2013

MONETARY AND FINANCIAL CONDITIONS

INTERNATIONAL MONETARY AND FINANCIAL CONDITIONS

Global financial markets in 2013 continued to face headwinds from policy uncertainties in the advanced economies. The financial markets of both the advanced and emerging economies experienced markedly different trends prior to and after 22 May 2013, which coincided with the Federal Reserve's (Fed) first indication of a possible scale-back of its asset purchase programme.

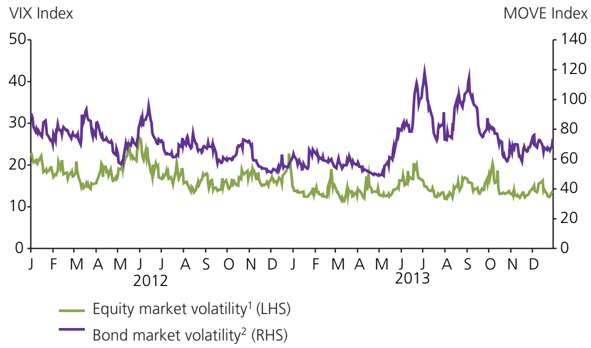
Global financial markets continued to be weighed down by policy uncertainties in the advanced economies in an environment of a modest and uneven global recovery

Global financial markets were relatively stable at the start of 2013 against the backdrop of ample global liquidity and a prolonged period of low interest rates in the advanced economies. Despite ongoing uncertainties, especially on fiscal concerns in both the euro-area and the US, international investor sentiments were broadly positive during this period. These positive sentiments mainly reflected the gradual improvement of economic conditions in most of the advanced economies. As a result, net capital inflows of about USD62.5 billion[1] were estimated to have entered emerging economies between January and April. During the period, regional equity markets increased by between 1.7% and 21.2%, while changes in the regional 5-year government bond yields ranged between a decline of 99 basis points and an increase of 12 basis points.

Global financial market volatility, however, increased significantly in May following heightened uncertainties over monetary policy adjustments in the advanced economies. Amid an improved economic outlook, the Fed's statement

Chart 2.1

Global Financial Market Volatility



Note: [1]Refers to VIX Index
[2]Refers to MOVE Index

Source: Bloomberg

was interpreted by the market as a start of a possible scale-back of its asset purchase programme. The expectation of a reduction in purchases of long-term securities and the subsequent decline in bond prices in the US led to the sell-off in the US long-term bonds in favour of more liquid short term securities and equities. This, in turn, resulted in an immediate increase in the benchmark bond yields and prompted a rebalancing of portfolio investments globally. As a result, the impact spilled over into a broad range of asset classes, and contributed to a decline in asset prices and a depreciation of currencies. Emerging markets were particularly affected by the strong reversal of portfolio flows between May and August. The pace of portfolio outflows from emerging markets were further exacerbated by the adverse sentiments surrounding emerging economies' moderating growth outlook amid weaker commodity prices and policies by the authorities to lean against the risk of financial imbalances. In some countries, concerns over the current account and fiscal positions further spurred the portfolio outflows. In managing the sharp outflows, some countries pursued current account management measures, including imposing or increasing duties on certain imports, as well as limiting resident direct investments abroad. Between May and August, the MSCI Emerging Market Index declined by 10.6% and

[1] Source: Emerging Market Portfolio Research (EPFR) Global

Chart 2.2

MSCI Emerging Market Index

Source: Bloomberg

Chart 2.3

JP Morgan Emerging Markets Bond Index (EMBI) Spread

Source: Bloomberg

the JP Morgan Emerging Market Bond Index (EMBI) spread widened by 83.8 basis points as the emerging economies recorded net capital outflows of USD60.5 billion.

Financial market conditions stabilised somewhat towards the end of the year. In the advanced economies, the resolution to end the US government shutdown and the return of the euro-area to positive growth provided a positive boost to market sentiments. In the emerging economies, improving economic indicators, especially from the external sector, alleviated some of the earlier concerns regarding the fundamentals of these economies. Despite the announcement by the Federal Open Market Committee (FOMC) to reduce its monthly bond purchases on 18 December 2013, the impact on emerging economies has been relatively small compared to the period between May and August. As a result, measures of volatility, such as the Chicago Board Options Exchange Volatility index (VIX) and Merrill Lynch Option Volatility Estimate (MOVE) Index, declined to levels seen earlier in the year, while the pace of capital outflows from emerging economies moderated to USD28.2 billion for the period September to December. The MSCI Emerging Market Index recovered by 7.8% and the JP Morgan EMBI spread narrowed by 47.9 basis points.

Periodic spikes in market volatility are likely to remain a common feature in the global financial landscape as the global economy transitions into an environment of less accommodative monetary conditions. For advanced economies, greater clarity and timely communications will be key to avoiding market over-reaction. Resolution of the ongoing concerns on fiscal sustainability will also be important. For emerging economies, the challenge is to ensure the adjustments from capital outflows are orderly and do not pose risks to the domestic economy and financial system. The improved financial market resilience and capacity to intermediate potential outflows suggest emerging economies are now better prepared to manage adverse spillover effects (see box article `Spillovers of Quantitative Easing on Asia´). However, policy makers must remain vigilant in managing any perception of domestic vulnerabilities, which could unduly exacerbate the volatility in the financial markets.

DOMESTIC MONETARY AND FINANCIAL CONDITIONS

Exchange rate

The ringgit exchange rate was influenced mainly by two-way portfolio and trade flows, reflecting both international and domestic developments. The ringgit was relatively stable in the first four months of the year, trading within the range of RM3.0040 and RM3.1400 against the US dollar. The conclusion of the 13th General Election in Malaysia in early May contributed to the strengthening of the ringgit, with the ringgit reaching RM2.9600 on 6 May 2013 against the US dollar, the highest level since 2 August 2011.

During the year, most emerging market currencies, including the ringgit, were affected by developments relating to the possible scale-back in the asset purchase programme in the US. Market expectations for a reduction in the asset purchase programme by the Fed prompted a reversal of portfolio flows from

Spillovers of Quantitative Easing on Asia

Introduction

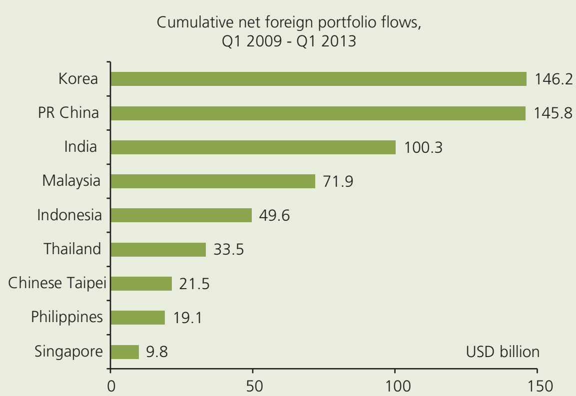
The Global Financial Crisis (GFC) triggered unprecedented policy interventions in the crisis-affected advanced economies. Major central banks reduced policy interest rates to close to zero and implemented unconventional monetary policies such as massive injections of liquidity through quantitative easing (QE). These measures have had a significant spillover impact on global economic and financial conditions. To some extent, these policies have contributed to stabilising financial conditions and supporting the recovery that is gaining momentum in these economies. While the avoidance of a more severe global economic recession has benefitted the emerging economies, there were unintended consequences from maintaining such policies for an extended period of time, particularly, large capital inflows into many emerging economies in search for higher yields. As economic recovery in the advanced economies becomes more entrenched, policymakers will eventually need to unwind these unprecedented injections of liquidity to achieve more normal monetary conditions. This transition, nevertheless, is likely to have an impact on the rest of the world through various channels and in varying degrees. This article explores the spillovers of QE on Asia and assesses the region's strengths and vulnerabilities in facing the challenges that will emerge from the reversal of the unconventional monetary policy measures by the advanced economies.

Impact of QE on Asia

The introduction of QE has led to a massive injection of liquidity into the financial systems of the advanced economies. The balance sheet of the Federal Reserve (Fed), for instance, grew by about four times between December 2006 and August 2013. The balance sheet of the Bank of England expanded by six times, while those of the European Central Bank and the Bank of Japan doubled. Cumulatively, global liquidity, as proxied by the GDP-weighted M2 of the US, euro area, Japan and the UK, increased from USD7.3 trillion in the third quarter of 2008 to about USD10 trillion in the first quarter of 2013. The massive build-up of liquidity and the search for yields caused large capital inflows into the emerging economies given their more favourable growth prospects and higher rates of return. Between 2009 and 2013, Asia received portfolio inflows amounting to USD597.7 billion, equivalent to 2.4% of its combined GDP[1] (Chart 1).

Chart 1

Impact of Quantitative Easing on Asia



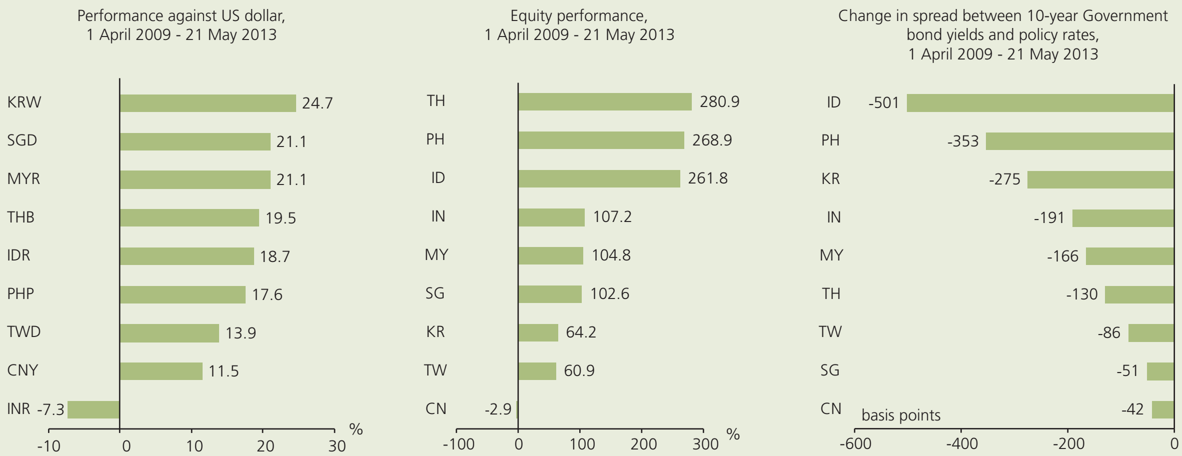
Source: Haver and National Authorities

[1] Asia includes Chinese Taipei, India, Indonesia, Korea, Malaysia, Philippines, PR China, Singapore and Thailand.

This surge in capital inflows exerted significant upward pressure in the currency, equity and bond markets of these Asian economies (Chart 2). The decline in bond yields, in tandem with that of the advanced economies, contributed to a reduction in the domestic cost of financing. The lower interest rate environment and ample liquidity conditions may have contributed to the underpricing of risks, thereby encouraging excessive investments in risky assets and led to the build-up of financial imbalances. As a result, several Asian economies experienced high credit growth and rising property prices.

Chart 2

Impact of QE on Asian Currencies and Financial Markets



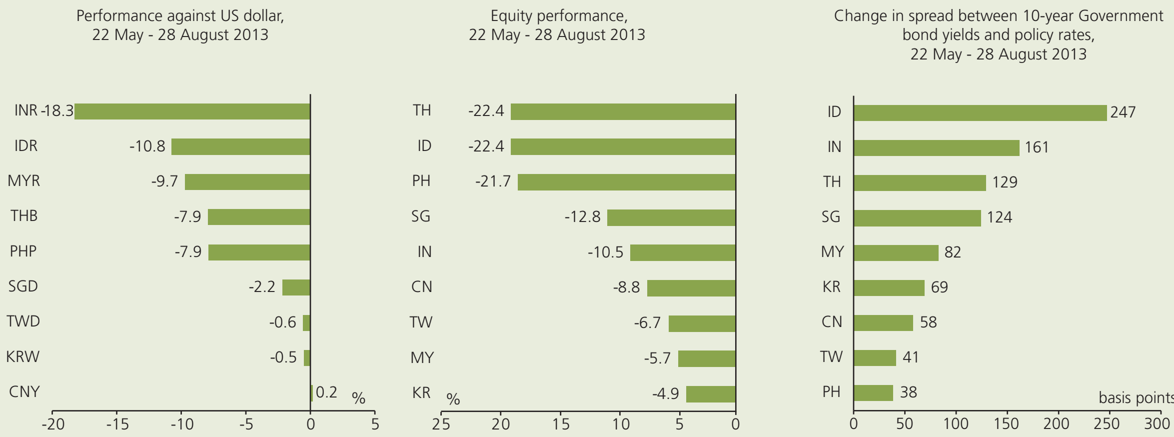
Source: Bloomberg and Bank Negara Malaysia

As the recovery in the advanced economies gains momentum, the unconventional policies and the highly accommodative monetary conditions will be gradually unwound. The transition, if not managed properly, could lead to sudden and sharp reversals of capital flows from the emerging economies, which would in turn trigger disruptions in the global financial markets and affect the pace of global recovery. This was evident in May 2013 following the initial indication of a potential QE scale-back. Uncertainty over the timing and magnitude of the QE scale-back, coupled with the rising expectations of narrowing interest rate differentials between the advanced and emerging economies, prompted investors to rebalance their portfolio position and rapidly unwind their investment positions in the emerging economies. Large capital outflows led to significant downward pressure on currencies and prices in equity and bond markets in the emerging economies between May and August 2013 (Chart 3). In some markets, the reversals caused excessive fluctuation in the bond and equity markets, and overshooting in the exchange rates.

In contrast, the Fed's announcement to begin reducing the pace of asset purchases in December 2013 initially had a more limited impact across economies, as investors had already built in the expectations of an eventual scale back in QE. The enhanced forward guidance in the December FOMC statement had realigned market expectations of the timing of the Fed's first rate hike to a later period. However, the December 2013 decision only marks the beginning of the policy transition in the US. Indications are that the path towards normalisation of monetary policy is expected to be gradual and would take place over a period of time, as well as being conditioned by the strength of the economic recovery. During this transition, the emerging economies will operate in a highly uncertain environment with frequent sharp increases in volatility in the financial markets as investors reassess and shift their positions. In the early part of 2014, volatility in the international financial markets has risen with several emerging economies being severely affected by massive capital outflows. It is also evident that there has been greater differentiation between emerging economies, as investors scrutinise the fundamentals of each country. The risk of contagion, nevertheless, still remains and is on the rise.

Chart 3

Impact of Potential Scaling-back of QE on Asian Currencies and Financial Markets



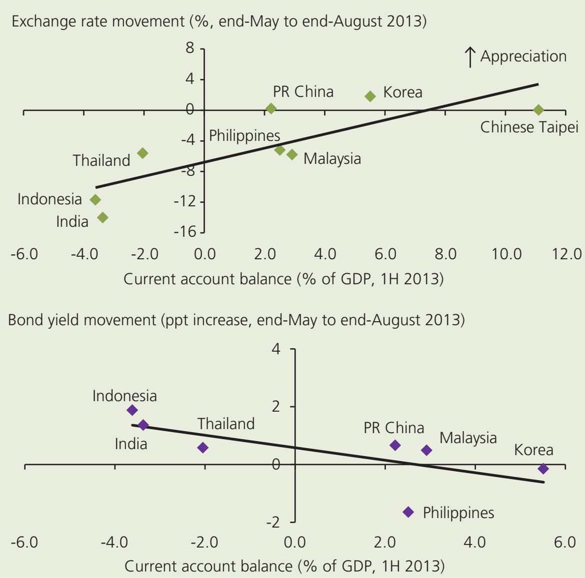
Source: Bloomberg and Bank Negara Malaysia

Asia's challenges and policy responses

While Asia is in a better position relative to the period prior to the Asian Financial Crisis (AFC), recent developments have highlighted the key challenges faced by the emerging economies in an environment of highly volatile capital flows. These include the sustainability of external positions, adequacy of policy space and the health of domestic balance sheets. In particular, countries that have twin deficits are judged to be more reliant on short-term funding and vulnerable to capital reversals (Chart 4). While the narrowing of the emerging economies' current account surplus post-GFC was initially welcomed as a sign of global rebalancing, it has subsequently been seen as increasing the likelihood of potential funding stress if the economies rely heavily on external short-term flows.

Chart 4

Exchange Rate and Bond Yield Movements versus Current Account Balances



Source: Bloomberg and Haver

Widening fiscal deficits and high public debt following large stimulus measures during the GFC raised concerns over the increase in debt servicing costs and the adequacy of fiscal space to embark on future counter-cyclical policies. Another concern is that rapid capital outflows could lead to sharp declines in asset prices with serious repercussions on household balance sheets.

The policy responses by Asian policymakers in addressing the challenges that have been highlighted can be segregated into two phases. Post-GFC, household balance sheet had been a core policy concern. Hence, policymakers in Asia have, since 2009, progressively implemented policies to tackle rising household indebtedness. In particular, countries such as Hong Kong SAR, Singapore and Malaysia have adopted pre-emptive measures including the implementation of macroprudential and demand management policies to address potential overheating in the property market and to slow the growth of credit. Beginning in 2013, the policy focus in several Asian countries has been extended to address the issue of twin deficits. These countries introduced a series of policies which included easing of export rules and improved management of foreign exchange liquidity to strengthen their external positions. In several economies, policy rates have been raised. Fiscal consolidation plans, including tax reforms and subsidy rationalisation, are also being used to restore the health of the government balance sheet. The credibility of these plans has been reinforced by the commitment of clear milestones for fiscal targets in the short and medium term.

Building greater resilience against external shocks

Beyond these immediate challenges, proactive efforts have been undertaken in the recent years to ensure that capital inflows and their subsequent reversal do not significantly disrupt the domestic financial system and economic activity. This has been complemented by structural reforms that have been steadily rolled out since the AFC to increase the resilience of economies, both at the national and regional level.

The strength in the emerging economies' growth in the five years after the GFC has been supported by more diversified sources of growth. In particular, Asia's domestic demand accounted for 86% of GDP in 2012 (1990: 81%). At the same time, regional economies have diversified their trade partners, with intra-regional trade accounting for close to 50% of total trade in 2012 (1990: 37%). Asia's resilience has also been enhanced by more flexible exchange rate regimes, as well as more developed and stronger financial sectors. Compared to the pre-AFC period, most Asian economies are now less reliant on short-term debt funding, have expanded the sources of funding for the economy and have higher level of foreign exchange reserves. In addition, the quality of foreign debt funding has also improved given the deeper and broader capital markets in many countries in the region. These have significantly improved the resilience of Asia in withstanding and responding to external shocks and safeguarding domestic financial and macroeconomic stability.

In addition, there is now greater regional financial integration and cooperation. Over the past decade, regional initiatives have been strengthened to provide a much stronger framework for cross-border financial assistance to improve the crisis readiness of the region. This includes the enhancement of multilateral liquidity support among the Asian economies, such as the Chiang Mai Initiative Multilateralisation (CMIM), which is complemented by economic surveillance conducted by the ASEAN+3 Macroeconomic Research Office (AMRO) and Monetary and Financial Stability Committee of the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP). The recently enhanced Crisis Management and Resolution Framework among EMEAP member countries also serves as a mechanism for collective policy response, surveillance and information sharing. New financial arrangements to facilitate trade financing and settlement in domestic currencies, primarily through local currency swap arrangements between regional central banks have also added a degree of resilience as these have reduced the vulnerability of regional trade to global financial market volatility.

Conclusion

The implementation of unconventional monetary stimulus in the advanced economies was premised upon achieving domestic policy objectives but has had wide-ranging global spillovers. As the pace of economic recovery in the advanced economies gains momentum, the shift towards policy normalisation will eventually take place. This shift will have implications for global capital flows, in particular through the rebalancing of portfolio flows from the emerging economies back to the advanced economies. Against this backdrop, policymakers in Asia face the challenge of managing the impact of capital flow reversals on their domestic economic and financial conditions. Asia, as a whole, has exhibited greater resilience than in previous decades, reflecting in part, the dividends from the post-AFC reforms. In addition, a broader and enhanced policy toolkit will help manage the potential negative externalities that may arise. All these will not necessarily insulate the Asian economies from the spillover effects from policy normalisation in the advanced economies. However, pre-emptive response will enable Asia to alleviate some of these effects and maintain the resilience of the region.

most regional financial markets, resulting in a depreciation of most regional currencies from May to August. Following a temporary period of currency strengthening, the depreciation trend resumed amid renewed expectations for such policy action from end-October and the eventual announcement at the end of the year of a reduction in the size of the Fed's asset purchase programme beginning January 2014.

Ringgit depreciated amid increased global financial market volatility

In the increasingly volatile market environment, more investors, corporates and resident companies proactively managed their currency exposure by using derivatives. The volume of ringgit forwards and swaps was higher during the May to August period compared to the first four months of the year. The volume of forward foreign exchange transactions, in particular, increased by 11.3%, contributed mainly by resident companies hedging their foreign currency exposure arising from international trade transactions. This increased demand for hedging, coupled with the high market volatility, resulted in an increase in the cost of borrowing in US dollars through the cross-currency USD/RM swap market. The 5-year USD/RM cross-currency swap rates widened from 84 basis points in May to 145 basis points in June. However, this subsequently declined to around 70 basis points by the end of the year as market volatility abated.

Chart 2.4

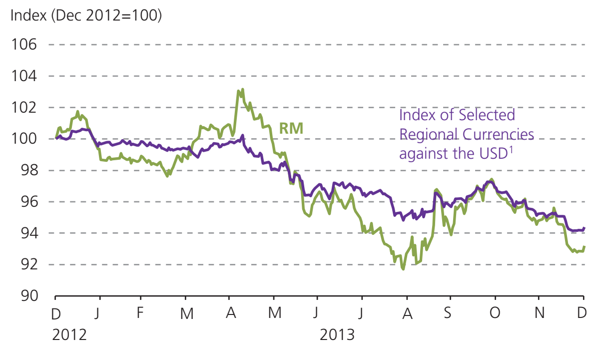
Summary of Malaysian Ringgit (RM) Performance against Major and Regional Currencies

Note: (+) indicates an appreciation of the ringgit against foreign currency

Source: Bank Negara Malaysia

Chart 2.5

Exchange Rate of the Malaysian Ringgit (RM) and Selected Regional Currencies against the US Dollar (USD)



[1]Regional currencies: Chinese renminbi, Indonesian rupiah, Korean won, Philippine peso, Singapore dollar, New Taiwanese dollar and Thai baht. Each currency carries equal weight.

Note: An increase in the index represents an appreciation of the ringgit or of selected regional currencies against the US dollar

Source: Bank Negara Malaysia

For the year as a whole, the ringgit depreciated by 6.8% to end the year at RM3.2815 against the US dollar. The ringgit also depreciated against the euro and pound sterling, but appreciated against the Japanese yen. Against regional currencies, the ringgit exhibited a mixed performance. The ringgit's Nominal Effective Exchange Rate (NEER), a measure of ringgit performance against the currencies of Malaysia's major trading partners, depreciated by 2.2%.

In the near term, intermittent spikes in currency volatility would remain a feature of the international financial markets. Sentiments will continue to be affected by uncertainty about the progress of the normalisation of financial conditions in the advanced economies and the resilience of some emerging economies. Nevertheless, as demonstrated throughout the year, the Malaysian economy and financial system have improved in their ability to withstand the spillovers from shocks in the external environment.

Interest rates, bond yields and equity prices

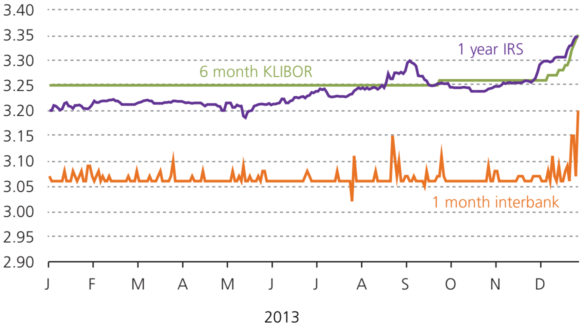
In balancing the risks surrounding the outlook for domestic growth and inflation, the Monetary Policy Committee (MPC) maintained the Overnight Policy Rate (OPR) at 3.00% throughout 2013. Reflecting the unchanged OPR, money market rates remained broadly stable throughout the year. The daily weighted average overnight interbank rate (AOIR) traded close to the OPR, within a tight range of 2.88-3.00% over the period. Interbank rates for other short term tenures were also relatively stable. Movements in medium-term money market rates, however, were influenced by global financial market developments. Rates on interest rate swaps (IRS) increased towards the middle of the year as market expectations for a scale-back in the asset purchase programme by the Fed led to increases in financial market yields globally. Size and turnover of the ringgit IRS market continued to remain healthy, with the total outstanding notional contracts at RM595 billion and a turnover of RM269 billion in 2013. In terms of domestic interest rate expectations, market participants continued to expect BNM to leave the OPR unchanged, as reflected by the stable rates on the 6-month Kuala Lumpur Interbank Offered Rate (KLIBOR), during the year.

Interest rates remained stable and supportive of domestic economic activity

Retail lending rates were broadly stable throughout the period and unaffected by the increase in financial market volatility in the middle of the year. The benchmark lending rate, as measured by the average base lending rate (BLR), remained constant at 6.53%. Lending rates on new loans to businesses and households were generally stable across most sectors and purposes. The stable retail lending rates reflected the unadjusted monetary policy stance and the continued healthy credit profile of borrowers. The weighted average lending rate (ALR) on loans

Chart 2.6

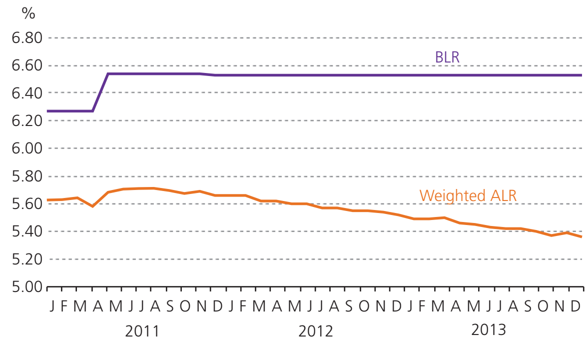
Money and Financial Market Rates



Source: Bank Negara Malaysia and Bloomberg

Chart 2.7

Commercial Banks' Lending Rates (at end-period)



Source: Bank Negara Malaysia

outstanding continued on its gradual moderating trend which had started in 2011 (January 2013: 5.49%; December 2013: 5.36%). This reflected the maturing of loans that were contracted during the period of higher borrowing costs prior to the OPR reductions in 2008 and 2009, as well as the addition of new loans contracted at lower rates.

Deposit rates of commercial banks remained stable throughout the year. The average quoted fixed deposit (FD) rates for the tenures of 1 to 12 months were relatively unchanged, ranging between 2.91% and 3.15% respectively as at end-December 2013. Depositors continued to benefit from positive real rates of return, although real returns gradually moderated as inflation rose towards the end of the year.

Despite the volatile external environment, the spillover effects on MGS yields were relatively contained due to the support of domestic institutional investors

Yields on Malaysian Government Securities (MGS) were driven primarily by external factors, influenced by policy uncertainties in the advanced economies. As with other emerging markets, Malaysia has been experiencing sustained portfolio inflows since early 2009. The bulk of the portfolio inflows went into Government debt instruments, particularly the MGS. The pace of portfolio inflows accelerated following the conclusion of the 13th General Election in May, causing downward pressure on yields. By mid-May, non-resident holdings of government debt instruments had increased to 32.4% (Dec 2012: 29.8%) as the share of non-resident holdings in MGS reached 49.8% (Dec 2012: 44.4%). MGS yields fell between 11 and 41 basis points across all maturities. Such a large exposure to non-residents holdings raised concerns about the potential vulnerability of the domestic financial system to a sudden and sharp withdrawal of non-residents' investment in the MGS market. To date, the risk remains manageable, underpinned by the strong domestic investor base comprising of financial institutions, insurance companies and provident funds. Given the growing demand from these investors for more investible assets in tandem with their growing liabilities, the unwinding of portfolio holdings by non-residents presented opportunities for domestic institutional investors to purchase these domestic assets at attractive yields. As these domestic participants stepped in to purchase these assets, the domestic financial market stabilised.

The support of domestic institutions in the MGS market was evident towards the end of May. The indication of a potential scale-back by the Fed of its asset purchase programme triggered a readjustment of expectations in the global financial markets towards the possibility of tighter global financial conditions. As a result, bond markets began to experience significant portfolio reversals that saw yields increasing across the region. The sizable portfolio outflows of RM19.0 billion from the MGS market between May and August caused MGS yields to increase

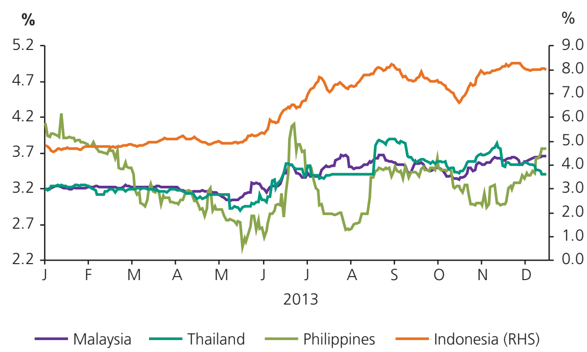
Chart 2.8

MGS Yields

Source: Bank Negara Malaysia

Chart 2.9

5-year Government Bond Yields



Source: Bank Negara Malaysia and Bloomberg

by between 16 and 68 basis points across the 1 to 10-year tenures. These increases were generally smaller compared to markets across the region. The depth and breadth of the domestic bond market had ensured that these volatile flows were intermediated without causing undue dislocation in the financial markets. In line with the efforts to deepen and diversify the domestic bond market, a RM2.5 billion 30-year MGS was also issued during the year. Despite the volatile environment, this inaugural long-term MGS issue attracted a bid-to-cover ratio of 2.44 times, reflecting investors' confidence on Malaysia's long-term economic prospects.

PDS yields remained attractive for fund-raising activities

During the year, the cost of private debt financing remained favourable, despite the uncertain external developments. Private debt securities (PDS) yields were stable, particularly during the first half of the year before registering an increase in the subsequent period. For the year, yields on the 5-year AAA, AA and A-rated papers registered a marginal increase of 15.4 basis points, 10.4 basis points and 3.7 basis points respectively. The stable PDS yields ensured that the fund-raising activity in the PDS market continued to support the economy. The liquidity and credit conditions in the PDS market also continued to remain healthy in 2013. Total turnover amounted to RM143.2 billion (2012: RM159.7 billion), while the number of negative rating actions during the year declined to 23 (2012: 25).

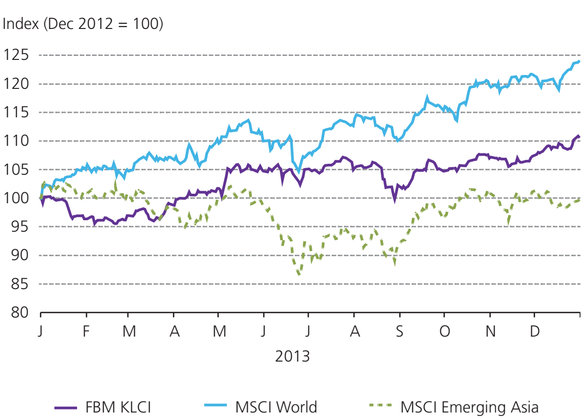
In 2013, the FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI) increased by 10.5% (2012: 10.3%) to close at 1,867.0 points. While sentiments in the market were affected by both domestic and external factors, the underlying performance of the equity market was supported by investors' confidence in the positive economic outlook for the Malaysian economy.

While the FBM KLCI was affected by external and domestic developments, investors' confidence remained anchored on the positive outlook for the economy

The domestic equity market entered the year amid cautious sentiments following the uncertainty on the timing of Malaysia's 13th General Election, which led to domestic investors reducing their holdings of equities. As the General Election concluded on 5 May, the FBM KLCI rose 3.4%, reaching a new high of 1,752.0 points on the first trading day post-election. The strong performance of the equity market was primarily driven by the construction and property sectors amid expectations of the continuation of projects under the Economic Transformation Programme (ETP). Subsequently, investor sentiments were affected by developments surrounding the possible scale-back of the Fed's asset purchase programme, prompting non-resident investors to reduce their holdings of equities in emerging markets including Malaysia. The impact was, however, mitigated by positive sentiment with respect to the export sector due to the recovery in demand for electrical and electronics (E&E) exports and expectations of rising crude palm oil prices in the second half of the year. This kept the domestic equity market on an upward trend, which peaked at 1,872.5 points on 30 December 2013.

Chart 2.10

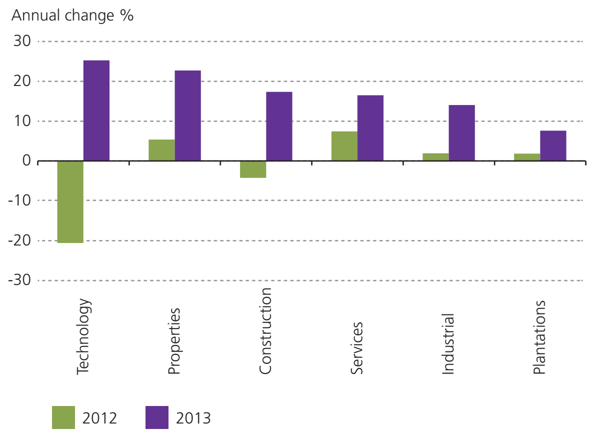
Equity Market Indices



Source: Bloomberg

Chart 2.11

Performance of Sectoral Indices



Source: Bloomberg

Liquidity and Monetary Aggregates

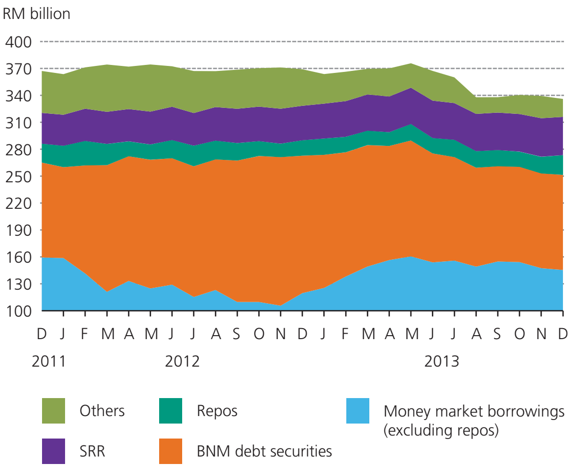
Liquidity conditions remained supportive of economic activity throughout 2013. Notwithstanding the net withdrawal of liquidity due to net foreign outflows during the year, overall surplus liquidity placed with Bank Negara Malaysia remained high with most banking institutions still operating within surplus liquidity positions.

Amid greater volatility in capital flows, the Bank's operations were focused on maintaining stable conditions in the interbank money market. During periods of outflows, the contractionary pressure on liquidity was offset by the net release of funds lent to the Bank. In this respect, the large placements by banks with Bank Negara Malaysia acted as a liquidity buffer for the banking system as a whole.

Private sector liquidity, as measured by broad money or M3, grew at a more moderate pace of 8.1% during the year (2012: 9.0%) due to both domestic and external factors. On the domestic front, M3 rose more gradually due to the slower

Chart 2.12

Outstanding Liquidity Placed with Bank Negara Malaysia (at end period)



Source: Bank Negara Malaysia

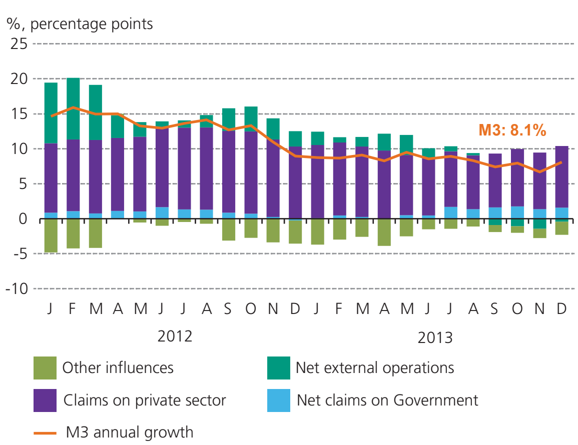
increase in bank lending to businesses and households. On the external front, M3 growth moderated due to outflows on both trade and financial accounts.

FINANCING OF THE ECONOMY

Financing continued to remain supportive of domestic economic activity in 2013. For the year as a whole, net financing to the private sector through the banking system and private debt securities (PDS) market expanded at an annual rate of 9.8% (2012: 12.4%).

Chart 2.13

Contribution to M3 Growth



Source: Bank Negara Malaysia

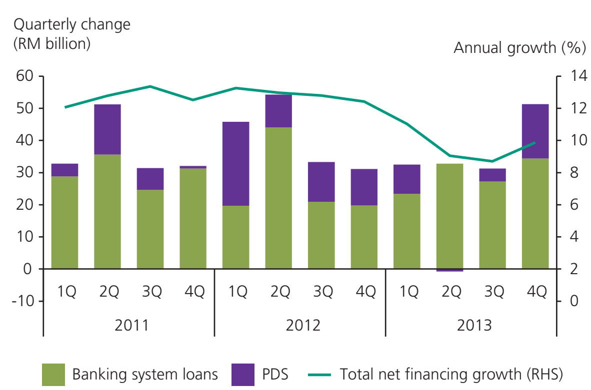
The moderation in the growth of net financing extended to businesses through the banking system and the PDS market (2013: 8.0%; 2012: 14.5%) partly reflected a normalisation from the relatively high level in 2012. The strong increase in 2012 was due to loans disbursed to businesses involved in projects under the Economic Transformation Programme (ETP) and the commodity-related sectors. Notwithstanding the moderation in outstanding loans growth, the overall demand for gross financing by businesses was sustained following continued strength in private consumption and investment activity. The level of loan disbursements to businesses, including SMEs was sustained (monthly average in 2013: RM55 billion; 2012: RM54.8 billion) with the bulk of the loans extended to the *wholesale and retail, restaurants and hotels*; *construction*, *agriculture* and *real estate* sectors.

While growth in net financing moderated, the level of loans disbursed and funds raised in the capital market remained favourable

Business demand for funding from the capital market in 2013 also remained healthy by historical standards, despite the absence of large scale issuances for ETP-related infrastructure projects and government divestment initiatives as seen in 2012. New PDS issuances amounted to RM83.9 billion

Chart 2.14

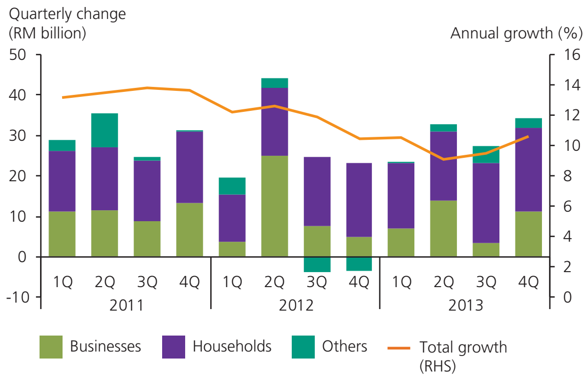
Total Net Financing to the Private Sector through Banking System Loans and PDS Issuances



Source: Bank Negara Malaysia

Chart 2.15

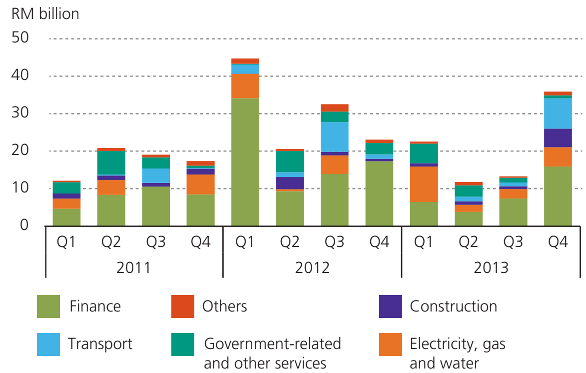
Loans Outstanding by Borrowers



Source: Bank Negara Malaysia

Chart 2.16

Gross PDS Issued by Sector



Source: Bank Negara Malaysia

in 2013 (2012: RM121.1 billion; average 2010-2012: RM80.9 billion)[2]. The bulk of the issuances was from the *finance, insurance, real estate and business services* and *electricity, gas and water* sectors. Financing via the equity market amounted to RM16 billion (2012: RM27.4 billion), mainly by the *trading and services* sector.

Demand for loans by households was also sustained, with the growth in outstanding banking system loans to the sector remaining relatively stable at 12% in 2013 (2012: 11.6%). This was supported by favourable employment conditions and wage growth. Of note, the growth rate of outstanding loans for *personal use* moderated to 4.6% in 2013 (2012: 9.1%), partly as a result of the pre-emptive measures by the Bank in July 2013 to prevent excessive household indebtedness and to reinforce responsible lending practices. The overall growth of household loans, however, was relatively stable due to higher growth rates of loans for the *purchase of securities* and *credit card facilities*, and sustained growth in loans for the *purchase of properties*.

[2] PDS issuances in 2012 was exceptionally high at RM121.1 billion due to a RM30.6 billion single issuance by Projek Lebuhraya Usahasama Berhad