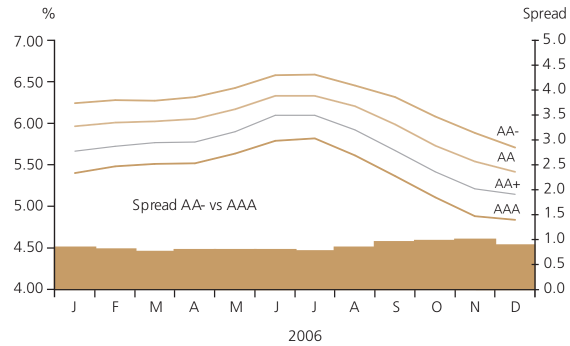
relatively low after the May correction, when foreign investors had pulled back capital from emerging markets, had rose to its highest levels during the second-half of the year.

In the corporate bond market, issuers were more aggressive in entering the market in anticipation of further OPR increases. The rally in the MGS market also sparked buying interests towards the high-grade segment of the corporate bond market.

Despite a higher number of downgrades being recorded in 2006 compared to 2005, the credit spread in the corporate bond market remained stable throughout the year. The higher downgrades were mainly within the investment

Chart 2.37
Corporate Bonds Indicative Yields (2006)



category and were isolated cases due to more stringent rating criterion being adopted. These

Increased Cooperation in the Development of the Regional Bond Market

Cooperative efforts to further develop the regional bond markets had advanced in 2006 with several developmental milestones achieved aimed at enhancing the depth and breadth of the regional bond markets.

Asian Bond Market Initiative (ABMI)
Under the auspices of the ABMI, the various working groups established in 2003 to promote the issuance and trading of bonds within the region have achieved several important milestones on a wide range of issues. These include a study on the possible creation of a "Regional Basket Currency Bonds" (RBCB). The study addresses issues on possible structures, impediments as well as effective regulatory framework to facilitate the creation of RBCB. The study on "Credit Guarantee and Investment Mechanism" had also progressed to Phase 2 towards development of a business model on credit guarantee and investment mechanism for the region.

Under the Working Group on Foreign Exchange Transactions and Settlement issues chaired by the Bank, the interim report on the study on "Minimising Foreign Exchange Settlement Risk in ASEAN+3 Region" has been completed and distributed to member countries. The study aimed to provide options to the region in minimising clearing and settlement risk for cross-border bond transactions including the possible establishment of a regional intermediary.

Other areas of collaboration and cooperation focused on identifying measures to promote rating harmonisation and further utilisation of local credit rating agencies in the ASEAN+3 region. Efforts were also undertaken to pool valuable experiences from member countries to identify an appropriate policy framework that could facilitate the funding of infrastructure development through the Asian bond markets. Phase 2 of the technical assistance programmes for 5 participating countries namely Cambodia, Indonesia, Philippines, Thailand and Vietnam has also been completed. To further improve comparability of information on the domestic bond markets in the region, the Asian Bond Online Website, which was developed in 2004, was also enhanced.

Asian Bond Fund

The Asian Bond Fund 2 (ABF2) that was launched in 2005 has experienced encouraging growth of 48% in the number of units and achieved a USD return of 6.9% per annum since its launch. The funds have also gained greater international recognition within the investment community. For the year ending 3 August 2006, Lipper ranked the Pan-Asian Investment Fund (PAIF) first in its survey of open-ended Asia bond funds.

The ABF Malaysia Bond Index fund, one of the funds under the ABF2, was listed in 2005 and has since helped to increase investor interest in the Malaysian bond market. Since listing, it has recorded a return of 3.9% per annum in ringgit terms (8.5% in US dollar[1] terms), placing it among the three best-performing single domestic market funds under the ABF2 umbrella while achieving unit growth of 13%. For 2006, the fund achieved a ringgit return of 4.6% (12.2% in US dollar terms). The number of ABF Malaysia units traded on Bursa Malaysia has been low mainly due to conservative buy-and-hold investors. However, the situation is expected to improve as the domestic market matures and becomes more liquid.

[1] These are total returns which include redistributed regular periodic income, capital gains from any rise in unit price and foreign exchange translation gains, if any, into US dollars.

downgrades thus did not affect the overall market sentiments.

Equity Markets

Despite a cautious start to the year, and notwithstanding some distinct periods of volatility, the Malaysian equity market ended 2006 on a significantly positive note. Among the factors that contributed to the better performance were renewed foreign inflows into the equity markets, strong corporate earnings, corporate mergers and acquisitions and expectation-driven sentiments following the announcement of the Ninth Malaysia Plan (9MP) infrastructure projects.

Driven by positive macroeconomic fundamentals and foreign investor interest, local equity markets performed well in 2006

After the relatively weak performance in 2005, the KLCI ended 2006 at 1,096.24 points or 21.8% higher compared to end-2005. Although the benchmark index closed the year at its highest level since 1996, the Malaysian market lagged the other regional markets. The KLCI's performance was weak in the first half of the year but posted stronger gains in second half of the year as foreign investors' interests in the market increased.

There was also significant difference in the performance of the three major domestic indices, with the small-capitalisation MESDAQ recording a better performance relative to the Kuala Lumpur Main Board. On a sectoral basis, the construction and plantation sectors were the strongest performers, each posting gains of 57.5% and 54.2% respectively, for the year.

The KLCI started 2007 on a positive note, supported by inflows of non-resident funds driven by expectations of stronger domestic economic growth, favourable corporate earnings, and stable inflation outlook. The KLCI reached a high of 1,283.47 points on 23 February before the correction at the end of February and early March. As at 7 March 2007, the KLCI stood at 1,156.58 points or 5.50% higher compared to end-2006.

Capital flows into the equity market were important in explaining the KLCI's performance in 2006. The nature of capital flows into the equity market differed significantly between the two halves of the year. Despite the weak inflows