Financial Markets

Financial Markets

Overview

In 2004, the financial markets continued to function effectively in mobilising and allocating funds to serve the needs of investors and corporates, and to facilitate market-based competitive financing for Malaysian businesses and the public sector. Total funds raised from the capital market in 2004 continued to be significant. After accounting for redemptions, net funds raised from the capital market remained high at RM42.7 billion (2003: RM50.4 billion). The Federal Government continued to tap the domestic market to finance its development activity, given the ample liquidity situation. The public sector raised a higher net amount of RM26.7 billion (2003: RM24.7 billion), accounting for 62.5% of total funds raised from the capital market. Meanwhile, net funds raised by the private sector through the equity and bond markets declined by 37.6% to RM16 billion, due mainly to the lower issuance of private debt securities (PDS). A major reason for this decline was the completion of most corporate restructuring activity, and the bulk of the new funds sourced were to finance new activities. Overall, financing of the economy through PDS issuance remained significant, accounting for 23.7% of total private sector financing obtained through PDS and loans.

The financial markets continued to play an important role as a vital source of financing for the economy. Efforts were undertaken to further develop the financial markets as an efficient allocator and mobiliser of investible funds.

In the equity market, fund raising activity was supported by the positive market performance and the improved economic fundamentals. The Kuala Lumpur Composite Index (KLCI) rose by 14.3% to reach 907.43 points as at end-2004, the highest year-end level since the Crisis in 1997. Total funds raised from the equity market amounted to RM6.5 billion, arising mainly from the listing of 72 companies on the Bursa Malaysia, the highest since 1998. The higher number of new listings, especially by small to medium capitalised companies, reflected the improvement in domestic investment activity, especially in the new growth areas of the economy.

Graph 9.1
Net Funds Raised in the Capital Market by the Public and the Private Sectors

Table 9.1
Funds Raised in the Capital Market

	2003	*2004p*
	RM million	
By Public Sector		
Government Securities (gross)	41,262	43,173
Less Redemptions	18,600	18,200
Less Government holdings	0	0
Equals Net Federal receipts	22,662	24,973
Khazanah Bonds (net)	346	-1,198
Government Investment Issues (net)	1,729	1,423
Malaysia Savings Bond/Merdeka Savings Bond (net)	-9	1,474
Net Funds Raised by Public Sector	**24,729**	**26,671**
By Private Sector		
Shares	7,772	6,475
Debt securities		
Issuance (gross)	50,975	36,340
Less Redemptions	33,123	26,814
Equals Net Issues	17,853	9,526
Net Funds Raised by Private Sector	**25,624**	**16,001**
Total Net Funds Raised	**50,353**	**42,672**
Short-term papers and notes (net)[1]	3,753	-3,208
Total	**54,106**	**39,465**

[1] Refers to Commercial Papers and Cagamas Notes. For 2003, include Medium Term Notes

p Preliminary

In the PDS market, the low inflation and interest rates environment coupled with the strengthening economic fundamentals were the main factors contributing to the continuous supply of new PDS, with a total issuance of RM36.4 billion. The PDS market remained the preferred avenue for financing by companies involved in the utilities and construction sectors, which accounted for 59.5% of the total funds raised by the private sector (excluding Cagamas Berhad). In terms of utilisation of bond proceeds, 46.5% of total issuances were for financing new activity, the highest share recorded since the Crisis. This encouraging development provided further evidence of improvement in private investment activity in the Malaysian economy. A significant development in the domestic bond market was the introduction of new asset classes. Several new instruments including the Residential Mortgage Backed Securities and ringgit bonds by the multilateral development banks were issued during the year.

In terms of market transaction and trading activity, both the Kuala Lumpur interbank foreign exchange market and the exchange-traded derivatives market recorded robust activity with volumes increasing by 44% and 32%, respectively. In the equity, bond and money markets, trading volume declined slightly during the year. Trading of money market papers during the year was influenced largely by changing market expectations on the prospects for economic growth and the direction of interest rate.

The increased transactions in the Kuala Lumpur foreign exchange market can be attributed to increased trade and investment activity, as well as greater volatility in the major currencies. The increased volatility in the foreign exchange markets encouraged currency traders to diversify and to hedge portfolios as well as to trade on opportunities arising from exchange rate movements.

On Bursa Malaysia Derivatives, trading activity was concentrated on CPO futures and KLCI futures, which together accounted for 93.7% of total trade. Of significance was the higher annual growth of 229% recorded in the KLCI futures, due mainly to the better performance in the underlying equity market as well as measures taken by Bursa Malaysia Derivatives to reduce margin requirements and transaction costs in late 2003. To further enhance the risk management tools for palm oil traders, the Palm Kernel Oil Futures was launched, allowing market participants to better manage their exposures to palm oil prices.

On the developmental front, the Government and the relevant authorities continued to support the further growth and strengthening of the domestic financial markets towards achieving higher levels of efficiency, resilience and competitiveness. Of significance, several liberalisation measures were introduced to allow foreign stockbrokers, futures brokers and fund managers to operate in Malaysia. In addition, non-resident companies were exempted from withholding tax on interest income earned on holdings of ringgit-denominated debt securities issued by the Government as well as debt securities approved by the Securities Commission. These developments continued to further widen the investors' profile in the domestic capital market. Details are contained in the white box on **Key Capital Market Measures in 2004**.

Money Market

Activity in the money market was slightly lower in 2004, as reflected by the decline in the trading volume of both interbank deposits and money market papers.

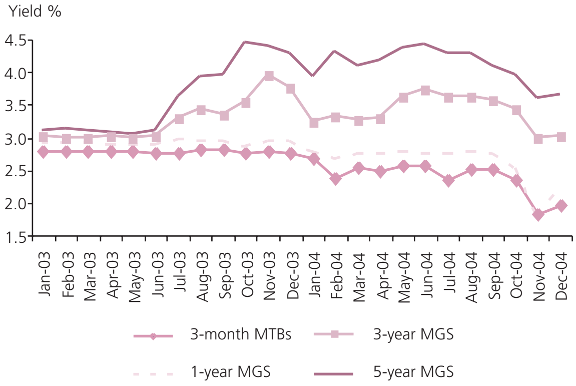
Amidst an environment of stable interbank rates and continued ample liquidity throughout the year, the volume of transactions in the interbank deposit market declined by 2.5% in 2004 as market participants had less incentive to source funds from the interbank market. Compared to 2003, the daily weighted average overnight interbank rate fluctuated within a narrower range of 2.65 – 2.74%, averaging at 2.70%.

Table 9.2
Money Market[1]

	2003		2004	
	Volume (RM billion)	Annual change (%)	Volume (RM billion)	Annual change (%)
Total money market transactions	**1,541.0**	**5.2**	**1,487.0**	**-3.5**
Interbank deposits	**1,084.7**	**7.2**	**1,057.5**	**-2.5**
Money market papers	**456.3**	**0.6**	**429.5**	**-5.9**
Bankers Accecptance (BAs)	37.3	-27.4	48.0	28.7
Negotiable instrument of deposits (NIDs)	43.0	17.3	36.3	-15.7
Malaysian Government Securities (MGS)	231.4	-5.2	193.3	-16.5
Khazanah bonds	18.7	20.7	17.8	-5.1
Treasury bills	9.9	17.7	17.1	73.1
Bank Negara bills	74.5	36.9	74.1	-0.4
Cagamas bonds	25.6	-12.4	38.6	51.0
Cagamas notes	16.0	16.2	4.4	-72.7

[1] All data are sourced from the Bond Information and Dissemination System, except for BAs and NIDs which are sourced from money market brokers.

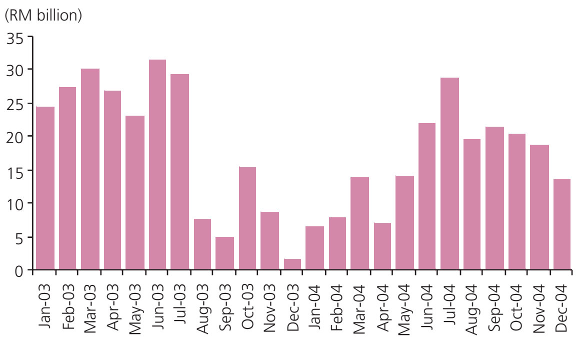
Graph 9.2
Yields of Money Market Instruments



Trading of money market papers during the year were influenced largely by changing market expectations about the prospects for economic growth and interest rate direction. In the first quarter, the low inflation rate and assurances of unchanged domestic monetary policy spurred trading in MGS, as both domestic and foreign investors raised their exposure in fixed income securities. Consequently, the volume of MGS traded rose substantially from RM1.7 billion in December 2003 to RM13.8 billion in March 2004 with a shift in preference towards long-term fixed income instruments. The stronger demand pushed yields down for 3-year and 5-year MGS by 51 basis points (bps) and 20 bps to 3.25% and 4.08% respectively. Trading in treasury bills was also high at an annual rate of 173.7% in the first quarter of 2004, while the yield for the 3-month treasury bills declined by 23 bps compared to the end-December 2003 level.

Subsequently, bond yields began to trend upwards in the second quarter of 2004. The release of the strong first quarter GDP growth and rising US Treasury yields

Graph 9.3
Volume of Traded MGS



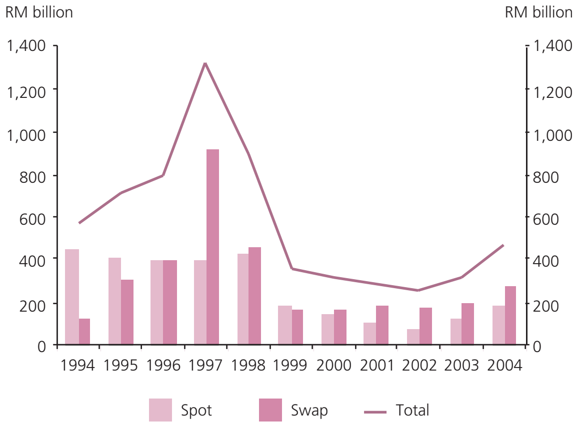
Graph 9.4
Interbank Deposits

amidst expectations that the strong growth in the US would prompt the Federal Reserve to increase interest rates, changed market expectations over the direction of interest rates in Malaysia. This led to selling pressure in the MGS market and caused the 3-year and 5-year MGS yields to increase to 3.72% and 4.41% respectively as at end-June, the highest yields recorded in 2004.

However, in the second half of the year, the trend in bond yields reversed and trended downwards again, mainly influenced by the escalating crude oil prices and their negative impact on prospects for global growth. Demand for ringgit-denominated fixed income securities rose on investor confidence that the inflation outlook in Malaysia remained subdued and on expectations of realignments of currencies in Asia against US dollar. This was further reinforced by the declining US Treasury yields following indications by the Federal Open Market Committee (FOMC) that the increase in the interest rate in the US would be at a moderate pace and the exemption of withholding tax on interest earned on holdings of ringgit-denominated debt securities issued by the Government as well as securities approved by the Securities Commission. The strong interests in ringgit-denominated assets led to a steep decline in the yields, particularly in short-term papers. Between end-October and end-November, yields on 1-year MGS dropped by 76 bps, while yields for 3-month treasury bills declined by 51 bps.

Graph 9.5
Money Market Instruments

Graph 9.6
Volume of Interbank Transactions in the Kuala Lumpur Foreign Exchange Market



Note: Data from 2002 onwards is based on the new Ringgit Operations Monitoring System (ROMS), whereas observations for previous years are based on transactions of the eight Authorised Dealers.

A notable development during the year was the significant movements in the trading of Cagamas debt securities. The trading in Cagamas notes declined by 73%, due mainly to the lower issuance of only RM1 billion in 2004 compared to almost RM10 billion in 2003. Meanwhile, trading in Cagamas bonds increased significantly following the removal of regulatory incentive of Cagamas debt securities in September 2004, which resulted in marginal increase in yields of Cagamas bonds.

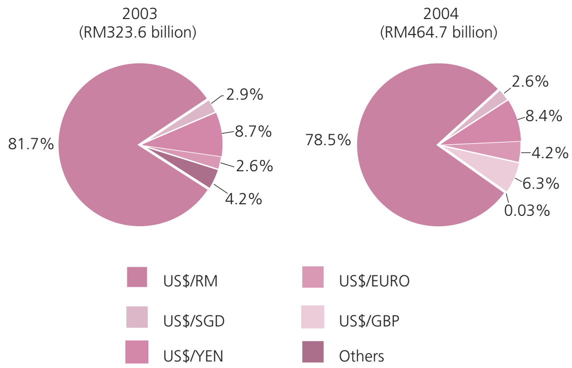
Foreign Exchange Market

In the Kuala Lumpur interbank foreign exchange market, the average daily volume of interbank foreign exchange transactions (spot and swap) increased by 44% compared to 2003. There was a greater increase in spot transactions of 57%, compared to a 36% increase in swap transactions. In general, changes in volume and composition in the foreign exchange market can be attributed to increased trade and investment and greater volatility in the major currencies during the year. Amid the increased volatility among major currencies, currency traders sought to diversify, adjust and hedge their portfolios and trade on profit opportunities created by the movements of exchange rates.

The increased trade and investment activity had a direct positive impact on the volume of both spot and swap transactions. In 2004, Malaysian exports and imports grew by 20.8% and 26.3% respectively, as compared to 11.3% and 4.4% in 2003. The KL foreign exchange market also saw higher activity following a marked increase in portfolio inflows. Higher volatility in the foreign exchange markets amid a depreciating US dollar and the resultant adjustments of world currencies also led to a rise in hedging activity by market participants to manage their exposure to currency risks.

By composition, the Kuala Lumpur foreign exchange market comprised mainly transactions involving the ringgit, yen, euro, Singapore dollar and pound sterling against the US dollar. The US dollar is used widely in the settlement of trade, services and capital account transactions, thus the continued domination of transactions in the US

Graph 9.7
Transactions in the Kuala Lumpur Foreign Exchange Market by Currency



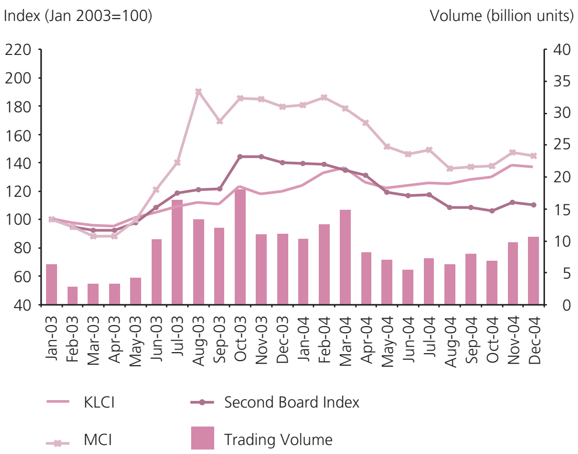
dollar against the ringgit. Nonetheless, the share of such transactions in total foreign exchange transactions decreased from 81.7% in 2003 to 78.5% in 2004. Similarly, the share of transactions involving the yen and Singapore dollar against the US dollar decreased by 3% and 10% respectively. By contrast, there was a significant increase in transactions involving the pound sterling against the US dollar, which became the third largest traded currency pair in 2004. Euro transactions against the US dollar also increased to 4.2% of total transactions in 2004 compared to 2.6% in 2003. To some extent, the shift can be explained by a more active diversification from lower yielding currencies such as the dollar and yen, into higher yielding ones such as the pound sterling and the euro.

Equity Market

In 2004, the Malaysian equity market performed well with most major market indices ending the year higher. The Kuala Lumpur Composite Index (KLCI) ended the year at 907.43 points or 14.3% higher than the end-2003 level. Total market capitalisation increased to RM722.04 billion, an increase of 12.8% compared to the end-2003 level. Market activity remained significant as the annual market turnover amounted to 108 billion units valued at RM216.7 billion. Regionally, the KLCI was one of the outperformers in the Asian region.

Market liquidity declined slightly in 2004 as the average daily turnover decreased to 435.5 million units, from 456 million units in 2003. Market sentiments, on the whole, were negatively influenced by unfavourable external factors, such as the high oil prices and the rising US interest rates. However, stronger overall economic growth and rising corporate earnings buoyed investors' interest in the Malaysian equity market. The reorientation of Government-linked companies (GLCs) towards greater shareholder value creation

Graph 9.8
Kuala Lumpur Composite Index (KLCI), Second Board Index, MESDAQ Market Composite Index (MCI) and Bursa Malaysia's Trading Volume



Source: Bursa Malaysia

Table 9.3
Bursa Malaysia: Selected Indicators

	2003	2004
Price Indices:		
Composite	793.94	907.43
EMAS	195.57	214.26
Second Board	140.64	110.87
MESDAQ	152.25	122.84
Total Turnover:		
Volume (billion units)	112.2	108.0
Value (RM billion)	183.9	216.7
Average Daily Turnover:		
Volume (million units)	456.0	435.5
Value (RM million)	747.5	873.7
Market Capitalisation (RM billion)	640.5	722.0
Market Capitalisation / GDP (%)	162.5	161.3
Total No. of Listed Companies:	906	963
Main Board	598	622
Second Board	276	278
MESDAQ	32	63
Market Liquidity:		
Turnover Value / Average Market Capitalisation (%)	33.4	31.9
Turnover Volume / Number of Listed Securities (%)	43.2	36.4
Market Concentration:		
*10 Most Highly Capitalised Stocks / Market Capitalisation (%)	31.6	34.4
Average Paid-Up Capital of Stockbroking Firms (RM million)	170.9	167.0

* Based on market transactions only.

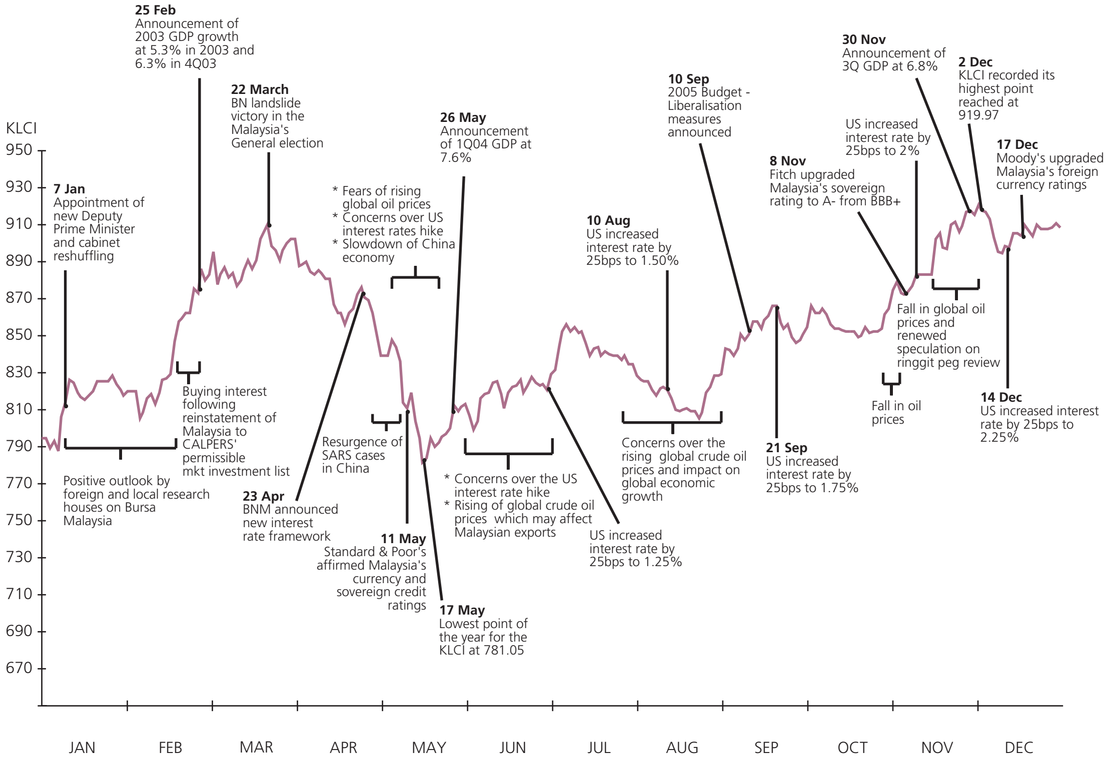
Source: Bursa Malaysia

Table 9.4
Bursa Malaysia: Performance of Sectoral Indices

	2003	2004
	Annual change (%)	
Kuala Lumpur Composite Index	22.8	14.3
EMAS	24.4	9.6
Second Board	43.2	-21.2
MESDAQ Composite Index	82.9	-19.3
Finance	33.2	15.3
Trading / Services	18.3	14.3
Industrial	31.3	10.9
Plantation	19.3	9.4
Syariah	23.2	8.9
Consumer Products	28.8	7.3
Mining	74.8	6.7
Industrial Products	23.4	4.6
Properties	38.8	-4.5
Construction	24.6	-8.9
Technology	33.9	-28.5

Source: Bursa Malaysia

Graph 9.9: Performance of the Kuala Lumpur Composite Index in 2004



Better market performance and broader investor interest resulted in 72 IPOs, the highest since 1998, further evidence of the growing importance of the stock market as a source of equity capital to finance growth in the economy.

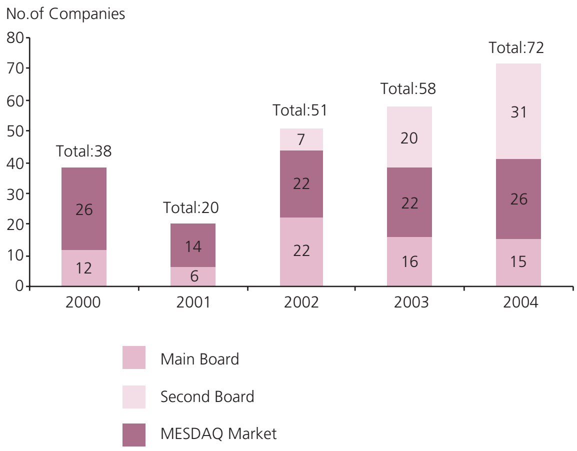
and the initiatives taken by the Government to improve the delivery system of the public sector in order to drive greater efficiency and competitiveness of the economy attracted foreign funds to increase weightings in Malaysia.

Investors were further encouraged by the announcement of new liberalisation measures to allow foreign stockbrokers, fund managers and venture capitalists to operate in Malaysia. These measures are expected to enhance market liquidity, boost competitiveness and strengthen Malaysia's capital market.

The performance of the equity market was supported by strong growth in corporate earnings and strengthened financial position of the corporate sector. From a sample of 351 listed non-financial corporations (representing close to 75% of Bursa Malaysia's total market capitalisation), profits for 2004 grew by 19%. Annualised return-on-equity for the sample rose to 9.1% in the fourth quarter of 2004 (Q4 2003: 8.2%). Earnings growth was particularly strong in the telecommunications, transport and timber sectors, as well as in selected manufacturing sub-sectors (steel products, rubber products, and electronics). The improvement in profitability was also driven by the successful turn-around of a number of companies that had completed their restructuring exercises in the last few years.

In line with the earnings improvement, cash flows from the operations of the corporate sector rose in 2004. Stronger cash flows enabled firms to fund a larger portion of their capital expenditure from internally generated funds. As a result, corporate indebtedness remained stable. Stronger cash flows, together with stable leverage and low interest rates, resulted in stronger debt servicing capacity of the corporate sector. Stronger cash flows also enabled some large corporations to increase their dividend payments to shareholders.

Graph 9.10
Bursa Malaysia: Number of New Listings

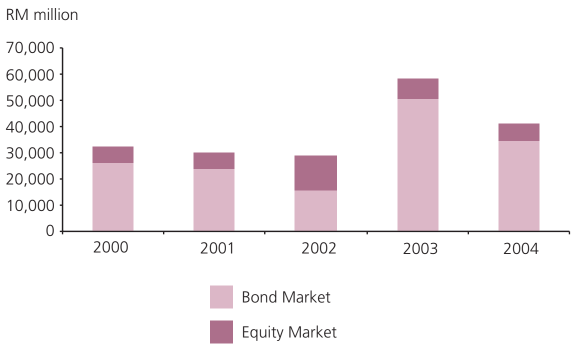


The equity market remained a significant source of financing for the private sector in 2004. Positive market performance coupled with strong economic fundamentals encouraged a larger number of small to medium capitalised companies to raise equity funds in the market. More companies sought listing on the MESDAQ Market and Second Board during the year, with the total number of new listings on the Bursa Malaysia rising by 72, the highest since 1998. Of the total, 31 companies were listed on the MESDAQ Market, 26 on the Second Board and the remaining 15 on the Main Board. Most companies that were listed were from the technology and high growth sectors as well as consumer and industrial products sectors. Two large companies sought listing during the year which enhanced market capitalisation by 0.8%. The higher number of new companies listed on Bursa Malaysia in 2004 provided further evidence of improvement in private investment activity, especially in the new growth areas of the economy. The total number of companies listed in Bursa Malaysia was 963 by the end of 2004. In terms of the number of listed companies, Bursa Malaysia ranks second, after Hong Kong China in the East Asia (excluding Japan) region.

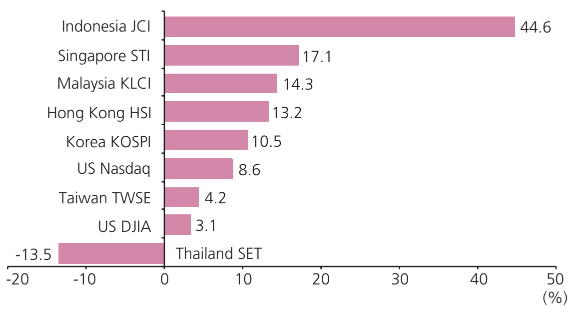
Total funds raised through the equity market, however, were slightly lower at RM6.5 billion, compared with RM7.8 billion in 2003. The bulk of these funds were raised through initial public offerings (IPOs) and rights issues, amounting to RM4 billion and RM1.5 billion, respectively. The funds raised were lower, due to the smaller size of the IPOs. However, most of the IPOs during the year were oversubscribed reflecting strong investor interest in new listings. Funds raised in the equity market constituted about 40% of the total net funds raised by the private sector in the capital market in 2004.

Recognising the significance of equity market as an important source of financing for the economy, the Government and relevant authorities introduced several measures to further strengthen the equity market. The new liberalisation measures were aimed at increasing global competitiveness, promoting innovation and widening market coverage. Other measures introduced in 2004 were targeted at easing the listing process, enhancing disclosure by listed companies, enhancing stockbroking companies' resilience and improving investor protection. Details of the measures introduced during the year are contained in the white box on **Key Capital Market Measures in 2004**.

Graph 9.11
Funds Raised by the Private Sector in the Capital Market



Graph 9.12
Performance of Selected Stock Markets Indices (% change from end-2003 to end-2004)



Source: Bursa Malaysia

Key Capital Market Measures in 2004

Capital market measures introduced in 2004 were aimed at further strengthening the capital market, improving the intermediary process and protecting investors. Key measures introduced in 2004 were as follows:

Strengthening the Bond Market

- Effective 1 April, Bank Negara Malaysia **liberalised the foreign exchange administration rules** to allow Multilateral Development Banks (MDBs) or Multilateral Financial Institutions (MFIs) and Multinational Corporations to raise ringgit-denominated bonds in the Malaysian capital market, in line with Malaysia's on-going efforts to enhance development of the domestic bond market. In facilitating the issuance of the ringgit-denominated bonds issued by MDBs or MFIs, various flexibilities were accorded. Among others, Bank Negara Malaysia classified ringgit-denominated bonds issued by MDBs and MFIs as liquefiable assets under the new liquidity framework for banking institutions, accorded 0% risk weight under the risk-weighted capital ratio framework and allowed deduction from eligible liabilities for the computation of statutory reserves requirements. In addition, for resident insurers, ringgit-denominated bonds issued by MDBs and MFIs are qualified as low risk assets to support their margin of solvency. Similarly, the Securities Commission (SC) also provided various flexibilities, which among others, included accepting international credit ratings and exempting MDBs or MFIs from various requirements of the PDS Guidelines.

- On 26 July, the **Guidelines on the Offering of Islamic Securities (IS Guidelines)** were introduced by the SC to further facilitate the issuance of Islamic securities in Malaysia. With the release of the IS guidelines, the PDS Guidelines were no longer applicable with regards to the issuance of Islamic securities.

- On 3 September, Bank Negara Malaysia **revised the regulatory treatment accorded to new Cagamas debt securities issued after 4 September.** The aim was to promote more market-based pricing and increase investors' interest in the new Cagamas debt securities. The revised regulatory treatment for all new Cagamas debt securities were as follows:
  i. Holdings by banking institutions qualified for a 20% risk weight for capital adequacy purposes and Class-2 liquefiable asset status under the liquidity framework. In line with this, the threshold for Class-2 liquefiable assets recognised under the liquidity framework was increased to 50%;
  ii. Cagamas debt securities would be subjected to the Single Customer Credit limit of 35% of total capital funds of banking institutions;
  iii. Holdings by insurance companies were classified as 'credit facilities' and would continue to be accorded admitted asset status; and
  iv. Primary issuance of Cagamas debt securities would be market driven.

- Effective 11 September, **tax exemption was given on interest income derived by non-resident companies** from ringgit-denominated Islamic securities and debentures, excluding convertible loan stocks, approved by the SC and securities issued by the Government of Malaysia.

Widening Market Coverage for the Equity and Derivatives Markets

- As announced in the Budget 2005 on 10 September, the Government announced several **liberalisation measures to strengthen the equity and derivatives markets** by increasing global market competitiveness, promoting innovation and widening market coverage; as follows:
  i. **allow five major foreign stockbrokers to operate in Malaysia**;
  ii. **allow five leading global fund managers** to participate in the institutional segment of the Malaysian fund management industry;
  iii. **allow 100 percent foreign ownership in futures broking companies**;
  iv. allow local stockbroking companies which have merged with at least one other stockbroking company to **establish four additional branches or Electronic Access Facilities Permitted Activities;** and
  v. **abolish the limit** on the number of foreign dealer representatives.

Easing the Listing Process

- On 9 February, the SC announced some amendments to Schedule 1 of the Securities Commission Act 1993, which **allowed public companies to undertake bonus issues, employee share schemes and employee share option schemes (ESOS) without the need for a prior approval from the SC.**

Enhancing Disclosure by Listed Companies

- From 1 April, **listed companies that delay the submission of their financial statements for a period exceeding three months will be subjected to trading suspensions.**

- On 19 May, the SC released the "Prospectus Guidelines – Guidelines Supplement 1 for listing of Foreign-Incorporated Companies" to **enhance the disclosure requirements for foreign corporations seeking listing** in Bursa Malaysia.

- On 30 November, Bursa Malaysia Securities Berhad **amended the Listing Requirements** in relation to listed companies with unsatisfactory financial conditions and levels of operations. The amendments, among others, required listed companies to submit their regularisation plans within eight months in lieu of trading suspensions and de-listment from the Bursa Malaysia.

Enhancing Stockbroking Companies' Resilience

- On 28 October, the SC announced **revisions to the capital requirements framework for stockbroking companies** to provide the stockbroking industry with greater flexibility in managing their capital requirements as well as to enhance the overall competitiveness. The new capital requirements framework, among others, reduced the minimum paid-up capital for Universal Brokers (UBs) to RM100 million from RM250 million previously and required a minimum level for shareholders' funds unimpaired by losses of RM20 million for non-UBs and RM100 million for UBs.

Improving Investors Protection

- On 25 February, the SC announced several **amendments to the securities laws to better safeguard investors' interests and further enhance corporate governance.** The securities laws included the Securities Industry (Amendment) Act 2003 (SIA), the Securities Commission (Amendment) Act 2003, the Futures Industry (Amendment) Act 2003 and the Securities Industry (Central Depositories) (Amendment) Act 2003. The amendments were aimed at:
  i. enhancing client's asset protection;
  ii. introducing whistle blowing provisions;
  iii. strengthening the framework on investment advice;
  iv. enhancing civil and administrative action powers; and
  v. strengthening clearing and settlement arrangements.

Promoting the Fund Management Industry

- On 28 April, the SC issued a guidance note to the unit trust guidelines that **allowed more Malaysian-incorporated licensed banks and licensed merchant banks to act as guarantors for guaranteed funds.** The guidance note, which aimed at promoting the growth of the unit trust industry in Malaysia, requires the guarantor to have a minimum long-term rating that indicates adequate safety for timely payments of financial obligations and have a credit profile which is regarded as adequate by any global or domestic rating agency.

- On 24 November, the SC released a set of guidelines to **facilitate unit trust management companies (UTMC) to establish online transactions of unit trusts.**

Bond Market

The ringgit bond market remained an important source of financing for the economy in 2004. Total gross financing amounted to RM85.8 billion. After taking into account redemptions during the year, total net funds raised in the bond market amounted to RM36.2 billion. As a result, total outstanding ringgit bonds grew by 10.7% to RM363 billion, equivalent to 81% of GDP. The general market conditions remained favourable for both issuance and trading activities, given the low inflation and interest rates environment and the strengthening of economic fundamentals. A significant development for the bond market was the introduction of new assets classes, which widened the breadth of the market. During the year, two Multilateral Development Banks issued ringgit bonds, while Cagamas MBS Berhad issued the Residential Mortgage Backed Securities (RMBS). The inaugural issuance of the Asian Development Bank (ADB)'s Putra bonds (RM400 million) and the International Finance Corporation (IFC)'s Wawasan Islamic bonds (RM500 million) reflected the confidence of the international institutions in the Malaysian capital market as a reliable source of competitive funds. The ADB and IFC bond issuances were oversubscribed by 6.5 and 4.3 times respectively.

Developments in the bond market were positive and supported the increase in domestic private investment activity in 2004.

In the primary market, the public sector raised net funds of RM26.7 billion. The Federal Government issued and reopened a total of fourteen Malaysian Government Securities (MGS) and three Government Investment Issues (GIIs). Funds raised by the Government were used to finance development activity. In an effort to further lengthen the benchmark yield curve, the Government issued a 15-year MGS through an open tender to provide the private sector a new benchmark for longer-maturity instruments. As the development of the Islamic bond market runs parallel with the conventional market, the Government had also increased the nominal issuance size of GIIs to RM4.1 billion in 2004 from RM2 billion in 2003. In addition, the GII maturity structure was lengthened from 5-year to 7-year with the objective of developing an Islamic benchmark

Table 9.5
Funds Raised in the Bond Market

	2003	2004*p*
	RM million	
By Public Sector		
Government Securities (gross)	41,262	43,173
Less Redemptions	18,600	18,200
Less Government holdings	0	0
Equals Net Federal Receipts	22,662	24,973
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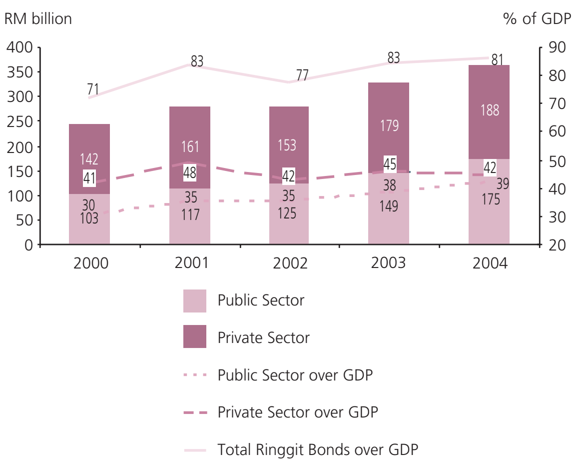
Khazanah Bonds (net)	346	-1,198
Malaysia Savings Bond/Merdeka Savings Bond (net)	-9	1,474
Net Funds Raised	**24,729**	**26,671**
By Private Sector		
Private Debt Securities (gross)	50,975	36,340
Straight Bonds	27,983	4,313
Bonds with Warrants	0	60
Convertible Bonds	3,177	4,301
Islamic Bonds	8,143	9,104
Asset Backed Securities	3,487	2,958
Medium Term Notes[1]	0	7,315
Cagamas Bonds	8,185	8,290
Less Redemptions	33,123	26,814
Private Debt Securities	27,971	19,648
Cagamas Bonds	5,152	7,166
Net Funds Raised	**17,853**	**9,526**
Net Funds Raised in the Bond Market	**42,582**	**36,197**
Private Debt Securities, excluding Cagamas (gross)	*42,790*	*28,050*
Net Funds Raised in the Bond Market, excluding Cagamas	*14,820*	*8,402*
Net Issues Short Term Securities, Commercial Papers[2]	3,753	-3,208
Total	**46,335**	**32,990**

[1] Compilation of medium-term notes began in 2004.
[2] Refers to Cagamas Notes and Commercial Papers. For 2003, includes Medium-Term Notes.
p Preliminary

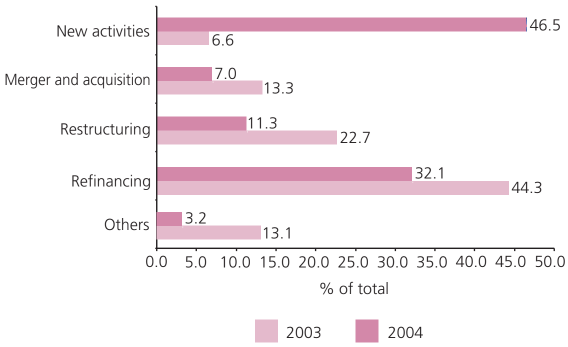
Graph 9.13
Total Bonds Outstanding



yield curve. During the year, BNM launched the Merdeka Savings Bond (MSB), providing a new investment instrument to senior citizens and retired uniformed personnel. Subsequently, the MSB was also made available to Malaysian citizens who have retired on medical grounds. Since its launch, four series of MSBs were issued in 2004 with net funds raised amounting to RM1.9 billion. As at end-2004, total outstanding public sector bonds amounted to RM175.4 billion, equivalent to 39% of GDP.

Favourable market conditions, a low inflation and interest rates environment, coupled with strengthening economic conditions in 2004 were the main factors contributing to the continuous supply of new PDS. Total gross funds raised by the private sector remained significant at RM36.3 billion. A total of 89 companies sourced financing from the PDS market and raised RM28 billion, while Cagamas Berhad raised the balance of RM8.3 billion. Compared to total new issuances of RM51 billion in 2003, there was a decline in new issuances of PDS in 2004. Between 1999 to 2003, the bulk of new issuances of PDS (70% of total, excluding Cagamas bonds) were for restructuring and refinancing purposes. By 2004, the corporate sector had successfully undertaken most of its restructuring exercise and the need to use bond market to finance its restructuring activity declined. The corporate sector continued to register strong earnings and has strengthened its balance sheets since the Crisis. Stronger cash flow positions have enabled firms to embark on new investment activities, as evidenced from the increase in their capital expenditures. Reflecting this development and the continued increase in domestic private investment activity, issuance of PDS to finance new business activity increased significantly in 2004 and accounted for 46.5% of total issuances. Corporations in the infrastructure and utilities sectors were the main issuers for this purpose. Meanwhile, issuances for refinancing purposes accounted for 32.1% of total issuance, of which 20% were issuances of asset-backed securities.

Graph 9.14
Utilisation of Bond Proceeds[1]



[1] Excluding Cagamas

After netting out redemptions during the year, net funds raised by the private sector amounted to RM9.5 billion. As at end-2004, total outstanding private sector bonds had increased to RM187.6 billion, equivalent to 42% of GDP or 51.7% of total outstanding bonds in the market. The share of PDS financing (excluding Cagamas) to the private sector remained significant, at 23.7% of total PDS and loans financing to the private sector.

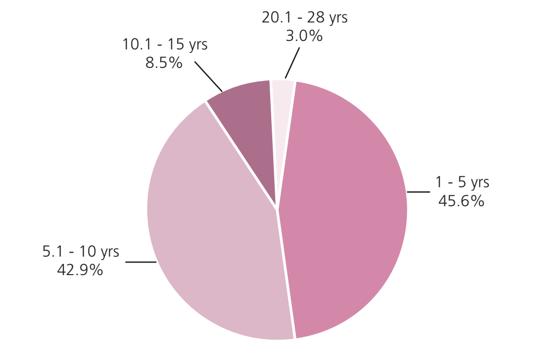
Companies from the construction and utilities sectors were the main issuers of PDS, raising 31.5% and 28% of the total funds respectively. Major issuers within these sectors were the major developers of infrastructure projects, water projects and independent power producers that required long-term and flexible financing.

Table 9.6
New Issues of Private Debt Securities by Sector[1]

Sector	2003		2004p	
	RM million	% share	RM million	% share
Agriculture, forestry and fishing	993.1	2.3	0.0	0.0
Mining and quarrying	0.0	0.0	0.0	0.0
Manufacturing	9,072.4	21.2	3,264.5	11.6
Construction	6,049.7	14.1	8,844.9	31.5
Electricity, gas and water supply	3,410.5	8.0	7,480.2	28.0
Transport, storage and communication	8,603.8	20.1	796.0	2.8
Financing, insurance, real estate and business services	8,372.8	19.6	4,767.8	17.0
Government and others	6,288.1	14.7	1,315.4	4.7
Wholesale and retail trade,restaurants and hotels	0.0	0.0	1,221.1	4.4
Total	**42,790.4**	**100.0**	**28,049.9**	**100.0**

p Preliminary
[1] Excluding Cagamas

Graph 9.15
PDS Issues by Tenure[1]



[1] Excluding Cagamas.

During the year, new PDS issues with tenures between one to ten years accounted for 88.5% of total value issued, reflecting investors' preference for short to medium-term securities. A notable development during the year was the lengthening of the PDS maturity profile. PDS issued with tenures between 20 - 28 years represented 3% of total value issued in 2004, compared with 0.9% in the previous year.

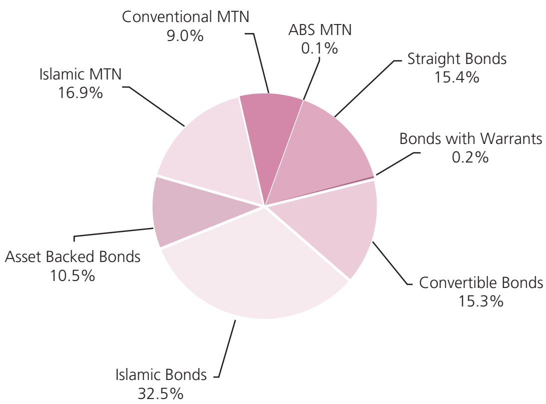
In terms of the types of instruments, Islamic PDS (including Islamic Medium Term Notes) was the most preferred form of funding, accounting for 49.4% of total issuance. Over the years, greater demand from both Islamic and conventional institutional investors for Islamic PDS has led to more competitive bidding for these bonds and resulted in lower costs for the issuers. Another reason for this development was the implementation of tax incentives for Islamic products, as announced in the 2004 Budget, which also resulted in several new structures of Islamic PDS products. The Securities Commission also introduced new guidelines for Islamic securities in 2004, which facilitated the development of a more innovative and sophisticated Islamic capital market.

During the year, Cagamas Berhad maintained its position as an active issuer in the PDS market, accounting for 22.8% of total PDS issuance. Cagamas made 18 issues of debt securities with a total value of RM9.3 billion (including two issues of short-term Cagamas notes totalling RM1 billion). In terms of the types of instruments, fixed rate bonds recorded a higher share of 71.8% of total issuance, while the balance were Sanadat Cagamas and short-term Cagamas discount notes.

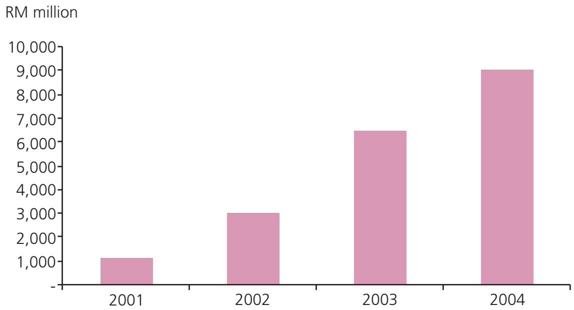
Bank Negara Malaysia revised the regulatory treatment of Cagamas securities to promote a more competitive capital market. Cagamas successfully issued a Sanadat Cagamas for the first time through a book building process in October. The Sanadat Cagamas, an Islamic instrument based on *Bai-Bithaman Ajil* was issued to purchase Islamic housing and hire-purchase debts, totalling RM1.6 billion, the highest volume of Islamic debt ever purchased by Cagamas. Cagamas Berhad through its single purpose and wholly-owned subsidiary, Cagamas MBS Berhad (CMBS) successfully made the first issuance of RMBS backed by the Government's staff housing loans in October. RMBS issuance augured well for the development of the securitisation market in Malaysia. The RMBS is expected to create a yield curve for mortgage-backed securities and serve as a benchmark for other Asset Backed Securities (ABS) issues.

Concurrently, in the securitisation market, four new ABS amounting to RM3 billion, which were backed by

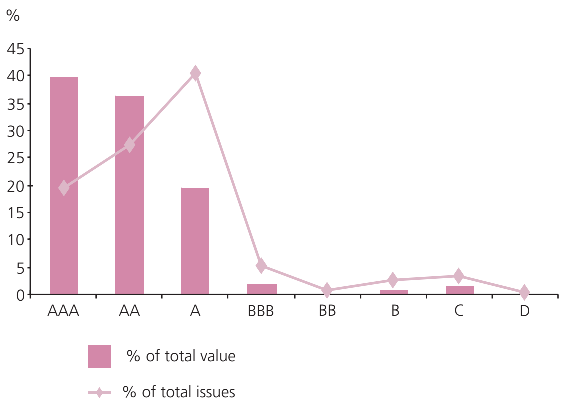
Graph 9.16
PDS Issues by Type of Instrument (excluding Cagamas)



Graph 9.17
ABS Outstanding (2001-2004)

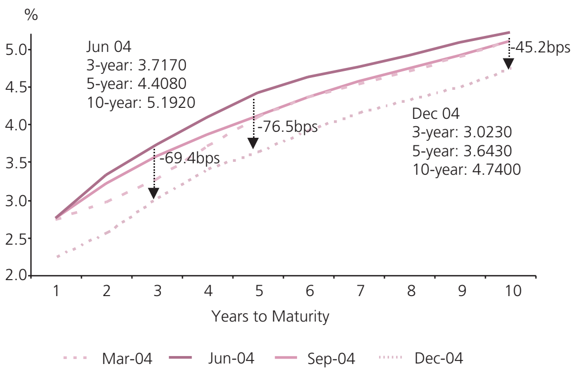


Graph 9.18
Rating Distribution of Outstanding PDS (As at end-2004)



Sources: RAM and MARC

Graph 9.19
MGS Benchmark Yields



credit card receivables, loans, as well as property and mortgage receivables, were issued during the year. In total, there were fifteen ABS (including one commercial paper ABS) outstanding, amounting to RM8.7 billion.

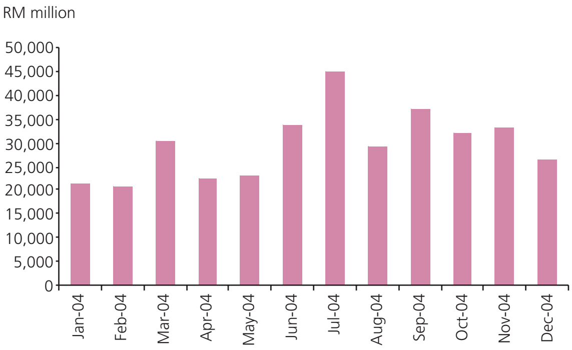
During the year, the Rating Agency Malaysia (RAM) and the Malaysian Rating Corporation Berhad (MARC) rated a total of 139 new PDS issues, valued at RM38.7 billion. The long-term issues represented 68.2% of the total gross value rated. In terms of rating profiles, the issues were distributed throughout the AAA, AA and A categories. Although single A-rated PDS recorded the highest number of issues, the AAA-rated PDS accounted for the largest share in terms of value. Investors' preference for companies with good credit qualities and strong credit profiles had resulted in companies with high ratings tapping the PDS market at competitive pricing. Throughout the year, RAM and MARC conducted 244 rating reviews on the existing long-term debt securities. A total of 213 issues were reaffirmed, 17 were upgraded and seven were downgraded.

In the secondary market, for the first three quarters, the MGS bond yield movements and market sentiments were influenced mainly by investors' expectations on the direction of interest rates. Bond yields shifted downwards in the first quarter, as investors began to rebuild their portfolios, leading to a higher demand for debt securities. In an environment of low inflation, investors were confident that domestic interest rate would remain low. Bond yields, however, reversed direction and trended upwards in the second quarter on improving economic outlook following the release of several positive economic indicators pointing to stronger growth. The rising yields on US Treasury securities arising from expectations of interest rate hikes also influenced domestic bond yields.

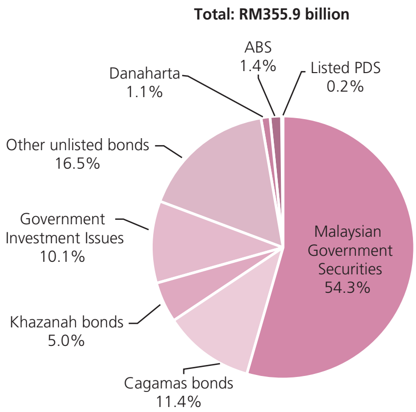
However, in the second half of the year, the bond yields trended downwards again, mainly influenced by the escalating crude oil prices and their negative impact on prospects for global growth. Demand for fixed income securities rose on investor sentiments that the inflation outlook in Malaysia remained subdued and on expectations of realignments of currencies in Asia against the US dollar. This was further reinforced by the declining US Treasury yields following indications by the Federal Open Market Committee (FOMC) that the increase in the interest rate in the US would be at a moderate pace. In addition, the exemption of withholding tax on interest income earned on holdings of ringgit-denominated debt securities issued by the Government as well as securities approved by the Securities Commission generated higher demand for fixed income securities. The strong interest in ringgit-denominated assets led to a steep decline in the yields.

Trading in the ringgit bond market amounted RM355.9 billion (2003: RM436.8 billion) with activities concentrated in the short- to medium-end tenures. The highest trading activity was recorded in July arising from the larger supply of Government papers in June. In September, trading activity rose following the exemption of withholding tax on interest income, which attracted higher foreign investor participation in the bond market. The most actively traded papers were MGS, accounting for 54.3% of total trades. Turnover for corporate bonds accounted for 18.1% of the total trades and were mainly high investment grade papers. Liquidity, as

Graph 9.20
Monthly Trading Volume



Graph 9.21
Turnover of Selected Debt Securities (Jan-Dec 2004)



measured by the ratio of trading volume to total outstanding bonds, was highest for GII and Khazanah bonds, at 3.94 times and 1.78 times, respectively. Liquidity for corporate bonds, however, was the lowest at 0.4 times the outstanding amount.

On the international front, spreads of Malaysia's foreign currency sovereign and corporate bonds tightened during the year. Standard & Poor's affirmed Malaysia's currency and sovereign credit ratings in May, Fitch International upgraded Malaysia's sovereign rating from BBB to A- in November and Moody's Investors Services upgraded Malaysia's foreign currency ratings in December, reflecting strengthening economic fundamentals.

Several measures were introduced in 2004 to further strengthen the bond market. The detailed bond market measures are explained in the white box on **Key Capital Market Measures in 2004**.

Table 9.7
Sovereign Over US Treasury Benchmark

	Dec-03	Mar-04	Jun-04	Sep-04	Dec-04
MALAYSIA 09	80	86	97	62	48
MALAYSIA 11	131	151	156	108	90
CHINA 11	123	123	119	116	98
INDONESIA 06	288	243	312	134	43
KOREA 08	38	54	48	18	1
PHILIPPINES 10	494	556	470	444	377
THAILAND 07	126	110	125	110	53
PETRONAS 06	104	92	100	63	48

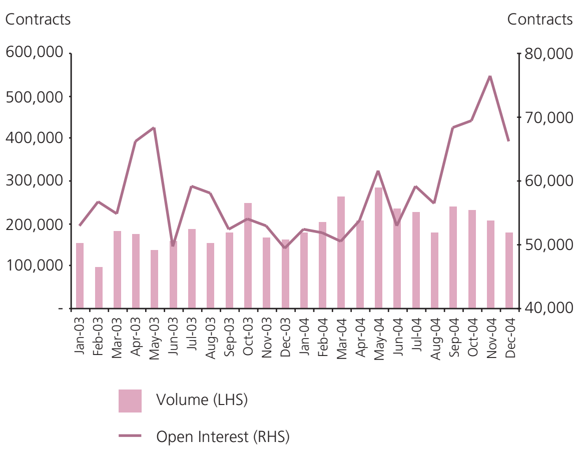
Source: Bloomberg

Exchange-traded Derivatives Market

The Malaysian derivatives market continued to register encouraging growth in 2004. This positive development was attributed to the continued high trading interest in Crude Palm Oil (CPO) Futures, and the significantly stronger interest in KLCI Futures and the 3-year MGS Futures. The total volume of contracts traded on Bursa Malaysia Derivatives increased by 32% from the previous year, as a result of greater awareness and knowledge on the use of derivatives as well as higher activity in the underlying markets. The annual trading volume reached a new record of 2.6 million contracts, from a previous record of 2 million contracts in 2003.

The favourable performance of the commodity futures market, coupled with continued rapid growth of the palm oil industry, induced Bursa Malaysia Derivatives to launch the Palm Kernel Oil Futures (CPKO) on 20 February 2004. The launch of

Graph 9.22
Bursa Malaysia Derivatives: Total Monthly Volume and Month-end Open Interest

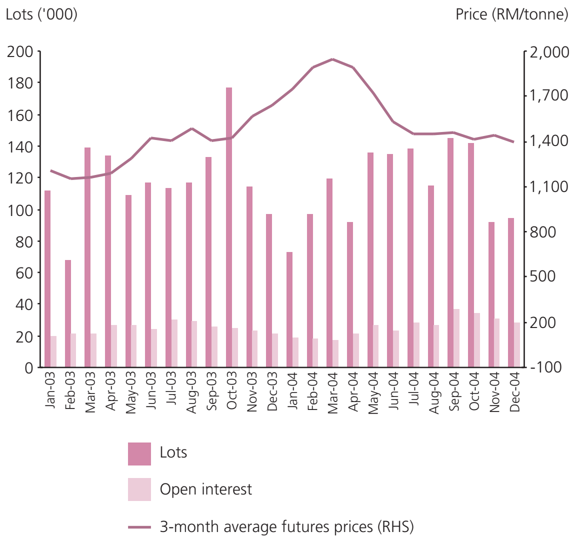


Source: Bursa Malaysia Derivatives

this new product allowed market participants to more effectively monitor, manage and control the pricing of palm oil products. With the launch of this new product, a total of eight products are now being traded on the Bursa Malaysia Derivatives. To further improve the products and services in the capital market, restrictions on foreign equity ownership in futures broking companies were lifted, by allowing 100 percent foreign ownership in these companies.

As in the previous year, the CPO Futures remained the most actively traded product on Bursa Malaysia Derivatives in 2004, accounting for 52.3% of the total volume transacted during the year. The price range for the benchmark 3-month CPO contract was between RM1,372 and RM1,993 per tonne in 2004, a difference of RM621 (2003: RM622). Nevertheless, the performance of the newly-launched CPKO Futures was subdued due to a lack of market participants.

Graph 9.23
Crude Palm Oil Futures



Source : Bursa Malaysia Derivatives

The 3-month CPO Futures prices began the year on a strong note at RM1,766 per tonne, and rallied further in the first quarter to register the highest daily traded price of RM1,993 per tonne on 4 March. Thereafter, prices reversed their earlier trends and declined to RM1,550 on 30 June, on the back of subdued buying interest from overseas investors (that accounted for about 44% of total volume traded) as well as increased CPO production in the major producing countries. In the second half of the year, an increase in Malaysian palm oil stocks and better-than-expected soybean harvests in the US further influenced the downward trend in prices. As

Table 9.8
Performance of Bursa Malaysia Derivatives Products

Products	Turnover						Share of total volume in Bursa Malaysia Derivatives (%)	
	2003			2004				
	Number of lots	Annual change (%)	Average daily volume	Number of lots	Annual change (%)	Average daily volume	2003	2004
CPO Futures	1,429,959	57.3	5,813	1,378,334	-3.6	5,603	71.5	52.4
Open interest position (as at end-year)	21,149			28,314				
Palm Kernel Oil Futures				449	n.a.	2	n.a.	…
KLCI Futures	331,218	41.6	1,346	1,088,419	228.6	4,424	16.6	41.3
Open interest position (as at end-year)	*8,993*			*10,092*				
KLCI Options	-	-	-	-	-	-	-	-
3-month KLIBOR Futures	119,659	86.1	486	141,969	18.6	577	6.0	5.4
Open interest position (as at end-year)	18,977			27,418				
3-year MGS Futures [1/]	781	n.a.	3	4,327	454	18	…	0.2
5-year MGS Futures	118,635	47.5	482	19,494	-83.6	79	5.9	0.7
Open interest position (as at end-year)	127			-				
10-year MGS Futures [1/]	11	n.a.	…	-	-	-	…	…

[1/] Introduced in September 2003
n.a. Not available
… Negligible
Source: Bursa Malaysia Derivatives

a result, prices consolidated to a range of RM1,400 – 1,500 per tonne in the third quarter, before declining further in the fourth quarter to register the lowest daily traded price of RM1,372 per tonne on 18 October. The 3-month CPO Futures ended the year at RM1,387 per tonne, 21.5% lower than the price at the start of the year.

The KLCI Futures was the best performing derivatives product on Bursa Malaysia Derivatives in 2004. Trading activity in KLCI Futures registered a significantly higher annual growth of 229%. The derivatives liquidity ratio (DLR), which represents the ratio between the turnover value of futures against the turnover value of the underlying KLCI component stocks, increased to 46.9% in 2004 (2003: 40.3%). The higher volume was attributed to the better performance of the underlying equity market during the year. In addition, the modification of the contract size and the increase in tick sizes since September 2003, encouraged more participation by both domestic and foreign investors. These measures effectively reduced the margin requirements and the cost of trade. In terms of market participant, domestic retail investors and foreign institutions accounted for 80% of the total trading volume.

Activity in the financial futures market in 2004 was mixed and continued to mirror developments in the underlying markets, which were influenced by changing expectations on economic growth prospects and the direction of interest rates. Participation in the financial futures market continued to be dominated by domestic institutions, which accounted for more than 93% of total trading. The 3-month KLIBOR Futures continued to record a positive growth of 18.6%, in terms of volume traded for the year. The total turnover of MGS Futures, however, registered a decline of 80%, following slightly lower total trading activity in the underlying market. As trading activity in the underlying market was concentrated mainly in the shorter-end tenures, the total turnover of 3-year MGS futures improved significantly.