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Steering Through Volatility: Enhancing Market Efficiency to Preserve Financial Market Stability

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HIGHLIGHTS

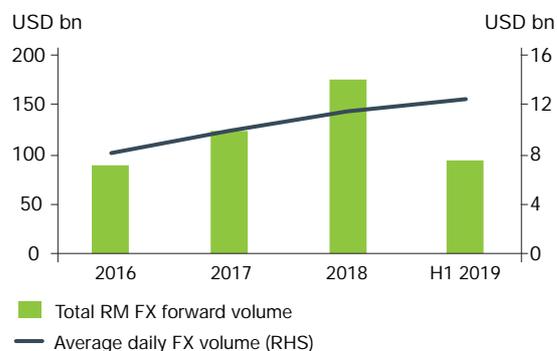
- A deep and liquid financial market is fundamental to preserve market stability.
- The Bank is committed to enhance market liquidity, risk management capabilities and transparency in order to strengthen the role of financial markets in supporting economic activity.
- Financial market development to enhance access to the onshore market reflect current priorities based on the nation's state of development.

Malaysia's deep financial markets continue to facilitate efficient allocation of resources in order to support economic growth

The deepening of Malaysia's financial markets has played an important role in the nation's economic development, helping businesses fund investments and manage risks with improved access and efficiency. This in turn has supported the continuous restructuring of the economy, from trade-oriented industrialisation in the past, to the diversification into services and innovation-based industries, and digitalisation of the economy moving forward.

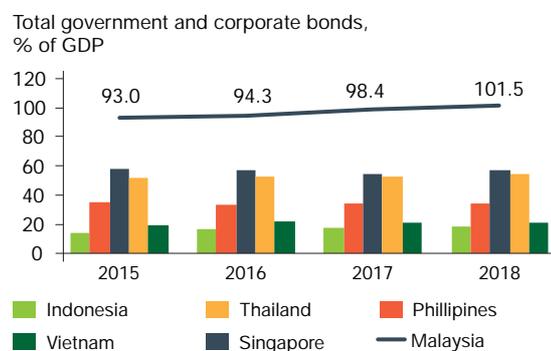
Today, Malaysia has one of the largest bond markets in the region along with an active foreign exchange market. Daily foreign exchange (FX) volumes have increased to more than USD12 billion from an average of USD8 billion daily in 2016, with the annual forward market volume doubling to a peak of USD175 billion since 2016. The capitalisation of the equity markets has grown twofold since 2009, with new markets such as ACE and LEAP¹ for young and growing firms gaining greater traction. Importantly, risks associated with greater access by Malaysian businesses to global sources of funding continue to be mitigated through prudential measures, strengthened surveillance of capital flows and strong domestic institutional investors.

Malaysia's onshore FX market continues to grow in support of economic growth



Source: Bank Negara Malaysia

Malaysia's bond market is the largest in Southeast Asia



Source: Asian Bonds Online

¹ LEAP, or Leading Entrepreneur Accelerator Platform was established by Bursa Malaysia in 2017 as a complementary marketplace for small and medium enterprises.

Market development initiatives aim to further enhance market access and liquidity, while containing risks to stability

Recognising the importance of well-developed financial markets to economic growth and performance, measures continue to be taken to further enhance access, liquidity and efficiency of Malaysia's financial markets. A well-defined legal framework, robust market infrastructure and sound macroeconomic fundamentals remain key to Malaysia's attractiveness to investors. Current priorities of the Bank to further enhance market accessibility and liquidity include:

<p>Increase repo market liquidity and flexibility</p>	<ul style="list-style-type: none"> • Bank Negara Malaysia will further increase the availability of off-the-run bonds to be borrowed via repo for market-making activities. • The repo guidelines will be reviewed accordingly to extend the repo tenor beyond one year, among other enhancements.
<p>Enhancement to the MGS futures market</p>	<ul style="list-style-type: none"> • To further develop an effective hedging platform for investors, Bank Negara Malaysia, in collaboration with Securities Commission Malaysia, Bursa Malaysia and key market players will further enhance the delivery mechanism for MGS futures settlements.
<p>Expand participation in dynamic hedging programme</p>	<ul style="list-style-type: none"> • Trust banks and global custodians can now apply under the dynamic hedging programme (introduced in December 2016) to undertake dynamic hedging on behalf of their clients.
<p>Greater dynamic hedging flexibility to manage FX risks</p>	<ul style="list-style-type: none"> • Registered institutional investors can enter into forward contracts to buy ringgit beyond 25% of underlying assets upon approval by Bank Negara Malaysia. • Applications can be submitted to investorregister@bnm.gov.my
<p>Simplified FX trade and documentation process</p>	<ul style="list-style-type: none"> • Standard documentation guides for FX transactions have been developed by the industry to ease investor's accessibility to the onshore FX market.
<p>Improve ringgit liquidity beyond local trading hours</p>	<ul style="list-style-type: none"> • Bank Negara Malaysia will continue to facilitate the market-making capacity of AOOs to ensure sufficient access to two-way ringgit prices.

As an open economy with an internationally integrated financial system, Malaysia is exposed to contagion risks that can arise from external developments, including those associated with rising geopolitical tensions and unexpected economic uncertainty. The heightened and prolonged financial market volatility can undermine the effectiveness of monetary policy and amplify risks in the economy. Against this backdrop, the Bank remains committed to improving the breadth and depth of onshore financial markets while preserving orderly market conditions. Two key developments have supported the ability of the market to meet the diverse needs of firms and investors for access to financial products with differing risk, return and maturity profiles:

(i) Appointed Overseas Office as a gateway to invest in Malaysia

While ringgit exchange rates are market determined, the spillover impact from speculative and unregulated offshore FX markets can severely destabilise the real economy. Recognising the need to maintain accessibility while mitigating these risks, Malaysia introduced the Appointed Overseas Office²

² A licensed onshore bank is allowed to appoint its overseas branches to facilitate the settlement of ringgit assets for non-resident investors with firm underlying investment commitment. The AOO framework is intended to provide additional flexibilities on ringgit transactions where a non-resident financial institution appointed by a licensed onshore bank can undertake back-to-back transactions to facilitate settlement of trade and ringgit assets between non-resident with a resident.

(AOO) framework in 2007 to maintain connectivity with the global network of investors and bridge geographical and timezone differences.

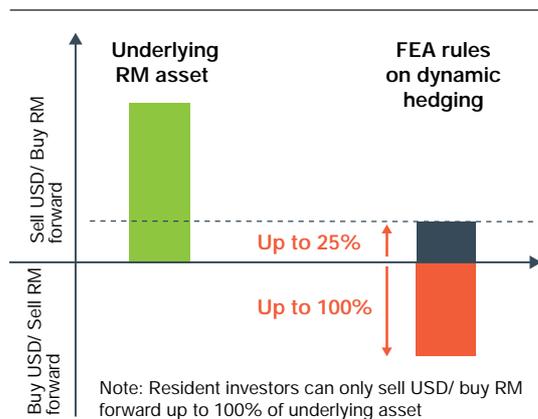
The AOOs function as a gateway for international entities such as corporates, financial institutions and investors to conduct trade and investment activities, thereby maintaining efficient access by foreign investors to Malaysia. The AOO framework works to harness greater synergies between onshore and offshore banking institutions to respond to the needs and preferences of investors and businesses. To meet demand from market participants, the AOO framework was expanded in 2016 to include additional transaction capabilities such as the facilitation of foreign exchange hedging for own account and on behalf of clients for current and financial accounts, opening of ringgit accounts and extension of ringgit trade financing facilities.

The AOO network has continued to gain prominence, with more than 150 AOOs from 21 banking groups operating in 36 countries to-date. The Bank is currently looking to further enhance and facilitate AOOs’ ringgit market-making capacity beyond local trading hours through increased flexibilities for transactions among trading parties.

(ii) Dynamic hedging programme aids risk management

In times of market stress, one-sided capital flows arising from herd behaviour by investors homogeneously managing risks can be highly disruptive. To facilitate two-way liquidity for currency hedging in the onshore market, the dynamic hedging programme introduced in 2016 provides market access for institutional investors to actively manage FX exposures of their invested assets in a transparent and orderly manner. Under the programme, flexibilities are provided for investors to undertake forward hedging upon registration³ with the Bank without the need for documentation.

Illustration of dynamic hedging programme



Source: Bank Negara Malaysia

The dynamic hedging programme is supported by onshore banks and the AOO network, thus enabling access by both domestic and foreign investors to a broader suite of risk management products and avenues. As at end of the second quarter of 2019, 89 investors (72 non-residents; 17 residents) were registered under the programme with RM128 billion of assets under management. In May 2019, the programme was further expanded to include trust banks and global custodians that undertake dynamic hedging on behalf of their clients.

Continuous expansion in market data further supports informed investment decisions

Since 2018, resident and non-resident investors conduct transactions and settlements through segregated securities accounts in the Real-time Electronic Transfer of Funds and Securities System (RENTAS). The segregation of securities accounts enables all securities transactions to be settled in RENTAS in a transparent manner, allowing for better information flows on the composition of investors in Malaysia. Information such as investor categories aligned with international standards and flows in

³ A non-resident institutional investor registered with the Bank is allowed to: (i) Enter into forward contracts to sell ringgit up to 100% of invested underlying ringgit asset; (ii) Enter into forward contracts to buy additional ringgit up to 25% of invested underlying ringgit asset, or higher with the approval of BNM; or (iii) Unwind the forward contracts described in (i) and (ii) above.

the government bond market for both non-resident and resident investors have been made available on the Bond Info Hub website⁴ and the Quarterly Bulletin. The operationalisation of the segregated securities account leverages on the use of the global legal entity identifier (LEI) system, thereby also facilitating Malaysia's compliance with global standards to improve the identification and management of financial risks within and across counterparties and jurisdictions.

Financial market development initiatives are part of the broader economic strategy to ensure the sustainability of Malaysia's economic development

Amid a global landscape characterised by elevated volatility and heightened uncertainties, Malaysia's flexible exchange rate policy combined with the increasing sophistication of its financial market serve to buffer the impact of external shocks and mitigate risks from excessive volatility to the real economy. The Bank continues to take a forward-looking approach in strengthening the resilience of the onshore financial market, while continuing to improve market access and efficiency for both domestic and foreign investors. A flexible exchange rate will continue to be the key source of strength for Malaysia in managing capital flow volatility, with sound market infrastructure and accommodative policy initiatives serving as pillars to secure an attractive financial marketplace for trade and investments in Malaysia.

⁴ <http://bondinfo.bnm.gov.my/portal/server.pt>