

Overview

Risks to financial stability have remained contained even as a resurgence of COVID-19 infections and lagging vaccine rollouts, especially in many emerging markets, weighed on the recovery of the global economy in the first half of 2021. Policymakers around the world continue to finely balance the need to maintain exceptional policy support for the economy given the outlook that remains clouded by the pandemic, and avoid a build-up of future vulnerabilities from stretched asset valuations, increased risk-taking and higher private sector leverage amid an extended period of low interest rates. Expectations of normalisation of monetary policy in advanced economies could increase risks for financial systems where the recovery has yet to gain a firm footing and vulnerabilities are more pronounced.

In Malaysia, domestic financial stability continues to be firmly supported by a resilient financial sector. The ramp up of provisions in 2020 has provided banks with some headroom this year to moderate the amount of additional provisions set aside for credit losses, and supported a recovery in profitability. This enabled banks to further extend debt repayment assistance to households and businesses that were affected by the most recent movement restrictions, while sustaining lending activities. Similarly, insurers and takaful operators generally remain profitable and well-placed to assist individuals and businesses by providing flexibilities for premium and contribution payments that would preserve their protection coverage. In the domestic financial markets, conditions have remained orderly. This is further supporting overall funding conditions for banks and corporates. Domestic bond yields could see continued upward pressure from the higher incoming government bond supply and a further rise in US Treasury yields reflecting improvements in US economic prospects. However, the impact on the profitability and capital positions of banks and insurers and takaful operators is expected to be manageable, even under scenarios of larger-than-expected yield movements.

Business sector performance began to recover heading into the second quarter of 2021 amid the easing of movement restrictions. The share of firms-at-risk has declined from earlier peaks seen in 2020, although it remains higher than the average pre-pandemic levels due to continued challenges faced by firms in sectors that have been harder hit by movement restrictions. Overall business leverage has also improved in line with higher debt repayments by firms. The re-imposition of stricter nationwide containment measures towards the end of the second quarter of 2021 could, however, see some of these financial improvements set back, particularly among smaller firms in the construction and services sectors, while prolonging difficulties that were already challenging firms in the tourism-related industries. This could lead to a renewed pressure on the debt-servicing capacity of more affected firms. Repayment assistance programmes, as well as support measures from the Government and the Bank have so far contained any material increase of loan defaults. In particular, the cashflow relief from deferred loan repayments is helping SMEs cope better under renewed movement control restrictions, along with positive impacts from cost-cutting measures and increased digital adoption. Consistent with this, the share of SME loans assessed by banks to be of higher credit risk remained relatively modest despite an increase in SMEs that applied for repayment assistance in recent months. Banks also continued to lend to viable SMEs with various financing guarantee schemes remaining available to complement direct bank lending to these segments.

Most household borrowers remain reasonably resilient, with existing financial buffers and policy assistance measures providing a cushion against potential shocks. Repayment assistance extended by banks continued to provide support to distressed household borrowers, staving off further damage to their finances and, in turn, the economy and financial system at large. While this is helping to temporarily

support borrowers' debt-servicing capacity, a more entrenched economic recovery remains key to restoring the longer-term financial health of borrowers. The share of household borrowers who have applied for repayment assistance has risen sharply in line with the further expansion of repayment assistance by banks in June and July, but as observed prior to June, this is expected to decline again as the economy gradually reopens and households see less need to build up precautionary buffers. Importantly, new bank lending to the household sector continues to be underpinned by sound underwriting standards. The exposure of banks to higher-risk household borrowers with thinner buffers also remains low.

Activity in the housing market reversed earlier improvements observed in the second half of 2020 as the effects from the positive response to various home ownership incentives introduced by the Government subsided. However, house prices continued to be supported by sustained demand among first-time house buyers for affordable properties. This is expected to mitigate risks associated with a significant house price correction that could undermine household balance sheets and increase potential losses to banks. Limited exposures of banks to loans for the purchase of property by household investors further contained such risks. Despite interest rates being at record lows, existing macroprudential measures have also continued to reinforce prudent lending behaviour among banks, thereby containing a build-up of future risks from a credit-induced residential property price boom such as that experienced in some other jurisdictions.

Banks continue to take a forward-looking approach to credit risk management despite considerable challenges faced in updating assessments of borrowers' creditworthiness. This is partly due to the absence of more current repayment data, especially for borrowers enrolled under the various repayment

assistance programmes. Throughout the first half of 2021, banks have continued to increase provisions for credit losses in anticipation of a deterioration in asset quality as repayment assistance programmes are gradually unwound. The loan loss coverage ratio has remained around historically high levels, reflecting the higher degree of stringency in the provisioning practices of banks. Provisions by banks with significant retail exposures have also notably increased in recent months in response to the successive expansion of repayment assistance programmes. This continues to provide assurance that banks are reasonably well-positioned to withstand higher-than-expected credit losses in the event of more adverse credit developments.

While recovery prospects for the domestic economy remain subject to some degree of uncertainty surrounding the pandemic trajectory, the domestic financial system is expected to remain resilient against potential economic and financial shocks. Banks, insurers and takaful operators continue to have sufficient financial buffers to absorb potential losses under severe macroeconomic and financial conditions, while sustaining support for economic recovery. With the need to keep remote and flexible working arrangements in place for longer than expected as well as greater digitalisation of financial services that also rely on third party service providers, managing risks from information technology disruptions and cyber-attacks continues to be a high priority for the Bank and financial institutions. Ongoing, significant investments by financial institutions to strengthen business continuity plans and cyber risk resilience remain critical to reduce operational risks, both at the institution and system-wide levels. The operationalisation of the Financial Sector Cyber Threat Intelligence Platform in September, which is overseen by the Bank, will further support these efforts by enhancing the financial sector's ability to swiftly detect and respond to cyber threats.