

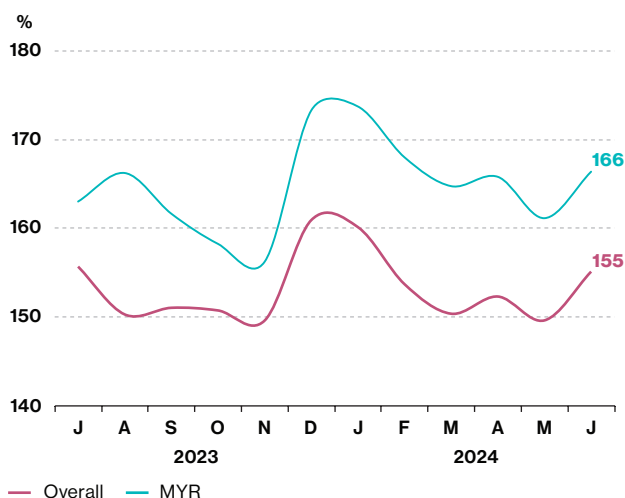
Financial Institution Soundness and Resilience

THE BANKING SECTOR

Banks' strong funding and liquidity positions remained supportive of intermediation activities

In the first half of 2024, the liquidity and funding positions of the banking system remained resilient against liquidity shocks. The aggregate Liquidity Coverage Ratio (LCR) (Chart 2.1) and Net Stable Funding Ratio (NSFR) (Chart 2.2) remained healthy and above regulatory minima, at 155.1% and 115.5% respectively as at end-June 2024 (December 2023: 161.0% and 118.2% respectively). Banks continued to hold large amounts of high-quality liquid assets (HQLA) (RM762.7 billion; December 2023: RM758.2 billion), mostly in the form of government bonds and central bank placements, which can be pledged in the interbank market or with Bank Negara Malaysia (BNM) for access to additional liquidity.

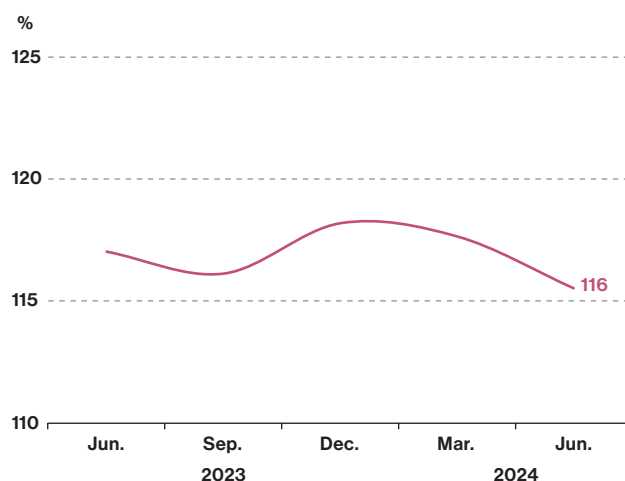
Chart 2.1: Banking System – Liquidity Coverage Ratio



Note: 1. MYR LCR is calculated based on HQLA and expected net cash outflows denominated in ringgit.
2. Overall LCR is calculated based on HQLA and expected net cash outflows denominated in all currencies.

Source: Bank Negara Malaysia

Chart 2.2: Banking System – Net Stable Funding Ratio



Source: Bank Negara Malaysia

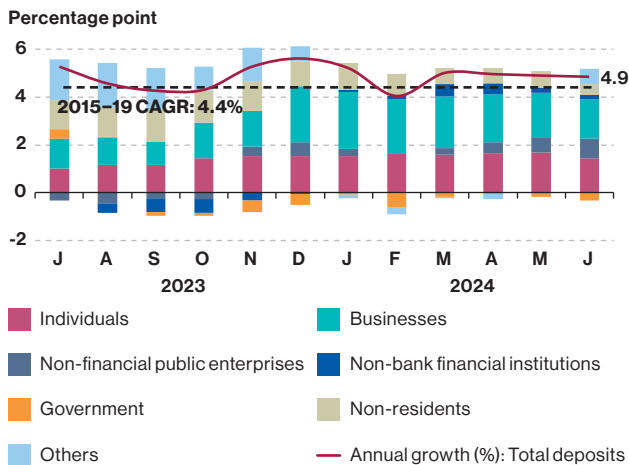
Total banking system liquidity remained supportive of financial intermediation, ranging between RM95 billion and RM127 billion between March and September 2024 (average: RM106.7 billion). Overnight and shorter-term interbank rates also remained relatively stable, reflecting orderly conditions in the interbank money market. Meanwhile, banking system deposits continued to grow at a healthy pace of 4.9% (2015–19 CAGR: 4.4%) (Chart 2.3), driven by both resident individuals and businesses (including non-financial public enterprises). These segments continued to form the bulk of the deposit base at 36.2% and 33.6% respectively, in line with the improvements in household incomes and business activities. Nearly half of the total banking system deposits (48.7%; December 2023: 48.5%; 2015–19 average: 51.2%) consists of fixed deposits (including Commodity Murabahah) (Chart 2.4) that provide banks with a stable funding source. The share of fixed deposits has risen again over the past year after a steady decline since the pandemic, reflecting a gradual unwinding of excess contingency cash buffers held by households and firms in line with improving confidence, as well as firmer expectations of unchanged policy interest rates going forward. Banks have also continued to bolster their stable funding base through the issuance of medium-term notes, which comprised 4.9% of banks'

total liabilities (2015–19 average: 5.6%). To further reinforce sound liquidity risk management by banks, BNM will soon finalise the policy document on Liquidity Risk following the close of the consultation period on the exposure draft in November 2023. The policy document, which will be published in the second half of 2024, will codify BNM's expectations on liquidity risk management, including additional guidance on liquidity stress testing, intra-day liquidity management and disclosure of high-quality liquidity-related information.

Banks' average cost of funds moderated slightly by six basis points (bps) to 2.90% between December 2023 and June 2024 (Chart 2.5), in line with easing competition for corporate deposits. Compared to the pre-pandemic

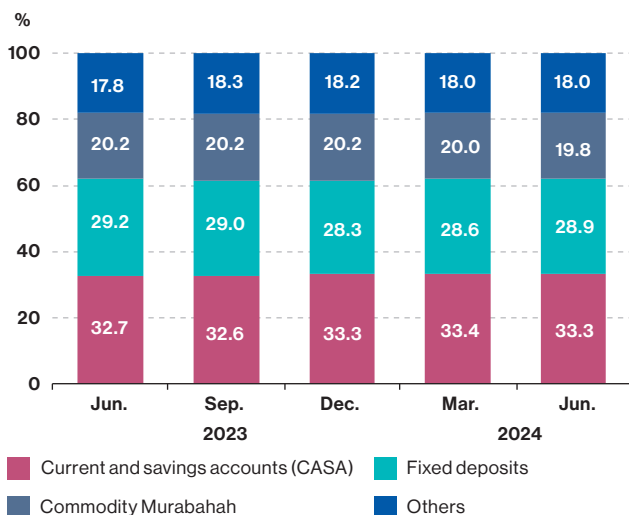
level however, the average cost of funds is around 10 bps higher despite policy rates returning to the pre-pandemic level. This reflects the lower level of overall banking system liquidity compared to earlier periods and to some extent, an uneven distribution of liquidity across banks. Ample HQLA buffers continue to preserve the ability of individual banks to tap central bank and market-based sources of funding to meet their liquidity needs. Consistent with this, there has been little evidence of a notable tightening in credit conditions. Lending to households and businesses continued to expand at a healthy rate (+6.4%; December 2023: +5.3%) (Chart 2.6). The weighted average lending rates for new business and retail loans have also remained broadly stable (-4 bps and -1 bps from December 2023 to June 2024, respectively) amid the healthy competition observed among banks.

Chart 2.3: Banking System – Contribution to Growth in Deposits Accepted



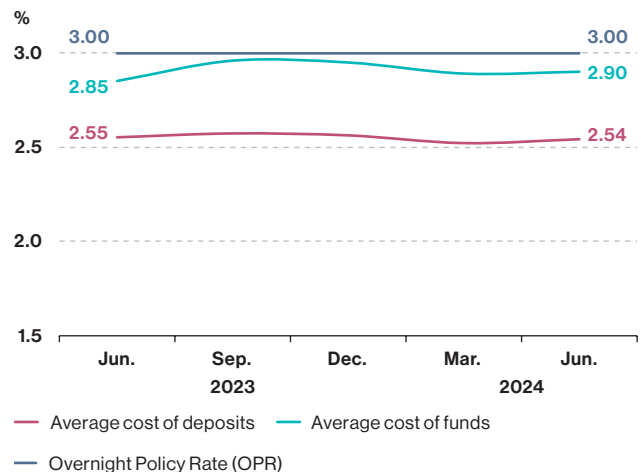
Source: Bank Negara Malaysia

Chart 2.4: Banking System – Composition of Deposits by Type



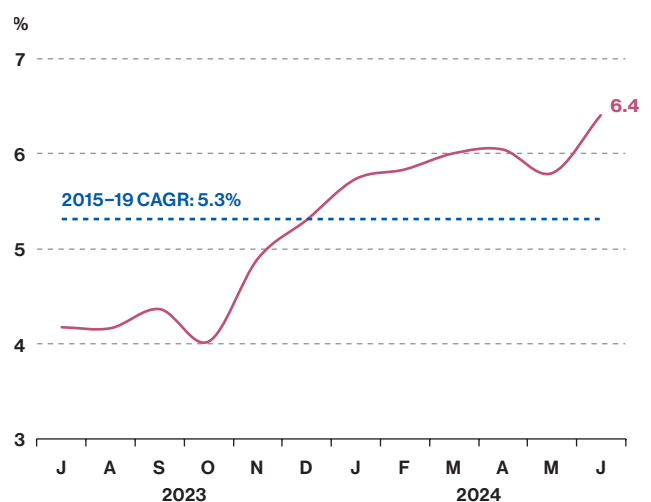
Source: Bank Negara Malaysia

Chart 2.5: Banking System – Average Cost of Deposits, Average Cost of Funds and OPR



Source: Bank Negara Malaysia

Chart 2.6: Banking System – Annual Loan Growth



Source: Bank Negara Malaysia

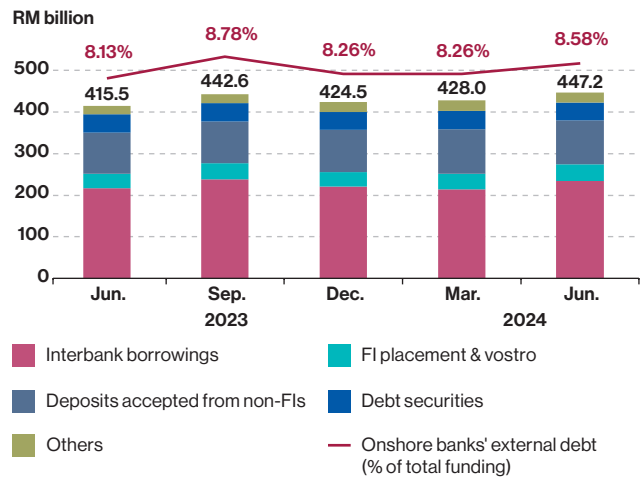
Contagion risks from banks' exposures to external counterparties remained manageable

Banks' external debt increased by RM22.7 billion in the first half of 2024 (Chart 2.7), driven largely by higher interbank borrowings. More than half of this were intra-group exposures, mainly by locally-incorporated foreign banks (LIFBs) sourcing funds from parent companies located abroad and by banks located in the Labuan International Business and Financial Centre (LIBFC) to facilitate transactions arranged and managed by foreign head offices. Additionally, some banks have increased their foreign currency borrowings to obtain cheaper ringgit funding via FCY swap arrangements. However, this accounted for only around 3% of total bank funding and is not expected to grow significantly amid the strengthening ringgit and expectations of further Fed rate cuts.

The low reliance on external counterparties for domestic funding needs has thus continued to limit risks from banks' external debt exposures. The bulk of banks' external exposures continued to be with related counterparties or in the form of long-term stable debt (78.4%; December 2023: 78.6% of total external debt), minimising rollover and withdrawals risks. Meanwhile, short-term external debt with unrelated counterparties is adequately buffered as banks continue to hold sizeable FCY liquid assets, sufficient to cover up to 2.5 times (December 2023: 2.4 times) of total FCY external debt-at-risk¹ (Chart 2.8).

Banks also continued to be resilient against foreign exchange (FX) risk. The overall FX net open position (FX NOP) of banks rose in line with increased market volatility (Chart 2.9) during the period under review, but remained manageable at 5.2% of total capital (December 2023: 3.9%; 2020–22 average: 4.2%). Moving forward, risks are expected to remain manageable with the strengthening ringgit amid lower global policy interest rates and Malaysia's positive economic growth prospects.

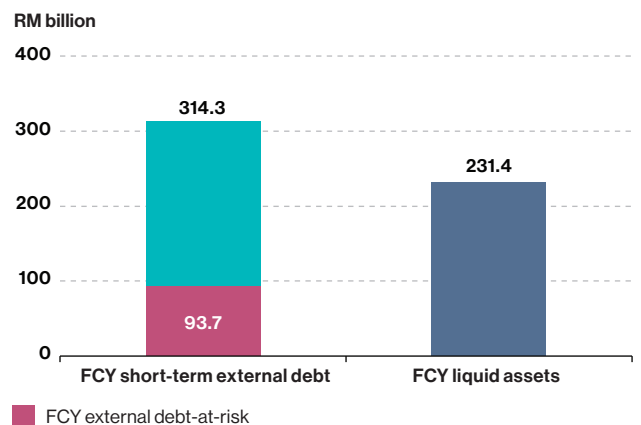
Chart 2.7: Banks' External Debt – by Instrument



Note: Banks' external debt in this context refers to external debt of DBGs, LIFBs and banks in the Labuan International Business and Financial Centre (LIBFC).

Source: Bank Negara Malaysia

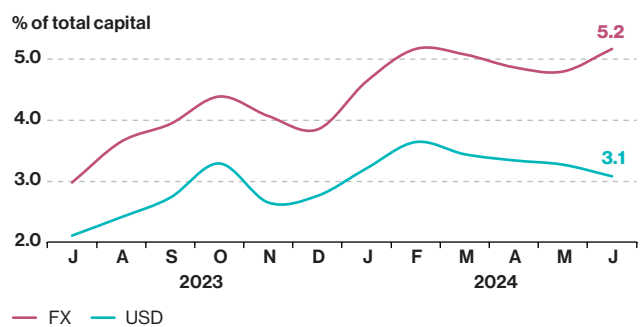
Chart 2.8: Banking System – FCY External Debt-at-Risk and Liquid Assets



Note: Liquid assets comprise cash and cash equivalents, unencumbered debt securities held and interbank placements.

Source: Bank Negara Malaysia

Chart 2.9: Banking System – FX and USD Net Open Positions



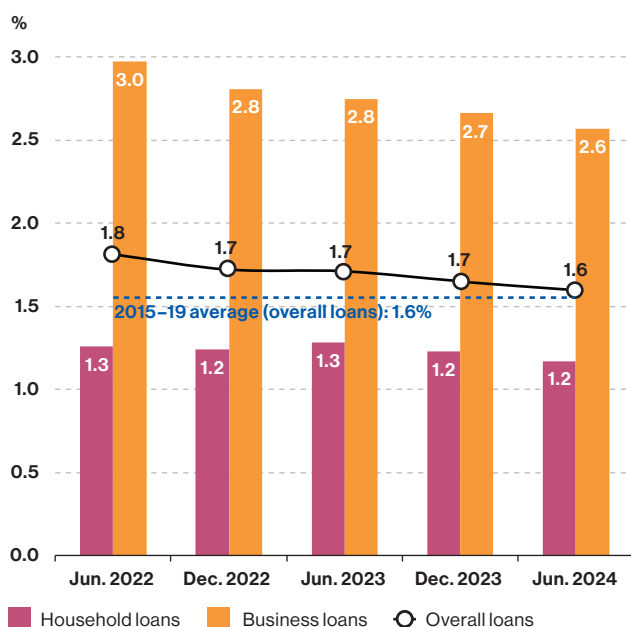
Source: Bank Negara Malaysia

¹ Banks' external debt-at-risk comprises financial institutions' deposits, interbank borrowings and short-term loans from unrelated non-resident counterparties, which are considered to be more susceptible to sudden withdrawal shocks.

Banks' asset quality improved but downside risks remain

Banks' asset quality remained sound as most borrowers continue to show improvements in their debt-servicing ability. The gross impaired loans ratio declined to 1.6% in the first half of 2024 (December 2023: 1.7%) (Chart 2.10). The outlook for asset quality also improved, with the share of loans classified as Stage 2 declining further below the pre-pandemic average to 7.0% of banking system loans (December 2023: 7.2%; 2018–20 average: 8%) (Chart 2.11). Consistent with this, loans under repayment assistance programmes² declined to 2.0% of total banking system loans (December 2023: 2.4%), while new rescheduled and restructured loans from borrowers facing financial strains remained small at 0.09% of banks' total loans (December 2023: 0.16%). Ongoing improvements in economic activity will continue to underpin sound asset quality. That said, banks continue to closely monitor pockets of vulnerable borrowers impacted by higher cost pressures particularly from the lower-income households and small businesses in the wholesale and retail, and manufacturing sectors. Most banks are gradually releasing the management

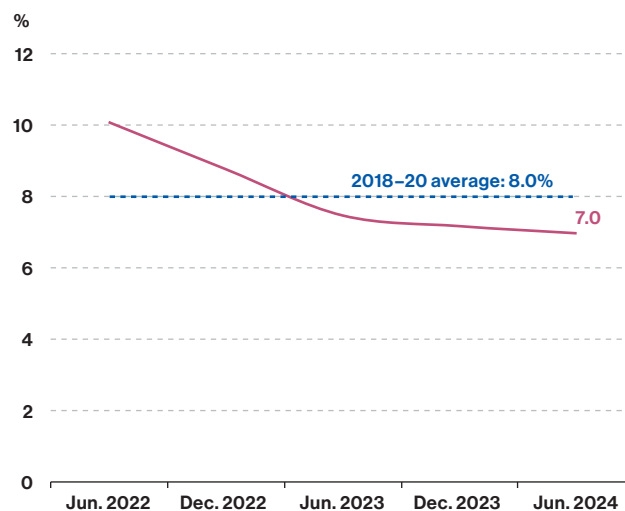
Chart 2.10: Banking System – Gross Impaired Loans Ratio



Source: Bank Negara Malaysia

² Refers to all types of repayment assistance programmes including remaining loans under assistance extended under COVID-19, banks' bespoke packages and restructuring and rescheduling (R&R).

Chart 2.11: Banking System – Stage 2 Loans Ratio

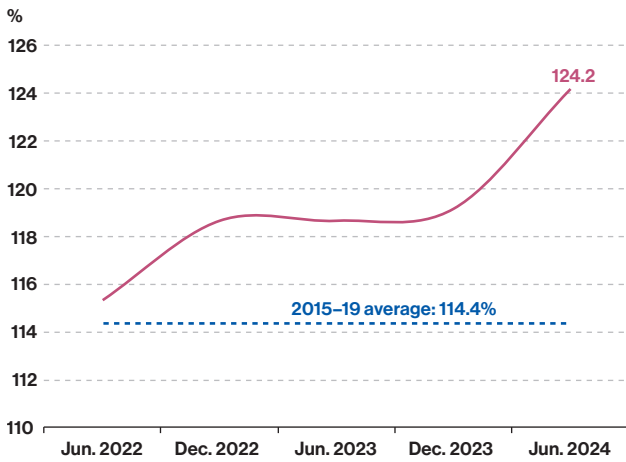


Source: Bank Negara Malaysia

overlays³ accumulated since the COVID-19 pandemic, contributing to lower overall provisions. As of June 2024, management overlays stood at around 25% of banks' expected credit loss (ECL) provisions for loans, a decline from 27% in December 2023. ECL provisions as a share of total loans have correspondingly declined from recent peaks but remain higher than their historical average as banks stay vigilant of continuing cost challenges among some higher-risk borrower segments. The banking system loan loss coverage ratio (including regulatory reserves) also remained high at 124.2% (December 2023: 119.2%) (Chart 2.12). Potential losses from vulnerable borrower segments are therefore expected to remain comfortably within banks' available buffers, standing banks in good stead to withstand earnings shocks. Additionally, a few banks have applied management overlays for borrowers highly exposed to physical climate risk. With conservative provisioning practices remaining in place, annualised credit costs have been broadly stable around the pre-pandemic historical average (Chart 2.13).

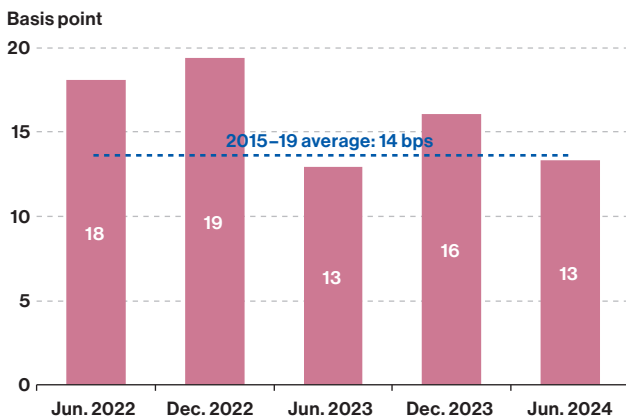
³ Management overlays are additional provisions set aside on top of provisions derived from expected credit loss (ECL) models. It reflects adjustments to account for data deficiencies or uncertainties not adequately captured by the ECL models.

Chart 2.12: Banking System – Loan Loss Coverage Ratio (Including Regulatory Reserves)



Source: Bank Negara Malaysia

Chart 2.13: Banking System – Annualised Credit Cost Ratio

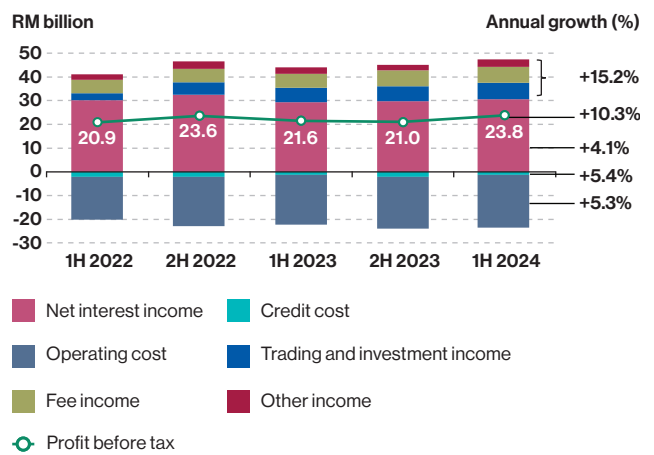


Source: Bank Negara Malaysia

Banks' earnings improved amid signs of stabilising interest margins

Banks' profitability continued to be supported by sustained interest income amid stronger loan growth and improvements in operational efficiency (Chart 2.14). The cost-to-income (CTI) ratio⁴ decreased to 46.9% in the first half of 2024 (December 2023: 48.5%). This helped to cushion pressures on net interest margins (June 2024: 1.96%; December 2023: 1.97%; 2015-19 average: 2.11%) arising from the elevated cost of funds. Margins have improved modestly in more recent months on the back of easing deposit competition and stabilising share of fixed deposits as a proportion of total funding.

Chart 2.14: Banking System – Income, Cost and Profit before Tax



Note: 1. Annual growth computed based on figures for 1H 2023 and 1H 2024.
2. Figures may not add up due to rounding.

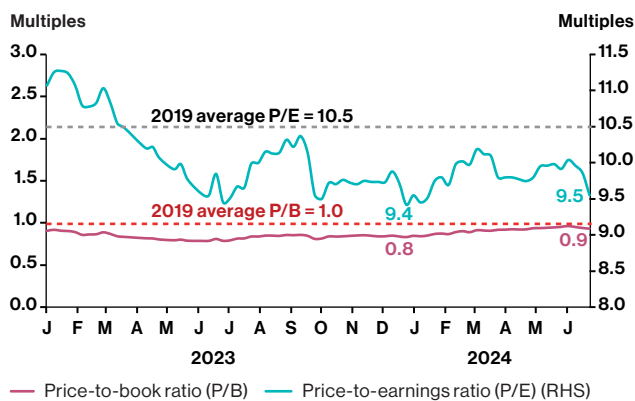
Source: Bank Negara Malaysia

⁴ CTI ratio refers to the costs of running operations (i.e. operating costs), over banks' total income.

Trading and investment income (1H 2024: RM6.8 billion; 2H 2023: RM6.4 billion) provided additional support to banks' profitability. While banks' overall holdings of government bonds continued to increase marginally (10.6% of total banking system assets; December 2023: 10.3%), their exposure to interest rate risk in the banking book remains manageable.⁵ This has been supported by active strategies to reduce duration.

In line with higher earnings, returns on asset and equity of the banking system rose to 1.3% and 12%, respectively (December 2023: 1.2% and 11.2%, respectively). This in turn supported improved market valuations of listed banks, as measured by the price-to-book (P/B) and price-to-earnings (P/E) ratios (Chart 2.15) along with broader improvements in investor sentiment which further lifted the performance of equities during the period.

Chart 2.15: Banking System – Price-to-Book and Price-to-Earnings Ratios of Publicly Listed Banks in Malaysia



Note: Refers to the median ratio of domestic banking groups in Malaysia.

Source: Bloomberg

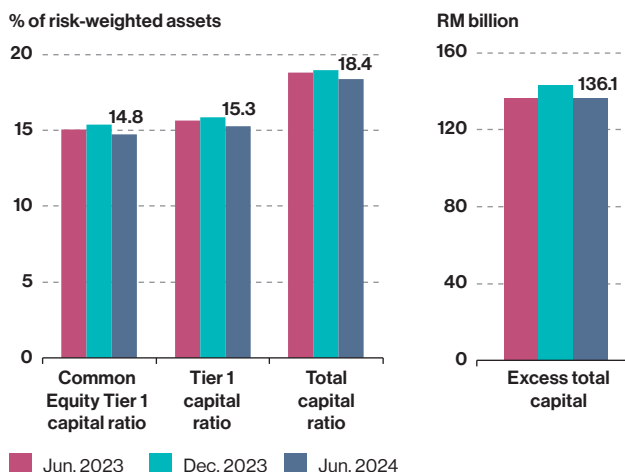
⁵ Interest rate risk in the banking book (IRRBB) reflects the current or prospective risk to the bank's capital and earnings arising from adverse movements in interest rates that affect the banks' banking book positions. It is measured as a percentage of banks' capital (June 2024: 6.7%; December 2023: 6.9%).

Banking system remained well-capitalised

The banking system total capital ratio remained healthy at 18.4% of total risk-weighted assets (December 2023: 19.0%), with excess capital buffers of RM136.1 billion (December 2023: RM143.4 billion) (Chart 2.16). The strong buffers continue to enable banks to withstand unexpected shocks and facilitate credit intermediation to the economy.

Based on BNM's latest assessment of domestic systemically important banks (D-SIBs) using end-2023 data submissions, the list of banking groups designated as D-SIBs and their respective higher loss absorbency (HLA) requirements to reflect their systemic importance remained unchanged (Table 2.1). All D-SIBs continued to maintain Common Equity Tier 1 (CET1) capital comfortably above the regulatory minima, including the HLA requirements.

Chart 2.16: Banking System – Capitalisation



Note: Excess total capital refers to total capital above the regulatory minimum, which includes the capital conservation buffer requirement of 2.5% and bank-specific higher minimum requirements.

Source: Bank Negara Malaysia

Table 2.1: D-SIBs HLA Requirement

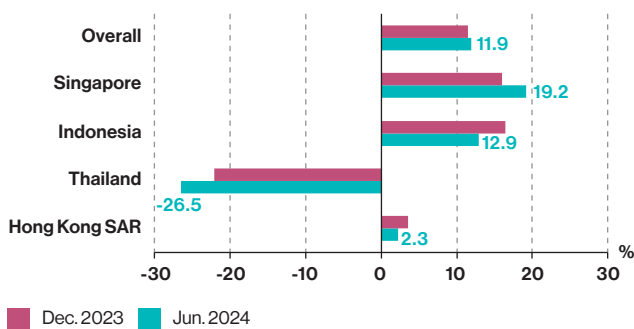
D-SIBs	HLA Requirement (% of risk-weighted assets)
Malayan Banking Berhad	1.0
CIMB Group Holdings Berhad	1.0
Public Bank Berhad	0.5

Source: Bank Negara Malaysia

Contagion risk from DBGs' overseas operations remained limited

The overseas operations of domestic banking groups (DBGs) remained profitable (Chart 2.17). This was mainly driven by operations in Singapore (representing 55% of overseas operations' assets) (Chart 2.18) which recorded improvements in operating income and higher write-backs of loan loss allowances. Operations in Thailand continued to record losses due to the high credit costs for selected non-retail borrowers that have yet to recover from the effects of the pandemic.

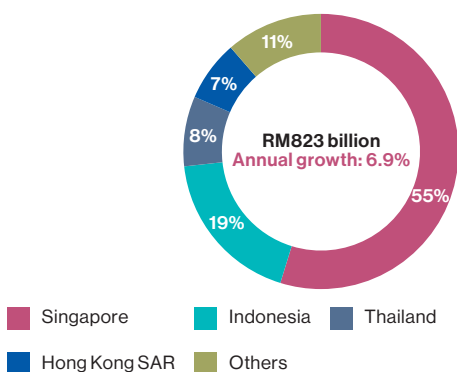
Chart 2.17: Banking System – Return on Equity of Overseas Operations by Jurisdiction



Note: 1. Overall average return on equity (ROE) is weighted by the asset size of selected overseas operations.
2. Average ROE is weighted by the asset size of each domestic banking group's overseas operations in respective jurisdictions.

Source: Bank Negara Malaysia

Chart 2.18: Banking System – Asset Profile of Major Overseas Operations



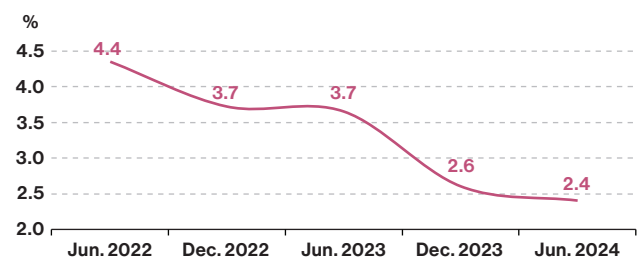
Note: Figures may not add up due to rounding.

Source: Bank Negara Malaysia

Notwithstanding this, spillover risks to parent banks in Malaysia remain manageable, as operations in Thailand contributed only up to 2% of DBGs' total consolidated assets.

Similar to Malaysia, asset quality of overseas operations continued to improve (Chart 2.19). The share of loans under repayment assistance programmes continued to decline (0.9% of total overseas operations loans; December 2023: 1.3%). Liquidity and funding risks posed by DBGs' overseas operations remain limited as major overseas operations are primarily funded by stable customer deposits (Chart 2.20). DBGs' overseas operations also continue to be supported by strong capital buffers (average total capital ratio as at June 2024: 20.9%; December 2023: 20.7%).

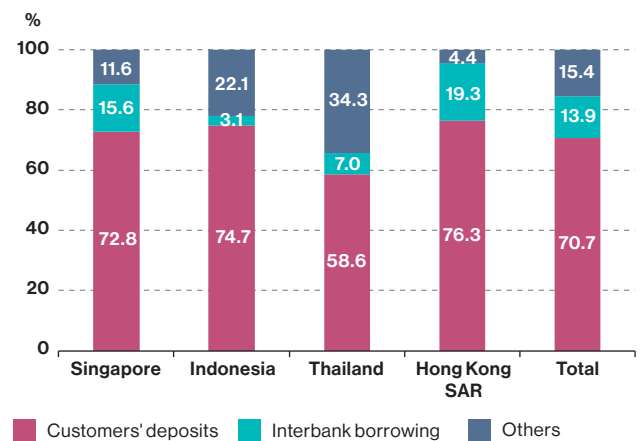
Chart 2.19: Banking System – Gross Impaired Loans Ratio of Overseas Operations



Note: The average gross impaired loans ratio is weighted by the asset size of selected overseas operations.

Source: Bank Negara Malaysia

Chart 2.20: Banking System – Funding Profile of Major Overseas Operations



Note: Figures may not add up due to rounding.

Source: Bank Negara Malaysia