

# Key Developments in the First Half of 2023

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# Key Developments in the First Half of 2023

## MARKET RISK

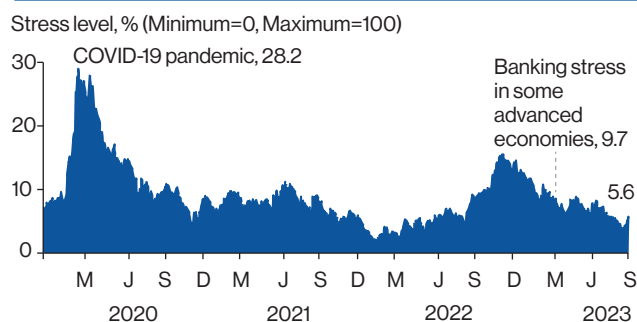
### Domestic financial markets remained orderly despite volatile global market conditions

Global financial markets continued to be significantly influenced by shifting expectations around developments in major economies that could signal turning points in the path of monetary policy. Heightened risk aversion from the episodes of US and European banking stress in March has however abated, although investors remain cautious about underlying vulnerabilities in the non-bank financial sector that could be amplified by higher interest rates. Continuing stress in the property sector and a slower-than-expected pace of recovery in China have also contributed to elevated financial market volatility particularly for economies heavily reliant on Chinese trade. While direct risks from struggling property developers in China to the global financial system are expected to be largely contained, a significant slowdown in the Chinese economy would heighten risks in global financial markets.

Domestic financial markets have remained orderly despite the global volatility. Overall domestic market stress levels, as measured by the Financial Market Stress Index (FMSI) (Chart 1.1), have declined since end-March as contagion fears associated with banking system stresses in some advanced economies subsided. Spillover risks from the global banking sector stress have had limited impact on domestic financial markets. Although some banks reported more cautious institutional investor appetite for new issuances of domestic Additional Tier 1 (AT1) capital instruments,

the take-up of recent AT1 issuance by domestic banks remained healthy. Markets also benefitted from improved investor sentiment in the second half of July amid data releases pointing to more benign global inflation and continued strength in global labour market conditions. More recently however, the FMSI increased slightly amid renewed expectations for the US Federal Reserve (Fed) to hold interest rates higher for longer following the September 2023 Federal Open Market Committee meeting. Stress levels, nonetheless, remained well below the peak observed at the onset of the pandemic in March 2020.

**Chart 1.1: Financial Market – Financial Market Stress Index (FMSI)**

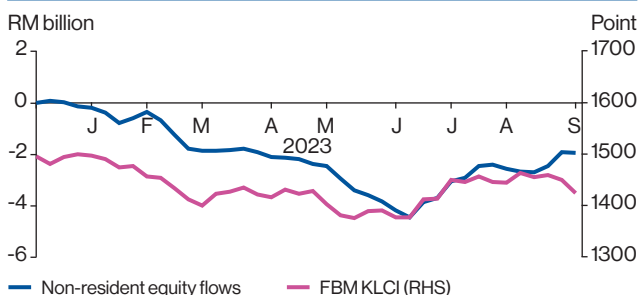


Source: Bloomberg, Reuters and Bank Negara Malaysia estimates

Amid improving investor sentiment in recent months, the domestic equity market recorded non-resident inflows from July, partially reversing earlier outflows. Year-to-date (YTD) net outflows by non-residents up to September were correspondingly lower at RM2.0 billion<sup>1</sup> (1H 2023: -RM4.2 billion; 2022: +RM4.4 billion) (Chart 1.2). The utilities, property and construction sectors were among the sectors that recorded significant gains – reflecting positive sentiments from the announcement of the National Energy Transition Roadmap, sustained property market activity and continued progress in the implementation of large infrastructure projects.

<sup>1</sup> All data in the Market Risk section are as at 29 September 2023, unless stated otherwise.

**Chart 1.2: Financial Market – Cumulative Non-resident Equity Flows and Performance of the Domestic Equity Market**



Source: Bloomberg

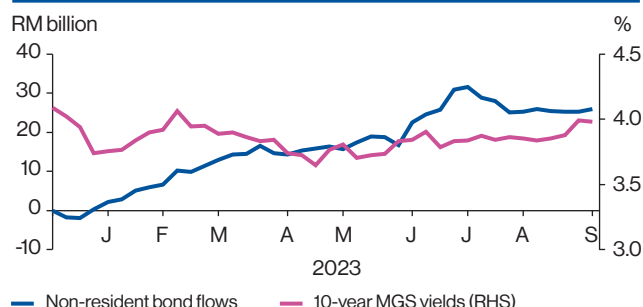
Domestic institutional investors<sup>2</sup> remained net buyers of domestic equities, offsetting non-resident outflows with a net purchase of RM0.7 billion between April and September 2023 (YTD: RM2.4 billion). Retail investors also remained key players in the market, although retail transactions continue to decline as a share of total market activity (April-September 2023: 26.9% of total value traded in equity market; peak 2020: 40.3%; 2015-2019 average: 18.5%). Market observers expect a further moderation in retail activity as the exceptional conditions during the pandemic which spurred higher-than-average activity return to normalcy. These include the normalisation of interest rates from historical lows and the expiry of various stimulus programmes. The paring down of retail equity investments has so far been gradual, given that the bulk of retail investments has not been funded through leverage. This is expected to continue to support orderly market conditions and limit risks to households from debt-related stress due to volatile equity prices. Consistent with earlier observations, household loans to purchase quoted shares remain low and stable, accounting for only 0.5% of banking system loans.

### Government bond market continued to record non-resident inflows

The domestic government bond market recorded net non-resident inflows (April-September 2023: RM11.7 billion; April-September 2022: -RM10.0 billion), amid the attractive total returns of domestic

government bonds (Chart 1.3). The inflows from non-residents were also observed following the affirmation of Malaysia’s sovereign ratings by Moody’s Investors Service and S&P Global Ratings in April and June, respectively. The share of non-resident holdings in the government bond market stood at 23.0%, a moderate increase over the level recorded at the end of 2022 (December 2022: 22.2%; 2015-2019 average: 27.0%). Importantly, the share of more stable non-resident holdings<sup>3</sup> has remained broadly unchanged. This will continue to mitigate excessive volatility in market conditions. Market liquidity remained healthy with sustained demand for government bonds in the primary market, as evidenced by the healthy average bid-to-cover ratio of 2.1 times between April and September 2023 (2015-2019 average: 2.3 times). The 10-year Malaysian Government Securities (MGS) yields increased slightly by 8.0 basis points (bps) between April and September 2023 (2022: +50.8 bps), averaging at 3.8%. Meanwhile, average daily trading volume in the secondary market also improved, averaging RM4.7 billion between April and September 2023 (2015-2019 average: RM3.1 billion). Domestic institutional investors also increased their purchase of government bonds compared to the same period last year (January-September 2023: RM62.8 billion;<sup>4</sup> January-September 2022: RM50.6 billion), in line with the higher government bond issuances during the period.

**Chart 1.3: Financial Market – Cumulative Non-resident Bond Flows and Performance of the Domestic Bond Market**



Source: Bank Negara Malaysia and Bloomberg

<sup>2</sup> Domestic institutional investors include banks, non-bank financial institutions (NBFIs) and insurers and takaful operators (ITOs).

<sup>3</sup> Refers to holdings by non-resident central banks, governments, pension funds and insurance companies.

<sup>4</sup> Data for purchase of government bonds by ITOs is as at 31 July 2023.

The corporate bond market continued to provide conducive and stable funding conditions for businesses. Credit spreads between 10-year AAA-rated papers and 10-year MGS have narrowed further compared to pre-pandemic levels (April-September 2023 average: 42.2 bps; April-September 2022 average: 48.9 bps; 2015-2019 average: 55.4 bps), reflecting sustained demand for corporate bonds by yield-seeking investors. Gross corporate bond issuances amounted to RM55.2 billion between April and August 2023, above levels recorded in the same period last year (April-August 2022: RM51.6 billion). Issuances remained of high quality, with AAA-rated papers continuing to account for the largest proportion of corporate bonds.

Conditions in the interbank money market improved with the easing of seasonal year-end funding demands by banks alongside diminishing market expectations of further OPR hikes. Overall banking system liquidity stood at RM142.0 billion as of September 2023, with the spread between the 3-month Kuala Lumpur Interbank Offered Rate (KLIBOR) and OPR closely tracking its long-term average of about 45 bps.

While overall banking liquidity has remained ample in recent years, there has been a notable increase in total overnight surplus liquidity placed with the Bank since the start of the pandemic. By the end of 2022, the overnight surplus liquidity reached RM101 billion and has remained around RM70 billion to RM80 billion since (2015-2019 average: RM39 billion). This shift primarily reflected a preference by financial institutions for shorter-term placements amid the interest rate hike cycle. As part of the Bank's liquidity management operations, the Bank increased its issuance of term Bank Negara Interbank Bills (BNIBs) to reduce the high overnight balances. This would also help to improve efficiency and price discovery in the interbank funding market by encouraging more active interbank trading activities. Interbank trading volume has since picked up as a proportion of banks' surplus overnight balances. A similar trend was also observed in the secured interbank funding market with the repo volume across tenures increasing by 32%. The Bank continues to

monitor developments that may influence liquidity conditions, with a primary focus of maintaining an appropriate level of domestic liquidity to facilitate efficient intermediation in the interbank money market.

Between April and September 2023, the ringgit weakened by 6.0% against the US dollar to 4.6953. The ringgit's movement continued to be primarily influenced by developments in the global financial markets including uncertainties surrounding the US debt ceiling, combined with strong US economic and labour market data, and evolving market expectations of higher terminal interest rates by the Fed. These external developments led to a temporary decline in global risk appetite. However, once uncertainties in global financial markets subsided, the improvement in investor sentiment provided positive support for the ringgit as seen in the stronger ringgit performance at the start of the third quarter of 2023. Despite being a highly diversified economy with diversified trade partners, weaker-than-expected growth in China led to a renewed weakness in the ringgit against the US dollar, consistent with movements of other regional currencies.

Notwithstanding these global developments, the domestic FX market remains conducive for financial intermediation. Daily onshore trading volume remains healthy, averaging at USD15.4 billion in 2023 (2022: USD13.7 billion). While the average 1-month USD/MYR implied volatility for the year stood above levels recorded in recent periods at 5.4% (2022: 4.5%; 3-year average: 4.8%), it remains well below the peak recorded during the pandemic (March 2020: 8.1%). Ringgit volatility also remains lower than most regional currencies. An orderly movement in the ringgit exchange rate is important to promote confidence for businesses undertaking investment decisions and the efficient allocation of resources. The conversion of foreign currency export proceeds into ringgit in the first half of 2023 remained stable within the long-term average range of 60% to 70% of total proceeds, sustaining support for the ringgit. Over the near term, ringgit movement will continue to be largely driven by external developments including expectations on the Fed's monetary policy path and the outlook for global growth.

## CREDIT RISK

### Businesses in some segments continued to face persisting operating headwinds

Domestic business activity has improved considerably. Consumer-related businesses benefitted from the sustained growth in household spending, while the steady flow of inbound tourist arrivals as well as domestic tourism further supported tourism-related subsectors. Notwithstanding these improvements, businesses continued to face a challenging operating environment. Elevated input costs and weak external demand have continued to weigh on business profitability, particularly those in the manufacturing and construction sectors. Despite some easing since the start of the year, input costs remained elevated due to higher imported prices, a weaker ringgit exchange rate as well as higher electricity<sup>5</sup> and labour costs. The median cost of goods sold ratio<sup>6</sup> for the construction and manufacturing sectors remained above pre-pandemic levels (2Q 2023: 77.8%; 2015 - 2019 average: 75.9%). Some property developers also reported cashflow challenges due to delayed payments from contract awarders. In the commercial real estate sector, persistent oversupply issues continued to suppress occupancy and rental rates for office and retail space.

Firms have generally remained resilient against these headwinds. The debt-servicing capacity of businesses, as measured by the median interest coverage ratio (ICR), remained healthy and comfortably above the prudent threshold of two times, while the aggregate share of firms-at-risk<sup>7</sup> has trended lower in the recent quarter (Chart 1.4). Strong liquidity buffers built up during the pandemic have further supported business resilience.

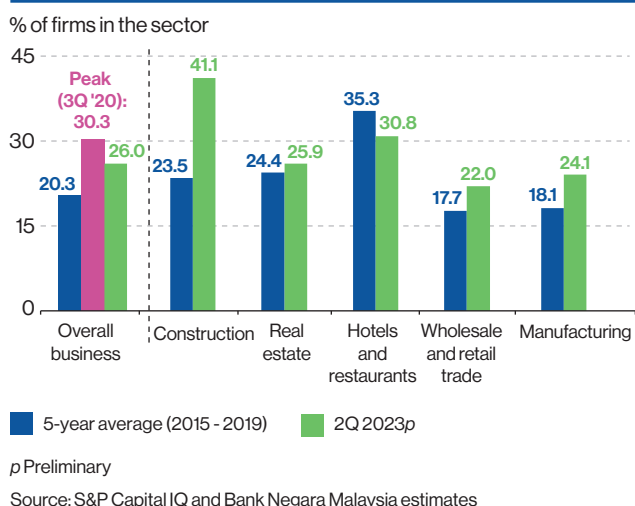
<sup>5</sup> Imbalance Cost Pass-Through (ICPT) is a mechanism under the Incentive Based Regulation (IBR) framework which allows Tenaga Nasional Berhad (TNB) to reflect changes in fuel and other generation-related costs in a user's electricity tariff every six months. Since 2023, ICPT surcharge rate for non-SMEs has increased in line with the implementation of a more targeted subsidy scheme.

<sup>6</sup> Cost of goods sold (COGS) ratio is calculated by taking a firm's COGS divided by its revenue. A higher ratio indicates that COGS makes up a higher proportion of revenue.

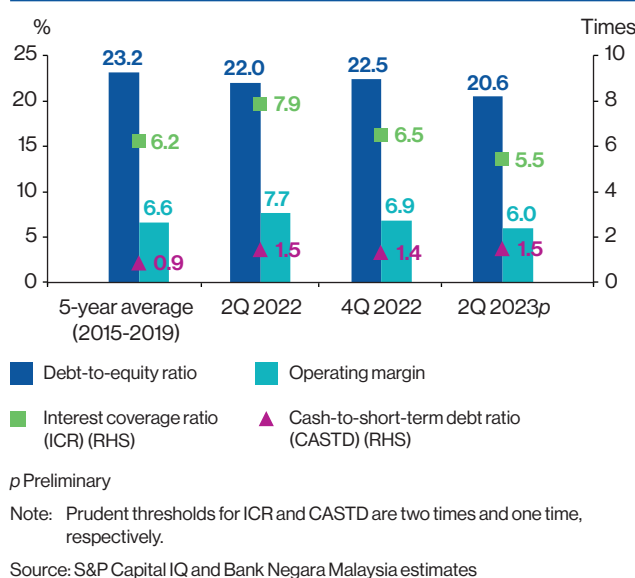
<sup>7</sup> Firms-at-risk refers to firms with interest coverage ratio below the prudent threshold of two times.

Larger businesses – particularly those with economies of scale, more efficient inventory management and larger cash buffers – have been better able to navigate these challenges. However, smaller firms continued to be disproportionately affected given their thinner buffers, limited economies of scale and lower bargaining positions (further details elaborated under the assessment of business credit quality below). Reflecting the uneven impact of demand and cost factors on firms, overall business profitability declined below the average profitability recorded before the pandemic (Chart 1.5).

**Chart 1.4: Business Sector – Firms-at-risk for Selected Sectors**



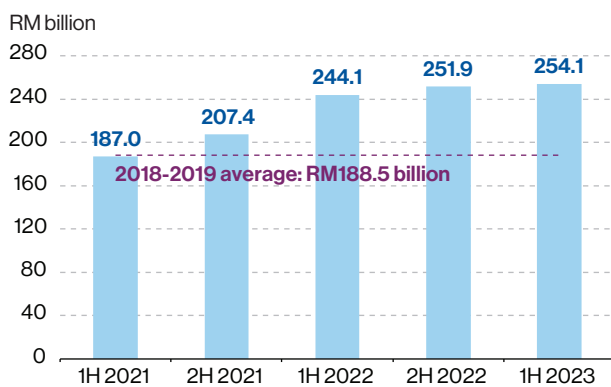
**Chart 1.5: Business Sector – Key Financial Performance Indicators**



## Credit quality of businesses generally remained sound

Businesses continued to be cautious in taking on new debt amid uncertainties in the operating environment and higher interest rates. Business loans expanded at a slower pace of 0.7% in the first half of 2023 (December 2022: 3.5%). This was mainly due to lower demand for financing by large corporates, particularly export-oriented firms, amid the weaker outlook on external demand. In contrast, financing to SMEs grew at a faster pace of 6.4% (December 2022: 5.8%), supported by sustained disbursements to SMEs that are more reliant on financing to meet working capital and investment needs (Chart 1.6). In line with the more prudent management of debt by large corporates, overall business leverage improved further, with the

**Chart 1.6: Business Sector – SME Financing Disbursements**

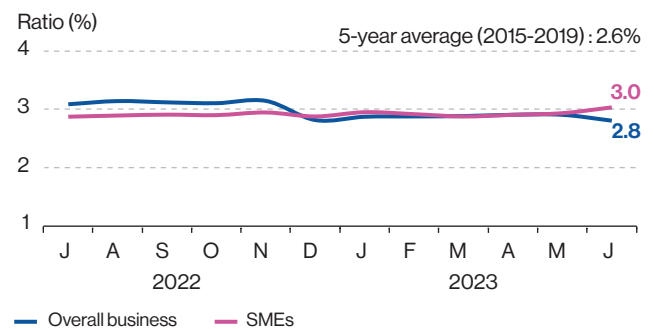


Source: Bank Negara Malaysia

median debt-to-equity ratio declining to the lowest level reported since 2017. Going forward, credit conditions are expected to remain conducive for businesses. The supply of bank credit to viable businesses continues to be forthcoming, supported by a strong banking system, ample liquidity and expectations of an improving growth outlook going into 2024. Banks continue to maintain healthy business loan growth targets. Financing to SMEs is further supported by facilities under BNM's Fund for SMEs.<sup>8</sup>

The credit quality of business loans generally remained sound. The overall business loan impairment ratio was unchanged at 2.8% of business loans (2015 – 2019 average: 2.6%), or 1% of total banking system loans (Chart 1.7). Impaired SME loans however, edged higher to 3% of total SME loans (December 2022: 2.9%), or 0.5% of total banking system loans, amid emerging signs of financial vulnerabilities in some pockets of SME borrowers which drove higher missed repayments in the first half of 2023 (Table 1.1).

**Chart 1.7: Business Sector – Gross Impaired Loans**



Source: Bank Negara Malaysia

**Table 1.1: Business Sector – SME Loans-in-Arrears<sup>1</sup> for Selected Sectors**

Sector	Outstanding Loans (% of total banking system loans)	Loans-in-Arrears <sup>1</sup> (% of SME loans to the sector)	
		Dec 2022	Jun 2023
Wholesale and retail trade	5.1	1.5	1.8
Retail food and beverages	0.1	0.7	1.6
Construction	2.1	3.8	4.5
Agriculture	0.5	2.3	6.2

<sup>1</sup> Refers to loans with 3 months or more in-arrears, equivalent to more than 90 days past due.

Source: Bank Negara Malaysia

<sup>8</sup> About RM9.2 billion (from a total allocation of RM32.4 billion) remained available as at end-June 2023.

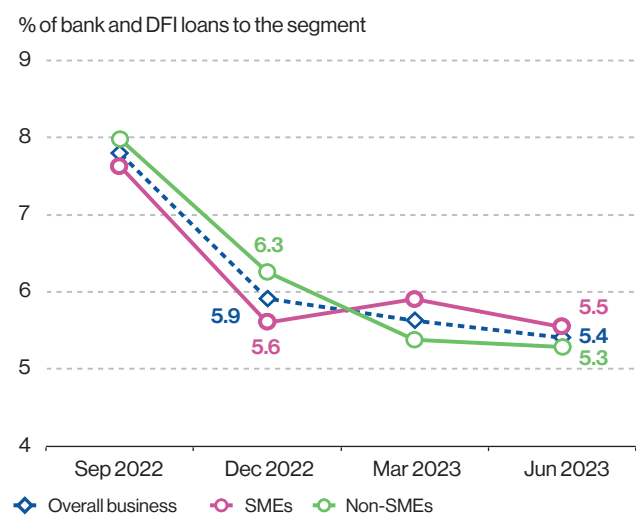
## Key Developments in the First Half of 2023

- Wholesale and retail:** Small and micro-SMEs in the sector are finding it more challenging to adapt to the post-pandemic business environment. Food and beverages (F&B) operators, for example, faced higher overhead costs to maintain physical premises as more consumers return to in-person shopping and dining experiences. Additionally, recovering small standalone businesses also face intense competition from the larger retail chain stores that have better economies of scale.
- Construction:** Profit margins of SMEs in the construction sector continue to be affected by elevated material costs, particularly for contracts awarded pre-pandemic under lower cost assumptions. Despite some contracts providing for price variations, such clauses may only cover selected materials and up to a certain quantum. While labour shortages have eased, labour costs remain elevated as firms have to compete for foreign labour with other sectors such as the palm oil, manufacturing and F&B sectors. In addition, delayed payments from contract awarders, coupled with tighter credit terms by suppliers, are driving tighter cashflows for SME contractors.
- Agriculture:** SMEs in the sector were affected by lower production arising from ageing oil palm trees, hot weather conditions and a decline in average selling prices. Labour shortages continue to persist due to a lack of experienced workers, keeping labour costs elevated. The weaker ringgit also led to the cost of inputs, such as fertilisers, remaining high.

Correspondingly, more SMEs were observed to have sought early assistance from the Small Debt Resolution Scheme (SDRS).<sup>9</sup> The number of applications for SDRS in the first half of 2023 increased by 20% (+254 applications) compared to the corresponding period in 2022, although it remains small as a share of total SME loan accounts in the banking system (0.03%).

At present, these emerging risks are within banks' expectations and are not expected to lead to a widespread deterioration in credit quality. Banks' credit reviews continue to indicate that most SMEs in the above subsectors will be able to maintain their loan repayments through challenging conditions in the near term. The share of SME loans under Stage 2 correspondingly improved further to 12.4% (December 2022: 12.8%; March 2022 (peak): 16.5%). Further improvements could be more modest given that more than 40% of Stage 2 SME loans are associated with borrowers in the vulnerable sectors above. This remains a small share of total banking system loans (0.89%). The share of SME loans under repayment assistance programmes also declined further to 5.5% of total SME loans or 0.9% of total banking system and development financial institution (DFI) loans (Chart 1.8), while new enrolments remained limited at 0.1% of total SME loans (December 2022: 0.3%). Most of the SMEs that have exited repayment assistance programmes have thus far been able to resume and sustain loan repayments.

**Chart 1.8: Business Sector – Share of R&R Loans by Segment**



Note: Beginning 1 January 2023, the R&R data used is based on updated statistical reporting requirements to reflect more accurate data definition and reporting methodology.

Source: Bank Negara Malaysia

<sup>9</sup> SDRS was established in 2003 as a platform for financial institutions and viable SMEs to work out debt rehabilitation solutions without resorting to legal recourse, allowing SMEs to focus on plans to revive their businesses.

Larger corporates with strong financials continued to have access to domestic debt markets. Outstanding corporate bonds grew by 5.2% (December 2022: 4.8%) in the first half of 2023. The quality of corporate bond issuers remained strong. During the period, only four issuers (2022: 6 issuers), or 0.6% of total outstanding domestic bonds, were downgraded due to firm-specific vulnerabilities. Non-financial corporate external borrowings, which make up 27.2% of overall business debt, increased to RM485.3 billion (December 2022: RM461.1 billion), due mainly to exchange rate valuations. Although almost 85% of corporate external borrowings are in foreign currency, the risks from such exposures remained manageable given prudent FX risk management practices generally observed by large resident corporates. The bulk of corporates' external debt is hedged, either financially or naturally. This limits FX risks arising from currency mismatches. Rollover risks associated with total corporate external exposures also remained low as approximately 70% of the total exposures have medium- to long-term maturities. Furthermore, more than one-third of these exposures are with related counterparties which would afford greater debt management flexibilities. At the aggregate level, non-financial corporate external exposures continue to be well-covered by assets, with corporate external assets standing at 1.2 times of corporate external debt.

Going forward, improvements in business conditions are expected in sectors supporting the

tourism industry such as recreation and hotels, and consumer essentials such as healthcare and education. More broadly however, businesses are likely to experience continued headwinds amid moderating global growth and as earlier tailwinds from the post-pandemic recovery taper. Businesses also cited higher cost of businesses – among others from higher electricity tariffs, higher employment costs, and the weak ringgit – as downside risks that may further compress profit margins in an environment where consumers are also more price-sensitive due to elevated costs of living. In addition, businesses are increasingly factoring in climate-related risks and opportunities in response to the higher frequency of extreme weather events, greater clarity on national sustainability strategies and shifting imperatives among financiers, key markets and consumers.

Most businesses are expected to be able to withstand a potential worsening in the operating environment. Improvements in terms of lower business leverage, healthy cash buffers and more agile business models would also suggest that firms may be better placed to respond to new shocks. Consistent with this, banks do not expect a broad-based tightening in lending standards in the near term. In the unlikely event of a large increase in business defaults, stress tests carried out by the Bank earlier this year affirmed that banks have sufficient capital buffers to absorb significant credit losses arising from the business sector.<sup>10</sup>

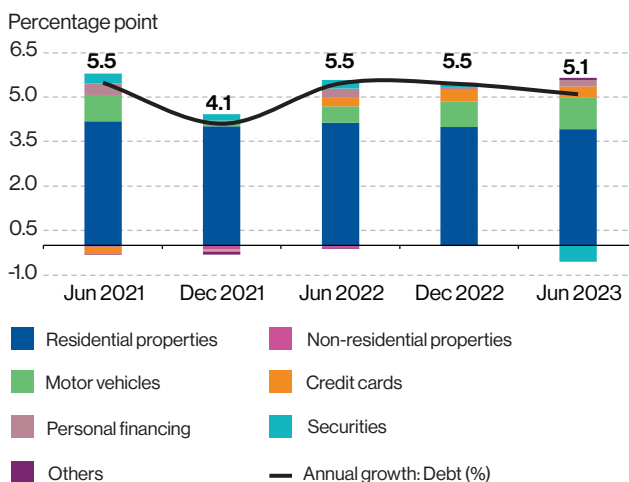
<sup>10</sup> Refer to the section on 'Assessing the Resilience of Financial Institutions' in the BNM Financial Stability Review for Second Half 2022 for further details.

## Overall credit risks from the household sector remained manageable, supported by continued employment and wage growth

Household debt<sup>11</sup> expanded by 5.1% on an annual basis (December 2022: 5.5%) (Chart 1.9). Growth in household debt continued to be driven primarily by housing and car loans. This is in line with continued improvements in private sector wages, which increased by 4.1%, while existing measures to encourage home ownership have also sustained demand for house purchases. Car financing growth continued to pick up in pace, driven by the ongoing fulfilment of backlog orders<sup>12</sup> and strong car sales as newer models were launched during the period.

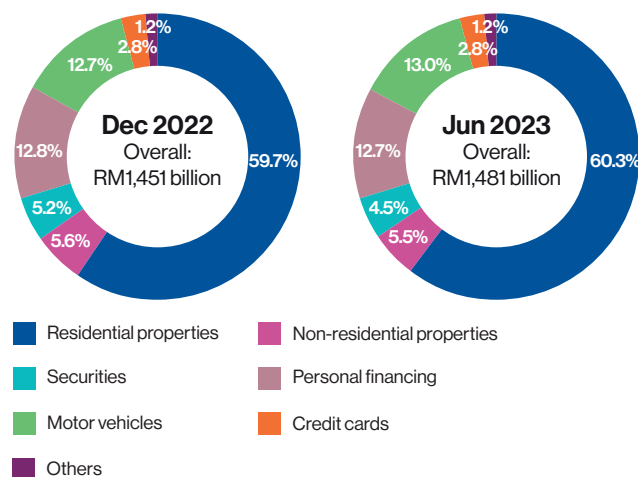
Consumption loans also grew in tandem with the ongoing recovery in consumer spending levels and the introduction of the Employees Provident Fund (EPF) Account 2 Support Facility (FSA2)<sup>13</sup> (further elaborated below). The share of consumption loans to household debt has, however, remained broadly unchanged (Chart 1.10). Risks from the growth in credit card debt have also been well-contained. Outstanding credit card debt is near pre-pandemic levels. Credit card users continue to be largely transactors, with credit card cash advances and revolving balances remaining below pre-pandemic levels (June 2023: 78% and 91%, respectively, of June 2019 levels). Amid narrowing spreads between investment returns and financing costs, loans for the purchase of securities recorded a sharp decline (-10.2%; December 2022: +2.8%). This was mainly driven by lower financing for the purchase of Amanah Saham Bumiputera units as borrowers pared down existing debt and had lower appetite for new leveraged purchases. As at June 2023, the ratio of household debt-to-GDP was broadly stable at 81.9% (December 2022: 81.0%) (Chart 1.11).

Chart 1.9: Household Sector – Annual Growth of Debt



Source: Bank Negara Malaysia

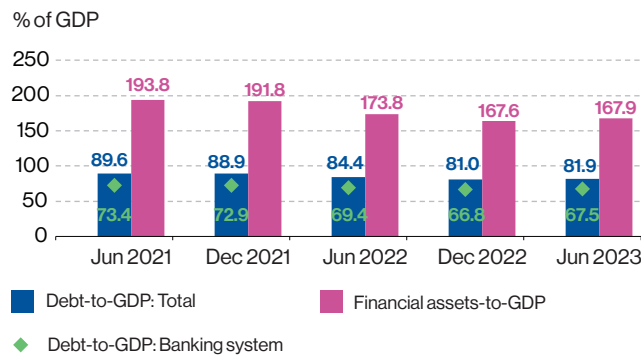
Chart 1.10: Household Sector – Composition of Debt by Purpose



Note: Figures may not add up due to rounding.

Source: Bank Negara Malaysia

Chart 1.11: Household Sector – Key Ratios



Source: Bank Negara Malaysia, Bursa Malaysia, Department of Statistics, Malaysia, Employees Provident Fund and Securities Commission Malaysia

<sup>11</sup> Extended by both banks and non-bank financial institutions.

<sup>12</sup> These backlog orders are mostly from the Sales and Service Tax (SST) exemption period i.e. for vehicles that are booked from 15 June 2020 to 30 June 2022 and are registered by 31 March 2023.

<sup>13</sup> EPF FSA2 enables EPF members to make advance application for Age 50 or Age 55 Conditional Withdrawal ahead of their retirement age, to support their application for personal financing from participating banking institutions. Application for Phase 1 began on 7 April 2023 and will remain open for 1 year, applicable to members aged 40 to 54 years old.

Outstanding household loans extended by banks grew 5.4% in the first half of 2023 (December 2022: 5.9%). The bulk (69.7%) of this debt continues to be held by borrowers earning a monthly income of above RM5,000 (Chart 1.12). Despite higher financing rates, the median debt-to-income (DTI) ratios for households across all income groups were broadly stable (Chart 1.13) amid sound lending standards maintained by banks. Other measures of debt-servicing capacity also remained healthy. The median debt service ratios (DSRs) of newly approved and outstanding household loans stood at 42% and 36%, respectively (December 2022: 43% and 37%), preserving healthy buffers for households to support loan servicing. Two-thirds of newly approved loans in the first half of 2023 were associated with borrowers having DSRs below 60%. Meanwhile, the share of borrowers with DSRs exceeding 60%, who could be more susceptible to repayment stress, has remained stable at around a quarter of total household borrowers. The bulk (67%) of these credit exposures is held by middle- and high-income<sup>14</sup> borrowers who typically have larger financial buffers to sustain loan repayments in the event of financial shocks. Impairments among high-DSR borrowers have correspondingly remained low (June 2023: 1.3% of outstanding loans of borrowers in this segment; December 2022: 1.2%). Banks expect some deterioration in asset quality among higher-risk borrowers as repayment assistance extended to borrowers during the pandemic come to an end. Borrowers employed in sectors that continue to face challenges from the external environment are likely to be more affected. Notwithstanding this, banks continue to hold significant buffers against potential credit losses and remain well-positioned to facilitate debt workouts for affected borrowers.

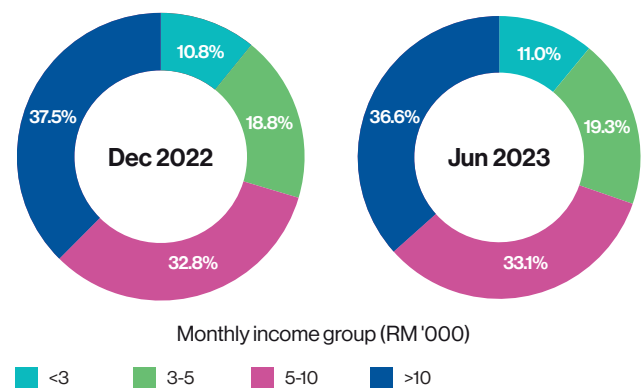
The introduction of the EPF FSA2 programme in April 2023 seeks to help EPF members<sup>15</sup> who are facing temporary liquidity issues to meet their needs for cash flow through personal financing from participating banks at a lower cost and with minimal impact on their retirement savings. This programme is targeted at EPF members who have savings in Account 2 and are supported with reasonable income to ensure they can repay the financing without compromising their retirement income adequacy

<sup>14</sup> The middle-income group refers to individuals earning a monthly income of between RM5,000 to RM10,000 while the high-income group includes individuals earning above RM10,000 per month. Individuals with monthly income less than RM5,000 are categorised as lower-income.

<sup>15</sup> Eligible EPF members must have a minimum amount of RM3,000 in their EPF Account 2. EPF members can apply for a maximum financing amount of RM50,000, subject to EPF Account 2 balance at the point of application, with a repayment tenure of up to 10 years.

and security. As of July 2023, 2.7% of eligible EPF members obtained financing under the first phase of the programme. This amounted to 56,849 loan accounts (or 0.24% of total household loan accounts) with a total value of RM1.15 billion (0.08% of total household loans). Consistent with the stated intention of the programme, participating banks are required to conduct affordability assessments before approving loans under the programme to mitigate risks of borrowers falling into future financial hardship due to inadequate savings for retirement. A significant share (70%) of these borrowings therefore have prudent DSRs below 60%. The Government had earlier announced plans to launch the second phase of the programme for eligible EPF members below 40 years of age. Under conservative assumptions of a take-up rate three times higher than currently observed in the first phase, aggregate household debt is not expected to increase materially.

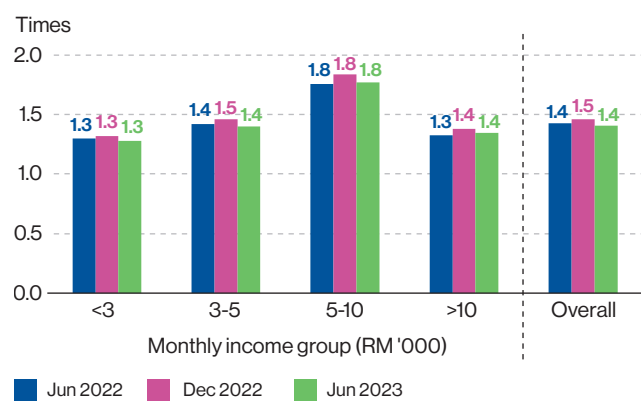
**Chart 1.12: Household Sector – Composition of Banking System Debt by Income Group**



Note: 1. Figures exclude loan accounts with incomplete income information.  
2. Figures may not add up due to rounding.

Source: Bank Negara Malaysia

**Chart 1.13: Household Sector – Median Debt-to-Income Ratios by Income Group**

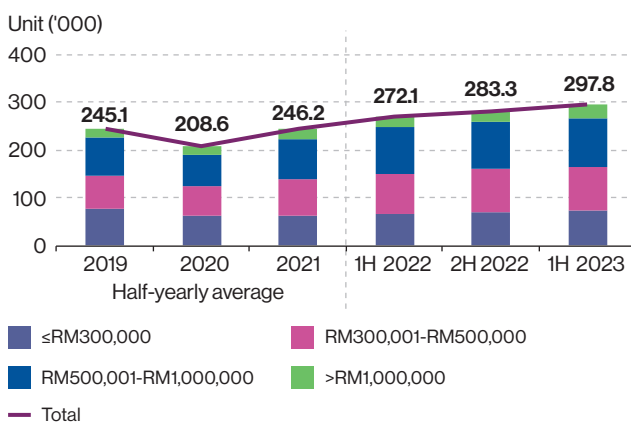


Source: Bank Negara Malaysia

## Key Developments in the First Half of 2023

Housing debt remains the largest share (60.3%) of household debt. Despite the normalisation of OPR, financing activity for the purchase of residential properties remained forthcoming. Higher financing activity was recorded for properties across all price segments in the first half of 2023 (Chart 1.14). Reflecting prudent loan affordability assessments maintained by banks, the median DSR of new housing loans remained broadly stable at 54% (December 2022: 53.3%), while the overall approval rate trended higher to 77.6% (2022: 75.8%; 2015-2019 average: 75.9%). This continued to be largely driven by higher approvals for first-time homebuyers (June 2023: approval rate of 72%; December 2022: 70.1%; December 2019: 66.3%), in line with overall improvements in household income.

**Chart 1.14: Property Market – Volume of Housing Loan Applications by Price Segment**



Source: Bank Negara Malaysia

Risks from a sharp fall in house prices have also receded further on the back of sustained improvements in the residential property market (see box on “Developments in the Residential Property Market”). The normalisation of interest rates further mitigates risks from yield-seeking or speculative activity that could worsen affordability issues and compound supply-demand imbalances in the housing market going forward. Owner-occupiers<sup>16</sup> who have stronger incentives to service their loans continued to drive overall growth of house financing, accounting for the bulk (75.8%) of the increase in housing debt. The median loan-to-value (LTV) ratio of outstanding housing loans also remained stable (June 2023: 65.9%; December 2022: 65.5%) and continues to provide comfortable buffers for borrowers and banks against a decline in house prices in the event downside risks to prices materialise.

Credit risk among individual property investors,<sup>17</sup> who are more likely to default if their mortgages fall into negative equity or if rental income is lost, remains low. Housing loan growth in this segment continued to moderate (4.4%; December 2022: 5.2%; 2015-2019 average: 10.1%). The bulk (82.9%) of new housing loans to individual property investors were extended to those earning more than RM5,000 a month, who are generally more able to withstand income shocks. The median LTV ratio of outstanding housing loans of individual property investors also remained low at 62.3% (December 2022: 62.0%), further limiting potential losses.

<sup>16</sup> Proxied by individual borrowers with one housing loan. Includes first-time home buyers as well.

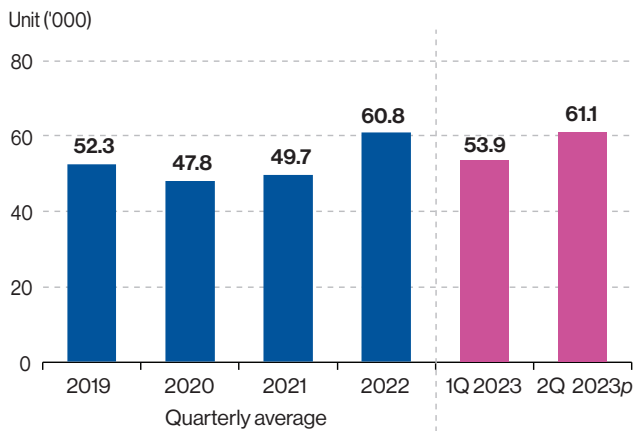
<sup>17</sup> Individual property investor refers to an individual borrower with more than one housing loan.

## Developments in the Residential Property Market

The overall residential property market remained broadly steady in the first half of 2023, supported by favourable labour market conditions, coupled with measures to promote home ownership. Total market transactions continued to hover above the pre-pandemic average, driven by the mass market segment. Houses priced RM500,000 and below accounted for close to 80% of total transactions in the first half of 2023 (Chart 1.15). The oversupply condition continued to gradually ease, with the number of unsold housing units declining further (141,855; 4Q 2021 (peak): 183,918; 2015-2019 average: 130,210) (Chart 1.16).<sup>18</sup> While the improvements were rather broad-based across property types and price segments, more significant declines in unsold units were observed in the high-rise segment, particularly among units priced between RM500,000 and RM1 million. Despite the strong demand in the mass market housing segment, the share of incoming supply of newly launched residential properties priced RM500,000 and below in the first half of 2023 was sharply lower (58.0%<sup>p</sup> of total newly launched units; 2022: 71.1%). This may be reflective of improved confidence among property developers seeking to manage higher overall cost, which in turn, could continue to aggravate the shortage in supply of affordable houses.

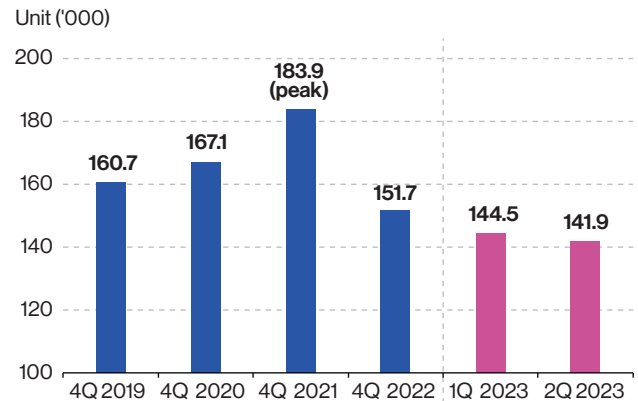
<sup>p</sup> Preliminary number.

<sup>18</sup> Comprises overhang and unsold under construction for residential units, serviced apartments and SOHO units.

**Chart 1.15: Property Market – Housing Transaction Volume**

p Preliminary

Source: National Property Information Centre (NAPIC)

**Chart 1.16: Property Market – Volume of Unsold Housing Units**

Note: Figures include both overhang and unsold under construction for residential, serviced apartments, and small office, home office (SOHO) units.

Source: National Property Information Centre (NAPIC)

House prices<sup>19</sup> expanded at a faster rate of 4.8% in the first quarter of 2023 (4Q 2022: 3.9%) but remained below the 2015-2019 long-term average of 5.3%. Beyond the improvements in income and employment conditions, the housing market has benefitted from stamp duty exemptions provided under the Malaysian Home Ownership Initiative.<sup>20</sup> Although asking prices from sellers in the secondary market<sup>21</sup> remain high, potential buyers are becoming more discerning in their purchase decisions as interest rates normalise. Property investors with three or more housing loans also continue to be subjected to a lower LTV limit of 70%. Market observers expect these factors to moderate house price growth going forward. In the primary market, improvements in house price transparency are also needed to address the artificial inflation of house prices and encourage further adjustments in the supply of housing towards the more affordable price segments.

House prices in all states in Malaysia remain well above the affordability levels of most households, with the median house price relative to median income<sup>22</sup> continuing to fall within the 'seriously unaffordable' range at 4.3 times as at end-2022 (2020: 4.7 times).<sup>23</sup> Housing unaffordability remains a major barrier for households to access home financing, with 86.1% of loan rejections attributable to high house prices (and therefore loan values) that are beyond their financial means even with the availability of loan guarantee schemes.<sup>24</sup>

In ensuring the sustainability of the housing market and continued affordability of homes for the masses, broader reforms remain imperative. These include, among others:

- Accelerating the establishment of an integrated housing database for the planning and allocation of housing that is more in line with household income, characteristics, and preferences;
- Strengthening requirements for developers to provide greater transparency around disclosed/advertised house prices with separate disclosures of discounts/rebates to improve decision-making by potential buyers, developers, as well as lenders; and
- Expediting the implementation of the Residential Tenancy Act to promote a more vibrant rental market as a viable option of choice alongside home ownership for households.

<sup>19</sup> As measured by the Malaysian House Price Index.

<sup>20</sup> This initiative provides a full exemption from stamp duty for first-time property buyers who purchase residential properties valued at RM500,000 or below until the end of 2025. Additionally, buyers of residential properties priced between RM500,000 and RM1 million can avail of a 75% stamp duty exemption under the same initiative until 31 December 2023.

<sup>21</sup> Secondary market refers to the resale of existing properties rather than sale of new properties directly from developers (i.e., primary market). Transactions in the secondary market accounted for 79.4% of total transactions in 1H 2023.

<sup>22</sup> Based on the Median Multiple approach, as recommended by the World Bank as well as the United Nations (UN). It is the ratio of median house price to the median annual household income. A house is considered 'affordable' if the house price is not more than 3 times the annual income.

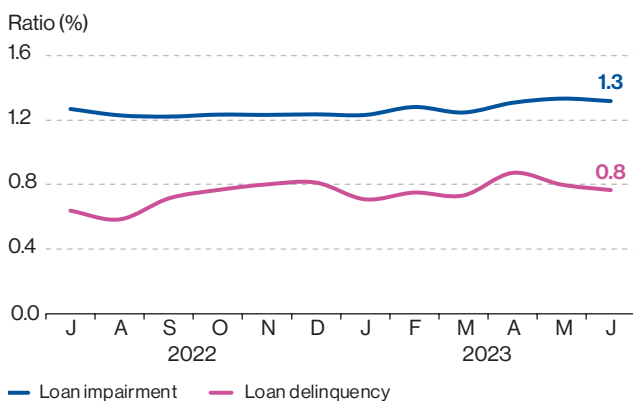
<sup>23</sup> While the affordability levels vary across states, Melaka previously stood out as the only state in the country for having house prices that are within the affordable range in 2020. However, this is no longer the case with the increase in the median house price-to-income ratio for Melaka in 2022 to above 3 times.

<sup>24</sup> Such as Skim Rumah Pertamaku by Cagamas Berhad (available up to end-March 2023) and Syarikat Jaminan Kredit Perumahan Berhad (SJKP).

## Overall household resilience remains intact against the backdrop of higher interest rates and cost of living pressures, but vulnerabilities remain in some borrower segments

The quality of household borrowings remained in line with banks' expectations. The household loan impairment ratio edged slightly higher to 1.3% (December 2022: 1.2%) (Chart 1.17) as some borrowers continue to face financial strains amid higher borrowing costs following the normalisation of interest rates. This is more notable for households whose incomes have yet to fully recover after the pandemic and are further strained by higher costs of living.

**Chart 1.17: Household Sector – Loan Impairment and Delinquency Ratios in the Banking System**

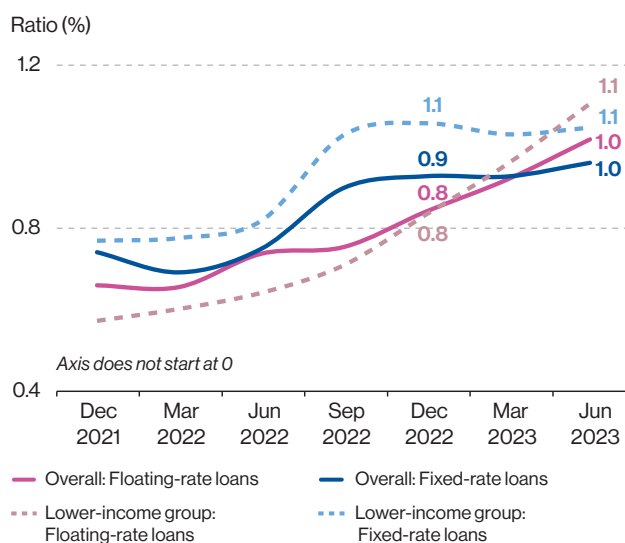


Source: Bank Negara Malaysia

There is limited evidence of new pockets of vulnerabilities emerging in the household sector. The share of household borrowings under repayment assistance remains low (June 2023: 1.7%; December 2022: 1.9% of total banking system and DFI loans). Newly restructured or rescheduled (R&R) household loans also remain small, at RM3.4 billion or equivalent to 0.15% of total banking system and DFI loans. Of this, exposures with no prior history of repayment assistance only amounted to RM1.2 billion (or 0.05% of total banking system and DFI loans), indicating that new pockets of vulnerabilities remain limited.

As expected, higher incidences of missed repayments were observed on floating-rate loans compared to fixed-rate loans (Chart 1.18). This was primarily driven by a small segment of vulnerable household borrowers who were previously under repayment assistance programmes or are currently under R&R. For households not previously or currently under these programmes, the increase in missed payments remains marginal, with no discernible difference observed in the performance of floating- versus fixed-rate loans. To some extent, lower-income borrowers, who are more vulnerable to financial distress, are partly shielded from OPR increases given their higher share of fixed-rate loans (54.4% of total loan accounts of lower-income borrowers), mainly comprising of car loans and personal financing. However, around 50% of lower-income borrowers also have at least one floating-rate loan account (usually a housing loan) which would be affected by OPR changes. The performance of floating-rate loans among lower-income borrowers have showed a more pronounced deterioration in the first half of 2023, compared with overall household borrowers. Notwithstanding this, overall impairments among lower-income borrowers remain low (June 2023: 1.3%; December 2022: 1.1%).

**Chart 1.18: Household Sector – 3 Months-in-Arrears (MIA-3) Ratio by Floating-Rate and Fixed-Rate Loans**



Note: Refers to loans with 3 months or more in-arrears.

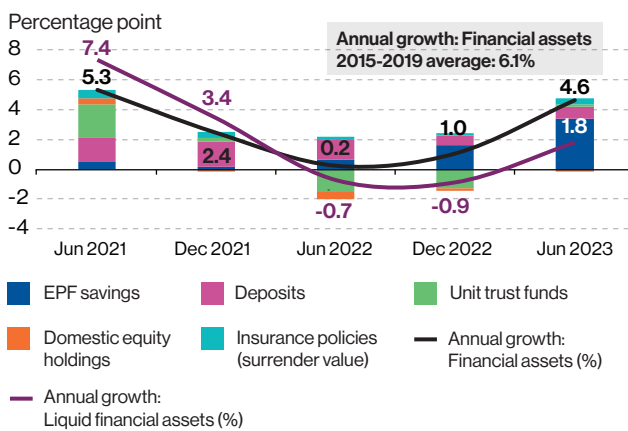
Source: Bank Negara Malaysia

Household financial assets continued to grow in the first half of 2023 (4.6%; December 2022: 1.0%; 2015-2019 average: 6.1%) supported by growth in EPF savings and deposits (Chart 1.19). In particular, EPF savings among households steadily increased in 2023 following the conclusion of EPF special withdrawal schemes and improving labour market conditions.<sup>25</sup> This was partly offset by the lower valuation of domestic equity holdings during the same period. Overall, households continued to hold financial assets in excess of

debt, with the aggregate value of financial assets remaining steady at 2.1 times of total household debt (December 2022: 2.1 times; December 2019: 2.2 times). This continues to support overall household resilience despite persisting pockets of vulnerabilities noted above.

Looking ahead, banks remain vigilant over a further deterioration in the quality of household borrowings, given ongoing challenges faced by borrowers in the vulnerable and higher-risk segments. However, any deterioration is expected to be well within banks' existing provisioning and capital buffers. The share of household loans classified as Stage 2 (identified as having higher credit risk) improved further (June 2023: 4.6%; December 2022: 6.7%). This is largely reflective of the reclassification of a greater share of household borrowers from Stage 2 to Stage 1 after observing a consistent track record (at least 6 to 12 months) of repayments upon exiting repayment assistance programmes. Favourable labour market conditions and the continued availability of assistance for viable borrowers will continue to lend support to overall debt-servicing capacity. New borrowers enrolled in Credit Counselling and Debt Management Agency's (AKPK's) Debt Management Programme and the volume of registered bankruptcy cases and petition filings remained low in the first half of 2023.

**Chart 1.19: Household Sector – Annual Growth of Financial Assets**



Source: Bank Negara Malaysia, Bursa Malaysia, Employees Provident Fund and Securities Commission Malaysia

<sup>25</sup> In the first half of 2023, contributions in EPF amounted to RM50.48 billion, representing an increase of 16.8% from RM43.23 billion in 1H 2022, and an increase of 30.6% from RM38.66 billion recorded in 1H 2019.

## OPERATIONAL RISK

### Financial institutions remained operationally resilient despite challenges

Financial institutions continue to invest significant resources in managing technology and cyber-related risks. During the period, financial institutions continued to advance the implementation of more robust fraud countermeasures to protect their customers against online banking fraud, in line with the Bank's directives in September 2022.<sup>26</sup> Following the launch of the National Scam Response Centre (NSRC)<sup>27</sup> in October 2022, financial institutions with the cooperation of law enforcement agencies now have better capabilities to identify and act on mule accounts<sup>28</sup> used to facilitate financial scams. Immediate information obtained from affected victims via the 997 hotline has also facilitated efforts to trace suspected fraudulent activity in mule accounts. Since October 2022, over 40,000 mule accounts have been disrupted by financial institutions, making it more difficult for fraudsters to perpetrate fraud and scams. As mule accounts are operated with the cooperation of account owners, often for a fee, they can be hard to identify in the absence of reported fraud incidents. Increasing public awareness of the risks, including criminal prosecution, of knowingly allowing bank accounts to be used for fraudulent activities therefore continues to be an important priority to protect the financial system and public from financial fraud.

Financial institutions are expected to continuously monitor evolving threats and ensure that their digital services can withstand new forms of attacks directed at their information technology (IT) infrastructure and/or customer devices. Given the increasing use of cloud for critical services, the Risk Management in Technology (RMiT) policy document

was also updated on 1 June 2023 to include additional expectations on cloud risk management for financial institutions. Separately, an ongoing focused review of financial institutions' Application Programming Interface (API) security practices is expected to further improve the industry's cyber controls. The Bank is also improving its cyber risk surveillance efforts via the introduction of a set of Cyber Key Risk Indicators (KRIs)<sup>29</sup> to enhance monitoring and identify risk hotspots within the industry. Relevant aggregated threat information is then shared back with the industry via the Financial Sector Cyber Threat Intelligence Platform (FinTIP).<sup>30</sup>

Financial institutions are also making further progress in aligning business operations with environmental and sustainability goals. In addition to mitigating associated financial risks, these efforts are critical to manage increasing legal and reputational risks. As of February 2023, 41 financial groups (or 62% of financial groups) comprising banking and insurance/takaful entities have announced net zero or carbon neutral targets. Towards meeting these targets, financial institutions are taking measures to align business strategies and meet expectations set out by the Bank in the Climate Risk Management and Scenario Analysis policy document. This includes enhancing investment and lending considerations to take into account environmental impacts, and expanding green financial solutions that include support for customers to transition towards more sustainable practices.

Addressing data needs and building capacity in climate risk management remain an ongoing priority for financial institutions to deliver on climate goals, support transition activities and effectively manage risks associated with greenwashing. Collaborative efforts through industry associations and forums are helping to address these issues. Apart from an ongoing focus on improving the consistency of classifications under the Climate Change and Principle-based Taxonomy (CCPT),<sup>31</sup> the Joint Committee on Climate Change (JC3) recently

<sup>26</sup> For details on the additional key measures to further strengthen safeguards against financial scams, please refer to the announcement by BNM Governor during the launch of the virtual Financial Crime Exhibition on 26 September 2022.

<sup>27</sup> NSRC was set up by the Government to tackle the growing number of cyber fraud cases in Malaysia. NSRC is a joint effort among the National Anti-Financial Crime Centre (NFCC), Royal Malaysia Police (RMP), the Bank, Malaysian Communications and Multimedia Commission (MCMC), financial institutions and telecommunication companies.

<sup>28</sup> A mule account is a bank account in which an account holder allows criminals to hold or transfer money that is acquired illegally.

<sup>29</sup> Selected conglomerate banks are required to report their Cyber KRIs to the Bank on a quarterly basis, beginning from the second quarter of 2023.

<sup>30</sup> The FinTIP was established by the Bank in 2021 as a cyber threat intelligence and collaboration platform for the financial industry. The platform facilitates cyber threat information collation, aggregation, analysis and sharing from multiple trusted sources.

<sup>31</sup> Refer to Spotlight Article on 'Implementation Progress of the CCPT in the Financial Sector' in the BNM Financial Stability Review for Second Half 2022 for further details.

established a Small and Medium Enterprise (SME) Focus Group. This Focus Group facilitates a more focused and targeted approach in raising awareness, reducing the transition cost for green certifications and facilitating better disclosures by SMEs. In addition, the JC3 also continues to support the implementation of initial green pilot projects and capital market initiatives to expand sustainable and transition finance.

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## Payment and settlement systems continued to be resilient

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The Real-time Electronic Transfer of Funds and Securities System (RENTAS)<sup>32</sup> and major retail payment systems (RPS) continued to be resilient, with no cyber incidents detected in the first half of 2023. During the period, the Bank and Payments Network Malaysia Sdn. Bhd. (PayNet) as the payment system operators of RENTAS and major

RPS, respectively, continued to undertake measures to further strengthen cyber threat and defence management capabilities. This included ongoing exercises to update and test the business continuity plan under a range of cyber threat scenarios.

Following the recognition of the real-time Retail Payments Platform (RPP) as a Designated Payment System (DPS) under the Financial Services Act 2013 and Islamic Financial Services Act 2013 effective 10 February 2023, the RPP successfully completed a major upgrade exercise, boosting its operational capacity and overall performance to support the rising trend of credit transfers. The RPP also continues to support growing cross-border payments, with the roll-out of cross-border interlinkages with Singapore on 31 March 2023. This marks the third bilateral arrangement for Quick Response (QR) payments, following successful collaborations with Thailand and Indonesia in June 2021 and January 2022, respectively.

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<sup>32</sup> RENTAS is a real-time gross settlement system for interbank fund transfers, debt securities settlement and depository services for scripless debt securities.