



Monetary and Financial Developments

5



Monetary and Financial Developments

Overview

Monetary policy and financial conditions remain supportive of growth...

The domestic economic environment in 2008 is more challenging amid slower global growth and rising inflationary pressures due to escalating food and energy prices. Monetary policy in Malaysia continues to support growth with price stability, although the risks of slower world growth and increased inflation have become more pronounced. During the first seven months of 2008, the monetary policy stance remained unchanged with the Overnight Policy Rate (OPR) maintained at 3.50%, despite pressures on domestic prices following the restructuring of petrol and diesel subsidies on 5 June. Inflation rose 8.5% in July and is expected to remain high in the second half of the year and into early 2009 before moderating towards mid-year. The Government will continue to closely monitor current developments and undertake an appropriate monetary policy response, depending on the extent of generalised price increases and the risks to growth.

Monetary policy remains accommodative with ample liquidity and stable interest rates. Loans of the banking system expanded further in the first six months of 2008 with the loan indicators posting strong increases. In line with the objective to increase the contribution of small and medium enterprises (SMEs) to the economy, SME loans by the banking system and development financial institutions (DFIs) continued to expand. There was greater emphasis on promoting financial inclusion to all segments of the economy, especially to micro enterprises. The consumer protection framework has been strengthened

through initiatives to enhance financial information and consumer education, as well as to ensure adequate mechanisms for redress.

Islamic finance continues to expand, with significant progress in the Malaysia International Islamic Financial Centre (MIFC) initiative. Malaysia remains the world's largest Islamic bond (*sukuk*) market, accounting for more than 60% of total global outstanding *sukuk*. Funds raised in the capital market increased, with the private sector raising more funds mainly to finance new activities, while the Government raised funds to finance development projects. The domestic capital market also attracted foreign entities to issue ringgit-denominated bonds. However, in line with the bearish performance of other major and regional markets, the domestic equity market was more subdued. Meanwhile, measures and initiatives continue to be taken to further strengthen the capital market.

Monetary Policy

Monetary policy amid a more challenging environment...

In 2008, monetary policy has been confronted with the challenge of heightened volatility in international financial markets, as well as uncertainties surrounding the prospects for global growth and inflationary expectations. Despite signs of slowing global growth, food and energy prices have continued to rise, resulting in higher inflation worldwide. Inflation in Malaysia surged 7.7% in June and 8.5% in July 2008 and averaged 4.4% in the first seven months of 2008, due to higher food and fuel prices.

Although the risks of slower growth and higher inflation have become more pronounced, there was no change in the monetary policy stance in the first seven months of the year. However, current developments continue to be closely monitored, and an appropriate monetary policy response will be taken in the event the outlook for growth or inflation changes.

Monetary Developments

Money supply and private sector financing expanded strongly...

Money supply continued to expand during the first six months of 2008, with **M1** and **M3** increasing 17.8% and 14.2%, respectively, as at end-June 2008 (end-2007: 19.6%; 9.5%). The expansion in **M1 or narrow money** was attributed to higher placements of demand deposits by business enterprises and increased currency in circulation. The growth of **M3 or broad money** was driven by the increase in net external operations of RM57.1 billion, as shown in *Table 5.1*, reflecting higher net international reserves from sustained trade and investment inflows. The increase in loans outstanding and holdings of securities by the banking institutions (RM43.1 billion) also contributed to the expansion of M3.

TABLE 5.1

Determinants of M3 January – June

	Change (RM million)	
	2007	2008
M3	28,309.2	67,717.6
Net claims on Government	-19,737.8	-3,621.8
Claims on private sector	21,295.9	43,129.8
Loans	20,938.2	39,520.7
Securities	357.7	3,609.1
Net external operations	75,499.2	57,148.4
Bank Negara Malaysia	49,354.2	75,155.2
Banking system	26,145.0	-18,006.9
Other influences	-48,748.0	-28,938.8

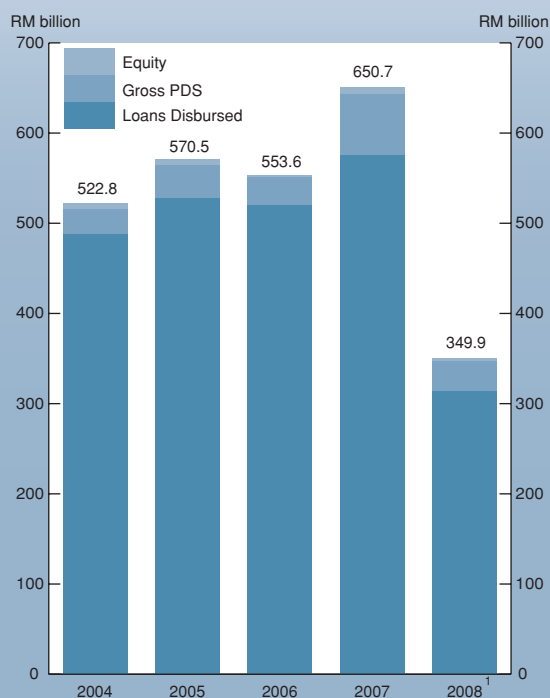
Source: Bank Negara Malaysia.

Interest rates remained stable in an environment of ample liquidity in the banking system during the first six months of 2008. With the OPR held steady at 3.50% since April 2006, the average base lending rate of commercial banks also remained unchanged at 6.72% as at end-June 2008. However, with inflation increasing 8.5% in July 2008 (2007: 2.0%), the real return on fixed deposits of 1-month to 12-month maturities, which ranged between 3.08% and 3.70% as at end-June 2008 (end-2007: 3.08% – 3.70%), turned negative.

Gross private sector financing through the banking system and capital market expanded strongly by 18.6% to RM349.9 billion (January – June 2007: 5.3%; RM294.9 billion), as shown in *Chart 5.1*. The increase was attributed to higher loans disbursed totalling RM313.9 billion with households and the manufacturing sector accounting for more than half of total loan disbursements. Total funds raised in the private

CHART 5.1

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



¹ As at end-June 2008.

Source: Bank Negara Malaysia.

debt securities (PDS) market grew further by 23.9% to RM33.2 billion (January – June 2007: RM26.8 billion), while equity issuance increased to RM2.8 billion (January – June 2007: RM2.2 billion).

Against the backdrop of sustained domestic economic growth, all financing indicators of the banking system expanded during the first six months of 2008. **Loan applications, approvals and disbursements** posted double-digit growth of

18.3%, 11.2% and 18.0%, respectively, (January – June 2007: 40.2%; 48.7%; 0.6%), as shown in *Table 5.2*. **Total loans outstanding** also grew at a stronger pace of 11.7% to RM685.9 billion as at end-June 2008 (end-2007: 8.6%; RM644.2 billion), as shown in *Chart 5.2*.

Loan applications and approvals to the business sector decreased 5.9% and 18.0%, respectively, in the first six months of 2008 (January – June 2007: 60.9%; 142.2%). However, after discounting a large syndicated bridging finance facility in May and June 2007, business loan applications and approvals posted positive growth of 29.8% and 20.6%, respectively. Meanwhile, loan disbursements expanded at a stronger pace of 21.5% to RM124.3 billion (January – June 2007: 5.0%; RM102.3 billion), mainly for working capital (55.7% of total loans disbursed). The disbursements were largely channelled to the manufacturing; wholesale and retail trade, restaurants and hotels; finance, insurance and business services; and construction sectors, as shown in *Table 5.3*.

TABLE 5.2

Banking System: Loan Indicators
January – June

Indicator	RM billion		Annual growth (%)	
	2007	2008	2007	2008
Total¹				
Loan applications	203.0	240.2	40.2	18.3
Loan approvals	136.3	151.6	48.7	11.2
Loan disbursements	266.0	313.9	0.6	18.0
Loans outstanding ²	614.0	685.9	6.0	11.7
of which:				
Business sector³				
Loan applications	65.5	61.7	60.9	-5.9
Loan approvals	56.2	46.1	142.2	-18.0
Loan disbursements	102.3	124.3	5.0	21.5
Loans outstanding ²	141.5	166.2	6.9	17.5
SMEs				
Loan applications	44.3	53.0	38.2	19.6
Loan approvals	25.0	28.2	39.6	12.7
Loan disbursements	67.9	81.6	1.8	20.1
Loans outstanding ²	108.9	122.0	5.0	12.0
Households				
Loan applications	86.1	118.9	27.3	38.2
Loan approvals	52.6	73.0	13.4	38.9
Loan disbursements	79.2	92.0	4.5	16.1
Loans outstanding ²	342.1	374.0	7.3	9.3

¹ Total sectors including other sectors (foreign entities, other domestic entities, Government and others).

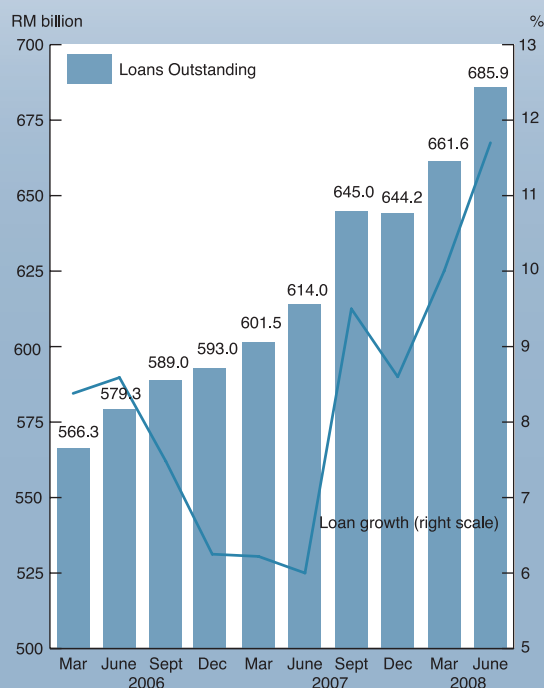
² Outstanding loans as at end period.

³ Business sector excludes SMEs.

Source: Bank Negara Malaysia.

CHART 5.2

Banking System: Loans Outstanding¹ and Growth



¹ End period.

Source: Bank Negara Malaysia.

TABLE 5.3

Loans by Sector

	Loans disbursed				Loans outstanding			
	End-2007		Jan - June 2008		End-2007		End-June 2008	
	RM billion	% Share	RM billion	% Share	RM billion	% Share	RM billion	% Share
Business enterprises	372.5	64.7	205.8	65.6	264.6	41.1	288.2	42.0
Large corporations	230.9	40.1	124.3	39.6	150.5	23.4	166.2	24.2
SMEs ¹	141.5	24.6	81.6	26.0	114.2	17.7	122.0	17.8
<i>Selected sectors</i>								
Primary agriculture	14.1	2.4	8.0	2.5	13.9	2.2	15.0	2.2
Mining and quarrying	2.0	0.3	1.2	0.4	1.6	0.2	1.8	0.3
Manufacturing (including agro-based)	135.1	23.5	76.1	24.2	74.5	11.6	81.9	11.9
Electricity, gas and water supply	1.3	0.2	1.3	0.4	3.8	0.6	4.0	0.6
Wholesale and retail trade, restaurants and hotels	91.9	16.0	54.8	17.5	56.5	8.8	60.7	8.8
Construction	32.6	5.7	18.0	5.7	32.1	5.0	34.3	5.0
Real estate	12.3	2.1	7.7	2.4	20.2	3.1	22.7	3.3
Transport, storage and communication	32.2	5.6	6.6	2.1	15.1	2.3	17.8	2.6
Finance, insurance and business activities	45.7	7.9	29.3	9.3	39.9	6.2	43.2	6.3
Households	169.6	29.4	92.0	29.3	358.1	55.6	374.0	54.5
Purchase of residential properties	43.0	7.5	23.9	7.6	174.4	27.1	181.7	26.5
Purchase of passenger cars	32.4	5.6	19.4	6.2	102.3	15.9	106.9	15.6
Consumption credit ²	77.6	13.5	42.3	13.5	49.9	7.7	52.2	7.6
of which:								
Credit cards	57.1	9.9	30.8	9.8	22.8	3.5	23.3	3.4
Other Sectors	33.9	5.9	16.1	5.1	21.4	3.3	23.7	3.5
Total³	575.9	100.0	313.9	100.0	644.2	100.0	685.9	100.0

¹ Includes loans to individual businesses.

² Consumption credit = Credit cards + personal use + consumer durables.

³ Total = Business + Households + Other Sectors.

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

Initiatives taken over the years have helped increase the share of SME financing from 30% of total business loans of banking institutions in 1999 to 43% as at end-June 2008. Loans outstanding of the banking system to SMEs rose 12.0% to RM122 billion as at end-June 2008 (end-2007: 9.1%; RM114.2 billion). The wholesale and retail trade, restaurants and hotels and the manufacturing sectors accounted for RM61.2

billion or half of the total loans outstanding to SMEs. Apart from this, SMEs also made good use of the six Special Funds administered by BNM, drawing a utilisation rate of 148.7% as at end-June 2008 (end-2007: 139%). In addition, lending to SMEs by DFIs increased to RM14 billion as at end-June 2008 (end-2007: RM13.8 billion). The establishment of the SME Credit Bureau, which commenced operations on 1 July 2008,

marks a key initiative under the Credit Guarantee Corporation (CGC) to further enhance access to financing for SMEs. BNM also established two financing facilities totalling RM1.2 billion for SMEs in August. The RM700 million SME Assistance Facility is for SMEs facing financial difficulties and for restructuring of loans following rising costs. Another RM500 million under the SME Modernisation Facility is to help SMEs finance the modernisation of operations and purchase of energy-saving equipment.

Additionally, significant efforts were taken to increase access to financial services for all segments of society, particularly micro enterprises. The development of microfinance is important in promoting financial inclusion as about 80% of SMEs in Malaysia are micro enterprises, with only 13% of them obtaining funds from financial institutions (refer feature article, *Microfinance in Malaysia*).

Loan applications, approvals and disbursements to the household sector remained strong, expanding 38.2%, 38.9% and 16.1%, respectively, in the first six months of 2008 (January – June 2007: 27.3%; 13.4%; 4.5%), amid ample liquidity and stable interest rates. Housing loan approvals grew strongly by 43.1% to RM30 billion (January – June 2007: 27.8%; RM20.9 billion), supported by the exemption of the real property gains tax in April 2007, and the 50% exemption of stamp duty on purchases of houses below RM250,000 introduced in the 2008 Budget. The household sector accounted for RM374 billion or 54.5% of total outstanding loans of the banking system as at end-June 2008 (end-2007: RM358.1 billion; 55.6%).

The utilisation of credit cards remained high, with transactions comprising purchases and cash advances, increasing 17.0% to RM30.8 billion in the first six months of 2008 (January – June 2007: 18.1%; RM26.3 billion). The tiered pricing structure (TPS) for credit card users became effective 1 July 2008, as part of continuous efforts to promote prudent financial management. Under the TPS, credit card users with good track record of promptly settling credit card balances will enjoy reduced finance charges of between 15% and

Update on Credit Guarantee Corporation

The CGC was established in 1972 to provide guarantee cover and assist SMEs without collateral, or with inadequate collateral, to obtain credit facilities from financial institutions. Until end-2007, the CGC has cumulatively guaranteed about RM38.8 billion, benefiting 378,450 SMEs. In the first five months of 2008, the CGC guaranteed loans worth RM1,032 million, the bulk of which was extended to SMEs involved in general business, such as retail and wholesale trade and other services, accounting for RM815 million or 79.0% of total loans.

In 2005, the CGC underwent a transformation process to better support SMEs. It is now able to provide a wider range of credit enhancement products, advisory services on financial and business development and credit information services to SMEs. A key achievement was the establishment of Malaysia's first specialised credit bureau for SMEs, which commenced operations on 1 July 2008. The SME Credit Bureau serves as a source of reliable credit information for SMEs and potential financiers. As a one-stop centre for banks to obtain consolidated information on SMEs, the bureau helps to enhance SME access to financing as well as reduce loan processing time.

Other recent key initiatives of the CGC include extending the scope of guarantees to cover financing by Islamic banks and DFIs; introducing a new guarantee scheme called the Direct Access Guarantee Scheme Start-up for SMEs to set up their business, and the Direct Bank Guarantee Scheme to assist SMEs, which have been offered Government contracts; and participating in Malaysia's inaugural first synthetic securitisation of SME loans amounting to RM600 million. The securitisation, undertaken in May 2007, has enabled SMEs to access the capital market for funding.

17% per annum from 18% previously. At the same time, those who make partial payments will no longer enjoy the 20-day interest-free period on new retail transactions. The TPS is also aimed at encouraging the use of debit/ATM cards as an alternative payment instrument, in line with the objective of accelerating the migration to electronic payments.

Microfinance in Malaysia

Introduction

Poverty eradication remains a major thrust of the Government, with several dedicated programmes implemented to reduce poverty and narrow income and regional disparities. Microfinance (MF) is an important tool to eradicate poverty. It refers to the provision of a range of financial services, such as loans, deposits, money transfers, payment services and insurance to the poor, low-income households and micro enterprises.

The experience of countries, such as Bangladesh, Indonesia and Mexico, clearly demonstrates the success of MF in uplifting the poor from poverty. The United Nations Millennium Project, an independent advisory body commissioned in 2002 to propose the best strategies to meet the Millennium Development Goals, also recognises that *“MF is one of the practical development strategies and approaches that should be implemented and supported to attain the bold ambition of reducing world poverty by half”*.

Microfinance Programmes in Malaysia

MF programmes in Malaysia are aimed at alleviating poverty through the provision of small loans to poor households for income-generating activities. A number of institutions are involved in providing MF, including cooperatives and non-governmental organisations (NGOs). The better-known MF institutions are *Amanah Ikhtiar Malaysia* (AIM) and *Tabung Ekonomi Kumpulan Usahawan Nasional* (TEKUN). AIM has achieved considerable success in alleviating rural poverty, while TEKUN has contributed towards developing *bumiputera* entrepreneurs by providing them with MF.

The development of the MF industry in Malaysia further accelerated, following several initiatives to promote greater access to financial services for all segments of society. The 2005 Census of Establishments and Enterprises conducted by the Department of Statistics revealed that micro enterprises¹ formed about 80% of the small and medium enterprises (SMEs) in Malaysia. The census also found that only 13% of these micro enterprises relied on financial institutions for financing. SMEs, in turn, account for 99% of total establishments, employ 5.6 million people and contribute 35.0% to Gross Domestic Product (GDP). As such, there is huge potential to increase the contribution of SMEs to the economy. In this regard, a sustainable MF industry is essential in ensuring SMEs and in particular, micro enterprises have access to adequate and continuous financing from the formal financial system.

Towards this end, the MF Institutional Framework was introduced in August 2006, comprising banking institutions, development financial institutions (DFIs) and credit cooperatives to develop a sustainable MF industry. Given the constraints on Government funds and outreach, the involvement of banking institutions in MF is important, as the banking system has the resources and the network of branches for a wider outreach. *Bank Simpanan Nasional* was mandated to provide MF to micro enterprises and individuals with businesses, while *Bank Pertanian Malaysia*, now known as Agrobank, will provide MF to micro enterprises in the agriculture and agro-based sector. *Bank Kerjasama Rakyat Malaysia* will provide MF to members of cooperatives, which remain important as they enable the members to pool their resources to participate in business ventures.

Amanah Ikhtiar Malaysia

AIM was established in September 1987, with the objective of *“assisting poor households lift themselves out of poverty through the provision of benevolent loans to be used for financing income-generating activities”*. With a network of 48 branches in the Peninsula as well as 21 branches in

¹ Defined as business entities with less than five full-time employees or annual sales turnover of less than RM250,000 in the manufacturing sector and less than RM200,000 in the primary agriculture and services sectors.

Sabah and Sarawak, AIM has achieved significant outreach of 190,900 members as at end-June 2008, up from only 3,220 members in 1990. AIM has so far disbursed MF loans totalling RM2.6 billion to its members, with nearly 100% comprising women.

During the first six months of 2008, the bulk of AIM loans amounting to RM163.3 million or 63.3% of total loans was provided for economic activities, including business, agriculture, manufacturing, livestock and services. Another 35.6% was mainly channelled for the repair and renovation of houses as well as purchase of consumer durables to enable members to improve their quality of life.

Initially focused on the eradication of rural poverty, AIM has recently been tasked with tackling urban poverty. AIM started the *Program Kewangan Mikro Bandar* (PKMB) in April 2008 with an initial allocation of RM100 million. The programme has just started in Kuala Lumpur and will expand to other major towns nationwide.

In terms of impact, the findings of six impact studies showed significant improvement in the incomes of members after receiving MF from AIM on a continuous basis, as shown in *Table 1*. The increase in incomes has enabled poor households to graduate out of poverty (see Poverty Line Income in *Table 2*).

TABLE 1:
Impact Studies of AIM

No.	Year	Income (RM)		Increase	
		Before	After	RM	%
1.	1988	142	220	78	54.9
2.	1990	142	460	318	223.9
3.	1990 – 1991	198	465	267	134.8
4.	1991 – 1993	223	532	309	138.6
5.	1994 – 1995	201	760	559	278.1
6.	2004 – 2005	321	1,904	1,583	493.1

Source: Amanah Ikhtiar Malaysia.

TABLE 2:
Poverty Line Income (RM / month), 1987 – 2007

Year	1987	1989	1992	1995	1997	1999	2002	2004	2007
Pen. Malaysia	350	370	405	425	454	510	529	661	720
Sabah	533	544	582	601	626	685	690	888	960
Sarawak	429	452	492	516	535	584	600	765	830

Note: PLI 1987 – 2002 calculated using 1977 methodology.
PLI 2004 – 2007 calculated using 2005 methodology.

Source: Department of Statistics, Malaysia.

The MF programmes of AIM have benefited the poor and helped them move out of poverty. However, from a policy perspective, it is important that MF borrowers eventually graduate and become more financially independent. This requires them to be dynamic and possess the drive to succeed, which are important determinants in ensuring the sustainability of entrepreneurs and micro enterprises.

Tabung Ekonomi Kumpulan Usahawan Nasional

TEKUN Nasional, previously known as *Yayasan TEKUN*, was established under the Ministry of Entrepreneur and Cooperative Development in 1998 to provide MF to small *bumiputera* entrepreneurs. TEKUN has played a key role in the development of *bumiputera* entrepreneurs through easy access to MF as well as business guidance and support services. In addition, TEKUN provides a savings plan to encourage entrepreneurs to invest their savings in their businesses. It has a network of 193 branches nationwide, and has provided MF totalling RM893 million to 147,546 entrepreneurs since 1999 to end-June 2008. From August 2008, the service charge for loans taken from TEKUN will be reduced from 8% to 4% to ease the burden of entrepreneurs, especially in the light of rising costs.

An important initiative in 2008 was the extension of MF to Indian youths through TEKUN under the programme *Skim Pembangunan Usahawan Muda India* (SPUMI), with an allocation of RM3 million. The SPUMI programme is carried out with the cooperation of *Yayasan Strategik Sosial* (YSS), an NGO which addresses the holistic development of the Indian community.

Participation of Financial Institutions in Microfinance

Since 2006, there has been commendable progress in involving financial institutions in the provision of MF. As of July 2008, nine financial institutions comprising six banking institutions and three DFIs have provided MF to micro enterprises and the self-employed. Access to the MF products offered by these financial institutions has been made simple, fast and convenient, with no collateral required and minimal documentation. More importantly, the MF can be obtained at branches and various distribution channels of the financial institutions and their strategic partners. The demand for MF has been encouraging with total outstanding loans of RM224.7 million provided to 22,799 MF customer accounts and an average financing amount of RM9,800 as at end-2007. The amount of MF outstanding loans further grew 147% year-on-year to RM353.2 million, while the number of clients increased 121% to 34,524 as at end-June 2008.

Conclusion

The Government has taken several initiatives to assist poor households and *bumiputera* entrepreneurs as well as enhance the access to financing for micro enterprises. The various financing programmes of AIM have helped the poor to uplift themselves from poverty and improve their livelihood, while TEKUN has contributed towards the development of *bumiputera* entrepreneurs. Meanwhile, the increased access to MF following the participation of banking institutions and DFIs will provide increased opportunities for micro enterprises to grow and enhance their contribution to the economy, particularly in terms of employment creation and income generation.

As part of ongoing initiatives to promote greater use of electronic payments and to reduce the cost of doing business, the transaction fees for payments made by financial institutions on behalf of customers using the real time gross settlement system (RENTAS) was reduced from RM2.50 to RM1.50 effective 15 July 2008. In addition, the existing Inland Exchange Commission of 0.03% on fund transfers was also abolished.

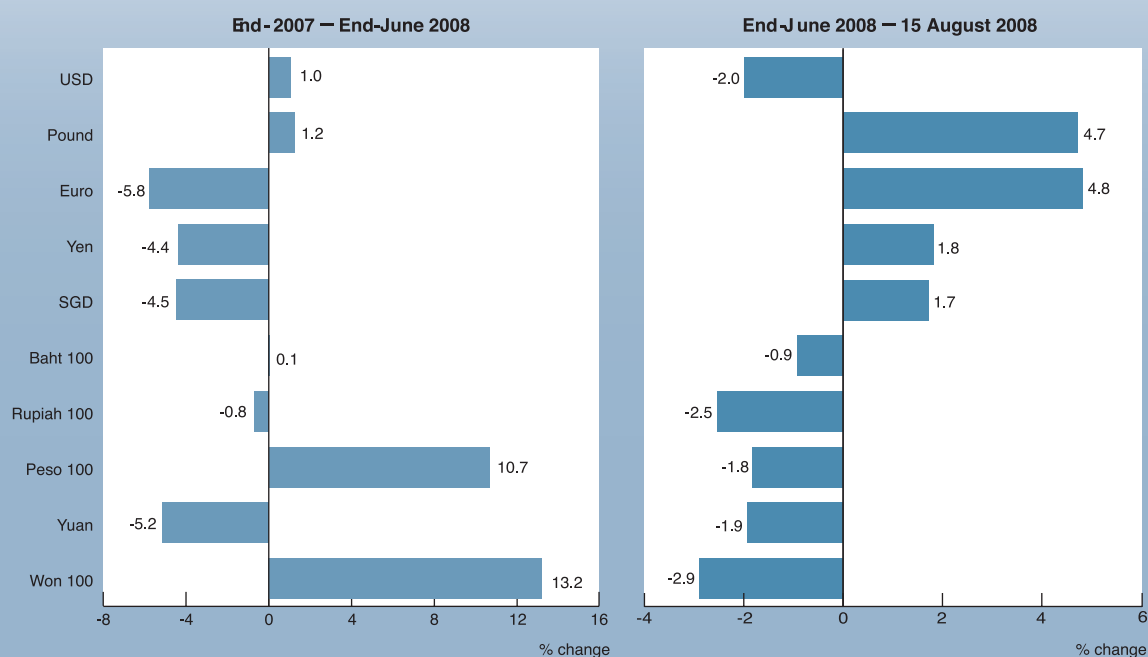
During the first six months of 2008, the **ringgit** recorded a mixed performance against major and regional currencies, as shown in *Chart 5.3*. The performance of the ringgit was influenced by several factors including increased volatility in financial markets and changing investor sentiment towards regional economies. The ringgit appreciated 1.0% to RM3.2740 against the US dollar, supported by sustained inflows and strong economic fundamentals. The ringgit also rose 1.2% to RM6.5267 against

the pound sterling as at end-June 2008 as the pound was weighed down by slower economic growth in the United Kingdom (UK). The performance of the ringgit was mixed against regional currencies, appreciating in the range of 0.1% – 13.2% against the baht, peso and won, and depreciating between 0.8% and 5.2% against the rupiah, Singapore dollar and yuan.

From end-June 2008 to 15 August 2008, the performance of the ringgit was mixed against major and regional currencies following further uncertainties over global economic growth and volatility in financial markets. During the period, the ringgit depreciated 2.0% against the US dollar, but appreciated 4.7% and 4.8% against the pound sterling and euro, respectively. Against regional currencies, the ringgit softened in the range of 0.9% and 2.9% *vis-à-vis* the baht, peso, yuan, rupiah and won, while appreciating against the Singapore dollar (1.7%) and yen (1.8%).

CHART 5.3

Performance of Ringgit Against Selected Currencies



Source: Bank Negara Malaysia.

Update on Foreign Exchange Administration Rules

The **foreign exchange administration rules** continue to be progressively relaxed. The liberalisation is aimed at enhancing Malaysia's competitiveness through reducing the cost of doing business, increasing efficiency of the regulatory delivery system and facilitating greater access to financing.

1 January 2008

To increase the efficiency of the regulatory delivery system, the requirement to submit the following reports to Bank Negara Malaysia was abolished:

- Overseas Account Statement for accounts maintained by resident corporations with offshore banks; and
- Inter-Company Account Statement for accounts maintained by resident corporations with non-resident corporations.

15 January 2008

To support the development of the commodity futures market in Malaysia, the following flexibilities were granted:

- Investments by residents in USD-denominated crude palm oil futures contracts (USD FUPO) on *Bursa Malaysia* by residents are excluded from the investment in foreign currency assets rule, if the contracts are settled in ringgit; and
- Commodity futures brokers licensed by the Securities Commission are allowed to act as agents to licensed onshore banks to quote exchange rates to facilitate settlement of USD FUPO with *Bursa Malaysia*.

28 May 2008

To further enhance business efficiency by granting flexibilities for residents to borrow in foreign currency and ringgit by allowing:

- A resident company to obtain any amount of foreign currency borrowing from its non-bank non-resident parent company, other resident companies within the same corporate group in Malaysia and licensed onshore banks;
- A resident company to obtain any amount of foreign currency supplier's credit for capital goods from non-resident suppliers;
- A resident company or individual to refinance outstanding approved foreign currency borrowing (principal and interest);
- A resident company to borrow any amount of ringgit from its non-bank non-resident parent company to finance activities in the real sector in Malaysia;
- A resident company or an individual to borrow up to RM1 million in aggregate from other non-bank non-residents for use in Malaysia; and
- A licensed onshore bank, resident company or individual to lend any amount in ringgit to a non-bank non-resident to finance activities in the real sector in Malaysia.

Developments in the Financial Sector

Health of the Banking System

Banking system remains sound...

The banking system remains resilient and sound supported by strong capitalisation, higher profitability and improved quality of assets. The level of capitalisation of banking institutions, measured in terms of the risk-weighted capital ratio (RWCR), stood at 13% as at end-June 2008 (end-2007: 13.2%), significantly higher than the Basel minimum requirement of 8%, as shown in *Chart 5.4*. Unaudited pre-tax profits of the banking system rose 30.2% to RM10.8 billion in the first six months of 2008 (2007: 36.7%; RM17.7 billion), mainly driven by sustained revenue from financing related activities, wealth and portfolio management as well as remittance services.

The quality of the loans portfolio continued to improve, with net non-performing loans (NPLs)

reaching a 10-year record low during the first six months of 2008. The improvement was underpinned by higher reclassification of NPLs to performing status and better loan recoveries in line with the favourable economic conditions as well as intensified efforts to strengthen balance sheets of the banking institutions via loan write-offs, securitisation and outright sales. The NPLs based on 3-month classification fell RM4.9 billion to RM36.9 billion as at end-June 2008 (end-2007: RM41.8 billion). Consequently, the net NPLs ratio improved further to 2.7% (end-2007: 3.2%).

Consumer Protection

Comprehensive consumer protection framework...

The consumer protection framework has been strengthened with various initiatives to enhance financial literacy and awareness among consumers as well as to ensure sufficient redress mechanisms. These initiatives include the establishment of the Credit Counselling and Debt Management Agency (CCDMA) to provide credit counselling and debt management services; the *Perbadanan Insurans Deposit Malaysia* (PIDM), which administers the deposit insurance system to protect depositors and promote financial stability; the BNMLINK, which provides assistance on queries and complaints to walk-in customers; the BNMTELELINK, which handles written and telephone enquiries and complaints; and the Financial Mediation Bureau, which helps resolve consumer disputes against financial institutions.

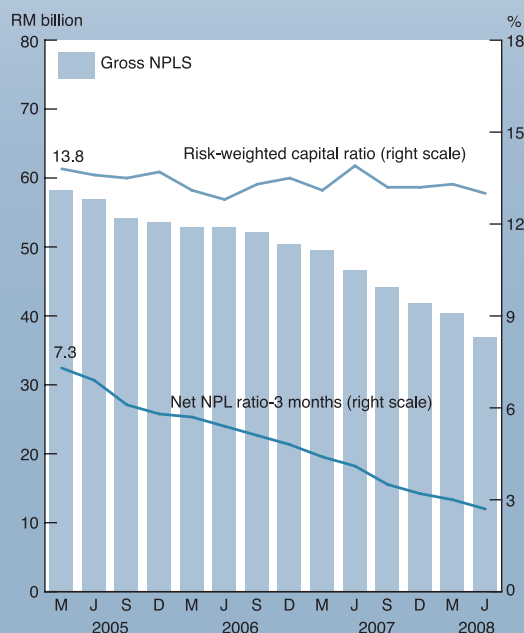
Investment Banks

Investment banks make inroads...

The emergence of investment banks has enhanced the capacity and capability of Malaysian financial institutions to capitalise on domestic and regional business opportunities, widened the range of products and services and strengthened their competitive advantage. Investment banks are co-regulated by BNM and the Securities Commission (SC), with BNM responsible for

CHART 5.4

**Banking System:
Gross Non-Performing Loans (NPLs)¹,
Net NPL Ratio¹ and Risk-Weighted
Capital Ratio¹**



¹ As at end-June 2008.

Source: Bank Negara Malaysia.

Update on Credit Counselling and Debt Management Agency

The CCDMA, established in April 2006, is a pre-emptive measure to address issues relating to household financial commitments. It provides free credit counselling, education and debt restructuring services to consumers. CCDMA has expanded its services to a wider outreach, through the opening of three new branches in Melaka, Perak and Pahang in 2007, in addition to the regional offices located at five BNM branches. In a short span of time, the number of people who sought the services of CCDMA has grown tremendously from 6,800 individuals in 2006 to 25,300 in 2007. In the first half of 2008, a total of 19,800 individuals sought the services of CCDMA, bringing the total to date to 52,000 individuals. Since January 2007 to June 2008, individuals with credit card related debts accounted for 78% of the total number of individuals enrolled under the debt management programme, involving debts of RM249 million.

The CCDMA also continued to contribute towards improving financial education, especially for youths. In this regard, CCDMA has developed a module on Personal Financial Education to be taught in universities. The objective is to prepare graduates to face the challenges of managing their finances wisely at the start of their career. From July 2008, eight universities have included the module into their curriculum, while seven other universities indicated interest in the module. In addition, CCDMA will continue to collaborate with the National Service Training Department to provide personal financial education for trainees.

Update on Perbadanan Insurans Deposit Malaysia

The PIDM, established in 2005, marks an important initiative in the Financial Sector Master Plan (FSMP) to strengthen the consumer

protection framework and promote financial stability. The PIDM administers the Malaysian deposit insurance system, replacing any other guarantees previously provided by the Government related to deposits held in licensed financial institutions. The deposit insurance system promotes financial stability by providing depositors with explicit protection over the safety of their deposits in the event a banking institution is unable to meet its financial obligations.

The PIDM protects depositors up to RM60,000, inclusive of principal and interest per depositor per member institution. Separate coverage is provided for Islamic and conventional deposits, joint accounts, trust accounts and accounts held under a sole proprietorship, partnership or professional practice. The Malaysian deposit insurance system is funded by premiums paid by member institutions. Membership in the deposit insurance system is compulsory for commercial banks, including locally incorporated subsidiaries of foreign banks operating in Malaysia and Islamic banking institutions. As at end-June 2008, the PIDM has 35 member institutions, comprising 22 commercial banks and 13 Islamic banks. As Malaysia has a dual banking system, the PIDM administers two separate funds, the Islamic Deposit Insurance Fund and the Conventional Deposit Insurance Fund. Total insured deposits held by member institutions totalled RM191.5 billion as at end-2007.

In May this year, the PIDM implemented the Differential Premium Systems (DPS) in line with the mandate to promote sound risk management in the financial system. Under the DPS, premiums paid by member institutions are assessed based on their individual risk profiles, as against the previous flat rate of 0.06% on total insured deposits. The PIDM is the first deposit insurer in Southeast Asia to establish a DPS based on international best practices and customised to the Malaysian banking system. The PIDM is also active in raising consumer awareness on the deposit insurance system.

prudential regulation to preserve financial stability and soundness, and the SC for business and market conduct to promote market integrity and investor protection. The implementation of the investment bank framework has achieved commendable results since its introduction in 2005, with 13 investment banks already in operation. As at July 2008, only two merchant banks and one universal broker have yet to transform into investment banks.

Progress of the Financial Sector Master Plan

Implementation of FSMP on track...

The FSMP, launched in March 2001, aims to develop a more resilient, competitive and dynamic financial system to support the economy as well as face the challenges of liberalisation and globalisation. It outlines strategies for the development of the Malaysian financial sector from 2001 to 2010. The reforms and developmental initiatives focus on three broad thrusts, namely, capacity building of domestic institutions, diversification of the financial sector, as well as gradual deregulation and liberalisation.

Several initiatives have been taken to achieve the above objectives during the first six months of 2008, including encouraging proposals and efforts for consolidation among the domestic financial institutions as well as forming strategic alliances with foreign financial institutions. During the period, BNM approved seven applications to commence negotiations for mergers and acquisitions. Approval was also granted to a financial institution from the United Arab Emirates to acquire an equity stake in a domestic banking group.

Developments in Islamic Finance

Islamic finance charts significant progress...

Malaysia remains at the forefront of Islamic finance. The domestic Islamic capital market (ICM) has an array of *syariah*-compliant products, including *sukuk*, equities, unit trust funds, exchange-

traded funds (ETFs) and real estate investment trusts (REITs). The nation's ICM has charted significant achievements, including Malaysia being the first to issue global sovereign *sukuk* in 2002. Malaysia is the world's largest *sukuk* market, with USD66 billion or 62.6% of global outstanding *sukuk* issuance as at end-June 2008. To date, the world's largest issuance of *sukuk* valued at RM15.4 billion (USD4.8 billion) was made by a Malaysian company in 2007. The world's first Islamic REIT and Asia's first Islamic ETF were also listed in Malaysia. The domestic capital market has attracted foreign entities, such as the World Bank and International Finance Corporation to raise ringgit-denominated *sukuk*. Malaysia also has one of the world's largest and most comprehensive *takaful* markets. A new re-*takaful* company with total capital of USD300 million, the world's largest, is in the process of being established.

The MIFC initiative, launched in August 2006, continues to make commendable progress. The initiative aims to position Malaysia as a centre of origination, distribution and trading of Islamic financial instruments. In June 2008, the MIFC was named the "Best International Islamic Finance Centre" at the 2nd Annual London *Sukuk* Summit Awards of Excellence. As at end-June 2008, there were one international Islamic bank and one international *takaful* operator conducting foreign currency business activities in Malaysia. In addition, 11 Islamic banks, two commercial banks, one investment bank and six *takaful* operators had set up international foreign currency business units (ICBUs). The ICBUs of banks are allowed to conduct Islamic commercial banking, investment banking and other banking activities in foreign currencies, while the ICBUs of *takaful* operators are permitted to conduct non-ringgit *takaful* and re-*takaful* business. The SC has also fully liberalised international participation in the Islamic fund industry with the removal of restrictions on ownership and investments abroad.

The International Centre for Education in Islamic Finance (INCEIF), established in 2006, continues to play an instrumental role in meeting the human capital needs of the domestic and global Islamic finance services industry. Since its establishment,

INCEIF has made significant progress with more than 1,000 registered students from 46 countries in its professional Islamic finance certification programme. In January 2008, INCEIF introduced its PhD in Islamic finance programme while a Masters Programme in Islamic finance was launched in June 2008. In March 2008, the International *Syariah* Research Academy (ISRA) for Islamic finance was established within INCEIF. ISRA is a dedicated research centre with the strategic focus to act as a repository of knowledge for *syariah* views or *fatwa* as well as to develop *syariah* talent and promote *syariah* understanding.

The 2008 Budget also provided income tax exemption on fees received in respect of Islamic fund management activities and for the Employees Provident Fund to channel RM7 billion to be managed by Islamic fund management companies (IFMCs). In July 2008, the SC approved three leading financial institutions to establish IFMCs in Malaysia. The IFMCs will play a key role in the internationalisation of Malaysia's ICM.

The SC undertook several initiatives in 2008 to further promote and strengthen the domestic ICM. These include establishing an International Advisory Committee to provide strategic guidance and international perspectives for the ICM and organising the semi-annual International Islamic Capital Market Forum, a platform for scholarly exchange of ideas and views to enhance awareness and understanding of Islamic finance. Apart from this, the SC also introduced the ICM Visiting Scholar Programme, whereby internationally renowned scholars will be attached with *Universiti Malaya* to promote and enhance research in the ICM, as well as the project to compile *syariah* rulings worldwide as a source of reference.

Islamic Banking

Islamic banking expands rapidly...

The **Islamic banking system** remained well-capitalised with the RWCR at 15.1% as at end-June 2008 (end-2007: 15.6%), after taking into account the implementation of the

revised capital adequacy framework for Islamic Banks in January 2008. The framework specifies the standardised approach to capital computations, while reflecting the differences in the underlying contracts and incorporating specific elements peculiar to Islamic banking such as the capital requirements for inventory risks as well as the treatment of profit sharing investment accounts. Although net income from financing and securities increased 20.5%, pre-tax profits, however, declined 12.6% to RM904.3 million in the first six months of 2008 (January – June 2007: RM1,034.9 million), due to higher operating expenses and lower non-financing income. The quality of financing improved further with net non-performing financing (net NPLs under conventional banking) declining 12.7% to RM2.5 billion and accounting for 2.6% of total financing as at end-June 2008 (end-2007: RM2.9 billion; 3.3%).

TABLE 5.4

Islamic Banking: Key Indicators

	RM million		Change (%)
	End-2007	End-June 2008	
Assets	157,157.7	177,002.4	12.6
Deposits	121,974.6	142,727.9	17.0
of which:			
Investment	57,588.9	65,196.5	13.2
Savings	13,559.9	14,479.0	6.8
Demand	25,169.6	25,134.2	-0.1
Others	25,656.1	37,918.2	47.8
Financing	89,865.1	97,524.7	8.5
of which:			
Primary agriculture	2,615.7	2,618.0	0.1
Manufacturing (including agro-based)	9,727.2	10,492.0	7.9
Wholesale and retail trade, restaurants and hotels	4,787.6	5,628.9	17.6
Finance, insurance and business activities	4,159.4	4,163.1	0.1
Households	55,163.1	58,519.8	6.1

Source: Bank Negara Malaysia.

Total assets expanded 12.6% to RM177 billion as at end-June 2008 (end-2007: RM157.2 billion) and accounted for 13.6% of total banking system assets, as shown in *Table 5.4*. Deposits increased 17.0% to RM142.7 billion (end-2007: RM122 billion) to capture a market share of 13.6%. Financing grew 8.5% to RM97.5 billion and accounted for 14.2% of total banking system loans (end-2007: RM89.9 billion). Lending remained concentrated on the household sector, with loans amounting to RM58.5 billion or 60.0% of total outstanding loans (end-2007: RM55.2 billion).

Insurance Industry

Motor insurance rebounds...

The **insurance industry** remained resilient with sustained business expansion and improved solvency. Combined premium income of the insurance industry increased 19.5% to RM15.6 billion in the first half of 2008 (January – June 2007: 10.0%; RM13 billion).

The **life insurance sector** recorded a lower volume of new business premiums, declining 12.8% to RM3.4 billion (January – June 2007: 19.7%; RM3.9 billion), as shown in *Table 5.5*, following slower sales of new investment-linked and endowment policies. However, investment-linked policies continued to account for a higher share of 36.4% of new business premiums. In terms of distribution channels, bancassurance tie-ups captured 39.3% of new premiums, while the market share of agency business improved to 52.5% (January – June 2007: 43.6%). Market penetration of life insurance, as measured in terms of the total number of policies in force to total population, rose to 40.1% as at end-June 2008 (end-June 2007: 39.2%), indicating huge potential to increase Malaysian life insurance market penetration.

In the **general insurance sector**, gross direct premiums grew 8.2% to RM5.6 billion (January – June 2007: 2.5%; RM5.2 billion). The motor segment rebounded on renewed demand for motor vehicles following the launch of new models, with gross direct motor premiums increasing

TABLE 5.5

Life and General Insurance Business

	End-2007	End-June 2008 ¹
Life Insurance Business (RM million)		
New business:		
Number of policies ('000 units)	1,337.5	617.6
Sums insured	185,066.0	117,128.0
Total premiums	7,587.0	3,397.0
Business in force		
Number of policies ('000 units)	10,909.8	11,053.3
Sums insured	722,679.4	740,754.0
Annual premiums	14,538.8	14,713.0
Premium income	18,773.9	11,004.4
Benefit payments	9,653.6	6,964.5
General insurance (RM million)		
Premium income:		
Gross direct premiums	10,046.4	5,629.5
Net premiums	8,186.7	4,488.2
Reinsurance placed outside Malaysia	1,030.6	321.7
Retention ratio ² (%)	90.3	92.4
Number of insurance companies		
Direct:		
Life	8	8
General	25	25
Composite	8	8
Reinsurance:		
Life	1	1
General	5	5
Composite	1	1

¹ Preliminary data.

² Net premiums to gross direct and reinsurance accepted premiums less reinsurance within Malaysia.

Source: Bank Negara Malaysia.

9.9% to RM2.4 billion in the first half of 2008 (January – June 2007: -1.3%: RM2.2 billion). This was further supported by the non-motor segment, such as marine, aviation and transit, fire, medical expenses and personal accident as well as other insurance, which expanded 7.0% to RM3.2 billion (January – June 2007: 5.5%; RM3.0 billion).

The solvency position of the insurance industry remained strong with an increase in unaudited aggregate solvency surplus to RM16.5 billion as at end-June 2008. The life insurance sector registered lower excess of income over outgo totalling RM4.6 billion. The underwriting margin ratio for the general insurance sector was 0.1% (January – June 2007: 0.5%) on account of better claims experience, with the claims ratio reduced to 65.4% (January – June 2007: 68.3%). Operating profits, however, declined 42.2%, following higher net provisions for diminution in value of investments totalling RM134.8 million (January – June 2007: RM27.1 million) due to greater volatility in the equity market.

In tandem with business growth, the combined assets of the insurance industry expanded 9.6% to RM127.6 billion in the first half of 2008, as

shown in *Table 5.6*. Asset allocation remained concentrated on corporate equities and debt securities as well as Government securities, accounting for 67.0% of total assets. Life insurance business continued to account for a significant portion of the industry's total assets with a share of 83.8%.

The insurance industry has achieved significant progress with regard to consolidation. Since 1998, the insurance industry has been encouraged to consolidate to increase the level of competition between players and to form a robust, effective and efficient insurance sector. The consolidation efforts have yielded positive results, with the number of insurance companies reduced to 41 in June 2008 from 56 in 1999. These efforts have been facilitated by the flexibility given to domestic financial institutions to allow multiple negotiations with prospective bidders simultaneously. Incentives are also provided to insurance companies that merge or acquire other insurance companies. There are currently seven insurance companies that have been granted approval to commence negotiations for proposed mergers and acquisitions.

TABLE 5.6

Assets of Life and General Insurance Funds
(RM million)

	Life Insurance		General Insurance	
	End-2007	End-June 2008	End-2007	End-June 2008
Property, plant and equipment	483.3	502.6	783.0	772.6
Loans	11,470.2	11,714.5	238.0	220.3
Investments	72,128.7	74,606.5	10,404.4	10,856.0
Government papers	17,362.8	17,654.0	3,506.2	3,692.8
Corporate and debt securities	53,140.8	55,179.4	6,415.2	6,696.0
Other investments	1,625.1	1,773.1	483.0	467.1
Investment properties	2,986.5	3,030.5	242.0	243.4
Cash and deposits	11,770.7	13,093.1	6,165.5	6,352.6
Other assets ¹	3,663.6	3,982.8	2,078.5	2,267.6
Total	102,502.9	106,930.0	19,911.4	20,712.4

¹ Includes other investments and foreign assets.

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

An important regulatory measure came into force for the insurance industry in 2008, with the commencement of the Risk-Based Capital (RBC) framework in January. The RBC framework requires each insurer to maintain a capital adequacy level that is more sensitive to its underlying risk exposure compared with the existing solvency requirements. The framework also adopts more transparent and market consistent valuation requirements with the objective to promote greater transparency and comparability between players in the financial sector. Under the framework, better-managed insurers will be given greater flexibility to manage their investment and business portfolios.

Takaful Industry

Strong growth driven by family takaful...

The **takaful industry** grew strongly in the first six months of 2008 with combined *takaful* contribution income increasing 23.0% to RM1.4 billion (January – June 2007: 34.7%; RM1.1 billion). This accounted for 8.5% of total premiums of the insurance industry as at end-June 2008 (end-2007: 8.3%). In the family *takaful* sector, new business contributions recorded stronger growth of 98.1% to RM1 billion (January – June 2007: 41.5%), driven by the expansion in investment-linked products following new product launches in early 2008, and high growth in endowment products recorded by the new *takaful* operators. New business contributions for investment-linked business grew more than twofold to RM351.2 million (January – June 2007: RM152.1 million). Market penetration, measured in terms of family *takaful* certificates in force to the total population, deepened to 8.2% as at end-June 2008 (end-2007: 7.7%). In the general *takaful* sector, net contributions, however, declined 6.7% on account of the decrease in fire insurance by 34.2% to RM97.6 million (January – June 2007: 2.2%; RM148.3 million), and marine, aviation and transport insurance by 46.0% to RM13.8 million (January – June 2007: 12.0%; RM25.5 million). *Takaful* assets expanded 25.1% to RM9.6 billion as at end-June 2008 and accounted for 6.9% of the total assets of the insurance industry, as shown in *Table 5.7*.

TABLE 5.7

Family and General *Takaful* Business

	End-2007	End-June 2008
Assets (RM million)	8,818.3	9,564.7
Fixed assets	13.5	10.8
Financing	48.3	47.9
Investment	7,613.3	8,323.4
Government securities	777.9	808.6
PDS and equities	3,871.3	4,458.3
Investment deposits	2,964.1	3,056.5
Cash and bank balances	186.2	207.3
Others	957.0	975.3
Family <i>takaful</i> business		
New business:		
Total contributions (RM million)	1,486.6	1,003.3
Sums participated (RM million)	55,080.6	53,587.3
Number of certificates	490,709	225,136
Business in force:		
Total contributions (RM million)	990.1	1,159.2
Sums participated (RM million)	148,457.8	161,086.2
Number of certificates	2,101,827	2,247,309
General <i>takaful</i> business		
Gross contributions (RM million)	767.6	404.6
Net claims paid (RM million)	218.6	109.5

Source: Bank Negara Malaysia.

Development Financial Institutions

Enhancing effectiveness and efficiency of DFIs...

The **DFIs** play a significant role in supporting the development of priority sectors, such as agriculture, manufacturing, SMEs and infrastructure development. Several measures have been implemented towards further enhancing the effectiveness and efficiency as well as strengthening the DFIs in performing their mandated roles.

The Capital Framework for DFIs was issued in February 2008 to further strengthen and preserve their capital position. The Framework comprises a set of comprehensive capital requirements, namely, the maintenance of an absolute minimum capital of RM300 million to ensure sufficient financial capacities to sustain the business operations on an ongoing basis. In addition, DFIs are required to maintain a minimum RWCR of 8% at all times as well as to maintain a reserve fund, including transferring a certain percentage of the net profits to the fund, once the RWCR falls below the BNM specified threshold.

On 1 April 2008, *Bank Pertanian Malaysia* was corporatised into *Bank Pertanian Malaysia Berhad*, and rebranded as Agrobank. It is now governed by the *Bank Pertanian Malaysia Berhad* Act 2007, while the paid-up capital was raised to RM1 billion. Agrobank is envisaged to be more effective in supporting the Government's strategy to promote the development of the agriculture and agro-based sector. It will provide a broader range as well as more innovative financial and non-financial products and services to its customers, ranging from small farmers to corporates involved in agriculture and agro-business. Agrobank is wholly owned by the

Minister of Finance Incorporated (MoF Inc.). In ensuring that activities undertaken by the bank are in line with its entrusted mandate, Agrobank will remain under the purview of the Development Financial Institutions Act 2002.

A guideline on the participation of DFIs in the interbank market was issued to enable DFIs to source cheaper funds from the market. Approval was granted to *Bank Kerjasama Rakyat Malaysia Berhad (Bank Rakyat)* to fully participate in the interbank market effective from 1 July 2008. In addition, a corporate restructuring exercise for *Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank)* and *Bank Pembangunan Malaysia Berhad (Bank Pembangunan)* was undertaken to further realign their activities and institutional structures. The restructuring exercise, completed on 1 April 2008, resulted in the separation of the SME Bank from *Bank Pembangunan*, with the former now placed directly under MoF Inc. The objectives of the restructuring exercise are to better position the SME Bank as a specialised financial institution to promote national strategies for the development of SMEs as well as to enable it to better control the deployment of resources and facilities in supporting its business operations.

TABLE 5.8

Development Financial Institutions¹: Direction of Lending

Sector	RM million		% share	
	End-2007	End-June 2008	End-2007	End-June 2008
Primary agriculture	4,017.3	4,014.0	6.2	5.9
Manufacturing	5,793.7	5,555.5	8.9	8.2
Wholesale and retail trade, restaurants and hotels	1,094.9	1,271.2	1.7	1.9
Construction	8,130.3	8,173.6	12.5	12.0
Transport, storage and communication	5,531.2	5,501.5	8.5	8.1
Finance, insurance and business activities	1,306.8	1,649.0	2.0	2.4
Others	39,332.2	41,966.7	60.3	61.6
Total	65,206.4	68,131.5	100.0	100.0

¹ Refers to Bank Pembangunan Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Bank Pertanian Malaysia Berhad (Agrobank), Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank), Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad, Borneo Development Corporation (Sarawak) Sendirian Berhad, Credit Guarantee Corporation Malaysia Berhad, Sabah Credit Corporation and Lembaga Tabung Haji.

Source: Bank Negara Malaysia.

Financing activities of the DFIs expanded 4.5% to RM68.1 billion as at end-June 2008 (end-2007: RM65.2 billion), as shown in *Table 5.8*. The expansion reflected higher financing for consumption credit and the services sector. Consumption credit, mainly extended by *Bank Rakyat* and *Bank Simpanan Nasional*, grew 11.9% to RM26.8 billion, supported by sustained consumer demand. Lending to the services sector increased 6.5% to RM12.6 billion, on account of higher financing to the utilities, general commerce and business services sectors. The DFIs continued to support the development of SMEs, with total SME loans outstanding at RM14 billion, accounting for 20.5% of total loans outstanding of the DFIs. Deposits and borrowings from the Government remained the major sources of DFI funding, accounting for 66.7% of total resources.

Capital Market Developments

Progress of the Capital Market Masterplan

85% of CMP recommendations completed...

The **Capital Market Masterplan (CMP)**, launched in 2001, charts the strategic direction of the Malaysian capital market over a ten-year period. The CMP is currently in Phase 3 (2006 – 2010), with 129 or 85% of the 152 recommendations completed. Phase 3 of the CMP focuses on enhancing the international competitiveness of the domestic capital market. This includes increasing the efficiency of intermediation of the large pools of domestic and regional savings and enhancing the attractiveness of the capital market to domestic and international investors and issuers. Efforts will continue to focus on creating a conducive environment to increase overall wealth creation and growth generation as well as further strengthening Malaysia as an international centre of origination and trading of Islamic instruments and for wealth management services.

Funds Raised in the Capital Market

Higher generation of funds...

Gross funds raised in the **capital market** increased 13.8% to RM64.8 billion during the first six months of 2008 (January – June 2007: 77.3%; RM57 billion). After adjusting for redemption, net funds raised were also higher at RM40.2 billion (January – June 2007: RM32.3 billion), as shown in *Table 5.9*. The issuance of Government securities grew 4.3% to RM26.8 billion (January – June 2007: RM25.7 billion), largely to finance development projects. The private sector raised RM33.7 billion from the PDS market (January – June 2007: RM28.5 billion), including seven issuances of ringgit-denominated bonds totalling RM6.3 billion by non-resident entities. Islamic bond issuances remained strong, with Islamic medium-term notes and bonds comprising 34.0% of total PDS issued.

On a sectoral basis, RM13.7 billion or 50.8% of total PDS issuances were raised by the finance, insurance, real estate and business services sector, largely used for working capital and to support financial activities, as shown in *Table 5.10*. Among the purposes for the issuance of PDS, funding new activities constituted the bulk, accounting for RM22.6 billion or 84.0%, while refinancing of existing debt made up RM4.3 billion or 16.0%. Meanwhile, funds raised in the equity market increased 29.0% to RM2.8 billion (January – June 2007: RM2.2 billion).

Equity Market

KLCI dampened by external developments...

The **equity market** was adversely affected by external developments in 2008. These included uncertainties over the growth outlook of the US economy following the sub-prime mortgage crisis and housing market slump as well as escalating food and energy prices, which raised concerns over global inflation and slower growth. The benchmark Kuala Lumpur Composite Index

TABLE 5.9

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

	2007	2008 ¹
By Public Sector		
Government securities		
Malaysian Government Securities	19,215.4	21,316.5
Khazanah bonds	524.4	0.0
Government investment issues	6,500.0	5,500.0
Bon Simpanan Merdeka	0.0	1,483.1
New issues of Government securities	26,239.8	28,299.6
Less: Redemptions	8,153.2	6,650.3
Net funds raised	18,086.6	21,649.3
By Private Sector		
Shares² / Warrants		
Initial public offers	1,085.2	490.3
Rights issues	889.5	2,018.1
Special issues	185.5	0.0
Warrants	10.5	290.2
New issues of shares / warrants	2,170.7	2,798.6
Debt securities³ (gross)		
Straight bonds	2,910.6	13,756.4
Convertible bonds	30.8	204.9
Islamic bonds	5,958.0	4,477.5
Asset-backed bonds	3,540.3	1,200.0
Medium term notes	14,363.1	13,566.0
Cagamas bonds	1,750.0	540.7
New issues of debt securities	28,552.8	33,745.5
Less: Redemptions⁴	16,427.4	17,996.0
Net issues of debt securities	8,240.0	6,595.0
Net funds raised	14,296.2	18,548.1
Total net funds raised	32,382.8	40,197.4

¹ Preliminary data.

² Excludes funds raised by the exercise of Employees Share Option Scheme, Transferable Subscription Rights and Irredeemable Convertible Unsecured Loan Stocks.

³ Includes bonds issued by banking institutions.

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

Source: Bank Negara Malaysia.

TABLE 5.10

New Issues of PDS by Sector¹
January – June

Sector	2007		2008 ²	
	RM million	% Share	RM million	% Share
Manufacturing (including agro-based)	2,008.4	7.8	120.0	0.4
Electricity, gas and water supply	9,118.2	35.5	2,536.1	9.4
Wholesale & retail trade, restaurants and hotels	54.0	0.2	-	-
Construction	3,897.2	15.2	4,789.6	17.8
Transport, storage and communication	1,710.0	6.7	5,582.4	20.7
Finance, insurance, real estate and business services	8,894.9	34.6	13,666.7	50.8
Government and others	20.0	0.1	230.0	0.9
Total	25,702.7	100.0	26,924.8	100.0

¹ Excluding Cagamas bonds and bonds issued by non-resident entities.

² Preliminary data.

Source: Bank Negara Malaysia.

(KLCI) started the year on a promising note on the back of higher crude palm oil (CPO) prices and anticipation of an early general election, to reach an all-time high of 1,516.22 points on 11 January. The circuit breaker was, however, triggered on 10 March for the first time, since its introduction in 2002, following the sharp correction in the KLCI, after the outcome of the recent general election. The KLCI lost 123.11 points or 9.5% to 1,173.22 points from its previous close of 1,296.33 points on 7 March.

Investor sentiment was further weakened amid growing fears of a US recession and rising energy prices, causing the KLCI to shed 258.46 points or 17.9% to 1,186.57 points as at end-June 2008 (end-2007: 1,445.03 points). Total market transactions declined 60.4% to 82.3 billion units in the first six months of 2008 (January – June 2007: 100.5%; 208 billion units), as shown in *Table 5.11*, while average daily market transactions decreased 60.1% to 679.9 million units (January – June 2007: 98.8%; 1,705.1 million units).

TABLE 5.11

Bursa Malaysia: Selected Indicators
 January – June

	2007	2008
Price indices¹		
Composite	1,354.38	1,186.57
FBMEMAS	9,107.91	7,900.36
FBM2BRD ²	–	5,535.59
FBM-MDQ ²	–	4,404.77
Total turnover³		
Volume (million units)	208,025.0	82,267.4
Value (RM million)	299,428.7	185,363.1
Average daily turnover³		
Volume (million units)	1,705.1	679.9
Value (RM million)	2,454.3	1,531.9
Market Capitalisation ¹ (RM million)	1,088,282.1	901,237.0
Market Capitalisation ¹ / GDP (%)	169.6	125.9
Total no. of companies listed¹		
Main Board	642	638
Second Board	241	223
MESDAQ Market	129	125
Market liquidity¹		
Turnover value / Market capitalisation (%)	27.5	20.6
Turnover volume / No. of listed securities (%)	58.5	21.6
Market concentration¹		
10 most highly capitalised stocks / market capitalisation (%)	33.8	36.5

¹ As at end period.² Effective on 1 November 2007, FBM2BRD replaced the Second Board Index and FBM-MDQ replaced the MESDAQ Market Index.³ Based on market transactions only during period.

Source: Bursa Malaysia.

Total market transacted value also fell 38.1% to RM185.4 billion (January – June 2007: 144.7%; RM299.4 billion). Similarly, market capitalisation decreased 18.5% to RM901.2 billion as at end-June 2008 (end-2007: RM1,106.2 billion).

The major and regional stock markets ended in negative territory with double-digit declines in the first six months of 2008. The worst hit markets were Ho Chi Minh (-57.0%), Shanghai (-48.0%), Mumbai (-33.6%) and Manila (-32.1%), as shown in *Chart 5.5*. During the same period, the KLCI fell 17.9%, with all sectoral indices declining. The indices with smaller decreases were the plantation sector (-2.0%) and consumer goods sector (-6.7%), as shown in *Table 5.12*. The plantation sector was somewhat cushioned by higher CPO prices, while the consumer goods sector was supported by strong domestic demand. During the period end-June 2008 to 15 August 2008, the KLCI shed 7.7% to 1,095.05 points due to further uncertainties over global economic growth, volatility in financial markets as well as falling commodity prices.

Despite lacklustre market conditions, the equity market remained an important avenue to raise funds. During the first half of 2008, 14 new companies were listed on *Bursa Malaysia*, comprising four on the Main Board, five on the Second Board and five on the MESDAQ Market (2007: 26 listings), while seven companies took their shares private. The privatisation resulted in a reduction of RM6.6 billion or 0.6% of total market capitalisation as at end-2007. The total number of companies listed on *Bursa Malaysia* stood at 986 as at end-June 2008 (end-2007: 987). Funds mobilised during the period amounted to RM3.8 billion, accounting for about 23.0% of the RM16.7 billion in 2007.

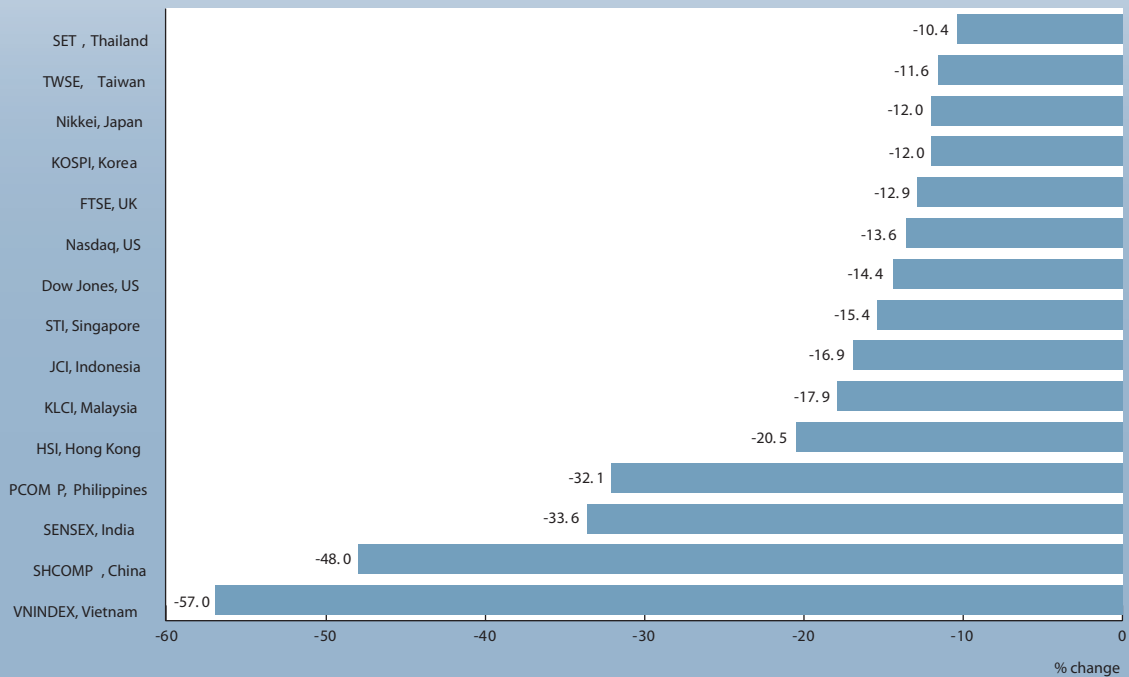
Unit Trust Industry

Unit trusts remain dominant...

The domestic **unit trust industry**, the largest among Southeast Asian countries, account for more than 70% of the Malaysian investment

CHART 5.5

Performance of Selected Stock Markets
(End-2007 – End-June 2008)



Source: Bloomberg.

management industry. The industry grew further during the first six months of 2008, with the launch of new funds which brought about an increase in the number of units in circulation. Thirty-five new funds were introduced to total 530 as at end-June 2008, as shown in *Table 5.13*. Investors continued to view unit trusts as a viable investment instrument, as reflected by the growth in the number of accounts and units in circulation of 14.4% and 10.7%, respectively. The Islamic unit trust segment continued to grow with the launch of eight new funds to reach 136, while the net asset value (NAV) increased 6.6% to RM18.0 billion as at end-June 2008 (end-2007: 128 Islamic funds; 83.9%; RM16.9 billion). The NAV of the overall unit trust industry, however, decreased 5.6% to RM159 billion and accounted for 17.7% of the market capitalisation of *Bursa Malaysia* as at end-June 2008 (end-2007: 39.0%; RM169.4 billion; 15.3%), in line with the decline in the KLCI.

Unit trust fund managers continue to diversify into foreign markets, following the liberalisation of the threshold for investments abroad, which was progressively raised to 50% of NAV of resident funds in April 2007. During the first six months of 2008, 27 new unit trust funds were launched for investment in foreign markets. As at end-June 2008, 11 funds had invested RM401 million in foreign assets, bringing the total number of funds invested in foreign markets to 160 with investments totalling RM13.3 billion.

The growth of REITs and ETFs has gradually gained momentum. While the total number of REITs, including two Islamic REITs, listed on *Bursa Malaysia* remained at 13, the total asset size of REITs rose to RM7.7 billion as at end-June 2008 (end-2007: RM7.0 billion). The SC also approved the first private REIT in February 2008. Meanwhile, Asia's first Islamic ETF was listed on *Bursa Malaysia* in January, bringing the

TABLE 5.12

Bursa Malaysia: Performance of Indices

Index	End-2007	End-June 2008	Change (%)
Composite	1,445.03	1,186.57	-17.9
FBMEMAS	9,810.83	7,900.36	-19.5
FBM2BRD ¹	6,732.35	5,535.59	-17.8
FBM-MDQ ²	6,109.16	4,404.77	-27.9
FBM30	9,343.67	7,656.73	-18.1
FBM70	9,944.61	7,639.54	-23.2
FBM100	9,502.36	7,679.58	-19.2
FBMSCAP	12,260.97	9,631.36	-21.5
FBMFLG	8,867.29	7,054.25	-20.5
FBMEMAS Syariah	10,533.13	8,587.00	-18.5
FBMHJRAH Syariah	11,660.06	9,723.32	-16.7
Industrial goods	114.58	99.47	-13.2
Consumer goods	343.89	320.94	-6.7
Trading/Services	196.26	154.42	-21.3
Property	1,035.66	698.68	-32.5
Industrial	3,014.43	2,558.26	-15.1
Finance	10,905.35	8,746.18	-19.8
Construction	313.04	207.82	-33.6
Plantation	8,089.30	7,924.93	-2.0
Mining	429.61	354.63	-17.5
Technology	24.42	18.08	-26.0

¹ Effective 1 November 2007, FBM2BRD replaced the Second Board Index.

² Effective 1 November 2007, FBM-MDQ replaced the MESDAQ Market Index.

Source: Bursa Malaysia.

total to three ETFs during the first six months of 2008. The market capitalisation of ETFs rose to RM1.2 billion as at end-June 2008 (end-2007: RM531.8 million).

The REIT industry is set to grow further following the recent measures announced in August 2008 to enhance *Bursa Malaysia* as a destination for REIT listings as well as to promote a vibrant and competitive REIT industry. The measures include raising foreign equity in REITs to 70% from 49%; providing greater flexibilities for REIT managers to manage their portfolios; and allowing

TABLE 5.13

Unit Trust Industry: Selected Indicators

	End-2007	End-June 2008
Number of unit trust management companies	39	39
Number of unit trust funds ¹	495	530
Conventional	367	394
Islamic	128	136
Units in circulation (million)	208,342	230,659
Number of accounts (million)	12.3	14.4
Net asset value (NAV) (RM million)	169,414	159,849
Conventional	152,553	141,874
Islamic	16,861	17,975
NAV / Bursa Malaysia market value (%)	15.3	17.7

¹ Refers to funds already launched.

Source: Securities Commission.

REIT managers to issue units up to 20% of its fund size without seeking the mandate from unit holders.

Derivatives Market***KLCI and CPO futures dominate market...***

Trading on the **derivatives market** was sustained at 3.6 million contracts in the first seven months of 2008 (January – July 2007: 3.7 million contracts), despite the lacklustre performance of the underlying stock market. Trading was concentrated on the KLCI and CPO futures, accounting for 96.4% of total turnover. The KLCI futures declined 2.0% to 1.81 million contracts (January – July 2007: 1.85 million contracts).

Turnover of CPO futures decreased 3.0% to 1.68 million contracts (January – July 2007: 1.73 million contracts). CPO prices generally track the price movements of crude oil, in view of the potential demand of CPO as an input for biofuel. The benchmark 3-month CPO

futures surged to a high of RM4,486 a tonne in early March 2008 in tandem with the upward trend of crude oil prices, which surpassed the USD100-level per barrel. Subsequently, the average price of 3-month CPO futures for January – July 2008 was also sharply higher by 58.4% to RM3,484 per tonne (January – July 2007: RM2,199 per tonne). However, in line with declining crude oil prices since July, CPO prices have softened to RM2,827 per tonne as at 8 August 2008.

Venture Capital Industry

Growing source for financing of start-ups...

The **venture capital (VC)** industry progressed further as an alternative source of financing, in particular for seed, start-up and early stage companies facing difficulties in obtaining bank lending or financing through the debt or equity market. Several initiatives were introduced by the Government to promote the VC industry, such as establishing VC funds, providing tax incentives and liberalising foreign equity ownership. The Government remained the main source of VC funding, accounting for 36.0% of total VC funds as at end-2007, as shown in *Table 5.14*.

Recognising the importance of VC in financing start-ups, the allocation for VC in the Ninth Malaysia Plan (9MP) was increased to RM1.6 billion (Eighth Malaysia Plan: RM690 million).

The VC industry continued to grow as reflected by the number of venture capital companies (VCCs) and venture capital management companies (VCMCs), which increased to 52 and 46, respectively, as at end-2007 (end-2006: 49 VCCs; 42 VCMCs). Of the total 98 companies registered with the SC, 93 were 100% domestic-owned, while five were partly foreign-owned. Total VC investments rose 54.0% to RM1,784 million in 2007 (2006: RM1,159 million), with the bulk of investment in investee companies (66.5%) for financing the expansion/growth stage.

A key VC initiative under the Ministry of Science, Technology and Innovation, launched in June 2008, involved a strategic tie-up between MIMOS Berhad, Malaysia Venture Capital Management Berhad (MAVCAP), Cradle Fund Sendirian Berhad (CFSB) and Multimedia Development Corporation (MDeC). The initiative, called the Innovation Eco-System for Industry Development, aims to spur the growth of indigenous industries and nurture them into global players. The initiative will facilitate companies with business ideas by providing technology and funding support from the initial stage to commercialisation.

TABLE 5.14

Source of Venture Capital Funds

Source	End-2007		End-2006	
	RM million	Share (%)	RM million	Share (%)
Government agencies	1,181	35.7	1,348	40.7
Corporations	1,056	31.9	1,244	37.6
Banks	513	15.5	243	7.3
Pension and Provident	62	1.9	24	0.7
Insurance	33	1.0	38	1.2
Foreign	308	9.3	249	7.5
Individuals	155	4.7	164	5.0
Total	3,308	100.0	3,310	100.0

Source: Securities Commission.

Outlook for 2009

Monetary policy to support growth...

The Malaysian economy is projected to grow 5.4% in 2009, driven by sustained domestic demand. The moderation in global and domestic growth in the second-half of 2008 and into the first-half of 2009 is expected to reduce the pressure on prices, allowing headline inflation to moderate in the second half of 2009. Monetary policy will continue to support growth with price stability. However, the monetary policy stance will depend on the assessment of the risks to sustainable growth and price stability.

The outlook for the capital market is envisaged to remain favourable in 2009, supported by the ongoing implementation of the 9MP projects, including the five regional growth corridors. Foreign issuers are likely to continue to tap the

domestic capital market for long-term funding, a trend observed in recent years. Malaysia is also expected to make further strides in Islamic finance, in line with the growing global demand for Islamic financial products and services.

Key Capital Market Measures

Measures to promote a strong and dynamic capital market...

Several measures and initiatives continued to be taken in the first seven months of 2008, aimed at further strengthening the capital market. The key measures include the following:

Strengthening the Islamic Capital Market

- On 27 March 2008, the SC announced several initiatives to strengthen the ICM. The initiatives include: strengthening partnerships through collaborative efforts with regard to the compilation and publication of global *syariah* rulings, and establishing a Visiting Scholar Programme; setting up an International Advisory Committee to provide strategic guidance and international perspectives; and organising the semi-annual International Islamic Capital Market Forum.
- On 7 May, the SC introduced new guidelines and best practices to promote the adoption of appropriate standards for the development of the Islamic VC industry. The Guidelines and Best Practices on Islamic VC stipulate the minimal requirements for the establishment of an Islamic VCC and Islamic VCMC. Under the guidelines, a *syariah* adviser must be appointed for the establishment of an Islamic VCC or VCMC, and the activities of Islamic VC entities must be *syariah*-compliant.
- On 14 July, the SC announced the approval of three leading financial institutions (Kuwait Finance House (M) Berhad, DBS Asset Management Limited and CIMB-Principal Islamic Asset Management Sendirian Berhad) to establish Islamic fund management companies in Malaysia.

Promoting the Unit Trust Industry

- On 3 March, the SC issued revised and new guidelines aimed at enhancing disclosure requirements of unit trust prospectus to enable investors to make informed decisions, and providing a single source of reference for disclosure requirements for unlisted unit trust funds as well as listed funds, such as REITs, ETFs and closed-end funds. The revised guidelines provide greater flexibility in structuring innovative products as well as enable fund managers to enhance returns to investors; allow unit trust funds to have higher exposure in derivatives; provide greater relaxation on securities lending and removal of the requirement to seek the SC's approval for foreign markets; and allow unit trust funds to borrow cash to meet repurchase requests.

Promoting the Derivatives Market

- On 9 January, Bursa Malaysia announced plans to launch CPO futures contracts denominated in USD, known as FUPO, aimed at attracting foreign traders and investors to the derivatives market. FUPO is a cash settlement contract that uses CPO futures contract prices, while the currency exchange rate of BNM will be used in calculating the final settlement value to enhance price transparency.
- On 10 April, Bursa Malaysia introduced the Direct Market Access (DMA) for the derivatives market to enhance market accessibility and trading efficiency.

Enhancing Market Liquidity, Efficiency and Competitiveness

- On 1 January, the new stockbroking commission rate structure became effective. The 2008 Budget had announced that commission rates for internet trading and cash upfront transactions would be fully negotiable to reduce the costs of transactions; encourage direct retail participation in share investment and trading; and promote greater use of technology in the capital market. In addition, clearing fees were reduced from 0.04% to 0.03%, with a maximum fee of RM1,000, while the minimum broking charge per transaction was fixed at RM40. The new commission rate is also part of a phased approach towards a more deregulated, competitive and vibrant stock market.
- On 7 January, Bursa Malaysia introduced the Central Matching Facility (CMF), an automated settlement system, to provide for more efficient and speedier matching of settlement of institutional trades.
- On 11 January, the SC introduced an over-allotment option and price stabilisation mechanism to enhance the efficiency and competitiveness of the fund raising process for initial public offerings (IPOs) in line with international best practices.
- On 28 January, Bursa Malaysia made key amendments to the corporate governance framework under the Listing Requirements (of the Main and Second Boards) and MESDAQ Market Listing Requirements. The amendments include strengthening the effectiveness of the audit committee, whereby executive directors are prohibited from being part of the audit committee to enhance its independence. In addition, the internal audit function is made compulsory to support the audit committee in carrying out its functions. The amendments will improve accountability, market integrity and boost investor confidence.
- On 31 January, the SC issued new guidelines to liberalise fund raising requirements as part of efforts to create a more competitive market. The Guidelines on the Offering of Equity and Equity-Linked Securities (for the Main and Second Boards) and Guidelines on the Offering of Equity and Equity-Linked Securities for the MESDAQ Market, which became effective from 1 February 2008, introduced several liberalisation measures in line with international best practices. These include subjecting companies with foreign-based assets/operations to the same listing criteria as companies with domestic operations. In addition, property development companies seeking listing are not required to have a minimum land bank of 500 acres while MESDAQ-listed companies are permitted to undertake acquisitions that result in significant changes in their business direction.
- On 10 March, Bursa Malaysia introduced the Electronic Trading Platform (ETP) for the Malaysian bond market. The ETP will enhance transparency and liquidity as well as increase efficiency in bond trading.
- On 25 March, several initiatives were announced at the Invest Malaysia 2008 Conference to further strengthen the capital market:
 - The Main and Second Boards will be merged into a unified Board for companies with an established profit track record where the qualifying criteria for listing will be based on the current Second Board criteria. This is to consolidate liquidity and facilitate companies' access to the equity market.
 - The MESDAQ Market will be transformed into a sponsor-driven market and expanded to include the listing of both technology and non-technology emerging companies in line with international trends.

- A market-making framework will be established for Bursa Malaysia to enhance liquidity. The market makers will include proprietary traders in commercial and investment banks as well as foreign traders.
- To further liberalise the bond market, the extension of the “deemed approved” process now applies to all domestic or foreign issuers that have been rated AAA by domestic rating agencies or a minimum BBB rating by foreign rating agencies.
- Allow the establishment of a third credit rating agency with foreign equity of up to 49% to promote competition.

Enhancing Investor Protection and Corporate Governance

- On 31 January, the SC issued new guidelines to strengthen investor protection by promoting higher standards of market conduct. The Guidelines on Principal Advisers for Corporate Proposals (Adviser Guidelines) and Guidelines on Due Diligence Conduct for Corporate Proposals (Due Diligence Guidelines) became effective from 1 February 2008. The Adviser Guidelines clarify who can act as principal advisers for the submission of corporate proposals to the SC, as well as identify the required competency standards for principal advisers. The Due Diligence Guidelines set out the SC’s expectations on issuers, advisers and experts in their conduct of due diligence to ensure that investors can make informed investment decisions based on sound and accurate information.
- Effective 3 March all prospectuses for the issuance of shares or securities will be made available on the SC website for public comments. The measure is part of efforts to further enhance disclosure standards and transparency of fund raising.
- On 8 April, the SC introduced new guidelines, known as the Guidelines on Market Conduct and Business Practices, to strengthen investor protection by promoting responsible conduct among stockbrokers and their representatives.