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MONETARY AND FINANCIAL DEVELOPMENTS

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4 | MONETARY AND FINANCIAL DEVELOPMENTS

Overview

Monetary and financial conditions are expected to remain accommodative and supportive of economic growth. Monetary operations will be supported by vibrant money and foreign exchange markets as well as intermediation activities. The banking sector is expected to remain robust and orderly underpinned by ample liquidity and strong capital buffers. Meanwhile, the capital market is anticipated to be resilient, driven by well-developed infrastructure and instruments. Nevertheless, external factors which include the lingering US-China trade tensions, concerns over the pace of world growth as well as volatile global financial markets may influence financial and capital market performance.

Monetary Developments

Monetary Policy

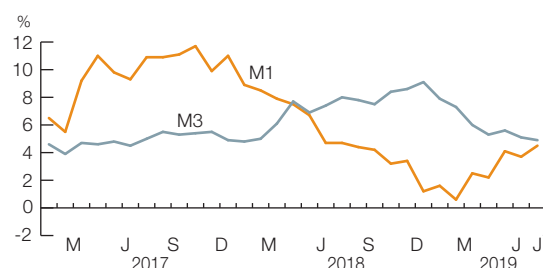
The monetary policy in 2019 remains accommodative and supportive of growth amid stable prices. The Overnight Policy Rate (OPR), which was kept unchanged at 3.25% since January 2018 was reduced by 25 basis points (bps) to 3.00% in May 2019. The reduction of OPR was made by taking into consideration of the downside risks on growth from heightened uncertainties in the global environment, trade tensions and extended weaknesses in the prices of commodity. Meanwhile, with ample liquidity in the financial system, the Statutory Reserve Requirement (SRR) was held steady at 3.50% of eligible liabilities.

The interest rate in the banking system was lowered in tandem with the OPR adjustment in May 2019. The weighted base rate (BR) of commercial banks stood at 3.68% while average lending rate (ALR) at 4.82% as at end-July 2019.

The average interest rate on savings deposit of commercial banks was reduced further to 1.00% as at end-July 2019. Similarly, the interest rates on 1-month to 12-month fixed deposits ranged between 2.83% and 3.10%.

Monetary aggregates continued to expand during the first seven months of 2019. M1 grew 4.5% to RM429.6 billion as at end-July 2019 following higher demand deposit which edged up 4.6%. Likewise, M3 grew 4.9% to RM1,913.3 billion contributed by claims from the private sector. In the near term, the money supply is expected to be supported by the extension of credit to the private sector in the form of loans and securities.

Figure 4.1. Monetary Aggregates
(% change)



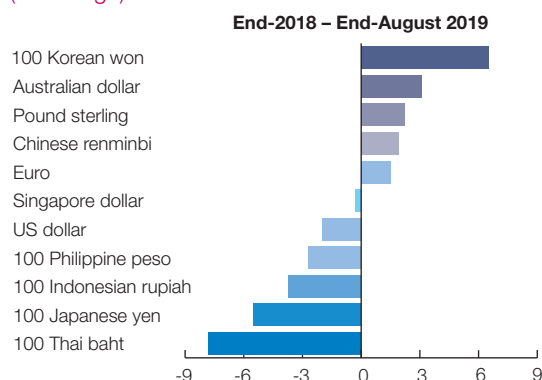
¹ End-July 2019.
Source: Bank Negara Malaysia.

Table 4.1. Factors Affecting M3
January – July

	Change (RM billion)	
	2018	2019
M3	87.0	18.8
Net claims on Government	13.1	-10.9
Claims on Government	39.2	18.3
Less: Government deposits	26.2	29.2
Claims on private sector	104.8	37.9
Loans	78.7	26.8
Securities	26.1	11.1
Net foreign assets ¹	10.9	10.9
Bank Negara Malaysia	8.3	10.8
Banking system	2.6	0.1
Other influences	-41.7	-19.1

¹ Includes exchange rate revaluation losses/gains.
Note: Total may not add up due to rounding.
Source: Bank Negara Malaysia.

Figure 4.2. Performance of Ringgit against Selected Currencies
(% change)



Source: Bank Negara Malaysia.

In line with major regional currencies, the ringgit appreciated against the US dollar during the first quarter of 2019. The strengthening of ringgit reflected strong risk-appetite following improved market sentiment supported by the Fed's dovish stance on the interest rate hike, which led to increased investment in regional financial markets. Nevertheless, from May onwards, the ringgit trended downwards attributed to escalating global trade tensions between the US and China as well as investors' concern over the possibility of FTSE Russell removing Malaysian bonds from the World Government Bonds Index (WGBI).

As at end-August 2019, the ringgit and other regional currencies depreciated within the range of 1.7% to 8.3% against the US dollar. However, the ringgit performed better against the euro, Chinese renminbi, pound sterling, Australian dollar and Korean won. Moving forward, Malaysia's resilient economy is likely to support the movement of ringgit amid a challenging global outlook.

Financial Sector Developments

Banking System Performance

During the first seven months of 2019, activities in the banking system remained resilient. Loan approvals and disbursements expanded 5.8% and 2.8% to RM238 billion and RM704.8 billion, respectively. Nevertheless, loan applications declined 1.8% to RM500.9 billion. Meanwhile, total loans outstanding expanded 3.9% to RM1,728.8 billion as at end-July 2019.

Borrowing to businesses expanded with total disbursements increasing 0.4% to RM446.3 billion, representing about 63% of total loans disbursed. Loan applications by businesses declined 0.7% to RM203.6 billion between January and July 2019. The bulk of loans were channelled into manufacturing (31.8%); wholesale and retail trade, restaurants and hotels (29.4%) and construction (11.4%) sectors. Meanwhile, total loans outstanding to businesses increased by 2.5% to RM610.2 billion, accounting for 35.3% of total loans outstanding. For the rest of the year and 2020, the banking system is expected to remain sound, operating with strong capital and liquidity buffers.

Lending to households continued to grow with loan approvals increasing 3.7% to RM128.1 billion and disbursements expanding 1.4% to RM199.8 billion. Loans disbursed to the household sector were mainly for consumption credit (49.8%). This was followed by the purchase of residential properties (24.8%) and passenger cars (10.9%). As at end-July 2019, total household loans outstanding grew 4.7% amounting to RM1,007.4 billion, which accounts for 58.3% of total loans outstanding in the banking system.

Table 4.2. Banking System: Loan Indicators
January – July

	RM billion		Change (%)	
	2018	2019	2018	2019
Total¹				
Loans applications	510.0	500.9	6.8	-1.8
Loans approvals	224.9	238.0	6.0	5.8
Loans disbursements	685.3	704.8	7.1	2.8
Loans outstanding ²	1,663.4	1,728.8	7.4	3.9
<i>of which:</i>				
Businesses				
Loans applications	205.0	203.6	8.5	-0.7
Loans approvals	89.9	92.5	3.4	2.9
Loans disbursements	444.4	446.3	6.7	0.4
Loans outstanding ²	595.1	610.2	4.9	2.5
Households				
Loans applications	284.3	278.8	4.9	-1.9
Loans approvals	123.4	128.1	7.4	3.7
Loans disbursements	197.0	199.8	11.6	1.4
Loans outstanding ²	962.1	1,007.4	8.9	4.7

¹ Includes 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.

Table 4.3. Banking System: Loans Outstanding by Sector
(End-July)

	RM billion		Share (%)	
	2018	2019	2018	2019
Businesses	595.1	610.2	35.8	35.3
<i>Selected sectors</i>				
Primary agriculture	34.3	34.4	2.1	2.0
Mining and quarrying	9.3	7.7	0.6	0.4
Manufacturing ¹	107.1	114.7	6.4	6.6
Electricity, gas and water supply	12.1	12.7	0.7	0.7
Wholesale and retail trade, restaurants and hotels	118.5	126.7	7.1	7.3
Construction	84.7	91.2	5.1	5.3
Real estate	115.6	113.0	7.0	6.5
Transport, storage and communication	36.8	36.9	2.2	2.1
Finance, insurance and business activities	53.6	48.8	3.2	2.8
Households	962.1	1,007.4	57.8	58.3
<i>of which:</i>				
Purchase of residential properties	517.8	556.3	31.1	32.2
Purchase of non-residential properties	79.9	80.1	4.8	4.6
Purchase of passenger cars	146.3	145.1	8.8	8.4
Consumption credit	129.5	133.5	7.8	7.7
<i>of which:</i>				
Credit cards	37.2	38.3	2.2	2.2
Personal use	92.4	95.1	5.6	5.5
Purchase of securities	64.9	68.9	3.9	4.0
Others	23.8	23.5	1.4	1.4
Other sectors	106.3	111.2	6.4	6.4
Total	1,663.4	1,728.8	100.0	100.0

¹ Including agro-based.

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

The overall household debt increased slightly to RM1,216.7 billion, accounting for 82.2% of GDP as at end-June 2019. Nevertheless, the debt level has been moderating since 2015 following macro-prudential measures and financial literacy programmes introduced to rein in household debt levels. The bulk of debt comprises loans for the purchase of residential properties (54.2%), followed by personal use (14.1%) and passenger cars (12.9%). Total household financial assets remain strong at RM2,627.6 billion with the debt servicing capacity of households remained intact, supported by stable income

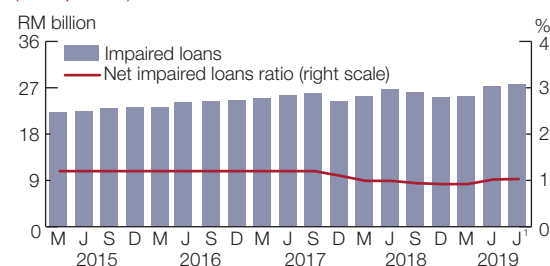
and employment growth. Consequently, the household debt level is expected to remain manageable in 2019 and 2020.

The banking system's capacity to absorb losses remains robust supported by strong capital position. As at end-July 2019, Common Equity Tier 1 Capital, Tier 1 Capital, and total capital ratios stood at 13.9%, 14.6% and 17.9%, respectively. The levels were well above the Basel III minimum regulatory levels of 4.5%, 6% and 8% of risk-weighted assets, respectively. Furthermore, excess total capital buffer¹ remained high at RM111.4 billion.

In the first seven months of 2019, the banking system recorded a higher pre-tax profit of RM23.2 billion despite a challenging operating environment. The interest-/finance-related activities contributed approximately 65.3% of gross income. Meanwhile, returns on assets and equity remained steady at 1.4% and 12.6%, respectively.

Loan quality of the banking system remained sound throughout the period with stable net impaired loans ratio of 1% as at end-July 2019. Meanwhile, the banking system loan loss coverage ratio (including regulatory reserves) stood at 126.4%. The Liquidity Coverage Ratio (LCR) of the banking system stood at 155% well above the 100% minimum requirement. Despite external challenges which include slower global economic growth due to trade and geopolitical tensions, the outlook for the domestic financial system is expected to remain positive. This is supported by a deep and liquid financial market as well as robust financial institutions. The outlook is also premised on confidence in the system following reforms undertaken during the Asian and global financial crises as well as evolving business models to meet market expectations.

Figure 4.3. Banking System: Impaired Loans and Net Impaired Loans Ratio
(End-period)



¹ End-July 2019.

Source: Bank Negara Malaysia.

¹ Excess total capital refers to the total capital above the Bank's regulatory minima, which also includes the capital conservation buffer requirement (2.5% of risk-weighted assets) and bank-specific higher minimum requirements.

Feature Article 4.1

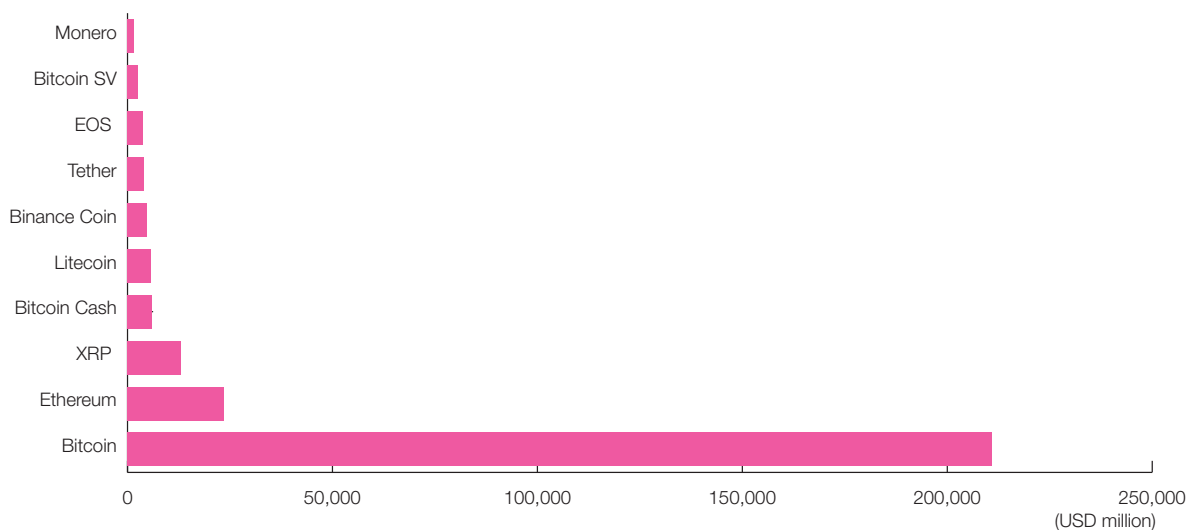
Digital Assets

Introduction

Decentralised digital currencies and digital tokens (digital assets) are built on a distributed ledger network, using a combination of cryptography and economic theory to verify transactions and control the supply of the assets. The first workable digital asset, the Bitcoin, was first proposed by Satoshi Nakamoto in 2008 as a strictly peer-to-peer electronic payment system together with a solution to the problem of double-spending¹ in a digital transaction. There are now more than 700 digital assets available in the market since the creation of Bitcoin, where the early use of digital assets was aimed at creating digital money. Nevertheless, different digital tokens have been created for other broader uses beyond financial services. However, Bitcoin remains the most widely known and used digital asset. Meanwhile, the total market capitalisation of digital assets experienced tremendous growth in 2018, peaking at USD818 billion² but has since moderated to USD263 billion³ in 2019.

Simultaneously, a new type of alternative fundraising avenue known as initial coin offerings (ICOs), has been developed. Through ICOs, companies can issue their own digital tokens and offer them to investors where these ICOs are typically utilised by start-up companies where entrepreneurs need to raise funds to kickstart projects and businesses. Despite stemming from a new group of enthusiasts, digital assets are increasingly gaining awareness and interest within the broader public and businesses. Therefore, it is essential to understand the features, benefits and risks posed by digital assets.

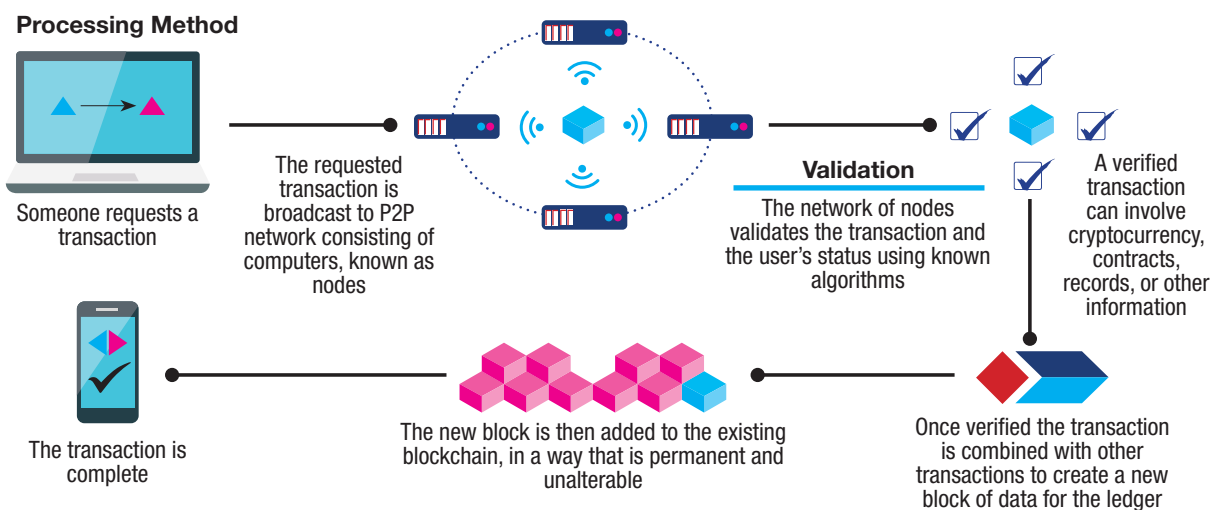
Figure 4.1.1. Top Ten Digital Currencies by Market Capitalisation



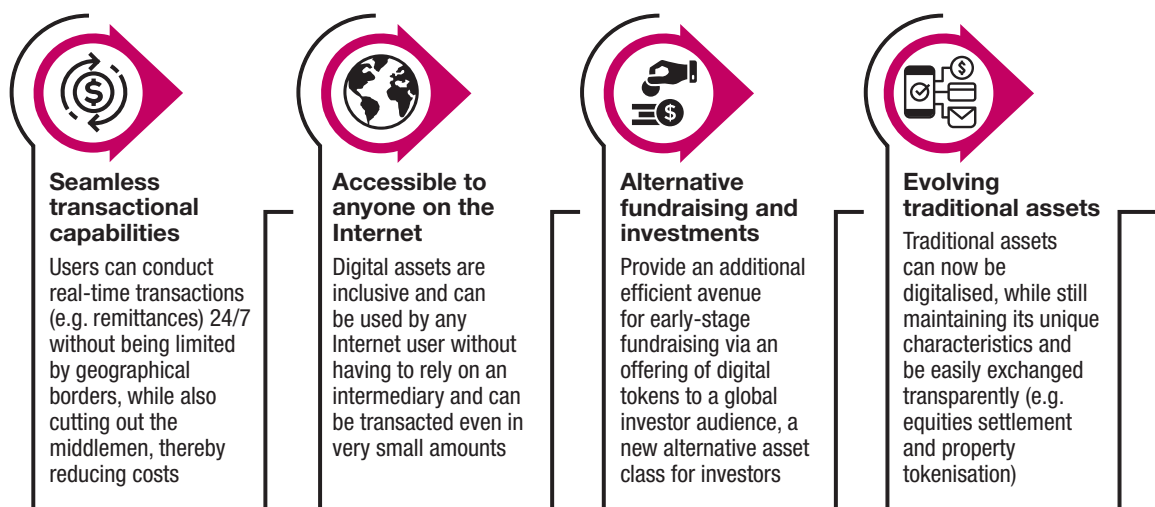
¹ Double-spending is a potential flaw in which the same single digital token can be spent more than once.

² As at 8 January 2018.

³ As at 23 September 2019.

Figure 4.1.2. How Do Digital Assets Work?

Source: Yusuf, 2019.

Figure 4.1.3. Benefits and Risks of Digital Assets**Benefits****Risks****Financial Integrity and Market Confidence**

- Money laundering and terrorism financing due to anonymity of transactions
- Investors exposed to high price volatility
- Cybersecurity risks and consumer exploitation (e.g. Ponzi schemes and scams)
- ICOs are statistically high risk: 71% without a working prototype/product and 10% of ICO funds were lost/stolen (EY, 2018)

Monetary and Financial Stability

(if digital assets are widely used for real economic activities)

- Large substitution of Ringgit for transactions affects monetary policy effectiveness (akin to dollarisation)
- Lack of issuance discipline can affect price stability and undermine trust in the monetary system
- Affects the bank's lending function through competition for deposits
- Rapid withdrawals may trigger bank runs and loss of confidence in the financial system

Digital Assets in the Malaysian Context

In response to the rapid development of digital assets globally, governments and regulators have adopted different stances and measures towards the potential risks arising from activities involving these assets. The Financial Action Task Force (FATF) has published guidance to all member countries including Malaysia and virtual asset service providers in June 2019 to understand their anti-money laundering and counter-terrorist financing obligations and effectively implement the FATF's requirements as they apply to this sector. From Malaysia's perspective, the financial regulators, namely Bank Negara Malaysia (BNM) and the Securities Commission Malaysia (SC) have been collaborating closely to proactively respond to this emerging sector and exploring ways to facilitate innovation in the local market while ensuring that necessary safeguards are in place. As such, BNM and SC have issued multiple warning statements to the general public when dealing with digital assets and have taken the necessary regulatory action against any suspicious or unlawful behaviour since 2017.

In terms of formal regulations, BNM has in February 2018 amended its Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT) Regulations to include a new Sector 6 for digital assets which sets out the AML/CFT requirements for digital asset service providers in Malaysia. In January 2019, the Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order 2019 came into force which prescribes any digital assets, when being offered as a form of investment or used as a method of fundraising, as securities in Malaysia. The SC has subsequently amended its Guidelines on Recognised Markets to include regulatory requirements for digital asset exchanges (DAX) and had registered three DAX operators under these guidelines in May 2019. These DAX operators have been given nine months to be fully compliant and operational and are now the only legitimate venues for digital asset trading in Malaysia. Finally, the SC had also published a public consultation paper on ICOs, with a view to introducing formal guidelines in the near future. While regulatory developments are ongoing, there have been significant experiments/pilot projects being conducted locally on the application of distributed ledger technologies within the broader economy. These include the SC's Project Castor on unlisted and over the counter markets; BNM's efforts with nine banks on trade finance applications; Bursa Malaysia's pilot project on Securities Borrowing and Lending (SBL); as well as the Ministry of Education's efforts to set up a consortium of universities to record and validate university certificates on a distributed ledger.

Conclusion

Despite digital assets having garnered significant attention due to its potential disruption on the financial system, it is important to note that it is still a nascent and emerging sector where global and domestic adoption rates have not reached widespread adoption. There have been recent steps taken by some large and prominent companies in key sectors to adopt some form of digital currencies in their operations. Although the impact of these projects has yet to be felt more widely, depending on the outcome of its usage, digital assets may well emerge as a part of the wider economy or recede into the background as a novelty. Towards this end, authorities around the world will continue to closely monitor the development of this sector in order to formulate blueprints to address issues and challenges surrounding digital assets.

Capital Market Performance

During the first seven months of 2019, gross funds raised in the capital market increased 27.8% to RM167.9 billion mainly due to higher fundraising activity in the private sector, which grew significantly by 47% to RM89.2 billion. Gross funds raised by the private sector through domestic equity market edged up drastically from RM0.9 billion to RM5 billion, of which initial public offerings (IPOs) rose from RM0.6 billion to RM1.6 billion while rights issuances increased from RM0.3 billion to RM3.5 billion. This was driven by Malaysia's position as an attractive investment destination among local and foreign investors.

Table 4.4. Funds Raised in the Capital Market January – July

	RM million	
	2018	2019
Public Sector		
Government securities		
Malaysian Government Securities	35,423.6	38,797.1
Malaysian Government Investment Issues	35,246.2	39,853.7
New issues of debt securities	70,669.9	78,650.8
Less: Redemptions	25,970.7	26,093.4
Net funds raised by the public sector	44,699.1	52,557.3
Private Sector		
Shares¹/Warrants		
Initial Public Offers	571.8	1,570.0
Rights Issues	324.7	3,466.7
Warrants	-	-
New issues of shares/warrants	896.4	5,036.8
Debt securities²		
Straight bonds	2,470.0	3,090.0
Convertible bonds	-	-
Islamic bonds	724.6	2,944.3
Medium-term notes	56,594.1	78,137.8
New issues of debt securities	59,788.7	84,172.1
Less: Redemptions	24,835.6	41,630.0
Net issues of debt securities	34,953.1	42,542.1
Net funds raised by the private sector	35,849.5	47,578.8
Total net funds raised	80,548.6	100,136.2

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

² Excludes short-term papers in conventional and Islamic principles.

Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

Table 4.5. New Issuance of Corporate Bonds by Sector January – July

	RM million		Share (%)	
	2018	2019	2018	2019
Agriculture, forestry and fishing	83.6	50.0	0.1	0.1
Manufacturing	1,490.0	670.0	2.5	0.8
Construction	3,977.9	1,724.3	6.7	2.0
Electricity, gas and water	8,057.1	4,600.0	13.5	5.5
Transport, storage and communication	1,415.0	32.0	2.4	0.0
Finance, insurance, real estate and business services	41,080.3	70,263.5	68.7	83.5
Government and other services	3,277.8	5,354.9	5.5	6.4
Wholesale and retail trade, restaurant and hotels	407.0	1,477.5	0.7	1.8
Total	59,788.7	84,172.1	100.0	100.0

Note: Includes corporate bonds issued by Cagamas and non-resident corporations. Total may not add up due to rounding.
Source: Bank Negara Malaysia.

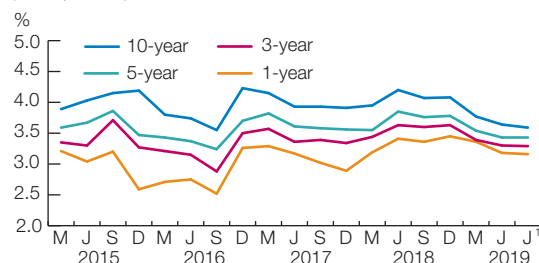
Funds raised through new corporate bond issuances increased 40.8% to RM84.2 billion during the same period. The increase was reflected through higher new issuances of medium-term notes, accounting for 92.8% of total corporate bonds. The bulk of funds were raised by finance, insurance, real estate, and business services sector, accounting for 83.5% of new corporate bond issuances. The funds were mainly used to finance infrastructure projects, business activities and working capital. In the near term, fundraising in the capital market is expected to remain robust in 2020 driven by various strategic projects.

Similarly, gross funds raised by the public sector increased by 11.3% to RM78.7 billion during the first seven months of 2019. The issuance of Malaysian Government Securities (MGS) expanded RM38.8 billion, while Malaysian Government Investment Issues (MGII) increased RM39.9 billion. The increase was due to continued buying interest among

local institutional and foreign investors in Government securities. As at end-July 2019, foreign holdings of MGS and MGII stood at 38.3% and 4.4%, respectively. The improved foreign investors' appetite for local bonds was spurred by the hunt for yield amid dovish sentiment.

Figure 4.4. Malaysian Government Securities Indicative Yields

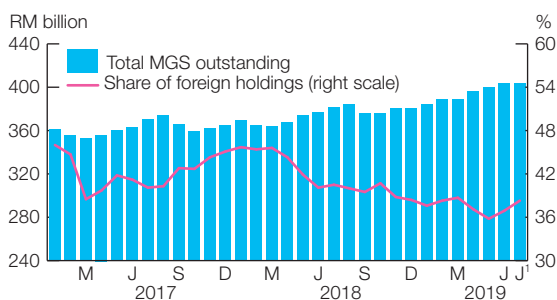
(End-period)



¹ End-July 2019.
Source: Bank Negara Malaysia.

Figure 4.5. Share of Foreign Holdings in Total MGS Outstanding

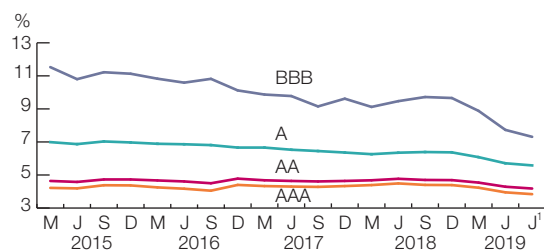
(End-period)



¹ End-July 2019.
Source: Bank Negara Malaysia.

Figure 4.6. 5-Year Corporate Bond Yields

(End-period)



¹ End-July 2019.
Source: Bank Negara Malaysia.

As at end-July 2019, yields of MGS and corporate bonds have declined across the entire maturity spectrum and rating bands in line with global bonds. The downward trend was caused by stronger foreign investors' risk appetite for Malaysian fixed-income securities. This was driven by active yield hunting following the OPR cut by BNM and dovish stance taken by the Fed. Between January and July 2019, the 1-year, 3-year, 5-year, and 10-year MGS yields declined within the range of 29 and 49 bps. In the corporate bond market, yields on the 5-year AAA-rated, AA-rated and A-rated securities dropped between 51 and 79 bps, following investors shifting to safe-haven assets.

The FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI) along with major regional bourses began the year on a soft note amid bearish sentiment following heightened trade tensions and global monetary tightening. In the first week of January 2019, the local bourse faced minor correction before picking up in the third week of 2019. The positive trend continued reaching a year-to-date high of 1,730.68 points on 21 February 2019. The upward trend was mainly supported by positive market sentiment following the resumption of trade talks.

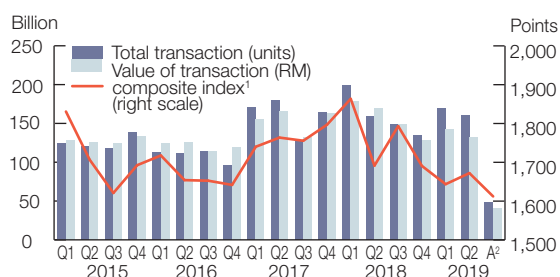
Nevertheless, during the first quarter of 2019, the local bourse remained subdued following concerns over increased uncertainties in the global economic environment, particularly China's slower growth and lower-than-estimated 2018 fourth-quarter domestic corporate earnings. The trend continued in the second and third week of April due to Norway's decision to drop Malaysia from its fixed-income benchmark list, the downward revision of global growth by the IMF and the possibility of Malaysian bonds being downgraded by FTSE Russell. However, as at end-April 2019, the FBM KLCI closed 1,642.29 points following improved

investors' sentiment as a result of revival of projects such as East Coast Rail Link (ECRL) and Bandar Malaysia.

Beginning May, the equity market started to decline to reach 1,598.32 points during the third week of the month mainly due to concerns over the breakdown in trade negotiations between the US-China which led to the outflow of foreign funds. However, the FBM KLCI rebounded in the final week of May and throughout June 2019. The upward trend was attributed to among others, the anticipated rate cut by the Fed in July as well as the resumption of trade talks between the US-China. However, the FBM KLCI retreated to 1,612.14 points as at end-August, due to slower world growth forecast by IMF and intensified US-China trade tensions.

As at end-August, the market capitalisation decreased 9.4% to RM1,690.3 billion, while total volume declined 5.2% to 444.3 billion units. Likewise, total market transacted value decreased by 20.5% to RM361.2 billion. However, market velocity sustained at 28.8%, while market volatility was at 21.9%. Meanwhile, foreign holdings based on market capitalisation in the local bourse stood at 23% as at end-August 2019. The domestic equity market is expected to remain resilient in 2020 on account of strong macroeconomic fundamentals, ample domestic liquidity and well-developed capital market instruments.

Figure 4.7. Performance of Bursa Malaysia

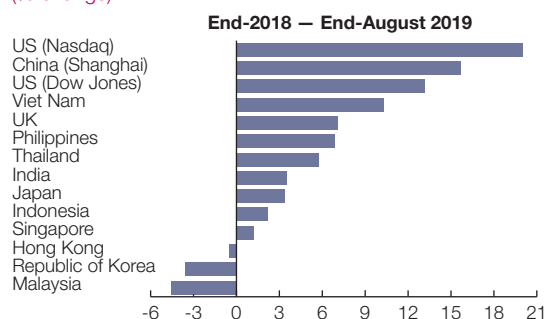


¹ As at end-period.

² End-August 2019.

Source: Bursa Malaysia.

Figure 4.8. Performance of Selected Stock Markets
(% change)



Source: Bloomberg.

Table 4.6. Bursa Malaysia: Selected Indicators
(End-August)

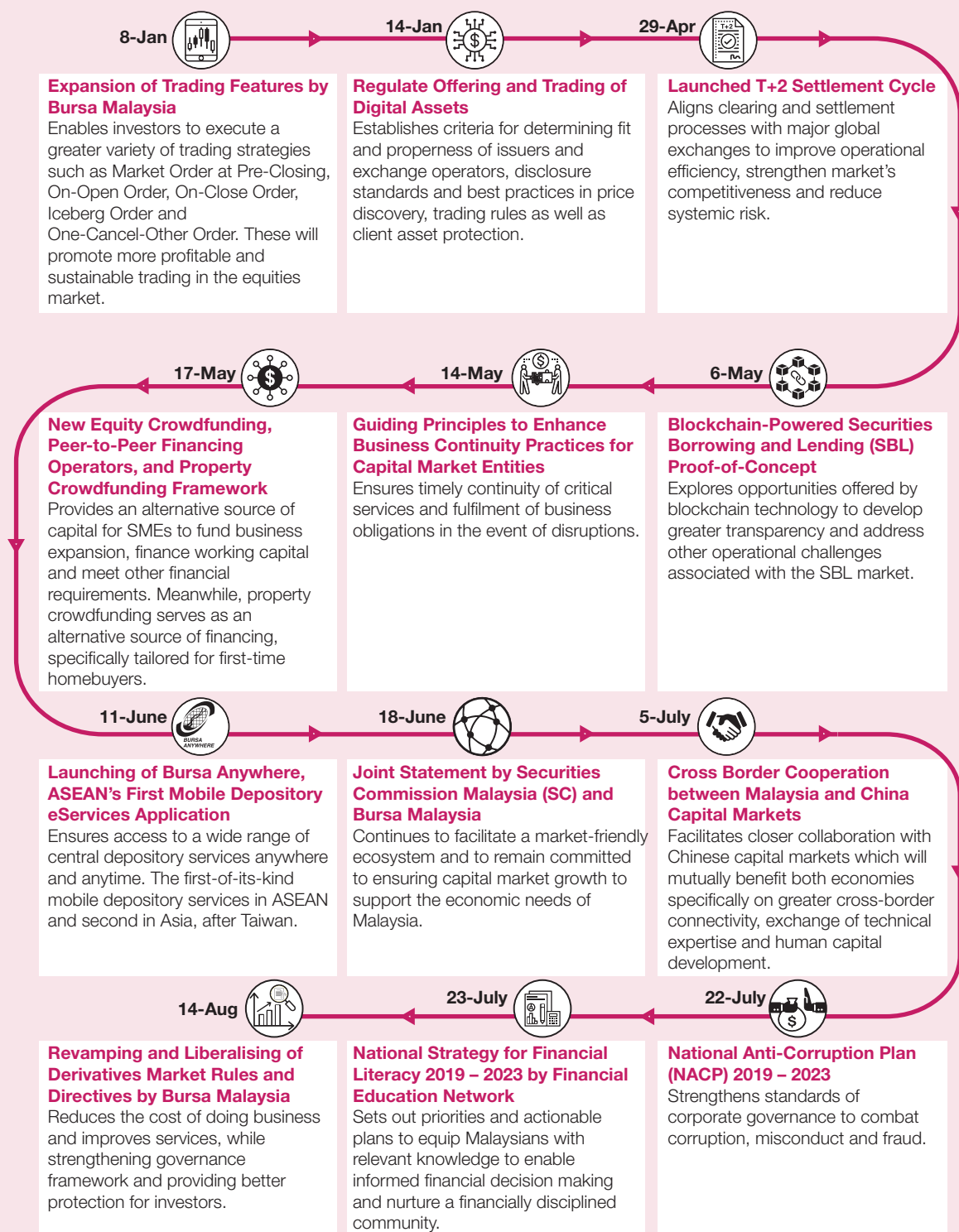
	2018	2019
Indices		
FBM KLCI	1,819.66	1,612.14
FBM EMAS	12,719.42	11,348.50
FBM 100	12,526.43	11,190.63
FBM SCAP	14,453.18	12,876.98
FBM ACE	5,283.71	4,488.20
Total turnover¹		
Volume (million units)	468,760.02	444,344.95
Value (RM million)	454,233.15	361,163.09
Average daily turnover¹		
Volume (million units)	2,875.83	2,742.87
Value (RM million)	2,786.71	2,229.40
Market capitalisation (RM billion)	1,865.84	1,690.26
Total number of listed companies		
Main Market	781	773
ACE Market	121	126
LEAP Market	8	24
Market liquidity		
Turnover value/market capitalisation (%)	24.3	21.4
Market concentration		
10 highest capitalised stocks/market capitalisation (%)	34.5	34.1

¹ Based on market transactions and direct business transactions between January and August.

Source: Bursa Malaysia.

Key Capital Market Measures

Several measures were undertaken in the first eight months of 2019 to enhance liquidity and efficiency in the capital market. These measures include the following:



Islamic Banking and Capital Market Performance

Islamic banking industry exhibited sustained growth with total assets valued at RM977 billion² and market share at 32.9% as at end-July 2019. Meanwhile, the total Islamic financing outstanding increased further by 12.9% to RM716 billion. The growth is primarily contributed by household sector financing, which increased by 17.1% to RM449 billion mainly for purchase of residential properties. The significant increase was partly due to rising demand and on-going initiatives and promotions by various stakeholders.

For the rest of 2019, the Islamic banking sector is expected to maintain its stable outlook in parallel with the conventional banking sector. This is supported by the sustained demand for Islamic banking products and services as well as the implementation of Value-Based Intermediation by BNM. In 2020, the market share for the local Islamic banking industry is expected to reach 40% of total banking assets.

Malaysia continues to be the leader in the Islamic Capital Market (ICM) with Islamic equity and sukuk issuances being among the largest in the world. The domestic equity portion of ICM, valued at RM1,081.1 billion, accounts for 62.7% of total market capitalisation as at end-July 2019. Meanwhile, sukuk issuances amounted to RM148.9 billion, accounting for 60.9% of total bonds issued. In terms of sukuk outstanding, it stood at 61.6% or RM922.8 billion of total bonds outstanding. As at end-July 2019, Malaysia accounts for the largest share of global sukuk outstanding at 48.8%.

As a leading exchange in emerging markets, Bursa Malaysia offers a variety of Shariah-compliant securities products. These Shariah-compliant securities are listed on the Main and ACE markets. As at end-July 2019, a total of 699 of the 924 listed companies was Shariah-compliant with the list being updated twice a year.

Table 4.7. Islamic Banking: Key Indicators¹
(End-July)

	RM billion		Change (%)	
	2018	2019	2018	2019
Assets	725.8	806.5	17.8	11.1
Financing	549.8	594.8	18.8	8.2
Primary agriculture	15.2	16.4	0.1	8.1
Mining and quarrying	5.1	3.5	-7.8	-30.8
Manufacturing ²	23.0	27.3	3.5	18.4
Electricity, gas and water supply	2.7	3.4	50.9	26.4
Wholesale and retail trade, restaurants and hotels	23.7	27.4	16.3	15.4
Construction	33.9	35.0	57.3	3.2
Real estate	26.5	28.4	13.0	7.1
Transport, storage and communication	16.3	17.3	-10.1	5.7
Finance, insurance and business activities	35.6	33.5	-6.2	-5.9
Education, health and others	21.2	20.2	-0.5	-4.5
Households	331.7	367.3	23.4	10.7
Others	14.9	15.1	134.2	1.9
Liabilities	673.2	748.6	17.8	11.2
Deposits and Investment Account	537.3	610.3	19.4	13.6
Investment	0.8	0.7	-15.3	-16.1
Savings	40.9	44.2	6.2	8.1
Demand	74.4	82.7	4.9	11.2
Investment account	76.0	80.6	1.1	6.0
Others	421.2	482.6	24.0	14.6

¹ Excluding DFIs.

² Including agro-based.

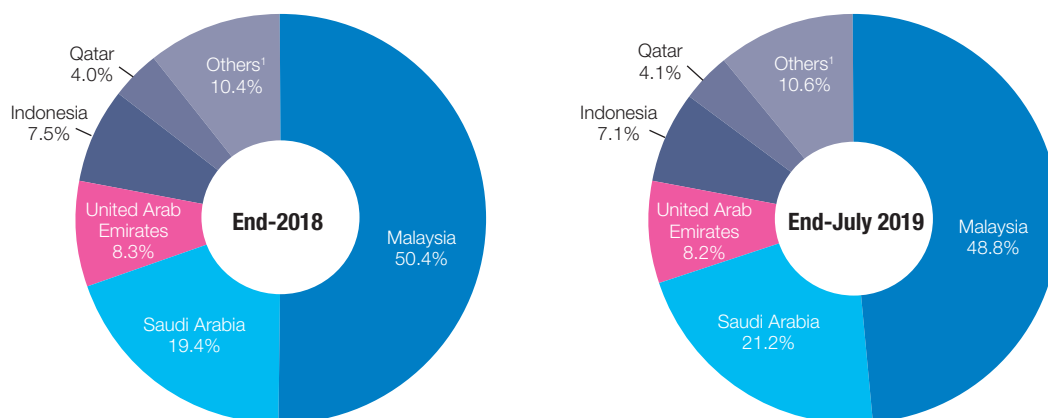
Note: Total may not add up due to rounding.

Source: Bank Negara Malaysia.

The average daily trading value (ADV) of Shariah-compliant securities amounted to RM1.3 billion from the total ADV valued at RM2 billion, indicating that Shariah-compliant indices exceed conventional indices. In addition, five individuals and two new companies were approved by the SC as registered Shariah advisors for ICM products and services during the same period. Currently, 69 Shariah advisors comprising 49 individuals and 20 companies are supporting the initiative towards strengthening trade in Shariah-compliant products.

² Includes Development Financial Institutions (DFIs).

Figure 4.9. Global Sukuk Outstanding by Country
(% share)



¹ Others includes Bahrain, Bangladesh, Brunei, Gambia, Hong Kong, Ivory Coast, Jordan, Kuwait, Luxembourg, Maldives, Mauritius, Nigeria, Oman, Pakistan, Senegal, Singapore, South Africa, Turkey, the UK and the US.

Note: Total may not add up due to rounding.

Source: Malaysia International Islamic Financial Centre.

The ICM is expected to play a crucial role in Malaysia's capital market driven by growing demand for Shariah-compliant instruments. In addition, continuous innovation will ensure that Malaysia remains as the global leader in ICM. This is due to ICM being identified as one of the financing channels to support the

development of Sustainable Development Goals (SDGs) agenda. In line with this aspiration, Malaysia is putting forth recommendations to further accelerate the development of Sustainable and Responsible Investment (SRI) instrument to support green taxonomy for the capital market.

Feature Article 4.2

The Potential of Islamic FinTech in Malaysia

Introduction

Technology has been a key part of the financial services market worldwide for decades. Financial technology (FinTech) driven by IR 4.0 is exponentially enhancing 20th-century financial services, operations, business models and customer engagement (IFR, 2018). FinTech entities are not financial institutions but utilise FinTech in providing financial services such as lending, investment, payment, risk management, data analytics and wealth management (GIFR, 2017). Some of the activities include mobile payments, money transfer, trading platforms, crowdfunding and Peer-to-Peer (P2P) financing. In the context of Islamic FinTech, all these activities must be Shariah-compliant. According to Thomson Reuters (2018), the Islamic finance industry has ample opportunities, with assets expecting to reach USD3.9 trillion by 2023. However, the Islamic FinTech in Malaysia is still at the infancy stage with substantial room for growth.

Opportunities and Challenges

The advent of FinTech makes Islamic finance more competitive and attractive to customers as it provides choices which are more aligned to individual needs. It also attracts more customers by providing a wider range of products and services at a lower cost in a more efficient manner.

Furthermore, users benefit from superior customer experience as Islamic FinTech leverages the internet, mobile devices, social media integration, big data analytics (BDA) and artificial intelligence (AI). For SMEs, FinTech also enables Musharakah¹ and Mudharabah² based equity financing to be effectively performed via crowdfunding and P2P platforms.

Following the proliferation of FinTech in Islamic finance, traditional Islamic finance institutions (IFIs) face increasing competition. The IFIs have to reduce financing profit margins and service fees to remain competitive. In addition, broader options available for customers to invest through online P2P and crowdfunding marketplace may result in less deposit and investment portfolio.

Recent Developments in Islamic FinTech

At the beginning of the Islamic FinTech era in Malaysia, the crowdfunding platform was the first to be introduced to the marketplace. In 2016, significant progress in Islamic FinTech was achieved. This includes the introduction of Investment Account Platform (IAP), Islamic Crowdfunding, Islamic FinTech Alliance (IFT Alliance), Islamic P2P financing and Islamic Robo-Advisor.

Investment Account Platform

IAP is the first online bank-intermediated FinTech platform backed by six IFIs. It was established to facilitate the matching of investments with viable ventures or projects which require funding and serves as a central marketplace to finance SMEs. As of August 2019, IAP has listed 12 deals for various business purposes valued at RM184 million by its sponsoring IFIs.

Islamic Crowdfunding

Generally, crowdfunding is an alternative source of capital, particularly for start-ups and SMEs to finance business expansion, working capital and meet other financial requirements. However, Islamic crowdfunding is not only meant for businesses such as equity or P2P financing, but also for donation drives and as reward-based crowdfunding. In May 2019, Securities Commission Malaysia (SC) registered three new Equity Crowdfunding (ECF) companies, with one of it being an Islamic ECF platform operator which provides services such as real estate and Sadaqah.³

Islamic FinTech Alliance

In April 2016, the IFT Alliance was launched in Kuala Lumpur involving eight Islamic crowdfunding platform operators worldwide. The founding members offer various services such as lending money to entrepreneurs, investment opportunities, education funding and real estate crowdfunding. The IFT Alliance aims to ensure safety and trust by establishing, promoting and enforcing shared standards for Islamic finance. It also develops, expands and improves innovative ideas in accordance with Shariah and social impact elements. Furthermore, it works with regulators and stakeholders to build and support a dynamic ecosystem through interfacing and providing industry insights.

Shariah-Compliant Peer-to-Peer Crowdfunding

In 2016, SC licensed the world's first Shariah-compliant P2P to one of the six P2P registered companies. This initiative aims to complement the growing global awareness of Islamic finance with technology to ensure seamless transactions between funding businesses and making returns

¹ A joint enterprise in which all partners share the profit or loss according to the agreed ratio.

² The investor (called Rabbul Mal) provides the capital while the entrepreneur (Mudarib) provides the expertise and specialisation.

³ Covering waqf and zakat as well as scholarships for higher education.

on investment. Furthermore, with the P2P, SMEs are expected to have greater access to funding while investors have an alternative channel to earn higher returns on their investments.

Islamic Robo-Advisor

Shariah-compliant robo-advisor services known as Algebra was introduced in July 2017 in Kuala Lumpur as the world's first Islamic robo-advisor. The online system provides automated portfolio management advice to clients. The Algebra manages asset portfolios by matching individual risk appetites against stock indices by using algorithms. Robo-advisor offers a more transparent, convenient and low-cost alternative to human financial advisors.

Way forward

Malaysia maintains a leading position as the most developed Islamic financial market globally (Thomson Reuters, 2017). However, in terms of Islamic FinTech, Malaysia has to step-up efforts to strengthen its position. At this point, several initiatives are being implemented to accelerate the growth of Islamic FinTech in the country.

Malaysia has issued a FinTech Regulatory Sandbox guideline as a reference document. The framework aims to provide an environment that is conducive for the deployment of financial technology to foster innovations in financial services that can contribute to the growth and development of the financial sector. It also enables innovation of both Islamic and conventional FinTech to be deployed and tested in a live environment, within specified parameters and time frame. Other supportive elements in the broader FinTech ecosystem are also available for FinTech players in Islamic finance to leverage such as the Financial Technology Enable Group (FTEG), Alliance of FinTech Community (aFINity) and the Global Islamic FinTech Hub.

Furthermore, Malaysia Digital Economy Corporation (MDEC) introduced the Islamic Digital Economy (IDE) Guide to assist Islamic digital players by providing opportunities to scale up capacity and increase demand for their products and services. Known as Mi'yar, the guide serves as a reference for start-ups, venture capital and supporting ecosystem players, wishing to explore and understand various IDE components. These include, among others, Islamic venture capital, business operation as well as product and services in Shariah-compliant or Halal perspective. The players that adhere to Mi'yar will be listed as IDE-compliant and recognised as Islamic-centric goods and services providers.

Conclusion

There is enormous growth potential for Islamic FinTech in Malaysia despite being in its infancy stage. The growth is supported by raising awareness among stakeholders and strong demand from customers as well as the facilitative regulatory environment in key Islamic financial markets. By embracing and embarking on Shariah-compliant digital innovations, new and greater opportunities will be available for industry players. Therefore, industry players need to play an aggressive role in accelerating digital innovations. Ultimately, by leveraging Islamic FinTech, Malaysia's aspiration of becoming a global Islamic Financial hub can be achieved through wide-ranging Shariah-compliant products and services offered to cater to the rapidly evolving market and customer demand.

Conclusion

Monetary policy is expected to continue to support economic growth and ensure price stability. Meanwhile, the financial market is anticipated to be vibrant, supported by steady domestic economic activities and the revival of strategic projects. Nevertheless, external factors

which include trade conflicts, volatility in global financial markets and geopolitical unrest may inhibit capital market and financial performance. Given these factors, efforts will be intensified towards strengthening the financial market by allowing greater innovation and adoption of alternative financing channels driven by the advancement in digital technology.

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