Total
Unit Trust Mgt. Cos.	10	27	37	10	27	37
Unit Trust Funds ¹	32	116	148	32	129	161
Units in Circulation (million)	41,948	29,444	71,392	43,832	33,847	77,679
Number of Accounts (RM million)	8.609	1.381	9.99	8.734	1.505	10.239
Net Asset Value (NAV) (RM million)	30,980	16,360	47,340	34,605	19,601	54,206
NAV/KLSE Market Value (%)	6.66	3.52	10.18	6.49	3.67	10.16

¹ Refers to funds already launched.

Source: Securities Commission.

565 contracts since its introduction in 2000 due to lack of product understanding and high margin requirement.

Turnover of the **3-month Kuala Lumpur Interbank Offered Rate (KLIBOR) Futures** performed better with the switch from an open outcry platform to an electronic-based system, with volume increasing by 14.9% to 40,958 contracts during the first seven months of 2002 (January-July 2001: 35,657 contracts). The higher trading activity during the period was attributed to ample liquidity in the interbank cash market as well as higher interest in the local bond and interest rate swap markets.

MDEX, in its efforts to add depth to the present range of products, launched the **5-year Malaysian Government Securities Futures (FMG5)** on 29 March 2002. The FMG5 is a cash settled futures contract to buy or sell MGS with a minimum issuance of RM500 million and maturity between 4½ to 5½ years. The FMG5 received encouraging response from participants as it closed its first day with 686 lots traded amounting to RM68.6 million. The trading volume reached 29,386 contracts up to end-July.

Trading in **CPO futures** was significantly higher, increasing by 80.9% to 453,909 contracts equivalent to 11.348 million tonnes (January-July 2001: 250,912 contracts, equivalent to 6.273 million tonnes). The increase in trading was due to improved prospects of palm oil exports due to factors, such as depleting CPO stocks, China's threat to impose import duty on US soy oil, and a strengthening rupiah which could limit exports from Indonesia, thus providing opportunities for Malaysia to seek more prospective buyers. These developments exerted upward pressure on the prices of CPO futures with the benchmark of the third month contract reaching RM1,545 per tonne in July 2002 (July-December 2001: RM913-RM1,264). Subsequently, average settlement prices increased 22.2% from RM1,105 per tonne in February to RM1,350 per tonne in July 2002. The outlook for CPO prices remains positive on expectations of depleting domestic and world CPO stocks and production during the year. Meanwhile, efforts continued to be undertaken to further develop the derivatives market. In this regard, MDEX is working towards encouraging

greater participation of domestic institutions as well as forming strategic alliances with other foreign derivatives exchanges to improve liquidity, intensify international participation and enhance competitiveness.

Key Capital Market Measures

Enhanced competitiveness and corporate governance has improved the capital market...

Capital market measures introduced by the Securities Commission (SC) and the KLSE during the first eight months of 2002 were aimed at further enhancing ongoing efforts to promote efficiency, enhance transparency and improve corporate governance, as a continuing process to improve the resilience and competitiveness of the capital market as well as investor confidence. The key capital market measures included the following:

Completion of the KLSE-MESDAQ Merger

The exercise for MESDAQ to join the KLSE undertaken in December 2001 was completed on 18 March 2002. MESDAQ has since ceased business as an exchange but retained its name under the merged entity to operate as a market on the KLSE. The merger has resulted in expanding investor access to the MESDAQ market. Specifically, 47 stockbroking member companies (previously, 16) and more than 7,000 dealer representatives (previously, about 1,000) now have access to the MESDAQ market.

Demutualisation of the Malaysian Exchange

Efforts to demutualise the KLSE began with the merger of the futures exchanges, involving the Kuala Lumpur Options and Financial Futures Exchange (KLOFFE) and the Commodity and Monetary Exchange of Malaysia (COMMEX) in 2001 as well as the recent merger of MESDAQ with the KLSE to the eventual listing of the demutualised KLSE by 2003. Under a demutualised structure, the exchange will be converted from a company limited by guarantee

to one with shares and shareholders. The objective of demutualisation is to position the KLSE as a global player with the ability to respond swiftly to changing market needs. It will also facilitate the development of strategic linkages and alliances aimed at further enhancing liquidity in the market.

Consolidation of the Stockbroking Industry

The *Securities Commission Act 1993* was amended on 23 March 2002 and took effect from June 2002 to further accelerate the consolidation of the stockbroking industry, providing for a vesting order to facilitate the merger process. There was further progress in consolidation of the stockbroking industry. As at end-July 2002, the number of stockbroking companies (SBCs) stood at 46, including five Universal Brokers (end-2001: 60 SBCs and five Universal Brokers). The number is expected to be further reduced to 33 upon completion of all the merger proposals. Apart from tax incentives, branching flexibilities and allowing the provision of a wider range of capital market services, Universal Brokers have been allowed to set up electronic access facilities (EAF), enabling them to expand their market reach in a cost effective manner. As at end-July, the SC has approved two Universal Brokers to establish EAF in 17 locations, with the flexibility to provide certain discounts.

The consolidation has resulted in creating a group of larger, better capitalised and stronger SBCs that are able to provide investors with a range of capital market services. More importantly, the merger exercise has placed the stockbroking industry on firmer footing to face the increasing challenges of deregulation and liberalisation.

Facilitating Corporate Restructuring

In May, the SC announced the relaxation of several conditions for the injection of foreign assets and multinational companies (MNCs) into Malaysian listed companies to further facilitate corporate restructuring. The relaxations provide

listed companies, particularly distressed companies with more options to acquire quality assets and diversify their income base.

Circuit Breaker

In March, the KLSE implemented circuit breakers in the stock market aimed at enhancing market stability and investor confidence. The circuit breaker mechanism has the capacity to halt trading activities temporarily when large declines are experienced during a trading day. The circuit breaker will be triggered when the KLCI declines 10% and more below its closing index of the previous market day. The mechanism also provides for greater information dissemination to market participants, enabling them to make well-considered investment decisions upon resumption of trading.

Liberalisation of Transaction Costs

Transaction costs have been gradually liberalised in efforts to make the KLSE more competitive. Effective 1 July 2002, under the second stage of cost liberalisation, stockbroking commission rates are fully negotiable for all trades, including derivatives, subject to a cap of 0.7% (previously, negotiable for all trades above RM100,000 with trades of RM100,000 and below subject to a fixed rate of 0.75%). The minimum brokerage payable is RM2 on transaction of loan instruments and RM12 on any other transaction. In a similar move, effective 1 July 2002, trustees and management companies of unit trust funds are able to negotiate on trustee fees without any minimum restriction (previously, not below 0.08% on the gross net asset value of the scheme).

Derivatives Market

In line with efforts to further develop the domestic derivatives market, the MDEX has introduced the country's first bond futures contract, the FMG5 in March. The product provides more opportunities for risk management and hedging for market participants, especially in dealing with movements of interest rates as well as facilitating greater liquidity in the secondary bond market.

In January, the Malaysian Derivatives Clearing House (MDCH) business rules pertaining to Direct Clearing Membership (DCM) were amended. Local DCM are now allowed to clear trades directly with MDCH without having to go through a futures broker, thus saving on costs.

In May, *Section 94(2)(a) of the Futures Industry Act 1993* was amended, authorising MDEX to disclose information to the KLSE for the purpose of a joint audit exercise. This is aimed at enhancing the overall regulatory framework to provide for systemic risk management.

Fund Management Industry

Consistent with efforts to enhance the professional conduct of investment management industry participants, the SC introduced guidelines on the appointment of trustees for unit trust schemes in situations where there may be conflict of interests (*Guidelines on Allowing a Person to be Appointed or to Act as a Trustee under Subsection 99(1) of the Securities Commission Act 1993*) in February 2002. The guidelines specify the categories of persons considered to be in a conflict of interest situation and persons eligible to be appointed or to act as trustees of unit trust schemes upon obtaining SC's approval.

In line with measures to gradually liberalise the fund management industry, the SC introduced a new policy (*Practice Note 16 Guidelines on Unit Trust Funds*) in May 2002 to allow a group of companies or individuals to have interests in more than one unit trust management company, subject to certain conditions. This flexibility has been introduced in recognition of the growing complexity of shareholding structures within a group of companies.

Bond Market

The National Bond Market Committee (NBMC) which was formed in 1999 continues to provide policy direction towards the development of the bond market, with the SC as the sole agency for the regulation of the bond market since July 2000. In order to further widen intermediary

participation in the bond market the SC is in the process of developing Guidelines on the Minimum Operational Requirements and Best Business Practices for Dealings in Unlisted Debt Securities by universal brokers, which are expected to be released during the year.

In addition, the PDS and asset-backed securitisation Guidelines are currently being reviewed in order to streamline further existing requirements to reduce regulatory and other costs for market participants. The revised guidelines are expected to be finalised by year end.

Labuan International Financial Exchange

The Labuan International Financial Exchange (LFX), a wholly-owned entity of the KLSE, was launched in November 2000. Its objective is to facilitate the mobilisation of funds and capital raising through the listing and trading of a wide range of multi-currency financial instruments in the offshore market of Labuan. Measures continue to be taken to promote the LFX, including working towards the introduction of the LFX as a surrogate exchange, to enable issuers in countries that do not have a developed capital market to have an alternative to raising capital from the international capital market. A significant development for the LFX will be the listing of the sovereign global *Sukuk Al-Ijarah* scheduled in September, marking Malaysia's first Islamic bond offered to international markets.

Islamic Capital Market

In July, the SC issued two sets of practice notes (PN) relating to *Syariah*-based unit trust schemes to further enhance the quality of management and administration of such schemes in ongoing efforts to develop the Islamic capital market. PN18 on *Additional Requirements for Schemes Managed and Administered in Accordance with Syariah Principles* to take effect from 1 January 2003, stipulates the roles of the scheme's *Syariah* committee/ consultant as well as the trustee and compliance officer overseeing the management of the scheme to ensure that a

Syariah-based unit scheme is managed and administered in accordance with generally accepted Syariah principles.

PN19 on *Procedures for Registration and Appointment of Syariah Committee Members/Syariah Consultants for Schemes Managed and Administered in Accordance with Syariah Principles* took effect on 10 July. It sets out registration procedures for Syariah committee/consultants of Syariah-based schemes.

Venture Capital Industry

In August, the SC issued a set of guidelines to help venture capital companies (VCCs) register with the SC for the exempt dealer status. The guidelines are to further facilitate the development of the venture capital industry to effectively meet the financing needs of emerging high-growth companies. Under the guidelines, VCCs and venture capital management corporations are required to submit annual periodic reports to the SC. The submission of annual reports will assist the SC in formulating policy decisions and assessing the progress of the industry as well as facilitate the certification of VCCs for tax exemption purposes.

Enhancing Corporate Governance

Trading Restrictions on PN4 Companies

In March, the KLSE imposed trading restrictions on PN4 companies that fail to comply with the time frames specified to regularise their financial conditions. PN4 companies are listed companies that fail to meet the financial conditions for continued trading and listing on the KLSE. The trading restriction requires full payment in advance from buyers who wish to purchase securities of PN4 companies. To further alert investors of the risks associated in the trading of listed securities of PN4 companies, a separate sector classification for PN4 companies has been established.

Disclosure-Based Regulation

Full disclosure-based regulation (DBR) for the issuance of corporate bonds has already been implemented since July 2000. With respect to

new equity issues, the study on market readiness has been completed and the findings are currently being reviewed with intended DBR implementation during the year.

Minority Shareholder Watchdog Group

A key measure proposed by the Finance Committee on Corporate Governance, has been the formation of the Minority Shareholders Watchdog Group (MSWG) in August 2000. The objective of the MSWG is to protect the interests of minority shareholders through harnessing the strength of large institutional investors, such as EPF, SOCSO, Lembaga Tabung Haji, Permodalan Nasional Berhad and the Armed Forces Fund in monitoring and instituting changes in the companies in which they invest. MSWG has been operational since July 2001.

Among the services that MSWG intends to provide are corporate monitoring and proxy-voting services. The MSWG will provide proxy-voting services on behalf of its members at companies' annual general meetings and extraordinary general meetings. It also intends to continuously monitor PLCs with respect to their corporate governance practices and to highlight breaches and non-adherences that are detrimental to the legitimate rights and interests of minority shareholders.

Outlook for 2003

Thrust of monetary policy is to support private sector initiatives, dynamism and growth...

Growth of the Malaysian economy is envisaged to further strengthen in 2003, given the prospects of more positive world trade and growth while loan growth is expected to improve on the back of better overall economic performance. The focus of monetary policy in 2003 will be on supporting private sector initiatives, dynamism and growth, particularly in light of the need to pursue domestic-driven growth strategies. The synchronised

VENTURE CAPITAL - FINANCING THE NEW ECONOMY

Introduction

Knowledge, innovation, and creativity are driving growth in the new economy, as evident from the experience of knowledge-driven economies, such as the United States (US), Ireland, Finland, Japan, Korea and Taiwan. Nonetheless, despite its increasing importance, investors in ideas or knowledge or embryonic companies with innovation often face difficulties in getting financing due to its intangible value, which invariably increases the probability of uncertainty of returns and the timeframe for realising returns from ideas. As such, alternative modes of financing are necessary to assume the risks for enterprises with ideas but lack funding. In the same vein, financing from equity and bond markets have taken off in Malaysia, particularly to finance projects with longer-term gestation, thereby circumventing the need to rely on traditional collateral-based bank financing.

The venture capital (VC) industry in Malaysia is relatively young, having only taken roots in the 1980s. In contrast, the VC industry had originated in the US in the 1950s and was largely instrumental to the success of the Silicon Valley. Other Asian economies, in particular Taiwan, have similarly placed great emphasis in developing the VC industry and created successful homegrown world-class companies. Recognising the importance of VC in financing innovation and high technology, the Government has been supportive of the VC initiative in Malaysia. Despite the recent meltdown of dot.com and high-tech companies in the US, VC activities in Malaysia must continue to support innovation and the commercialisation of ideas to enable the economy to compete and attain sustainable development.

Venture Capital (VC) Initiatives

The Government has focussed on creating an enabling environment for the VC industry. Of significance was the establishment of the Multimedia Super Corridor (MSC), providing a world-class information and communications technology (ICT) infrastructure and environment to nurture the development of high technology by both foreign and domestic companies. Tax incentives have also been provided, such as tax exemptions on income received by venture capital companies (VCCs) and tax deductions on investments in approved VCCs for start-up, seed capital and early stage financing.

In addition, the Government has established special VC funds to encourage the development of new high technology industries, such as automated manufacturing technology, material technology, biotechnology, advanced electrical and electronics, information technology, renewable energy technology and indigenous technology. These include a RM200 million fund launched in June 2000 to finance high-tech projects under the Bank Industri dan Teknologi Malaysia Bhd besides two RM150 million funds also launched during the same period, each under Mayban Ventures Capital Company Sdn Bhd and Commerce Technology Ventures Sdn Bhd, with contribution from Bank Negara Malaysia (BNM) amounting to RM100 million to each VCC. An earlier VC fund, the MSC Venture One, totalling RM120 million was launched by the Multimedia Development Corporation (MDC) in 1999 to provide VC financing to information technology and multimedia companies.

Budget 2001 also announced the establishment of a larger VC fund amounting to RM500 million. The fund is managed by a Government-owned company, the Malaysia Venture Capital Management Bhd (MAVCAP) for the strategic purpose of providing an alternative source of risk capital to ICT and high growth sectors for seed/start-up/early stage companies as well as to drive the development of innopreneurs to create new wealth in the new economy and to steer the development of the VC industry.

A recent VC initiative is the RM1,600 million ICT fund that was launched on 30 August 2002. The fund, specially targeting the ICT sector, is sponsored by the government of Japan through the Japan Bank for International Cooperation (JBIC). It is managed by the newly established Malaysia Debt Ventures Bhd, previously a division of MAVCAP. The ICT fund began accepting applications for financing from 2 September.

Malaysia Debt Ventures Berhad

Despite the progress made in the development of the VC industry as an alternative mode of financing for new growth areas and higher risk ventures, there are still several constraints. VCCs find it difficult to raise resources due to the high risk and long-term nature of their investments, often lacking track records. ICT companies too face difficulties in sourcing financing from banks and financial institutions due to higher risks, particularly at the seed, start-up and the early stages. Banks conventionally insist on assets as collateral, not recognising the intangible asset of ideas or knowledge. VCCs themselves are generally hesitant to finance start-ups and technology-based firms, preferring to finance the expansion and pre-IPO stages. The establishment of the Malaysia Debt Ventures Berhad in August 2002 was aimed at reducing some of these constraints. The Malaysia Debt Ventures Berhad provides loans to multimedia developers, service providers, traders and those who use ICT in education, health and entertainment.

Eligibility for the ICT Fund

Debt Ventures offer project-based loans, guarantee to bank schemes and export finance schemes whilst its other support services cover business building and research and technology, corporate advisory services and business and project monitoring. The ICT Fund covers the entire spectrum of industry that uses ICT to improve productivity and promote innovation both in the public and private sectors. **Eligible applicants** must comply with the following pre-requisites:

1. Public and private limited company incorporated in Malaysia.
2. Minimum paid-up capital of RM100,000.
3. Minimum 5 employees.
4. With or without MSC status and no restriction on shareholders' nationalities.
5. No specific requirement on history, however, management track record is important.
6. Companies which provide or procure high value-added ICT solutions and other high value-added ICT products and services and companies that provide goods to ICT companies for use in the production of high value-added ICT products and services.

In addition, applicants must take into consideration the following:

1. Applicants to take into account appropriate environmental considerations on pollution control, ecological impact and social impact of the project.
2. Applicants must furnish all information concerning the impact of each project on the environment.

Applicants involved in the following industries are subject to approval by the JBIC and, therefore, requires a longer period for assessment.

1. Textile manufacturing.
2. Metal moulding.
3. Agriculture/food producer and/or processor.

The following projects are **not eligible** for the ICT Fund:

1. Projects located in "Sensitive Areas" or having effect on designated conservation areas. Sensitive Areas include primary forests, tropical rain forests, state-designated wetlands, coral reefs, mangroves, tidal flats, protected areas, national parks, state-designated coastal areas, habitats of endangered species, world heritage sites, areas where ethnic minorities or indigenous peoples reside and areas where large-scale involuntary resettlements may occur.

2. Projects related to import/export and production of hazardous materials to humans, including without limitation polychlorinated biphenyl, asbestos and radioactive material or goods whose international trade is restricted under any international treaty to which Japan is a signatory.
3. Projects that involve the production of, or the supply of products to a company which produces military products or any goods and/or services deemed to offend public order or morals.

Application Assessment

After initial screening and acceptance of indicative offer by the applicant and the submission of complete information, DEBT VENTURES requires approximately four (4) weeks for due diligence assessment and decision on loan application prior to processing of legal documentation and disbursement of funds.

The Malaysian Exchange of Securities Dealing and Automated Quotation (MESDAQ) was launched in 1999 as an exchange for growth and technology companies as well as providing viable exit options for VCCs. MESDAQ has since March, 2002 been merged with the Kuala Lumpur Stock Exchange, thereby expanding its investor base. Meanwhile, both the Financial Sector Masterplan and the Capital Market Masterplan have also addressed the issue on the further development of a vibrant VC industry to support the long-term growth of the economy.

On the part of the private sector, initiatives that have been taken towards the development of the VC industry include the establishment of the Malaysian Venture Capital Association (MVCA), comprising 44 VCCs with a total fund size of approximately RM1,000 million as at end-June 2001. In addition, the private sector has been active in organising business plan competitions. The first competition, Venture 2001, was launched in November 2000, with the objective of converting potential ideas into actual business and to foster an entrepreneurial culture in Malaysia. The competition attracted business plans in areas such as information technology, telecommunications, electronics, manufacturing and life sciences. A second competition, Venture 2002, covering three phases, was launched in January 2002 and attracted 214 business plans under the first phase, which ended on 22 March.

Growth and Direction of Financing

The number of VCCs monitored by BNM increased to 36 at end-2001 (end-2000: 31), while investee companies with VC investments rose to 180 (end-2000: 159). Investments in 2001, however, declined by 16.7% to RM109.3 million in line with the slower growth of the economy. The major portion of investments amounting to RM76 million or 70% continued to be placed in the ICT sector. Investments in the manufacturing sector remained significant at RM16.8 million, accounting for 15% of total investments, with the bulk (RM11.3 million) placed in advanced electronics technology.

VCCs provide various financing to investee companies. These include seed capital, start-up, other early stage, expansion, bridge/mezzanine or pre-initial public offering (IPO) and acquisition or buy-out financing. A higher proportion at 62% of total VCC investments was placed at the start-up and early stages (2000: 27%), reflecting an increased risk tolerance of the VC industry in supporting companies during the riskier period of their lifespan.

Venture Capital Funds/Companies

	At End	
	2000	2001 ^P
VC funds/ companies (nos)	31	36
Investee companies (nos)	159	180
Sources (RM million)		
Shareholders' funds	972.6	983.2
Liabilities	543.4	993.8
Uses (RM million)		
Investments in investee companies	718.2	652.9
Other assets	797.8	1,324.0
Total	1,516.0	1,976.9

^P Preliminary.

Source: Bank Negara Malaysia.

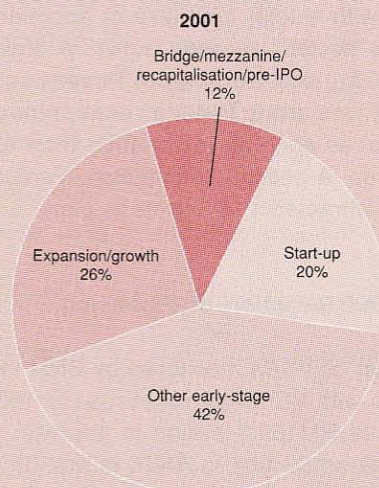
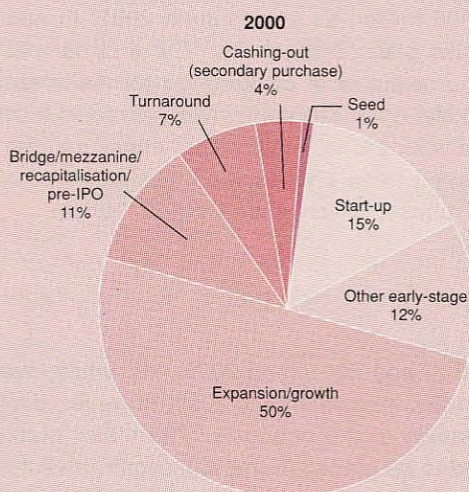
Investments of Venture Capital Funds/
Companies

	At End	
	2000	2001 ^P
Investee companies (nos)	35	42
Investments (RM million)	131.3	109.3
By sector		
Manufacturing Of which	25.4	16.8
- IT based products	0.3	1.9
- Electrical and electronic products	7.5	-
- Advanced electronics technology	8.9	11.3
Information and communications technology	53.1	76.0
Life Sciences	3.5	3.2
Others	49.4	13.4

^P Preliminary.

Source: Bank Negara Malaysia.

Investment by Stages



- Seed Capital: Financing to research, assess and develop an initial concept and/or prototype.
- Start-up: Financing for product development and initial marketing.
- Other Early Stage: Financing to companies after completion of product development stage to initiate commercial manufacturing and sales.
- Expansion/Growth: Financing for the growth and expansion of a company that is breaking even or trading profitably, or as additional working capital and to finance increased production capacity or market or product development.
- Bridge/Mezzanine/recapitalisation/Pre-IPO: Financing to a company or its shareholders during the transition period from being privately owned to being publicly quoted or for subsequent capital/corporate exercise.
- Turnaround: Financing to existing businesses with trading difficulties, with a view to re-establishing prosperity.
- Cashing-out (secondary purchase): Purchase of existing shares in a company from another private equity investment organisation or from another shareholder(s).

Source: Bank Negara Malaysia
Malaysia Industry-Government Group for High Technology (MIGHT)

Conclusion

The VC industry is pertinent to the development and growth of knowledge-intensive industries in tandem with the Government's efforts to transform Malaysia into a knowledge-based economy. In this regard, the Government will continue to support and facilitate the development of the VC industry in ensuring an enabling environment for VC to thrive. The private sector must also play a more active role, particularly in addressing the various constraints, to enable the VC industry to be more dynamic in meeting the financing needs of the new economy.

slowdown of the three major economies of the US, Japan and the euro area in 2002 warrants the need to re-strategise and increase the role of the domestic sector and its contribution to growth with a view to reducing the vulnerabilities of over-dependence on external demand. The direction of lending will, therefore, be channelled forwards private capital formation, particularly in services including tourism, health and education as well as agriculture.

Meanwhile, the financial and capital markets are expected to chart a more impressive performance in 2003. The strengthened and more resilient banking sector, arising from the

significant progress made in financial and corporate sector restructuring, is now better able to ensure a healthy credit expansion to meet the financing needs of the economy, particularly in extending loans for private domestic investments. The restructured companies will also be able to focus on their core competencies. Similarly, the capital market is anticipated to be more active due to increasing recourse to financing of economic activities through the PDS market, while the equity market should also improve in consonance with the stronger performance of the economy.