



5

MONETARY AND FINANCIAL DEVELOPMENTS

Monetary and Financial Developments

Overview

Financial sector resilience supports growth

Amid an environment of moderate growth in the global economy, the domestic economy maintained its resilience and chalked a strong growth of 6.3% in the first six months of 2014, underpinned by strengthening exports and continued expansion in domestic demand. However, with firm growth prospects and inflation above the long-run average, the Overnight Policy Rate (OPR) was increased from 3.00% to 3.25% on 10 July 2014. The degree of monetary accommodation was also adjusted to mitigate the risk of broader economic and financial imbalances that could undermine the longer-term growth prospects of the economy. Meanwhile, the Statutory Reserve Requirement (SRR) was maintained at 4.00%.

Financing through the banking system and capital market remained strong, supporting the further expansion of economic activities during the first seven months of 2014. At the same time, volatility in the global financial markets continued as monetary accommodation especially in the US shifted towards normalisation. While this resulted in increased capital flow volatility in the region, the domestic financial markets have remained orderly and financial intermediation has not experienced any disruptions. Capitalisation of the banking system remained high, with the common equity tier 1 (CET1) capital ratio, tier 1 capital ratio, and total capital ratio well above the regulatory minimum levels¹, at 12.4%, 13.2% and 15.1%, respectively as at end-July 2014.

Besides the conventional financial system, the Islamic finance industry has also shown robust growth over the last five years. Total assets in the Islamic banking industry grew on an average of 16.4% per annum, from RM303.2 billion at end-2009 to RM558.2 billion at end-2013. As at end-July 2014, the total assets of the Islamic banking system (including the development financial institutions (DFIs)) have reached RM580.8 billion. This translated into a 25.1% market share of the total banking system assets. The Islamic banking industry itself continued to be well-capitalised with the CET1 capital ratio (12.6%), tier 1 capital ratio (12.7%), and total capital ratio (16.1%) well above the regulatory minimum requirements as at end-July 2014.

Malaysia continued to be the market leader in global sukuk issuances, accounting for 63% or USD41.7 billion of the total global sukuk issued during the first half of 2014. Foreign issuers continued to choose Malaysia, the largest and most liquid Islamic capital market, as the preferred platform for sukuk issuances. These included Societe Generale SA (France) setting up its RM1 billion multi-currency sukuk programme; Bank of Tokyo-Mitsubishi UFJ (Malaysia) Berhad's (BTMU's) USD500 million multi-currency programme; Turkiye Finans Katilim Bankasi A.S. (Turkey) RM800 million sukuk issuance under its RM3 billion programme; Bumitama Agri (Singapore) Ltd's RM500 million under its RM2 billion programme; and Islamic Development Bank's USD1.5 billion sukuk.

At the same time, the emerging trend of sovereign sukuk issuances by leading conventional financial markets such as London and Hong

¹ Beginning 1 January 2014, regulatory minimum levels for CET1 capital ratio is 4%, tier 1 capital ratio (5.5%) and total capital ratio (8%).

Kong will further fuel the growth in global sukuk. UK became the first western sovereign sukuk issuer with its GBP200 million 5-year sovereign sukuk *ijarah* issued in June 2014. In September, the Government of Hong Kong Special Administrative Region issued its inaugural USD1 billion 5-year sukuk *ijarah*, while Indonesia also issued its USD1.5 billion 10-year sovereign sukuk. In each of these three sovereign sukuk issuances, a major domestic bank was appointed as joint lead manager. The involvement of domestic financial players and professional services firms in providing Islamic financial advisory and services at the international level, attest to Malaysia's established expertise in the sukuk market.

Monetary Developments

Monetary policy

Monetary policy remains accommodative

Monetary policy in 2014 is focused in supporting the sustainable growth of the economy in an environment of price stability while mitigating any potential vulnerabilities arising from financial imbalances. The economy continued to register strong growth of 6.4% in the second quarter of 2014, after recording 6.2% in the first quarter. Growth was underpinned by strong external demand and resilient domestic activity. However, inflationary pressures, which recorded 3.3% in the first seven months of 2014 remained above the 2% – 3% level projected for the year. This was due to the impact from the upward adjustments in the administered price of fuel, sugar and electricity since September 2013 and at the beginning of this year.

With firm growth prospects and inflation expected to remain above the long-run average, the OPR, which was held steady at 3.00% since 5 May 2011, was increased by 25 basis points (bps) to 3.25% on 10 July 2014. The normalisation of monetary conditions was also aimed at mitigating

the risk of broader economic and financial imbalances that could undermine the growth prospects of the economy. At the new level of the OPR, the monetary policy stance remains supportive of economic activities. However, the SRR was left unchanged at 4.00% since its last adjustment in July 2011.

Following the Monetary Policy Committee meeting on 18 September 2014, the OPR was left unchanged at 3.25%.

Interest rates adjust upward

Following the adjustment in the OPR, **interest rates** in the banking system were revised upward. The base lending rate (BLR) of commercial banks increased to 6.78% as at end-July 2014 (end-2013: 6.53%), the first adjustment since December 2011. Likewise, the weighted average lending rate of commercial banks increased 13 bps to 5.49% (end-2013: 5.36%). Meanwhile, the interest rate on savings deposit also increased eight bps to 1.07% (end-2013: 0.99%). The increase in the interest rate on fixed deposits of 1-month to 12-month maturities was smaller, with the adjusted rates ranging between 3.07% and 3.30% (end-2013: 2.91% and 3.15%), compared with the adjustment in the BLR. The real return on fixed deposits of all maturities remained negative during the first six months of 2014. However, when the OPR was increased to 3.25% in July 2014, the real return on fixed deposits of 9-month and 12-month maturities turned positive as the inflation rate in July moderated to 3.2%.

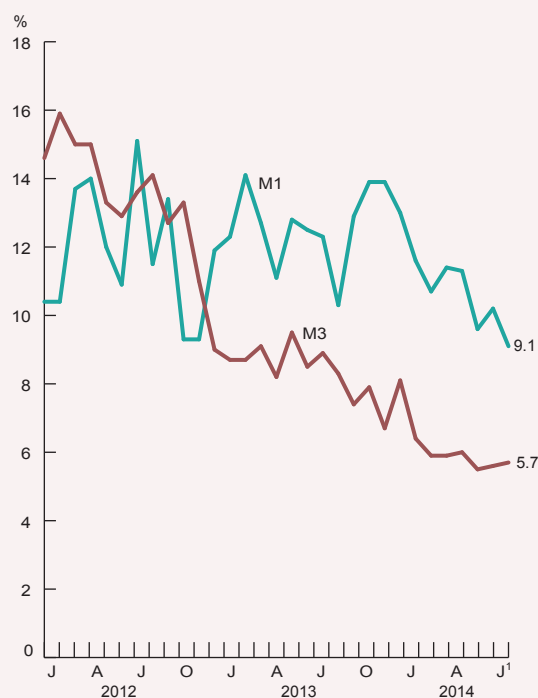
Increase in monetary aggregates reflect strong economic activities

Monetary aggregates expanded further on the back of strong economic activities during the first seven months of 2014. M1 or narrow money, rose 9.1% to RM331.9 billion as at end-July 2014 (end-2013: 13%; RM327.5 billion), mainly due to the increase in demand deposits

CHART 5.1

Monetary Aggregates

(% annual change)

¹ End-July 2014.

Source: Bank Negara Malaysia.

TABLE 5.1

**Factors Affecting M3
January – July**

	Change (RM billion)	
	2013	2014 ¹
M3	77.7	51.4
Net claims on Government	19.0	13.3
Claims on private sector	57.9	57.5
Loans	57.5	52.6
Securities	0.3	4.9
Net foreign assets	-1.5	0.4
Bank Negara Malaysia	11.0	-18.3
Banking system	-12.4	18.7
Other influences	2.3	-19.8

¹ Beginning January 2014, the compilation of monetary aggregates uses data collected based on a new taxonomy.

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

by 8.9% (end-2013: 13.9%). Meanwhile, M3 or broad money, increased at a slower rate of 5.7% to RM1,503.7 billion as at end-July 2014 (end-2013: 8.1%; RM1,462.4 billion). The growth in broad money was mainly on account of the expansion in bank lending to the private sector.

The ringgit strengthens

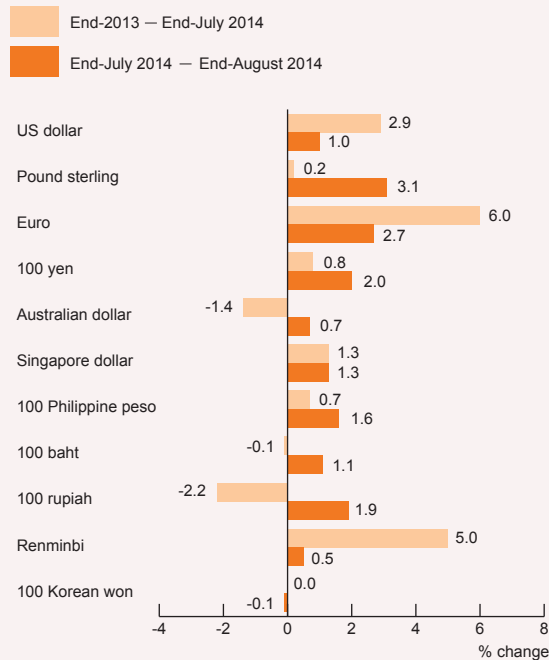
The **ringgit** initially depreciated before strengthening for most of the period between January to August 2014. In January, the ringgit, together with most regional currencies depreciated against the US dollar. The ringgit traded lower against all major and regional currencies in the range of 0.3% and 4.3% but advanced against the Philippine peso by 0.2%. The ringgit eased 1.9% to RM3.3460 against the US dollar following the US Federal Reserve (Fed) reiterating its plan for the stimulus cut and moderation in China's economy, which dampened investors' demand for emerging market assets.

Since February, however, the ringgit has been on an appreciating trend. From February to end-July 2014, the ringgit appreciated 4.9% against the US dollar, 6.9% against the euro, 5.4% against the yen and 2.7% against the pound sterling. Against regional currencies, the ringgit also advanced between 0.5% and 6.9% except against the Australian dollar and the Indonesian rupiah. The improved ringgit performance was supported by the better-than-expected first and second quarter GDP growth arising from the strong domestic economic activities and stronger pace of exports as well as expectations of another increase in interest rate after the first OPR hike in July. The movement of the ringgit during the period was also due to better regional growth prospects and the anticipation of a more gradual reduction of the quantitative easing by the Fed, which sustained investors' interest in the regional financial market.

Meanwhile, in August, the ringgit advanced 1% against the US dollar to RM3.1570. The ringgit also gained against other major and regional

CHART 5.2

Performance of Ringgit Against Selected Currencies



Source: Bank Negara Malaysia.

currencies in the range of 0.5% and 3.1%. However, the ringgit weakened 0.1% against the Korean won. The ringgit was the best performer among 24 emerging-market currencies due to the strong GDP growth in the second quarter. On 28 August 2014, the ringgit appreciated and posted a new high of RM3.1480 against the US dollar.

In September, the ringgit depreciated 3.5% against US dollar and posted a mixed performance against other currencies. Year-to-date to end-September 2014, the ringgit, however, appreciated 0.3% against the US dollar, 9% against the euro, 4.5% against the yen and 1.7% against the pound sterling. The ringgit also gained against most regional currencies in the range of 0.1% and 1.9%.

Financial Sector Developments

Banking System Performance

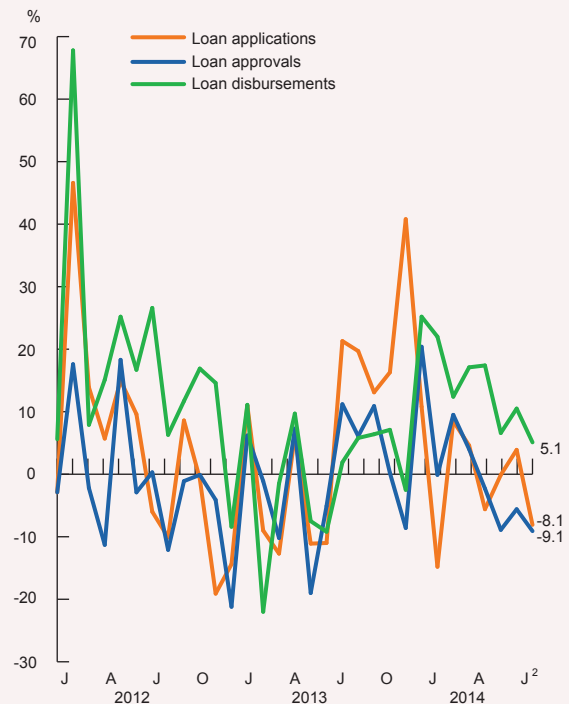
Lending grows moderately

Against the backdrop of strong economic performance, financing indicators of the banking system continued to grow moderately during the first seven months of 2014 as total **loans outstanding** expanded 8.6% to RM1,273 billion as at end-July 2014 (end-2013: 10.6%; RM1,225.7 billion). During the same period, **loan disbursements** grew 13% to RM601.2 billion (January – July 2013: -3.3%; RM531.9 billion). Meanwhile, **loan applications** and **loan approvals** declined 1.9% and 2.4% to RM462.7 billion and RM222.5 billion, respectively (January – July 2013: -1.8%, -2.7%; RM471.9 billion, RM227.9 billion).

CHART 5.3

Banking System: Lending Indicators¹

(% annual change)



¹ Monthly data.

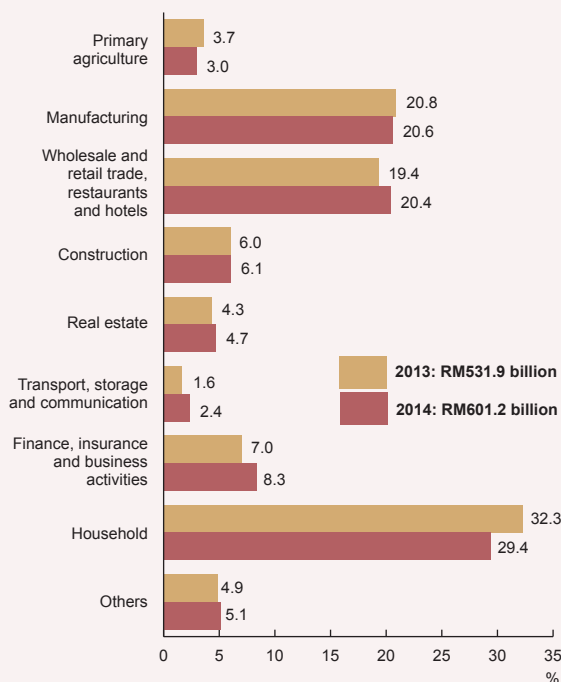
² End-July 2014.

Source: Bank Negara Malaysia.

CHART 5.4

Loan Disbursements by Sector January – July

(% share)



Source: Bank Negara Malaysia.

Lending to **businesses** also moderated. During the first seven months of 2014, business loan approvals declined 8.4% to RM82.5 billion (January – July 2013: -23.2%; RM90.1 billion), while loan applications increased 2.5% to RM210.7 billion (January – July 2013: 10%; RM205.4 billion). Loan disbursements to businesses grew 17.8% to RM424.5 billion and were mostly to finance working capital (January – July 2013: -6.9%; RM360.3 billion). The manufacturing sector continued to account for most of the loans disbursed at 20.6%, followed by the wholesale and retail trade, restaurants and hotels sector at 20.4%. Overall, as at end-July 2014, loans outstanding to the business sector increased 6.8% to RM467.6 billion (end-2013: 8%; RM451.5 billion).

Financing for **small and medium enterprises (SMEs)** also moderated with applications and approvals declining 5.3% and 12.6% to RM105.2

TABLE 5.2

Banking System: Loan Indicators January – July

	RM billion		Change (%)	
	2013	2014	2013	2014
Total¹				
Loan applications	471.9	462.7	-1.8	-1.9
Loan approvals	227.9	222.5	-2.7	-2.4
Loan disbursements	531.9	601.2	-3.3	13.0
Loans outstanding ²	1,171.8	1,273.0	9.2	8.6
of which:				
Business				
Loan applications	205.4	210.7	10.0	2.5
Loan approvals	90.1	82.5	-23.2	-8.4
Loan disbursements	360.3	424.5	-6.9	17.8
Loans outstanding ²	437.7	467.6	7.9	6.8
of which:				
SMEs				
Loan applications	111.1	105.2	-0.1	-5.3
Loan approvals	42.4	37.0	-12.7	-12.6
Loan disbursements	131.3	132.1	5.2	0.6
Loans outstanding ²	191.1	212.7	12.2	11.3
Households				
Loan applications	266.5	252.1	13.8	-5.4
Loan approvals	137.9	140.1	17.8	1.6
Loan disbursements	171.5	176.6	5.1	3.0
Loans outstanding ²	659.8	732.9	11.8	11.1

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.

billion and RM37 billion, respectively, in the first seven months of 2014 (January – July 2013: -0.1%, -12.7%; RM111.1 billion, RM42.4 billion). During the same period, loan disbursements increased 0.6% to RM132.1 billion (January – July 2013: 5.2%; RM131.3 billion). Most of the SME loans were to the finance, insurance and business activities sector (27.3%) as well as the wholesale and retail trade, restaurants and hotels

TABLE 5.3

**Loans Outstanding by Sector
(as at end-period)**

	RM billion		Share (%)	
	2013	2014 Jul	2013	2014 Jul
Business	451.5	467.6	36.8	36.7
Large corporations ¹	253.4	254.8	20.7	20.0
SMEs	198.1	212.7	16.2	16.7
<i>Selected sectors</i>				
Primary agriculture	31.6	31.6	2.6	2.5
Mining and quarrying	7.9	8.0	0.6	0.6
Manufacturing	96.6	98.3	7.9	7.7
Electricity, gas and water supply	9.7	13.1	0.8	1.0
Wholesale and retail trade, restaurants and hotels	91.8	94.2	7.5	7.4
Construction	49.7	52.5	4.1	4.1
Real estate	70.0	75.8	5.7	6.0
Transport, storage and communication	28.7	30.7	2.3	2.4
Finance, insurance and business activities	88.2	82.6	7.2	6.5
Households²	693.0	732.9	56.5	57.6
of which:				
Purchase of residential properties ³	325.4	348.8	26.6	27.4
Purchase of passenger cars ³	139.7	142.0	11.4	11.2
Consumption credit ^{3,4}	92.4	92.0	7.5	7.2
of which:				
Credit cards ³	34.7	33.5	2.8	2.6
Personal use ³	57.5	58.1	4.7	4.6
Other sectors	81.1	72.5	6.6	5.7
Total⁵	1,225.7	1,273.0	100.0	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 Reflecting household sector only.

⁴ Consumption credit = Credit cards + Personal use.

⁵ Total = Business + Households + Other sectors.

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

sector (24.8%). Total SME loans outstanding rose 11.3% to RM212.7 billion as at end-July 2014 (end-2013: 12.8%; RM198.1 billion) and accounted for 45.5% of total business loans outstanding (end-2013: 43.9%).

In addition to the banking system, five **special revolving funds**² administered by Bank Negara Malaysia (BNM), also provided financing to SMEs. From January to July 2014, loans were approved to 1,859 SMEs amounting to RM724.4 million (January – July 2013: 2,678 SMEs; RM998.9 million). Since the establishment of the funds, 60,648 SMEs have benefited from RM25 billion of total financing approved with an average utilisation rate of 68.8% (end-July 2013: 57,057 SMEs; RM23.6 billion; 75.8%).

Microenterprises continue to receive financing support from participating financial institutions under the *Skim Pembiayaan Mikro* since 2006. The scheme provides both conventional and Islamic microfinancing products through more than 2,400 access points. Demand for **microfinancing** under the scheme remained robust, with RM185 million approved to 9,814 microenterprises accounts during the first seven months of 2014 (January – July 2013: RM181.3 million; 9,302 microenterprises accounts). As at end-July 2014, total loans outstanding under the scheme amounted to RM859.8 million from 66,736 microenterprises accounts (end-2013: RM857 million; 68,360 microenterprises accounts).

In addition, Amanah Ikhtiar Malaysia (AIM) and Tabung Ekonomi Kumpulan Usaha Niaga (TEKUN Nasional) continue to extend financing to microentrepreneurs. AIM currently provides seven types of Islamic financing to its growing members. As of July 2014, AIM has a total of 347,640 registered members, of which about 70% are between 20 and 50 years old. Most of the members are involved in the business sector (37%) followed by other sectors (16.3%),

² 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 Projects Fund – Islamic (2009).

housing (14.4%) and agriculture (14.1%). In the first seven months of 2014, AIM approved total financing amounting to RM1.1 billion to 205,744 members (January – July 2013: RM1.1 billion; 204,061 members). The repayment rate of financing extended, remains high at 98.7% during the same period (January – July 2013: 98.5%). Meanwhile, TEKUN Nasional disbursed a total of RM211.2 million to 16,005 microentrepreneurs (January – July 2013: RM368.5 million; 29,668 microentrepreneurs), with the bulk of the financing channelled to the services (48%) and the retail (36.4%) sectors. Overall, TEKUN Nasional has provided financing totalling RM3.2 billion to 294,857 microentrepreneurs since its establishment in 1998 until end-July 2014.

Lending to **households** remained active with total household loans outstanding expanding 11.1% to RM732.9 billion, and accounting for 57.6% of total loans outstanding in the banking system as at end-July 2014 (end-2013: 12%; RM693 billion; 56.5%). From January to July 2014, loan applications by the household sector eased 5.4% to RM252.1 billion (January – July 2013: 13.8%; RM266.5 billion), while loan approvals and disbursements continued to grow 1.6% and 3% to RM140.1 billion and RM176.6 billion, respectively (January – July 2013: 17.8%, 5.1%; RM137.9 billion, RM171.5 billion). Loans disbursed to the household sector were mainly for consumption credit which totalled RM74.5 billion or 42.1% of total loans disbursed to households during the first seven months of 2014 (January – July 2013: RM74 billion; 43.1%). This was followed by loans for purchase of residential properties at RM46.2 billion or 26.2% (January – July 2013: RM41.9 billion; 24.4%).

Total household debt, which includes loans provided mainly by the banking system, DFIs, Treasury Housing Loan Division and other credit institutions, increased at the slowest pace since 2010 by 9.9% to RM904.3 billion, and accounted for 86.7% of nominal GDP as at June 2014 (end-2013: 11.5%; RM855.9 billion; 86.7%). The risks to domestic financial stability, however,

remained well-contained supported by more than sufficient financial assets of households, stable labour market conditions and steady income growth. Household financial assets continued to grow 8.1% to RM1,996.9 billion as at end-July 2014 (end-2013: 11.1%; RM1,902.6 billion). During the same period, household financial assets accounted for more than twice the household debt. The composition of both financial assets and debts was broadly unchanged. Of the total financial assets, 41.6% was held in the form of deposits and deposit-like instruments. The ratio of deposits and deposit-like instruments to household debt remained stable at 91.8%. The availability of these liquid assets provides households with some flexibility to temporarily weather any income shocks, thus safeguarding their debt repayment capacity. As at end-July 2014, the net impaired household loans ratio improved slightly to 1.2% of total household loans in the banking system (end-2013: 1.3%).

During the first seven months of 2014, **credit card** utilisation grew 3.5% and 5.9% in terms of volume and value to 200.2 million transactions and RM60.2 billion, respectively (January – July 2013: 5.9%, 5.9%; 193.4 million transactions, RM56.9 billion). Most of the transactions were for local purchases and purchases from abroad, which together accounted for 97.7%, while the balance was for cash advances. Credit card outstanding balance rose 2.5% to RM34.4 billion as at end-July 2014 (end-2013: 4.3%; RM35.5 billion). Meanwhile, during the same period, credit card outstanding balance as a share of total household loans and total outstanding loans in the banking system declined from 5.1% to 4.7% and 2.9% to 2.7%, respectively, compared to end-July 2013. The impaired loans ratio of credit card improved slightly to 1.2% as at end-July 2014 (end-July 2013: 1.3%).

Agensi Kaunseling dan Pengurusan Kredit (AKPK) continued to promote financial literacy and management to consumers as well as borrowers through counselling, Debt

Management Programme (DMP) and financial education. During the first seven months of 2014, AKPK provided credit counselling totalling 31,937 cases, of which 11,317 or 35.4% committed to DMP (January – July 2013: 21,337 cases; 9,550 cases; 44.8%). The number of credit card-related debt cases handled by AKPK increased to 8,053 in the first seven months of 2014 (January – July 2013: 6,958 cases), and accounted for 71.2% of the total cases undergoing DMP with total debt valued at RM521.4 million (January – July 2013: 72.9%; RM420.9 million). As at end-July 2014, AKPK has provided credit counselling totalling 280,428 cases, of which 112,188 or 40% committed to DMP. Meanwhile, 192,842 participants took part in Pengurusan Wang Ringgit Anda (POWER!)³ programme since it was introduced in 2011.

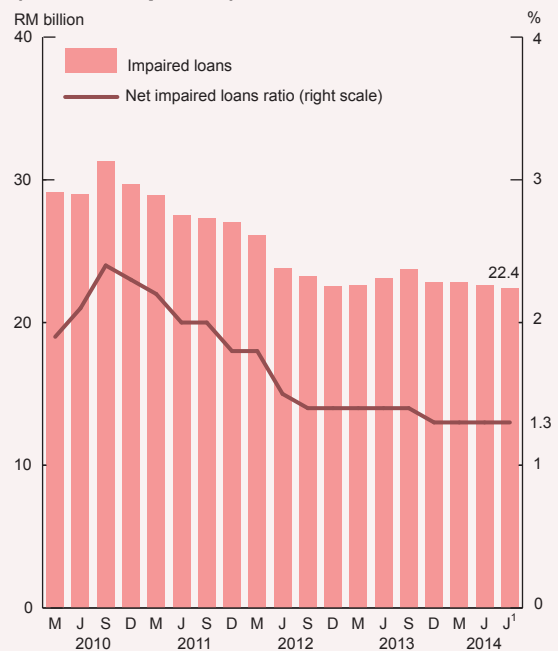
The scope of AKPK debt management services was further expanded in 2013 to cover borrowers with non-bank lenders such as the Malaysia Building Society Berhad (MBSB) and credit cooperatives, in addition to borrowers from financial institutions regulated by BNM. There is also ongoing collaboration with the Ministry of Education to integrate financial education in the school curriculum, starting with the progressive incorporation of financial education themes covering basic money management, spending and savings, credit and debts, e-payments, financial risk management and consumer responsibilities beginning in 2014. Building on the successful implementation of the POWER! programme, AKPK enhanced the initiative to provide targeted programmes for working adults through public-private sector partnerships, including agencies such as AIM, Institut Pendidikan Guru Malaysia, Jabatan Kemajuan Islam Malaysia, the Royal Malaysian Police and the Royal Malaysian Navy.

Banking system remains robust

The **banking system** remained well-capitalised under the Basel III capital adequacy framework. As at end-July 2014, the CET1 capital ratio, tier 1 capital ratio and total capital ratio of the banking system were at 12.4%, 13.2% and 15.1%, respectively (end-2013: 12.6%; 13.5%; 14.9%), well above the minimum regulatory levels. Capital buffers in excess of the minimum regulatory requirement remained high at more than RM91 billion (end-2013: RM79 billion). Liquidity remained ample with banks maintaining strong liquidity buffers and large placements of more than RM124 billion with BNM to meet liquidity demands (end-2013: RM135 billion). The banking system also recorded a projected liquidity surplus

CHART 5.5

Banking System: Impaired Loans and Net Impaired Loans Ratio (as at end-period)



¹ End-July 2014.

Source: Bank Negara Malaysia.

³ A specially designed programme targeting primarily young individuals and new borrowers, with the aim of empowering them to effectively manage their finances.

of 14.9% of total deposits for liquidity needs maturing within one week (end-2013: 14.7%). In the first seven months of 2014, pre-tax profit of the banking system increased 16.1% to RM18.9 billion (January – July 2013: -5.1%; RM16.3 billion), contributed mainly by revenue from financing activities and fee-based services. Loan quality in the banking system remained stable with net impaired loans ratio at 1.3% of net loans as at end-July 2014 (end-2013: 1.3%), while the overall loan loss coverage ratio remained above 100%.

Financial integration and interlinkages with regional and international economies continued to deepen. Foreign banks continue to have significant presence in the banking sector, accounting for 23.7% of banking sector assets as of July 2014. There are currently 19 locally incorporated foreign banks operating in Malaysia, out of a total of 39 commercial banks and investment banks. Progress on the regional financial integration continued with the Association of Southeast Asian Nations (ASEAN) Banking Integration Framework (ABIF) at the advanced stage of being finalised. The establishment of a set of principles by the ASEAN member countries to identify qualifying ASEAN banks, will spearhead the banking integration process within the region. This is expected to result in increased presence of indigenous ASEAN banks in Malaysia, as Malaysian banks continue to strengthen their presence in ASEAN. Six domestic banking groups have overseas operations in 22 countries worldwide, including in all ASEAN countries.

Financing by DFIs to targeted sectors increases

During the first seven months of 2014, the **DFIs** continued to provide financing to support the targeted sectors of the economy, including agriculture, infrastructure, SMEs and export sectors. As at end-July 2014, total financing outstanding of DFIs rose 8.4% to RM126.1 billion (end-2013: 8.1%; RM120 billion), mainly

TABLE 5.4

Development Financial Institutions¹: Direction of Lending by Sector (as at end-period)

	RM billion		Share of Total (%)	
	2013	2014 Jul	2013	2014 Jul
Primary agriculture	6.8	7.6	5.7	6.0
Manufacturing	4.8	5.5	4.0	4.4
Wholesale and retail trade, restaurants and hotels	3.1	3.3	2.6	2.6
Construction	9.9	13.3	8.2	10.5
Transport, storage and communication	12.3	9.5	10.2	7.5
Finance, insurance and business activities	3.6	4.1	3.0	3.2
Others	79.6	82.9	66.3	65.7
Total	120.0	126.1	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) and Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank).

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

on account of higher financing to support export-oriented businesses and cross-border ventures, consumption credit and the construction sector. Financing to the export-oriented businesses and cross-border ventures expanded 67.8% to RM8.8 billion during the same period (end-2013: 46.8%; RM6.4 billion), reflecting higher financing extended for investment activities of Malaysian companies in construction, property development and utility sectors in overseas market.

Meanwhile, consumption credit, which was largely extended by Bank Kerjasama Rakyat Malaysia (Bank Rakyat) and Bank Simpanan Nasional (BSN), recorded an increase of 5.9% to

RM64.4 billion (end-2013: 8.1%; RM62.1 billion). Lending to the construction sector rose 43.6% to RM13.3 billion as at end-July 2014 (end-2013: 11.2%; RM9.9 billion), mainly extended by Bank Pembangunan Malaysia Berhad for the construction of public universities and polytechnic campuses under private finance initiative (PFI) as well as roads and highways. Total SME loans outstanding provided by DFIs was RM13.6 billion as at end-July 2014 (end-2013: RM13.3 billion), mainly extended to the construction, primary agriculture as well as transport and communication sectors.

Personal financing extended by Bank Rakyat and BSN, continued to increase albeit at a slower pace of 5.3% to RM60 billion as at end-July 2014 (end-2013: 8.6%; RM58.1 billion). The lower financing growth was partly due to the implementation of macroprudential measures to curb excessive household indebtedness, as part of the efforts to strengthen resilience of the household sector. Similarly, during the first seven months of 2014, both approvals and disbursements of personal financing were also significantly lower at RM8 billion and RM6.8 billion, respectively (January – July 2013: RM17.1 billion; RM15.6 billion). Notwithstanding the lower growth in personal financing, these measures have resulted in strengthened DFIs' underwriting and risk management standards. The demand for personal financing is expected to be sustained in the future supported by expectations of favourable employment conditions and higher income levels.

Among the significant developments of DFIs during the first seven months of 2014 were the issuances of prudential guidelines and initiatives to enhance institutional capacity in elevating the performance of DFIs. Recognising the importance of sound operational risk management in all activities, products and services offered by financial institutions including DFIs, a concept paper on Operational Risk Management was issued by BNM on 27 June 2014. The concept paper sets out key principles on sound operational

risk management framework and practices for adoption by financial institutions to enhance overall performance.

Significant efforts were also undertaken to broaden the outreach of financial services to the underserved segments, with BSN instrumental in supporting the initiative. Agent banking was introduced by BSN in January 2012, using non-bank retail outlets to deliver financial services on its behalf. Currently, 5,133 agents (end-2013: 5,014 agents), accounting for 91.8% of total agent banks nationwide, were appointed by BSN (with the rest appointed by Maybank Berhad and RHB Bank Berhad). Transactions conducted through these agents totalled 23 million with a value of RM1.9 billion. The initiatives by BSN has made significant impact on the expansion of financial services throughout the country, whereby all districts under Parliamentary constituencies and State Legislative Assembly now have access to basic financial services.

In addition, a new financing scheme of Bank Rakyat, Ramadhan Bazaar i-Micro Financing scheme was launched by the Prime Minister on 5 June 2014. With a fund size of RM45 million, the scheme is intended to provide capital for traders and hawkers to start small businesses, particularly those operating at Ramadhan bazaars during the fasting month. Eligible applicants are entitled to an interest-free microcredit up to a maximum of RM3,000. Financing were approved prior to Ramadhan month with full settlement of the loans to take effect within a period of two months after disbursement.

Resilience of insurance industry remains intact

The **insurance industry** maintained its resilience with strong capitalisation and higher profits during the first seven months in 2014. The capital adequacy ratio for the industry was higher at 250.4% (end-2013: 246.1%), supported by stable reserves. Similarly, the capital buffer in excess of the minimum requirement improved further to RM24.2 billion.

TABLE 5.5

Life and General Insurance Business

	2013	2014 Jan – Jul
Life Insurance (RM million)		
New business		
Number of policies (units)	13,614,088	13,059,605 ³
Sums insured	528,639.9	405,204.0 ³
Total premiums	8,570.2	4,669.4 ³
Business in force		
Number of policies (units)	19,535,286	20,218,824 ⁴
Sums insured	1,273,970.1	1,332,895.8 ⁴
Annual premiums	25,139.1	25,878.3 ⁴
Premium income	26,458.1	15,894.7
Benefit payments	16,357.7	9,795.1
General Insurance (RM million)		
Premium income		
Gross direct premiums	15,911.0	10,283.1
Net premiums	10,808.6	7,607.1
Reinsurance placed outside Malaysia	1,212.6	485.3
Retention ratio¹ (%)	73.6	74.0
Number of insurance companies²		
Direct	32	32
Life	9	9
General	18	18
Composite	5	5
Reinsurance	7	7
Life	1	1
General	5	5
Composite	1	1

¹ Proportion of premiums retained in the country.² As at end-period.³ Includes data for reinsurers.⁴ As at end-June 2014. Data updated on quarterly basis.

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

During January to July 2014, the profitability of the **life insurance** sector improved to RM8.2 billion (January – July 2013: RM6.8 billion), supported by net capital gains and higher net premium income. Life claims increased 10.2% to RM9.8 billion (January – July 2013: 6.1%; RM8.9 billion) on account of higher benefits paid on maturing policies and medical claims. The new business premiums for life insurers experienced a slight decrease of 0.6% to RM4.7 billion (January – July 2013: -0.9%; RM4.7 billion), due to a 0.1% decline in ordinary life insurance premiums. The market penetration rate of the life insurance improved marginally to 41.2% as at end-July 2014 (end-2013: 41%).

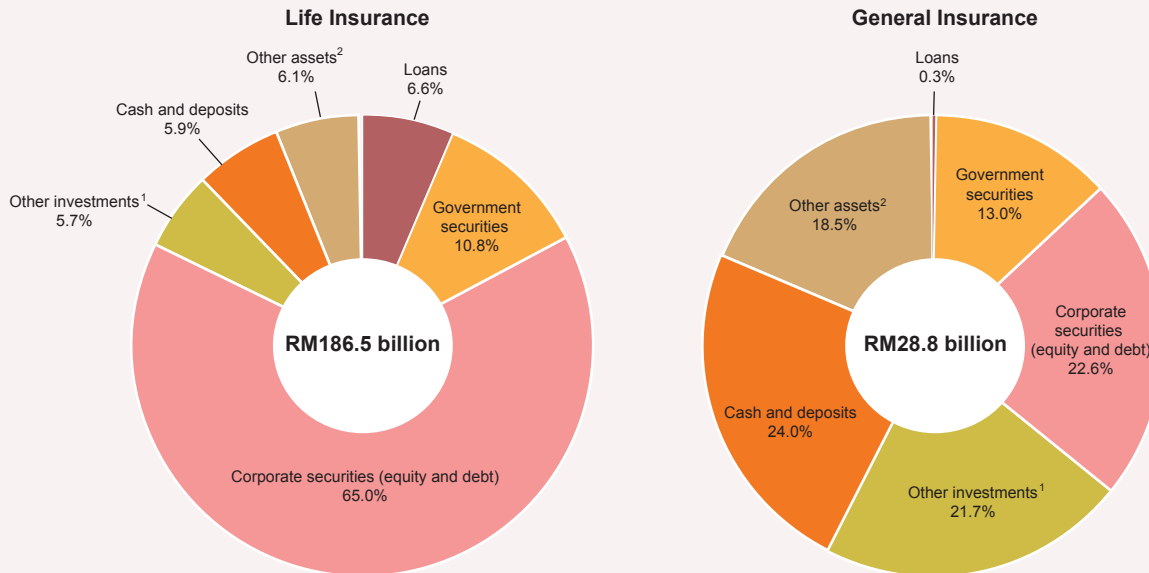
Meanwhile, the operating profit for the **general insurance** sector stood at RM1.3 billion (January – July 2013: RM2.8 billion). Gross direct premiums rose 5.3% (January – July 2013: 7%) contributed by an increase in the motor and fire businesses. The motor business continued to account for the biggest share (46%) of the total gross direct premiums. The claims ratio increased 58.3% (end-2013: 57.4%), with broad-based improvements registered across all classes of business. Meanwhile, the overall claims ratio of motor business remained stable at an average rate of 75.2%. The much higher claims from the compulsory motor third party liability insurance business continued to pose a significant drag on the overall profitability of motor business.

Insurance fund assets continued to expand 7.9% to RM215.3 billion as at end-July 2014 (end-2013: 7.1%; RM212.6 billion). The asset allocation was concentrated in private debt securities (PDS), which formed the bulk of life insurers assets at 43.5%, followed by investment in equities at 21.5%. Assets of the life insurance sector continued to account for the major share (86.6%) of the industry's total assets (January – July 2013: 86.7%). The composition of general insurers' asset holdings portfolio remained broadly unchanged.

CHART 5.6

Assets of Life and General Insurance Funds (as at end-July 2014)

(% share)

¹ Other investments = Government guaranteed loans + investment properties + others.² Other assets = Property, plant and equipment + foreign assets + others.

Source: Bank Negara Malaysia.

Capital Market Performance

Fund raising remains healthy

Gross funds raised in the capital market rebounded by 8.8% to RM119.3 billion in the first seven months of 2014 (January – July 2013: -28.4%; RM109.7 billion). This was driven by higher fund raising activities in the private sector. Gross funds raised by the public sector decreased 8.2% to RM56.7 billion (January – July 2013: -0.4%; RM61.8 billion). Funds were raised through the issuances of Malaysian Government Securities (MGS), Government Investment Issues and Government Housing Sukuk. However, gross funds raised by the private sector rose significantly by 30.8% to RM62.7 billion (January – July 2013: -47.4%; RM47.9 billion). The bulk of the funds raised were from the construction as well as insurance, real estate and business services sectors, which accounted for RM37.3

billion or 77.6% of new PDS issuances. Funds were mainly used for project financing, working capital and general corporate purposes.

After adjusting for lower redemptions in both public and private sectors, net funds raised in the capital market recorded a significant increase of 95.7% to RM65.8 billion (January – July 2013: -63.2%; RM33.6 billion). The bulk of net funds were from the private sector at RM33.1 billion (January – July 2013: RM15.7 billion), with the balance of RM32.6 billion by the public sector (January – July 2013: RM17.9 billion). In the equity market, funds raised rebounded 73.3% to RM14.7 billion in the first seven months of 2014 (January – July 2013: -58.2%; RM8.5 billion). This was supported by higher initial public offerings (IPOs) and rights issuances valued at RM4.9 billion and RM9.7 billion, respectively (January – July 2013: RM3.3 billion; RM5.1 billion). Fund raising activities remained strong, driven

TABLE 5.6

**Funds Raised in the Capital Market
January – July**

	RM million	
	2013	2014
Public Sector		
Government securities		
Malaysian Government Securities	34,059	29,423
Khazanah Bonds	-	-
Government Investment Issues	26,027	20,665
Sukuk Perumahan Kerajaan	1,700	6,600
New issues of debt securities	61,785	56,689
Less: Redemptions	43,861	24,043
Net funds raised by the public sector	17,924	32,646
Private Sector		
Shares¹ / Warrants		
Initial public offers	3,349	4,930
Rights issues	5,094	9,714
Private placements / Restricted offer-for-sales	-	-
Special issues	-	-
Warrants	13	6
New issues of shares / warrants	8,456	14,651
Debt securities		
Straight bonds	1,257	2,608
Convertible bonds	-	-
Islamic bonds	5,537	7,377
Asset-backed bonds	-	-
Bonds with warrants	-	-
Medium term notes	32,673	38,024
Cagamas bonds	-	-
New issues of debt securities	39,466	48,008
Less: Redemptions	32,232	29,535
Net issues of debt securities	7,234	18,473
Net funds raised by the private sector	15,690	33,124
Total net funds raised	33,614	65,770

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 Issuance of PDS¹ by Sector
January – July**

	RM million		Share of Total (%)	
	2013	2014	2013	2014
Agriculture, forestry and fishing	1,239	32	3.1	0.1
Mining and quarrying	-	12	-	0.0
Manufacturing	945	450	2.4	0.9
Construction	2,390	10,774	6.1	22.4
Electricity, gas and water	9,783	3,763	24.8	7.8
Transport, storage and communication	1,300	1,490	3.3	3.1
Finance, insurance, real estate and business services	19,946	26,491	50.5	55.2
Government and other services	3,809	4,530	9.7	9.4
Wholesale and retail trade, hotels and restaurants	55	467	0.1	1.0
Total	39,467	48,008	100.0	100.0

¹ Include PDS issued by Cagamas and non-resident corporations.

Note: Total may not add up due to rounding.

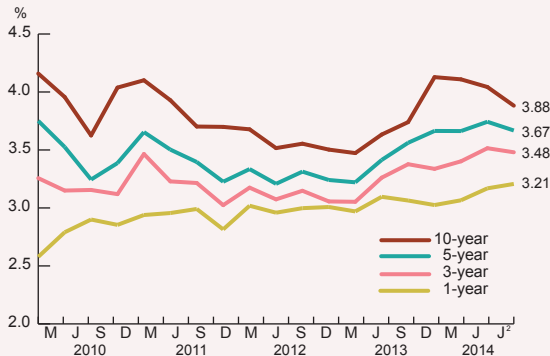
Source: Bank Negara Malaysia.

by the ongoing initiatives implemented under the Tenth Malaysia Plan (10MP) and Economic Transformation Programme (ETP).

The MGS yields initially increased in January due to the withdrawal of foreign portfolio funds from emerging market assets amid uncertainties over the pace of reduction in monetary accommodation by the Fed and growth concerns in China. Subsequently, yields remained relatively stable following indication by the Fed that the scale-back in its asset purchase programme will continue as expected. In May, yields on the short-term to medium-

CHART 5.7

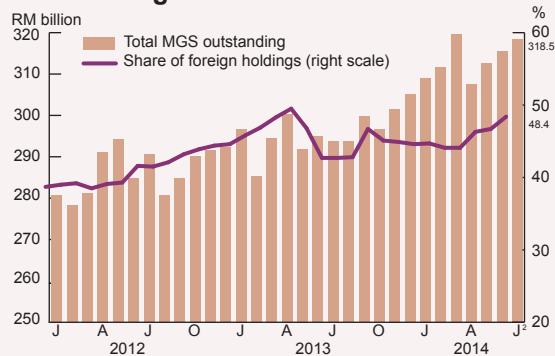
Malaysian Government Securities (MGS) Indicative Yields¹

¹ End-period.² End-July 2014.

Source: Bank Negara Malaysia.

CHART 5.8

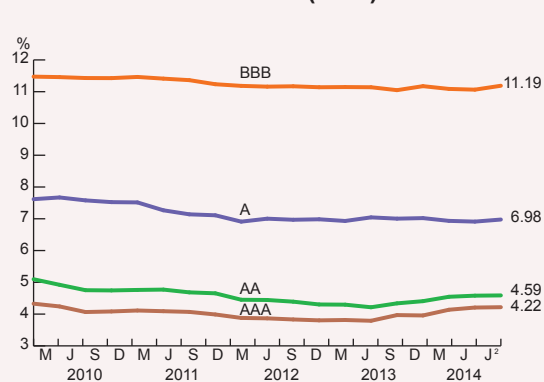
Share of Foreign Holdings in Total MGS Outstanding¹

¹ End-period.² End-July 2014.

Source: Bank Negara Malaysia.

CHART 5.9

Private Debt Securities (PDS) 5-Year Yields¹

¹ End-period.² End-July 2014.

Source: Bank Negara Malaysia.

term MGS began to gradually increase driven by market expectation of a policy rate increase by BNM. The increase in yields, however, was mitigated by sustained demand for domestic financial assets by non-residents, which was driven by positive sentiments over the better-than-expected domestic economic data. Overall, in the first seven months of 2014, the 3-year and 5-year MGS yields recorded an increase of 14 bps and 0.4 bps, respectively (January – July 2013: 42 bps; 44 bps) while the 10-year MGS recorded a decline of 25 bps (January – July 2013: 60 bps). Foreign holdings in MGS amounted to RM154 billion, accounting for 48.4% of total outstanding MGS as at end-July 2014 (end-2013: RM137.1 billion; 44.9%). Meanwhile, in the PDS market, yields on the 5-year AAA-rated and AA-rated securities increased 26 bps and 18 bps, respectively, while yields on the A-rated PDS declined 5 bps (January – July 2013: 7 bps; 2 bps; 5 bps).

From January to July 2014, PDS credit spreads (PDS yields minus MGS yields) of higher-rated debt securities widened as the increase in AAA-rated and AA-rated PDS yields outpaced that in the MGS yields. During the period, the 5-year PDS credit spreads for AAA-rated and AA-rated debt widened by 26 bps and 18 bps, respectively (January – July 2013: -36 bps; -41 bps). The MGS term spreads (10-year MGS minus 1-year MGS yields) narrowed by 43 bps (January – July 2013: 50 bps).

FBM KLCI performance influenced by external factors

The **equity market** performed relatively well during the first seven months of 2014 despite challenging external environment. The Financial Times Stock Exchange (FTSE) Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI) began 2014 on weak investor sentiment dampened by losses in regional markets due to weak economic data in China and the US. Nevertheless, the market rebounded in February following the new Fed Chair's comments that US monetary policy

TABLE 5.8

**Bursa Malaysia: Selected Indicators
January – July**

	2013	2014
Indices¹		
FBM KLCI	1,772.6	1,871.4
FBMEMAS	12,331.4	13,085.7
FBM 100	12,085.0	12,651.6
FBM SCAP	14,880.1	19,066.4
FBM-ACE	4,999.0	7,044.6
Total turnover²		
Volume (million units)	204,327.4	281,908.8
Value (RM million)	296,974.3	309,892.6
Average daily turnover²		
Volume (million units)	1,355.3	1,904.6
Value (RM million)	1,985.5	2,067.6
Market capitalisation¹ (RM billion)	1,611.1	1,783.7
Total number of listed companies¹		
Main Market	802	799
ACE Market	110	108
Market liquidity¹		
Turnover value / market capitalisation (%)	17.8	16.5
Market concentration¹		
10 highest capitalised stocks / market capitalisation (%)	34.7	34.1

¹ As at end-period.² Based on market and direct business transactions.

Source: Bursa Malaysia.

will remain accommodative, while the US debt ceiling was extended for another year. The FBM KLCI, however, underwent a sharp correction in March along with other markets, following adverse external environment arising from escalating geopolitical tensions between Russia and Ukraine as well as China's weaker-than-expected economic data. Subsequently, market sentiment improved during the final week of March aided by external market strength following a peaceful referendum by Crimea to join Russia, the tame sanctions by

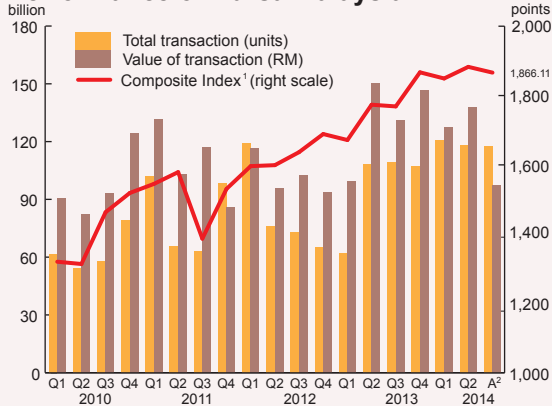
the US and EU on Russia as well as improved US trade data. The FBM KLCI ended the first quarter at 1,849.21 points (end-December 2013: 1,866.96 points).

The market extended its gains in April on the back of reassurance from the Fed to support the US economy as well as China implementing its stimulus plan to boost growth. The FBM KLCI reached a record high of 1,887.07 points on 19 May 2014, lifted by Malaysia's strong first quarter GDP growth combined with positive US economic data. However, the market slipped in the final week of the month influenced by weak regional investor sentiment. These included concerns over the imposition of martial law in Thailand, unrest and anti-China riots in southern Viet Nam and the July presidential election in Indonesia. The market edged higher in June, tracking the rally in the US stock market after the Fed reiterated its commitment to maintain low interest rates for a considerable time. Thereafter, the FBM KLCI reached a new high of 1,892.33 points on 24 June 2014. However, the uptrend was capped towards the end of the month amid increased geopolitical concerns over Iraq and the downward revision to US economic growth. The FBM KLCI closed at 1,882.71 points as at end-June 2014 (end-June 2013: 1,773.54 points).

From 1 July to end-August 2014, the FBM KLCI reached another record high of 1,892.65 points on 8 July 2014 amid optimism as the IMF forecast an acceleration of global economic growth. The market closed lower for the month as investors' confidence was partly dampened by the tragedy of Malaysia Airlines flight MH17 as well as Israel's ground offensive in Gaza. As at end-July 2014, the FBM KLCI eased to 1,871.36 points (end-July 2013: 1,772.62 points). The market retreated and continue to edge lower in August due to the ongoing geopolitical tensions in Ukraine, mostly disappointing second quarter corporate earnings as well as the weak crude palm oil (CPO) prices. From the beginning of the year until end-August 2014, the FBM KLCI saw

CHART 5.10

Performance of Bursa Malaysia

¹End-period.²End-August 2014.

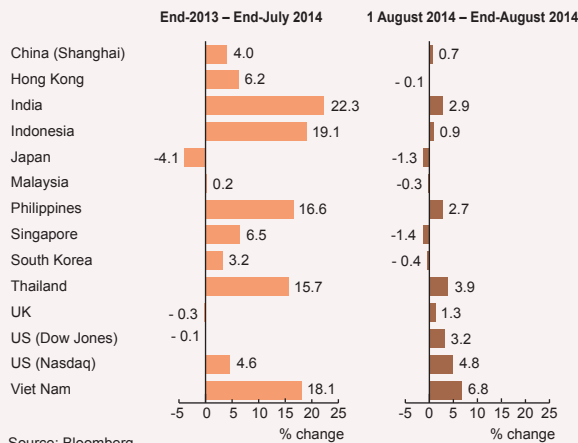
Source: Bursa Malaysia.

an increase of 138.53 points or 8% to stand at 1,866.11 points (end-August 2013: 81.47 points; 5%; 1,727.58 points).

In September 2014, the FBM KLCI continues to decline due to lack of positive market leads and quiet regional trade. Disappointing domestic trade data, weaker-than-expected industrial production, poor corporate earnings coupled with concerns over US interest rate hike and intensified geopolitical risks following US airstrikes in Iraq and Syria had combined to weigh down the market. The FBM KLCI closed at 1,846.31 points as at end-September 2014 (end-September 2013: 1,768.62 points).

CHART 5.11

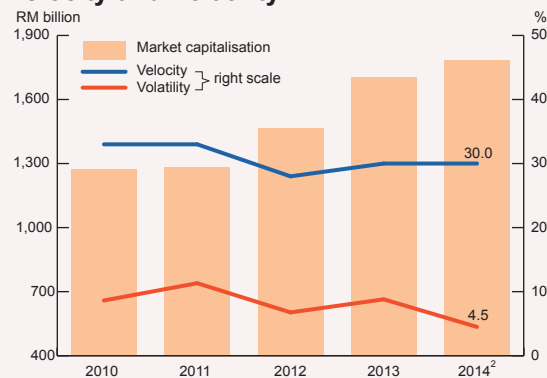
Performance of Selected Stock Markets



Source: Bloomberg.

Meanwhile, market capitalisation grew 10.7% to RM1,783.7 billion as at end-July 2014 (end-July 2013: 13.2%; RM1,611.1 billion). Total market transactions also improved 38% to 281.9 billion units during the same period (January – July 2013: -8%; 204.3 billion units). Similarly, the value of total market transactions increased 4.4% to RM309.9 billion (January – July 2013: 18%; RM297 billion). Both market velocity and market volatility declined 30% and 4.5%, respectively (end-July 2013: 32%; 7.2%). During the first seven months of 2014, 10 new companies were listed on the market, bringing the total number of companies listed on Bursa Malaysia to 907 (end-2013: 911 companies).

CHART 5.12

Bursa Malaysia: Market Capitalisation¹, Velocity and Volatility¹End-period.²January – July 2014.

Source: Bursa Malaysia.

On 5 March 2014, the Private Retirement Scheme (PRS) Youth Incentive Kick-Off event was launched to promote the importance of savings from an early age among youths in order to ensure sufficient savings after retirement. During the first six months of 2014, the Private Pension Administrator (PPA) and the PRS Providers conducted 50 seminars and road shows to a total of 53,730 people to further increase investor awareness about the PRS. During the same period, PPA also conducted Corporate Presentations & Educational Talks to a total of

43 institutions. As at end-June 2014, there were 86,915 members with total net asset value (NAV) of approximately RM418 million.

On the regional front, ASEAN Exchanges announced an expanded FTSE ASEAN Index Series on 29 May 2014, including a comprehensive suite of indices broadly covering the growing ASEAN equity market. The three new tradable ASEAN indices are the FTSE ASEAN All-Share Index, FTSE ASEAN Stars Index and FTSE ASEAN All Share Ex-Developed Index. With the inclusion of constituents from Viet Nam to the FTSE ASEAN Index Series, the new expanded index series will further increase the visibility and transparency of ASEAN and create a larger universe of stocks for all ASEAN markets. The creation of indices will be the building block towards creating broader benchmark indices, meaningful sector indices and new ASEAN-centric products that will bring more ASEAN tradable opportunities for investors and enhance liquidity among the exchanges.

Likewise, the ASEAN Capital Markets Forum (ACMF) announced on 25 August 2014, that the ASEAN Framework for cross-border offering of collective investment schemes (CIS) is now operational in Malaysia, Singapore and Thailand. Within this framework, qualified fund managers in Malaysia now have the opportunity to offer their products directly to investors in Singapore and Thailand. Correspondingly, Malaysian investors would benefit from a wider range of investment products that will be made available.

On 26 August 2014, Bursa Malaysia Berhad introduced ASEAN Post Trade services to its participating organisations for outbound (non-Bursa Malaysia Securities) trades executed on participating ASEAN stock exchanges that are currently on the ASEAN Trading Link. These ASEAN Post Trade services offered by Bursa Malaysia will facilitate the clearing and settlement of outbound trades executed on the respective participating stock exchanges, including safekeeping of the securities traded on

participating exchanges of the ASEAN Trading Link. Bursa Malaysia will be the single contact point in respect of clearing, settlement and custody of foreign securities in relation to their outbound trades executed on any of the participating ASEAN Stock Exchanges. The initiative will result in shorter lead time in receiving cross-border announcements on corporate actions and entitlements.

CPO futures drive derivatives market

The **derivatives market** registered growth of 6.4% in trading to 6.7 million contracts during the first seven months of 2014 (January – July 2013: 20.2%; 6.3 million contracts). Turnover was dominated by CPO futures (FCPO), accounting for 80.3% of the total trading followed by FBM KLCI futures (FKLI) with 18.4%, while other derivative instruments, namely gold futures (FGLD) and 3-Month Kuala Lumpur interbank offered rate futures (FKB3) added only a small contribution to the trading. The 3-year and 5-year MGS futures, crude palm kernel oil futures, USD CPO futures as well as the single stock futures were not traded during the period. Trading volume of FCPO surged 14.9% to 5.4 million contracts for the period of January to July 2014 (January – July 2013: 20.7%; 4.7 million contracts), equivalent to 10.7 million metric tonnes of CPO (January – July 2013: 10.1 million metric tonnes). However, trading volume of FKLI declined 23% to 1.2 million contracts (January – July 2013: 20.7%; 1.6 million contracts), attributed to reduced volatility in the underlying index.

The performance of options on FKLI (OKLI) declined with 1,976 contracts traded as at end-July 2014 (end-2013: 5,311 contracts). Likewise, trading in options on FCPO (OCPO) saw a significant drop to 265 contracts during the same period (end-2013: 2,520 contracts). Trading in options is still low due to a lack of understanding of options in the Malaysian market. Therefore, Bursa Malaysia Derivatives Berhad (BMD) has embarked on a series of awareness and educational programmes including classes

and workshops on options to highlight the benefits of OKLI and OCPO trading as well as the new opportunities offered to market participants.

Meanwhile, BMD introduced the RBD palm olein futures contracts (FPOL) which commenced trading on 16 June 2014. The new USD-denominated futures contract provided a complete solution to manage refining margin risk and hedge against unfavourable price movements in the CPO and palm olein markets. Both FPOL and FCPO are expected to firmly place Bursa Malaysia as the global marketplace and benchmark for palm oil derivatives. In addition, the FGLD, which was launched on 7 October 2013, is beginning to attract interest from domestic and international institutions with trading volume of FGLD recording 79,724 contracts for the first seven months of 2014.

Unit trust industry grows steadily

The **unit trust** industry launched five new funds during the first seven months of 2014, bringing the total to 600 funds (end-2013: 6 new funds; 595 funds). Total units in circulation rose 9.5% to 407.4 billion units, while the number of accounts declined 3.2% to 16 million (end-2013: 10.5%, 388.5 billion units; 4.1%, 16.8 million). Meanwhile, the size of the unit trust industry, in terms of total NAV grew 5.7% to RM354.7 billion as at end-July 2014, accounting for 19.9% of market capitalisation on Bursa Malaysia (end-2013: 13.8%; RM335.5 billion; 19.7%). Equity funds were the most preferred funds by investors, with net sales of RM15.9 billion, followed by mixed asset funds at RM0.8 billion for the first seven months of 2014 (January – July 2013: RM16.2 billion; -RM1.5 billion). During the same period, the wholesale funds saw 28 new funds launched, bringing the total number of funds to 221 (end-2013: 22 new funds; 193 funds) and with a higher NAV of RM64.3 billion (end-2013: RM59.5 billion).

From January to July 2014, 12 new global funds were launched for investment in the foreign markets (January – July 2013: 21 new funds). During the period, eight global funds have invested

TABLE 5.9

Unit Trust Industry: Selected Indicators (as at end-period)

	2013	2014 Jul
Number of management companies	38	37
Number of funds launched	595	600
Conventional	417	415
Islamic	178	185
Units in circulation (billion)	389	407
Number of accounts (million)	17	16
Net asset value (NAV) (RM billion)	336	355
Conventional	293	309
Islamic	43	45
Market capitalisation of Bursa Malaysia (%)	19.7	19.9

Note: Total may not add up due to rounding.
Source: Securities Commission Malaysia.

RM0.8 billion in the foreign markets (January – July 2013: 15 funds; RM1.3 billion). Overall, 290 funds have invested in foreign markets with a total investment of RM22.7 billion, representing a foreign exposure of 6.4% of the industry's total NAV (end-2013: 290 funds; RM22.2 billion; 6.6%).

The **real estate investment trusts (REITs) industry** continued to grow during the first seven months of 2014. As at end-July 2014, there was a total of 16 REITs listed on Bursa Malaysia, following the delisting of one REIT on 19 February 2014 (end-2013: 17 REITs). From January to July 2014, trading volume declined 37.2% to 1.1 billion units and trading value also decreased 45% to RM1.4 billion (January – July 2013: 61.1%, 1.7 billion units; 88.7%, RM2.6 billion). As at end-June 2014, market capitalisation increased to RM34.1 billion, while the total NAV stood at RM28.1 billion (end-2013: RM33.1 billion; RM28.6 billion).

As at end-June 2014, the number of **exchange traded funds (ETFs)** listed on Bursa Malaysia increased to six ETFs with the total market

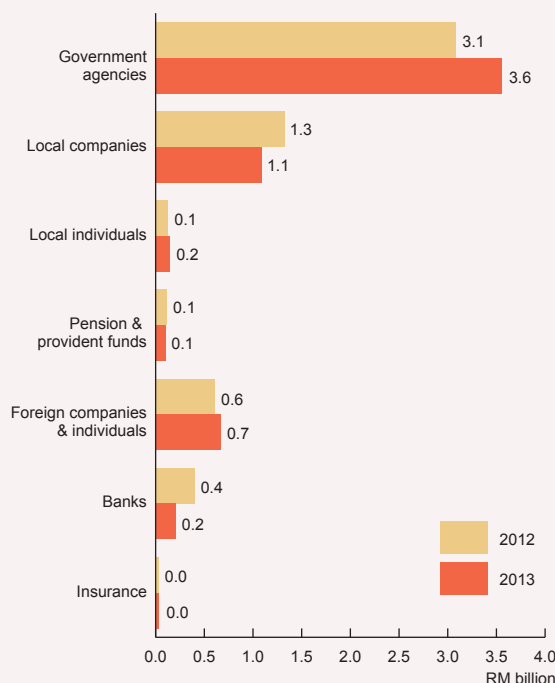
capitalisation almost unchanged at RM1 billion (end-2013: 5 ETFs; RM1 billion). From January to June 2014, the volume transacted decreased 79.3% to 19.3 million units (January – June 2013: 14.5%; 93.4 million units), while the value also declined 79.5% to RM20.9 million (January – June 2013: 22.7%; RM102.3 million).

VC investment improves

The **venture capital (VC)** industry continues to play an important role as a source of financing for emerging high-growth companies. As at end-2013, the total number of registered venture capital companies (VCCs) increased to 61 companies, while the number of venture capital management companies (VCMCs) increased to 58 companies (end-2012: 59 VCCs; 53 VCMCs), of which Islamic VCCs and Islamic VCMCs totalled eight and five, respectively (end-2012: 7 Islamic VCCs; 5 Islamic VCMCs). Total value of VC investment by sector rebounded 24.5% to RM3.4 billion as at end-2013 (end-2012: -23.1%; RM2.8 billion), with information and communication technology (ICT) accounting for 35.2%; life sciences, 31%; manufacturing, 12%; and electricity and power generation, 5.4%. Meanwhile, in terms of VC investment by stages, the bulk of the funds were for bridge/pre-IPO financing (41.3%) and expansion/growth (34.5%). Total committed funds increased 1.7% to RM5.8 billion, with government

CHART 5.13

Source of Venture Capital Funds



Note: Total may not add up due to rounding.
Source: Securities Commission Malaysia.

agencies continuing to be the main source of financing, totalling RM3.6 billion or 61.4% of total funds committed as at end-2013 (end-2012: 4.4%, RM5.7 billion; RM3.1 billion, 54.1%).

Key Capital Market Measures

Several measures were undertaken in the first nine months of 2014 to further enhance liquidity and efficiency in the capital market. These included the following:

- On **2 January**, Bursa Malaysia Berhad (Bursa Malaysia) amended its rules to shorten the timeframe for the issuance of annual reports and other amendments to facilitate compliance by listed issuers for issuance of annual reports.
- On **14 April**, Bursa Malaysia Derivatives Berhad (BMD) amended its rules to revamp the structure for trading participants and associate participants. Consequently, trading participants and associate participants are now able to trade in all classes of contracts, and trading participants are no longer required to hold preference shares "A", "B" and "C".

- On **28 April**, Bursa Malaysia launched the BURSAMKTPLC, a virtual marketplace, which provides comprehensive information and insights of the Malaysian equity market. Retail investors and traders will now have access to big market data and analytical tools.
- On **16 June**, BMD amended its rules by removing the details relating to specified exchanges and position limits and setting them out separately in directives, as well as simplifying the rules relating to contract specifications for products as part of its effort to achieve a balanced regulatory framework, streamlined and consistent rules as well as a shorter time-to-market for the launching of new products.
- On **19 June**, the Securities Commission Malaysia (SC) launched InvestSmart™, a comprehensive investment literacy outreach campaign to enable more confident and informed retail participation in the capital market. InvestSmart™ aims to provide the public, particularly the next generation of investors, with valuable investment information.
- On **27 June**, the SC and the Minority Shareholder Watchdog Group (MSWG) launched the Malaysian Code for Institutional Investors, a code and set of best practices collectively developed by Malaysia's largest institutional investors. The code outlined broad principles of effective stewardship by institutional investors and the adoption of the code's principles by institutional investors demonstrate their intent towards good corporate governance.
- On **30 June**, the SC revised requirements on holders of a Capital Market and Services Licence (CMSL) in respect of the outsourcing processes, services or activities by removing the requirement to obtain the approval of Bursa Malaysia for CMSL holders to enter into material outsourcing arrangements.
- On **22 July**, Bursa Malaysia Securities Berhad introduced the Best Practice Guide in relation to Independent Advice Letters (IALs), which provides practical direction to Independent Advisers in discharging their role in order to improve the quality of the advice given and the standard of disclosure in IALs prepared. It also provides guidance on the quantitative and qualitative evaluation of a corporate proposal, as well as on the information that may improve clarity and quality of their IALs.
- On **28 August**, the SC launched the Sustainable and Responsible Investment (SRI) Sukuk framework to facilitate the financing of sustainable and responsible investment initiatives. The introduction of the framework will facilitate the creation of an ecosystem conducive for SRI investors and issuers. It is also in line with the rising trend of green bonds and social-impact bonds that have been introduced globally to facilitate and promote sustainable and responsible investing. The framework is an extension of the existing sukuk framework and therefore, all the requirements in the Guidelines on Sukuk continue to apply. The additional areas addressed in the framework for the issuance of SRI sukuk include utilisation of proceeds, eligible SRI projects, disclosure requirement, appointment of independent party and reporting requirement.
- On **24 September**, Bank Negara Malaysia (BNM) and the SC have jointly launched the Financial Services Professional Board (FSPB). This industry-led independent board will promote, advocate and facilitate the identification, development and the adoption of professional and ethical standards across all sectors of the financial services industry. Such standards will clearly define the expected level of performance and ethical conduct that financial services professionals are required to achieve in the service of the public.

Islamic Finance Developments

Internationalisation of Islamic finance bearing fruit

Malaysia continues to promote **Islamic finance** actively in the domestic financial market and the international arena with initiatives created to increase and facilitate cross-border Islamic financial transactions with other global financial communities. These initiatives serve to develop the Islamic financial sector through product diversification, enhancement of the Shariah regulatory framework and promoting Islamic wealth management as a new growth area. Efforts were also focused on capacity building and technical training, as well as Shariah research and dialogue. Other significant developments include promotional activities for the rebranded Malaysia Islamic Finance Marketplace, as well as partnerships and collaboration with new Islamic finance jurisdictions such as Hong Kong and Japan.

The establishment of the International Islamic Liquidity Management Corporation (IILM) by nine central banks and monetary authorities⁴ and the Islamic Development Bank in 2010 was a major breakthrough in addressing the global need for short-term liquidity instruments for Islamic financial institutions. After issuing its first 3-month USD490 million sukuk on 29 August 2013, IILM made a second issuance of a 3-month USD860 million sukuk on 23 January 2014. The sukuk was rated A1 by Standard & Poor's. Both papers have since been reissued five times, and IILM's outstanding sukuk now stands at USD1.35 billion.

Given the vast potential of Islamic finance, especially in untapped areas, an Islamic Wealth Management Symposium was held on 30 April 2014 to promote awareness and business matching in Islamic wealth management. The Symposium deliberated on practical issues and challenges in further developing the Islamic wealth management

industry and its structures to gain a competitive advantage in establishing Malaysia as a preferred Islamic wealth management destination.

A policy on "Perbankan Islam" logo was issued on 30 May 2014, which requires Islamic banking institutions (IBIs), including the DFIs to use the logo in all documents and promotional items as well as displaying the logo at branches that only provide Islamic products and services. The requirement to display the logo would provide visibility and promote awareness on the availability of Islamic financial products and services at the branches.

On the international front, Malaysia continued to provide assistance to new Islamic finance jurisdictions such as Hong Kong and Japan to establish an enabling environment for Islamic finance. BNM and the Hong Kong Monetary Authority (HKMA) jointly organised a Joint Conference on Islamic Finance in Hong Kong to raise the level of interest and appreciation of sukuk as a viable financing and investment instrument among Hong Kong's business and financial community. This marked a significant step towards deepening Hong Kong-Malaysia Islamic financial linkages, which may be expanded to include the sharing of sukuk market expertise as well as legal and Shariah advisory. Other potential areas of collaboration may include sukuk dual-listing, leveraging Malaysia's Shariah governance framework and arbitration platform, and human capital development. During the conference, HKMA announced Hong Kong's plan to issue its first sovereign sukuk with a major domestic banking group mandated as a joint lead arranger.

Malaysian regulators also participated in the Securities and Futures Commission, Hong Kong (SFC) and SC Joint Seminar on Islamic Funds in Hong Kong. The Seminar paved the way for Malaysian fund managers to launch the first SFC- authorised Islamic regional balanced fund in Hong

⁴ Indonesia, Kuwait, Luxembourg, Malaysia, Mauritius, Nigeria, Qatar, Turkey and the United Arab Emirates.

Kong under the Mutual Recognition Agreement between SFC and SC. This development is hoped to spur other fund managers to launch more Islamic funds in both markets, which will provide the necessary demand for Islamic equities and sukuk.

In April 2014, the Joint Working Group on Financial Cooperation between Malaysia and Japan organised an Islamic Finance Workshop in Tokyo, Japan. The workshop, which targeted potential Japanese sukuk issuers and investors, focused on practical issues and challenges on sukuk issuance and investment in both countries. Discussions by participants from both countries also provided clarity on the Malaysian legal infrastructure and tax treatment required for Islamic finance to succeed. The Japanese regulators also agreed to draft an action plan for Japanese financial institutions to issue and invest in sukuk, clearly stating their commitment towards the long-term development of Islamic finance in Japan.

Malaysia maintains the lead in Islamic capital market

The **Islamic capital market** continues to strengthen by actively promoting and creating a vibrant sukuk market through the provision of supportive banking and capital market legislations. The country also has a large base of domestic institutional investors, namely pension funds, banks and insurance companies to sustain growth of the sukuk market. As at end-July 2014, 664 Shariah-compliant securities were listed on Bursa Malaysia, representing 73.2% of total listed securities with RM1,084.5 billion of total market capitalisation (end-2013: 650 securities; 71.4%; RM1,029.6 billion). In the first seven months of 2014, the trading volume of Shariah-compliant securities increased to 205 billion units, valued at RM199.8 billion (January – July 2013: 165.6 billion units; RM199.2 billion). The domestic sukuk market has grown rapidly and Malaysia continued to maintain its position as the largest sukuk issuer in the world, accounting for 57.3%

or USD161 billion of the global sukuk outstanding and 63% or USD41.7 billion of sukuk issuances in the first six months of 2014. Meanwhile, Bursa Malaysia continued to retain its leadership position as the premier sukuk listing destination for the fifth consecutive year, with 21 programmes undertaken by 18 issuers and valued at USD37.8 billion (end-2013: 20 programmes; 18 issuers; USD32.9 billion).

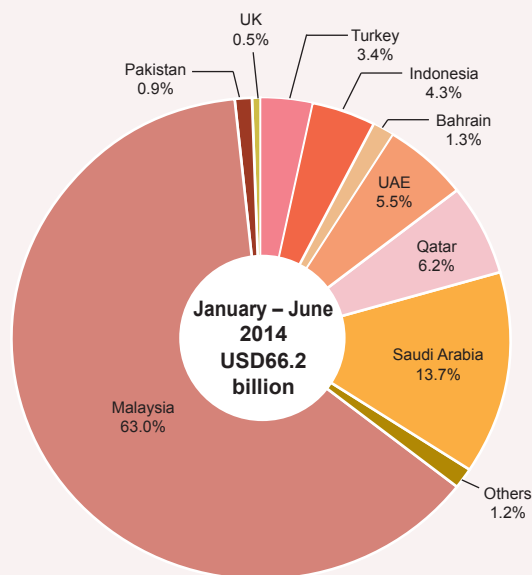
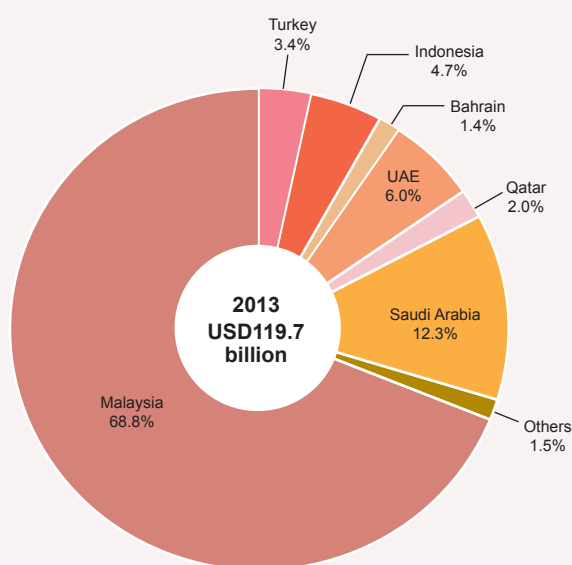
Similarly, Bursa Suq Al-Sila' (BSAS), the world's first multi-commodity and multi-currency Shariah-compliant platform, continued to grow with the number of BSAS participants increasing to 85 (end-2013: 77 BSAS participants), comprising 64 commodity trading participants and 17 foreign participants as at end-July 2014. During the first seven months of 2014, trading revenue rebounded 28% to RM3.8 billion (January-July 2013: -18.9%; RM2.9 billion) with RM386 billion commodities offered and RM756.6 billion traded (January-July 2013: RM279.5 billion; RM507.9 billion).

Malaysia continued to be a significant player in the Islamic fund management industry. As at 17 June 2014, Malaysia continues to account for approximately 25% of Islamic assets under management (AUM) globally. On the domestic front, Islamic AUM accounted for approximately 16.9% of the industry's total AUM as at end-June 2014. During the first seven months of 2014, fund management companies remained at 19, while seven additional Islamic unit trust funds and 13 Islamic wholesale funds were launched, bringing the total to 185 and 65 funds, respectively (end-2013: 19 funds; 178 Islamic unit trust funds; 52 Islamic wholesale funds). As at end-July 2014, the total NAV of Islamic unit trust funds stood at RM45.4 billion and the Islamic wholesale funds at RM17.5 billion (end-2013: RM42.8 billion; RM16.4 billion). Following the delisting of one REIT on 19 February 2014, the remaining three REITs had a market capitalisation of RM14.3 billion as at end-June 2014 (end-2013: 4 REITs; RM14.1 billion). Meanwhile, the market capitalisation of two Islamic ETFs increased from RM304 million to RM325 million as at end-June 2014.

CHART 5.14

New Sukuk Issuances by Country

(% share)



Note: Total may not add up due to rounding.

Source: Securities Commission Malaysia.

As part of the efforts to widen the international base of the Islamic capital market, a revised Shariah screening methodology for listed equities was implemented in November 2013. The screening methodology is expected to further increase the attractiveness of Malaysia's Islamic equity and fund management segments as well as harmonise the standards to global expectation. During the first seven months of 2014, two new Shariah advisers were approved for registration by the SC to provide Shariah advisory on Islamic capital market products and services. As at end-July 2014, the number of Shariah advisers approved and registered with the SC stood at 72, comprising 52 individuals and 20 corporations (end-2013: 74 advisers; 55 individuals; 19 corporations).

On 10 February 2014, Bursa Malaysia and the Saudi Stock Exchange (Tadawul) entered into a Memorandum of Understanding (MoU) to

formalise a collaboration aimed at enhancing financial and economic linkages between Malaysia and Saudi Arabia in the domain of Islamic capital markets. The MoU enables both exchanges to share knowledge and expertise while opening doors for skills development and future cross-border opportunities. Among others, the MoU aims to pursue various areas of cooperation, including product development, cross-listing, market data exchange, index creation, corporate governance and other market-led activities. The partnership is expected to provide new dimensions to the Islamic market and greater internationalisation of Islamic finance.

The Export-Import Bank of Malaysia Berhad (MEXIM) issued its inaugural USD300 million 5-year sukuk wakala in February 2014. Being the world's first export-import bank to issue USD sukuk, it received overwhelming response from investors globally and was oversubscribed

more than 10 times. The issue was accorded credit rating which are on par with Malaysian sovereign ratings.

In May, Malaysia's largest takaful operator issued a RM300 million 10-year sukuk musharaka. This is the world's first takaful sukuk. Proceeds from the sukuk are used to fund general business operations and working capital.

Following the launch of the USD500 million multi-currency sukuk programme in June 2014, BTMU successfully issued the world's first yen-denominated sukuk in September. It is also the first Japanese commercial bank to issue Islamic bond, the funds raised from this JPY2.5 billion 1-year sukuk wakala, will be used mainly to grow BTMU's Islamic business in Malaysia and Saudi Arabia.

Steady growth in Islamic banking

The **Islamic banking** industry has shown significant growth over the last five years, with assets almost doubling from RM303.2 billion as at-end 2009 to RM558.2 billion as at end-2013. As at end-July 2014, total assets of the Islamic banking system (including DFIs) grew 9.7% to RM580.8 billion (end-2013: 14.1%; RM558.2 billion). Likewise, total deposits of the Islamic banking system rose 13% to RM458.9 billion as at end-July 2014 (end-2013: 13%; RM436.3 billion). During the same period, total financing of the Islamic banking system grew 16.1% to RM399.1 billion (end-2013: 18%; RM371.6 billion). The strong growth of the Islamic banking system has also resulted in a higher market share of Islamic banking assets (including DFIs), which reached 25.1% of total banking system assets as at end-July 2014 (end-2013: 24.9%).

As at end-July 2014, the household sector continued to account for the bulk of Islamic financing at 64.8% or RM258.8 billion (end-2013: 64.8%; RM240.9 billion). This was followed by the finance, insurance and business activities

TABLE 5.10

Islamic Banking¹: Key Indicators (as at end-period)

	RM billion		Change (%)	
	2013	2014 Jul	2013	2014 Jul
Assets	558.2	580.8	14.1	9.7
Deposits	436.3	458.9	13.0	13.0
of which:				
Investment	190.7	192.8	10.2	4.8
Savings	35.5	37.6	8.6	8.5
Demand	60.8	62.8	9.6	16.8
Others	150.0	165.7	19.6	23.9
Financing	371.6	399.1	18.0	16.1
of which:				
Manufacturing	17.3	19.4	2.1	12.7
Construction	16.5	18.8	13.3	26.6
Finance, insurance and business activities	23.9	23.6	58.8	43.2
Education, health and others	18.2	17.2	26.2	5.7
Households	240.9	258.8	16.9	13.6

¹ Includes development financial institutions (DFIs).

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

sector with 5.9% or RM23.6 billion (end-2013: 6.4%; RM23.9 billion) and the manufacturing sector with 4.9% or RM19.4 billion (end-2013: 4.7%; RM17.3 billion).

Potential for takaful industry to expand

Total **takaful industry** assets stood at RM22.2 billion, accounting for 9.3% of total insurance and takaful sector assets as at end-July 2014 (end-2013: 9%; RM20.9 billion). The takaful industry recorded higher profitability despite lower net contributions during the corresponding period. Meanwhile, capitalisation of takaful industry remains sound at 190.8%.

Meanwhile, the excess of income over outgo for the **family takaful** business remained stable at RM1.5 billion (January – July 2013: RM1.5 billion) attributed to the combination of lower net contributions and net certificate benefits of RM1.1 billion (January – July 2013: RM1.2 billion). During the first seven months of 2014, the net contributions declined by 10.9% to RM2.7 billion (January – July 2013: 15.3%; RM3 billion). The decrease in the net contributions was mainly from reduction in income from Mortgage Reducing Term Takaful (MRTT), which constitutes 56.5% of total new business contributions. However, the takaful industry posted net capital gain of RM32.4 million during the same period (January – July 2013: -RM49.5 million). The market penetration rate of takaful also improved slightly to 14.2% as at end-July 2014 (end-2013: 13.9%).

The **general takaful** business continued to grow in the first seven months of 2014, with gross contributions increasing 13.2% to RM1.3 billion

(January – July 2013: 10%; RM1.1 billion). Growth was mainly supported by the motor business, which accounted for 58% of total general takaful business. Total industry claims ratio improved to 48.6% (end-2013: 53.6%), mainly contributed by the reduction in fire claims. Meanwhile, the operating profit for general takaful business increased to RM203.9 million in the first seven months of 2014 (January – July 2013: RM186.5 million).

In tandem with the implementation of the Risk-based Capital Framework for Takaful Operators effective from 1 January 2014, industry players have enhanced business strategies to better align capital positions to suit the risk profile of business operations. Initiatives undertaken include the restructuring of investment strategies and product offerings, further strengthening the capital positions and enhancing underwriting

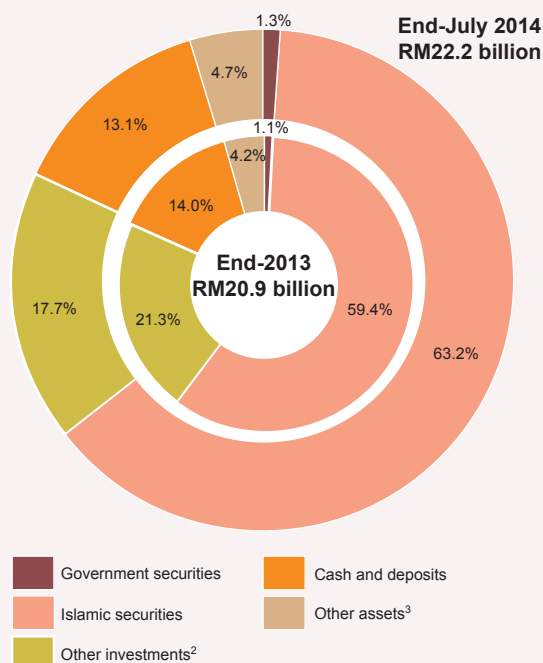
TABLE 5.11

Family and General Takaful Business

	2013	2014 Jan – Jul
Family Takaful (RM million)		
New business		
Total contributions	3,563.5	2,008.3
Sums covered	245,563.6	114,644.7
Number of certificates (units)	836,836	355,207
Business in force		
Annual contributions	2,655.5	2,835.2
Sums covered	494,083.6	549,130.8
Number of certificates (units)	4,171,066	4,280,710
General Takaful (RM million)		
Gross direct contributions	1,908.8	1,301.4
Net contributions	1,400.5	928.4

Source: Bank Negara Malaysia.

CHART 5.15

Assets of Takaful Funds¹
(% share)¹ Assets of family and general takaful funds.² Other investment = Investment properties + others.³ Other assets = Fixed assets + financing + foreign assets + others.

Source: Bank Negara Malaysia.

capacity. As a result, some takaful operators have directly injected additional capital, and in certain cases, plan to raise capital through sukuk issuance.

Prospects for 2015

Global growth, which is picking up in the second half of 2014, is expected to strengthen further in 2015. While recovery in the advanced economies is gaining momentum, albeit at an uneven pace, the emerging and developing economies are projected to continue to drive global growth in 2015. Growth in the Malaysian economy is expected to remain steady at between 5% – 6%, underpinned by resilient domestic demand and higher exports. However, the spillover and contagion effects from the continued monetary policy normalisation in the US may still impact emerging and developing economies. In this regard, a more resilient domestic financial system

following the decade of reforms, will be able to moderate the impact, while continuing to support the expanding economic activities.

Efforts will continue to focus on the development of a progressive, sustainable and inclusive financial sector to support the country's transformation towards a high value-added and high-income economy by 2020. As guided by the Financial Sector Blueprint, this will include further increasing the capacity of financial institutions and financial markets to provide value-enhancing products and services; developing a comprehensive regulatory framework to facilitate greater diversification of Islamic banking businesses and products; operationalising the Financial Services Talent Council to ensure that the financial sector has a sustainable pool of high-quality talent to meet its future needs; and further strengthening Malaysia's regional and international financial linkages through, among others, operationalising the ABIF.