

59	Overview
59	International Monetary and Financial Conditions
62	Domestic Monetary and Financial Conditions
69	Financing of the Economy

Monetary and Financial Conditions



Monetary and Financial Conditions

OVERVIEW

The direct impact of the global financial crisis on the Malaysian financial conditions in early 2008 was relatively modest as domestic financial institutions and markets had negligible exposures to structured credit products. In addition, domestic financial institutions had strengthened and built significant buffers during the decade after the Asian financial crisis. Nevertheless, capital flows driven by the deleveraging by international financial institutions created increased volatility in the domestic financial markets. The deepening financial crisis and worsening global economic outlook, particularly during the fourth quarter of 2008, had affected sentiments in the financial markets.

While the domestic monetary and financial conditions in 2008 were affected by the short-term capital inflows during the first half of the year and reversals in the second half of the year arising from deleveraging activities by international financial institutions, the credit market was well supported by a strong banking sector and liquidity remained ample. During the year, interest rates remained supportive of financing the economy. Critically, while the developed economies experienced a severe credit crunch due to dysfunctional financial institutions and markets, the credit situation in Malaysia remained resilient. Domestic financial institutions and markets continued their intermediation function effectively.

INTERNATIONAL MONETARY AND FINANCIAL CONDITIONS

In 2008, the international financial markets were mainly characterised by the two-fold concern of rising global inflation in the first half of the year and the sharp deterioration in the health of the global financial system in the second half of the year.

In the first half of the year, inflation rates globally rose significantly due mainly to the sharp rise in the prices of a wide range of commodities. The increase resulted from strong demand from emerging economies, short-term supply constraints and the shift of funds to commodities as an asset class. Global oil prices rose to unprecedented levels, breaking the USD100 per barrel mark for the first time in history. Concurrently, global food prices

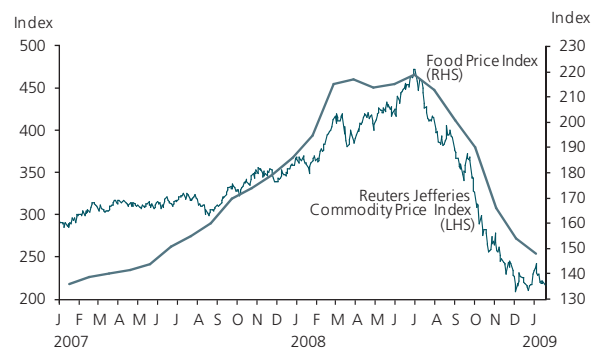
also rose to record levels. Notably, rising biofuel production which fueled the demand for corn and rapeseeds oil, spilled over to other foods through demand and crop substitution effects. The sharp surge in oil prices could not be entirely explained by fundamentals alone. The combination of the depreciating US dollar in the first half of 2008, rising credit risk in advanced economies and investors' search for a hedge in oil futures had increased the attractiveness of oil and other storable commodities as alternative assets.

Stress in the global financial system intensified in 2008, exacerbating the deleveraging process

The impact of high food and fuel prices on inflation was especially felt in emerging market economies, owing to the higher share of food and fuel in the consumption baskets. In addition, the removal of subsidies to contain the fiscal burden also contributed to the significant rise in the headline inflation in several of these economies.

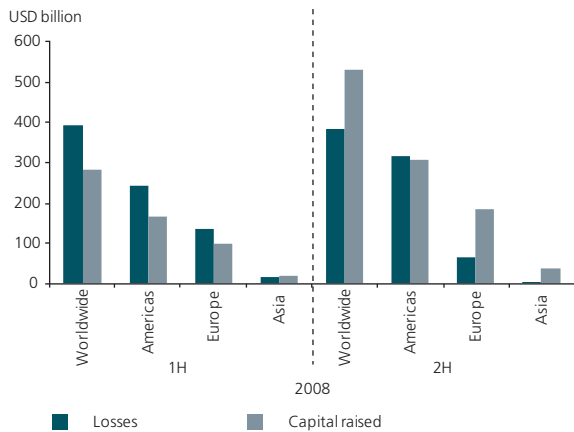
Against the backdrop of inflation concerns, international financial markets continued to experience significant disruptions throughout the year. The global financial turmoil that began with the collapse of the US sub-prime mortgage market in mid-2007, and the end of the housing market

Chart 2.1
Food and Commodity Price Indices



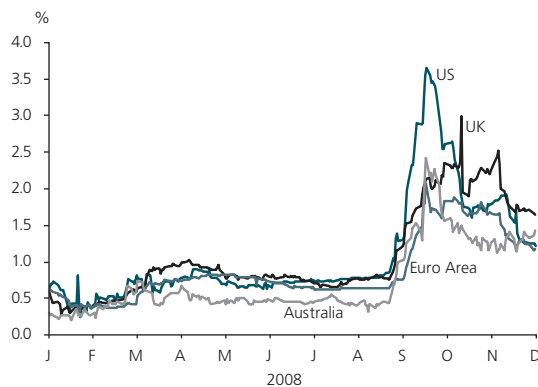
Source: Bloomberg, Food And Agriculture Association (FAO)

Chart 2.2
Financial Institutions Losses and Capital Raised



Source: Bloomberg

Chart 2.3
Money Market Spreads¹



¹ 3 month LIBOR less 3 month Overnight Index Swaps (OIS)
Source: Bloomberg

boom, spread to other financial markets. The rise in delinquencies in the US sub-prime market complicated the valuation of asset-backed securities that used the sub-prime mortgages as their underlying assets. Price discovery for all structured products became problematic, resulting in bouts of panic and tightening liquidity conditions. The health of the financial sector worsened as many major financial institutions posted large write-downs and losses. With the erosion of the capital base and inability to raise sufficient funds to meet regulatory requirements, the US banking sector began to show signs of severe distress.

The liquidity crisis turned into a full-fledged solvency and confidence crisis in the second half of the year. The bankruptcy of a US investment bank, Lehman Brothers, in September 2008 triggered a freeze in the interbank money markets as confidence in counterparties faded. Corporate debt spreads widened sharply to reflect the heightened default risk as well as concerns of possible further failures of financial institutions. At the same time, banks' reluctance to lend to one another globally resulted in acute shortages in dollar liquidity, driving short-term US dollar rates upwards.

The global deleveraging process accelerated as financial institutions addressed the need to reduce their debts and repair their balance sheets. This led to the large sell-off in the global equity markets. The yen also appreciated sharply against all currencies as carry trades were unwound and funds were repatriated back to Japan beginning September 2008. Meanwhile, investors sought safe-haven assets, such as US Treasury bond, and drove long term yields down by around 150 basis points in the fourth quarter to near all-time lows.

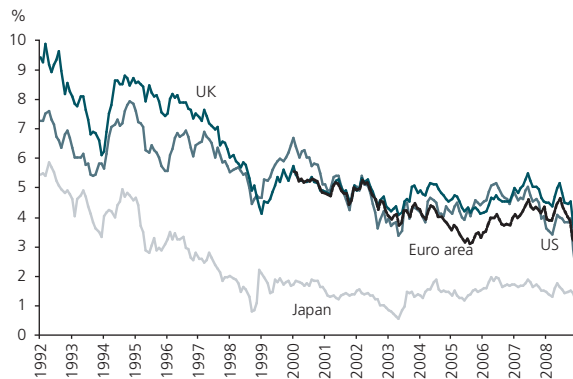
As bank losses escalated, there was a heightened concern of a global credit crunch. The combination of sustained uncertainty in global financial markets and significantly weaker financial institutions weighed heavily on financing conditions. Banks in the major economies also tightened their supply of credit due to the less favorable economic outlook, the reduced tolerance for risk and the decline in customers' creditworthiness.

Chart 2.4
MSCI Equity Market Indices



Source: Bloomberg

Chart 2.5
Developed Markets 10-year Sovereign Yields

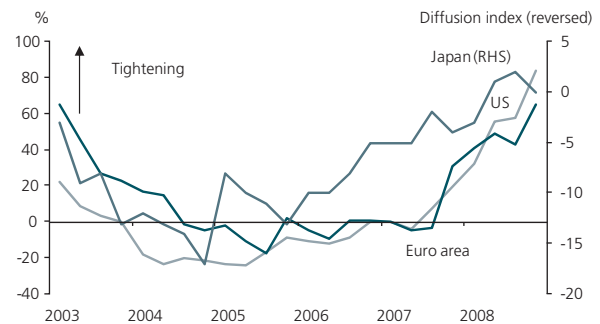


Source: Bloomberg

During the year, the major central banks and governments responded to the challenging financial environment by aggressively reducing policy rates and expanding the range of their liquidity facilities. Further measures were then deployed to recapitalize weakened financial institutions through direct cash injections and the purchase of equity stakes in these institutions.

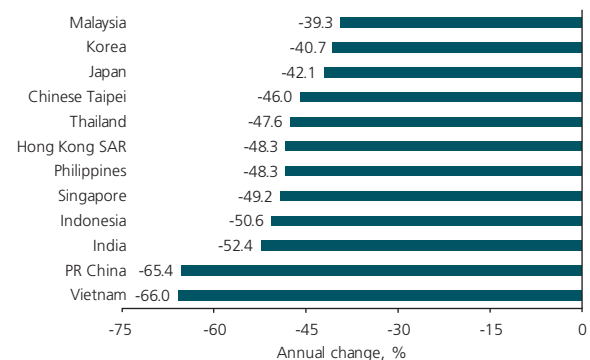
Inevitably, emerging markets were affected by the global financial crisis due to the increased financial linkages with the major economies. Several countries in the former Eastern Bloc such as Ukraine and Hungary were significantly affected given their substantial exposure to the financial markets of the advanced economies, high domestic credit growth and weak external positions. The initial financial effects of the crisis, however, were largely averted in most Asian economies due to their limited direct exposure to the US credit derivatives markets. Nevertheless, pressures on the emerging economies intensified as concerns that a protracted global credit crunch and the sharp deterioration in global growth outlook would severely affect regional economic activity. The combination of the global deleveraging process as well as the downward revision on earnings expectations had large ramifications on the region. As a result, equity markets in the Asian region declined by 30-70% in 2008. Capital outflows from the region increased during the year as funds were repatriated to the United States.

Chart 2.6
Bank Lending Conditions¹ for Business



¹ Based on Senior Loan Officer Survey conducted in selected countries
Source: Central Banks' Websites

Chart 2.7
Performance of Asian Equity Indices in 2008



Source: Bloomberg

The escalating crisis led emerging Asian economies to take decisive actions to sustain confidence. Some of the measures included providing deposit guarantees and the injection of liquidity into the financial markets. Collaborative efforts with major economies through the introduction of foreign currency swap lines helped to ease tensions in the money markets. Monetary policy was also eased to address mounting concerns on the growth prospects. In addition, governments implemented large fiscal stimulus packages to mitigate the risk of a deep and protracted slowdown in their respective domestic economies. Nevertheless, ongoing concerns on tightening external financing conditions, volatile capital flows and the uncertain growth outlook, continued to weigh on emerging markets.

DOMESTIC MONETARY AND FINANCIAL CONDITIONS

Exchange rate

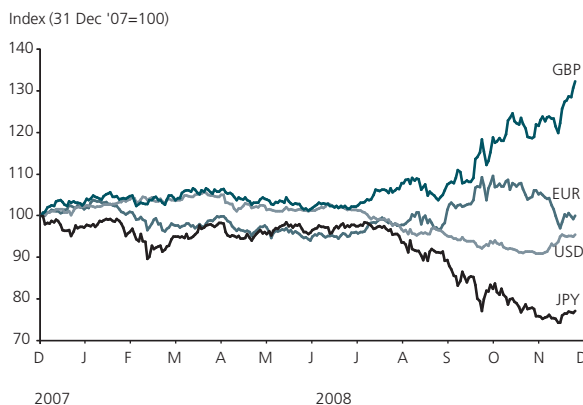
The broad appreciating trend of the ringgit in 2007 continued into the early part of 2008. Underlying demand for the ringgit was driven by the positive net trade balance, as high commodity prices continued to support Malaysia's export performance. The ringgit demand was also augmented by significant inflows of portfolio funds given Malaysia's limited direct exposure to the global financial crisis and a sound financial system, as well as the relatively resilient prospects for economic growth. The increased expectations for a weaker economic growth in the US had also led to the broad weakness of the US currency against regional currencies, including the ringgit. The ringgit appreciated by 10.6% from end-2007 to RM3.1315 against the US dollar on 23 April 2008. This is the strongest level against the US currency since the move to the managed float exchange rate regime in July 2005.

Ringgit adjusted with the global financial market developments

This trend reversed towards the end of April due to a reversal in these investment flows. The failure of Bear Stearns and other financial institutions in the developed economies significantly increased counterparty risk and raised concerns over the possibility of broader systemic failures. The collapse of Lehman Brothers in September further intensified the unwinding of investments in emerging economies as the international financial institutions commenced to deleverage.

Despite the strong underlying demand for the ringgit due to the positive net trade balance, the ringgit was significantly affected by these global developments. Between May and December 2008, the ringgit oscillated around a broad depreciating trend similar with other regional currencies following rapid change in sentiments in the financial and the currency markets. While the ringgit weakened to RM3.6375 on 5 December 2008, the ringgit ended the year at the US dollar exchange rate of 3.4640, or 4.5% lower compared to the end of 2007.

Chart 2.8
Exchange Rate of the Malaysian Ringgit (RM) Against Major Currencies



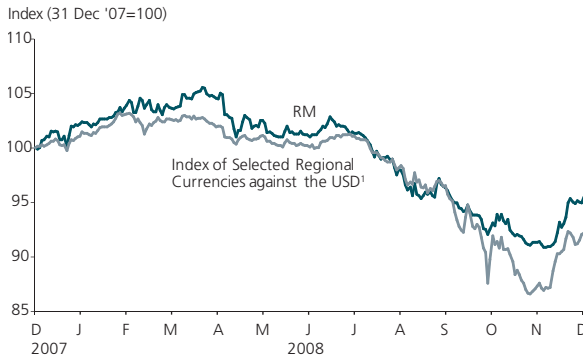
Note: An increase in the index indicates an appreciation of ringgit against the currency
Source: Bank Negara Malaysia

The ringgit also ended the year weaker against the Japanese yen as the large unwinding of yen carry trades increased the demand for the Japanese currency. The ringgit, however, ended the year stronger against the pound sterling, and was relatively unchanged against the euro. The pound sterling was adversely affected by the deterioration of the British economy and concerns surrounding the UK financial system.

Ringgit performance against the regional currencies was mixed. Although other regional currencies were similarly affected by the trend in major currencies, intra-regional exchange rate performance was differentiated by country specific factors. In particular, the Korean won and the Indonesian rupiah weakened significantly against most currencies. Both currencies had experienced a significant degree of market overshooting as their earlier rapid appreciation quickly turned into sharp depreciation.

In a more volatile and uncertain global environment, the managed float regime has provided the requisite flexibility for the ringgit to adjust to global economic and financial developments. At the same time, the current regime has also accorded a degree of exchange rate stability against the country's main trading partners. While there were concerns that the ringgit depreciation against the US dollar and the Japanese yen had increased the cost of

Chart 2.9
Exchange Rate of the Malaysian Ringgit (RM) and Selected Regional Currencies Against the US Dollar

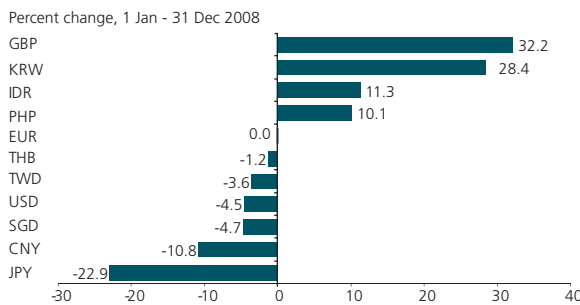


¹ Regional currencies: Chinese renminbi, Indonesian rupiah, Korean won, Philippine peso, Singapore dollar, New Taiwanese dollar and Thai baht. Each currency is of equal weight

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

Source: Bank Negara Malaysia

Chart 2.10
Summary of Malaysian Ringgit (RM) Performance Against Major and Regional Currencies in 2008



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

Source: Bank Negara Malaysia

imports, especially productive inputs, only 24% of Malaysia's imports are sourced from the US and Japan. During the year, the average price increases of consumer goods and services in the US and Japan were lower than the price increase in Malaysia, which partially offsets the impact of ringgit depreciation against these currencies. A better measure for Malaysia's international purchasing power is the real effective exchange rate (REER). The REER is the weighted average of the ringgit against the currencies of our major trading partners and is

adjusted for differences in price changes. By this measure, the REER for the ringgit depreciated by only about 1.5% during the year.

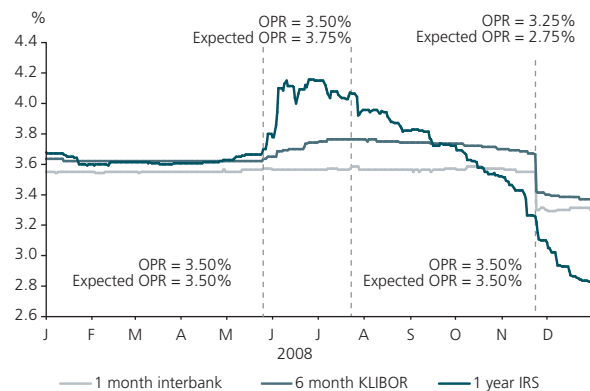
Interest rates, bond yields and equity prices

During the year, interest rates were low and stable to support the financing needs of the economy. Domestic interest rates reflected Bank Negara Malaysia's monetary policy stance, which in turn was driven by the Bank's assessment of the relative risks to growth and price stability. The thrust of monetary policy is to promote price stability in an environment of sustainable economic growth over the medium term.

Interest rates were strongly supportive of the economy

The overnight, one-week and one-month interbank rates were relatively stable in the first eleven months of the year, trading closely to the overnight policy rate (OPR). Medium term money market rates, however, were influenced by expectations of OPR movements. After remaining stable for the first six months, KLIBOR and interest rate swap (IRS) rates rose as markets anticipated a monetary policy response to rising inflation. The OPR was however left unchanged and the rates were subsequently pared down. Towards year-end, interbank rates adjusted downward following the 25 basis points reduction in OPR on 24 November.

Chart 2.11
Money Market Rates

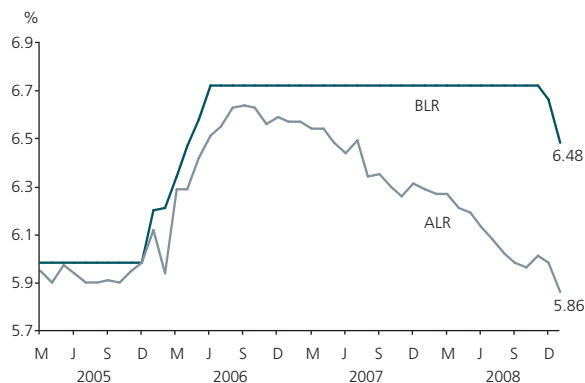


Note: Expected OPR compiled from analyst consensus at Bloomberg
Source: Bank Negara Malaysia and Bloomberg

Retail lending rates were near historic lows throughout 2008. Borrowers in both the household and business sectors continued to benefit from low interest rates. Low lending rates were underpinned by two factors. First, the low cost of funds as a result of the accommodative monetary policy stance and ample banking system liquidity. Second, the intense competition between banks kept the margins charged on loans low. Notwithstanding these factors, some upward pressures emerged in the money market during the middle of the year following expectations for monetary policy tightening as inflation rose significantly. Consequently, hire purchase loans were re-priced upwards in tandem with the rising cost of hedging fixed-rate loans through the interest rate swaps market. Such uptrend in interest rates proved to be temporary as market expectations for an OPR adjustment receded as the global and domestic growth outlook began to soften. After Bank Negara Malaysia reduced the OPR in November, lending rates to businesses and households declined. Consequently, the average lending rate (ALR) on loans outstanding ended the year at a new historic low of 5.86%.

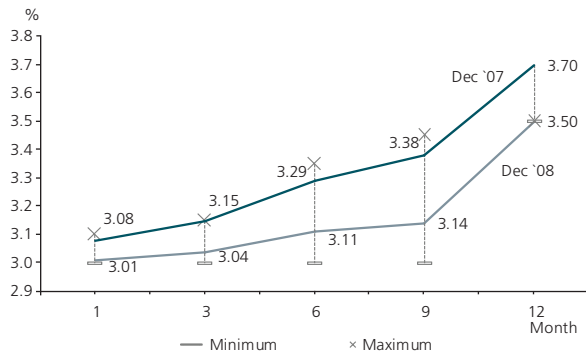
Meanwhile, deposit rates were stable in the first eleven months of the year. The downward pressure on deposit rates was mitigated by the interest rate floor imposed by the Bank on fixed deposit (FD). In contrast to the stable nominal interest rates, real interest rates declined and turned negative in May following the sharp increase in inflation.

Chart 2.12
Commercial Banks' Lending Rates (at end-period)



Source: Bank Negara Malaysia

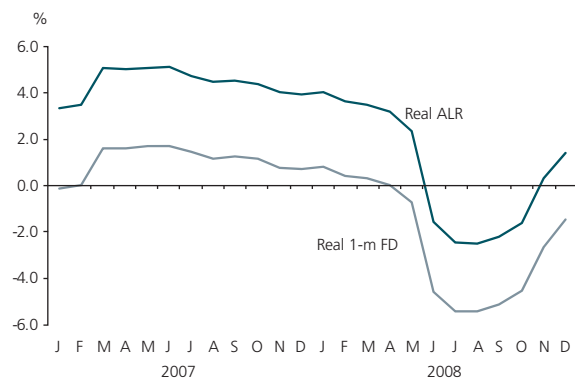
Chart 2.13
Commercial Banks' Fixed Deposit Rates



Source: Bank Negara Malaysia

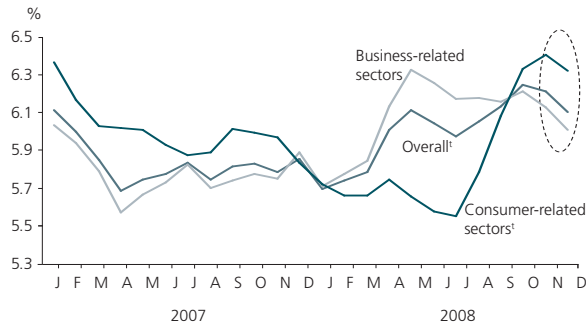
The reduction in the OPR in November was rapidly transmitted to retail lending rates. Twenty banks reduced their base lending rate within two weeks of the OPR cut. In addition, the magnitude of the pass-through was sizeable, as banks passed on the interest rate reductions to their customers. The average BLR of the commercial banks fell from 6.72% in October to 6.48% in December. Consequently, rates on loans approved to businesses and households fell by 26 and 25 basis points respectively in the following month, fully reflecting the 25 basis points reduction in the OPR. Deposit rates also fell as the reduction in the OPR was accompanied by a downward revision of the floor on FD rates.

Chart 2.14
Real Deposit and Lending Rates



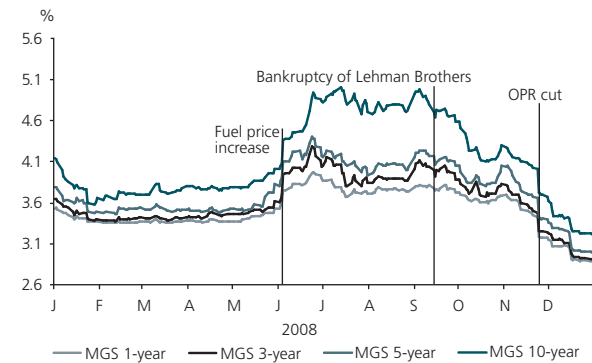
Source: Bank Negara Malaysia

Chart 2.15
Commercial Banks' ALR on New Loans Approved
(3-month moving average)



¹ Excludes loans for the purchase of residential property and credit cards.
Source: Bank Negara Malaysia

Chart 2.16
MGS Yields



Source: Bank Negara Malaysia

In 2008, sovereign bond yields were mainly influenced by inflation expectations and concerns over the growth outlook. In the first half of the year, expectations of higher domestic inflation led yields to gradually trend upwards, especially in the longer-tenures. The rise, however, was mitigated by the large inflows of capital into the equity and bond markets, as investors rebuilt their portfolio in the beginning of the year. The expectations of a further strengthening of the ringgit on account of the resilient performance of the economy also kept yields low and stable.

Sovereign yields reflected the changing outlook for growth and inflation

Inflationary expectations intensified in June following the increase in retail fuel and electricity prices. This, in turn, heightened expectations of a monetary policy tightening and raised MGS yields considerably. As investors weighed the higher interest rates outlook going forward, yields for the 10-year and 3-year MGS rose sharply by 84 and 50 basis points respectively in June. The maturity spread between the 10-year and shorter-term MGS also widened, resulting in the steepening of the slope of the yield curve. Furthermore, yields remained high as foreign investors unwound their portfolio investments as the global financial crisis intensified further.

By September, however, yields began to fall as inflation expectations eased. In addition, the

deepening global financial crisis resulted in extreme risk aversion among investors. Investors increased the demand for risk-free and lower risk assets and shifted their investments from the equity to the government securities markets, driving yields further downwards.

With pronounced indications of dissipating domestic inflationary pressures and mounting concerns over the economic slowdown, expectations of a reduction in OPR surfaced towards year-end. The reduction in OPR on 24 November was therefore, immediately and fully transmitted in the sovereign bond market, as reflected by the decline in yields across all maturities. In December, long-term MGS yields continued to decline to levels that were below the OPR as investors priced-in further policy interest rate cuts following the release of weak economic data. The bond-swap spreads for short to medium-term securities remained negative reflecting such expectations.

The movements of private debt securities (PDS) yields broadly mirrored those of the MGS in the first half of the year. In June, however, uncertainties with regard to debt issuers' viability arising from the imposition of windfall tax on Independent Power Producers (IPPs) and palm-oil plantation companies led to the deterioration in investor sentiments. As a result, liquidity in the PDS market declined significantly, raising yields sharply upwards.

Chart 2.17
MGS Maturity Spread



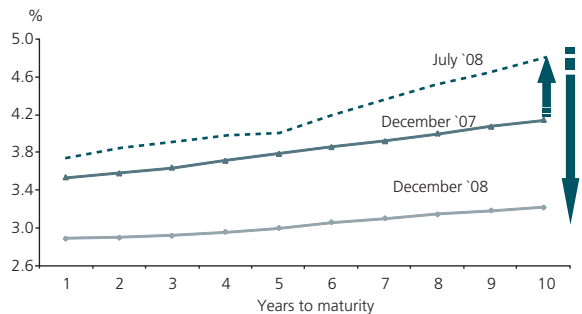
Source: Bank Negara Malaysia

Chart 2.19
Bond-Swap Spread¹



¹ Interest Rate Swap minus MGS yields
Source: Bank Negara Malaysia

Chart 2.18
MGS Benchmark Yield Curve



Source: Bank Negara Malaysia

Investors' sentiments were further undermined by concerns about creditworthiness arising from prospects of lower earnings in the second half-year.

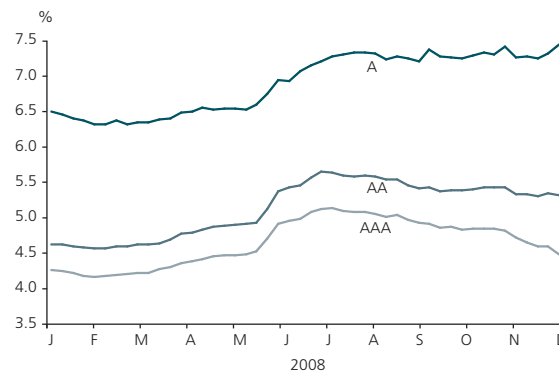
PDS yields affected by rising risk premiums

PDS yields, therefore, remained at elevated levels due to the higher risk premiums. The rebalancing of portfolio allocations by investors from the more risky PDS to sovereign papers also contributed to the increase in yields. These culminated into a significant widening of the spread between MGS and

PDS yields. Credit spreads began rising sharply in November as the magnitude of the decline in MGS yields exceeded that of the PDS. Notably, larger spreads were recorded for the lower-rated securities. Although PDS yields had not fallen as much as MGS yields, issuances of higher-rated PDS remained relatively healthy during the period.

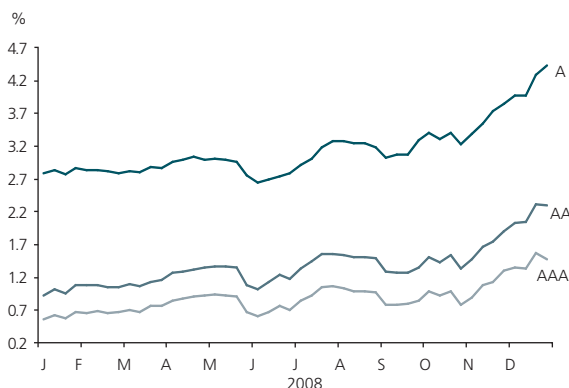
Equity prices were volatile due to domestic and external developments during the year. The Kuala Lumpur Composite Index, KLCI, was subjected to significant volatility because of its large exposure to the resource-based sectors that were affected by the substantial

Chart 2.20
PDS Yields (5-year)



Source: Bank Negara Malaysia

Chart 2.21
Corporate Yield Spread Against MGS (5-year)



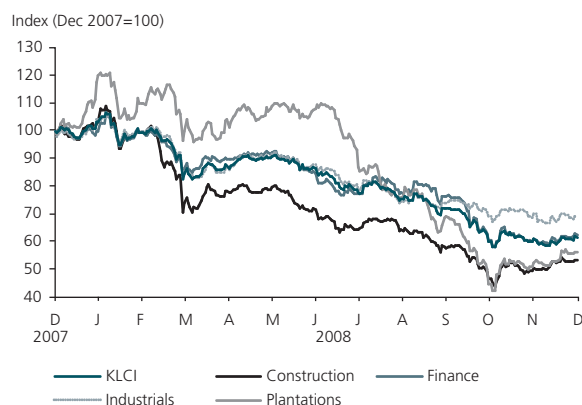
Source: Bank Negara Malaysia

fluctuations in commodity prices. The KLCI volatility was further augmented by outflows of funds driven by the worsening of sentiments in the financial markets and deleveraging activities by foreign investors. Widespread expectations of deteriorating earnings also influenced domestic sentiments and further amplified market volatility.

Share prices were volatile and on downward trend

Uncertainties with regard to the US financial turmoil and the outcome of the general election in March led to weak market sentiments in the first half-year. Despite these uncertainties, the

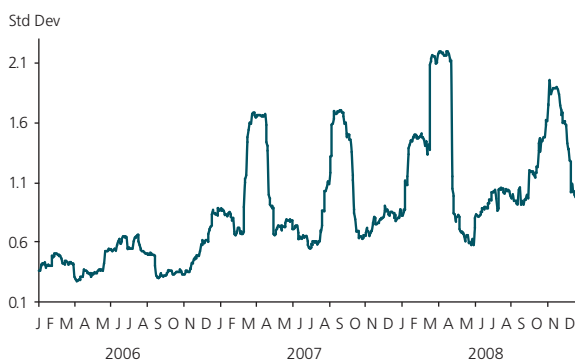
Chart 2.23
KLCI and Bursa Malaysia Sectoral Indices



Source: Bloomberg

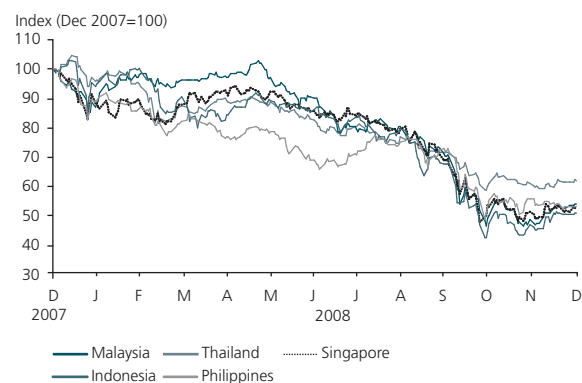
index remained buoyant, supported by gains in plantation-related stocks that benefited from rising commodity prices. In the second half of the year, however, a further deterioration in global and domestic sentiments exerted downward pressure on equity prices. The high cost of raw materials and increases in utilities charges, amid slower economic growth prospects, adversely impacted firms' earnings, and consequently, companies' valuations. Towards year-end, falling commodity prices, extreme risk aversion and deleveraging activities brought share prices further down. For the year as a whole, the KLCI fell by 39.3% to 876.8. The decline in the KLCI was broadly similar to that experienced in other regional markets.

Chart 2.22
Volatility of Returns on the KLCI¹



¹ Refers to 30-day rolling standard deviation of daily returns
Source: Bloomberg

Chart 2.24
Regional Indices



Source: Bloomberg

Liquidity

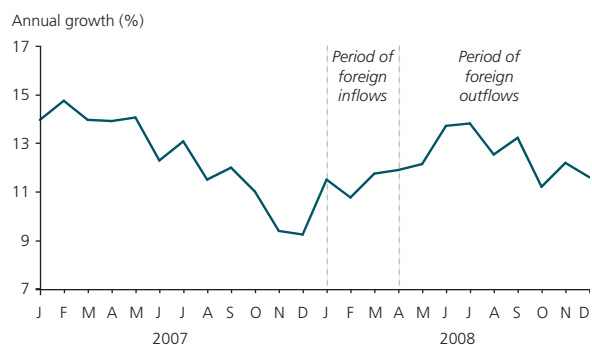
Liquidity conditions were ample throughout 2008. Malaysia's deep integration with the world economy through trade and financial links, however, meant that domestic liquidity was affected by global developments. As such, domestic liquidity, as measured by broad money, or M3, exhibited two distinct phases in 2008.

Domestic liquidity affected by foreign deleveraging but remained ample

In the first half of the year, broad money increased at a faster pace. The increase was underpinned by both external and domestic factors. On the external side, foreign inflows rose substantially on account of Malaysia's trade surplus and portfolio inflows. Credit growth to the private sector also increased, as banks continued to provide financing in line with the faster pace of economic activity. Broad money growth peaked in July, with an annual growth rate of 14.1% (end-December 2007: 9.5%).

In the second half of the year, the deleveraging process among international financial institutions created a strong demand for US dollars, causing sudden and large outflows from Malaysia. These exerted a contractionary impact on broad money. The effect of the outflows on broad money, however, was partially offset by the sustained pace of lending by the domestic banking sector. In addition, broad money growth was also supported by higher Government

Chart 2.25
Broad Money, M3



Source: Bank Negara Malaysia

spending, which was financed through the issuances of government securities, some of which were taken up by the banking sector. Accordingly, monetary aggregates continued to grow, albeit at a slower pace, in the second half of 2008. Broad money, or M3, ended the year with a growth rate of 11.9% in December.

Bank Negara Malaysia conducted operations in the money market to ensure that the level of liquidity was sufficient to meet the financing needs of the economy. In the first half of 2008, the Bank mopped up a higher amount of excess liquidity in order to prevent over expansionary liquidity conditions. This was achieved through the utilisation of a wide range of monetary instruments in the Bank's sterilisation operations, including direct borrowing, repos and the issuance of Bank Negara Monetary Notes (BNMNs). Accordingly, excess liquidity remained modest.

Large outflows of liquidity following foreign selling of domestic assets were compensated by the

Table 2.1
Broad Money, M3

	Change (RM billion)	
	2008	
	1H	2H
M3	66.4	32.7
Currency in circulation	2.9	1.3
Demand Deposits	5.3	5.8
Broad Quasi-Money	58.3	25.6
<i>Fixed deposits</i>	14.8	13.2
<i>Savings deposits</i>	4.0	3.8
<i>NIDs</i>	-0.3	0.4
<i>Repos</i>	1.1	-4.1
<i>FX deposits</i>	11.5	5.1
<i>Other deposits</i>	27.2	7.1
Determinants of M3		
Net claims on Government	-4.1	37.6
Claims on the private sector	43.3	51.7
<i>Loans</i>	40.2	36.5
<i>Securities</i>	3.1	15.2
Net foreign assets*	48.7	-95.4
<i>Bank Negara Malaysia*</i>	68.4	-80.9
<i>Banking system</i>	-19.7	-14.6
Other influences	-21.5	38.8

* Pre-revaluation of the international reserves

release of liquidity kept with the Bank. The large net interbank placements with the Bank acted as a liquidity buffer for the banking system. While the size of the surplus liquidity was reduced by outflows, liquidity in the banking system, nonetheless, remained in surplus. This was evident by the loan-deposit ratio remaining at modest levels, ranging between 72.5 in July to 73.5 in December. At the institution level, 49 out of 54 banking institutions operated from a position of surplus liquidity with net placement of funds with the Bank. The large number of institutions with a surplus of liquidity supported the domestic banking system's resilience by limiting over reliance on wholesale funding. The Bank also ensured adequate US dollar liquidity to prevent any shortage in foreign currency for trade activities.

FINANCING OF THE ECONOMY

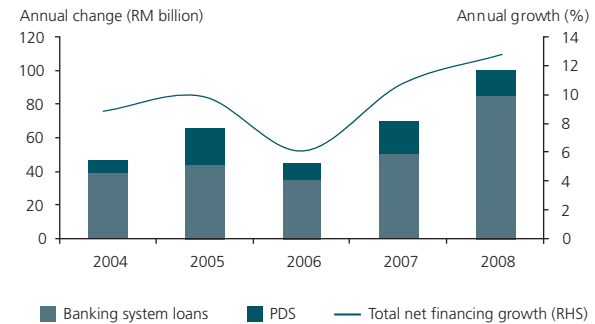
In 2008, the domestic credit situation remained conducive to sustainable growth. While inflationary pressures in the first three quarters of 2008 reflected the impact of the commodity price shock, credit expansion was broadly in line with the underlying economic conditions, and this helped to limit the potential for second-round effects of inflation.

Banking sector and capital markets continued to support demand for financing

Of importance, while the developed countries faced severe credit crunch conditions, especially in the fourth quarter of the year, domestic credit conditions continued to remain favourable. Banking institutions and the financial markets continued to support the demand for financing of the economy. Total net financing¹ channeled to both the public and private sectors increased at a sustained rate of 11.5% (2007: 9.2%). There continued to be robust demand for financing from both households and businesses during the year. Towards year-end, however, the demand for financing slowed down somewhat due to the moderation in economic growth and the more cautious sentiments of the private sector.

Net financing to the private sector through banking system loans and PDS outstanding

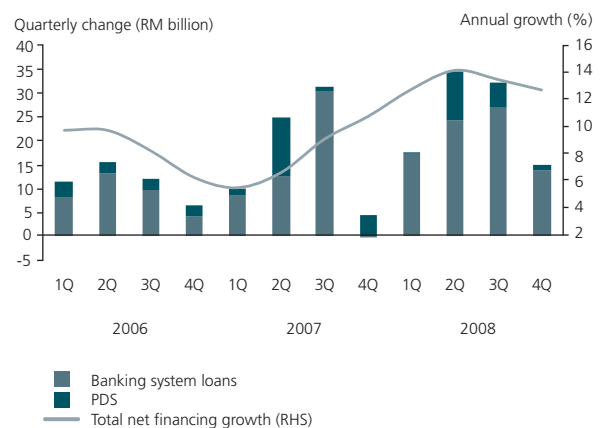
Chart 2.26
Net Financing to the Private Sector through Banking System Loans and PDS



Source: Bank Negara Malaysia

expanded at a faster annual pace of 12.7% in 2008 (2007: 11.3%). In the first three quarters of the year, robust private consumption underpinned by the continued resilience of the domestic economy, contributed towards the steady demand for financing. Additionally, the higher prices of raw materials, fuel and electricity resulted in a higher cost of operations and thus, raised the demand for financing working capital

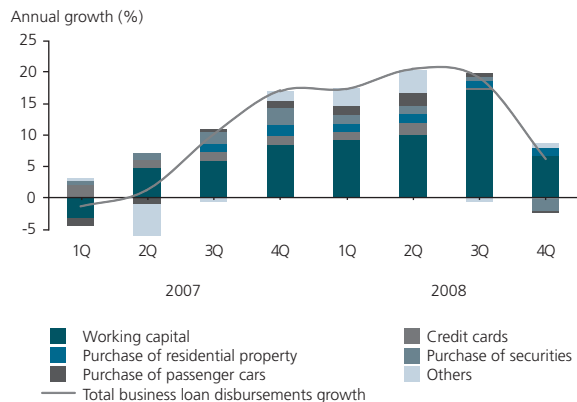
Chart 2.27
Net Financing to the Private Sector through Banking System Loans and PDS



Source: Bank Negara Malaysia

¹ Comprised financing provided by the banking system, capital market, development financial institutions (DFIs), insurance companies, leasing and factoring companies, housing credit institutions, Employee Provident Fund (EPF), Treasury Housing Loan Division and external sources.

Chart 2.28
Loan Disbursements to Businesses:
Total Growth and Contribution by Purpose

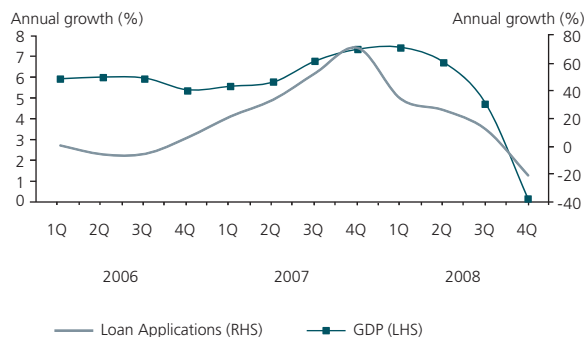


Note: Data excludes one large loan extended in 2007 for a privatisation activity
 Source: Bank Negara Malaysia

by businesses. Loans disbursed for the purpose of working capital rose significantly at an annual rate of 22.1% in the first nine months of 2008 compared to 4.3% for the corresponding period in 2007. In particular, loan applications from the food and beverages industry increased by 87.1% during January to September 2008 compared to 1.2% for the corresponding period in 2007.

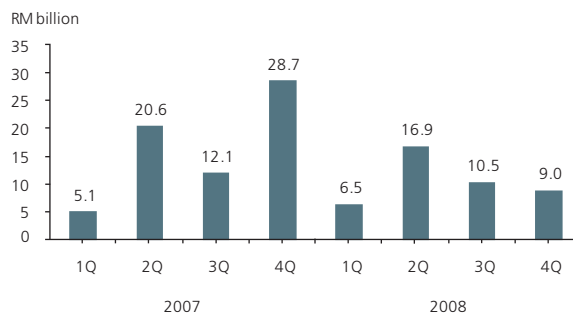
Banking system loan applications and approvals increased by 22.8% and 20.7% respectively in the first nine months of the year (2007: 36.7%; 37.5%)². The absence of demand for financing of merger and acquisition activities, however, meant

Chart 2.29
Loan Applications and GDP



Data excludes one large loan extended in 2007 for a privatisation activity
 Source: Bank Negara Malaysia

Chart 2.30
Gross PDS Issued



Note: Data excludes Cagamas bonds and issuances by non-residents
 Source: Bank Negara Malaysia

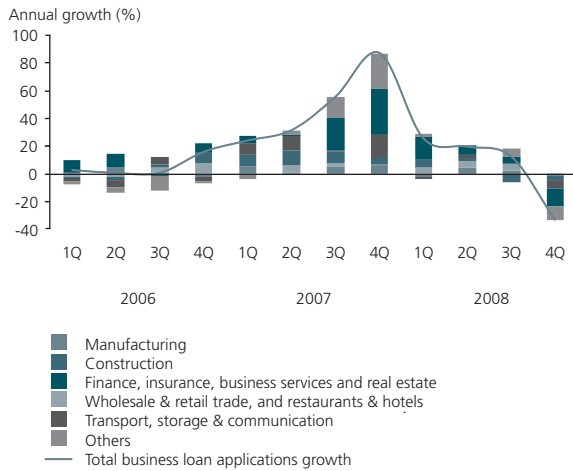
that growth in loan applications and approvals were smaller compared to the corresponding period in 2007. Despite bouts of weak market sentiment, PDS financing during the period was robust. Expectations of higher yields due to anticipated OPR increases, prompted businesses to secure financing ahead of the expected increase. In fact, the highest amount of issuance was recorded in June, prior to the July MPC meeting.

The demand for financing by households was supported mainly by the robust sales in residential properties and passenger cars. In part, the demand for mortgage financing was attributable to the various incentives introduced by the Government for the property sector in 2007, which included the flexibility to withdraw funds from the EPF Account II on a monthly basis for repayment of mortgages. The increase in commodity prices provided additional income to the rural population and these contributed to the demand for passenger cars and pick-up trucks. Higher prices of food, fuel and electricity by mid-year, however, raised the cost of living and reduced households' disposable income. Households became more cautious in their spending, as reflected by the decline in their discretionary expenditure. Consequently, by the third quarter, the growth of hire purchase loans, credit cards and mortgage financing moderated.

The effects of the sharper deterioration of the global economy began to have its impact on the

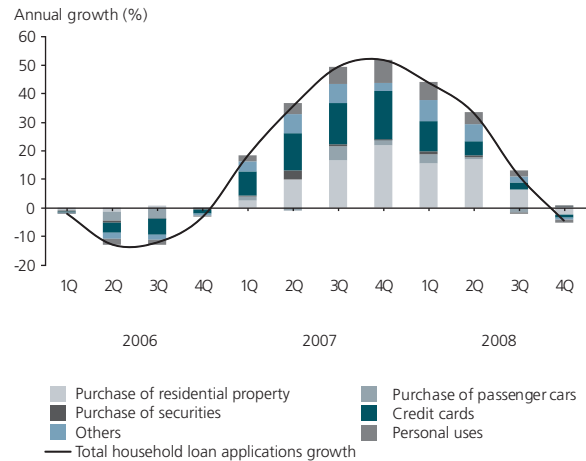
² The analysis on loan developments excluded one large loan extended in 2007 for a privatisation activity.

Chart 2.31
Loan Applications by Businesses:
Total Growth and Contribution by Sectors



Note: Data excludes one large loan extended in 2007 for a privatisation activity
 Source: Bank Negara Malaysia

Chart 2.32
Loan Applications by Households:
Total Growth and Contribution by Purpose



Source: Bank Negara Malaysia

domestic economy in the fourth quarter of 2008. The decline in external demand led to a sharp and rapid contraction in exports and a slowdown in the pace of private investment, which in turn, affected labour market conditions. Coupled with weak sentiments in the financial markets, the demand for financing from both businesses and households moderated during the quarter. Loan applications by businesses declined across all economic sectors in the fourth quarter, with the exception of the wholesale, retail trade, restaurants and hotels sector. Loan applications by households, namely for housing, credit cards and personal loans, also contracted during the period. In the PDS market, the higher risk premiums demanded by investors made it more costly for firms to raise funds. Some issuers also chose to postpone their bond issuances in anticipation of lower yields in the future. Thus, despite a continued flow of approvals for issuances of PDS, actual issuances moderated as firms delayed their bond issuances. Funds raised through the equity market also declined to RM5.5 billion (2007: RM7.1 billion). Reflecting weak market sentiments, funds raised were mostly through right issues rather than initial public offerings (IPOs).

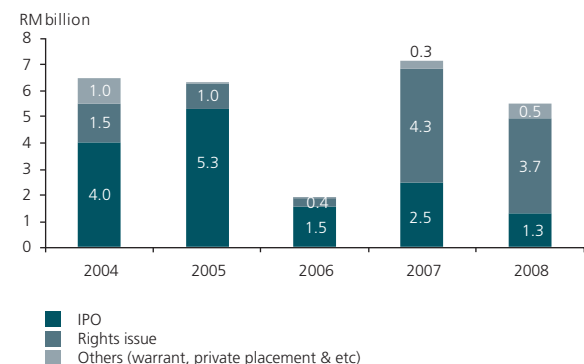
Sources of financing

As the domestic financial institutions and markets continue to function efficiently, the private sector benefited from having the flexibility to choose the

most effective sources of financing for its activities. In 2008, the banking system remained the largest provider of financing for the economy, with bank loans accounting for 42% of total financing. Meanwhile, financing through PDS issuances accounted for 15%, the third largest source after foreign direct investment. Reliance on external financing remained small at 5% due to ample domestic liquidity.

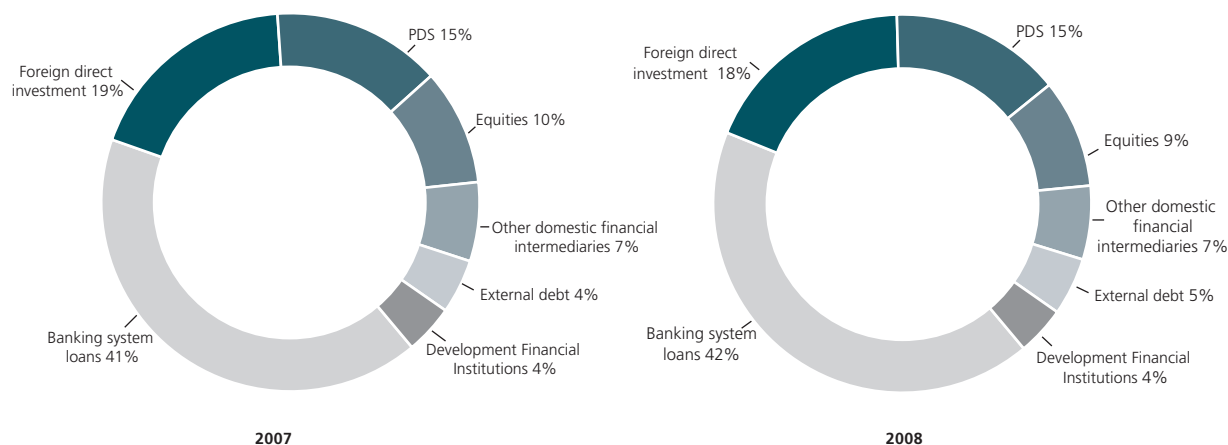
The choice of the sources of financing for the business sector primarily hinges on the purpose

Chart 2.33
Total Financing Raised via the Equity Market



Source: Bursa Malaysia, Bank Negara Malaysia estimates

Chart 2.34
Sources of Financing for the Private Sector



Source: Bank Negara Malaysia

Table 2.2
Special Funds for SMEs Administered by Bank Negara Malaysia

	RM million				%
	Allocations	Approvals	Disbursements	Loans Outstanding	Utilisation Rate ¹
	As at end-2008				
Special Funds					
Fund For Food ²	1,300.0	1,730.4	1,707.0	255.7	78.3 ³
New Entrepreneurs Fund 2	2,850.0	3,544.6	3,351.4	2,261.9	90.0
Fund for Small and Medium Industries 2	6,750.0	11,933.8	10,893.7	4,972.2	94.2
Bumiputera Entrepreneurs Project Fund	300.0	899.9	814.2	79.5	87.0
Micro Enterprise Fund	200.0	4.2	2.4	2.4	2.1
Total	11,400.0	18,112.8	16,768.8	7,571.7	90.3
SME Financial Assistance Schemes					
SME Assistance Facility	700.0	1,013.0	234.1	4.6	
SME Modernisation Facility	500.0	83.3	6.9	211.2	
Total	1,200.0	1,096.3	241.0	215.8	
	Change during the year				
Special Funds					
Fund For Food ²	-	-	0.5	-84.5	
New Entrepreneurs Fund 2	-	107.9	148.4	-134.1	
Fund for Small and Medium Industries 2	-	1,815.9	2,117.4	177.4	
Bumiputera Entrepreneurs Project Fund	-	139.6	158.0	8.2	
Micro Enterprise Fund	200.0	4.2	2.4	2.4	
Total	200.0	2,067.6	2,426.7	-30.6	
SME Financial Assistance Schemes					
SME Assistance Facility	700.0	1,013.0	234.1	4.6	
SME Modernisation Facility	500.0	83.3	6.9	211.2	
Total	1,200.0	1,096.3	241.0	215.8	

¹ Ratio of approvals over allocations and repayments.

² Exclude funds allocated by the Government under the Ninth Malaysia Plan.

³ Exclude repayments of RM541 million that has been converted into Agrobank's equity.

Source: Bank Negara Malaysia

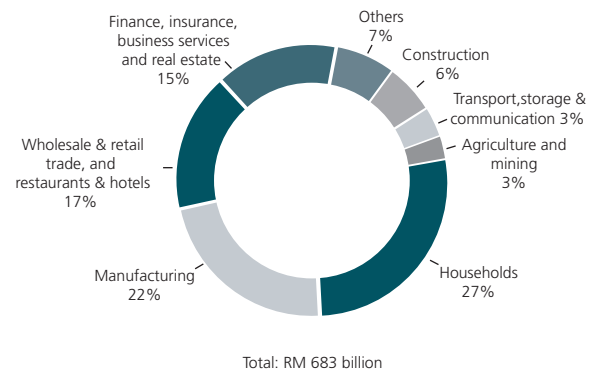
for which financing is being sought. In particular, firms issued PDS to finance larger and longer-term projects, and turned to the banking system for shorter-term financing needs such as for working capital. For the small and medium enterprises (SMEs) and micro enterprises, financing was primarily sourced from banking institutions and development financial institutions (DFIs). These were augmented by special funds established by Bank Negara Malaysia from time to time to achieve specific purposes. There has been in total, 21 funds set up by Bank Negara Malaysia since 1988. Currently, there are seven funds. The utilisation rate of the funds, excluding the guarantee facilities, stood at 90.3% in 2008. The household sector's credit requirements have been mostly met by the banking institutions. The availability of financing from the DFIs and insurance companies also widened the range of financing instruments and avenues for households and enhanced competition in the consumer credit segment.

Direction of lending

The steady flow of financing during the year was channeled across all the economic sectors and borrowers. Gross financing raised from the banking system and PDS market were extended mostly to the business sector, with the manufacturing, wholesale and retail trade, as well as finance, insurance, business services and real estate sectors, accounting for more than 50% of total gross financing. Amidst weakening external demand, financing to the manufacturing sector, which accounted for 22% of total gross financing, were mainly directed to the domestic oriented industries³. Financing to the household sector remained stable at 27% of total gross financing (2007: 28%).

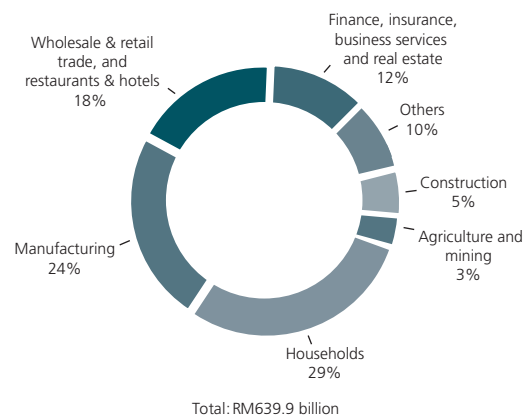
In the banking system, loans to the business sector were mainly disbursed to finance working capital. Disbursements of loans to the business sector were primarily channeled to the manufacturing, wholesale and retail trade, restaurants and hotels, and finance, insurance, business services and real estate sectors. Increased disbursement of loans to the business sector led to further expansion in outstanding business loans by 13.2% at end-2008 (2007: +10.3%). In the PDS market, funds were mostly raised to finance new investment activities. Of the total gross PDS issued in 2008, 60.6% was raised by firms from the finance, insurance,

Chart 2.35
Gross Private Sector Financing in 2008



Source: Bank Negara Malaysia

Chart 2.36
Loan Disbursements by Sector in 2008



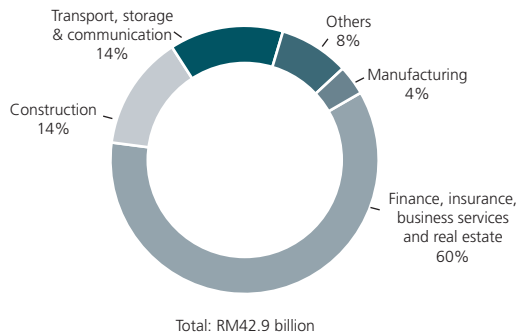
Source: Bank Negara Malaysia

business services and real estate sector. Of this amount, 21.7% was issued by the domestic banking institutions. Meanwhile, the transport, storage and communication, and construction sectors each accounted for 14% of total gross funds raised in 2008.

Loans extended to the SMEs accounted for 17.2% of total loans outstanding. Banking system loans to the SMEs rose by 9.4% at end-2008, after increasing by 13.2% in August 2008 (2007: 9.1%). The demand for financing by SMEs expanded at a more

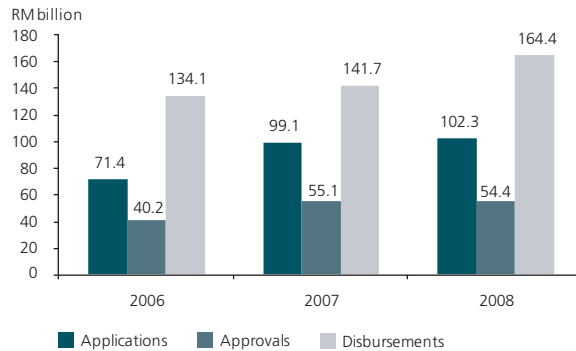
³ Refers to food, beverages, transport-equipment, paper, tobacco and construction related industries.

Chart 2.37
Gross PDS Issued by Sector in 2008



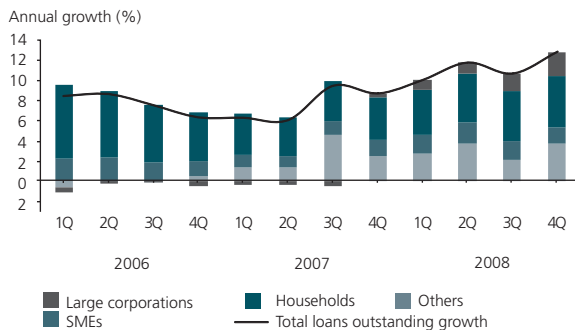
Note: Data excludes Cagamas bonds and issuances by non-residents
Source: Bank Negara Malaysia

Chart 2.39
Loan Indicators for the SMEs



Source: Bank Negara Malaysia

Chart 2.38
Loans Outstanding:
Total Growth and Contribution by Customers



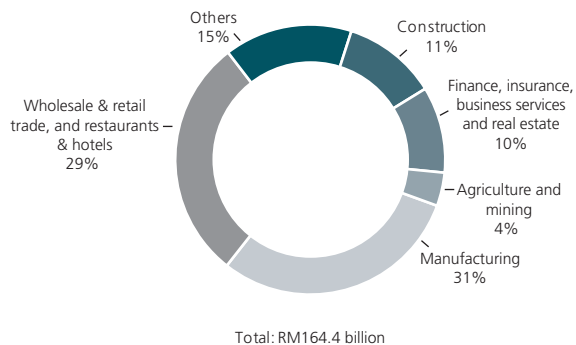
Data excludes one large loan extended in 2007 for a privatisation activity
Source: Bank Negara Malaysia

moderate pace during the year, with loan applications registering a slower growth of 3.3% (2007: 38.8%). The moderation was observed across all the economic sectors. Notwithstanding the slowdown in demand, loans disbursed to the SMEs in 2008 increased by 16% (2007: 5.6%), mainly to meet working capital requirements. Disbursements remained broad based with the manufacturing and wholesale and retail trade sectors accounting for 31% and 29% of total loan disbursements, respectively.

In July 2008, Bank Negara Malaysia introduced two financial assistance programs, the SME Assistance Facility and

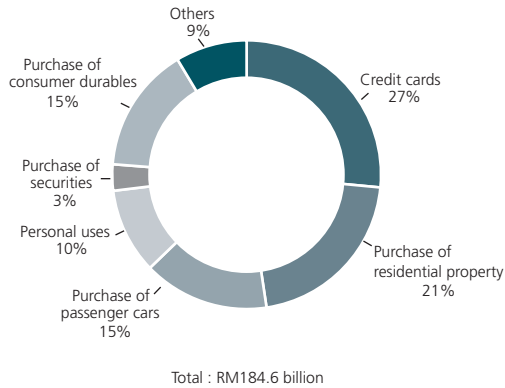
SME Modernisation Facility, totaling RM1.2 billion. These facilities were introduced to assist SMEs to overcome temporary cash flow problems arising from the higher cost of doing business as well as to promote higher efficiency and productivity through modernisation and upgrading of machinery, equipment and operations. In November, Bank Negara Malaysia launched the RM200 million Micro Enterprise Fund to broaden the access to financing for micro enterprises with viable businesses. In January 2009, Bank Negara Malaysia established a RM2 billion SME Assistance Guarantee Scheme (SAGS). The micro financing and guarantee scheme are aimed at ensuring that viable SMEs

Chart 2.40
Loan Disbursements to SMEs by Sector in 2008



Source: Bank Negara Malaysia

Chart 2.41
Loan Disbursements to Households by Purpose
in 2008



Source: Bank Negara Malaysia

and micro enterprises which are facing temporary difficulties because of weakening demand, continue to have access to adequate financing.

In the household sector, loan disbursements increased at an annual rate of 8.9% (2007: 12.8%), and were primarily channeled to finance the purchase of residential properties and passenger cars. Consumption credit expanded at a slower pace. Growth in credit card spending fell markedly to 2.1% compared with 20.6% in 2007. Credit cards continued to be used largely as a mean of payment rather than as a mode of financing, as evident by the high repayment ratio⁴ of 61.2%. With sustained disbursements of housing and car loans, loans outstanding to the household sector expanded at a faster pace of 9.1% (2007: 7.4%), accounting for 53.4% of the total increase in bank loans.

⁴ Repayment ratio = [(total spending + cash advance) – outstanding balance] / (total spending + cash advance)