

MANAGING RISKS TO FINANCIAL STABILITY

Financial stability remained intact

Financial system stability was maintained throughout the second quarter. This was underpinned by a sound financial system and institutions and orderly financial markets that continue to support efficient financial intermediation and sustained public confidence in the financial system.

Overall credit risk exposures of the financial sector remained manageable. Both impaired loans and loans in arrears improved to 2.0% of net loans (1Q 11: 2.2%) and 2.9% of gross loans (1Q 11: 3.2%) respectively. The level of household indebtedness rose by 2.8% for during the quarter to 77.0% (1Q 11: 76.5%). Total impaired loans improved to 2.0% of household loans (1Q 11: 2.2%). All categories of household loans had low levels of impairment. Household aggregate financial assets stood at more than twice the size of household debts.

Credit growth in the business sector continued to expand, amidst steady growth in revenue. Despite facing more challenging operating environment posed by rising commodity prices and higher electricity tariff, the risk of delinquency as measured by the Expected Default Frequency remained unchanged at 0.57%. Debt servicing capacity of businesses remained healthy with impairment levels

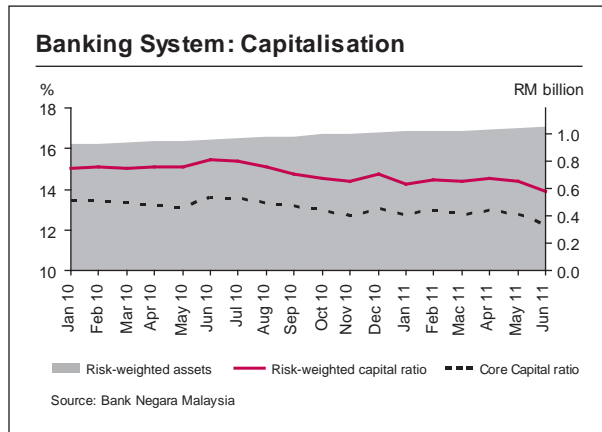
improving to 4.6% (1Q 11: 4.9%) of gross business loans and the repayment-to-disbursement ratio remaining stable at 90%. The credit risk outlook for businesses is neutral as commodity prices may remain elevated for a prolonged period.

Continued uncertainties over the fiscal position and sovereign debt concerns in some advanced economies have had no adverse impact on the domestic financial markets. Trading liquidity was favourable, whilst there was no significant increase in asset price volatility. Volatility in the FBM KLCI rose only slightly to average at 9.2% (1Q 11: 8.8%). The domestic financial markets continued to experience inflows of portfolio investment during the quarter. Despite the magnitude of flows, the financial markets remained orderly and exhibited the capacity to intermediate the financial flows effectively. No material changes in the risk-taking behaviours of financial institutions, has thus far been observed. The banking system's exposure to equity risk remained small at 1.3% of capital base as at end-June 2011 (1Q 11: 1.3%), whilst insurance and takaful sector's exposures to equity risk remained at 7.4% (1Q 11: 7.3%) of capital base.

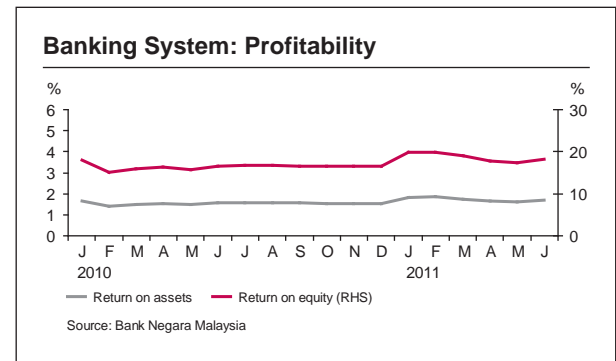
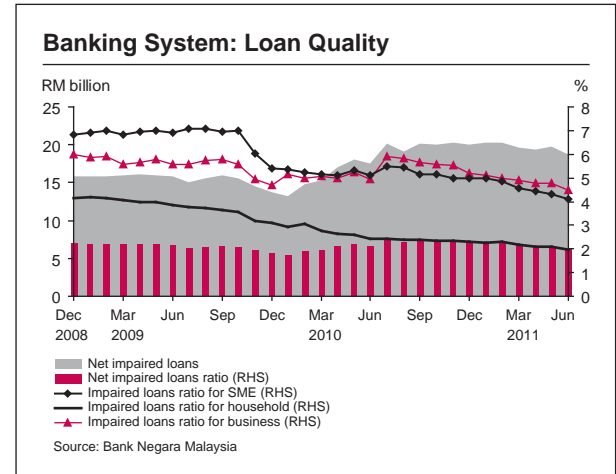
Interest rate risk remained low at 6.0% of capital base (1Q 11: 6.4%) for the banks and 3.3% (1Q 11: 3.3%) for the insurance and takaful sector.

The financial sector remained sound and supported the financial intermediation of domestic economic activity

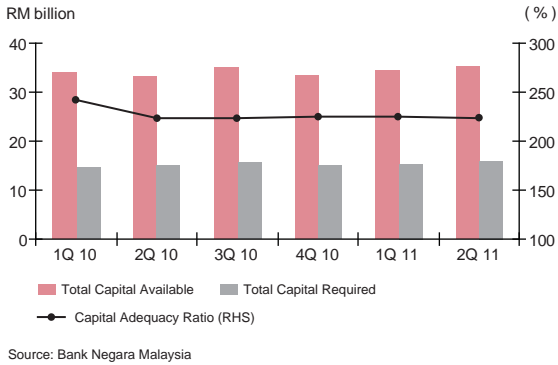
The domestic banking system remained well-capitalised with the core capital ratio and risk-weighted capital ratio remaining strong at 12.3% and 13.9% respectively. Financial buffers were sustained at a high level in excess of RM57 billion to absorb unexpected losses from any shocks while preserving the ability of the banking system to continue financing economic activity. The quality of capital continued to be supported by the high proportion of Tier 1 capital with common equity and reserves continuing to account for the bulk of banking



sector capital funds. As for the insurance and takaful sector, the capital position remained strong with a capital adequacy ratio of 224.1% and an excess capital of RM19.5 billion.



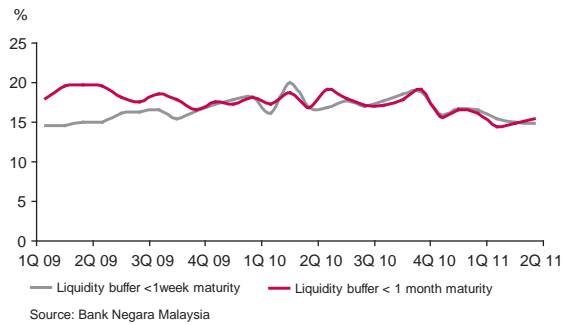
Insurance Sector: Capital Adequacy Ratio



Banks recorded pre-tax profits of RM6.6 billion (1Q 11: RM6.9 billion) on account of higher financing and net interest income. Returns on assets and equity stood at 1.7% and 18.2% respectively. Life insurance and family takaful recorded higher excess of income over outgo of RM3.8 billion (1Q 11: RM3.2 billion) driven by higher net premiums and investment income. Demand for investment-linked products continued to expand in tandem with favourable financial market conditions. Similarly, the general insurers and takaful operators registered higher operating profits (2Q 11: RM603.8 million, 1Q 11: RM526.5 million) contributed by higher investment income (+24.5%) of RM248.6 million (1Q 11: RM199.6 million).

Liquidity remained ample to meet the demand for deposit withdrawals and other liquidity obligations. The overall liquidity buffer of the banking system remained at comfortable levels and was well above the regulatory requirements. The loan-to-deposit ratio was almost unchanged at 81.8% (1Q 11: 82%).

Banking System: Liquidity Buffer to Total Deposit Ratio



Insurance and Takaful Sector: Indicators

	2010		2011		
	2Q	1H	1Q	2Q	
	RM million				
Life insurance & family takaful					
Excess of income over outgo	2,922.9	5,881.4	3,226.5	3,763.3	6,989.8
General insurance & general takaful					
Operating profit	574.9	1,099.8	526.5	603.8	1,130.3
Claims ratio (%)	62.1	62.1	61.4	62.7	62.7

Source: Bank Negara Malaysia