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Monetary and Financial Developments

ECONOMIC REPORT 2012/2013





Monetary and Financial Developments

Overview

Financial sector continues to support growth

Resilient domestic consumption and investment activity continued to drive economic growth in the first seven months of 2012, amid global financial volatilities and uncertainties. Headline inflation, which began to ease since the fourth quarter of 2011, continued to moderate during the first seven months of 2012. Thus, monetary policy has remained focused on ensuring sustainable growth in an environment of price stability as well as appropriate to avoid the build-up of financial imbalances. Given the evolving external and domestic conditions, the Overnight Policy Rate (OPR) was maintained at 3.00% and the Statutory Reserve Requirement (SRR) at 4.00%.

In tandem with the strong economic growth during the first seven months of 2012, financing extended through financial institutions and the capital market increased to support the continued expansion in economic activities. While the global financial system, especially in the United States (US) and Europe was buffeted by shocks and stress, the domestic financial system remained resilient due to the strong governance and risk management practices, which resulted in robust balance sheets and asset quality as well as healthy liquid positions. Financing through the banking system remained strong with loan applications and disbursements increasing 10% and 20.9%, respectively. As at end-July 2012, the risk-weighted capital ratio (RWCR) and core capital ratio (CCR) stood at 14.4% and 12.7%, respectively. These were well above the current regulatory minimum of 8% for RWCR and 4% for CCR as well as the more stringent standards under Basel III.

During the first seven months of 2012, the global sukuk market grew 38% compared with the same period in 2011. The sukuk market had a buoyant start this year when PLUS Berhad issued the world's single largest sukuk of RM30.6 billion in January 2012. Factors contributing to the growth of sukuk issuances include the declining yields for both sovereign and corporate issuances due to significant demand; the dearth of high-quality and high-yielding papers; the flight to safety in fixed income assets amid persistent concerns over the euro area's unresolved debt problems; and borrowers seeking to diversify their funding sources. Malaysia continued to lead in Islamic finance, sustaining its dominance in the sukuk industry and accounting for 71% of the global sukuk issued in the first seven months of 2012.

Monetary Developments

Monetary policy remains supportive

In 2012, **monetary policy** continues to be supportive in providing a stable environment to promote growth, while managing the risk of inflationary pressures and avoiding financial imbalances. The OPR was maintained at 3.00% in the first seven months of 2012, unchanged since May 2011, reflecting the supportive monetary policy stance. This policy stance will continue to be assessed against the risks and outlook for growth and inflation. Meanwhile, the SRR has been held steady at 4.00% since July 2011.

Stable interest rates

Interest rates of the banking system were stable in line with the OPR during the first seven months of 2012. The base lending rate of commercial



banks was steady at 6.53% as at end-July 2012 (end-2011: 6.53%). However, the average lending rate of commercial banks fell by 13 basis points (bps) to 4.70% (end-2011: 4.83%). The savings deposit rate declined 10 bps to 1.05% in January 2012 and remained at that level throughout the first quarter of the year (end-2011: 1.15%). In April, the savings deposit rate dropped another one basis point and remained at 1.04% as at end-July 2012. Meanwhile, the fixed deposit rates of 1-month to 12-month ranged between 2.91% and 3.18% as at end-July 2012 (end-2011: 2.95% – 3.22%). With inflation trending downward from October 2011, the real return for all fixed deposits turned positive since January 2012.

Monetary aggregates continue to grow

Monetary aggregates continued to grow in the first seven months of 2012. M1 or narrow money increased 14% as at end-July 2012 (end-2011:

TABLE 5.1

Factors Affecting M3 January – July

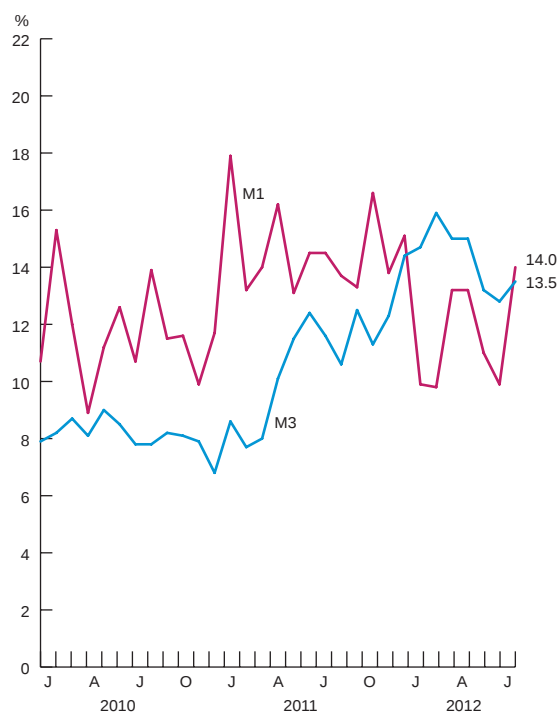
	Change (RM million)	
	2011	2012
M3	70,342.4	70,383.3
Net claims on Government	-19,367.1	-13,453.5
Claims on private sector	63,028.7	81,850.7
Loans	57,080.0	71,206.3
Securities	5,948.6	10,644.4
Net foreign assets	102,582.0	15,480.0
Bank Negara Malaysia	80,784.8	6,295.6
Banking system	21,797.2	9,184.4
Other influences	-75,901.1	-13,493.9

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

CHART 5.1

Monetary Aggregates (% annual change)



Source: Bank Negara Malaysia.

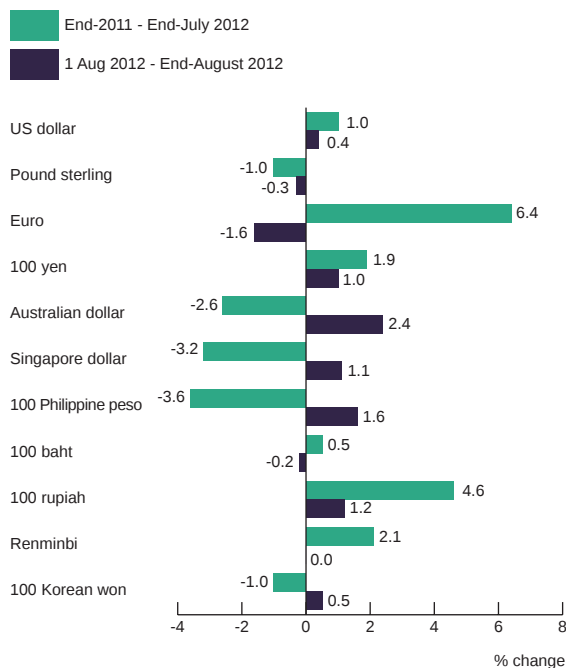
15.1%). M3 or broad money expanded further by 13.5% as at end-July 2012, reflecting the continued extension of credit by the banking system to the private sector (end-2011: 14.4%). M3 was also boosted by higher net foreign inflows.

Mixed performance of ringgit

The performance of the **ringgit** was mixed against major and regional currencies in the first seven months of 2012. The movement of the ringgit was largely influenced by several external factors, including foreign capital flows, concerns over the protracted euro area debt crisis and prospects for regional and global economic growth. Overall, the ringgit appreciated 1%, 1.9% and 6.4% against the US dollar, yen and euro, respectively while easing 1% against the pound sterling. The ringgit also softened between 1% and 3.6% against the Korean won, Australian dollar, Singapore dollar and the Philippine peso. However, the ringgit strengthened between 0.5% and 4.6% against the baht, renminbi and rupiah.



CHART 5.2

Performance of Ringgit Against Selected Currencies

Source: Bank Negara Malaysia.

In August, the movement of the ringgit was supported by strong domestic economic fundamentals and expectations of stimulus measures in China to help boost growth. The ringgit rose 0.4% against the US dollar to RM3.1315 during the period. The ringgit also strengthened 1% against the yen, but eased against the pound sterling and euro by 0.3% and 1.6%, respectively. Meanwhile, the ringgit gained between 0.5% and 2.4% against regional currencies, except against the baht.

The foreign exchange administration rules were further liberalised with effect from 31 January 2012. The liberalisation was aimed at enhancing competitiveness in the economy and to further develop the domestic financial markets. These measures include allowing licensed onshore banks to trade a foreign currency against another foreign currency with a resident; allowing a

licensed onshore bank to offer ringgit-denominated interest rate derivatives to a non-bank non-resident; and permitting flexibility for a resident to convert existing ringgit or foreign currency debt obligation into a debt obligation of another foreign currency. These measures, which are in line with the thrust of the Financial Sector Blueprint (the Blueprint), will contribute towards increasing the liquidity, depth and participation of a wider range of players in the domestic financial markets.

Financial Sector Developments

Banking System Performance

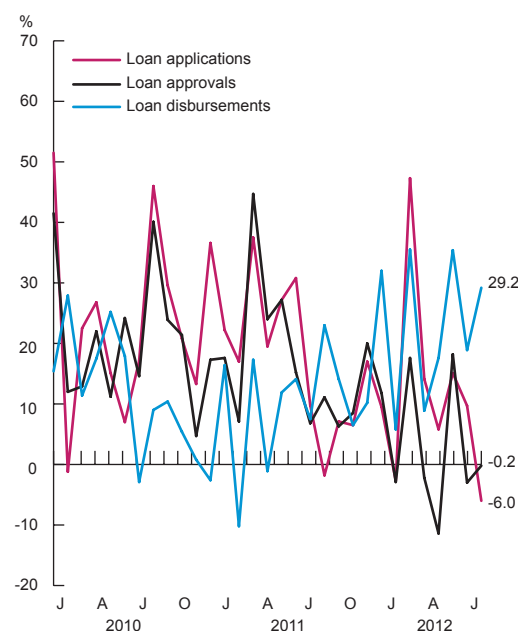
Lending remains robust

Lending by the banking system continued to support economic activities during the first seven months of 2012. Demand for financing remained robust with **loan applications** and **disbursements** growing 10% and 20.9%, respectively while **loan approvals** increased at a slower rate of 1.4%, reflecting partly the initial impact of the new lending guidelines, effective from January 2012 (January – July 2011: 23.5%; 8.2%; 20.5%). Meanwhile, total **loans outstanding** grew 13% to RM1,073.1 billion as at end-July 2012 (end-2011: 13.6%; RM1,003.5 billion).

During the same period, loan applications by **businesses** totalled RM246.5 billion, rising 18.6%, while approvals increased 7.3% (January – July 2011: RM207.8 billion; 29.6%; 26%). Loan disbursements to businesses grew 32.2% to RM394.4 billion and were mostly to finance working capital (January – July 2011: 6.1%; RM298.4 billion). The manufacturing sector continued to account for most of the loans disbursed at 21.8%, followed by the wholesale and retail trade, accommodation and restaurant sector at 19%, and the finance, insurance and business services sector at 10.9%. Overall, total business loans outstanding rose 14.6% to RM406.5 billion as at end-July 2012 (end-2011: 13.5%; RM377.9 billion).

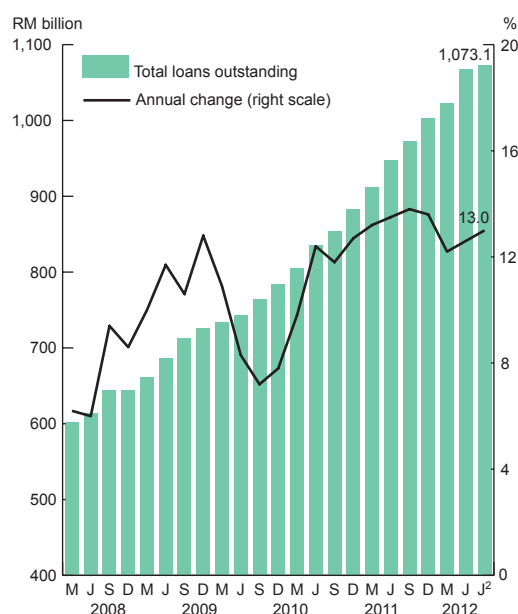


CHART 5.3
Banking System: Lending Indicators¹
(% annual change)



¹ Monthly data.
Source: Bank Negara Malaysia.

CHART 5.4
Banking System: Total Loans Outstanding¹



¹ End-period.
² End-July 2012.
Source: Bank Negara Malaysia.

TABLE 5.2

Banking System: Loan Indicators
January – July

Indicator	RM billion		Change (%)	
	2011	2012	2011	2012
Total¹				
Loan applications	434.2	477.6	23.5	10.0
Loan approvals	230.5	233.8	20.5	1.4
Loan disbursements	453.5	548.4	8.2	20.9
Loans outstanding ²	949.9	1,073.1	12.9	13.0
of which:				
Business				
Loan applications	207.8	246.5	29.6	18.6
Loan approvals	109.1	117.1	26.0	7.3
Loan disbursements	298.4	394.4	6.1	32.2
Loans outstanding ²	354.7	406.5	12.4	14.6
of which:				
SMEs				
Loan applications	96.3	111.4	31.6	15.8
Loan approvals	41.3	48.6	22.6	17.7
Loan disbursements	99.6	124.2	18.9	24.7
Loans outstanding ²	140.6	170.7	14.1	21.4
Households				
Loan applications	226.4	231.1	18.3	2.1
Loan approvals	121.3	116.7	16.1	-3.9
Loan disbursements	155.1	154.0	12.5	-0.7
Loans outstanding ²	524.9	586.9	12.7	11.8

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

² As at end-period.

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

Small and medium enterprises (SMEs) financing also remained robust with applications, approvals and disbursements posting double-digit growth rates of 15.8%, 17.7% and 24.7% (January – July 2011: 31.6%; 22.6%; 18.9%), respectively. A large proportion of the loans disbursed was channelled to the wholesale and retail trade, accommodation and restaurant (35.1%), and manufacturing (29%) sectors. SME loans outstanding increased 21.4% to RM170.7 billion and accounted for 42% of



TABLE 5.3

Loans by Sector

	Loans Disbursed				Loans Outstanding			
	2011		Jan – July 2012		End-2011		End-July 2012	
	RM billion	Share (%)	RM billion	Share (%)	RM billion	Share (%)	RM billion	Share (%)
Business	543.5	67.0	394.4	71.9	377.9	37.7	406.5	37.9
Large corporations ¹	363.6	44.8	38.7	7.1	224.8	22.4	235.8	22.0
SMEs	179.9	22.2	124.2	22.7	153.2	15.3	170.7	15.9
<i>Selected sectors²</i>								
Primary agriculture	22.9	2.8	16.0	2.9	21.9	2.2	25.4	2.4
Mining and quarrying	5.1	0.6	4.7	0.9	4.8	0.5	6.2	0.6
Manufacturing	175.6	21.6	119.4	21.8	92.3	9.2	96.3	9.0
Electricity, gas and water supply	5.6	0.7	4.5	0.8	10.4	1.0	8.9	0.8
Wholesale and retail trade, accommodation and restaurant	139.7	17.2	103.9	19.0	73.0	7.3	78.2	7.3
Construction	45.1	5.6	28.3	5.2	40.0	4.0	41.5	3.9
Real estate	33.3	4.1	25.9	4.7	51.0	5.1	58.1	5.4
Transport, storage and communication	19.7	2.4	11.4	2.1	30.5	3.0	28.9	2.7
Finance, insurance and business services	63.0	7.8	59.7	10.9	72.0	7.2	85.8	8.0
Households²	267.7	33.0	154.0	28.1	552.5	55.1	586.9	54.7
of which:								
Purchase of residential properties ³	64.5	8.0	37.3	6.8	255.9	25.5	275.0	25.6
Purchase of passenger cars ³	35.7	4.4	22.7	4.1	119.4	11.9	124.0	11.6
Consumption credit ^{3,4}	127.2	15.7	69.3	12.6	82.7	8.2	84.4	7.9
of which:								
Credit cards ³	93.7	11.6	50.8	9.3	32.2	3.2	31.8	3.0
Other sectors	-	-	-	-	73.1	7.3	79.7	7.4
Total⁵	811.3	100.0	548.4	100.0	1,003.5	100.0	1,073.1	100.0

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

² Encompasses loans to all customers (non-household and household).

³ Loans to households only.

⁴ Consumption credit = credit cards + personal use + purchase of consumer durables.

⁵ Total = business + households + other sectors.

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

total business loans outstanding in the banking system as at end-July 2012 (end-2011: 19.3%; RM153.2 billion; 40.5%).

Apart from the banking system, SMEs also sought financing from five **special revolving funds**¹ administered by Bank Negara Malaysia (BNM). The special funds were aimed at further

increasing SMEs' access to financing at lower lending rates ranging between 3.75% and 6.00%. During the first seven months of the year, total financing approved amounted to RM765.2 million for 1,945 SMEs (January – July 2011: RM542.6 million; 2,568). As at end-July 2012, total financing approved amounted to RM21.9 billion, reflecting a utilisation rate of 93.2%, and

¹ Fund For Food was established in 1993; Fund for Small and Medium Industries 2 (2000); New Entrepreneurs Fund 2 (2001); Micro Enterprise Fund (2008); and Bumiputera Entrepreneurs Project Fund – Islamic (2009).



52,933 SMEs were given assistance since the establishment of the funds (end-2011: RM21.2 billion; 95.2%; 50,988).

Financial institutions also offer **micro financing** under the Pembiayaan Mikro scheme to meet the needs of micro enterprises, which form the bulk of SMEs. During the first seven months of 2012, a total of 10,125 micro enterprise loans were approved totalling RM198.5 million (January – July 2011: 11,984; RM221.8 million). As at end-July 2012, total loans outstanding under this scheme, expanded further by 4% to RM867.7 million, and cumulatively, benefiting 69,327 micro enterprises (end-2011: 14.3%; RM887.6 million; 71,536).

Other micro financing sources include those provided by the Amanah Ikhtiar Malaysia (AIM) and Tabung Ekonomi Kumpulan Usaha Niaga (TEKUN Nasional). AIM was established in September 1987, with the objective to assist poor households through the provision of micro credit for income-generating activities. Contrary to conventional financing schemes, AIM loans do not require collateral or guarantors. It does

not resort to legal action against defaulters, and despite that, the default rate was only 0.6%, as at end-July 2012. With a network of 123 branches nationwide, AIM has 313,871 members, who are mostly women and had disbursed loans totalling RM7.4 billion as at end-July 2012. Meanwhile, TEKUN Nasional which was established in 1998, also provides micro financing to small entrepreneurs to start and expand their businesses. As at end-July 2012, TEKUN Nasional has a network of 198 branches nationwide and has provided micro financing totalling RM2.2 billion to 222,004 entrepreneurs since its establishment.

Lending to the **household** sector remained active with total household loans outstanding growing 11.8% to RM586.9 billion, and accounting for 54.7% of total loans outstanding in the banking system as at end-July 2012 (end-2011: 12.9%; RM552.5 billion; 55.1%). During the first seven months of 2012, household loan applications increased 2.1% while loan approvals and disbursements declined 3.9% and 0.7% (January – July 2011: 18.3%; 16.1%; 12.5%), respectively. The bulk of household loans were in the form of consumption

Guidelines on Responsible Financing

- The Guidelines which came into effect on 1 January 2012, are aimed at promoting prudent, responsible and transparent retail financing practices among financial institutions, including development financial institutions as well as responsible borrowing by consumers. The Guidelines complement a comprehensive range of pre-emptive measures introduced by Bank Negara Malaysia to prevent the household sector from becoming a source of vulnerability to the financial system and economy.
- The Guidelines focus on assessing borrowers' affordability to take on financing to ensure that they are not overly indebted. In assessing a financing application, financial institutions must take into consideration all debt repayment obligations and income after statutory deductions¹ in determining the borrower's ability to meet monthly repayments throughout the financing tenure. Financial institutions are given the flexibility to determine a prudent debt service ratio based on their respective lending policies and the circumstances of respective borrowers. In addition, financial institutions are required to provide more information to help consumers understand the impact of their borrowing decisions prior to entering into a loan contract, including information on how interest rate changes can affect the monthly repayment instalment. The Guidelines will serve to ensure that the pace of increase in household debt commensurates with the household's capacity to repay.

¹ Income tax and contributions to the Employees Provident Fund (EPF) and Social Security Organisation (SOCSO).



credit, which accounted for RM69.3 billion or 12.6% of total loans disbursed, followed by loans for the purchase of residential properties at 6.8% or RM37.3 billion.

Total debt of the household sector, which includes loans given primarily by the banking system, development financial institutions (DFIs), the Treasury Housing Loan Division and other credit institutions, continued to expand, albeit at a slower pace of 11.7% to RM694.8 billion as at end-July 2012 (end-2011: 12.6%; RM653.5 billion). Total household debt registered 75.6% of the nominal Gross Domestic Product (GDP) as at the end of second quarter 2012 (end-2011: 74.2%). Loans outstanding for the purchase of residential properties and vehicle financing still compose a large proportion of the total household debt with a combined share of 64% as at end-July 2012 (end-2011: 64%). Meanwhile, financial buffers of the household sector remained resilient as the level of household financial assets increased

9.8% to RM1.6 trillion as at end-July 2012, more than twice the level of total household debt (end-2011: 8.3%; RM1.5 trillion). Similarly, the ratio of household liquid financial assets to debt stood at 152.4% as at end-July 2012 (end-2011: 148%). The level of impaired household loans also improved to 1.6% of total household loans extended by the banking system as at end-July 2012 (end-2011: 1.8%).

Utilisation of **credit cards** in the first seven months of 2012 remained high with total transactions rising 6.7% to RM53.6 billion (January – July 2011: 11.8%; RM50.3 billion). Total outstanding balances of credit cards amounted to RM32.9 billion as at end-July 2012 (end-2011: RM33.4 billion). Credit card spending represented 3.1% of total loans outstanding in the banking system and 5.6% of total household loans as at end-July 2012 (end-2011: 3.3%; 6.1%). Credit card applications declined to one million while the approval rate stood at 51.7% (January – July

Central Credit Reference Information System

- The Central Credit Reference Information System (CCRIS) is a component of the credit information infrastructure administered by Bank Negara Malaysia (BNM). It is a computerised database system that collates factual credit-related information from participating financial institutions and disseminates the information back to participating financial institutions in the form of credit reports. Participating financial institutions submit credit information to CCRIS at the point of application, decision on the application and during the tenure of the credit facility.
- The credit report is a record of a borrower's credit history, with information on the types of credit facility, outstanding amount, conduct of account and any legal action status for the past 12 months. The credit report does not provide any judgement on the credit-worthiness of the borrower.
- Such credit reports are just one among a range of inputs and factors assessed by financial institutions to facilitate credit decisions. Individuals are also able to obtain their own credit report at no charge from any BNM office. There are also officers at BNM dedicated to assist consumers in understanding the credit reports.
- Consolidated credit information sharing has proven to be beneficial to both borrowers and lenders. The reduction in information asymmetry has contributed towards enhancing the efficiency of loan processing. The availability of shared information has also supported the development of more advanced credit risk management tools by financial institutions, including the development of credit scoring models and more granular portfolio analysis. Collectively, all these converge to contribute to promoting a sound credit culture and responsible financing.



The Registrar of Credit Reporting Agencies

- The office of the Registrar of Credit Reporting Agencies (RCRA) was established in 2011 under the Credit Reporting Agencies Act 2010. This Act was enacted to strike a balance between consumers' rights to privacy and protection, and lenders' rights to access information for improvements in credit evaluation and risk management. The sharing of credit information in a regulated environment will ensure that consumers' credit information is used appropriately. The RCRA is also responsible for resolving complaints and disputes between consumers and credit reporting agencies (CRAs).
- A preliminary study of the credit reporting industry in Malaysia indicated that there are 25 private CRAs, of which six have been identified as key players.
- The RCRA is tasked to:
 - a) advise the Minister of Finance on all matters in relation to the administration of the Act;
 - b) implement and enforce the Act, including the formulation of operational policies and procedures;
 - c) promote awareness and dissemination of information to the public in relation to the operation of the Act;
 - d) be responsible for the monitoring, controlling, supervision and regulation of CRAs;
 - e) encourage and promote the sound and orderly development of CRAs and the credit reporting sector; and
 - f) create a conducive environment for CRAs to carry out their activities.
- Under the Credit Reporting Agencies Act 2010, any CRA is prohibited to carry on a credit reporting business unless it has been registered and issued a certificate of registration by the RCRA.

2011: 1.4 million; 49.3%). Total non-performing loans of credit card debt declined to RM491 million with the impaired loans ratio improving to 1.5% of total loans outstanding in the banking system as at end-July 2012 (end-2011: RM528 million; 1.6%).

During the first seven months of 2012, the Credit Counselling and Debt Management Agency (AKPK) continued to provide financial advice and debt restructuring assistance in efforts to promote prudent financial management and enhance the level of financial literacy. AKPK conducted a total of 875 briefings and exhibitions nationwide for various target groups, of which 623 were for the *Pengurusan Wang Ringgit Anda* (POWER!) programme, involving 85,690 participants who were mostly young adults. Counselling provided to individuals increased 22.3% to 21,436 participants (January – July 2011: -4.1%; 17,529), of which 44.6% or 9,570 enrolled in the Debt Management Programme (DMP) (January – July

2011: 55.8%; 9,778). During the period, this programme assisted borrowers in restructuring their repayments to financial institutions with a debt value of RM629.6 million (January – July 2011: RM576.4 million). Credit card debt cases under the DMP dropped to 7,730 in the first seven months of 2012 with total debt amounting to RM376.9 million (January – July 2011: 8,156; RM352 million), while personal financing totalled 5,202 cases with a debt value of RM173.7 million (January – July 2011: 5,114; RM138 million).

Robust banking system

The **banking system** remained sound with firm capitalisation and stable liquidity buffers in the first seven months of 2012. Regular stress tests conducted further reaffirmed its resilience to abnormal shocks and market conditions. As at end-July 2012, the RWCR and CCR of the banking system were recorded at



14.4% and 12.7% (end-2011: 15.7%; 13.7%), respectively with approximately 87.7% of eligible capital in the form of high-quality Tier-1 capital comprising mainly paid-up capital and reserves. Capital in excess of the minimum RWCR requirement of 8% remained high at more than RM72 billion.

During the first seven months of 2012, profitability of the banking sector continued to improve on account of higher income from financing activities as well as higher trading and investment gains. This was also supported by lower provisions for delinquent loans in tandem with the overall low level of impaired loans. Pre-tax profit of the banking sector rose 11.6% to RM17.3 billion (January – July 2011: 38.1%; RM15.5 billion). In the same period, loan quality of the banking system continued to improve with the level of impaired loans declining to RM23.4 billion while the impaired loans ratio fell to a low of 1.5% of

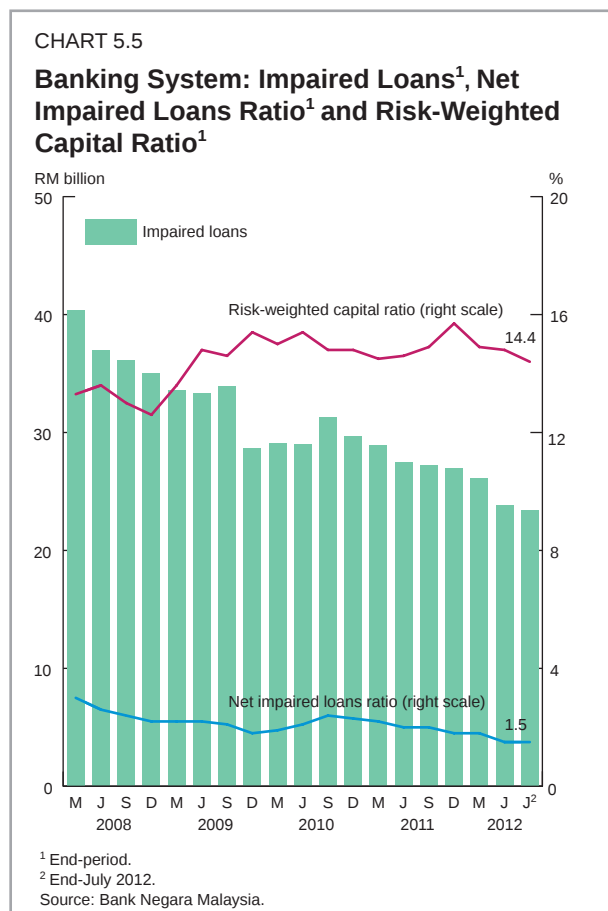
net loans as at end-July 2012 (end-2011: RM27 billion; 1.8%). The overall loan loss coverage remained above 90%.

Meanwhile, the direct impact of the euro area debt crisis on the domestic financial sector was well-contained as the increased volume and volatility in portfolio flows were effectively intermediated by the domestic financial and bond markets. The impact on the banks was also minimal given the prudent management of market risk exposures by the financial institutions; the low reliance on external borrowings for funding of the domestic and locally-incorporated foreign banks (LIFBs); and the limited credit exposures of the financial institutions to European counterparties.

Notwithstanding the relatively sizeable foreign claims on Malaysia based on the Bank for International Settlements statistics (19.7% of GDP as at end-2011), the risk to the domestic economy and financial system from deleveraging by European banks is limited. In an unlikely event of a massive retreat by European banks from Malaysia, domestic financial intermediation could be sufficiently supported by Malaysian-owned banks and other non-European banks, given the strong capitalisation and liquidity position of these banks.

Meanwhile, a new foreign commercial bank which was awarded a licence in 2010 commenced operation in July 2012. In addition, a foreign commercial bank from India had its commercial banking licence reinstated under a bilateral arrangement and has recommenced operations in July 2012. Given the strong global network of these new foreign commercial banks, their presence is expected to harness the large untapped potential of specialised areas of business and further strengthen Malaysia's linkages with international economies.

A total of 14 new LIFB branches were established across Malaysia since 2009 following greater operational flexibilities accorded to LIFBs, of which two commenced operations in July 2012. This development augurs well towards promoting financial inclusion while also enhancing the ability





of LIFBs to play a more effective intermediation role in the domestic economy. Existing financial institutions will also enjoy greater operational flexibility to establish new delivery channels. This expanded outreach will be implemented along with measures to accelerate the development of alternative delivery channels, while maintaining a balanced distribution of branch locations to support the needs of underserved areas and further promote financial inclusion.

Further liberalisation of the financial services sector to foreign investment will be guided by two key considerations as stated in the Blueprint. The first consideration is the prudential criteria which relates to the financial strength, business record, experience, character and integrity of the foreign investor; the soundness and feasibility of the business plans for the institution in Malaysia; transparency and complexity of the group structure that will not impede effective regulation and supervision; and the nature and extent of home country supervision. The second consideration will take into account the effect of the foreign investment on economic activity in Malaysia, particularly in catalysing new high value-added economic activities; contribution towards enhancing international trade and investment linkages; and impact on financial stability.

Widening outreach of DFIs

The **development financial institutions (DFIs)** continued to support the development of strategic sectors of the economy as reflected by the favourable growth in financing. During the first seven months of 2012, total financing outstanding of DFIs expanded 8.6% to RM106.5 billion as at end-July 2012 (end-2011: 7.1%; RM100.9 billion). This was contributed by increased financing for consumption credit as well as the transport and communication, construction, and business services sectors. In the light of sustained consumer demand, financing for consumption credit remained the largest portion of total financing provided by DFIs, with an annual growth of 11.2% and total financing outstanding of RM53.8 billion as at end-July 2012 (end-2011: 10.6%; RM50.2 billion). Financing to the transport and

TABLE 5.4

Development Financial Institutions¹: Direction of Lending

Sector	End-2011		End-July 2012	
	RM billion	Share (%)	RM billion	Share (%)
Primary agriculture	6.5	6.5	6.3	5.9
Manufacturing	5.0	4.9	5.1	4.8
Wholesale and retail trade, accommodation and restaurant	1.6	1.6	1.8	1.7
Construction	15.9	15.8	16.4	15.4
Transport, storage and communication	5.4	5.3	5.9	5.5
Finance, insurance and business services	2.3	2.2	2.6	2.4
Others	64.1	63.6	68.5	64.3
Total	100.9	100.0	106.5	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) and Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank).

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

communication sector turned around to record a favourable growth of 7% to RM5.9 billion, attributed mainly to higher financing for the purchase of transport equipment (end-2011: -5.4%; RM5.4 billion). Meanwhile, financing to the construction sector grew 9% to RM16.4 billion as at end-July 2012, reflecting higher financing for property development and overseas construction-related projects (end-2011: 14.4%; RM15.9 billion). Similarly, financing to the finance, insurance and business services sector grew strongly by 27.4% to RM2.6 billion due mainly to higher financing extended for cooperatives and trade activities (end-2011: 38.4%; RM2.3 billion). Of the total financing outstanding, 11.5% or RM12.2 billion was accounted by loans to SMEs, particularly those in the agriculture and construction sectors (end-2011: 12%; RM12.1 billion).



In the first seven months of 2012, policy efforts remained focused on enhancing the effectiveness and efficiency of DFIs with several policies and new products introduced to ensure the DFIs continue to provide support to their respective targeted sectors. The Blueprint emphasised the significant role of stronger and financially sustainable DFIs with economies of scale as well as wider outreach in supporting Malaysia's economic transformation. Towards this, Bank Simpanan Nasional (BSN) implemented branchless banking in January 2012, as part of the initiatives towards achieving financial inclusion. This is aimed at increasing customer outreach and delivery of financial services to the unbanked and underserved community in suburban and rural areas.

In efforts to extend financial inclusion to underserved areas, agent banking was introduced to provide basic banking services, such as making deposits and withdrawals, fund transfers, bill payments and financing repayments. All transactions are conducted by authorised banking agents on a real-time basis to protect client interest. During the pilot run of agent banking, over one million transactions totalling about RM190 million were conducted through 2,322 agents of three participating financial institutions as at end-July 2012.

Given the importance of sound liquidity management, the Guidelines on Liquidity Management Framework for DFIs were further extended to Bank Pembangunan Malaysia Berhad, SME Bank and Agrobank on 17 May 2012. The Guidelines specify the minimum liquidity level to be maintained by DFIs in line with sound liquidity management practices.

Resilient and sound insurance industry

The **insurance** industry remained resilient with strong capitalisation and improved profitability in the first seven months of 2012. The capital adequacy ratio for the industry stood at 216.7% with a capital buffer above RM20

billion (end-2011: 222.5%). The direct impact from developments in Europe on the domestic insurance sector has been minimal given the small exposures in terms of investment and reinsurance with European counterparties.

TABLE 5.5

Life and General Insurance Business

	2011	2012 Jan – July
Life Insurance (RM million)		
New business		
Number of policies (units)	1,502,110	893,145
Sums insured	287,073.9	192,720.2
Total premiums	8,206.4	4,738.6
Business in force		
Number of policies (units)	15,654,696	15,569,462
Sums insured	1,028,421.9	1,092,850.5
Annual premiums	20,891.2	22,185.5
Premium Income	22,877.7	13,834.8
Benefit Payments	14,015.5	8,375.2
General Insurance (RM million)		
Premium income:		
Gross direct premiums	13,794.3	9,121.5
Net premiums	11,651.9	6,310.8
Reinsurance placed outside Malaysia	1,040.5	554.1
Retention ratio¹ (%)	84.5	69.2
Number of insurance companies		
Direct	37	36
Life	9	9
General	22	21
Composite	6	6
Reinsurance	7	7
Life	1	1
General	5	5
Composite	1	1

¹ Proportion of premiums retained in the country.

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.



The bulk of the exposure is to strongly rated insurers and reinsurers who continued to report sound financial positions.

The **life insurance** sector recorded a growth of 18.8% in excess of income over outgo, which amounted to RM8.1 billion on account of higher net premiums and capital gains (January – July 2011: 2.9%; RM6.8 billion). Demand for investment-linked products continued to expand in tandem with favourable market conditions. New business premiums for investment-linked products expanded 24.8% to RM1.7 billion in the first seven months of 2012 (January – July 2011: 24.3%; RM1.4 billion). Meanwhile, the market penetration rate of the life insurance sector stood at 54.4% as at end-July 2012 (end-2011: 54.7%).

The operating profits of the **general insurance** sector remained stable, totalling RM1.2 billion (January – July 2011: RM981.8 million). This was attributed to the 9.1% growth in gross direct premiums, which amounted to RM9.1 billion,

derived mainly from the marine, aviation and transit businesses (January – July 2011: 7.1%; RM8.4 billion). The motor business remained the biggest segment in the general insurance sector, accounting for 43.9% of total premiums. In terms of claims experience, a lower overall loss ratio of 59.2% was recorded, with improvements in the medical and health, motor, and fire segments (end-July 2011: 60.8%).

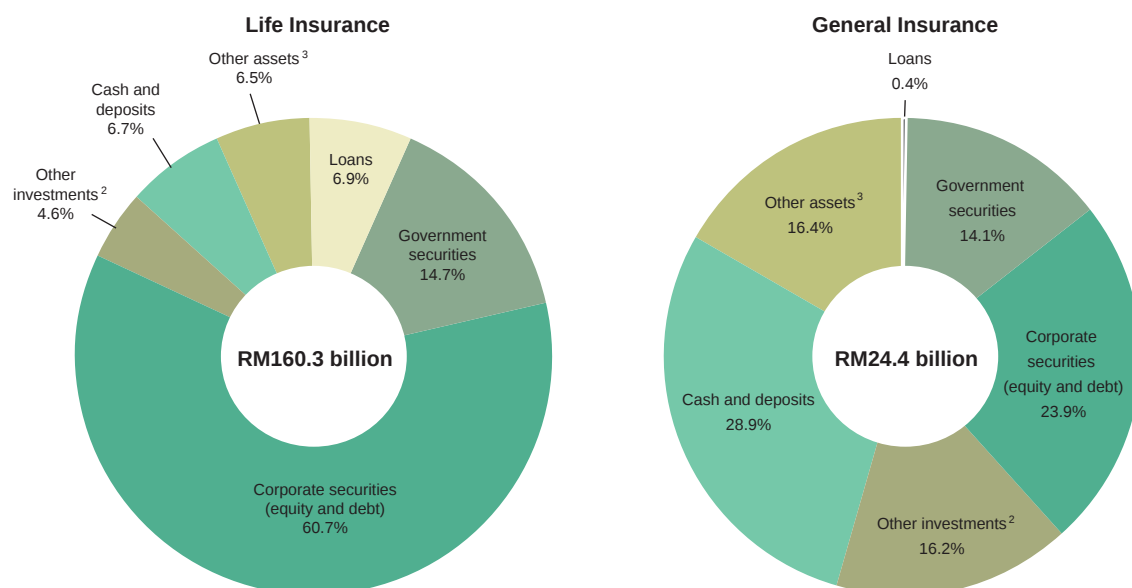
Total assets of the insurance industry continued to expand 8.3% to RM184.7 billion as at end-July 2012 (end-2011: 7.7%; RM180.9 billion). The asset portfolio was concentrated in corporate debt securities, accounting for 39.5% of total assets, while the equity component accounted for 16.3%. Assets of the life insurance sector remained the major segment of the industry's total assets with a share of 86.8%.

Over the past year, through a successful merger and acquisition (M&A) the number of insurance companies reduced from 37 to 36. A number of

CHART 5.6

Assets of Life and General Insurance Funds¹

(% share)

¹ End-July 2012.² Other investments = Government guaranteed loans + investment properties + others.³ Other assets = Property, plant and equipment + foreign assets + others.

Source: Bank Negara Malaysia.



M&As are in the pipeline which will see further consolidation and rationalisation in the general insurance industry.

Capital Market Performance

Robust fund raising

Gross funds raised in the capital market increased sharply by 46.3% to RM155.5 billion in the first seven months of 2012, supported mainly by infrastructure financing needs (January – July 2011: 31.8%; RM106.3 billion). Gross funds raised by the public sector expanded 3.3% to RM64.3 billion during the period (January – July 2011: 47.6%; RM62.2 billion). Funds were raised through the issuances of Malaysian Government Securities (MGS), Government Investment Issues (GIIs) and Government Housing Sukuk. After adjusting for redemptions, net funds raised increased 47.4% to RM91.3 billion (January – July 2011: 28.8%; RM62 billion), with the public sector accounting for 33.9% or RM31 billion and the private sector, RM60.4 billion (January – July 2011: 58%; RM35.9 billion; RM26.1 billion).

Gross funds raised by the private sector through private debt securities (PDS) issuances rose significantly by 97.9% to RM70.9 billion in the first seven months of 2012 (January – July 2011: 67.7%; RM35.8 billion). This was due to improved sentiments regarding Malaysia's economic performance and higher investor confidence, which attracted local and foreign institutional funds into the corporate bond market.

The bulk of the PDS issuances were from the finance, insurance, real estate and business services sector, which amounted to RM47.6 billion or 67.1% of total PDS issuances (January – July 2011: RM14.4 billion; 40.3%). Funds were mainly for M&As, working capital and general business activities. Despite volatilities in the international financial markets, funds raised in the domestic equity market also increased significantly by 147.5% to RM20.3 billion (January – July 2011: -51.9%; RM8.2 billion). Initial public offerings

TABLE 5.6

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

	2011	2012
Public Sector		
Government securities		
Malaysia Government Securities	36,040	35,052
Khazanah Bonds	-	-
Government Investment Issues	26,179	26,634
Merdeka Savings Bond	-	-
Sukuk Perumahan Kerajaan	-	2,600
New issues of Government securities	62,219	64,286
Less: Redemptions	26,288	33,291
Net funds raised by public sector	35,931	30,995
Private Sector		
Shares¹/Warrants		
Initial public offers	6,652	17,512
Rights issues	1,558	2,605
Private placements/ Restricted offer-for-sale	-	176
Special issues	-	-
Warrants	6	12
New issues of shares/warrants	8,216	20,305
Debt securities		
Straight bonds	4,453	5,219
Convertible bonds	-	-
Islamic bonds	3,450	3,022
Asset-backed bonds	-	40
Bonds with warrants	-	-
Medium-term notes	27,934	62,651
Cagamas bonds	-	-
New issues of debt securities	35,837	70,932
Less: Redemptions	18,002	30,890
Net issues of debt securities	17,835	40,042
Net funds raised by private sector	26,051	60,347
Total net funds raised	61,982	91,342

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

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.



TABLE 5.7

New Issues of PDS¹ by Sector January – July

Sector	2011		2012	
	RM million	Share (%)	RM million	Share (%)
Agriculture, forestry and fishing	266	0.7	977	1.4
Manufacturing	640	1.8	1,508	2.1
Construction	3,287	9.2	4,202	5.9
Electricity, gas and water	6,700	18.6	6,990	9.8
Transport, storage and communication	800	2.2	3,740	5.3
Finance, insurance, real estate and business services	14,425	40.3	47,567	67.1
Government and other services	9,370	26.2	5,878	8.3
Wholesale and retail trade, accommodation and restaurant	349	1.0	70	0.1
Total	35,837	100.0	70,932	100.0

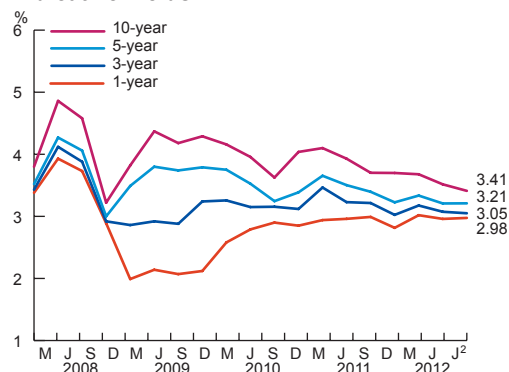
¹ Include private debt securities issued by Cagamas and non-resident corporations.

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

CHART 5.7

Malaysian Government Securities (MGS) Indicative Yields¹



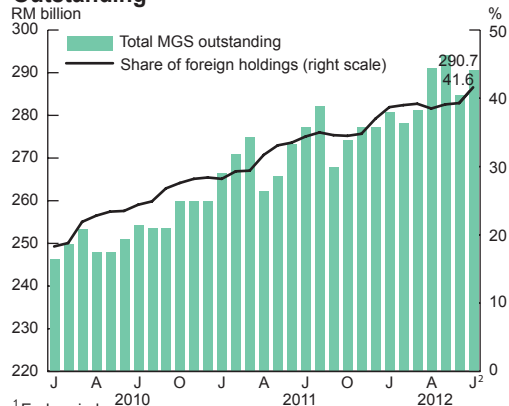
¹ End-period.

² End-July 2012.

Source: Bank Negara Malaysia.

CHART 5.8

Share of Foreign Holdings in Total MGS Outstanding¹



¹ End-period.

² End-July 2012.

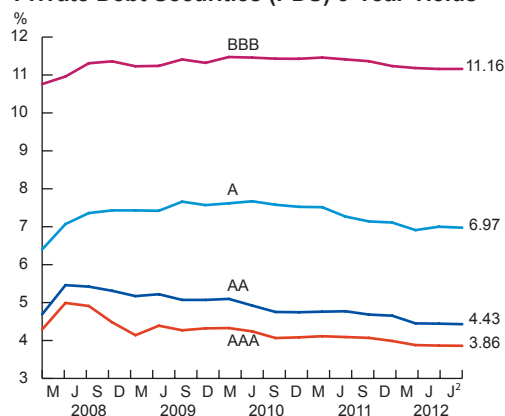
Source: Bank Negara Malaysia.

(IPOs) and rights issuances were higher at RM17.5 billion and RM2.6 billion (January – July 2011: RM6.7 billion; RM1.6 billion), respectively.

During the first seven months of 2012, MGS yields were broadly on a declining trend. The lower MGS yields were mainly due to expectations that domestic monetary conditions would remain accommodative given prospects of softening global and regional growth as well as sustained demand for MGS by non-residents. During the period, yields on 5-year MGS and 10-year MGS declined 2 bps and 29 bps (January – July 2011: +10 bps; -16 bps), respectively. However, yields on 1-year and 3-year MGS increased

CHART 5.9

Private Debt Securities (PDS) 5-Year Yields¹



¹ End-period.

² End-July 2012.

Source: Bank Negara Malaysia.



16 bps and 3 bps (January – July 2011: +6 bps; +12 bps), respectively. Foreign holdings of MGS increased 26.9% to RM121 billion as at end-July 2012 and accounted for 41.6% of total outstanding MGS (end-July 2011: 53.8%; RM95.4 billion; 34.4%).

During the first seven months of 2012, the 5-year PDS credit spreads (PDS yields minus MGS yields) for AAA-rated, AA-rated and A-rated debt narrowed by 11 bps, 21 bps and 12 bps (January – July 2011: -10 bps; -13 bps; -44 bps), respectively. This partly reflected the healthy financing activity in the PDS market. MGS term spreads (10-year MGS minus 1-year MGS) also narrowed by 45 bps, following stronger demand for longer-tenure papers (January – July 2011: -22 bps).

Encouraging FBM KLCI performance

Overall, the **equity market** remained resilient and continued to record gains despite the heightened global market volatility and challenging economic environment during the first seven months of 2012. The Financial Times Stock Exchange (FTSE) Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI) rose 82.79 points or 5.4% to 1,631.60 points as at end-July 2012 (end-2011: 11.82 points; 0.8%; 1,530.73 points). From the beginning of the year until end-July, the FBM KLCI gained 100.87 points or 6.6%. External headwinds, contributed by a confluence of factors including the lingering euro area debt crisis, concerns over the slower growth in China, Europe, India and the US, expectation of stimulus measures to boost global economic outlook as well as rising crude oil prices posed renewed risks to global growth and affected market sentiment. Nevertheless, positive factors on the domestic front, including the country's strong economic fundamentals coupled with the Government's ongoing economic transformation initiatives lent support to the market. In addition, sustained local corporate earnings results as well as the listing of Felda Global Ventures Holdings Berhad (FGVH) and IHH Healthcare Berhad (IHH) helped to boost local market sentiment.

TABLE 5.8

Bursa Malaysia: Selected Indicators January – July

	2011	2012
Price indices¹		
FBM KLCI	1,548.8	1,631.6
FBMEMAS	10,682.8	11,175.2
FBM 100	10,459.4	10,992.1
FBM SCAP	12,511.3	12,346.8
FBM-ACE	4,121.8	4,420.3
Total turnover²		
Volume (million units)	181,160.9	212,005.4
Value (RM million)	261,540.3	235,846.4
Average daily turnover²		
Volume (million units)	1,266.9	1,472.3
Value (RM million)	1,829.0	1,637.8
Market capitalisation¹ (RM billion)		
	1,339.3	1,423.8
Total number of listed companies¹		
Main Market	841	815
ACE Market	119	114
Market liquidity¹		
Turnover value/ market capitalisation (%)	19.5	16.6
Market concentration¹		
10 most highest capitalised stocks/ market capitalisation (%)	35.5	34.9

¹ As at end-period.

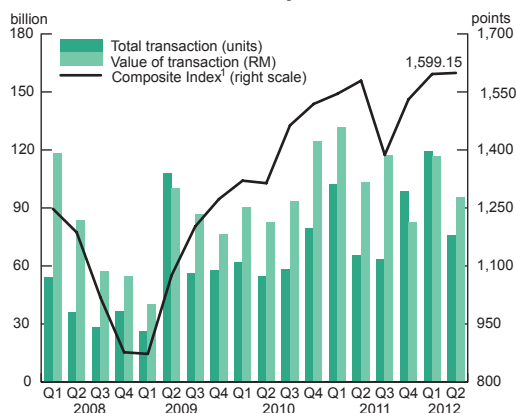
² Based on market transactions during the period.

Source: Bursa Malaysia.

The successful listing of FGVH on Bursa Malaysia placed the Malaysian capital market in the spotlight on 28 June 2012. This IPO was deemed the second largest in the world then after Facebook, raising a total of RM9.9 billion and drawing strong interest from local and foreign cornerstone investors with 262 million shares traded on the first day. Meanwhile, the concurrent listing of IHH on Bursa Malaysia and the Singapore Exchange on 25 July 2012, marked the company as one of the largest listed private healthcare providers in the world based



CHART 5.10
Performance of Bursa Malaysia

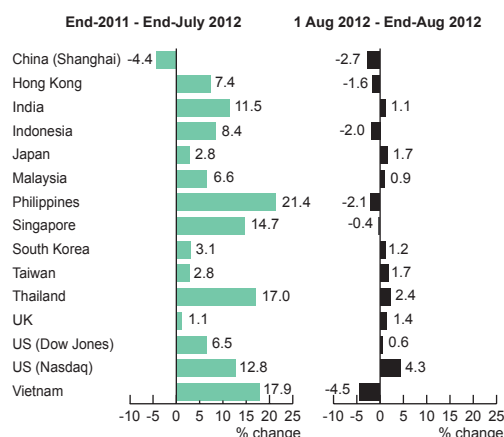


¹ End-period.
Source: Bursa Malaysia.

on market capitalisation. Trading of IHH was active on the first day, with 390.4 million shares valued at RM1.2 billion changing hands.

In August, the market continued its positive performance and registered a new high of 1,653.78 points on 15 August, boosted by the stronger economic growth of 5.4% in the second quarter of 2012. Share prices on Bursa Malaysia retreated slightly to 1,646.11 points as at end-August 2012 due to renewed uncertainties over global economic growth and cautious investor sentiment in anticipation of announcements by policy makers in handling the euro area debt crisis as well as boosting economic growth (end-August 2011: 1,447.27 points).

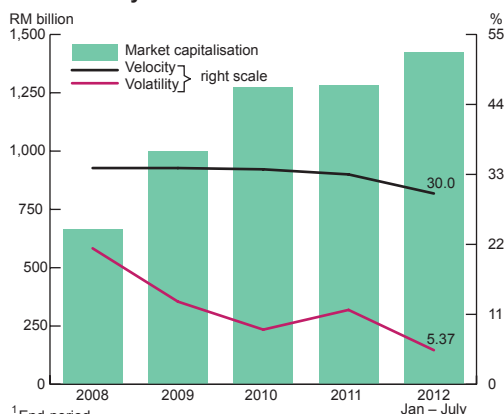
CHART 5.11
Performance of Selected Stock Markets



Source: Bloomberg.

Market capitalisation increased 6.3% to RM1,424 billion as at end-July 2012 (end-2011: 0.7%; RM1,285 billion). Total market transactions also improved 18.4% to 222.2 billion units during the first seven months of 2012 (January – July 2011: 40.2%; 187.7 billion units). This was due to favourable participation from local and foreign investors following strong corporate earnings. Meanwhile, total market transaction value declined 7.1% to RM251.7 billion (January – July 2011: 34.3%; RM270.9 billion). Market velocity and market volatility also declined to 30% and 5.4% (January – July 2011: 35%; 6.2%), respectively. The total number of companies listed on Bursa Malaysia decreased to 929 as end-July 2012 (end-2011: 941).

CHART 5.12
Bursa Malaysia: Market Capitalisation¹, Velocity and Volatility



¹ End-period.
Source: Bursa Malaysia.

Meanwhile, a new tone was set for Invest Malaysia 2012 (IMKL 2012) to positively shape investors' perspective on Malaysia as a key driver of the Association of Southeast Asian Nations (ASEAN) capital markets. Initiatives announced at IMKL 2012 include the establishment of a Capital Market Task Force to make recommendations and identify clear implementation programmes to streamline regulatory and management processes; and the establishment of a Consolidated Capital Market Compensation Fund to consolidate existing compensation schemes and serve as a one-stop centre for investor compensation. These are



part of the overall strategies towards creating a capital market that is internationally competitive, fair and efficient.

On the regional front, under the aegis of the ASEAN Capital Markets Forum, the securities regulators and stock exchanges of Malaysia, Singapore and Thailand signed a Memorandum of Understanding (MoU) on the Expedited Review Framework for Secondary Listings on 16 March 2012. The objective of the framework is to speed up the processing of secondary listing applications together with the relevant disclosure documents. The framework will foster greater capital market integration in the region and promote ASEAN as a global fund raising destination.

Steady trading in derivatives

Trading in the **derivatives** market grew 7.7% with turnover of 5.3 million contracts in the first seven months of 2012 (January – July 2011: 43.6%; 4.9 million). The turnover of KLCI futures (FKLI) and crude palm oil futures (FCPO) continued to dominate the derivatives market, accounting for 99.2% of total trading (January – July 2011: 98.4%). Trading in the Kuala Lumpur Interbank Offered Rate (KLIBOR) futures was minimal while the 3-year and 5-year MGS futures as well as the single stock futures were not traded during the period. Trading volume of FCPO expanded 11.9% to 3.9 million contracts, equivalent to 9.5 million tonnes of crude palm oil during the first seven months of 2012 (January – July 2011: 62%; 3.5 million; 10.3 million tonnes). Meanwhile, the trading volume of FKLI declined 0.1% to 1.3 million contracts (January – July 2011: 12.6%; 1.3 million).

On 16 July 2012, Bursa Malaysia Derivatives Berhad (BMD) commenced trading in options on crude palm oil futures (OCPO) contract, the first Asian exchange-traded agricultural options contract, to complement the highly successful FCPO contract. The OCPO, which uses FCPO as its underlying contract, offers another risk management tool for industry participants to

better meet their trading needs. Through BMD's partnership with the Chicago Mercantile Exchange (CME) Group, OCPO is listed and traded on the CME Globex electronic trading platform, making it accessible to traders around the world.

Unit trusts continue to grow

The **unit trust** industry saw two new funds launched in the first seven months of 2012, bringing the total to 589 funds (end-2011: 23 new funds; 587 funds). Total units in circulation increased 10% to 337 billion units, while the number of accounts rose 4.2% to 15.8 million (end-2011: 9.4%, 316.4 billion units; 5.5%, 15.4 million). The size of the unit trust industry in terms of net asset value (NAV) expanded 13.4% to RM283.4 billion, which accounted for 19.9% of market capitalisation (end-2011: 10%; RM249.5 billion; 19.4%). Equity funds were the most preferred funds for investment with net sales of RM12.2 billion in the first seven months of 2012 compared with bond and fixed income funds which recorded RM4.7 billion.

TABLE 5.9

Unit Trust Industry: Selected Indicators

	End-2011	End-July 2012
Number of management companies	40	40
Number of funds launched	587	589
Conventional	423	424
Islamic	164	165
Units in circulation (million)	316,411	337,013
Number of accounts (million)	15.4	15.8
Net asset value (NAV) (RM million)	249,459	283,427
Conventional	221,599	250,194
Islamic	27,860	33,233
NAV/Bursa Malaysia market capitalisation (%)	19.4	19.9

Note: Total may not add up due to rounding.

Source: Securities Commission Malaysia.



During the first seven months of 2012, 15 new funds were launched for investment in foreign markets (end-2011: 38 new funds). Meanwhile, 12 funds invested RM1.3 billion overseas (end-2011: 26 funds; RM1 billion). As at end-July 2012, a total of 278 funds have invested RM16.7 billion in foreign markets, representing 5.9% of the industry's total NAV (end-2011: 272; RM15.6 billion; 6.3%).

The performance of the **real estate investment trusts (REITs)** industry remained healthy during the first seven months of 2012. Trading volume grew 57.7% to 1.1 billion units while trading value rose 73% to RM1.4 billion (January – July 2011: 4.8%, 0.7 billion units; 10.2%, RM0.8 billion). Similarly, total market capitalisation increased to RM19.4 billion as at end-July 2012 (end-2011: RM16.3 billion). The total number of REITs remained at 15, comprising 14 REITs listed on Bursa Malaysia and 1 unlisted, with the total NAV increasing to RM15.9 billion as at end-June 2012 (end-2011: 15; 14; 1; RM15.4 billion).

The number of **exchange traded funds (ETFs)** listed on Bursa Malaysia remained at five as at end-July 2012, with total market capitalisation of RM920.6 million (end-2011: RM1 billion). Meanwhile, the volume transacted declined 32.2% to 99.9 million units (January – July 2011: 259.5%; 147.4 million units) while the value also fell 33.4% to RM103 million in the first seven months of 2012 (January – July 2011: 245.9%; RM154.8 million).

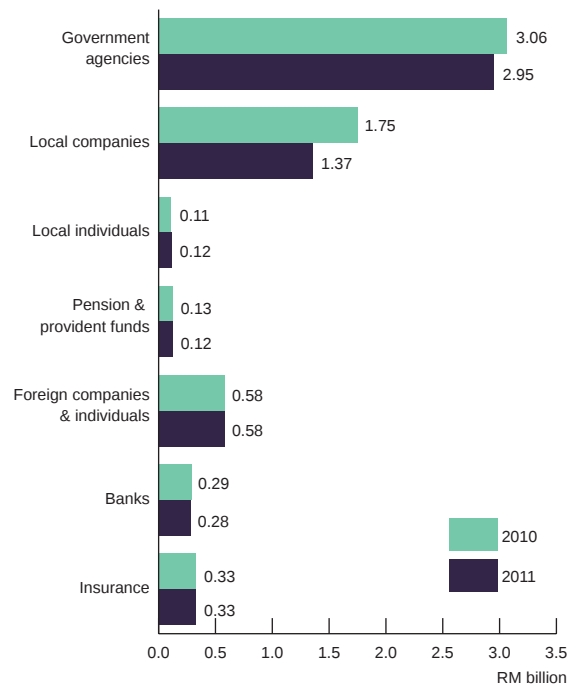
VC investment remains positive

The **venture capital (VC)** industry continued to be an important source of early stage funding for start-up companies and expansion. As at end-July 2012, the total number of registered venture

capital companies (VCCs) and venture capital management companies (VCMCs) increased to 60 and 53 (January – July 2011: 55 VCCs; 51 VCMCs), respectively. Total VC investments rose 5.8% to RM3.6 billion as at end-2011 (end-2010: 31.1%; RM3.4 billion) with the information technology and communication sector accounting for 42.4%, life sciences, 22.6% and manufacturing sector, 12.1% of total investments. However, total committed funds declined 8.4% to RM5.5 billion, with Government agencies the largest source of VC funds at RM3 billion, representing 54.1% of total funds committed (end-2010: 11.5%, RM6 billion; RM3.1 billion, 51.4%).

CHART 5.13

Source of Venture Capital Funds



Source: Securities Commission Malaysia.



Key Capital Market Measures

Several measures were undertaken in the first seven months of 2012 to further enhance market liquidity and efficiency in the capital market. These included the following:

- On **5 April**, the Securities Commission Malaysia (SC) approved eight intermediaries as providers of Private Retirement Schemes (PRS Providers), marking a significant milestone in the development of a long-term sustainable private retirement industry.
- On **1 June**, following amendments to the SC's Licensing Handbook, Bursa Malaysia introduced a referral agent activity, where securities and futures brokers are able to refer their respective clients to one another. The amendments created a more facilitative trading environment and are expected to boost the number of participants in the securities and derivatives markets.
- On **8 June**, Bursa Malaysia Derivatives Berhad (BMD) announced the easing of restrictions for the setting up of branches and kiosks by futures brokers, paving the way for greater retail participation in the derivatives market as well as reaching out to clients nationwide. In addition, this enabled BMD to work together with the brokers to educate the public on futures and options trading.
- On **18 June**, the Shariah Advisory Council of the SC adopted a revised screening methodology to determine the Shariah-compliant status of listed companies. This revision was in view of the developments and growing sophistication of the Islamic finance industry since the introduction of the current screening methodology in 1995. The revised methodology applies the business activity and the newly-introduced financial ratio benchmarks.
- On **6 July**, Bursa Malaysia enhanced its trading system through the introduction of new order and validity types, allowing market participants to execute a greater variety of trading and risk management strategies. The enhancements form part of the initiatives undertaken to improve the market's framework and efficiency.
- On **10 July**, Bursa Malaysia introduced the enhanced Central Matching Facility, an automated settlement system offering end-to-end electronic matching of trade and settlement details, between trading clearing participants (stockbroking companies) and non-trading clearing participants (custodian banks). This will help reduce market friction and is in line with international best practices and standards.
- On **18 July**, the private retirement scheme framework was fully in place with the establishment of the Private Pension Administrator and the approval of the first set of 24 funds under the Private Retirement Schemes.
- On **18 July**, the Government announced that the SC will develop two new segments of the capital market, namely a trading venue for unlisted companies to raise funds and a mercantile exchange to facilitate investments in gold futures and other precious metals. Meanwhile, the SC will also introduce two new categories of registered persons, namely execution agents and business development representatives, to strengthen the role of dealers, facilitate provision of specialised services and have access to a greater client base.



Catalysing Angel Investment in Malaysia

Introduction

Angel investors have increasingly been recognised globally as an important source of equity capital at the start-up stage of a company, providing financing for product development and initial marketing. This may include companies in the process of being set up or may have been in business for a short time but have not sold their products commercially. Angel financing fills the gap between the informal financing by founders, family and friends, and the formal venture capital financing, with a typical investment size of between USD25,000 and USD500,000. Well-known companies that have benefited from the backing of angel investors include Google, Facebook, Paypal, Tesla Motors, Twitter, Autocad, Intel, Apple and National Semiconductor. Angel investors are generally individuals who invest part of their personal assets in start-ups and also share their personal business management experience, including providing strategic and operational expertise to the entrepreneurs. Though angel investment has long been in existence, it was only in the past couple of decades that it became more formalised and organised through the creation of angel groups and networks.

TABLE 1: Equity Investors at the Seed, Early and Later Stage of Firm Growth

Informal Investor		Formal Investor
Founders, friends and family	Angel investors Typical investment size: USD25,000-USD500,000	Venture capital funds Typical investment size: USD3 million-USD5 million
Seed stage investments	Early stage investments	Later stage investments



Financing Gap

Source: OECD 2011 – Financing High Growth Firms: The Role of Angel Investors.

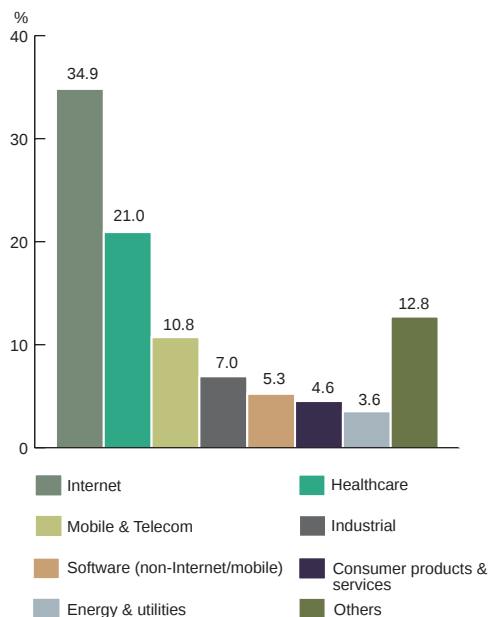
Angel Financing in Developed Countries

In the United States (US), estimates suggest that approximately 250,000 new jobs were created in 2009 by firms supported by angel investment, representing 5% of new jobs in the US. In comparison, the US has about 250,000 angel investors generating USD20 billion in investments, while Europe has about 75,000 angel investors generating four billion euros in investments. According to the 2012 first quarter Halo Report, the Internet sector dominated angel group deals over the past 12 months in the US, while healthcare companies received the largest share of total dollars over the same period.

The formation of angel groups and networks can reduce the information asymmetry which is a barrier to investors and entrepreneurs finding each other. In addition, the successful matching of each other's needs and risk appetite can close the funding gap, which is the main reason many nascent ideas and concepts fail to take off. Considering the potential economic benefits of encouraging angel investment, policy intervention such as tax incentives and providing support in establishing angel associations, could stimulate the growth of angel investors.

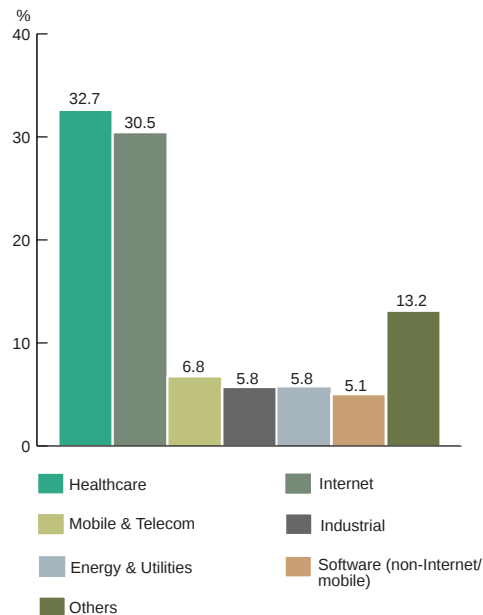


CHART 1

Angel Group Deals Across Sectors from April 2011 - March 2012

Source: Angel Resource Institute: Halo Report Q1 2012.

CHART 2

Share of Total USD Received Across Sectors from April 2011 - March 2012

Source: Angel Resource Institute: Halo Report Q1 2012.

An example is the United Kingdom's (UK) tax incentive schemes, namely the Enterprise Investment Scheme implemented in 1994 and the recently launched Seed Enterprise Investment Scheme in April 2012, formulated to attract angel money into financing start-ups and seed stage investments. Currently, there are about 15,000 angel investors and over 100 angel networks operating in the UK.

Angel Investment Landscape in Malaysia

In Malaysia, the early pioneers in angel investment started with groups like the KL Angels Club which were active in the late 1990s. However, between the period of the dotcom bubble burst and 2004, all the local angel clubs either became defunct or had moved to later stage investments. As a result, there was no angel investment activity between 2004 and 2009. During this period, funding of early stage investments at the seed and start-up level were mostly dependent on the Government.

Consequently, entrepreneurs and local technology start-ups ended up getting angel or early-stage funding in neighbouring countries in the region like Singapore, India and Hong Kong and subsequently locating their headquarters or main operations there. This is a significant leakage of entrepreneurial talent and job creation. In 2004, Cradle Fund Sendirian Berhad (Cradle), an agency under the Ministry of Finance, was established to administer early stage funding to develop innovative ideas and help start-up companies commercialise their innovative products and services. However, since late 2009, Cradle has also been tasked with reviving and growing angel investments in Malaysia.



As at end-July 2012, Cradle has played a catalytic role in funding 477 pre-seed projects, of which about 209 have been completed with 55% commercialised. In addition, Cradle funded 85 start-up companies for commercialisation, of which eight companies had co-investment with angel investors or venture capitalists.

In late 2010, two private angel clubs were formed, namely the Virtuous Investment Circle with 20 individual angels, and PIKOM Angels with about 100 members. Although this was an encouraging start, the rate of active investment by these angel networks was low, with about 20 investment deals totalling approximately RM10 million within the last two years.

According to a study in 2011, Malaysia has over 39,000 millionaires and a visible number of very high net-worth individuals and entrepreneurs, thus providing a ready pool of potential angel investors. The growth in the number of angel investors is expected to be gradual as the creation of a culture of investing in high-risk technology start-ups and ventures requires a new mindset change and higher tolerance for risks. This is especially so, given the many other investment alternatives in traditional sectors like real estate and finance. However, it is important for Malaysia to create and support more angel platforms to match private funding for early stage financing and reduce reliance on Government funding, while the Government continues to play a facilitative role through appropriate policy intervention.

Conclusion

During the Third Asian Business Angel Forum 2012 in Kuala Lumpur, the Government announced that the Malaysian Business Angels Network (MBAN) will be set by the end of 2012. MBAN will play a lead role in developing the angel investment community and ecosystem in Malaysia and enhance efforts to facilitate co-investment between angel investors in Malaysia and ASEAN and beyond.

Islamic Finance Developments

Greater international collaboration

Continuous efforts were taken to further position Malaysia as the leader in **Islamic finance** as Islamic finance continued to gain significant importance in the global financial market. These included a recent review of laws relating to land, hire purchase and contract applicable to Islamic finance by the Law Harmonisation Committee, to ensure their compatibility with Shariah and proposed amendments to the legislation to facilitate Islamic finance transactions. On the international front, global engagement and alliances in Islamic finance continued to be fostered in the first seven months of 2012. The collaboration between Islamic Development Bank Group and other development partners was strengthened with the launch of the Member

Country Partnership Strategy programme in Malaysia in early May.

Meanwhile, an MoU between the Association of Islamic Banking Institutions of Malaysia (AIBIM) and the Participation Banks Association of Turkey was signed on 15 May 2012 to further promote Islamic banking as well as Islamic capital and money markets on a global scale. In addition, the central banks of Malaysia and the Republic of Turkey signed an MoU on 16 May 2012 to enhance financial services and investment linkages between the two countries. The International Centre for Education in Islamic Finance (INCEIF) has also signed MoUs with the World Bank and the Islamic Financial Services Board in efforts to enhance collaboration on sharing of knowledge, undertaking research, development, training, and education in the Islamic financial services industry.



In May 2012, a Malaysia Business Forum was held in Istanbul, with the theme 'Promoting Global Financial and Economic Linkages through Islamic Finance', to further promote and showcase the contribution of Islamic finance in the real sector and cross-border transactions. About 200 participants mainly from the financial and business circles from Asia, Europe and the Gulf Cooperation Council (GCC) region attended the forum. Issues discussed included challenges towards better economic and financial linkages in the Islamic finance world, Shariah interpretation in cross-border transactions, human capital for the Islamic financial industry, and innovation in Islamic products and services. Meanwhile, in conjunction with the World Gas Conference in Kuala Lumpur in June 2012, a business networking event was held to highlight the potential of Islamic finance for the oil and gas industry.

Vibrant Islamic capital market

The **Islamic capital market** has contributed significantly to the development of the overall capital market and remains an important alternative source for raising capital. As at end-July 2012, 825 Shariah-compliant securities were listed on Bursa Malaysia, representing 89% of total listed securities with a market capitalisation of RM931 billion or 65% of total market capitalisation (end-2011: 839, 89%; RM806 billion, 63%). In the first seven months of 2012, the trading volume of Shariah-compliant securities increased to 148.4 billion units or 66.8% of the total 222.2 billion units traded (January – July 2011: 110.9 billion units; 59.1%; 187.7 billion units). Malaysia remains at the forefront in the innovation and development of sukuk and continues to be the global leader in the sukuk market, accounting for 68% of total global sukuk outstanding as at end-July 2012. Furthermore, Malaysia retained its number one position for issuing sukuk, with a market share of 71% as at end-July 2012 (end-2011: 73%). Meanwhile, Bursa Malaysia remains the top sukuk listing destination, with 19 sukuk listed totalling RM99.6 billion (USD31.7 billion) as at end-July 2012.

Malaysia also remained among the global leaders in the Islamic fund management industry. During the first seven months of 2012, two Islamic fund management licences were approved, bringing the number of full-fledged Islamic fund management companies to 18 (end-2011: 16). During the same period, an additional Islamic unit trust fund and four Islamic wholesale funds were launched (end-2011: 164; 28). As at end-July 2012, the total NAV of Islamic unit trust funds stood at RM33 billion and the Islamic wholesale funds at RM14 billion (end-2011: RM28 billion; RM7 billion). Meanwhile, the number of Islamic REITs stood at three, with a market capitalisation of RM3.6 billion as at end-July 2012 (end-2011: 3; RM2.9 billion). Similarly, the Islamic ETF remained at one with a total NAV of RM0.3 billion (end-2011: 1; RM0.4 billion).

Recent developments in funds and wealth management also saw a Malaysian Islamic fund management company in a joint venture with a foreign entity, launching three equity funds which are in compliance with the Undertakings for Collective Investment in Transferable Securities (UCITS) and Shariah. UCITS funds are globally recognised as well-regulated funds that have robust risk management procedures and a strong emphasis on investor protection. The UCITS-compliant funds can be distributed among European Union (EU) member states without any additional authorisation. These funds will be registered and distributed in seven countries – the United Kingdom, Switzerland, Germany, Saudi Arabia, Bahrain, United Arab Emirates and Singapore. This pioneering initiative to internationalise Malaysian Islamic asset management capabilities will further strengthen Malaysia's position as a global hub for Islamic finance.

Meanwhile, in line with the robust development in the Islamic capital market, Bursa Suq Al-Sila' (BSAS) being the world's first end-to-end Shariah-compliant commodity trading platform, has added Refined, Bleached and Deodorised (RBD) Palm Olein as a new commodity



offering to meet greater demand from local and international players for commodity-based Islamic financing and investment. Trading in the new commodity began on 17 April 2012 with RM75 million worth of trades recorded as of 23 April 2012. The diverse product offering on the BSAS platform is in line with Bursa Malaysia's strategy to expand the range of tradable instruments on the exchange. Overall, the daily average value of commodity traded, recorded an increase of more than 200%, equivalent to RM1.2 billion as at end-2011 (end-2010: RM0.4 billion). As at end-July 2012, there were 63 registered commodity trading participants.

Growth in Islamic banking continues

The **Islamic banking** business continued to expand in the first seven months of 2012. Total assets grew 20.6% to RM469.5 billion as at end-July 2012, which represented 24.2% of the total banking system assets (end-2011: 24.1%; RM436.1 billion; 23.7%). Total deposits rose 21.3% to RM362.7 billion or 26.1% of total deposits in the banking system as at end-July 2012 (end-2011: 23.4%; RM340.7 billion; 25.8%). Total Islamic financing continued to grow 19.3% to RM294.2 billion and accounted for 26.6% of total loans by the banking system (end-2011: 23.6%; RM268.3 billion; 25.9%).

Financing of the Islamic banking system was predominantly channelled to the household sector and accounted for 65% or RM191.1 billion as at end-July 2012 (end-2011: 65.4%; RM175.5 billion). The share of financing to business sectors was mainly to the manufacturing sector at 5.8% or RM17.1 billion (end-2011: 6%; RM16 billion) and the finance, insurance and business services sector at 5.6% or RM16.4 billion (end-2011: 4.8%; RM13 billion).

Vibrant takaful industry

The **takaful** industry expanded further during the first seven months of 2012, with assets increasing to RM18.3 billion and accounting for 9% of the

TABLE 5.10

Islamic Banking¹: Key Indicators

	End-2011		End-July 2012	
	RM million	Change (%)	RM million	Change (%)
Assets	436,078	24.1	469,526	20.6
Deposits	340,731	23.4	362,724	21.3
of which:				
Investment	178,415	13.8	180,890	9.5
Savings	27,374	15.3	55,294	35.0
Demand	43,206	26.5	26,022	19.5
Others	91,735	49.2	100,518	41.3
Financing	268,251	23.6	294,204	19.3
of which:				
Manufacturing	16,012	18.7	17,127	7.2
Construction	10,476	10.3	11,783	24.3
Finance, insurance and business services	13,007	39.5	16,422	43.3
Education, health and others	11,695	30.0	14,604	32.1
Households	175,531	24.0	191,143	17.6

¹ Includes development financial institutions (DFIs).

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

total insurance and takaful industry assets as at end-July 2012 (end-2011: RM16.9 billion; 8.6%). The bulk of takaful assets were concentrated in Islamic debt securities and GILs, which amounted to 74.4% of total takaful assets.

Excess of income over outgo for the family takaful business surged 47.2% to RM1.5 billion, driven by higher net contributions of RM2.6 billion during the period (January – July 2011: 9.6%; RM1 billion; RM2.2 billion). This was mainly attributed to continued expansion in temporary takaful products, which accounted for 62% of total new business premiums. The buoyant expansion in temporary takaful products, especially the Mortgage Reducing Term Takaful,

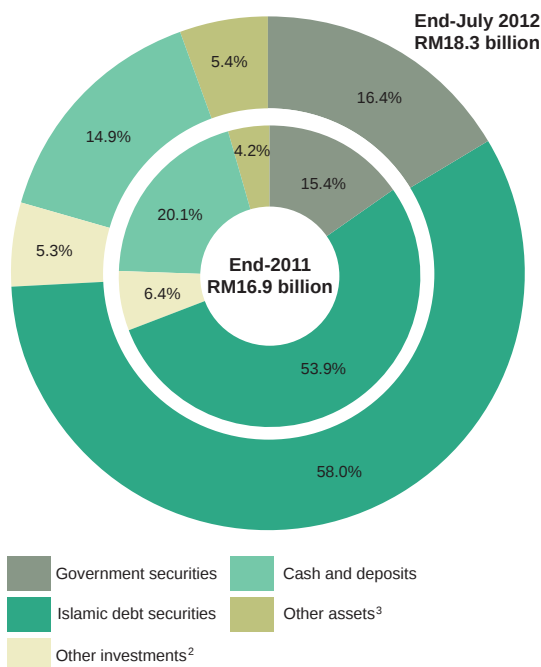


was in line with the expansion of home financing by the banks. Total contributions of new family takaful business expanded to RM2 billion during the same period (January – July 2011: RM1.6 billion). The market penetration rate of family takaful remained steady at 13% as at end-July 2012 (end-2011: 12.8%).

Gross direct contributions for the general takaful sector increased 14.2% to RM1 billion (January – July 2011: 18.1%; RM0.9 billion) due to higher contributions from the motor business segment, which accounted for 57.9% of total general takaful business. Operating profit for the sector improved 12.1% to RM152.4 million (January – July 2011: 6.1%; RM136 million) following higher contribution income totalling RM746.2 million. Meanwhile, a new takaful operator that was awarded family takaful licence in 2009, commenced operations in January 2012.

CHART 5.14

Assets¹ of Takaful Funds
(% share)



¹ Assets of family and general takaful funds.

² Other investments = Investment properties + others.

³ Other assets = Fixed assets + financing + foreign assets + others.

Source: Bank Negara Malaysia.

TABLE 5.11

Family and General Takaful Business

	2011	2012 Jan – July
Family Takaful		
New business		
Total contributions (RM million)	2,695.1	2,008.0
Sums covered (RM million)	226,384.7	122,962.1
Number of certificates (units)	884,360	491,224
Business in force		
Annual contributions (RM million)	2,138.7	2,210.1
Sums covered (RM million)	401,829.9	421,160.1
Number of certificates (units)	3,649,328	3,708,407
General Takaful		
Gross direct contributions (RM million)	1,599.1	1,048.1
Net contributions (RM million)	1,159.4	792.6

Source: Bank Negara Malaysia.

As part of efforts to strengthen the regulatory framework for the takaful industry, the updated Guidelines on Valuation Basis for Liabilities of Family Takaful Business and Guidelines on Valuation Basis for Liabilities of General Takaful Business were issued on 15 May 2012. The guidelines were revised to incorporate new rating categories and requirements on the use of subordinated debt rating in meeting the criteria of qualifying retakaful operators, as well as the reporting forms for the valuation of liabilities. These guidelines are expected to provide better clarity to takaful operators on the prudential requirements and facilitate the submission of actuarial valuation reports.

Progress of the Financial Sector Blueprint

The Blueprint, which was launched on 21 December 2011, charts the direction of the financial sector as the country transitions into a developed and high-income economy by 2020.



The Blueprint contains 69 recommendations and more than 200 initiatives. The implementation of the initiatives is on track.

In 2012, priority has been accorded to initiatives which address safeguards, preconditions or enabling environment for other recommendations under the Blueprint to succeed. This includes a comprehensive review of the legislative framework, further strengthening of the financial institutions and infrastructure to support effective intermediation of funds, deepening financial integration in the region and strengthening the key enablers for further development of the financial system.

Progress of the Capital Market Masterplan 2

The Capital Market Masterplan 2 (CMP2) with the theme 'Growth with Governance' was launched in April 2011. The CMP2 focuses on expanding the role of the capital market to invigorate economic growth and enhance the efficacy of markets.

Strategic direction of the CMP2 in 2012 includes strengthening investor protection and catalysing greater retail participation through the establishment of the RM420 million Consolidated Capital Market Compensation Fund and embarking on the 'Kempen Pelabur Bijak Kebangsaan'; strengthening corporate governance with the release of the Malaysian Code on Corporate Governance 2012, replacing the 2007 Code; and widening the range of products to include the relaunch of the FBM KLCI options and the trading of OCPOs, introducing the business trust structure following amendments to the Capital Markets and Services Act 2007 as well as introducing a framework to facilitate the offering of bonds to retail investors.

These key initiatives are expected to further strengthen the capital market to meet challenges from the changing global financial landscape and to support the national economic transformation process.

Prospects for 2013

With global growth expected to be moderate in 2013, the Malaysian economy is expected to grow between 4.5% and 5.5%, supported by resilient domestic demand underpinned by income growth as well as strong private sector activity generated by the ongoing initiatives under the Economic Transformation Programme. Barring any adverse developments, inflation is expected to remain low. Monetary policy will continue to focus on ensuring price stability and support sustainable economic growth while preventing the build-up of financial imbalances.

The domestic financial system is expected to remain resilient, notwithstanding the lingering uncertainties over the euro area sovereign debt and banking sector issues. With major projects being implemented to move the economy on its growth trajectory, financing through the banking system and capital market is expected to increase. The financial landscape is expected to be further shaped by the launch of the Tun Razak Exchange (TRX), (formerly the Kuala Lumpur International Financial District, KLIFD) in July 2012. This 70-acre exchange will create new investment opportunities with wide-ranging high multiplier economic activities. Furthermore, the financial sector developments will continue to be driven by the Blueprint (2011-2020) and the CMP2 (2011-2020). The Blueprint will continue to be the enabler and catalyst of economic growth, reinforcing the ongoing Government initiatives, while the CMP2 will expand the role of the capital market in financing economic activities.