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MONETARY AND FINANCIAL DEVELOPMENTS

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5 | MONETARY AND FINANCIAL DEVELOPMENTS

Overview

Financial sector withstands external headwinds

Monetary conditions remained accommodative and supportive of economic activity with resilient financial system and sufficient liquidity despite heightening external uncertainties. The expectation of interest rate increase by the United States (US) Federal Reserve (Fed) and China's economic slowdown has raised investors' concern on the stability of the domestic financial system. Over the years, the Government has taken several initiatives to strengthen the banking system as well as the domestic capital market which includes the development of the Financial Sector Blueprint 2011-2020 and the Capital Market Masterplan 2. In addition, effective from 1 February 2016, Bank Negara Malaysia (BNM) reduced the Statutory Reserve Requirement (SRR) ratio by 50 basis points to 3.50% to ensure sufficient liquidity in the domestic financial system and to support the orderly functioning of the domestic financial markets. Furthermore, on 13 July 2016, the Overnight Policy Rate (OPR) was reduced by 25 basis points to 3.00% to ensure the domestic economy continues on a steady growth path. This is in line with the monetary policy stance to achieve price stability and sustainable growth. The Government's economic policy has contributed to the gross domestic product (GDP) growth of 4.1% for the first half of 2016. In addition, average inflation for the first eight months recorded 2.3%. Meanwhile, the ringgit appreciated against most major and regional currencies in the first eight months of 2016. To ensure that the domestic financial system is fully integrated with the global financial market, BNM also established the Financial Markets Committee (FMC) in May 2016. The committee aims to broaden industry engagement with a focus in reviewing and formulating comprehensive strategies for the financial markets.

The capital market has continued to support the financing needs of the Malaysian economy. Fundraising in the capital market was sustained in 2016, supported by higher corporate bond issuances. Domestic financial asset prices continued to be affected by external developments and movements in global capital flows. Nevertheless, Malaysia's deep and diversified capital market has been able to accommodate the shifts in global liquidity and withstand bouts of volatility. In 2015, the bond market was the third largest market in Asia, after Japan and Republic of Korea with the size of RM1.2 trillion, equivalent to 97% of GDP. Malaysia leads in global sukuk, accounting for 53.4% or USD180 billion of the global sukuk outstanding as at end-June 2016. The success of the Government's

fifth USD-denominated global sukuk issuance in April 2016 proved investors' continued confidence in Malaysia's economic stability.

Financial institutions are operating with adequate liquidity buffers to ensure the orderly functioning of domestic financial markets. Efforts are also underway to further leverage technology in facilitating business transactions to be processed quickly and conveniently through the use of online applications or smart devices. Given these developments, the well-capitalised banking system and deep capital market will continue to integrate with regional and international financial markets. This will provide ample liquidity and efficient financial intermediation to meet the needs of the economy.

Monetary Developments

Monetary Policy

Monetary policy ensures steady growth

Following a moderate growth in the global economy, the **monetary policy** in 2016 is focused on ensuring steady expansion of the domestic economy. In the first six months of 2016, the Malaysian economy grew 4.1% (January – June 2015: 5.3%) with inflation averaging at 2.7%. In the efforts to ensure sufficient liquidity in the domestic financial system and to support the orderly functioning of the domestic financial markets, the SRR was reduced from 4.00% to 3.50% effective on 1 February 2016. The OPR, which was held unchanged since July 2014, was also reduced by 25 basis points to 3.00% on 13 July 2016. The adjustment to the OPR was intended to ensure that the domestic economy continues on a steady growth path amid stable inflation, supported by continued healthy financial intermediation in the economy. Overall, the accommodative monetary policy will enable the economy to remain on track.

Interest rates revised downward

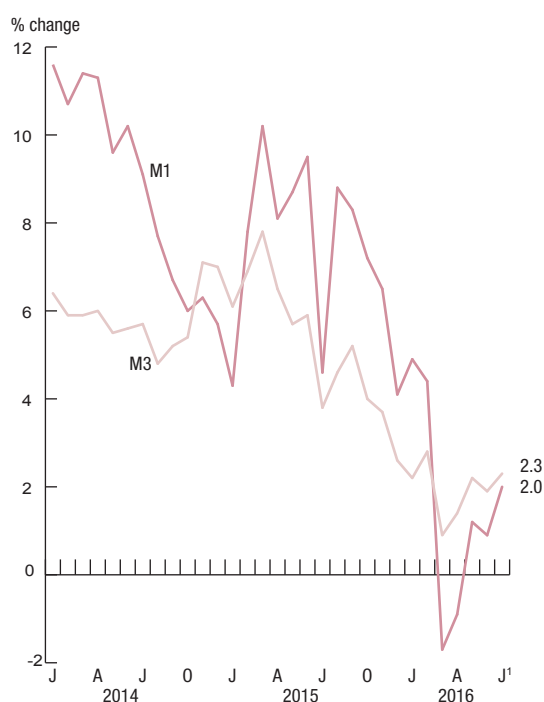
Interest rates in the banking system were revised downward following the OPR adjustment in July 2016. Consequently, the weighted base rate (BR) of commercial banks was lowered to 3.62% as at end-July 2016 (end-2015: 3.77%). Similarly, the weighted average lending rate (ALR) and interest rate on savings deposit of commercial banks decreased by nine basis points to 5.31% and six basis points to 0.98%, respectively (end-2015: 5.40%; 1.04%). Meanwhile, the interest rate on fixed deposits of 1-month to 12-month maturities eased with the rates ranging between 2.90% and 3.06% (end-2015: 3.08% and 3.31%) following the OPR cut. As inflation subdued, the real rates of return for all fixed deposit tenures remained favourable.

Monetary aggregates expand at a slower pace

Monetary aggregates expanded at a slower pace during the first seven months of 2016. M1 or narrow money grew 2% to RM354.2 billion as at end-July 2016 (end-2015: 4.1%; RM360.5 billion). Likewise, M3 or broad money continued to expand at a slower rate of 2.3% to RM1,597.8 billion as at end-July 2016 (end-2015: 2.6%; RM1,594.6 billion). The moderation in growth was

CHART 5.1

Monetary Aggregates



¹ End-July 2016.
Source: Bank Negara Malaysia.

TABLE 5.1

Factors Affecting M3 January – July

	Change (RM billion)	
	2015	2016
M3	7.5	3.2
Net claims on Government	-23.7	-4.4
Claims on private sector	60.4	37.4
Loans	54.5	30.0
Securities	5.8	7.4
Net foreign assets	-21.5	-14.9
Bank Negara Malaysia ¹	-42.5	-17.6
Banking system	21.0	2.7
Other influences	-7.6	-14.9

¹ Includes exchange rate revaluation loss/ gain.

Notes:

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

b. Total may not add up due to rounding.

Source: Bank Negara Malaysia.

mainly influenced by the continued issuance of equity by banks and the reclassification of Islamic Investment Accounts which took place in July 2015. The M3 was also weighed down by large outflow of portfolio funds, specifically through greater diversification of investments by domestic institutional investors as well as the narrowing of the current account surplus. During the period, net foreign assets recorded a decline, largely reflecting foreign exchange revaluation effects arising from the strengthening of the ringgit against major currencies.

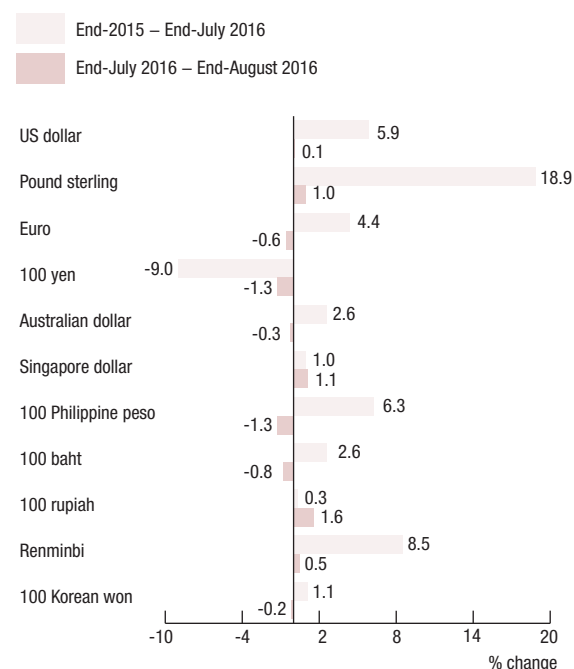
The ringgit strengthens

The **ringgit** advanced against most major and regional currencies during the period of January to July 2016. The ringgit appreciated 5.9% against the US dollar, the pound sterling (18.9%), the euro (4.4%) and the Australian dollar (2.6%), but depreciated 9% against the yen. At the same time, the ringgit advanced against all regional currencies within the range of 1% and 8.5%. The appreciation of the ringgit against the US dollar was driven by expectations of a delay in the next US interest rate increase following uncertainties in the global growth outlook. Furthermore, the improving global crude oil prices since January 2016 provided support for the currencies of commodity-exporting countries, including the ringgit.

However, the ringgit showed a mixed performance in August. The ringgit appreciated against the US dollar by 0.1% and the pound sterling by 1%, but eased against

CHART 5.2

Performance of Ringgit Against Selected Currencies



Source: Bank Negara Malaysia.

the yen and the euro by 1.3% and 0.6%, respectively. The appreciation of the ringgit against the US dollar was supported by further improvements in global crude oil prices which led to portfolio inflows. Towards the end of the month, however, the ringgit eased due to influx of outflows from regional markets following investors' anticipation of the US interest rates hike in September 2016.

Financial Sector Developments

Banking System Performance

Sustained demand for financing

During the first seven months of 2016, credit growth in the banking system remained moderate, consistent with the pace of domestic economic activity. Total **loan applications** recorded marginal increase to RM461.5 billion (January – July 2015: RM461.4 billion). However, total **loan approvals** and **loan disbursements** by the banking system declined significantly by 16% to RM192.6 billion and 3.1% to RM598.5 billion, respectively (January – July 2015: 3.1%; RM229.4 billion; 2.8%; RM617.8 billion). Meanwhile, total **loans outstanding** grew 5.1% to RM1,467.3 billion as at end-July 2016 (end-2015: 7.9%; RM1,445.1 billion).

TABLE 5.2

Banking System: Loan Indicators January – July

	RM billion		% Change	
	2015	2016	2015	2016
Total¹				
Loan applications	461.4	461.5	-0.3	0.0
Loan approvals	229.4	192.6	3.1	-16.0
Loan disbursements	617.8	598.5	2.8	-3.1
Loans outstanding ²	1,395.7	1,467.3	9.6	5.1
of which:				
Business				
Loan applications	213.2	219.3	1.2	2.9
Loan approvals	102.2	92.0	23.9	-10.0
Loan disbursements	441.1	436.0	3.9	-1.2
Loans outstanding ²	513.6	532.6	9.9	3.7
of which:				
SMEs				
Loan applications	111.0	101.5	5.6	-8.6
Loan approvals	38.4	36.3	3.8	-5.3
Loan disbursements	152.1	145.4	15.1	-4.4
Loans outstanding ²	247.6	270.4	16.4	9.2
Households				
Loan applications	248.2	242.1	-1.5	-2.4
Loan approvals	127.2	100.6	-9.1	-20.9
Loan disbursements	176.7	162.5	0.0	-8.0
Loans outstanding ²	795.7	841.4	8.6	5.7

¹ Include 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.

Lending to businesses grew marginally during the first seven months of 2016. Loan applications for business sector expanded 2.9% to RM219.3 billion (January – July 2015: 1.2%; RM213.2 billion), while loan approvals dropped 10% to RM92 billion (January – July 2015: 23.9%; RM102.2 billion). Meanwhile, loan disbursements to businesses declined 1.2% to RM436 billion (January – July 2015: 3.9%; RM441.1 billion). The business sector accounted for a significant share of total loans disbursed at 72.8%, mainly channelled to manufacturing (19.1%), wholesale and retail trade, restaurants and hotels (18.7%) as well as finance, insurance and business activities (10.1%) sectors. Total loans outstanding to the business sector increased 3.7% to RM532.6 billion as at end-July 2016 (end-2015: 8%; RM533 billion).

TABLE 5.3

Loans Outstanding by Sector (as at end-period)

	RM billion		% Share	
	2015	2016 July	2015	2016 July
Business	533.0	532.6	36.9	36.3
Large corporations ¹	273.3	262.2	18.9	17.9
SMEs	259.7	270.4	18.0	18.4
<u>Selected sectors</u>				
Primary agriculture	37.6	36.7	2.6	2.5
Mining and quarrying	14.0	12.3	1.0	0.8
Manufacturing	102.3	98.4	7.1	6.7
Electricity, gas and water supply	11.5	9.2	0.8	0.6
Wholesale and retail trade, restaurants and hotels	106.7	107.5	7.4	7.3
Construction	62.8	64.7	4.3	4.4
Real estate	97.9	103.8	6.8	7.1
Transport, storage and communication	34.3	33.6	2.4	2.3
Finance, insurance and business activities	99.9	102.2	6.9	7.0
Households²	820.9	841.4	56.8	57.3
of which:				
Purchase of residential properties ³	411.5	433.8	28.5	29.6
Purchase of non-residential properties ³	77.8	79.5	5.4	5.4
Purchase of passenger cars ³	146.5	145.1	10.1	9.9
Consumption credit ^{3,4}	98.9	99.2	6.8	6.8
of which:				
Credit cards ³	35.5	34.7	2.5	2.4
Personal use ³	63.3	64.4	4.4	4.4
Other sectors	91.2	93.3	6.3	6.4
Total⁵	1,445.1	1,467.3	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.

Financing to small and medium enterprises (SMEs) recorded a decline in applications, approvals and disbursements at 8.6%, 5.3% and 4.4%, respectively (January – July 2015: 5.6%; 3.8%; 15.1%). However, total SME loans outstanding grew 9.2% to RM270.4 billion, accounting for 36.3% of the total loans to businesses as at end-July 2016 (end-2015: 15%; RM259.7 billion; 36.9%). The bulk of the loans to SMEs were mainly channelled to the finance, insurance and business activities (30.7%), wholesale and retail trade, restaurants and hotels (24.6%) as well as manufacturing (15%) sectors.

BNM also provides financing at reasonable rates for SMEs through **special revolving funds**¹. Loans were approved to 69,274 SMEs amounting to RM28.6 billion (end-July 2015: 65,610 SMEs; RM26.7 billion) with the average utilisation rate stood at 76.2% as at end-July 2016 (end-July 2015: 69.8%). Loan approvals were granted to 3,256 SMEs amounting to RM1.3 billion for the first seven months of 2016 (January – July 2015: 4,363 SMEs; RM1.4 billion).

Microenterprises continued to receive financial support through Pembiayaan Mikro Scheme. During the first seven months of 2016, a total of 9,660 microenterprise loans amounting to RM213 million were approved (January – July 2015: 10,169 accounts; RM203.9 million). Total loans outstanding under the scheme grew 6.2% to RM940.8 million as at end-July 2016 (end-2015: 5.7%; RM912.5 million). Bank Simpanan Nasional (BSN), Agrobank and Bank Rakyat remained as the main financial institutions in providing support to **microfinance** activities, accounting for 84.8% or RM797.5 million of total loans outstanding as at end-July 2016 (end-2015: 86.1%; RM786 million). During the first seven months of 2016, a total of 7,388 accounts amounting to RM169.1 million was approved by these banks (January – July 2015: 8,371 accounts; RM174.2 million).

Household loans continued to moderate with loan applications declining 2.4% to RM242.1 billion during the first seven months of 2016 (end-2015: -1.3%; RM430.4 billion). Loan approvals and disbursements also decreased 20.9% and 8%, respectively (end-2015: -11.6%; -1%). In terms of share, loans disbursed to the household sector were mainly utilised for consumption credit, totalling RM76.6 billion or 12.8% (end-2015: RM132.1 billion; 12.1%), followed by the purchase of residential properties at RM44.7 billion or 7.5% of total household disbursements during the same period (end-2015: RM84.7 billion; 7.8%). Total household loans outstanding grew 5.7% to RM841.4 billion and accounted for 57.3% of total loans outstanding in the banking system as at end-July 2016 (end-2015: 7.7%; RM820.9 billion; 56.8%).

Total household debt² continued to register a moderate growth. As at end-July 2016, total household debt grew to RM1,059.2 billion, an increase of 5.9% (end-July 2015: RM999.8 billion; 8.1%), which accounted for 89.1% of

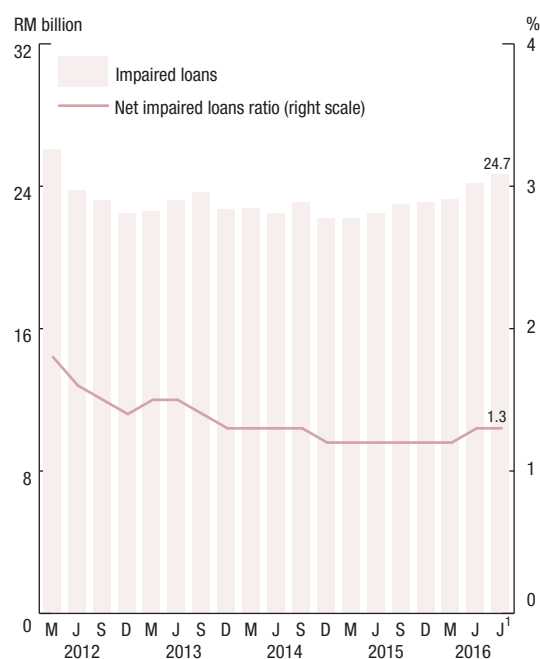
GDP (end-July 2015: 88.1%). On an aggregate level, household balance sheet remained healthy. A large portion of the household debt comprised of asset-backed loans. As at end-July 2016, households continued to accumulate more financial assets than debt. Household financial assets grew RM45.3 billion, compared with an increase of RM28.6 billion in household debt. However, higher cost of living has made households to be cautious in taking on new debt. As a proactive measure to assist borrowers in financial difficulties, Credit Counseling and Management Agency (AKPK) continues to provide financial advisory through counselling, debt restructuring services as well as financial education.

Banking system remains strong

The **banking system** remained resilient supported by strong capital position. As at end-July 2016, the common equity tier 1 (CET1) capital ratio, tier 1 capital ratio and total capital ratio stood at 13.3%, 14.3% and 16.9%, respectively (end-July 2015: 12.7%; 13.5%; 15.6%). Approximately 80% of banks' total capital consists of high quality capital in the form of retained earnings, paid-up capital and reserves. Total capital buffers in excess of minimum regulatory requirement were sustained at above RM128 billion (end-July 2015: RM106 billion). The liquidity in the banking system was enhanced through the reduction in the SRR on 1 February 2016, which released about RM8 billion into the banking system. The Liquidity Coverage Ratio (LCR), one of the

CHART 5.3

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



¹ End-July 2016.
Source: Bank Negara Malaysia.

¹ Special revolving funds (SRF) consists of the Fund for Food which 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). SRF was established in January 2015 to assist businesses that were affected by floods and closed for new applications on 30 June 2015.

² Comprising loans mainly provided by the banking system, DFIs and Public Sector Home Financing Board (LPPSA).

liquidity requirement introduced under Basel III stood at 124.7% as at end-July 2016 (end-2015: 130%) to ensure all banks are more robust. Currently, all banks reported having levels comfortably above the current minimum regulatory requirement of 70%. The minimum requirement will be progressively increased 10% each year to reach 100% beginning 1 January 2019 through phased transitioning.

The overall quality of banking system loans remains sound as reflected by the stable delinquency and impairment levels. As at end-July 2016, delinquency and net impairment ratios were at 2.2% and 1.3%, respectively (end-July 2015: 2.3%; 1.2%). Banks continued to maintain sufficient buffers for potential credit losses evidenced by loan loss coverage ratio of 88.7%. Earnings remained resilient with pre-tax profit of RM19 billion for the first seven months

of 2016 (January – July 2015: RM17 billion), mainly driven by income from financing activities supported by steady growth of income from fee-based, trading and investment activities.

In line with the aspiration of the Financial Sector Blueprint 2011-2020, Malaysia's financial sector has progressively become more integrated and diversified with regional and international financial markets. Malaysia's banking sector continues to have significant presence of foreign banks, accounting for 21.8% of banking sector assets as at end-July 2016. Currently, there are 28 locally incorporated foreign banks operating in Malaysia from a total of 57 banking institutions, which include commercial banks, investment banks and Islamic banks. Following the launching of the ASEAN Banking Integration Framework (ABIF) in 2015,

Info Box 1

An Update on Credit Counselling and Debt Management Agency

Introduction

The Credit Counselling and Debt Management Agency or commonly known as Agensi Kaunseling dan Pengurusan Kredit (AKPK), a wholly-owned subsidiary of Bank Negara Malaysia, was established in April 2006. AKPK provides an avenue for individuals to seek advice and assistance in managing their finances and debts. AKPK offers free services, including financial education on the prudent use of credit card and basic money management skills; counselling and advice on financial management, including financial budgeting to manage expenses; and Debt Management Programme (DMP) to assist financially distressed consumers in managing their finances. Since its inception, AKPK has made significant progress, especially with the expansion of its outreach programmes through state branches¹ to make its services available to a wider segment of the population.

Debt Management Programme

DMP assists borrowers to restructure their financial liabilities to help them meet their loan obligations and living expenses, thereby minimising non-performing loans and foreclosure of houses. As at end-July 2016, 460,031 individuals attended AKPK's counselling services, of which 156,892 individuals had enrolled in the DMP. In most cases, the factors contributing to their inability to repay their debts, include poor financial planning, ignorance and lack of financial discipline. Financial difficulties could also be triggered by unanticipated or change in circumstances such as health problems, the death of the breadwinner, loss of employment and business failure. As of 31 July 2016, 10,704 DMP participants successfully completed the programme. The success rate is expected to continue as more participants will benefit from the restructuring of their financial commitments.

TABLE 1

Cumulative Number of Counselling and DMP Enrolment 2007 – 2016

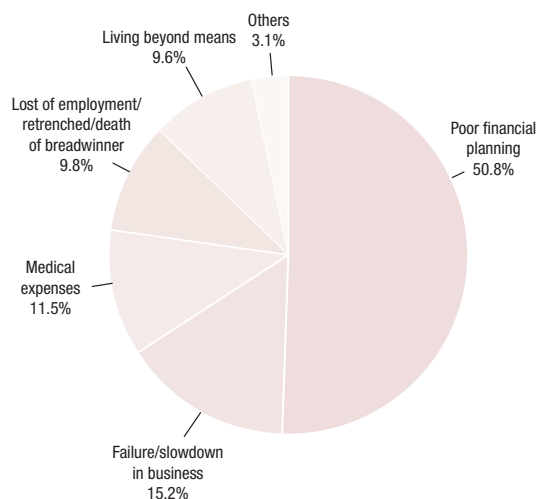
Year	Counselling	Debt Management Programme Enrolment	
	No. of Participants	No. of Participants	% Share of Total Counselling Cases
2007	32,157	8,172	25.4
2008	73,604	19,810	26.9
2009	110,452	35,647	32.3
2010	140,462	51,181	36.4
2011	172,172	67,992	39.5
2012	207,997	84,102	40.4
2013	248,491	100,871	40.6
2014	309,663	121,495	39.2
2015	394,327	143,703	36.4
2016 ¹	460,031	156,892	34.1

¹ End-July 2016.

Source: Credit Counselling and Debt Management Agency.

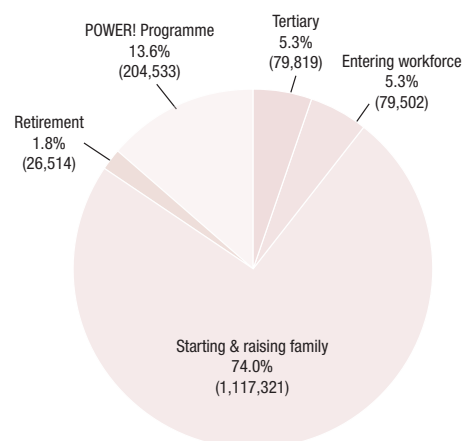
¹ Alor Setar, Ipoh, Johor Bahru, Kota Bharu, Kota Kinabalu, Kuala Terengganu, Kuantan, Kuching, Malacca and Penang.

CHART 1

Reasons for Default¹¹End-July 2016.

Source: Credit Counselling and Debt Management Agency.

CHART 2

Number of Participants of the Financial Education Programme¹¹End-July 2016.

Source: Credit Counselling and Debt Management Agency.

Financial Education Programme

Given the uncertainties in the global economic environment, it is imperative for Malaysians, particularly the vulnerable and low-income group to enhance their financial literacy. As such, increasing consumers' financial literacy enhances their appreciation for the need to save, which serves as the basis for wealth accumulation, preparedness for financial uncertainties and a comfortable retirement. In this respect, AKPK's consumer education programmes aim to nurture financially astute borrowers and at the same time promote good payment and repayment culture. The programme includes:

- ad-hoc tailor-made talks and briefings to various targeted groups;
- personal financial management education, which mainly targets university students; and
- POWER! Programme, which is designed to equip individuals with essential financial knowledge and ability to make responsible financial decisions.

The Financial Education Programme (FEP) modules comprise 10 topics which are commonly related to debt issues. The topics are cash flow, basic borrowing, debt management, risk management, investment, retirement planning, e-payment, credit card as well as buying cars and houses. From 2006 until 2014, the FEP was designed for various target groups such as retirees, students from higher learning institutions, newly employed individuals and newly married couples. However, beginning 2014, AKPK introduced the POWER! Programme, which encompasses all 10 topics into a single module.

Conclusion

AKPK is an important platform to enable rakyat to enhance their knowledge on prudent financial management. Moving forward, it is important for the rakyat to be aware on the need to manage their finances wisely and prudently. Meanwhile, the Government needs to intensify efforts to enhance financial literacy, especially among the younger generation to create a financially savvy society.

additional Heads of Agreement (HoA)³ was signed in March 2016 to outline the areas on market access and operational flexibilities that may be accorded to Qualified ASEAN Banks (QABs) in the respective jurisdictions.

Malaysia's continuous improvement on the regulatory framework of the financial sector has created a more transparent and predictable environment for financial players to benefit from higher connectivity and digital technology. Financial institutions have been applying technological innovations in their products and services to increase efficiency, offer higher quality of service and enhance ease of doing business. The emergence of financial technology (fintech) solutions, typically developed by startup companies, is providing alternative avenues to incumbent financial institutions that are traditionally less reliant on technology to improve their financial intermediation function. BNM is enhancing its regulatory framework with the introduction of Regulatory Sandbox (Sandbox) to facilitate the development of innovative fintech solutions. Under the Sandbox, financial institutions and fintech companies may be granted certain regulatory flexibilities to experiment the innovative solutions in a production or live environment with stipulated conditions to preserve financial stability and to protect consumers.

DFIs continue to support strategic sectors

The Development Financial Institutions (Amendment) Act 2015⁴ came into effect on 31 January 2016 to further strengthen the capacity and capability of **development financial institutions (DFIs)**. The amendments also aspire to provide better financial services to SMEs and exporters in strategic economic sectors, particularly agriculture and infrastructure. During the first seven months of 2016, total loans outstanding continued to register moderate growth of 4.6% to RM138 billion (end-2015: 5.5%; RM135.6 billion), in line with the growth in the household and agricultural sectors. In the first seven months of 2016, financing approved to SMEs expanded 55.3% to RM5.9 billion, benefiting 6,357 companies (January – July 2015: -32.2%; RM3.8 billion; 9,818 companies). The overall financing to SMEs stood at RM14.7 billion (end-July 2015: RM14.9 billion), mainly channelled to transport, storage and communication; construction; primary agriculture; as well as manufacturing sectors.

Further innovation in Islamic banking

The **Islamic banking** industry showed significant growth over the last five years, with total assets growing to RM685.4 billion (end-2010: RM351.2 billion) at a compounded annual growth rate (CAGR) of 14.3% as at end-2015. For the first seven months of 2016, total assets of the Islamic banking system, including DFIs grew 9.7% to RM715.6 billion (end-July 2015: 13.4%; RM652.5 billion). Total Islamic deposits and investment accounts of the Islamic banking system increased 9.6% to RM580.7 billion (end-

TABLE 5.4

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

	RM billion		% Share	
	2015	2016 July	2015	2016 July
Primary agriculture	8.0	8.7	5.9	6.3
Manufacturing	5.0	4.6	3.7	3.3
Wholesale and retail trade, restaurants and hotels	4.4	4.7	3.2	3.4
Construction	11.8	11.4	8.7	8.3
Transport, storage and communication	10.0	8.9	7.4	6.4
Finance, insurance and business activities	5.2	5.5	3.8	4.0
Households	79.8	83.2	58.8	60.3
Others	11.3	11.0	8.3	8.0
Total	135.6	138.0	100.0	100.0

¹ Refers to Bank Pembangunan Malaysia Berhad (BPMB), Bank Kerjasama Rakyat Malaysia Berhad (Bank Rakyat), Bank Simpanan Nasional (BSN), Export-Import Bank of Malaysia Berhad (EXIM Bank), Bank Pertanian Malaysia Berhad (Agrobank) and Small Medium Enterprise Development Bank Malaysia Berhad (SME Bank).

Note: Total may not add up due to rounding.
Source: Bank Negara Malaysia.

July 2015: 15.3%; RM530 billion) with investment accounts being the growth driver, following the migration to the new investment account classification since July 2015. During the same period, total financing of the Islamic banking system grew 10.2% to RM513.2 billion (end-July 2015: 17.3%; RM465.8 billion). The strong growth and progressive development of the Islamic banking has translated into an increase in the market share of Islamic banking assets (including DFIs), accounting for 27.5% of the total banking system assets (end-July 2015: 26.4%). The bulk of the Islamic financing was channelled to the household sector, which recorded a total of RM316.4 billion, accounting for 61.6%; followed by the finance, insurance and business activities (RM56.3 billion, 11%); construction (RM22.7 billion, 4.4%); education, health and others (RM22.6 billion, 4.4%); and manufacturing (RM22.4 billion, 4.4%) sectors, respectively.

In accordance to the new requirements under the Islamic Financial Services Act 2013, Islamic banks can mobilise funds either through Islamic deposits or investment accounts. Consequently, the Investment Account Platform (IAP) was launched in February 2016 to provide an efficient intermediation channel utilising technology to existing retail and corporate customers to access, capitalise and efficiently monitor a wide range of Shariah-compliant ventures. Meanwhile, the IAP also expands the financing opportunities for new ventures with viable projects to reach a wider investor base.

³ Between BNM with Bank of Thailand (BOT) and with Bangko Sentral Ng Philipinas (BSP), respectively.

⁴ Formerly known as the Development Financial Institutions Act 2002.

TABLE 5.5

Islamic Banking¹: Key Indicators

(as at end-period)

	RM billion		% Change	
	2015	2016 July	2015	2016 July
Assets	685.0	715.6	11.3	9.7
Deposits	551.0	580.7	11.2	9.6
of which:				
Investment	74.9	27.1	-49.4	-65.3
Savings	40.8	42.6	0.4	6.0
Demand	67.1	66.7	-0.4	-1.4
Investment Account	47.1	67.8	-	101.1
Others	321.0	376.5	32.5	20.8
Financing	491.4	513.2	14.6	10.2
of which:				
Primary agriculture	19.4	20.5	38.6	26.9
Mining and quarrying	7.8	6.5	150.1	12.1
Manufacturing	22.7	22.4	10.1	5.6
Electricity, gas and water supply	3.0	2.6	-10.7	-31.2
Wholesale and retail trade, restaurants and hotels	19.0	20.3	28.4	20.7
Construction	21.6	22.7	-1.9	10.2
Transport, storage and communication	15.6	15.0	23.9	-2.9
Finance, insurance, real estate and business activities	52.2	56.3	23.5	15.8
Education, health and others	20.2	22.6	16.8	17.7
Households	302.4	316.4	11.4	9.1
Others	7.5	7.8	-0.1	-2.7

¹ Includes development financial institutions (DFIs).

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

As part of the efforts to strengthen the nation's position as the leading global hub for Islamic finance, Malaysia continues to develop various Shariah standards aimed at promoting effective application of Shariah contracts in providing Islamic financial products and services. These comprehensive standards will support innovation in the industry by providing greater clarity on each Shariah contractual requirement. As of July 2016, six Shariah and operational standards have been issued, bringing a total of 11 Shariah standards issued thus far, while the remaining three Shariah standards will be finalised by the end of 2016.

Capital Market Performance

Higher fundraising by private sector

During the first seven months of 2016, the capital market remained as the key source for corporate fundraising. **Gross funds raised in the capital market** during the period increased 3.9% to RM110.9 billion (January – July 2015: -10.5%; RM106.8 billion) due to higher fundraising activity in the private sector, which rebounded and rose significantly by 20.8% to RM53.2 billion (January – July

2015: -29.7%; RM44.1 billion). The increase was reflected through higher new issuances of medium term notes which rose 39.3% to RM40.7 billion (January – July 2015: -23.2%; RM29.2 billion). The bulk of the funds were raised by the finance, insurance, real estate and business services sector, accounting for 51.3% of new corporate bond issuances, where the funds were mainly used to finance infrastructure projects, working capital and general business activities. Notably, Shariah-compliant papers constituted 59% of total Private Debt Securities (PDS) issued, reflecting the market's continued preference for Islamic-type issuance in the domestic debt capital market (January – July 2015: 53.2%).

Gross funds raised by the public sector declined 8% to RM57.7 billion from January until July 2016 (January – July 2015: 10.6%; RM62.7 billion) due to lower borrowings by the Government. Nevertheless, funds raised through the issuances of Malaysian Government Securities (MGS) grew

TABLE 5.6

Funds Raised in the Capital Market January – July

	RM million	
	2015	2016
Public Sector		
Government securities		
Malaysian Government Securities	28,063.9	30,877.7
Malaysian Government Investment Issues	27,155.0	26,807.4
Sukuk Perumahan Kerajaan	7,500.0	-
New issues of debt securities	62,718.9	57,685.1
Less: Redemptions	20,796.7	24,382.4
Net funds raised by the public sector	41,922.2	33,302.7
Private Sector		
Shares¹/ Warrants		
Initial public offers	3,640.0	434.8
Rights issues	5,893.0	5,683.7
Warrants	-	100.2
New issues of shares/ warrants	9,532.9	6,218.8
Debt securities		
Straight bonds	2,800.7	3,720.0
Convertible bonds	-	83.9
Islamic bonds	2,521.2	2,501.0
Medium term notes	29,214.2	40,692.6
New issues of debt securities	34,536.1	46,997.5
Less: Redemptions	24,615.0	28,309.9
Net issues of debt securities	9,921.1	18,687.6
Net funds raised by the private sector	19,454.0	24,906.4
Total net funds raised	61,376.2	58,209.1

¹ Excludes funds raised by the exercise of Employee Share Option Scheme, Transferable Subscription Rights, Warrants 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	
	2015	2016	2015	2016
Agriculture, forestry and fishing	96.0	1,088.7	0.3	2.3
Manufacturing	280.0	530.0	0.8	1.1
Construction	1,796.2	3,327.7	5.2	7.1
Electricity, gas and water	730.0	4,959.9	2.1	10.6
Transport, storage and communication	1,140.0	2,640.0	3.3	5.6
Finance, insurance, real estate and business services	27,594.3	24,121.3	79.9	51.3
Government and other services	2,710.0	10,179.7	7.8	21.7
Wholesale and retail trade, restaurants and hotels	189.5	150.2	0.5	0.3
Total	34,536.1	46,997.5	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.

10% to RM30.9 billion (January – July 2015: -4.6%; RM28.1 billion). Meanwhile, issuances of Malaysian Government Investment Issues (MGI) decreased slightly by 1.3% to RM26.8 billion (January – July 2015: 31.4%; RM27.2 billion).

During the first seven months of 2016, **total net funds raised in the capital market** decreased 5.2% to RM58.2 billion (January – July 2015: -6.7%; RM61.4 billion). After adjusting for redemptions, net funds raised by the private and public sectors amounted to RM24.9 billion and RM33.3 billion, respectively (January – July

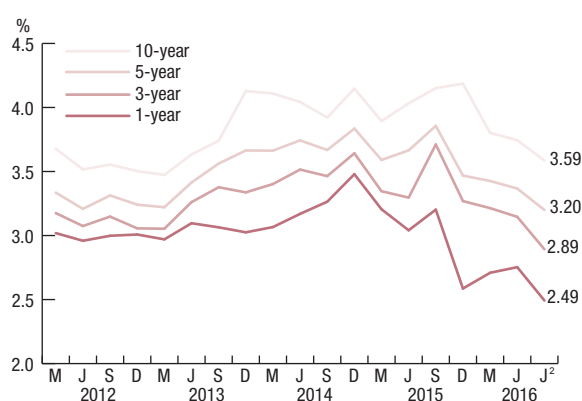
2015: RM19.5 billion; RM41.9 billion). The public sector accounted for 57.2% of the total funds raised in the capital market. Meanwhile, the domestic equity market recorded a double-digit decline of 34.8% to RM6.2 billion (January – July 2015: -34.9%; RM9.5 billion) in tandem with global financial market uncertainties. Lower fundraising in the equity market was on account of reduced initial public offerings (IPOs) which fell 88.1% to RM0.4 billion (January – July 2015: -26.2%; RM3.6 billion).

As at end-July 2016, yields of MGS and corporate bonds have declined across the entire maturity spectrum and rating bands, in tandem with the global drop in yields. The downward trend was significant due to uncertainties in Europe, resulting in stronger foreign investors' appetite for Malaysian fixed-income securities driven by active yield hunting. This development would aggravate the already-low interest rates in developed markets. The yields were dragged down further as investors had priced-in a further delay in the Fed's interest rate hikes and additional monetary stimulus by the Bank of England (BOE) and the European Central Bank (ECB) in a bid to support growth. True to those expectations, the BOE did eventually cut its policy rate to a record low of 0.25% and boosted its Quantitative Easing programme on 3 August 2016. Moreover, the sharp fall in yields was partly due to the OPR cut by BNM, which had been expected to adopt an expansionary stance in view of the external uncertainties. As at end-July 2016, the 3-year; 5-year; and 10-year MGS yields declined 38 basis points, 27 basis points and 60 basis points, respectively (January – July 2015: -35 basis points; -22 basis points; -7 basis points).

In terms of the corporate bond market, yields on the 5-year AAA-rated declined 31 basis points, while AA-rated and A-rated corporate bonds decreased 21 basis points each (January – July 2015: -6 basis points; -0.4 basis points; -4 basis points), amid sustained demand by domestic investors. As at end-July 2016, strong foreign

CHART 5.4

Malaysian Government Securities (MGS) Indicative Yields¹



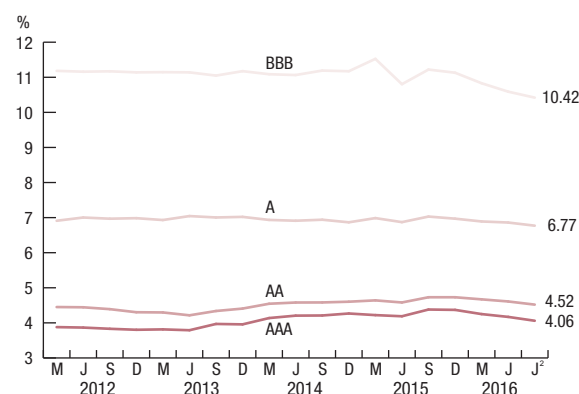
¹ End-period.

² End-July 2016.

Source: Bank Negara Malaysia.

CHART 5.5

Private Debt Securities (PDS) 5-Year Yields¹



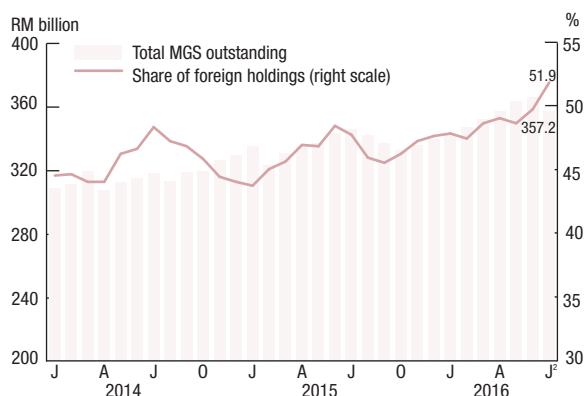
¹ End-period.

² End-July 2016.

Source: Bank Negara Malaysia.

CHART 5.6

Share of Foreign Holdings in Total MGS Outstanding¹

¹ End-period.² End-July 2016.

Source: Bank Negara Malaysia.

interest in the debt capital market mirrored the equity market. Foreign selling in the equity market slowed down dramatically in July 2016. As a result, foreign holdings of Malaysian debt securities hit a 20-month high to RM240.9 billion (end-July 2015: RM206.8 billion), while the share of total foreign holdings of MGS outstanding reached a historical high of 51.9% (end-July 2015: 47.8%).

As at end-July 2016, corporate bond credit spreads⁵, narrowed as higher oil prices led to improved investor sentiment, which helped to strengthen the ringgit and reduced risk premiums. The 5-year credit spreads for AAA-rated corporate bonds narrowed by four basis points (January – July 2015: 16 basis points), while PDS credit spread for AA-rated and A-rated papers widened by five basis points and six basis points, respectively (January – July 2015: 22 basis points; 18 basis points). Likewise, MGS term spreads⁶ narrowed by 51 basis points (January – July 2015: 33 basis points) during the period.

Equity market remains subdued

The **equity market** remained subdued in the first seven months of 2016. From the beginning of the year until end-July 2016, the Financial Times Stock Exchange (FTSE) Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI) declined 39.25 points or 2.3% to close at 1,653.26 points (end-December 2015: 68.74 points; -3.9%; 1,692.51 points). The market commenced the year on a weaker note amid signs of a global economic slowdown on the back of renewed concerns over the prolonged lower global crude oil and commodity prices. Despite heavy losses in the first three weeks of January, the market rebounded on the final week due to positive sentiment following the recalibration of the 2016 Budget and Bank of Japan's (BOJ) decision to boost its economy with negative interest rates, which helped to lift investors' confidence. The FBM KLCI posted a new year-to-date

high of 1,727.99 points on 15 April 2016 but remained volatile due to external factors throughout the rest of the period.

Some of the factors that affected the local bourse in 2015 still persist, influencing the overall market performance in the first seven months of 2016. The concerns over the possibility of further US interest rate hikes in 2016 continued to affect the market sentiment and fund flows. Furthermore, the divergent monetary policy by over 10 central banks since 2015 to stimulate growth resulted in greater volatility in the foreign exchange and equity markets. Apart from these external challenges, the FBM KLCI was also under pressure following lower-than-expected corporate earnings announced in the second quarter. Likewise, the rebalancing of the Morgan Stanley Capital International (MSCI) Emerging Market Index which trimmed Malaysia's weightage to 2.92% from 3.25% effective 1 June 2016 further contributed to the decline of the local bourse.

In July 2016, the FBM KLCI closed higher following BNM's decision to cut the OPR by 25 basis points as the lower rate was seen as an effective tool to enhance economic growth. However, Fitch Rating's decision to downgrade Malaysia's ringgit-denominated debt of several government-linked companies (GLCs), including Petroliaam Nasional Berhad (PETRONAS), added to the bearish market sentiment. In addition, the local bourse

TABLE 5.8

Bursa Malaysia: Selected Indicators January – July

	2015	2016
Indices¹		
FBM KLCI	1,723.1	1,653.3
FBM EMAS	11,894.1	11,585.1
FBM 100	11,569.4	11,283.8
FBM SCAP	16,071.3	15,332.1
FBM-ACE	6,272.4	5,420.2
Total turnover²		
Volume (million units)	283,061.9	256,207.2
Value (RM million)	294,531.2	283,028.6
Average daily turnover²		
Volume (million units)	1,965.7	1,804.3
Value (RM million)	2,045.4	1,993.2
Market capitalisation¹ (RM billion)	1,680.9	1,673.9
Total number of listed companies¹		
Main Market	799	794
ACE Market	107	111
Market liquidity¹		
Turnover value/ market capitalisation (%)	17.5	16.9
Market concentration¹		
10 highest capitalised stocks/ market capitalisation (%)	34.5	34.0

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

Source: Bursa Malaysia.

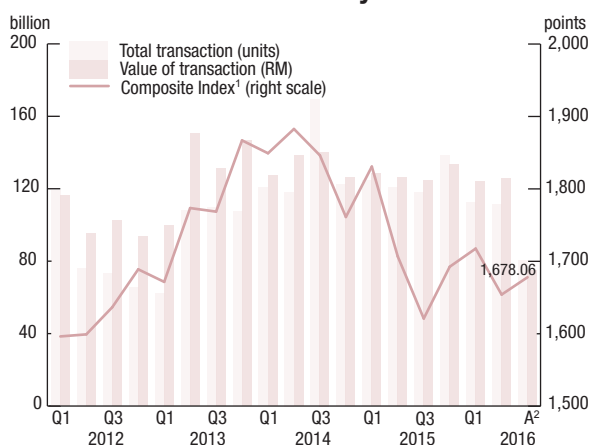
⁵ PDS yields minus MGS yields.⁶ 10-year MGS yields minus 1-year MGS yields.

closed lower as China, Malaysia's top trading partner, recorded a slower trade figure resulting in the narrowing of Malaysia's trade surplus.

The FBM KLCI advanced in August 2016 on better-than-estimated first half corporate earnings. Investors' confidence was also supported by positive external developments, including the recovery in global crude oil prices and the statement by the Fed that they would not raise interest rate soon despite the improvements in its economy which triggered more foreign fund inflows into the domestic market. Furthermore, the FBM KLCI closed higher after domestic manufacturing data and a series of other data released in mid-August showed healthy signs that the economy was on a positive momentum. News that Fitch Ratings affirmed Malaysia's long-term foreign-and-local currency issuer default ratings at A- with stable outlook had also driven the FBM KLCI higher. From the beginning of the year until end-August 2016, however, the FBM KLCI eased slightly by 0.9% or 14.5 points to close at 1,678.06 points (end-August 2015: -8.4%; -148.5 points; 1,612.74 points).

CHART 5.7

Performance of Bursa Malaysia



¹ End-period.

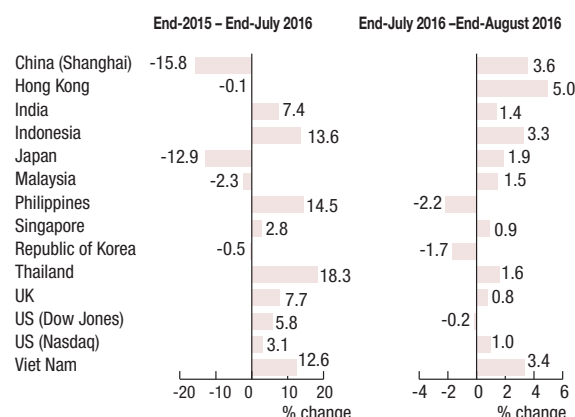
² End-August 2016.

Source: Bursa Malaysia.

Total volume of market transactions on Bursa Malaysia dropped significantly by 9.5% to 256.2 billion unit in the first seven months of 2016 (January – July 2015: 0.4%; 283.1 billion unit), while total market transacted value also declined 3.9% to RM283 billion (January – July 2015: -5%; RM294.5 billion). Average daily trading value remained unchanged during the period at RM2 billion. Market capitalisation declined 0.4% to RM1,673.9 billion as at end-July 2016 (end-July 2015: 5.8%; RM1,680.9 billion). Market velocity was sustained at 27.9%, while market volatility was higher at 6.9% (January – July 2015: 28.4%; 6.5%). Foreign investors consolidated their positions resulting in a year-to-date net sell of RM0.02 billion as at end-June 2016, compared to a net buy position of RM5.59 billion as at end-March 2016 (end-2015: net sell of RM19.38 billion). However, foreign shareholdings on Malaysian equities had trended slightly higher to 23% as at end-July 2016 (end-2015: 22.3%) reflecting higher foreign investors' confidence.

CHART 5.8

Performance of Selected Stock Markets



Source: Bloomberg.

Remarkable growth in options

The **derivatives market** recorded a 6.5% growth in trading to 8.3 million contracts during the first seven months of 2016 compared with the corresponding period in 2015 (January – July 2015: 16.1%; 7.8 million contracts). Turnover was dominated by crude palm oil (CPO) futures (FCPO), amounting to 79.5% of the total trading followed by FBM KLCI futures (FKLI) with 20.1%, while other derivative instruments, added only a small contribution to trading. Meanwhile, no transaction was recorded in MGS futures, 3-Month Kuala Lumpur interbank offered rate (KLIBOR) futures, crude palm kernel oil futures, USD CPO futures, RBD palm oil futures as well as the single stock futures during the period.

For the first seven months of 2016, trading volume of FKLI grew 8.7% to 1.7 million contracts (January – July 2015: 24.8%; 1.5 million contracts), while trading volume in FCPO recorded a 6% growth to 6.6 million contracts, equivalent to 9.2 million metric tonnes of CPO (January – July 2015: 15.5%; 6.2 million contracts; 10.9 million metric tonnes). The greater trading activity was driven by fluctuations in the prices of underlying commodities and the FBM KLCI. FCPO trading volume improved during the period, especially in June due to unexpected higher production of CPO since March 2016 and lower export figures in CPO as well as processed palm oil (PPO). These resulted in greater volatility in FCPO prices which in turn improved FCPO trading volumes. Meanwhile, trading volume of FKLI also increased due to higher volatility in the foreign exchange market which affected foreign buying and selling activities. In addition, the effects of global uncertainty on risky assets further influenced the local asset managers' decision on portfolio allocation.

Option market saw remarkable growth during the first seven months of 2016. Trading in options of FCPO (OCPO) grew almost seventeen-fold to 22,220 contracts compared with the corresponding period in 2015 (January – July 2015: 1,300 contracts). The higher uncertainty in CPO

prices was mainly due to weather, which affected the supply of CPO. The uncertainty was compounded further by the weakening of the global economy and currency volatility. Consequently, producers and commodity trading companies opted for sophisticated hedging instruments, which enable them to manage their risk more efficiently. Likewise, trading volume for options on FKLI (OKLI) was more than double to 4,696 contracts (January – July 2015: 2,204 contracts). Notably, there was a greater participation of retail investors in OKLI as reflected by the increase in the share of investors to 48% of total investors in 2016 (end-July 2015: 34%).

Unit trust industry expands further

The **unit trust** industry continued to expand in the first seven months of 2016. Eight new funds were launched, of which three were conventional funds while the remaining were Islamic funds. The total number of unit trust funds stood at 623, comprising 425 conventional funds and 198 Islamic funds (end-2015: 612 funds; 419 conventional funds; 193 Islamic funds). Meanwhile, total units in circulation grew 3.6% to 474.4 billion units (end-2015: 458 billion units), while the number of accounts increased 1.5% to 18.3 million (end-2015: 18 million accounts). Total net asset value (NAV) of unit trust industry grew 1.8% to RM352.7 billion, equivalent to 21.1% of the market capitalisation on Bursa Malaysia (end-2015: 1%; RM346.6 billion; 20.5%).

During the first seven months of 2016, **wholesale funds** continued to expand to 313 funds with an additional of 15 conventional funds and five Islamic funds (end-2015: 293 funds). The NAV of wholesale funds grew 14.7% to RM96.9 billion (end-2015: 15.3%; RM84.5 billion). Meanwhile, 13 new global funds were launched for investment in foreign markets amounting to RM484 million (end-2015: 29 new funds; RM841.2 million). Overall, 306 global funds were invested in foreign markets, recording a

total investment of RM29.1 billion (end-2015: 314 funds; RM28.5 billion). However, the foreign exposure remained low with the total NAV of the overall unit trust industry at 8.3% (end-2015: 8.2%).

The market capitalisation of the **real estate investment trusts (REITs)** increased to RM41.1 billion while the total NAV grew to RM46.9 billion (end-2015: RM37.5 billion; RM45.7 billion) as at end-July 2016. There were 17 listed REITs on the Main Market of Bursa Malaysia, including four Shariah-compliant REITs. From January until July 2016, there was no new listing of REITs on Bursa Malaysia.

As at end-July 2016, eight **exchange-traded funds (ETFs)** were listed on Bursa Malaysia, including four Shariah-compliant ETFs with total market capitalisation of RM2.5 billion (end-2015: 8 ETFs listed; RM1.7 billion). ETFs were established to provide investors an option to trade based on performance of a basket of stocks, bonds or other instruments through a tracking of underlying indices. Currently, there is a low investors' participation in ETFs due to lack of awareness and understanding of the product.

Innovation in market-based financing

Market-based financing has become an essential element to support investment and growth of early and growth-stage companies. As capital markets are deep, liquid and well-regulated, market-based financing can play a role in providing a viable alternative to bank financing. As such, the **venture capital (VC)** industry continued to grow with the total number of registered venture capital companies (VCCs) and venture capital management companies (VCMCs) stood at 51 and 60, respectively, in the first seven months of 2016 (end-2015: 55 VCCs; 63 VCMCs). In line with the newly-revised Guidelines on Registration of Venture Capital and Private Equity Corporations and Management Corporations (VC/ PE Guidelines) in 2015, two additional types of registered corporations were introduced, namely Private Equity (PE) Management Corporations (PEMC) and Private Equity Corporations (PEC). Key amendments in the guidelines include expansion of the registration scope to accommodate PE activities; allowing flexibility to VCs to invest in listed securities; provision for the appointment of a custodian; and enhanced data collection to support future policy formulation. As at end-July 2016, there were five registered PEMC and one PEC (end-2015: 2 PEMC; 0 PEC).

Total value of VC investment decreased 31.6% to RM2.2 billion as at end-2015 (end-2014: -5.4%; RM3.2 billion). However, new investment made in 2015 increased 15.1% to RM366 million (end-2014: 20.5%; RM318 million). Investment was mainly concentrated in the life sciences sector, accounting for 53.8% of total investment, followed by information technology and communication sector (17.6%) and others⁷ (12.5%). Public funds remained the largest source of capital for the industry with sovereign wealth funds and government investment companies, accounting

TABLE 5.9

Unit Trust Industry: Selected Indicators

(as at end-period)

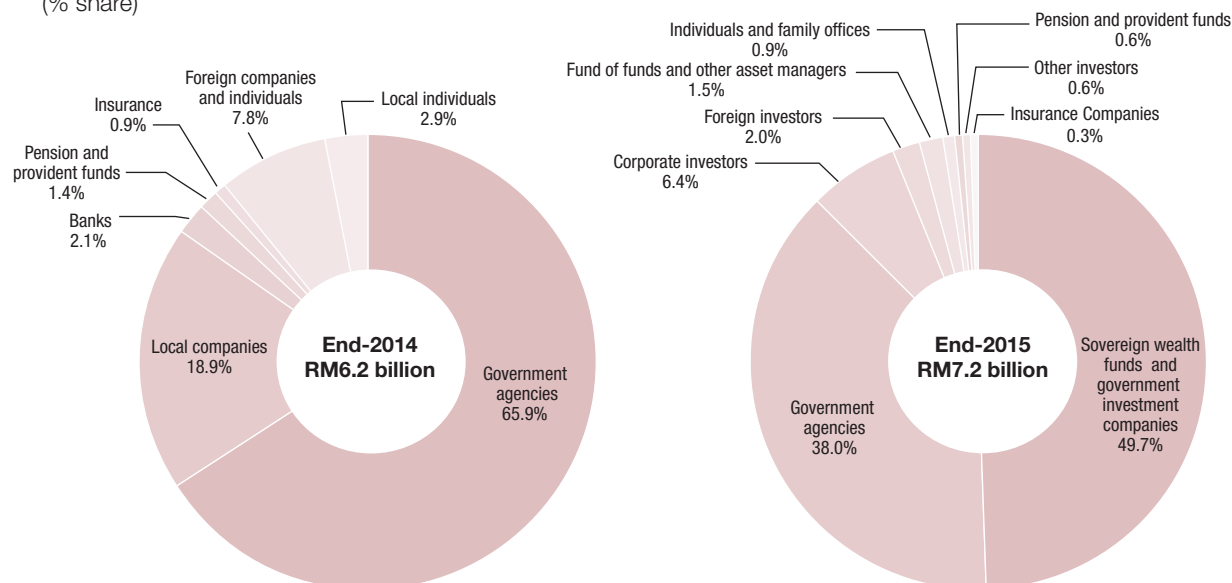
	2015	2016 July
Number of management companies	37	35
Number of funds launched	612	623
Conventional	419	425
Shariah-compliant	193	198
Units in circulation (billion)	458.0	474.4
Number of accounts (million)	18.0	18.3
NAV (RM billion)	346.6	352.7
Conventional	294.5	297.8
Shariah-compliant	52.1	54.9
NAV to Bursa Malaysia market capitalisation (%)	20.5	21.1

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

⁷ Others sector includes investment in wholesale and retail trading and media production.

CHART 5.9

Source of Venture Capital Funds (% share)



1. On 9 March 2015, the revised VC/ PE Guidelines were issued, superseding the earlier registration guidelines as well as the Guidelines and Best Practices on Islamic Venture Capital.

2. Notes on Type of Investors:

- Government agencies - Ministries and agencies (other than government investment companies) under them. Includes Minister of Finance (Incorporated) and Lembaga Tabung Haji.
- Sovereign wealth funds and government investment companies - Includes statutory and incorporated bodies established for the purpose of managing investments of public funds. For example, Khazanah Nasional Berhad, MAVCAP and Ekuinas.
- Pension and provident funds - Public and private funds or institutions managing investment of pension contributions from its members.
- Fund of funds and other asset managers - Funds, collective investment schemes or asset managers investing into VC or PE funds.

for 49.8%, while government agencies contributed 38%. Private sector contribution to the industry were led by corporate investors (6.4%), followed by foreign investors (2%) and asset managers (1.5%).

The Capital Market and Services Act (Amendment) 2015 (CMSA) and its guidelines on **equity crowd-funding (ECF)** introduced a new recognised market framework to facilitate the establishment of alternative trading platforms, including ECF platform. The ECF Guidelines aims to promote inclusion and widen avenues for small businesses and entrepreneurs to gain greater access to capital, making Malaysia the first country in Asia-Pacific to regulate ECF. As at 11 June 2015, six ECF platform operators were approved. Meanwhile, five of the six approved ECF platforms were launched, raising a total of RM3.4 million funds through ECF platform operators, as at June 2016. Furthermore, amendments to the Guidelines on Recognized Markets were announced on 13 April 2016, whereby additional requirements relating to ECF platform were introduced.

PRS achieves significant milestone

With the rising cost of living and Malaysia heading towards an aging nation by year 2030, **Private Retirement Scheme (PRS)** serves as an important tool to facilitate people to save more to achieve a sustainable retirement income. PRS funds achieved a significant milestone in the first seven months of 2016 with total NAV reaching RM1.3 billion (end-2015: RM1.2 billion), of which 34% were

Islamic PRS funds. As at end-July 2016, six additional PRS funds were approved resulting in a total of 50 PRS funds available to the public. Meanwhile, the total number of PRS members rose to 199,033 contributing to a year-to-date increase of 10.2% (end-2015: 180,651 members; 40%).

In an effort to create a more conducive environment and to widen investors' access to PRS, an online service called PRS Online Top Up was launched in September 2016 under the purview of the Private Pension Administrator (PPA). Meanwhile, the role of tax incentives has been instrumental in driving the development of PRS. In the 2012 Budget, the Government announced a tax relief of RM3,000 for contributions made by individuals to PRS for a period of 10 years, from 2012 to 2021. At the same time, employers will be provided tax deductions on contributions to PRS made on behalf of their employees. In order to cultivate a retirement savings culture among the youth, the Government in the 2014 Budget announced a one-off PRS tax relief incentive to contributors aged between 20 and 30 with a minimum cumulative investment of RM1,000 within a year. The incentive is valid from 1 January 2014 for a period of five years.

ICM continues its growth momentum

The **Islamic Capital Market (ICM)** continues to grow as a result of the vibrant development of various products and services. The ICM consists of products and services such

DIAGRAM 5.1

Key Capital Market Measures

Several measures were undertaken in the first nine months of 2016 to further enhance liquidity and efficiency in the capital market. These include the following:



as Bursa Suq Al-Sila' (BSAS) as a platform for commodity trading, and other Shariah-compliant securities which includes i-Stocks, Islamic Real Estate Investment Trusts (i-REITs), Islamic Exchange Traded Funds (i-ETFs), Islamic Indices, Exchange Traded Bonds and Sukuk (ETBS) and Islamic Special-purpose Acquisition Companies (i-SPACs). As at end-July 2016, 669 Shariah-compliant securities were listed on Bursa Malaysia, representing 70.7% of total listed securities with RM1.06 trillion of total market capitalisation (end-2015: 667 securities; 73.9%; RM1.09 trillion). In the first seven months of 2016, the trading volume of Shariah-compliant securities decreased to 160.8 billion units, valued at RM182.4 billion (end-July 2015: 192.2 billion units; RM196.1 billion). In addition, four new Shariah advisors, comprising three individuals and a corporation were registered in the same period. Cumulatively as at end-July 2016, the number of Shariah advisors approved and registered with the Securities Commission (SC) stood at 74, with 50 individuals and 24 corporations.

The domestic sukuk market has grown rapidly and Malaysia continues to maintain its position as the largest global sukuk issuer, accounting for 45% or USD38.4 billion. As at end-June 2016, Malaysia held 53.4% or USD180 billion of global sukuk outstanding. However, sukuk issuances decreased 3.3% compared with the corresponding period last year, mainly due to market uncertainties and sluggish global growth. Other countries including Indonesia (13%), United Arab Emirates (13%) and Saudi Arabia (8%) also contributed significantly to the global sukuk market. Nevertheless, Malaysia remains as the leading hub for both number of deals and amount raised through sukuk instruments.

For the first seven month of 2016, sukuk constituted 75.2% amounting to RM29.1 billion of total corporate bonds issued in the domestic market, signalling the preference for sukuk in fundraising. Simultaneously, Bursa Malaysia maintained its ranking as the top bourse for sukuk listings with a total of 23 sukuk valued at RM216.3 billion (January – July 2015: 21 sukuk listed; RM133.1 billion). Malaysia has embarked on further innovation in sukuk structure with the issuance of Wakalah Global Sukuk, the first sukuk utilising 100% non-physical assets, instead of land and buildings as well as commodity murabahah receivables as underlying assets.

Trading activities in BSAS as a Shariah-compliant commodity trading platform recorded a significant growth. As at end-July 2016, there were a total of 119 BSAS registered participants, encompassing 88 commodity-trading, 27 commodity-supplying and four commodity-executing participants, respectively (end-July 2015: 107 total of BSAS; 80; 23; 4 participants). As at end-July 2016, BSAS registered a significant growth of 24.7% with RM1.1 trillion commodities offered and 24.6% with RM2.4 trillion traded (end-July 2015: 124.6%; RM0.9 trillion; 154%; RM1.9 trillion). The growth was mainly attributed to the acceptance of BSAS, particularly in the Middle East, as a medium of trade for murabahah commodity.

The establishment of the Islamic fund management industry remains as the catalyst in raising Malaysia as the global leader. As at end-July 2016, the industry comprised of 20 Islamic Fund Management companies, with 198 approved Islamic unit trust funds and 97 Islamic wholesale funds (end-July 2015: 20 companies; 190 funds; 76 funds). Meanwhile, the total NAV of Islamic unit trust funds grew to RM54.8 billion, while the Islamic wholesale funds rose to RM37.6 billion (end-July 2015: RM49.1 billion; RM22.8 billion). As at end-July 2016, market capitalisation of four listed i-REITs increased to RM17.2 billion (end-July 2015: 3 listed i-REITs; RM15.6 billion), while market capitalisation of four approved i-ETFs as of end-July 2016 grew to RM419 million (end-2015: 4 approved i-ETFs; RM357.7 million).

Insurance and Takaful Industry Performance

Insurance industry remains sound

The **insurance** industry maintained strong levels of capitalisation in the first seven months of 2016. The capital adequacy ratio⁸ remained strong at 234.9% (January – July 2015: 239%). Similarly, total capital buffers in excess of the minimum requirement rose slightly to RM29.8 billion for the same period (January – July 2015: RM28.4 billion).

For the **life insurance** sector, new business premiums grew 5.9% to RM5.5 billion (January – July 2015: 2%; RM5.2 billion). This was largely supported by growth of non-participating life policies and annuities. However, new business premiums for investment-linked policies declined 5.1% (January – July 2015: -3.9%) following heightened domestic financial market volatility since 2015. Meanwhile, the life insurance claims rose 2.3% to RM12.1 billion during the first seven months of 2016 (January – July 2015: 20.7%; RM11.8 billion). Despite the increase in claims, the excess of income over outgo also rose RM8 billion during the period (January – July 2015: RM6.5 billion), with higher net capital gain of RM2.3 billion (January – July 2015: RM1 billion). At the same time, the market penetration rate of life insurance stood at 40.1% for the same period in 2016 (January – July 2015: 40.8%).

Operating profit for the **general insurance** sector remained steady at RM1.6 billion (January – July 2015: RM1.3 billion) mainly due to lower claims, with claims ratio stood at 54.1% (January – July 2015: 56.7%). This was largely contributed by the motor segment with claims of RM2.9 billion and the claim ratio at 65.7%, respectively (January – July 2015: RM3.1 billion; 73.6%). The gross direct premiums increased slightly by 0.8% to RM10.7 billion (January – July 2015: 2.8%; RM10.6 billion), on account of higher new businesses in the fire segment. Meanwhile, growth in gross direct premiums for the motor segment was flat at 0.3% (January – July 2015: 2.2%), reflecting lower sales for passenger and commercial vehicles.

⁸ Measures the adequacy of the capital available in the insurance and shareholders' funds of the insurer to support the total capital required.

TABLE 5.10

**Life and General Insurance Business
January – July**

	2015	2016
Life Insurance (RM billion)		
New business		
Number of policies (billion units) ¹	10.6	14.8
Sums insured ¹	257.5	247.7
Total premiums ¹	5.2	5.5
Business in force		
Number of policies (billion units) ²	20.2	19.8
Sums insured ²	1,413.9	1,507.7
Annual premiums ²	27.7	29.6
Premium income	14.3	15.2
Benefit payments	9.8	10.6
General Insurance (RM billion)		
Premium income		
Gross direct premiums	10.6	10.7
Net premiums	7.8	7.8
Reinsurance placed outside Malaysia	3.0	3.1
Retention ratio³ (%)	73.5	73.2
Number of insurance companies⁴		
Direct	32	32
Life	10	10
General	18	18
Composite	4	4
Reinsurance	7	7
Life	1	1
General	5	5
Composite	1	1

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

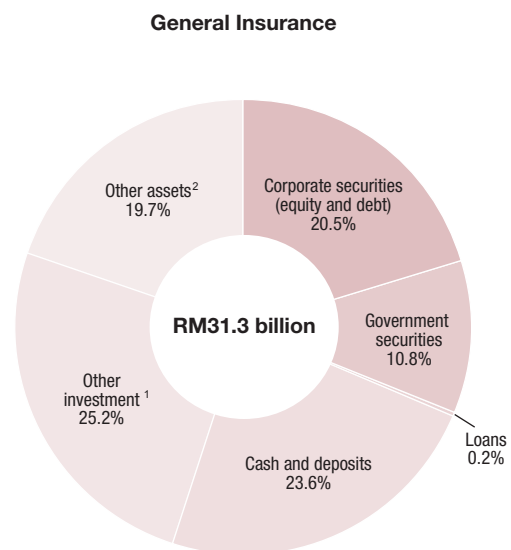
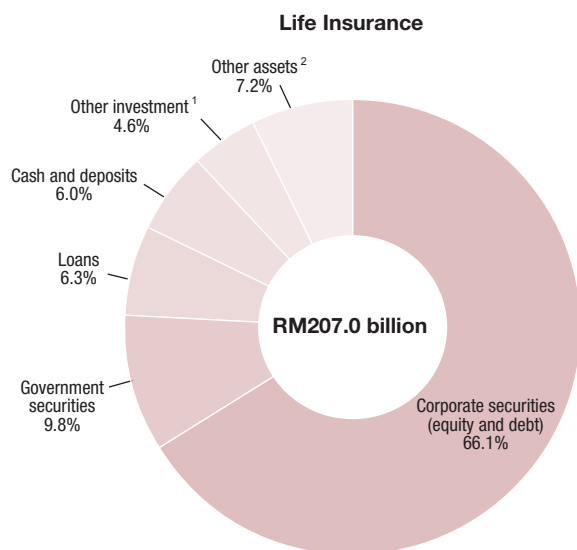
Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

As at end-July 2016, total assets of the life insurance expanded 5.8% to RM207 billion (end-2015: 5.4%; RM200.8 billion). The bulk of assets comprised of corporate bonds, accounting for 46.5% of the total insurance fund assets, followed by equities at 19.6%. Likewise, the general insurance sector's assets also increased 2.4% to RM32.3 billion. Cash and deposits continued to account for the largest asset class held by the general insurers at 23.6% of total assets.

The liberalisation of Motor and Fire Tariffs, with the first phase commencing on 1 July 2016, provides greater flexibility towards a more market-driven approach in the provision and pricing of motor and fire products. The phased deregulation of tariffs in the initial period allows general insurers and takaful operators to offer new products and optional add-on cover at market rate while public access to existing tariff products continues. Effective from 1 July 2017, premium rates for both Motor Comprehensive and Motor Third Party Fire and Theft products will be liberalised and determined by the market, while Motor Third Party as well as Fire products will be subject to premium adjustments as decided by BNM. The transition to a more competitive market-based pricing environment is expected to benefit consumers through a variety of competitively priced products, while the industry will benefit from a more risk-oriented price setting.

CHART 5.10

**Assets of Life and General Insurance Funds
As at end-July 2016**
(% share)¹ Other investments = Government guaranteed loans and others.² Other assets = Property, plant and equipment, foreign assets as well as others.

Source: Bank Negara Malaysia.

Takaful industry remains strong

The assets of the **takaful** funds grew steadily by 6.4% amounting to RM26.3 billion for the first seven months of 2016 (end-2015: 8.8%; RM24.7 billion). The growth was supported by a significant holding corporate sukuk valued at RM14.5 billion (55.1% of the total takaful funds' assets). During the same period, the amount of investment in Shariah-approved equities reduced further, mainly due to realisation of the investments which led to a corresponding increase in cash and deposits. Meanwhile, the capital position of the takaful industry remained stable where the Capital Adequacy Ratio (CAR) at 187.1% as at end-June 2016 (end-2015: 191.5%), with a capital buffer in excess of the minimum requirement of RM3.6 billion (end-2015: RM3.7 billion).

During the first seven months of 2016, the new business of **family takaful** recorded higher gross contributions of 7.4% amounting to RM2.3 billion (January – July 2015: 5.5%; RM2.1 billion). This was mainly contributed by a strong increase of term takaful (financing-related) as well as medical and health takaful. This was partly due to an increase in awareness on the need of medical coverage among consumers and higher level of takaful contributions required following rising private healthcare cost. In addition, the growth of investment-linked takaful business started to improve during the first seven months of 2016 after experiencing uncertain growth trend in 2015 in line with volatile movement of investment performance in the financial market. Net benefit payments, however, recorded an increase of 13.1% to RM1.5 billion (January – July 2015: 25.1%; RM1.4 billion). As at end-July 2016, the market penetration rate of family takaful business stood at 14.3% (end-July 2015: 14.4%).

General takaful business expanded further with gross direct contributions of RM1,421.7 million in the first seven months of 2016 (January – July 2015: RM1,395.9 million), mainly driven by fire and motor classes of business. The net contributions of the general takaful also increased 1.5% to RM1.1 billion (January – July 2015: 12.8%; RM1 billion). Net claims paid, recorded an increase of 14.9% to RM476.7 million (January – July 2015: 7.1%; RM414.7 million), mainly due to higher claims from motor takaful business segment.

During the same period, new key regulatory measures for takaful were introduced to promote a more rigorous process for capital management. Two policy documents were issued on Internal Capital Adequacy

TABLE 5.11

Family and General Takaful Business January – July

	2015	2016
Family Takaful (RM billion)		
New business		
Total contributions	2.1	2.3
Sums covered	123.9	190.0
Number of certificates (million units)	0.38	0.40
Business in force		
Annual contributions	3.2	3.6
Sums covered	594.3	632.4
Number of certificates (million units)	4.51	4.55
General Takaful (RM billion)		
Gross direct contributions	1.4	1.4
Net contributions	1.0	1.1

Note: Total may not add up due to rounding.
Source: Bank Negara Malaysia.

Assessment Process (ICAAP) for Takaful Operators and Stress Testing in April and June 2016, respectively. These measures aim to strengthen capital adequacy assessment and risk management, whereby takaful operators are expected to establish internal capital level targets and assess their overall capital adequacy and ability to meet future claims.

Prospects for 2017

Global growth is expected to expand with the Malaysian economy growing between 4% and 5% in 2017. Uncertainties in the international financial markets are expected to pose a downside risk on growth of emerging markets and developing economies. Despite the uncertainties, Malaysia will continue to strengthen the key financial fundamentals to drive the development of the domestic financial sector and steer the country's economic growth. Further liberalisation of the financial sector, as underlined in the Financial Sector Blueprint 2011-2020, will provide more flexibility in the banking system and the capital market to facilitate financing by the private sector. Further strengthening of the sector will focus on more innovative products, both for the conventional and Islamic finance, to allow for greater ease of doing business in Malaysia for domestic and foreign investors. In this regard, the monetary policy will continue to focus on price stability and sustainable growth given the risks in the global economy.