

Monetary and Financial Conditions in 2018



65	International Monetary and Financial Conditions
67	Domestic Monetary and Financial Conditions

Monetary and Financial Conditions in 2018

INTERNATIONAL MONETARY AND FINANCIAL CONDITIONS

Global financial conditions tightened in 2018 due to global monetary policy normalisation and financial market volatility

Overall global financial conditions tightened in 2018, reflecting the normalisation of global monetary policy and heightened financial market volatility due to ongoing policy and economic uncertainties. Monetary policy in most advanced economies, particularly the US, remained on their normalisation path. Emerging market economies also experienced tighter financial conditions as the monetary policy normalisation in advanced economies led to large portfolio outflows from emerging market financial assets. At the same time, ongoing risk-off developments such as the global trade tensions further contributed to sudden shifts in investor sentiments and episodes of financial market volatility. As funds shifted away from emerging market economies, pockets of vulnerabilities also emerged in some of these economies, which culminated in the currency sell-offs in Argentina and Turkey. A number of central banks in emerging market economies¹ also tightened monetary policy due to concerns on higher inflation arising from the depreciation of their currencies and the earlier increases in commodity prices. As a result of these developments, financial market performances in advanced economies, particularly the US, and emerging market economies diverged during the year. While US equity indices sustained a strong upward trend before reversing in the fourth quarter, equity markets in emerging market economies declined for the most part of the year. The US dollar also strengthened against most other currencies during the year, while emerging market currencies faced sharp

¹ In the second half of 2018, central banks in Argentina, Chile, India, Indonesia, Mexico, the Philippines, Russia, South Africa, Thailand and Turkey raised their policy rates.

Chart 2.1: S&P 500 Index and MSCI Emerging Markets Index*

Equity markets performance in the US and emerging market economies diverged during the year



* A benchmark index compiled by MSCI which tracks the equity market performance of 24 emerging market economies weighted by their respective market capitalisation

Source: Bloomberg

depreciation pressures. Global bond yields, however, trended upwards across both advanced economies and emerging market economies.

Global financial markets began the year with a continuation of the upward momentum, as investor optimism remained buoyed by expectations of sustained global economic expansion following the strong economic performance in 2017. Global equity markets experienced a strong rally in January, with the S&P 500 Index and Morgan Stanley Capital International Emerging Markets (MSCI EM) Index increasing by 5.6% and 8.3%, respectively. At the same time, bond yields in the advanced economies trended higher as investors began to price in expectations of tighter monetary policy. The higher investor risk appetite, however, proved to be temporary as concerns on tightening global financial conditions began to outweigh the positive economic outlook.

The ongoing monetary policy normalisation in the advanced economies was a key contributing factor towards tighter global financial conditions, both in

terms of the shifting market expectations on the pace of US Federal Reserve (Fed) interest rate increases and the actual outcome of monetary policy adjustments. In February, the releases of strong US wage and employment data² led to market expectations for a faster pace of interest rate hikes, which spurred a temporary sharp decline in investors' risk appetite in global equity markets. As the Chicago Board Options Exchange Volatility Index (VIX) spiked, an unwinding of "short-volatility" derivatives positions³ led to a technical correction in US equity indices which spilled over into other equity markets. Investor sentiments subsequently eased following the Fed's affirmation that monetary policy normalisation would continue at a gradual pace. As the US economy continued to improve, the Fed raised the target range for the federal funds rate four times during the year, beginning in March. Central banks in other advanced economies⁴ continued on a more moderate normalisation path, which helped to partially offset the effects of the Fed tightening on global financial conditions.⁵

The confluence of strong US economic conditions and narrowing interest rate differentials subsequently led to a rebalancing of funds away from emerging market economies towards US dollar assets. During the second quarter, emerging market economies experienced large portfolio outflows amounting to USD10.3 billion⁶ and the US dollar strengthened against most currencies.⁷ Despite the higher demand for US financial assets, yields on US Treasuries remained on an upward trend, driven by continued market expectations of tighter monetary policy. The 10-year US Treasury yield breached the key resistance level of 3.0% several times during the year, and recorded a peak of 3.2% in November, its highest level

² Growth in US nonfarm payrolls beat expectations at 200,000 in January 2018 (Analysts' forecast: 180,000), while average US hourly earnings increased by 2.9% on an annual basis, the strongest growth since 2009.

³ Short VIX contracts (also known as Inverse VIX contracts) are derivatives contracts that gain value when volatility remains low and lose value as volatility spikes. On 5 February 2018, the sharp increase in the VIX caused large losses to holders of these contracts. To hedge this short position, investors rapidly sold US equities, which resulted in the sharp decline in US equity indices.

⁴ During the year, the Bank of England (BOE) raised its policy rate by 25 basis points and the European Central Bank (ECB) gradually tapered down its large-scale asset purchase programme. The Bank of Japan (BOJ), however, continued on its negative interest rate policy and expanded its monetary stimulus programme during the year.

⁵ Source: BIS Annual Economic Report 2018.

⁶ Source: EPFR Global.

⁷ The US Dollar Index, a measure of the value of the US dollar against a basket of US major trading partners' currencies, increased by 5.0% during this period.

since 2011. The continued signaling of further rate increases by the Fed contributed to repricing of US financial assets in October, which led to broad-based declines in global equity markets, as reflected by the 8.8% decline in the MSCI EM Index during the month.

Towards the end of the year, divergence between market expectations and the Fed's communicated trajectory on the pace of US monetary policy normalisation contributed to higher financial market volatility. The Fed's decision to increase interest rates in December, despite moderating US growth prospects, resulted in a sell-off in US equities, with the S&P 500 Index declining by 9.2% during the month. The 10-year US Treasury yield, however, declined to 2.7% reflecting

Chart 2.2: US Dollar Index

US dollar remained on an appreciating trend throughout 2018



Source: Bloomberg

Chart 2.3: J.P. Morgan Emerging Market Bond Index (EMBI) Spread* and 10-year US Treasury Note Yield

Global bond yields trended upwards reflecting tighter financial conditions



* The spread refers to the difference in yields between US dollar-denominated emerging market sovereign bonds and US Treasury notes

Source: Bloomberg

the shift in sentiments as investors began pricing in a higher probability for a pause to further US monetary policy normalisation following the Fed's lower growth and inflation forecast for 2019.

In addition to the ongoing US monetary policy normalisation, the heightened trade tensions further amplified risk aversion towards emerging market financial assets. The introduction of protectionist policies by a number of major economies⁸ was a key concern in global financial markets as investors expected the disruptions to global value chains to weigh on global growth prospects. The tariffs already implemented, along with the corresponding retaliatory measures, were estimated to result in a reduction in annual global growth by 0.3 percentage points, with a large portion of the impact to manifest in 2019.⁹

Amid concerns on moderating global growth, investors also began to place increased scrutiny on country-specific vulnerabilities within emerging market economies. A key concern was the sustainability of their US dollar-denominated debt. As a result, several emerging market economies with perceived vulnerabilities experienced sharp sell-offs of financial assets, which generated vicious cycles of portfolio outflows and exchange rate depreciation pressures. In August, the Argentine peso experienced a sharp depreciation of 26% against the US dollar as concerns on the country's growing current account deficit, high inflation and large US dollar-denominated debt resulted in non-resident outflows. The Turkish lira also experienced a sell-off, depreciating by 25% against the US dollar in August due to similar concerns, which were further exacerbated by geopolitical tensions and sanctions imposed by the US. These episodes of currency sell-offs led to growing concerns on potential contagion risks among other vulnerable emerging market economies. Regional economies with twin deficits, such as India and Indonesia, were particularly affected and experienced sharp declines in their respective currencies and equity indices. As a result, some central banks in emerging market economies tightened monetary policy to address the impact of currency depreciation and earlier oil price increases on

inflation prospects.¹⁰ For the year as whole, the MSCI EM Index declined by 16.6% and the J.P. Morgan Emerging Markets Bond Index spread widened by 123.6 basis points.

Going forward, global financial markets will continue to face bouts of volatility, as many of the uncertainties that contributed to past episodes of volatility remain as potential risk factors in 2019. The materialisation of these downside risks could lead to a tightening of financial conditions globally, with implications on growth prospects. Firstly, moderating global growth conditions have led to diverging expectations on the trajectory of Fed interest rate hikes¹¹ and increases the risks of disorderly financial market adjustments in response to potential policy surprises. Second, the ongoing trade tensions between the US and PR China will likely come into focus again following the end of a 90-day trade truce agreed upon at the 2018 G20 Summit.¹² Escalation of tariff actions could cause further weakening in global growth prospects. Third, political developments in 2019 such as Brexit could lead to episodes of heightened volatility. Fourth, higher volatility in global crude oil prices could cast uncertainties in financial markets, particularly for commodity-exporting economies. For emerging market economies, the attractive valuations following the portfolio outflows in 2018 could support a reallocation of flows back into the asset class. This, however, could be limited by continued risk aversion amid tightening financial conditions and moderating macroeconomic conditions.

DOMESTIC MONETARY AND FINANCIAL CONDITIONS

Domestic financial markets were affected by shifts in non-resident portfolio flows, driven mainly by external developments

Amid the developments in global financial markets, the domestic financial markets experienced shifts in non-resident portfolio flows, largely reflecting changes in investor sentiments and risk appetite throughout the year. The trends observed in domestic financial markets

⁸ On 1 March 2018, the Trump administration announced a 25% tariff on steel and a 10% tariff on aluminium imports. Since then, additional tariffs were levied on USD250 billion worth of Chinese goods. Following these measures, several US trading partners responded with retaliatory tariffs, including PR China, which has applied tariffs on USD110 billion of US imports.

⁹ The impact of trade tensions to global growth in 2018 and 2019 was estimated as -0.02 and -0.26 percentage points, respectively. Source: BNM Quarterly Bulletin, Third Quarter 2018.

¹⁰ Source: IMF World Economic Outlook, January 2019.

¹¹ As at January 2019, the Federal Open Market Committee (FOMC) Dot Plot projected that the Fed will raise the target range for the federal funds rate two times in 2019, whereas the Federal Funds Futures market priced in no policy rate changes for the year.

¹² On 1 December 2018, the US and PR China agreed on a temporary 90-day truce with the intention of de-escalating the trade tensions, which ended on 1 March 2019. During this period, the US and PR China agreed not to increase or introduce new tariffs while the two countries negotiate on a new deal.

were largely in line with most regional financial markets, driven mainly by external developments. Domestic policy uncertainties also affected investor sentiments following the results of the 14th General Election. For 2018 as a whole, non-resident outflows from the bond and equity markets amounted to USD5.5 billion and USD2.9 billion, respectively. As a result, the ringgit depreciated by 1.8% to end the year at RM4.1385 against the US dollar. The benchmark Malaysian Government Securities (MGS) yield curve shifted upwards, reflecting an increase in bond yields across all maturities. The 3-year, 5-year and 10-year MGS yields increased by 29, 22 and 17 basis points, respectively. The FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI) declined by 5.9% (2017: 9.4%) to close at 1,690.6 points.

Developments in the domestic financial markets can be delineated into two distinct phases. In the first quarter, global financial markets continued their strong momentum from 2017 and investor sentiments remained buoyed by the positive economic outlook in emerging market economies. This led to broad-based non-resident portfolio flows into the region, including Malaysia. As a result, the demand for ringgit investment assets provided support to the ringgit exchange rate, as well as domestic bond and equity prices. However, this trend reversed from the second quarter onwards as global uncertainties, particularly related to US monetary policy normalisation, escalating global trade tensions and contagion risks from vulnerable emerging market economies, began to weigh on investor sentiments.

In the first quarter of the year, Malaysia's bond and equity markets experienced non-resident inflows amounting to USD0.9 billion and USD0.6 billion, respectively, as investors maintained a favourable outlook on emerging market economies, including Malaysia. This was amid continued optimism on global growth and market expectations for a gradual pace of monetary policy normalisation in the US. Investor sentiments were also buoyed by the strong domestic economic performance and growth prospects.¹³ Following this, the ringgit appreciated by 5.2% against the US dollar in the first quarter, with the ringgit reaching an annual high of RM3.8580 per US dollar at end-March. In the bond market, while MGS yields adjusted in line with the 25 basis point Overnight Policy Rate (OPR) increase during the

period, this was partially offset by the non-resident inflows. As a result, the 3-year and 10-year MGS yields increased by 10 and 3 basis points, respectively, and the 5-year MGS yield declined by 1 basis point. The equity market maintained its upward momentum well into April, supported by active buying by non-resident investors during the month.¹⁴ As a result, the FBM KLCI increased by 4.1% during the first four months of the year.

Several external developments took centre stage from the second quarter onwards, which led to shifting investor sentiments. These included investor expectations for a faster pace of monetary policy normalisation in the US, an escalation in global trade tensions and volatile global crude oil prices. Furthermore, incidences of currency sell-offs in several vulnerable emerging market economies contributed to the deterioration of sentiments as investors were concerned over contagion risks. Beyond these external factors, domestic policy uncertainties further weighed on investor sentiments, particularly following the unprecedented outcome of the 14th General Election. Nevertheless, the effects of domestic factors were temporary following improved policy clarity by the Government and expectations of supportive economic conditions.

This confluence of external and domestic factors led investors to rebalance their portfolios out of emerging market financial markets, including Malaysia. From April to December 2018, non-resident outflows from the domestic capital markets amounted to USD9.8 billion. As a result, the ringgit depreciated by 6.7% against the US dollar. Despite the outflows, bond market adjustments remained orderly due to sustained demand from domestic institutional investors, which partially offset the impact from these outflows. Notably, banks increased their holdings of MGS by RM22.8 billion during this period. The 3-year, 5-year and 10-year MGS yields increased by 19, 23 and 13 basis points, respectively.

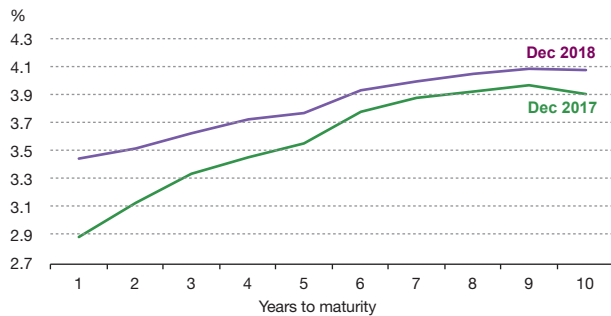
The domestic equity market, however, only started to trend lower from May onwards. Along with the global investor risk aversion arising from the external factors, domestic policy uncertainties following the 14th General Election also contributed to the cautious sentiments. Consequently, domestic equities experienced declines as investors waited

¹³ In 2017, Malaysia's GDP growth increased to 5.9% from 4.2% in 2016.

¹⁴ Unlike the bond market, the equity market continued to experience non-resident inflows in April amounting to USD0.4 billion.

Chart 2.4: MGS Benchmark Yield Curve

The MGS yield curve shifted upwards during the year

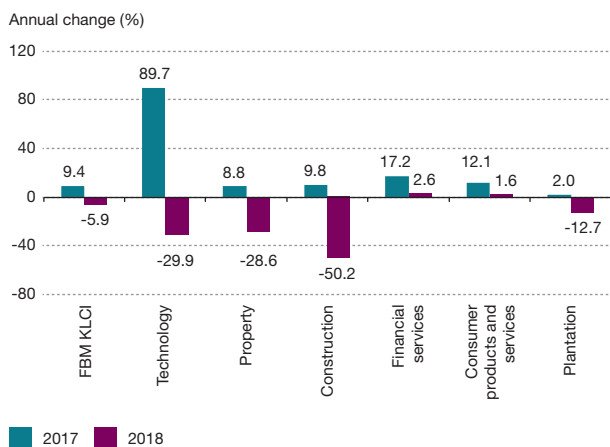


Source: Bank Negara Malaysia

for clarity on the status of major infrastructure projects,¹⁵ the potential impact of proposed fiscal reforms and introduction of new taxes. These losses, however, were partially retraced when there was greater policy clarity by the Government as the year progressed and positive earnings results in selected large-cap companies. Concerns on potential risks of contagion effects in emerging market economies following the currency sell-off in Turkey also caused selling pressure on domestic equities, particularly on Malaysian companies with exposure to the Turkish economy. For the period May to December 2018, the FBM KLCI declined by 9.6% to close the year at 1,690.6 points.

Chart 2.5: Performance of Sectoral Equity Indices

Domestic policy uncertainties resulted in sharp declines in selected sectors



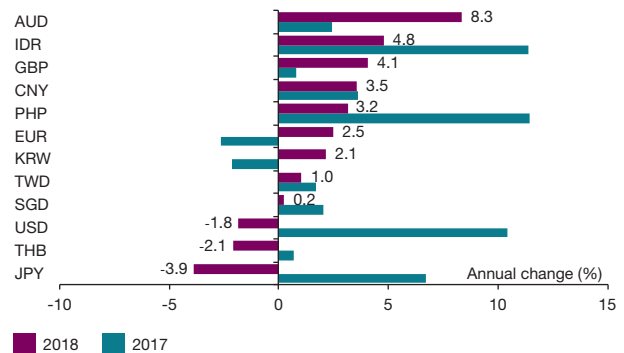
Source: Bloomberg

¹⁵ During the year, the FBM Construction index fell by 50.2% due mainly to the announcements of reviews on selected large infrastructure projects.

For the year as a whole, domestic financial markets performed relatively well and continued to intermediate shifts in capital flows in a stable and orderly manner. The ringgit remained as one of the better performing currencies in the region, depreciating by 1.8% against the US dollar compared to regional currencies which moved between -6.3% and +0.3% against the US dollar. The ringgit also appreciated against the euro (2.5%) and the British pound (4.1%), but depreciated against the Japanese yen (-3.9%). Against regional currencies, the ringgit was broadly stronger, with the biggest gains registered against the Indonesian rupiah (4.8%) and the Chinese renminbi (3.5%).

Chart 2.6 : Malaysian Ringgit (RM) Performance against Major and Regional Currencies

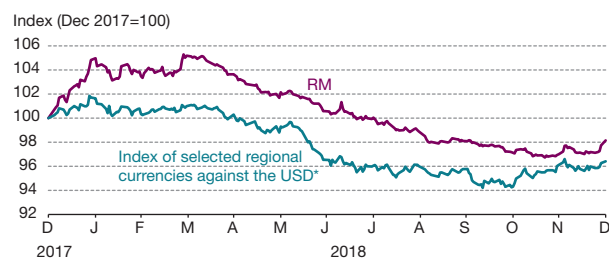
The ringgit appreciated against most major and regional currencies in 2018



Note: (+) indicates an appreciation of the ringgit against foreign currency
Source: Bank Negara Malaysia

Chart 2.7: Exchange Rate of the Malaysian Ringgit (RM) and Selected Regional Currencies against the US Dollar (USD)

The ringgit depreciated less compared to regional currencies in 2018



* Regional currencies: Chinese renminbi, Indonesian rupiah, Korean won, Philippine peso, Singapore dollar, New Taiwan dollar and Thai baht. Each currency carries equal weight.

Note: An increase in the index represents an appreciation of the ringgit or of selected regional currencies against the US dollar

Source: Bank Negara Malaysia

As a result, the ringgit's Nominal Effective Exchange Rate (NEER), a measure of ringgit performance against the currencies of Malaysia's major trading partners, appreciated by 1.1%.

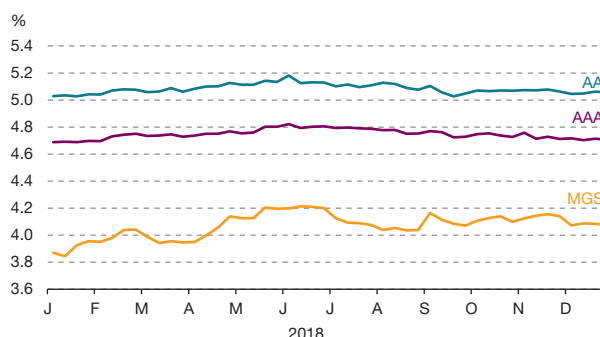
Conditions in the domestic foreign exchange market remained orderly despite the large non-resident capital outflows and environment of uncertainty during the year. This was partly attributed to policies introduced by Bank Negara Malaysia and the Financial Markets Committee (FMC) at end-2016. Foreign exchange liquidity improved following the introduction of the export conversion measure, as reflected in the average daily foreign exchange turnover which increased to USD11.5 billion in 2018 (2016: USD8.1 billion). In addition, the reinforcement of the non-facilitation of non-deliverable forward (NDF) transactions limited the spillovers from speculative activities in opaque offshore markets. By severing the link between offshore speculative outlets and the onshore foreign exchange market, the average daily gap between the domestic spot rate and 3-month NDF rate narrowed to 91 percentage in points (pips) as at end-2018 (2016: 211 pips). Overall, these measures supported orderly market conditions and better price discovery in the domestic foreign exchange market, thus contributing to greater market stability and minimised potential spillovers to the broader economy. Furthermore, the structure of the domestic economy and financial sector limits Malaysia from adverse spillovers arising from large exchange rate movements.

The magnitude of adjustments in the domestic capital markets also remained contained during the year despite the capital outflows. The upward movement in the MGS yield curve and the decline in the KLCI were relatively less sharp when compared to regional peers,¹⁶ owing to the large domestic investor base. Spillovers to the corporate bond market from non-resident outflows in the MGS market were limited, with yields on the 10-year AAA- and AA-rated papers increasing only marginally by 2 and 3 basis points, respectively. Orderly adjustments also contributed to healthy liquidity conditions. In the bond markets, annual trading value of government and corporate bonds remained stable at RM597.9 billion (5-year average: RM680.6 billion) and RM113.5 billion (5-year average: RM123.1 billion), respectively.

¹⁶ 10-year MGS yield increased by 17 basis points in 2018, while regional 10-year sovereign bond yields increased by between 16 and 171 basis points. FBM KLCI declined by 5.9% during the year, compared to the regional average decline of 8.4%.

Chart 2.8: 10-year MGS and 10-year Corporate Bond Yields

Domestic bond yields remained stable supported by domestic institutional investors



Source: Bank Negara Malaysia

Equity market liquidity also remained resilient, with an average monthly turnover ratio for the year of 2.8% (5-year average: 2.6%).

Going into 2019, external uncertainties will continue to affect the outlook for domestic financial markets. These include uncertainties surrounding the Fed's monetary policy normalisation path, a potential further escalation in global trade tensions, the unravelling of geopolitical developments such as Brexit and the resurgence of volatility in global crude oil prices. Under this uncertain environment, periods of heightened volatility will become part and parcel of domestic financial market developments as international investors' portfolio rebalancing and flight-to-safety motives are expected to continue.

In light of this, it is important for Malaysia to maintain a policy configuration that is both flexible and pragmatic. A flexible and market-determined ringgit exchange rate remains a key policy to ensure that the economy is capable of withstanding external shocks. In this regard, the Bank will continue to ensure that exchange rate adjustments are orderly and do not disrupt real economic activity. The Bank also maintains a broad policy toolkit in managing emerging risks. Efforts to develop the domestic financial markets will continue, especially in developing hedging instruments and allowing greater flexibility to manage foreign exchange exposures so that businesses can undertake better risk management. The Bank's monetary operations remains focused on ensuring sufficient liquidity to support the orderly functioning of the domestic financial markets through the judicious use of international reserves and a wide range of liquidity instruments. On the domestic front, efforts to strengthen economic fundamentals and greater policy clarity on

the direction of the economy and structural reforms will help to provide support to domestic financial markets amid these global uncertainties. All these efforts combined will ensure that domestic financial markets will continue to support sustainable growth.

Nominal interest rates increased in early 2018, reflecting the pass-through from the normalisation of the degree of monetary accommodation

Domestic interbank rates, retail lending rates and fixed deposit rates increased in early 2018, reflecting the pass-through from the increase in the OPR on 25 January 2018. For the rest of the year, funding costs remained relatively stable despite portfolio outflows, supported by sufficient aggregate liquidity in both the wholesale and retail markets of the banking system. This was in part due to the Bank's liquidity injection operations in the interbank market.

The transmission of the 25 basis point increase in the OPR to the money market was rapid. The average overnight interbank rate (AOIR) rose by 21 basis points on 25 January 2018 from 2.94% to 3.15% and subsequently stabilised within a narrow range of 3.14% – 3.25% for the remainder of the year. Interbank rates for longer tenures also increased in line with the increase in the OPR. The 3-month Kuala Lumpur Interbank Offered Rate (KLIBOR) rose by 24 basis points within a day of the OPR increase. For the year, the 3-month KLIBOR increased by 25 basis points.

Following the increase in the interbank rates, retail lending and deposit rates adjusted accordingly. The weighted average base rate (BR) of commercial banks initially increased by 12 basis points in January 2018 to 3.76% following the increase in the OPR and subsequently by another 13 basis points in February 2018 as more banks

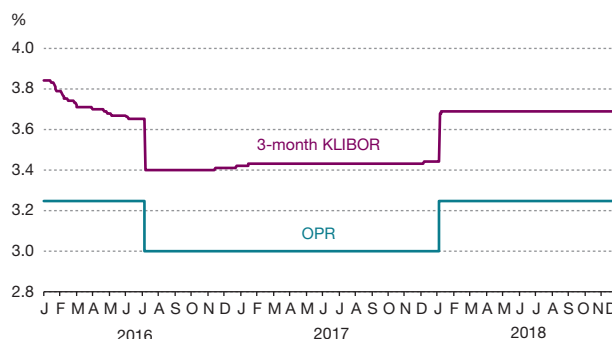
Table 2.1: Policy, Interbank and Lending Rates

	Dec-16	Dec-17	Jan-18	Dec-18
	%, as at end period			
Overnight Policy Rate (OPR)	3.00	3.00	3.25	3.25
3-month KLIBOR	3.41	3.44	3.69	3.69
Weighted average base rate (BR)	3.62	3.64	3.76	3.91
Weighted average lending rate (ALR)	5.22	5.22	5.27	5.42

Source: Bank Negara Malaysia

Chart 2.9: Policy and Interbank Market Rates

Money market rates increased in line with the increase in the OPR



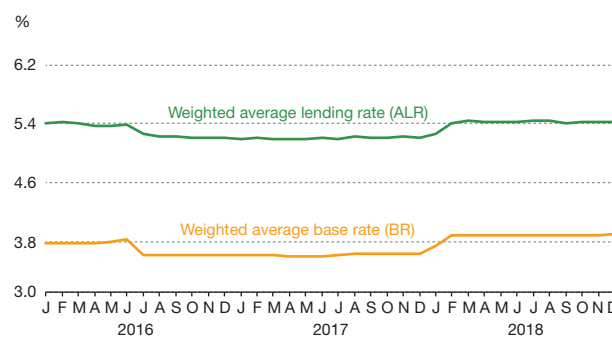
Source: Bank Negara Malaysia and Bloomberg

revised their respective BR. By end-2018, the weighted average BR stood at 3.91%. Correspondingly, the weighted average lending rate (ALR) on outstanding loans to both households and businesses increased by 20 basis points to 5.42% (2017: 5.22%).

The increase in the OPR also resulted in an upward revision to retail deposit rates, compensating savers with a higher rate of return. For the 1 to 12 months tenures, the average quoted fixed deposit (FD) rates of commercial banks rose by an average of 7 basis points in January 2018 following the increase in the OPR. By end-2018, the average quoted FD rates had risen by 22 basis points, ending the year within a range of 3.09% – 3.33%. Apart from higher nominal deposit rates, real deposit rates turned positive in January 2018 and increased steadily during the year due to the increase in nominal interest rates and moderating headline inflation.

Chart 2.10: Commercial Banks' Lending Rates (at end-period)

Retail lending rates adjusted upwards, reflecting the pass-through from the increase in the OPR



Source: Bank Negara Malaysia

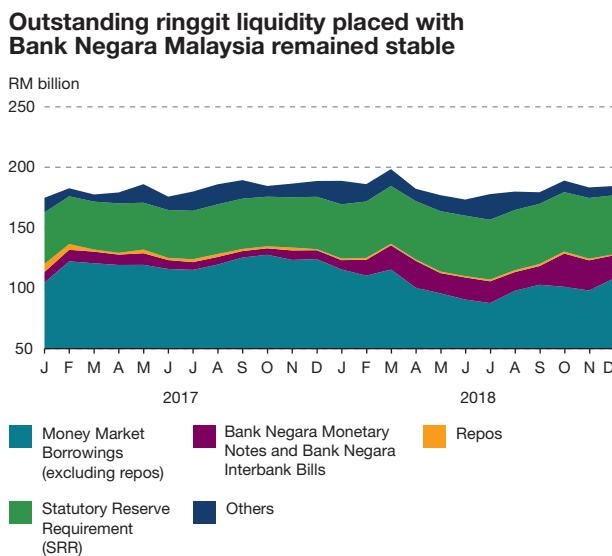
Overall liquidity conditions remained sufficient to facilitate financial intermediation

In 2018, overall banking system liquidity remained sufficient to support the financial intermediation process. At the system level, aggregate outstanding liquidity placed with the Bank remained stable despite portfolio outflows during the year. At the institutional level, most banking institutions continued to maintain surplus liquidity positions with the Bank.

Throughout the year, the Bank's monetary operations were focused on maintaining stability in the interbank market. The contractionary impact on liquidity arising from large portfolio outflows was offset by the Bank's liquidity injection operations undertaken through the reverse repo and foreign exchange swap facilities. As a result, price discovery in the domestic money market remained uninterrupted and money market rates remained stable during the year.

Private sector liquidity, as measured by broad money (M3), grew at a much faster pace of 8.0% in 2018 (2017: 4.9%). The expansion in M3 was supported by credit extended by banks to the private sector through loans and purchases of corporate bonds. The annual growth rate of total deposits in the banking system recorded a three-year high of 7.5%, due mainly to an increase

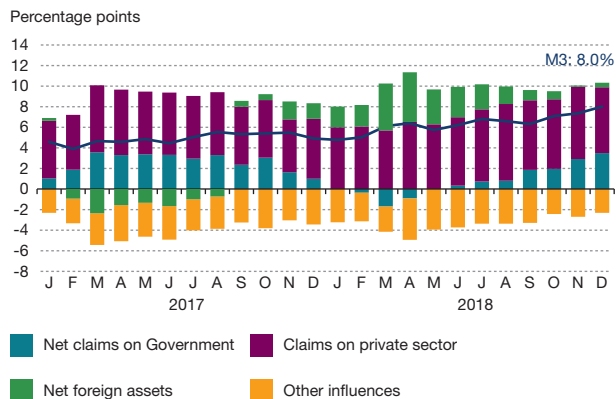
Chart 2.11: Outstanding Ringgit Liquidity Placed with Bank Negara Malaysia (at end-period)



Source: Bank Negara Malaysia

Chart 2.12: Contribution to M3 Growth

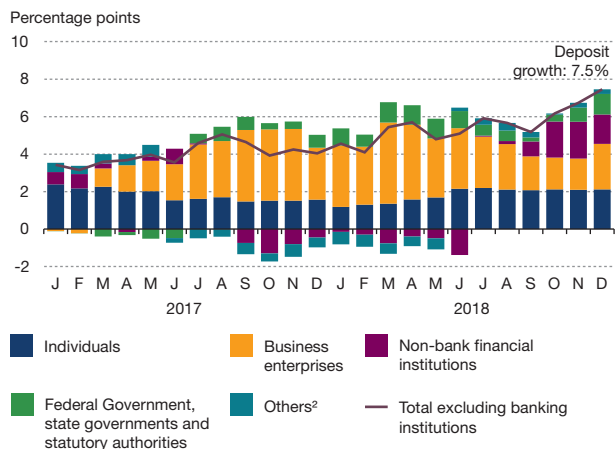
Private sector liquidity increased in 2018



Source: Bank Negara Malaysia

Chart 2.13: Contribution to Banking System Deposit¹ Growth by Holder

Deposit growth was driven by non-bank financial institutions' placements



¹ Excludes deposits accepted from banking institutions

² Includes domestic other entities and non-bank foreign entities

Source: Bank Negara Malaysia

in deposits placed by non-bank financial institutions. Household deposits also grew at a faster rate of 5.3% (2017: 3.9%) during the year.

Financing to the private sector was driven by stronger loan growth

Net financing through the banking system, non-bank financial institutions¹⁷ and the corporate bond¹⁸

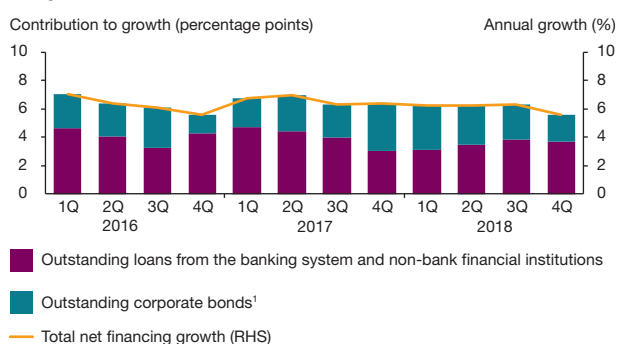
¹⁷ Non-bank financial institutions comprise development financial institutions (DFIs) and major non-bank financial institutions.

¹⁸ Excludes issuances by Cagamas and non-residents.

market recorded an annual growth of 5.6% as at end-2018 (2017: 6.3%). During the year, higher growth was recorded in outstanding loans¹⁹ (2018: 4.8%; 2017: 3.9%), driven mainly by the business segment. However, outstanding corporate bonds grew at a slower pace of 8.0% as at end-2018 (2017: 15.4%), reflecting a moderation from the high level of issuances in 2017.

Chart 2.14: Total Net Financing to the Private Sector through Banks, Non-Bank Financial Institutions and Corporate Bonds

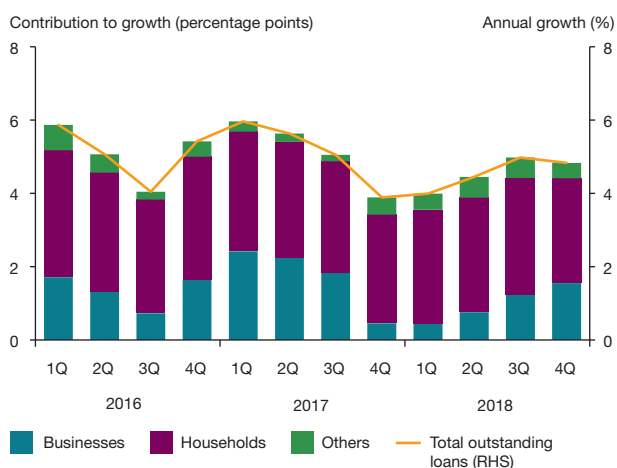
Net financing moderated as higher loan growth was offset by the lower growth in outstanding corporate bonds



¹ Excludes issuances by Cagamas and non-residents
Source: Bank Negara Malaysia

Chart 2.15: Outstanding Loans by Borrowers¹

Higher growth in outstanding loans as at end-2018



¹ Comprises outstanding loans from the banking system and non-bank financial institutions
Source: Bank Negara Malaysia

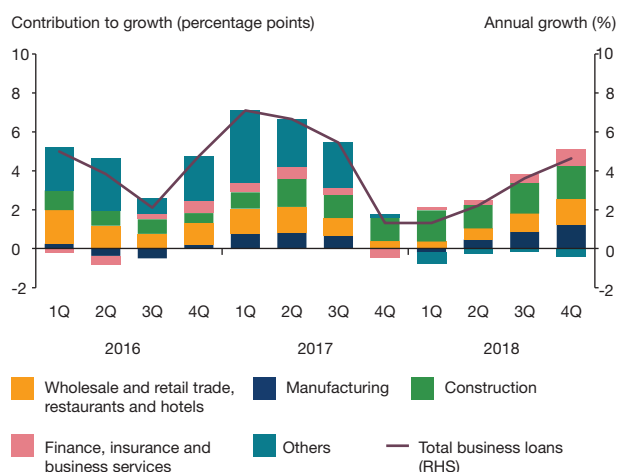
¹⁹ Comprises outstanding loans extended by the banking system (both conventional and Islamic banks) and non-bank financial institutions.

Outstanding business loans²⁰ increased steadily during the year, growing by 4.6% as at end-2018 (2017: 1.3%). The increase was driven mainly by the wholesale and retail trade, restaurants and hotels (WRRH); manufacturing; finance, insurance and business services; and construction sectors, collectively comprising a 61% share of business loans. The higher loan growth for the WRRH sector was in line with its improved performance amid greater consumer spending, especially during the zeroisation of the Goods and Services Tax (GST) rate. Higher loan growth for the manufacturing sector reflected, in part, capacity expansion activity by firms. By purpose, the growth of loans was higher for investment-related purposes, specifically for construction and the purchase of non-residential properties, and for working capital. The expansion in outstanding business loans was driven by higher levels of loan disbursements (2018: RM794.4 billion; 2017: RM749.9 billion) relative to repayments (2018: RM787.1 billion; 2017: RM755.5 billion). For small and medium enterprises (SMEs), the amount of loans disbursed increased for the year as a whole (2018: RM307.3 billion; 2017: RM296.3 billion).

Business demand for funding from the capital markets moderated, with issuances of corporate bonds²¹ at

Chart 2.16: Outstanding Business Loans by Sector¹

Business loans increased steadily during the year



¹ Comprises outstanding loans from the banking system and development financial institutions (DFIs)

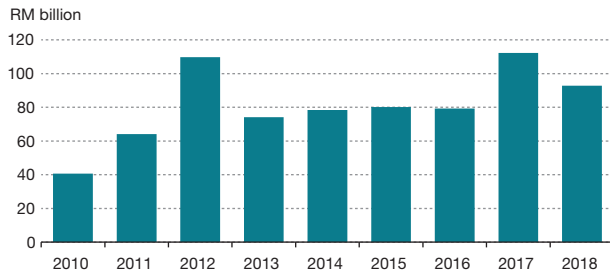
Source: Bank Negara Malaysia

²⁰ Includes outstanding loans of public enterprises (PEs), but excludes outstanding loans of domestic financial institutions, domestic non-bank financial institutions, Government, domestic other entities, and foreign entities with the banking system and DFIs.

²¹ Excludes issuances by Cagamas and non-residents.

Chart 2.17: Gross Corporate Bond Issuances¹

Corporate bond issuances moderated in 2018



¹ Excludes issuances by Cagamas and non-residents

Source: Bank Negara Malaysia

RM92.8 billion²² in 2018 (2017: RM112.2 billion). In particular, Government Guaranteed bond issuances were lower amid reviews on major public infrastructure projects from mid-year onwards. The bulk of the bond issuances was from the finance, insurance and real estate; electricity, gas and water supply; and construction sectors. These funds were used to finance infrastructure projects, and for working capital and capital expenditure purposes. Financing through the equity market,²³ however, was marginal at RM2.4 billion

(2017: RM12.2 billion) as investor sentiments remained cautious amid external and domestic uncertainties.

Outstanding household loans²⁴ recorded an annual growth of 4.7% as at end-2018 (2017: 4.9%), supported mainly by loans for the purchase of residential properties; purchase of securities; and personal use.²⁵ The growth in residential property loans, which accounted for 53.2% of total household debt, moderated to 7.7% by end-year (2017: 8.4%), partly reflecting lower demand for housing loans as applications²⁶ for residential property loans declined by 0.2% in 2018 (2017: 12.8%). Eligible households with the capacity to service their debt continued to have access to home financing during the year. Higher growth in loans for the purchase of securities (2018: 8.0%; 2017: 1.8%) was driven by both stronger consumer demand and higher supply of loans for purchase of unit trust funds²⁷ (2018: 10.5%; 2017: -0.7%). Of note, passenger car loans recorded positive annual growth from August to November 2018, for the first time since the second half of 2016 (2017: -0.5%),²⁸ driven by the higher demand for financing during the period of the zeroisation of the GST rate.

²² At this level, issuances remained robust compared to the 2013 – 2016 average of RM78.0 billion (excluding issuances by Cagamas and non-residents).

²³ Excludes issuances by non-residents.

²⁴ Loans from the banking system and non-bank financial institutions.

²⁵ The loans for these purposes grew at a sustainable pace, remaining significantly below their historical peaks during the period of 2013 – 2016.

²⁶ Refers to loan applications to the banking system only.

²⁷ Refers to banking system loans for purchase of unit trust funds, which accounted for 87% of the outstanding loans for the purchase of securities.

²⁸ Refers to loans from the banking system and DFIs only.