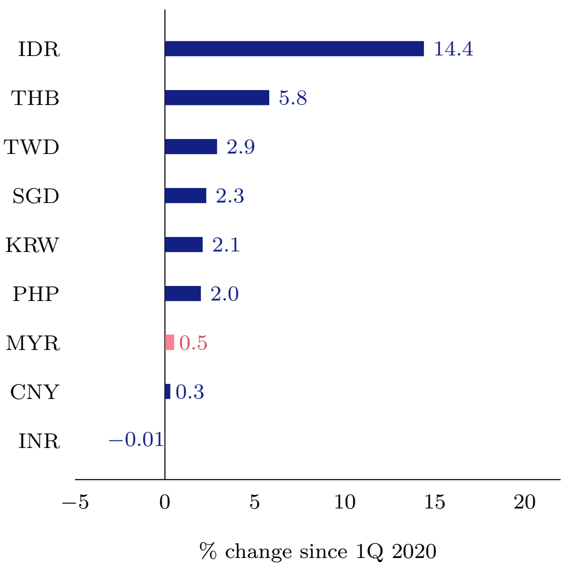
# Monetary and Financial Developments

## Highlights

- The ringgit appreciated marginally while bond and equity markets improved.
- Nominal interest rates in wholesale and retail markets declined further.
- Net financing continued to expand on an annual basis.

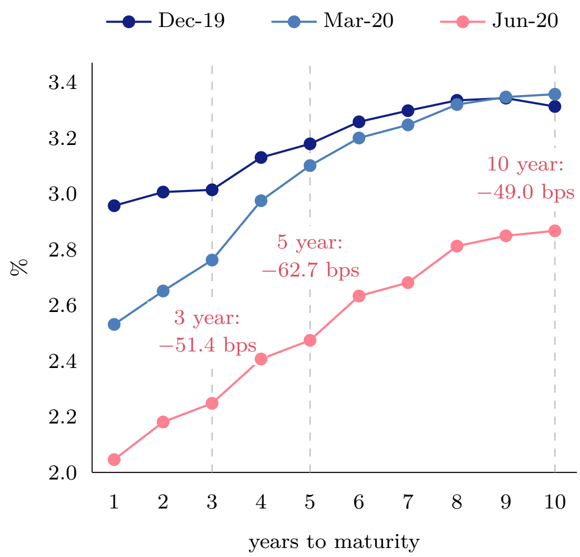
### Improved domestic financial market conditions as global risk aversion eased

Chart 20: Performance of Regional Currencies against the US Dollar




Source: Bank Negara Malaysia

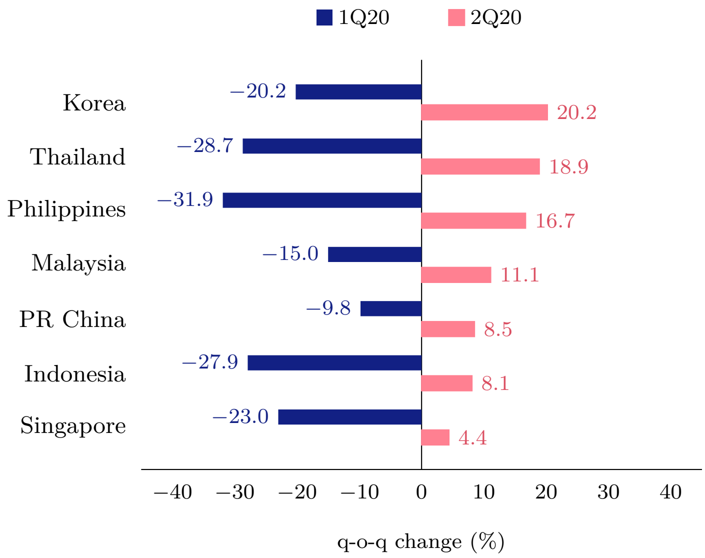
Chart 21: Trend in MGS Yields




Source: Bank Negara Malaysia

The performance of domestic financial markets improved during 2Q 2020, driven by a rebound in investor risk appetite following the quick implementation of large-scale liquidity injections and policy responses by central banks and governments around the world, particularly in advanced economies, to cushion the impact of the COVID-19 pandemic. The unprecedented magnitude of the policy actions by major central banks was sufficient to stabilise market sentiments. Additionally, as countries looked to restart their economies by gradually easing movement restrictions, this also provided further support to investor sentiments.

Chart 22: Performance of Regional Equity Markets



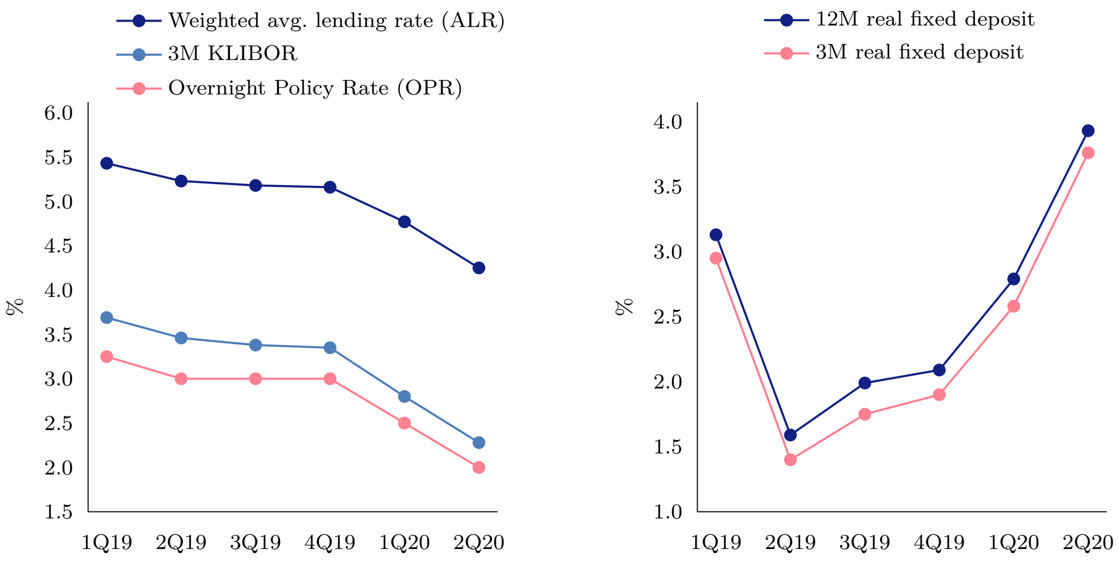

Source: Bloomberg

Consequently, regional financial markets including Malaysia exhibited broad-based improvements across asset markets. In 2Q 2020, domestic financial markets experienced a resumption of non-resident portfolio inflows, which led to an appreciation of the ringgit against the US dollar by 0.5%, in line with most regional currencies. These inflows were channelled into the domestic bond market, which contributed to the decline of the 3-year, 5-year and 10-year MGS yields by 51.4, 62.7 and 49.0 basis points, respectively. The lower bond yields also reflected the further reduction of the Overnight Policy Rate (OPR) in May 2020 by 50 basis points.

Similarly, the performance of domestic equity markets also improved, in line with the regional trend, reflecting positive sentiments from the global equity market rally. Domestically, higher resident participation and a strong performance led by healthcare sector stocks also provided additional impetus to the domestic equity market despite continued non-resident outflows. As at end-June, the FBM KLCI increased by 11.1% to close at 1,501.0 points (end-March: 1,350.9 points).

## Nominal interest rates declined further following the reduction in the OPR

Chart 23: Interest Rates (at end-period)



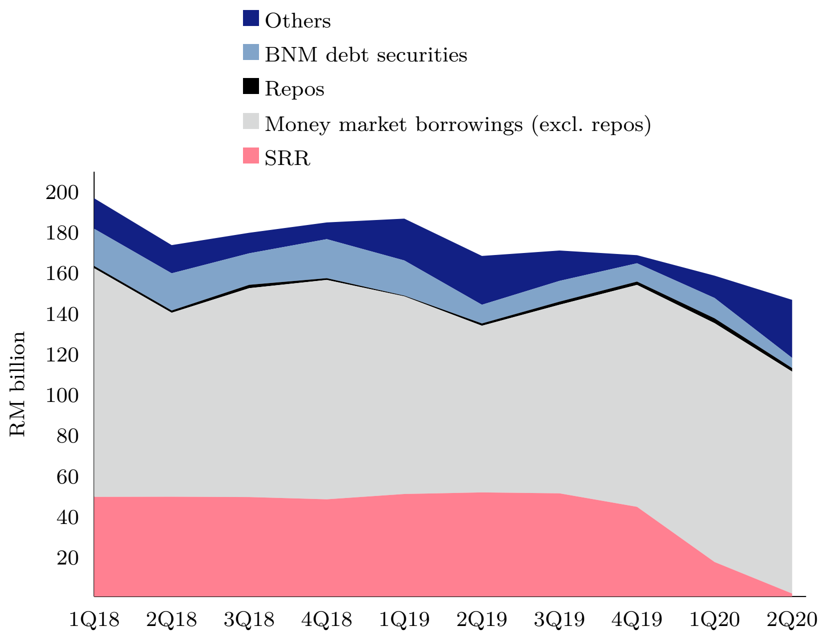

Source: Bank Negara Malaysia and Bloomberg

Interest rates in the wholesale and retail markets declined following the reduction in the OPR by 50 bps in May 2020. There was strong and immediate pass-through of the OPR reduction to interbank rates across all tenures, with the KLIBOR declining by 49 to 50 bps across tenures within one day of the OPR adjustment. The 3-month KLIBOR ended the quarter at 2.28% (1Q 2020: 2.80%). The transmission of the OPR reduction to retail lending rates was also strong, with continued pass-through from the previous OPR reduction in March 2020. This was reflected in the lower weighted average lending rate (ALR) on outstanding loans, which declined by 52 basis points to 4.25% in June (1Q 2020: 4.77%).

Similarly, nominal fixed deposit (FD) rates also decreased during the quarter, across tenures of 1 to 12 months, in line with the quantum of the OPR reduction. Real FD rates increased despite the decline in nominal rates given the lower inflation in June.

## Banking system liquidity remained sufficient to facilitate financial intermediation

Chart 24: Outstanding Ringgit Liquidity Placed with BNM (at end-period)



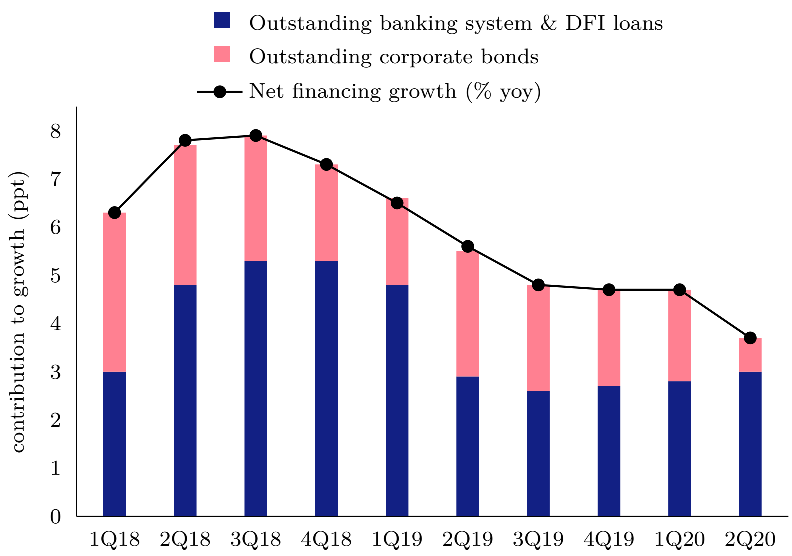

Source: Bank Negara Malaysia

The level of surplus liquidity placed with the Bank declined, due mainly to the higher currency in circulation, reflecting the increased demand for cash during the quarter. Nevertheless, banking system liquidity remained sufficient to facilitate financial intermediation. At the institutional level, most banks continued to maintain surplus liquidity positions with the Bank.

While the Statutory Reserve Requirement (SRR) ratio remained unchanged at 2.00%, the flexibility to use MGS and MGII to fully meet the SRR compliance was provided to all banking institutions in May. This measure has released approximately RM16 billion worth of liquidity into the banking system. The adjustment has provided greater flexibility for banks in their liquidity management and reduced the need for liquidity provision through the Bank's monetary operations. This flexibility provided to banking institutions has also supported the continued smooth functioning of the domestic bond market.

## Continued expansion of financing supporting business needs

Chart 25: Contribution to Net Financing Growth




Source: Bank Negara Malaysia

In 2Q 2020, net financing expanded by 3.7% on an annual basis (1Q 2020: 4.7%). Outstanding loan growth[9] increased during the quarter (4.1%; 1Q 2020: 3.8%), while the growth in outstanding corporate bonds[10] declined to 2.5% (1Q 2020: 7.6%) due mainly to a high base effect from a one-off large issuance in 2Q 2019.

Growth in outstanding business loans increased to 3.9% (1Q 2020: 3.4%), supported by loans for working capital purposes[11]. By sector, the wholesale and retail trade, restaurants and hotels (WRRH) and manufacturing sectors registered higher loan growth during the period. For the household segment, growth in outstanding loans was sustained (3.7%; 1Q 2020: 3.8%), supported by loans for the purchase of residential properties and personal use.

Disbursement and repayment levels were subdued during the quarter due to the MCO and ongoing moratorium on loan/financing repayments[12]. Following the gradual relaxation of the MCO, business loan disbursements normalised in June from the low levels in April and May, with high disbursements for working capital needs, in line with increased demand for financing during the quarter[13]. This was reflective of various policy measures to alleviate cash flow pressures faced by businesses due to the COVID-19 pandemic, supported by cheaper borrowing costs with monetary policy easing. Meanwhile, demand for household loans experienced a broad-based decline amid the MCO and cautious sentiments in line with the economic conditions.

[9] Loans from the banking system and development financial institutions (DFIs).

[10] Excludes issuances by Cagamas and non-residents.

[11] Classification of loans by purpose is only available for the banking system, which makes up 93% of outstanding loans extended to businesses.

[12] Refers to the automatic moratorium on household and SME loan/financing repayments for 6 months which came into effect on 1 April 2020, and the moratorium on eligible corporate loans/financing as assessed and facilitated by the banking institutions.

[13] Indicated by loan applications to the banking system.