

2015

MONETARY AND FINANCIAL CONDITIONS IN 2015

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MONETARY AND FINANCIAL CONDITIONS IN 2015

INTERNATIONAL MONETARY AND FINANCIAL CONDITIONS

Global financial markets experienced high uncertainty and volatility throughout most of 2015 due to a confluence of factors. These included the shifting expectations on interest rate normalisation in the US, concerns about the slowing momentum of global growth and sovereign debt concerns in the euro area. The continued decline in global crude oil and commodity prices also affected sentiments in the global financial markets primarily with regard to its impact on commodity-exporting economies. The volatility was exacerbated by speculative position-taking and the unwinding of those positions, as well as “risk-on” and “risk-off” investment cycles that led to volatile capital flows.

Global financial markets experienced high uncertainty and volatility during the year

Early in the first quarter of 2015, global financial markets were briefly affected by concerns about the slowing momentum of global growth and the continued decline in global oil prices. An environment of heightened risk aversion accompanied the downward revision of global growth forecasts by the IMF and World Bank in

January. Furthermore, the decline in global crude oil prices (Brent) to levels below USD50 per barrel led to concerns regarding the impact on commodity-exporting economies and the potential to add to the deflationary pressures in the advanced economies. The expectations of weakening growth in emerging market economies led to a sell-off in most emerging equity markets and depreciation of some regional currencies against the US dollar. However, sentiments in global financial markets improved in April. The markets took comfort from the monetary easing by the European Central Bank (ECB) and the People’s Bank of China (PBOC), which led to renewed demand for emerging market financial assets. Capital flows to emerging economies recovered while most regional currencies underwent appreciation.

The period of positive sentiments was, however, transitory as global financial market volatility increased again in the second and third quarters of 2015. During this period, signs of market fragility emerged amid greater financial market volatility and tighter liquidity in the bond markets. Financial conditions tightened for most emerging markets, as reflected by rising long-term sovereign bond yields, lower equity prices and weaker exchange rates. The period of volatility reached its peak in August, when the Chicago Board Options Exchange Volatility Index (VIX), a gauge of market volatility, rose to levels last seen during the height of the euro area sovereign debt crisis

Chart 2.1

Global Financial Market Volatility



Note: ¹ Refers to VIX Index
² Refers to Merrill Lynch Option Volatility Estimate (MOVE) Index

Source: Bloomberg

Chart 2.2

MSCI Emerging Market Index



Source: Bloomberg

Chart 2.3

JP Morgan Emerging Market Bond Index (EMBI) Spread



Source: Bloomberg

in 2011. Capital outflows from emerging markets were estimated to have been about USD53 billion during the second and third quarters of 2015¹. Correspondingly, the MSCI Emerging Market Index fell by 18.7% while the JP Morgan Emerging Market Bond Index (EMBI) spread increased by 64 basis points over the same period. During this period, several factors were affecting global financial markets.

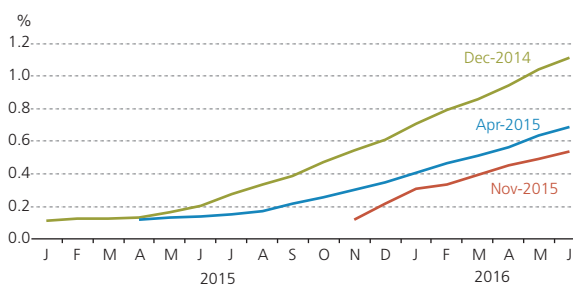
First, the uncertainty surrounding monetary policy in the US led to shifting expectations with regards to the timing of interest rate normalisation by the Federal Reserve (Fed). This was evident from the shifts in the market-implied federal funds rate², which showed expectations for Fed normalisation moving from the second half of 2015 towards later in the year. In particular, global financial markets were reactive to economic data releases or Fed statements that altered market expectations with regards to the timing of interest rate normalisation. During this period, there were more positive economic data releases and statements by Fed officials that appeared bullish, paving the way for an increase in interest rate. These led to international investors reallocating their portfolio investments towards the US financial markets and as a result, strengthened the US dollar vis-à-vis other currencies.

Second, increasing concerns on the slowing momentum of global growth, particularly that

of PR China, which is now the second largest economy in the world, became an additional source of volatility in global financial markets. While earlier in the second quarter of 2015 investor sentiments were supported by the continued easing measures by the Chinese authorities, this trend reversed following the release of weaker economic data from PR China and concerns over an overvaluation in Chinese stocks. Investor sentiments were adversely affected in August by stock market corrections in PR China³ and an unexpected move by the PBOC to lower the central parity rate of the renminbi (RMB). The sharp decline in Chinese equities triggered heightened global risk aversion as investors tried to digest the implications of developments in PR China for other economies.

Chart 2.4

Market-Implied Federal Funds Rate*

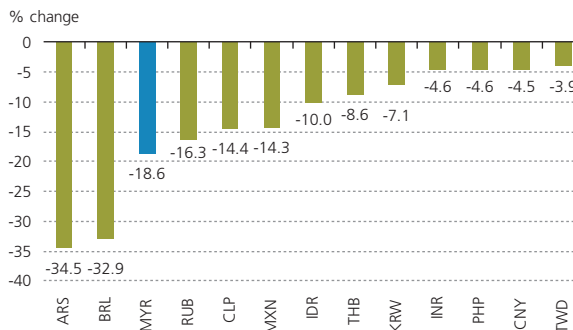


* The market-implied federal funds rate is derived from 1-month federal funds rate futures contracts. The prices of these contracts are typically used to gauge market expectations for the federal funds rate.

Source: Bloomberg, Bank Negara Malaysia calculations

Chart 2.5

Performance of Selected Emerging Market Currencies against the USD in 2015



Source: Bank Negara Malaysia, Bloomberg

¹ Source: Emerging Market Portfolio Research (EPFR) Global.

² The market-implied federal funds rate is derived from the prices of federal funds rate futures and is commonly used to gauge market expectations of where the US interest rate might be in the future.

³ The Shanghai Stock Exchange Composite Index fell sharply in August 2015, especially on 24 and 25 August where it fell by 15% over the two days.

Third, the uncertainty surrounding the Greek sovereign debt crisis also exerted considerable pressure on global financial markets. This mainly revolved around the solvency of the country as it struggled to meet its debt obligations. The prolonged negotiations over a third bailout package in five years, which resulted in Greece having to impose capital controls and default on its payments to the IMF in June, amplified investor risk aversion and added further to the global financial market volatility seen in the second and third quarter of 2015. Nevertheless, concerns on the Greek debt crisis subsided following the securing of the third bailout package in August.

Fourth, the decline in global commodity prices, especially crude oil, continued to exert pressure on global exchange rates, particularly on the currencies of commodity-exporting countries. Although the global crude oil price improved to USD68 per barrel (Brent) in the second quarter of 2015, it subsequently fell to a six-year low of USD42 per barrel in the third quarter. While global crude oil prices were affected by weaker global demand, the increasing global supply of crude oil was the primary factor behind the declining prices. This included the continued strong production by OPEC members and the US during the period. Most commodity exporters experienced large capital outflows and depreciation pressure on their exchange rates due to concerns over the impact of falling commodity prices on their economies.

Apart from these macroeconomic developments, the volatility in the global financial markets was exacerbated by the speculative behaviour of global investors. Globally, the rising role of the asset management industry – estimated to be intermediating USD76 trillion in assets globally (equivalent to about 100% of the world GDP and 40% of global financial assets)⁴ – have been a key conduit contributing to the increased volatility in global fund flows. Herding behaviour among global portfolio managers has become more prevalent, and this has amplified shocks to the global financial markets. As a result, the large movements of investment funds across global financial markets, triggered by “risk-on” and “risk-off” events, have resulted in large movements in prices of global financial assets. In most cases, these movements have been more

than what is warranted by the underlying economic fundamentals. For instance, the search for assets with higher returns by global investors led to capital flows into emerging markets in April as the ECB and the PBOC both announced further easing measures. This quickly reversed with the onset of the “risk-off” phase in the second and third quarters of the year as a sharp deterioration in investor sentiments led to a flight to safety. The rapid unwinding of emerging market financial assets and the reversal of capital flows towards safe-haven assets in the advanced economies led to negative trends in the financial markets and exchange rates of the affected emerging markets. These sudden shifts in investor risk attitudes and risk-taking behaviour were an important driver of global financial market volatility during the year.

While the eventual interest rate lift-off by the Fed has reduced a major source of uncertainty, other factors remain. The continued divergence in the monetary policies of the major central banks, against the backdrop of moderate and uneven global growth, persistently low global crude oil prices and negative geopolitical developments, points to the continuation of high volatility and large shifts in liquidity in the global financial markets.

DOMESTIC MONETARY AND FINANCIAL CONDITIONS

Exchange Rate

The ringgit, along with most major and regional currencies experienced significant depreciation pressure during the year. In large part, the exchange rate reflected global developments, in particular the slower growth momentum of emerging market economies and the uncertainty around monetary policy changes in the advanced economies. The decline in commodity earnings further hurt the value of currencies belonging to commodity-exporting economies. The ringgit, therefore, depreciated more than its peers during the year due to the sharp fall in global crude oil prices and negative sentiments arising from domestic developments.

For the year as a whole, the ringgit depreciated by 18.6% to end the year at RM4.2920 against the US dollar. Against major and regional currencies, the ringgit was broadly weaker. The ringgit’s Nominal Effective Exchange Rate (NEER),

⁴ IMF Global Financial Stability Report, April 2015.

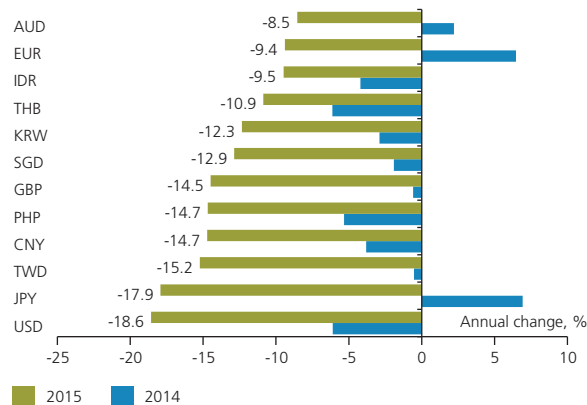
a measure of the ringgit's performance against the currencies of Malaysia's major trading partners, depreciated by 14.5%.

Ringgit depreciated against a stronger US dollar, due to domestic and global developments

Ringgit developments in 2015 were heavily influenced by flows of portfolio investment arising primarily from external factors. The broad depreciating trend of the ringgit in 2014 carried forward into the first quarter of 2015 as the factors that were affecting the ringgit in 2014 continued to remain unresolved. First, the anticipation and eventual normalisation of interest rates in the US resulted in the rebalancing of portfolio investments towards US financial assets. This led to the significant appreciation of the US dollar. As a result, the US Dollar Index⁵, a gauge of US dollar performance against a basket of currencies, appreciated by 9.3% in 2015. Against this backdrop, regional currencies depreciated against the US dollar within a range of 3.9% and 18.6%. Second, rising concerns about the global economic outlook following the downward revisions of 2015 global growth projections by the IMF and the World Bank also affected global sentiments. This combination of factors led to

Chart 2.6

Summary of Malaysian Ringgit (RM) Performance against Major and Regional Currencies



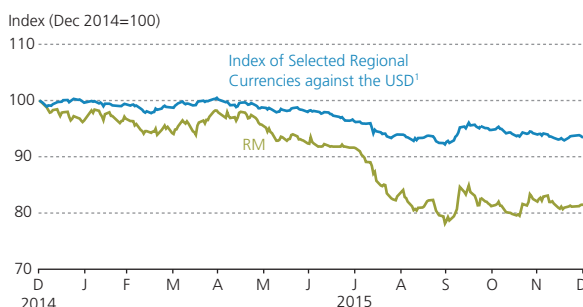
Note: (+) indicates an appreciation of the ringgit against foreign currency

Source: Bank Negara Malaysia

⁵ Source: Bloomberg.

Chart 2.7

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



¹ 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

portfolio investment outflows from most emerging markets, including Malaysia. Third, the ringgit, along with the currencies of most other commodity-exporting countries, was also affected by concerns over the impact of lower prices for crude oil and commodities on the economy. Finally, the negative sentiments on the ringgit were exacerbated by the uncertainty surrounding domestic developments. As a result, the ringgit depreciated to a low of RM4.4725 against the US dollar, coinciding with the peak of uncertainties in the global financial markets between August and September.

For an open economy like Malaysia, that is deeply integrated with the global economic and financial systems, the depreciation of the ringgit was a necessary adjustment to the external headwinds facing the domestic economy. The shift in global liquidity conditions and the signs of weakness in global growth coincided with declining and persistently low commodity prices. The ringgit adjusted in tandem with these developments, and thus helped contain the negative impact on the external sector of the economy. First, as most exports are priced in US dollar, a weaker ringgit allows Malaysia's exporters to mitigate potential losses from lower commodity prices through higher earnings from currency conversions. Second, when other currencies are depreciating, the depreciation of the ringgit is helpful in ensuring that the relative competitiveness of Malaysian exporters is not undermined by currency movements. Without nominal adjustments in the exchange rate, the burden of adjustments would

have been shifted to other parts of the economy. For instance, a loss in competitiveness may result in the shift of manufacturing investments away from Malaysia, resulting in job losses and falling incomes. In such an environment, the flexibility of the ringgit to adjust in response to global developments has been a key feature of the managed float regime that has allowed exchange rate changes to absorb external shocks and mitigated their impact on the domestic economy.

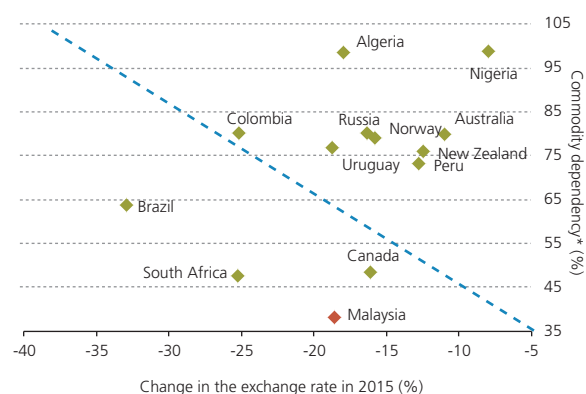
Nevertheless, given the highly volatile global financial markets, massive shifts in cross-border capital flows have also resulted in over-adjustments in the exchange rate. This has caused the ringgit to be undervalued and become misaligned from underlying economic fundamentals. The ringgit's weakness was further amplified by misperceptions about Malaysia's dependence on commodities and its position as the only net oil exporter in the region. The fact that the magnitude of ringgit depreciation is comparable to currencies of countries with much higher degree of commodity dependence points to this misperception. The ringgit was also weighed down by domestic developments that affected investor sentiments towards ringgit financial assets. Overall, the ringgit's overshooting during the year was driven by a rapid deterioration of investor sentiments, rather than significant changes in the underlying fundamentals of the economy.

Going forward, it is important for Malaysia to be able to withstand and ride out the volatility emanating from the external sector. Thus far, despite the volatility in the financial markets and the depreciation of the ringgit, there have been no disruptions to financial intermediation and, more importantly, no dislocation of economic activity. The impact of a weaker ringgit on inflation has been mitigated by the significant decline in global commodity prices. Balance sheets of financial institutions remain strong and financing activity continues to grow. The current account balance remains in surplus, bolstered by strong export growth. In addition, the impact of the depreciation of the ringgit on offshore borrowing in foreign currency, which would rise as the ringgit value of the debt increases, remains contained at 40.1% of GDP.

These volatile conditions are expected to continue as long as uncertainties on monetary policy, global growth and global commodity prices persist. In this regard, it is crucial for policy makers to have access to a wide range of policy tools to manage these risks. First, the flexible ringgit and the ample international reserves will act as shock absorbers to mitigate the impact of financial market volatility on the real economy. Second, Malaysia's deep financial markets and strong banking system will ensure that financial intermediation continues uninterrupted. Third, Malaysia's diversified economy helps ensure against risks emerging from any particular sector or any particular trading partner. Fourth, sustaining domestic demand through pro-growth measures will ensure that Malaysia's economic growth is sustained during these times of uncertainty.

Chart 2.8

The ringgit's performance does not reflect Malaysia's relatively low dependence on commodities



*Commodity dependency = Total exports of primary commodities/Total exports (%) in 2014. Primary commodities refer to beverages and tobacco, crude materials, foods, fuels, oils and fats, and metals.

Source: Bloomberg, Bank Negara Malaysia and UN Conference on Trade and Development (UNCTAD)

Interest Rates, Bond Yields and Equity Prices

Despite the developments in the domestic and international financial markets, domestic interest rates remained broadly stable throughout the year. In the money market, reflecting the unchanged Overnight Policy Rate (OPR), the daily average overnight interbank rate (AOIR) traded within a close range of 3.03% and 3.25%. Interbank rates of other short-term tenures⁶ were also relatively steady.

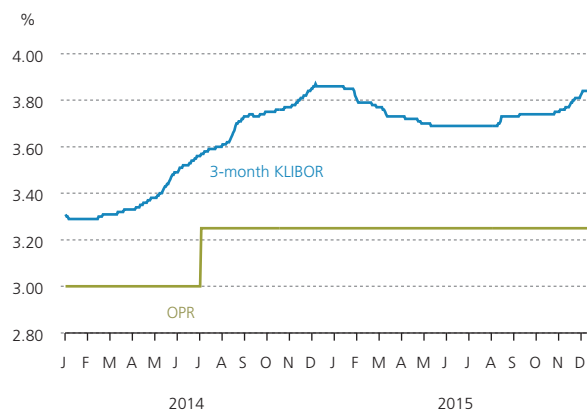
Longer-tenured interbank rates continued their elevated trend from end-2014. Higher interbank rates were a reflection of the increase in the funding costs of banks arising from greater

⁶ Short-term tenures refer to 1-month tenures or less.

competition for stable funding. The competition for stable funds was due to slower growth in deposits arising from net external outflows and the phasing-in of the Basel III Liquidity Coverage Ratio (LCR)⁷ requirements. However, following the Bank's announcement on 30 January 2015 on the arrangements to facilitate the transition to the full implementation of the LCR, a moderation in interest rates was observed in the second quarter. These arrangements, which have helped ease funding pressures, include broadening the scope of recognition of high-quality liquid assets (HQLA) and the clarifications on the treatment of banks' expected cash outflows. Reverse repo operations by the Bank to inject liquidity into the interbank market also facilitated the downward trend in interbank rates. In the second half of the year, interbank rates again began to trend higher, reflecting the shift in liquidity towards the shorter tenures. This reflected the resumption of capital outflows at the end of the third quarter. Nevertheless, the more recent increase in interbank rates was more modest. For the year as a whole, the 3-month Kuala Lumpur Interbank Offered Rates (KLIBOR) decreased from a high of 3.86% at the start of 2015 to a low of 3.69% from end-May to end-August, before increasing to 3.84% at the end of the year.

Chart 2.9

Policy and Interbank Market Rates

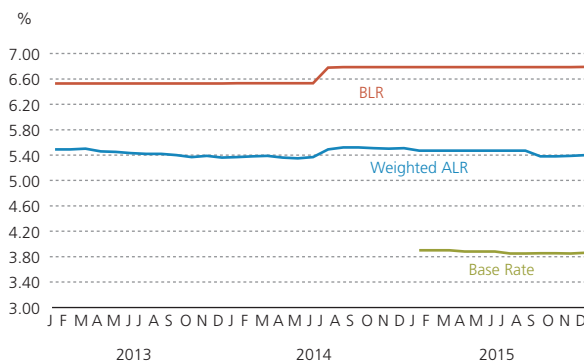


Source: Bank Negara Malaysia and Bloomberg

⁷ The objective of the Liquidity Coverage Ratio (LCR) is to promote the short-term resilience of the liquidity risk profile of banks. It does this by ensuring that banks have an adequate stock of unencumbered high-quality liquid assets (HQLA) that can be converted easily and immediately in private markets into cash to meet their liquidity needs for a 30-calendar day liquidity stress scenario.

Chart 2.10

Commercial Banks' Lending Rates (at end-period)



Source: Bank Negara Malaysia

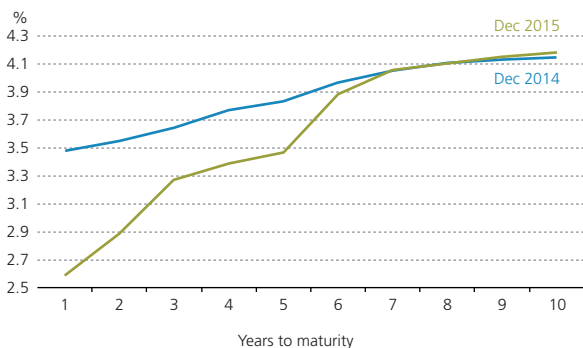
Retail lending rates were broadly stable throughout the year despite the movements in the money market interest rates. On 2 January 2015, the Base Rate (BR) for the banking system, which replaced the Base Lending Rate (BLR) as the main reference rate for new retail floating-rate loans and financing facilities, averaged 3.90% at its introduction. The transition to the BR was neutral on retail lending rates, with the majority of banks maintaining the same effective lending rates. Since the introduction of the BR, five banks have reduced their BRs downwards in the middle of the year in tandem with the decline in the KLIBOR during the period, bringing the average BR of the banking system to 3.85%. Towards the end of the year and early 2016, some of these banks revised their BRs higher following the upward movement of the KLIBOR. Nevertheless, the average BR of the banking system at 3.86% remained lower than at the beginning of the year. Reflecting the decline in the BR, the weighted average lending rate (ALR) on outstanding loans decreased slightly during the year (January 2015: 5.47%; December 2015: 5.40%). Lending rates on new loans to businesses and households were generally stable across most sectors and purposes.

The average quoted fixed deposit rates of commercial banks for the 1 to 12-month tenures were also relatively steady, ranging between 3.09% and 3.31%. Depositors continued to benefit from positive real rates of return on their savings in 2015.

The yields on Malaysian Government Securities (MGS) during the year continued to be influenced by both external and domestic factors. Despite prolonged uncertainties in

Chart 2.11

MGS Benchmark Yield Curve



Source: Bank Negara Malaysia

global financial markets, the spillover effects on Malaysia’s bond market were relatively contained. For the year as a whole, yields on both the 3 and 5-year MGS declined by 37 basis points, while those on the 10-year MGS increased by 4 basis points. Non-resident holdings of MGS were at a historical high of 47.7% of total MGS outstanding (2014: 44.1%).

Conditions in the domestic bond market were broadly stable despite heightened volatility in the global financial markets

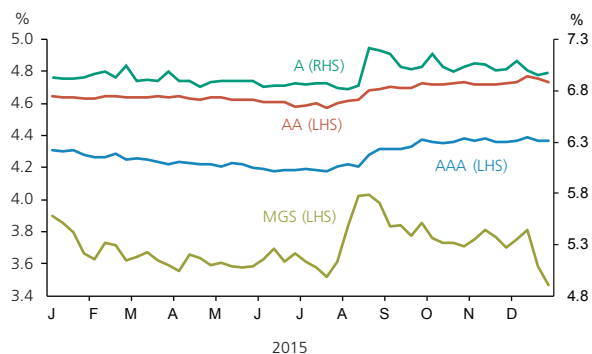
While Malaysia experienced net outflows primarily from Bank Negara Monetary Notes (BNMNs) and the equity market, the domestic sovereign bond market remained relatively stable due to continued non-resident portfolio inflows amounting to RM16.8 billion into the MGS market. In the first half of the year, monetary policy easing by major central banks contributed to the decline in long-term yields in advanced economies. Such developments further reinforced the search for higher yields among global investors in emerging sovereign bond markets, including Malaysia. This in turn, resulted in MGS yields, particularly at the shorter-end of the yield curve⁸, remaining low in the first half of 2015.

The downward pressure at the shorter-end of the yield curve was, however, offset by the reduction

⁸ Refers to 3-year MGS yield and below.

Chart 2.12

5-year MGS and 5-year PDS Yields



Source: Bank Negara Malaysia

of domestic banks’ MGS holdings. Banks were able to exercise greater flexibility in managing their MGS holdings as most of them had exceeded their LCR requirements. As a result, the banks played a stabilising role by containing excessive adjustments in the yields amid increased foreign participation in the MGS market.

Increased non-resident holdings of MGS continued throughout the year except for the temporary sell-off during the period between July and September 2015. Non-resident investors reduced MGS holdings by RM13.0 billion during this period, reflecting increased market expectations over a possible interest rate increase by the Fed in September coupled with the slowdown in PR China’s economic growth that led to concerns over the spillover effects on regional growth. Consequently, MGS yields increased across all tenures by 12 to 42 basis points during this period.

In the private debt securities (PDS) market, yields were generally unchanged in the first seven months before rising slightly in the subsequent months. The spillover from the MGS market was relatively contained due to the low and stable foreign participation in the PDS market (2015: 2.7%; 2014: 3.0%). For the year, yields on the 5-year AAA, AA and A-rated papers registered marginal increases of 10, 13 and 10 basis points, respectively. The relatively stable PDS yields ensured continued fundraising activity in the PDS market to support economic activity. New PDS issuances amounted to RM128.8 billion during the year (2014: RM117.3 billion)⁹, primarily reflecting the demand for financing for new activity,

⁹ Refers to conventional and Islamic securities issued in Malaysia by both local and foreign companies which can be either short-term, medium-term or long-term papers.

working capital and general corporate purposes. Liquidity in the PDS market also continued to remain healthy in 2015, as reflected by higher total turnover which amounted to RM114.5 billion (2014: RM112.4 billion).

Domestic equity market affected by global financial developments

In 2015, the FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI) declined by 3.9% (2014: -5.7%) to close at 1692.5 points. For the most part of the year, the performance of the domestic equity market was mainly affected by weak global investor sentiment and to a certain extent, uncertainties surrounding domestic developments.

In early 2015, despite bouts of volatility amid heightened uncertainties in global conditions, the domestic equity index rose steadily. This was primarily driven by the announcements of strong corporate earnings for 4Q 2014, particularly in the banking sector, which had recorded higher net interest income. In addition, the attractive valuations of equities prompted domestic institutional investors to increase their equity holdings. Positive sentiments following the announcement of monetary easing measures by the ECB also resulted in increased buying in regional equity markets by non-resident investors. In the KLCI, this was reflected by a resumption of non-resident inflows after seven consecutive months of net outflows. As a result, the index reached a year-to-date high of 1862.8 points on 21 April 2015.

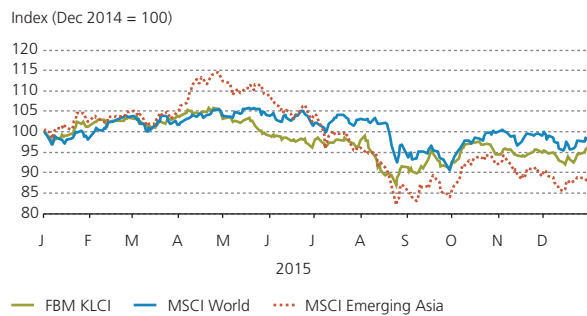
By May, however, the index was significantly affected by weak global and domestic market sentiments. The driving factors for the weak global sentiments included among others, the impending interest rate normalisation by the Fed which would lead to narrowing return differentials between advanced and emerging market financial assets. Furthermore, investors became increasingly concerned about PR China's economic growth and its implication on the sustainability of regional growth. These factors led to heightened risk aversion towards emerging market equities, which resulted in a reduction in non-resident equity holdings within the region, including in Malaysia. Of significance, non-resident investors sold domestic equities worth RM15.0 billion between May to

September 2015. Given the sizeable exposure of the KLCI to the resource-based sectors¹⁰, the sharp decline in global oil prices in August 2015 also contributed to the underperformance of the index. The weaker corporate earnings also resulted in negative domestic market sentiments. In particular, the telecommunication and transportation industries were affected by higher input costs due to the depreciation of the ringgit. The revenue of retail companies was also affected due to the moderation in consumer spending following the implementation of GST. As a result, the FBM KLCI reversed its upward trend and declined to its lowest level for the year at 1532.1 points on 24 August 2015.

Towards the end of the year, the performance of the domestic equity market improved, albeit modestly, supported by a temporary rebound in global commodity prices which boosted the plantation

Chart 2.13

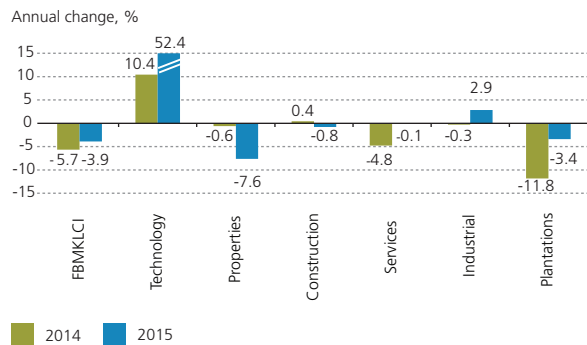
Equity Market Indices



Source: Bloomberg

Chart 2.14

Performance of Sectoral Equity Indices



Source: Bloomberg

¹⁰ Resource-based sectors account for almost 30% of total market capitalisation in the main market.

and oil and gas-related stocks. In addition, the announcement of pro-active economic measures by the Government on 14 September 2015 provided some stability to the market. The measures, which included reactivating ValueCap to support undervalued shares with a fund size of RM20 billion, managed to lift selected blue-chip stocks, which contributed to the FBM KLCI remaining relatively stable for the remainder of the year.

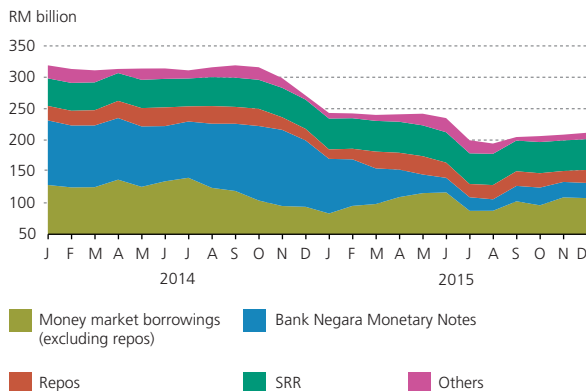
Liquidity and Monetary Aggregates

In 2015, banking system liquidity remained ample despite being lower due to net outflows in the external sector. At the system level, aggregate outstanding liquidity placed with Bank Negara Malaysia remained high. At the institutional level, most banking institutions continued to maintain surplus liquidity positions.

Throughout the year, the Bank’s operations were focused on maintaining stability in the interbank money market. The large placements of liquidity with the Bank served as a buffer for the banking system during periods of outflows as the contractionary pressure on liquidity was offset by the net release of funds placed with the Bank. The composition of monetary instruments used to absorb surplus liquidity was also adjusted to provide banks with greater flexibility in managing their liquidity positions. The issuance of Bank Negara Monetary Notes (BNMNs) was replaced with other instruments of shorter maturities, such as money market borrowings and repos. Consequently, funds lent to the Bank matured more frequently, allowing banks to

Chart 2.15

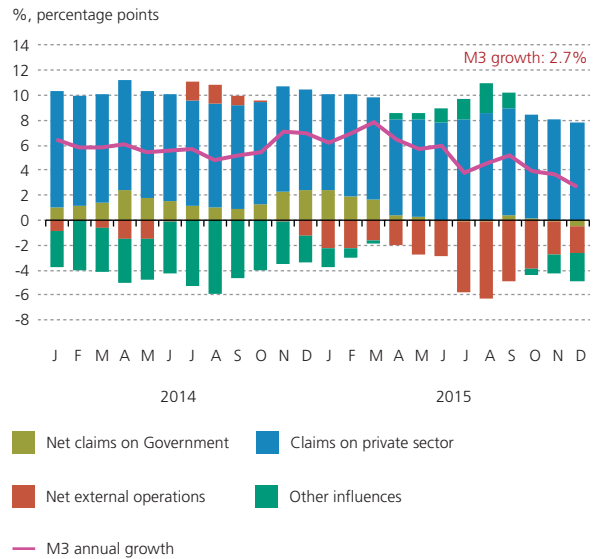
Outstanding Liquidity Placed with Bank Negara Malaysia (at end-period)



Source: Bank Negara Malaysia

Chart 2.16

Contribution to M3 Growth



Source: Bank Negara Malaysia

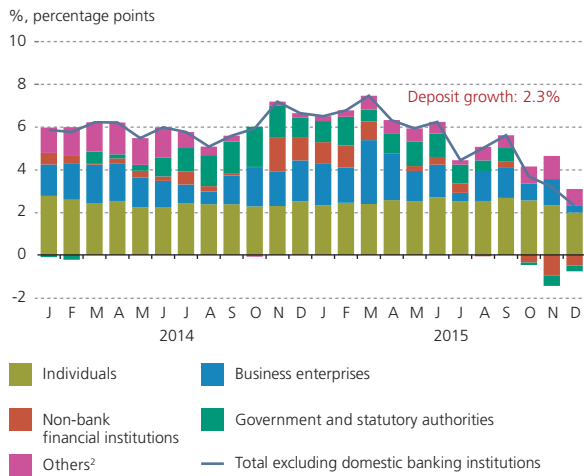
readily meet any sudden withdrawals of funds due to outflows. The Bank also used its monetary operations, including the reverse repo facility, to provide liquidity to the banking system during the year. As part of a comprehensive effort to further ensure sufficient liquidity in the domestic financial system, the Bank reduced the Statutory Reserve Requirement (SRR) ratio from 4.00% to 3.50%, effective from 1 February 2016.

Private sector liquidity, as measured by broad money (M3), grew at a more moderate pace of 2.7% during the year (2014: 7.0%). The moderation in broad money growth was due mainly to the net external sector outflows, given the large outflow of portfolio funds during the year. The net outflows also partly reflected structural factors such as the narrowing of the current account surplus, the regional expansion of domestic businesses and the greater diversification of investments by domestic institutional investors. This was reflected in the slower growth of deposits placed by domestic non-bank financial institutions (2015: -4.1%, 2014: 9.0%) and businesses (2015: 0.9%, 2014: 5.1%). As a result, total banking system deposits¹¹ also grew at a more moderate pace of 2.3% in 2015 (2014: 6.6%). Household deposits, however, continued to register a healthy growth of 5.3% during the year (2014: 6.7%).

¹¹ Excluding domestic interbank deposits.

Chart 2.17

Contribution to Banking System Deposit¹ Growth



¹ Excludes domestic interbank deposits

² Includes domestic other entities and foreign entities

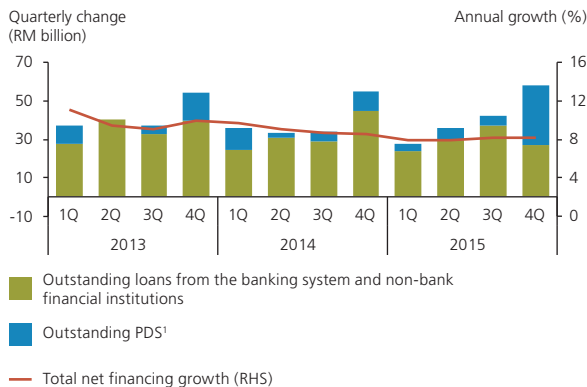
Source: Bank Negara Malaysia

FINANCING OF THE ECONOMY

The growth in net financing through the banking system, non-bank financial institutions¹² and the PDS market expanded at an annual rate of 8.2% in 2015 (2014: 8.6%). The more moderate pace of growth during the year was driven by the lower

Chart 2.18

Total Net Financing to the Private Sector through Banks, Non-bank Financial Institutions and PDS Market



¹ Excludes issuances by Cagamas and non-residents.

Source: Bank Negara Malaysia

¹² Non-bank financial institutions comprise development financial institutions (DFIs), Lembaga Pembiayaan Perumahan Sektor Awam (previously Treasury Housing Loans Division), insurance and stockbroking companies, and others.

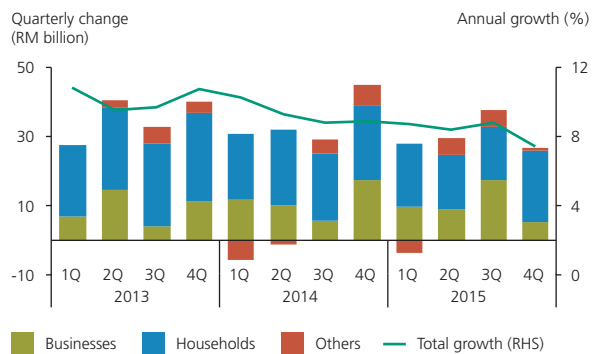
growth of outstanding loans¹³ (2015: 7.5%; 2014: 8.9%), particularly to the household sector. Financing to businesses, however, remained robust and in line with economic activity, with higher growth in outstanding loans and net issuances of PDS by businesses (2015: 9.4%; 2014: 8.3%).

Financing to the private sector remained healthy with continued strong growth in outstanding loans to SMEs

Outstanding business loans¹⁴ grew by 7.7%, mainly due to the strong growth in SME loans of 14.6% in 2015 (2014: 9.0% and 13.3%, respectively). The increase in SME loans growth was largely driven by loans to the *services* sector and for the purposes of *working capital* and the *purchase of non-residential property*. The level of loan disbursements to businesses, including to SMEs, was sustained (monthly average over 2015: RM67.1 billion; 2014: RM65.6 billion) with a larger volume of loans extended to the *agriculture; education, health and other services; finance, insurance and business services; and mining and quarrying* sectors.

Chart 2.19

Outstanding Loans by Borrowers¹



¹ Comprises banking system and non-bank financial institutions outstanding loans

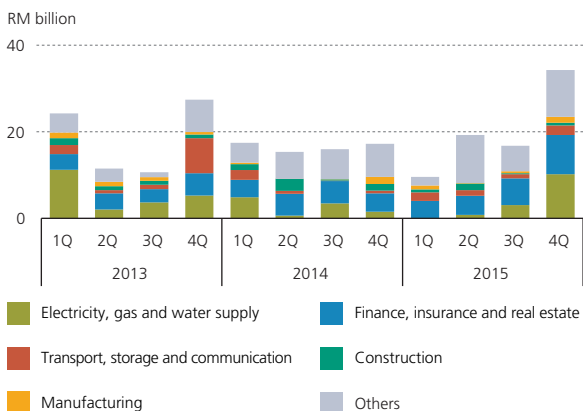
Source: Bank Negara Malaysia

¹³ Includes outstanding loans extended by the banking system and non-bank financial institutions.

¹⁴ Includes outstanding loans of non-financial public corporations, 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.

Chart 2.20

Gross PDS Issued by Sector¹



¹ Excludes issuances by financial institutions, Cagamas and non-residents

Source: Bank Negara Malaysia

Business demand for funding from the capital markets, particularly from the bond market, remained relatively stable amid financial market uncertainty that affected overall market sentiments. New PDS

issuances¹⁵ amounted to RM79.9 billion in 2015 (2014: RM66 billion) with issuances mainly from the *electricity, gas and water supply* and *finance, insurance and real estate* sectors. Financing via the equity market¹⁶ was sustained at RM11.3 billion in 2015 (2014: RM13.1 billion), with two large rights issuances and an Initial Public Offering (IPO) from corporations in the *trading and services* and *property* sectors.

The growth in household debt¹⁷ continued to moderate during the year to 7.3% (2014: 9.4%). This in part is the outcome of the pre-emptive macro- and microprudential measures implemented by the Bank and fiscal measures introduced by the Government since 2010 to ensure the sustainable growth of household debt. In particular, there was a moderation in loans for the *purchase of securities* (2015: 1.7%; 2014: 12.3%) and the *purchase of non-residential property* (2015: 8.1%; 2014: 10.6%). The growth in *residential property* loans, which account for 49% of total household debt, remained robust (2015: 11.0%; 2014: 12.4%).

¹⁵ Excludes funds raised by financial institutions, Cagamas and non-residents.

¹⁶ Excludes financial institution-related issuances.

¹⁷ Comprises outstanding household loans extended by banks and non-bank financial institutions. Non-bank financial institutions comprise two development financial institutions, Lembaga Pembiayaan Perumahan Sektor Awam (previously Treasury Housing Loans Division), insurance and stockbroking companies, and others.