

CREDIT RISK

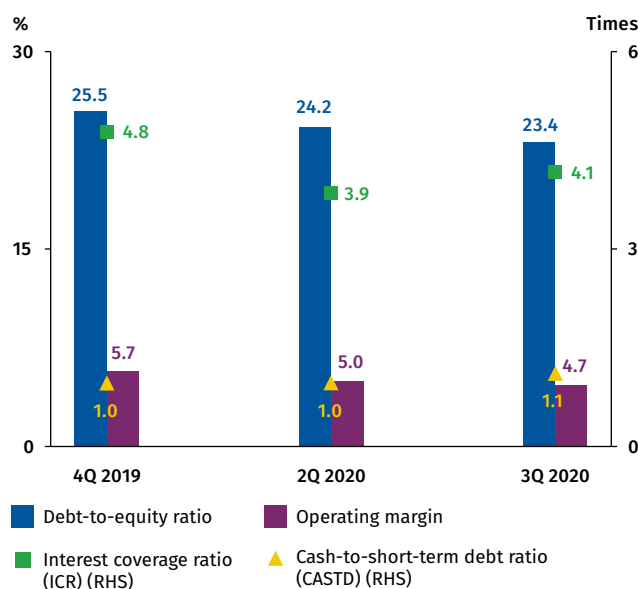
Overall business sector remains resilient despite operational disruptions, but several sectors face challenging outlook

The second half of 2020 saw some recovery in the operating environment for businesses, as movement restrictions gradually eased in most parts of the country. Compared to the halt in economic activity across most business sectors in the first half of 2020, the containment measures implemented in the second half were less restrictive and more targeted. The recovery nevertheless has been uneven across different business sectors. There have been sustained improvements in the manufacturing sector. Consumer-related sectors such as wholesale and retail trade, and hotels and restaurants, which accounted for 7.5% of total banking system loans, benefitted from relaxations in domestic movement restrictions in the second half of 2020, but experienced a relatively slower recovery amid continued weakness in consumer sentiment. Business closures and retrenchments in tourism-related industries² increased, as some firms in these segments incurred heavy losses and faced prospects of prolonged weakness in demand. Exposures in these industries remained small at 2.5% of total banking system loans. In the oil and gas sector,³ while oil prices have increased amid continued volatility in oil demand, a full recovery of the sector's activity to pre-pandemic levels remains dependent on the pace of global economic recovery.

The financial performance of businesses⁴ has been affected by these developments, compelling many to undertake operational and financial adjustments. Amid declining profitability, listed corporates responded to cashflow stresses by reducing expenses and increasing holdings of liquid buffers,

with the median cash-to-short-term debt ratio (CASTD)⁵ rising to 1.1 times (2Q 2020: 1 time). There was also some deleveraging observed among firms, notably in the manufacturing and most services sub-sectors. As a result, the median interest coverage ratio (ICR)⁶ improved to 4.1 times (2Q 2020: 3.9 times) (Chart 1.5). The share of firms-at-risk⁷ moderated slightly to 31.8% of listed corporates, but remains at an elevated level (2Q 2020: 32.9%; 5-year average: 21.7%). These improvements, however, masked the uneven impact of the crisis on different business sectors. Companies in more severely hit industries have seen financial buffers depleting amid sharp contractions in revenue. In the hotels and restaurants segment⁸ for example, the median CASTD and ICR have declined significantly since the onset of the crisis, to 0.5 times and 0.3 times (4Q 2019: 0.7 times and 2.5 times), respectively. Companies in these sectors, and those entering the crisis from a highly leveraged position are more likely to face defaults and insolvencies if economic conditions remain weaker for longer (refer to the Information Box on 'Debt Resolution Mechanisms for Viable Businesses Facing Temporary Financial Distress').

Chart 1.5: Business Sector – Key Financial Performance Indicators



Note: Prudent thresholds for ICR and CASTD are two times and one time, respectively

Source: S&P Capital IQ and Bank Negara Malaysia estimates

² The tourism-related sector includes companies in the following services sectors: airlines, land transport, hotels and restaurants, entertainment and theme parks, medical tourism, and travel agents.

³ Accounted for 0.3% of total banking system loans.

⁴ The assessment on financial performance of listed corporates is as at the end of third quarter of 2020. On 17 February 2021, the Securities Commission Malaysia and Bursa Malaysia Berhad announced additional temporary relief measures, including an automatic one-month extension to issue quarterly and annual reports for companies in the Main and ACE Markets, as well as semi-annual and annual audited financial statements for companies in the LEAP Market, which were initially due on 28 February, 31 March, and 30 April 2021, respectively.

⁵ Prudent threshold for CASTD is one time.

⁶ Prudent threshold for ICR is two times.

⁷ Firms-at-risk are defined as listed non-financial corporates with ICR below the prudent threshold of two times.

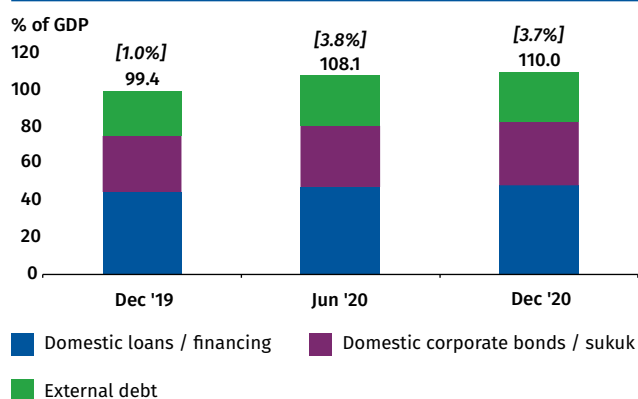
⁸ Accounted for 1.1% of total banking system loans.

While the impact of the health crisis has been felt across the business sector, small and medium enterprises (SMEs) were disproportionately impacted given their limited financial buffers and generally narrower profit margins. Surveys conducted throughout 2020 revealed that SMEs were less optimistic on survival prospects for their businesses through a prolonged pandemic, and were more constrained in their ability to re-engineer their businesses compared to larger firms (due to pre-existing limitations in financial and human capital and slower adoption of new technologies). Banks and development financial institutions have continued to provide repayment assistance to SMEs to weather protracted challenges in the economic environment. This was further augmented by the considerable support from the Government and the Bank, including targeted financing facilities and funds to alleviate cashflow constraints as well as facilitate capital investments in automation and digitalisation. Together with the gradual resumption of economic activities in the second half of 2020, these measures helped SMEs sustain financing repayments, with aggregate repayments by SMEs on existing and new loans returning to near pre-pandemic levels by the end of the automatic loan moratorium in September 2020. Additional relief measures introduced in the 2021 Budget, and PERMAI and PEMERKASA assistance packages are also expected to provide further support to SMEs going forward.

Business loan⁹ growth moderated in the second half of 2020 (0.9%; 1H 2020: 3.9%) as firms remained cautious of increasing their leverage amid the uneven recovery in business conditions. Banks also remained somewhat cautious in meeting demand for new credit in some borrower segments amid an uncertain macroeconomic outlook and lower visibility on debt-servicing capacity due to loan deferment programmes. In contrast, net non-financial corporate bond issuances have risen compared to the first half of 2020, as stronger large corporates took advantage of cheaper funding rates following successive Overnight Policy Rate (OPR) cuts to refinance debt and build cash buffers. Non-financial corporate sector external debt increased by 5.1%, driven by additional borrowings by manufacturers in the renewable energy and electrical and electronics (E&E) sectors, which remain relatively insulated from operational disruptions posed by the

reinstatement of movement restrictions in the second half of 2020. Among SMEs, which collectively account for 15.8% of total banking system loans, demand for financing remained relatively firm, with close to 162,000 loan applications received by banks in the second half of 2020 compared to an average of 123,500 in the same period between 2017 and 2019. However, amounts borrowed by SMEs were notably lower, with the average size of new working capital loan applications among SMEs up to 40% lower than prior to the onset of the pandemic. Overall, non-financial corporate debt-to-GDP ratio rose to 110%, attributable mainly to the weaker GDP in 2020 (Chart 1.6).

Chart 1.6: Business Sector – Non-financial Corporate Debt-to-GDP Ratio and Aggregate Debt Annual Growth Rate



[...] refers to aggregate non-financial corporate debt annual growth rate

Source: Bank Negara Malaysia

To assist businesses through this challenging period, financing support remains available to eligible and viable businesses through schemes such as the Danajamin PRIHATIN Guarantee Scheme (DPGS), and credit guarantees by Credit Guarantee Corporation Malaysia Berhad (CGC) and Syarikat Jaminan Pembiayaan Perniagaan Berhad (SJPP). The Bank has also allocated funds to manage the impact on industries hardest hit by the containment measures, via the PENJANA Tourism Financing (PTF) and Targeted Relief and Recovery Facility (TRRF), as well as to facilitate innovation and capital investments through the High Tech Facility – National Investment Aspirations (HTF-NIA). These funds, along with the Special Relief Facility which was allocated in the first half of the year, have augmented bank credit flows to businesses in an environment of higher risk aversion (refer to the Information Box on ‘Insights from Surveys on Credit Conditions’).

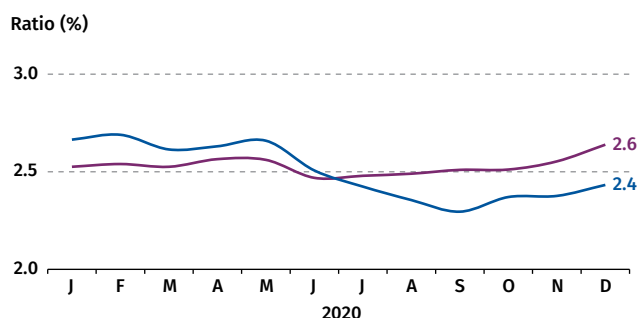
⁹ Refers to both loans and financing, unless otherwise stated.

The repayment assistance extended by banks has so far contained any notable increase in defaults, with the overall business loan impairment ratio at 2.6% (Chart 1.7). Downgrades in domestically-rated corporate bonds and sukuk were also limited (2020: 7; 2019: 7), reflecting the relatively stronger financials¹⁰ of corporates that tap the domestic bond market.

Risks from selected business sectors remain elevated, but banks are well-buffered to withstand potential credit losses

However, leading indicators from banks are pointing to expectations of continued weakness in business conditions in the period ahead. The share of business loans with increased credit risks¹¹ reported by banks increased further as at December 2020 (15.7%; June 2020: 14.1%) particularly for firms in sectors highly exposed to the pandemic. Businesses under repayment assistance plans have also increased, driven by SMEs after the end of the automatic loan moratorium, although the share of total business loan accounts remained modest (9.7% as

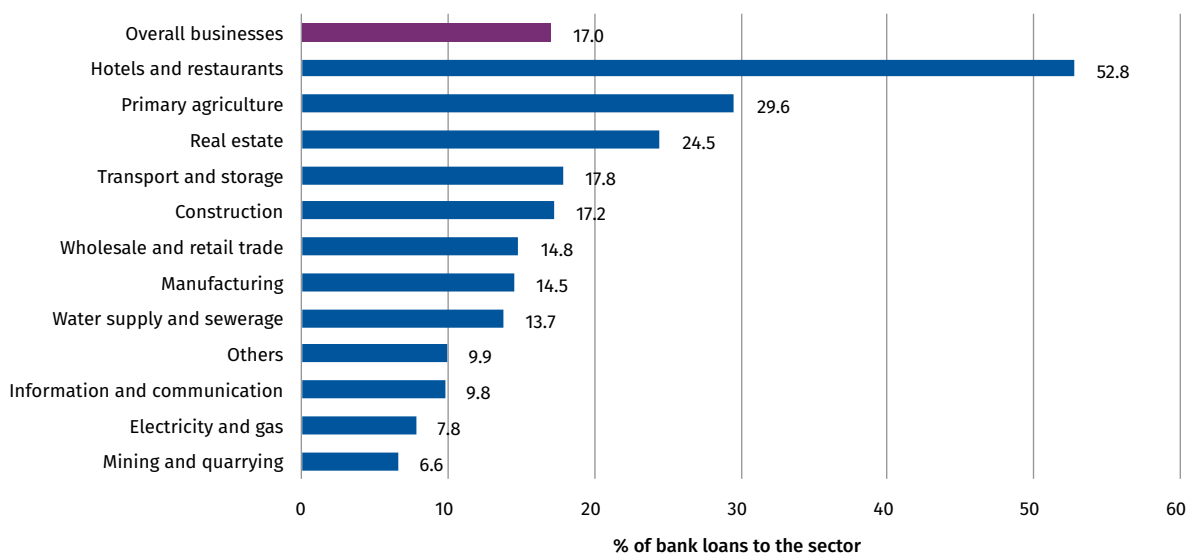
Chart 1.7: Business Sector – Gross Impaired Loans



Source: Bank Negara Malaysia

of December 2020). This indicates that the majority of borrowers are able to keep up with their loan repayments as their businesses recover. While the bulk of firms benefitting from repayment assistance are SMEs (accounting for 90% of total loan accounts approved for rescheduling and restructuring (R&R)), a sizeable share of non-SMEs operating within COVID-19-affected sectors have also sought R&R to manage their obligations. In value terms, total business loans under repayment assistance accounted for 17% of total business loans (Chart 1.8).

Chart 1.8: Business Sector – Share of R&R Loans by Sector



Source: Bank Negara Malaysia

¹⁰ Over 90% of outstanding rated bonds are rated AA and above, signalling strong ability to service payments on a timely basis.

¹¹ Classified as Stage 2 loans under the Malaysian Financial Reporting Standard 9 (MFRS 9).

The resurgence of COVID-19 cases in early 2021 has temporarily set some businesses back, with firms in certain sectors revising earlier expectations of an improvement in operating conditions in 2021. While the outlook for these sectors is expected to remain highly challenging, the recent easing of containment measures, vaccine roll-out, and continued repayment assistance support from banks are expected to temper any material

increase in risky loans. Improvements in the global and domestic economy should further support debt-servicing capacity, amid more targeted policy support going forward. Banks remain well-buffered against an expected increase in credit losses from the business sector, supported by pre-emptive provisions built up in 2020 (refer to the Chapter on 'Financial Institution Soundness and Resilience' for further details).

Insights from Surveys on Credit Conditions

This information box examines the credit conditions for businesses in 2020 and the outlook for 2021 amid rising credit risks and higher loan losses experienced by banks. It draws detailed insights from supply¹² and demand-side¹³ surveys conducted by the Bank in the fourth quarter of 2020.

Banks' capacity to lend remains sound, but risk appetite turned cautious

In aggregate, preliminary lending targets for 2021 across banks suggest that the banking system will be more than able to support credit demand consistent with the projected GDP growth. This is underpinned by the ability of banks to lend, given strong capital, funding and liquidity buffers. However, heightened credit risks and rising impairments and other related costs are increasing risk aversion and could affect specific lending decisions by banks. Given the highly uncertain economic outlook and its dependency on the progress of vaccinations and evolution of the virus, banks are taking a more cautious approach in meeting demand for new credit. Heightened repayment risks and an uncertain macroeconomic outlook remain key factors that could weigh on credit conditions in 2021.

Banks surveyed indicated that credit conditions could tighten a little more for corporate borrowers, while conditions are expected to ease for SMEs in the first half of 2021 compared to conditions in 2020 (Chart 1.9). This mainly reflects the larger loan sizes and typically unsecured nature of larger corporate loans. Conversely, SME loans are generally smaller in size, secured by collateral and continue to receive material support from various government measures.

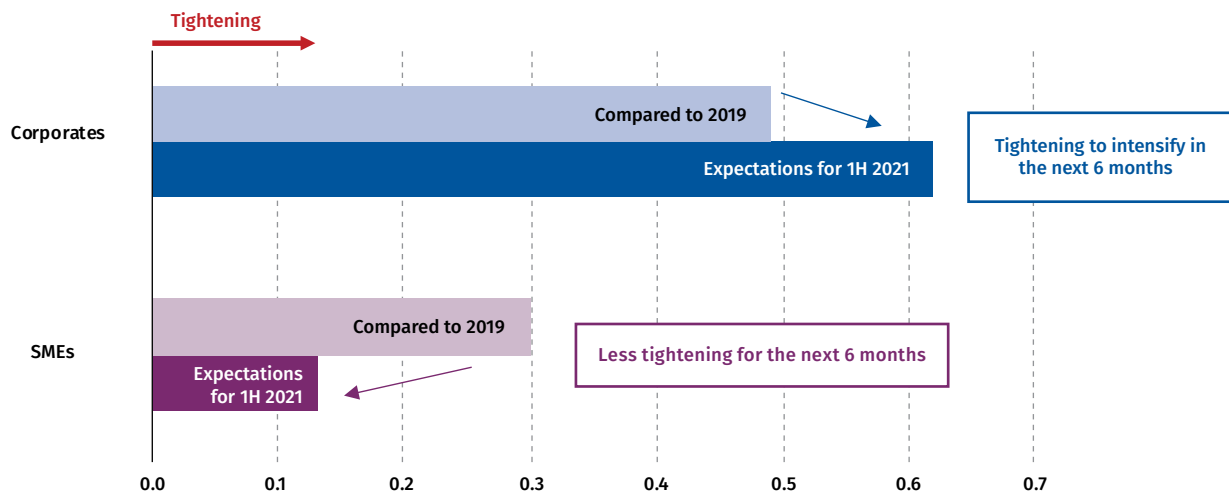
The more cautious bank risk appetite was also consistent with businesses' perception of financing conditions. Following the partial resumption of economic activity in May 2020 after movement restrictions were eased, businesses indicated an improvement in their demand for bank financing, but had lower perceived availability of bank financing. This resulted in a larger financing gap¹⁴ observed over the past six months. Smaller businesses were the most affected by this financing gap. Approximately 32% of SMEs indicated that the financing gap deteriorated. Larger businesses fared better, with 82% reporting either an unchanged or a decreased financing gap (Chart 1.10). Despite the greater tightening indicated by banks for non-SMEs, the more favourable credit conditions perceived by non-SMEs could be due to their more established relationship with banks, allowing for more bespoke negotiations for loans. Larger businesses can also rely on more diverse sources of financing such as capital markets and internal funds. Taken together, non-SMEs may therefore have lower perceived constraints when it comes to the availability of financing.

¹² The Credit Conditions Survey to Banks (4Q 2020) surveyed 17 banks, comprising domestic banking groups, locally-incorporated foreign banks and development financial institutions.

¹³ The BNM Survey on Firms' Access to Financing 2020 surveyed around 2,000 businesses comprising micro, small, medium and large businesses.

¹⁴ The change in financing gap is defined as the difference between the change in firms' demand for, and the change in perceived availability of bank financing. An increase in financing gap would be represented by an increase in the demand for bank financing and/or a decrease in the perceived availability of bank financing.

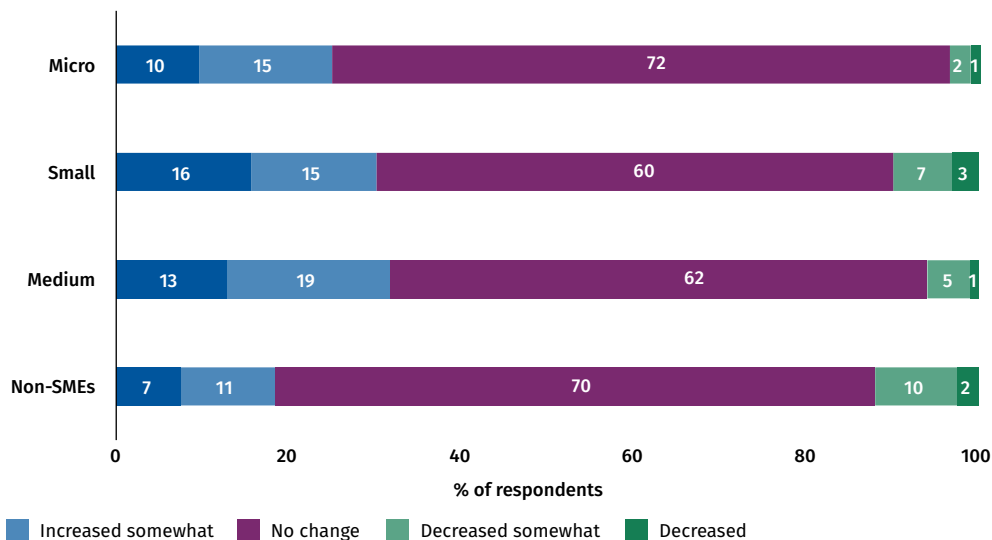
Chart 1.9: Banks' Expectations for Changes in Credit Supply Conditions by Size of Firms



Note: Weighted responses of banks surveyed. Scores are derived on a net basis, i.e. two banks with the same degree of easing and tightening will offset each other based on their share of loans. Scale: Ease significantly (-2); Ease somewhat (-1); Neutral (0); Tighten somewhat (+1); Tighten significantly (+2)

Source: Credit Conditions Survey to Banks (4Q 2020)

Chart 1.10: Firms' Demand for Bank Financing vs Perceived Availability for Bank Financing, 2H 2020

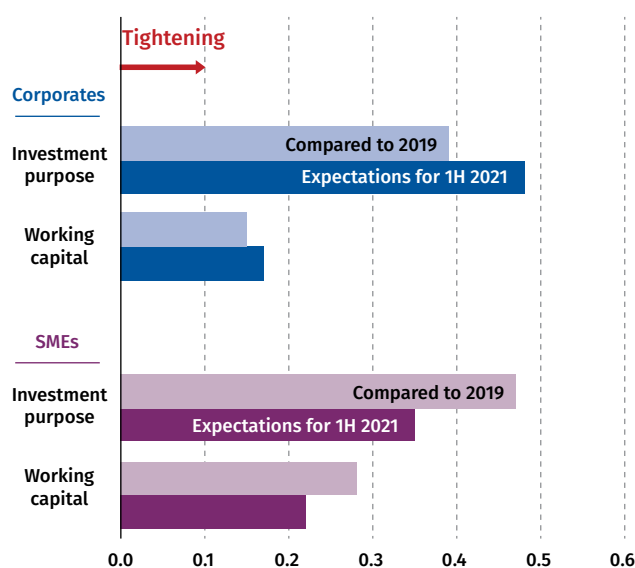


Note: Chart represents the difference between individual respondents' responses to their demand for bank financing and the perceived availability of bank financing in the last 6 months of 2020 on a scale of 'Decreased', 'Unchanged' and 'Increased'. An increase in financing gap would be represented by an increase in the demand for bank financing and/or a decrease in the perceived availability of bank financing

Source: BNM Survey on Firms' Access to Financing 2020

Consistent with higher concerns over repayment risks, supply of credit is likely to be more forthcoming for working capital financing which have shorter tenures compared to financing for investments and capital expenditure (Chart 1.11). This is generally aligned with the financing needs of businesses surveyed, which also indicated greater demand for working capital compared to capital expenditure financing over the first six months of 2021 (Chart 1.12). Looking further ahead, a pick-up in demand for investment financing is expected. Banks have the capacity to meet this demand growth, which would be more rooted in the improving strength and pace of economic recovery.

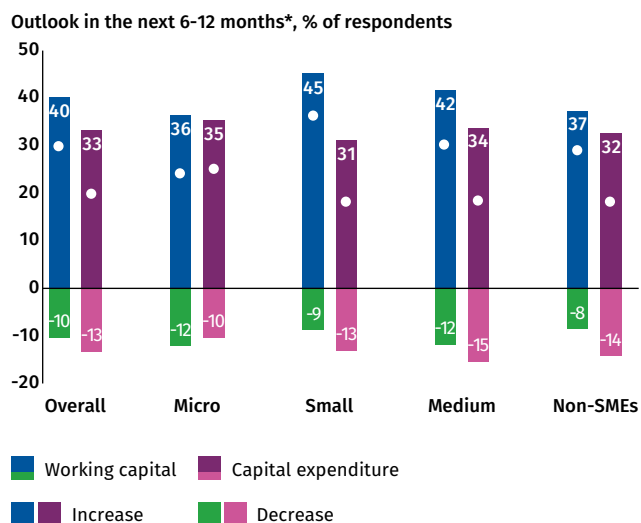
Chart 1.11: Banks' Expectations for Changes in Credit Supply Conditions by Financing Purpose



Note: Weighted responses of banks surveyed. Scores are derived on a net basis, i.e. two banks with the same degree of easing and tightening will offset each other based on their share of loans. Scale: Ease significantly (-2); Ease somewhat (-1); Neutral (0); Tighten somewhat (+1); Tighten significantly (+2)

Source: Credit Conditions Survey to Banks (4Q 2020)

Chart 1.12: Firms' Expectations for Changes in Demand for Financing by Financing Purpose



* Respondents were asked on their expected demand for working capital and capital expenditure financing in the next 6-12 months on a scale of 'Decrease', 'Unchanged' and 'Increase'. Respondents who responded 'Unchanged' or 'Not applicable' were not included in this chart. The net figure (in dots) is the difference between the percentage of respondents who responded with 'Increase' and 'Decrease' for each financing allocation category

Source: BNM Survey on Firms' Access to Financing 2020

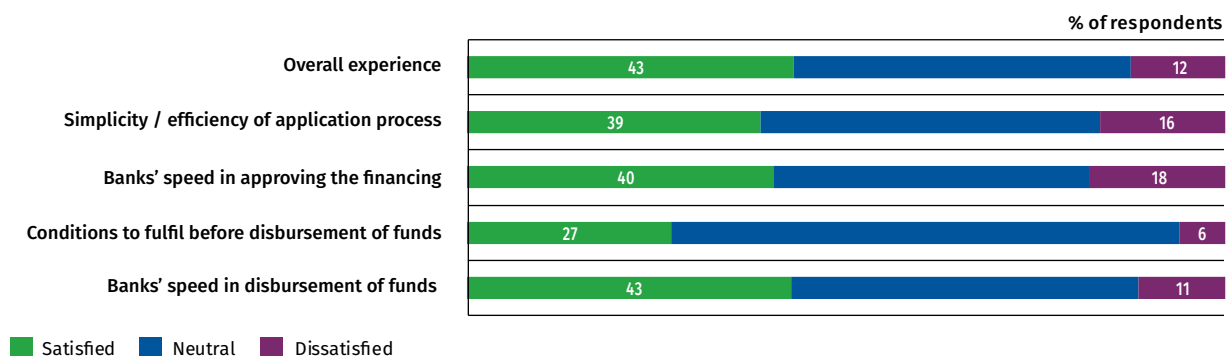
The cumulative reductions of 125 bps of the OPR in 2020 have also reduced banks' internal hurdle rates¹⁵ and helped stabilise financing rates. However, stiff competition for customers over the years have led to aggressive pricing and narrowing profitability. While banks generally maintain effective lending rates that are above hurdle rates, a significant increase in loan losses may erode profit buffers and affect the pricing for and supply of credit, especially to higher-risk segments.

In the nearer term, non-price tightening measures were expected to be more pervasive among the surveyed banks. These include tighter credit scoring criteria, more stringent collateral requirements, imposition of loan covenants and maximum loan size limits. More extensive background checks and more proactive actions, such as the use of alternative information sources, as well as more frequent engagements were also conducted with business borrowers to better assess their financial and operating conditions. These measures do not appear to have materially increased difficulties for borrowers, with 88% of businesses reporting either positive or neutral feedback on bank processes (Chart 1.13). Positive experiences were generally linked to process improvements that alleviated hardship and practical difficulties faced by borrowers during the MCO, which had helped expedite credit approvals and disbursements despite the challenging operating conditions.¹⁶ These process improvements include the increasing use of online processes and template financing to facilitate guarantor approvals, the conduct of virtual site visits and flexibilities on certain conditions precedent for loan disbursements.

¹⁵ Hurdle rate refers to the risk-adjusted breakeven point in pricing where banks' income from giving out a loan is sufficient to cover expected credit losses, associated funding costs and overhead costs.

¹⁶ Corroborated by the Credit Conditions Survey to Banks (4Q 2020).

Chart 1.13: Firms' Opinion on Banking Processes



Source: BNM Survey on Firms' Access to Financing 2020

Measures introduced to address risks to financial stability

Adjustments observed to the risk appetite of banks are expected and prudent given the current environment. However, excessive risk aversion may also pose risks to financial stability. Policy responses during this crisis have therefore been aimed at supporting credit flows to the economy, in particular for viable borrowers and segments that are more likely to be disproportionately impacted by more cautious bank lending behaviour. The series of policy measures introduced has and will continue to lend support to intermediation activities in the current environment of heightened credit risks. First, financing conditions have remained conducive on the back of continued accommodative monetary policy. Second, Targeted Repayment Assistance programmes with flexible repayment options continue to be made available to borrowers who need them. Third, the extension of regulatory flexibilities serves to expand the financial and operational capacity of banks to support existing and new borrowers. Fourth, the various financing facilities under BNM's Fund for SMEs, and the credit guarantee schemes for both SMEs and corporates have supported the continued flow of credit to viable businesses amid higher credit risk aversion.

Having entered this crisis with strong capital and liquidity positions, the banking industry continues to be well-placed to facilitate credit flows to the economy. Micro lending decisions by banks can, however, produce asymmetric outcomes on businesses affected by the pandemic. As the economic recovery becomes more entrenched, the effects are expected to dissipate and easing in credit conditions will become broader-based.

Debt Resolution Mechanisms for Viable Businesses Facing Temporary Financial Distress

A strong debt resolution framework remains vital to mitigate an insolvency cliff and provide critical support to distressed but viable firms. During periods of crisis, large numbers of such firms could precipitate widespread premature bankruptcy proceedings and hamper economic recovery. Drawing upon experience from the Asian Financial Crisis (AFC), Malaysia has in place well-established out-of-court debt restructuring mechanisms for different business segments. Coupled with court-sanctioned corporate rescue mechanisms, businesses can avail themselves of different platforms that facilitate efficient and effective debt workouts with creditors. These mechanisms collectively aim to:

- Assist balance sheet and cashflow restoration and avert the premature failure of viable borrowers;
- Improve the speed and value of debt recovery; and
- Mitigate potential losses to financial institutions which could adversely affect economic growth and recovery prospects.

The significant impact of COVID-19 on many businesses underscores the important role of these mechanisms which are being further strengthened to enhance their efficacy.

Court-sanctioned Corporate Rescue Mechanisms

Viable businesses that are facing difficulties in servicing their debt obligations can avail themselves of three different court-sanctioned rescue mechanisms under the Companies Act 2016 (CA 2016). The CA 2016 introduced two new rescue mechanisms, namely the Corporate Voluntary Arrangement (CVA) and Judicial Management (JM), in addition to the Scheme of Arrangement (SOA) which has been a widely used rehabilitative tool for businesses (Table 1.1).

More recently, the Companies Commission of Malaysia had issued a consultative document on the Companies (Amendment) Bill 2020, which will widen the coverage of firms that will benefit from these rescue mechanisms while embedding sufficient safeguards¹⁷ against potential abuse. This would be complemented by ongoing efforts to enhance the capacity of the court system in Malaysia to support the effective implementation of these mechanisms. In 2020, the take-up for court-sanctioned rescue mechanisms already registered a notable increase (2020: 53; 2019: 30)¹⁸ as more borrowers sought redress, particularly given lingering uncertainties surrounding the pandemic.

Out-of-court Rescue Mechanisms

The Bank has established two out-of-court debt resolution platforms, namely the Corporate Debt Restructuring Committee (CDRC) and Small Debt Resolution Scheme (SDRS) (Diagram 1.1), which help businesses restructure debt without resorting to lengthy, costly and complex legal proceedings. The out-of-court mechanisms provide greater flexibility in terms of the scope, size and focus of debt workouts to take into account prevailing conditions. In crisis, this can include the ability to adapt processes and resources more quickly to mitigate systemic risks posed by distressed firms. They also help avoid overwhelming the court system, especially during a crisis. These out-of-court platforms, coupled with the increased capacity of banks to manage debt workouts since the AFC, have enabled successful debt restructuring plans for SMEs and corporates.

¹⁷ These safeguards include codifying provisions to, among others, empower the Court to grant automatic moratorium on SOA, allow super priority for rescue financing, introduce cross-class cramdown mechanism and restrain disposition of properties during moratorium.

¹⁸ Up to December 2020 (Source: Companies Commission of Malaysia).

Table 1.1: Court-sanctioned Corporate Rescue Mechanisms

	Corporate Voluntary Arrangement	Judicial Management	Scheme of Arrangement
Establishment date	2016	2016	1965
Process	<ul style="list-style-type: none"> Restructuring is management-driven with minimal court involvement An insolvency practitioner, who may be nominated by the board of directors of the company, will assess the viability of the scheme 	<ul style="list-style-type: none"> The management power of a company will be placed under a court-appointed judicial manager who will prepare a restructuring scheme and manage the borrower's company affairs and property 	<ul style="list-style-type: none"> A court-approved arrangement is made between the company and creditors Upon filing of the application, the court may appoint a liquidator to assess the viability of the scheme proposed for the arrangement
Moratorium	<ul style="list-style-type: none"> Upon lodgement of documents to the court, an automatic moratorium of up to 28 days, which is extendable to a maximum of 60 days, is given 	<ul style="list-style-type: none"> Upon filing of the application, automatic moratorium will be in force for a period of 6 months and, with the approval of the court, may be extended for a further 6 months 	<ul style="list-style-type: none"> Upon application, the court may grant a restraining order for an initial period of 3 months, which may be renewed for a period of up to a further 9 months subject to fulfilment of its pre-statutory requirements
Application eligibility	<ul style="list-style-type: none"> Excludes: <ul style="list-style-type: none"> Public companies Private companies with secured creditors Licensees under the Financial Services Act 2013 (FSA 2013), Islamic Financial Services Act 2013 (IFSA 2013) and Capital Market and Services Act 2007 (CMSA 2007) 	<ul style="list-style-type: none"> Excludes: <ul style="list-style-type: none"> Public companies Licensees under the FSA 2013, IFSA 2013 and CMSA 2007 	<ul style="list-style-type: none"> For all companies
Court supervision	Minimal (for lodgement of corporate voluntary arrangement documents only)	Minimal (for granting of judicial management order only)	Yes

Source: Companies Act 2016

Diagram 1.1: Corporate Debt Restructuring Committee and Small Debt Resolution Scheme

Corporate Debt Restructuring Committee (CDRC)

CDRC was first established in 1998 to facilitate debt workouts during the AFC. It was reactivated in 2009 as an out-of-court platform for viable corporations and their creditors to work out feasible and holistic solutions to resolve debt obligations (i.e. bank borrowings and/or debt securities). Drawing upon the experiences of the London Approach in the United Kingdom, CDRC is guided by principles that ensure the fair treatment of borrowers, while maximising value for financial creditors.

CDRC assists in managing debt workouts of firms that meet the following criteria:

- i. Aggregate indebtedness of RM10 million or more;
- ii. Debt is owed to at least two financial creditors;
- iii. Not in receivership or liquidation, except for those where receivers have been appointed only over certain specified assets and the directors remain in control over the companies' overall operations; and
- iv. Experiencing difficulties in servicing their debt obligations but have not defaulted, provided they meet criteria (i) & (ii).

CDRC has assisted 38 firms to resolve RM14.1 billion in aggregate debt since 2009.

Small Debt Resolution Scheme (SDRS)

SDRS was established in 2003 as a platform for financial institutions and viable SMEs to work out debt rehabilitation solutions without resorting to legal recourse, allowing SMEs to focus on plans to revive their business.

SDRS supports debt workouts for SMEs that meet the following criteria:

- i. SME has business-related financing from participating financial institutions;¹
- ii. Business owner/shareholder(s)/guarantor(s) is not bankrupt; and
- iii. Business is not under advanced legal action i.e. winding-up order obtained, company wound-up, receivers and managers have been appointed/ in receivership, judicial manager has been appointed under judicial management.

In addition, businesses that have ceased operations would also be eligible to apply for SDRS, provided the business owner has other income sources to meet repayment obligations.

SDRS has facilitated debt workouts for more than 1,300 SMEs with total debt amounting to RM2 billion since 2003.

¹ All commercial banks, Islamic banks, and development financial institutions as prescribed under the Development Financial Institution Act 2002

Source: Corporate Debt Restructuring Committee and Credit Counselling and Debt Management Agency

Since CDRC's reactivation in 2009, its admission criteria¹⁹ have been refined several times to help more firms. Meanwhile, SDRS was absorbed into the Credit Counselling and Debt Management Agency (Agensi Kaunseling dan Pengurusan Kredit, AKPK) in September 2020 to foster greater synergy, expand its footprint through AKPK's established online channels and create a one-stop platform that provides holistic debt restructuring as well as financial education and advisory services for individuals and SMEs, including micro entrepreneurs. These changes enable CDRC and SDRS to effectively support the potential increase in firms requiring restructuring assistance, thereby mitigating economic scarring and broader risks to financial stability.

¹⁹ The minimum threshold for aggregate debt was revised from RM100 million to RM30 million in 2010, and subsequently reduced to RM10 million in 2017. The minimum threshold for the number of financial creditors to whom debt is owed was revised from three to two financial creditors in 2010.

The overall household sector has remained resilient throughout the crisis, but some segments are experiencing increased financial stress

The growth in household debt²⁰ normalised to pre-COVID-19 levels in the second half of 2020 as the country emerged from stringent movement control restrictions (Chart 1.14). Growth was mainly driven by car and housing loans, which expanded by 6.1% and 7.4% (June 2020: -0.7% and 7.2%), respectively, lifted

by the strong response to the sales and service tax (SST)²¹ incentives for the purchase of cars and various home ownership incentives. Personal financing also registered higher annual growth of 7.1% (June 2020: 4.4%), partly due to the suspension of repayments during the automatic loan moratorium period. On aggregate, the household debt-to-GDP ratio rose to 93.3% mainly due to GDP remaining below pre-crisis levels (Chart 1.15). A concern over high household debt is that it may lead to a rapid deleveraging by households in the aftermath of a crisis, thus dampening or derailing economic recovery. There has not been significant evidence of this, with new banking system disbursements to households

²⁰ Extended by both banks and non-bank financial institutions.

²¹ Effective 15 June 2020 until 30 June 2021.

reaching 112% of their corresponding levels in the same period last year.²² These disbursements have been mainly extended to middle- and high-income borrowers (71%) who can still afford to take on more loans. Among lower-income borrowers, measures over the years to encourage more responsible borrowing behaviour have partly mitigated more adverse impacts on their finances. Lending continued to be underpinned by sound underwriting standards, with stable overall median debt service ratios (DSR) for outstanding and newly-approved loans of 35% and 43%, respectively.

Recent shocks underscore the importance of households accumulating financial buffers during good times. These buffers allow households to tide over periods of economic displacement, thereby alleviating the impact to consumption and debt serviceability. For the vast majority of household borrowers, financial buffers remain broadly intact. Financial asset growth continued to outpace that of debt, driven by sustained deposit growth and a recovery in unit trust and equity holdings (Chart 1.16). This indicates that in aggregate, households have still managed to grow their financial wealth during this period. Consistent with these trends, in the second half of 2020, repayments by households in the banking system have reached 93% of levels observed in the corresponding period of the previous year,²³ indicating most have resumed repayments.

However, as highlighted by the Bank in past publications, those earning less than RM3,000 monthly remain stretched financially, with low financial buffers and substantially higher leverage²⁴ (Chart 1.17). Borrowers earning less than RM5,000 monthly (Chart 1.18) also appear to be showing some signs of financial stress as observed from the profile of households seeking repayment assistance. These borrowers are likely to face continued challenges in 2021 given an uneven recovery in the labour market. However, banks remain resilient against risks from the household sector, even under scenarios of assumed higher unemployment and underemployment affecting more household borrowers (refer to the Chapter on 'Financial Institution Soundness and Resilience' for a more detailed outlook).

Repayment assistance programmes by banks and government relief measures continued to provide support to households in distress, easing their cashflow constraints as they recover from income shocks and staving off more severe damage to both the financial system and the economy. The ability of banks to offer assistance to households at this unprecedented scale is enabled by their prudent build-up of buffers during good times. Following the end of the automatic moratorium on loan repayments, banks continue to offer more targeted assistance to those in need. As at December 2020, household loans covered under a repayment assistance plan²⁵ amounted to 8.9% of total household loan accounts, or 11.1% of total outstanding household loan exposures. Of these accounts, 59% were under a loan moratorium, of which 54% were made up by borrowers earning less than RM5,000 monthly (Diagram 1.2). While repayment assistance is helping to temporarily support the debt-servicing capacity of borrowers, a recovery in income alongside a more entrenched resumption of economic activities will be key for financially-stretched borrowers to maintain their debt-servicing capacity over the longer term.

Repayment assistance continues to provide support to household borrowers impacted by the pandemic

With Targeted Repayment Assistance measures that have remained in place, household impairments and delinquencies in the banking system only marginally increased after the end of the blanket auto-moratorium (Chart 1.19). Banks have continued to actively engage borrowers, particularly those in the lower-income groups and in more-affected employment sectors, such as hotels, restaurants, transportation, and construction, to provide repayment assistance aligned with borrowers' financial circumstances. Notwithstanding this, the share of household loans in Stage 2 has increased to 7.3% (June 2020: 5.6%), reflecting increased credit risks among household borrowers. Household asset quality is still expected to see some deterioration throughout 2021, but the credit losses materialising are projected to be within banks' buffers.

²² Excludes credit cards. This statistic compares total disbursements in the second half of 2020 to total disbursements in the second half of 2019.

²³ Excludes credit cards.

²⁴ Measured as a ratio of outstanding debt to annual income.

²⁵ Either in the form of a loan repayment moratorium or reduced instalment terms. Figures are based on repayment assistance applications that were approved by banks and subsequently accepted by customers.

Chart 1.14: Household Sector – Annual Growth of Debt

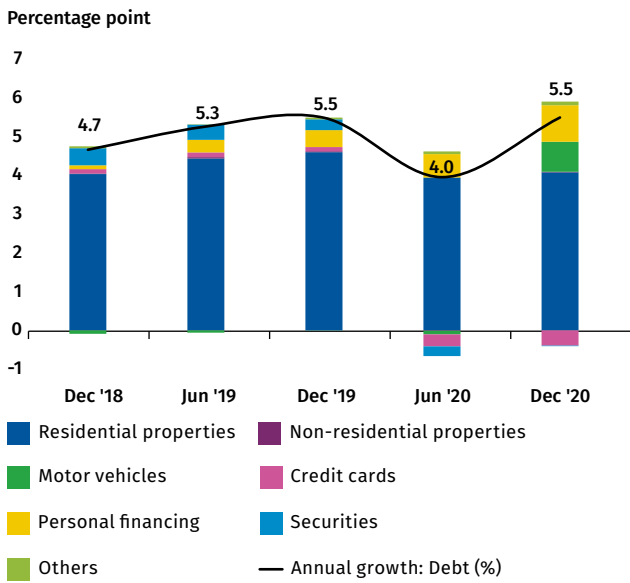


Chart 1.15: Household Sector – Key Ratios

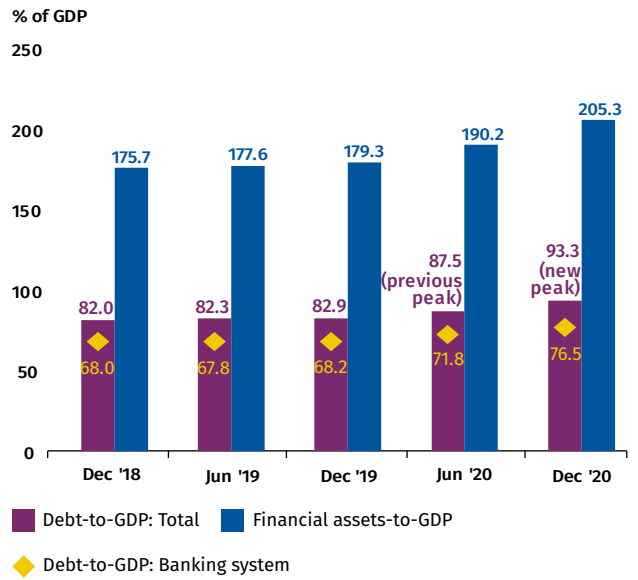


Chart 1.16: Household Sector – Annual Growth of Financial Assets

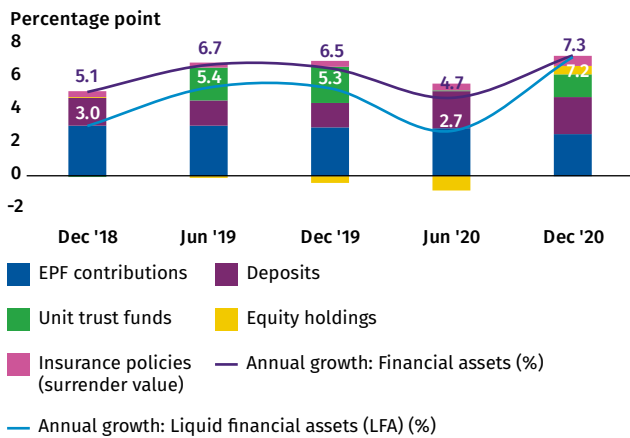


Chart 1.17: Household Sector – Leverage and LFA-to-Debt Ratios

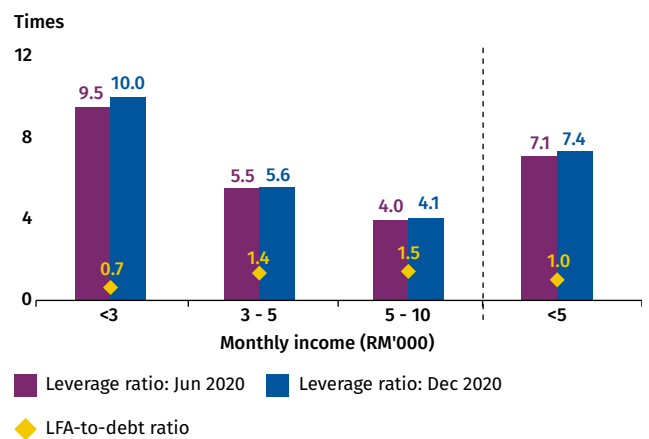


Chart 1.18: Household Sector – Debt by Monthly Income Group

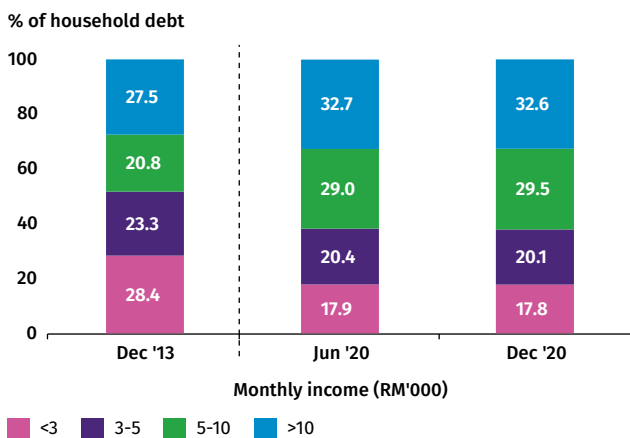
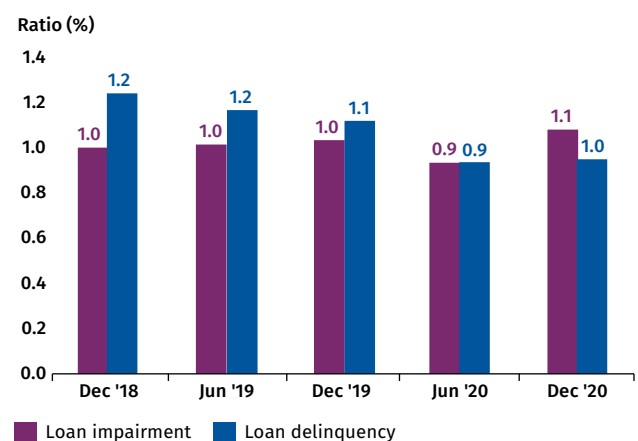
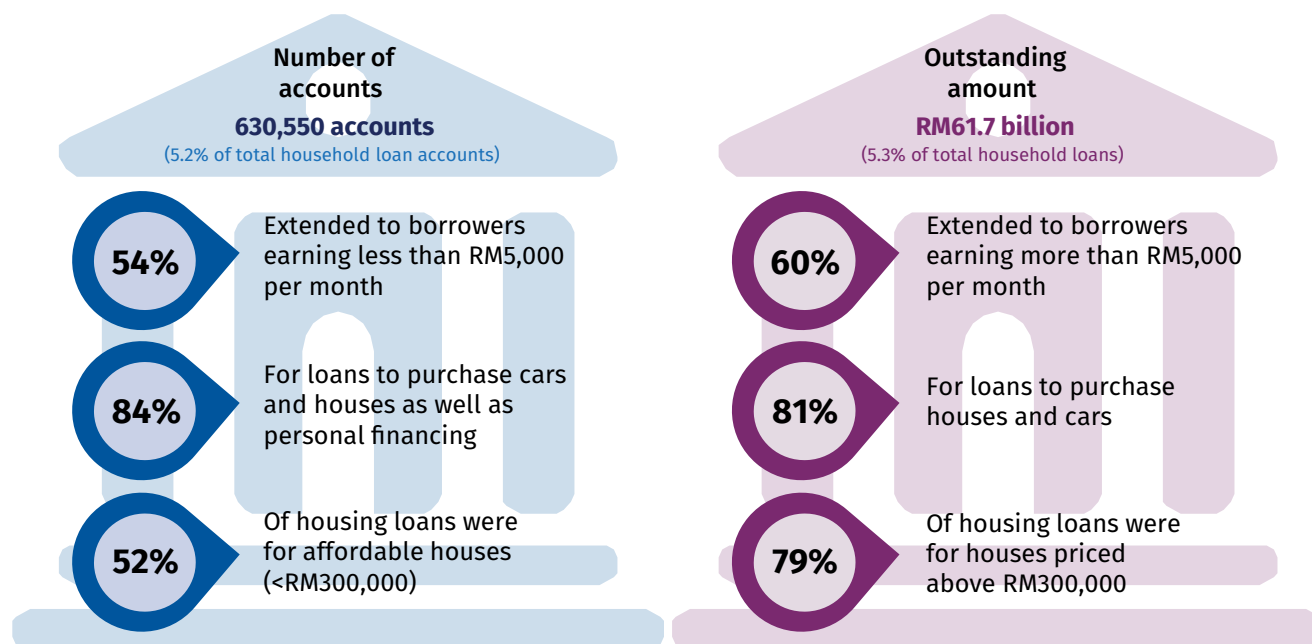


Chart 1.19: Household Sector – Loan Impairment and Delinquency Ratios in the Banking System



Source: Bank Negara Malaysia, Bursa Malaysia Berhad, Department of Statistics, Malaysia, Employees Provident Fund and Securities Commission Malaysia

Diagram 1.2: Household Sector – Profile of Accounts Under Loan Moratorium



Note: Loan moratorium extended by commercial and Islamic banks as well as major development financial institutions

Source: Bank Negara Malaysia

Risks in the property market remained elevated

Activity in the housing market rebounded after hitting a historical low in the second quarter of 2020 (Chart 1.20). Transaction volumes grew at a pace comparable to the average quarterly growth seen before the COVID-19 pandemic. This reflected the positive response to measures introduced by the Government to support demand such as the Home Ownership Campaign and stamp duty exemptions. The low interest rate environment also encouraged purchases for both own occupancy and investment purposes. Demand for financing correspondingly rose in line with market activity, with housing loan application growth picking up across most price segments except for houses priced below RM300,000 (Chart 1.21). Meanwhile, average transaction values recorded a second consecutive quarter of positive annual growth as market activity was more concentrated in the mid- to higher-priced segments, mainly in the secondary market, where buyers are more likely to be those whose incomes have been less affected by the pandemic. This continued to

support the growth in average house prices, as measured by the Malaysian House Price Index (MHPI), although prices increased at a more moderate pace during the third quarter of 2020.

Unsold houses remain at an elevated level, driven by serviced apartments, small office home office (SOHO) units, and houses priced above RM500,000 in less popular locations. Softer housing market conditions are prompting developers to adjust supply towards more affordable housing segments. While overall launches declined significantly across all price segments in the first three quarters of 2020 (24,853 units; 1Q-3Q 2019: 60,955), the decline has been notably sharper for properties priced above RM500,000. As a result, the share of newly-launched properties in this segment fell to 20.5% of overall new launches (1Q-3Q 2019: 31.8%). This is a welcomed adjustment and will help reduce demand-supply mismatches that had worsened housing affordability and increased risks of price corrections in the past. These adjustments also do not appear to have induced a more broad-based decline in house prices in the secondary market, with average transaction prices continuing to rise, as noted earlier, owing to firm demand.

Among household borrowers, household investors²⁶ in the property market are more likely to be influenced by price declines, given their relatively higher incentive to default should they fall into a negative equity position and experience a loss of rental income. Household investors account for about one-fifth of overall banking system loans, but largely comprise higher-income earners (those earning above RM5,000 per month) who typically have stronger debt-servicing capacity. Risks to banks remain well-contained, with the current impairment ratio and share of borrowers in negative equity for household investors at only 0.9% and 1.3%, respectively. The average loan-to-value ratio of outstanding housing loans remained below 60%, substantially mitigating the risk of more borrowers falling into negative equity as well as limiting the potential losses to banks.

The non-residential property segment continued to face considerable challenges. Average hotel occupancies have improved from the all-time low of 11% during the MCO, but remained well below pre-COVID-19 occupancy levels (Chart 1.22), as interstate travel restrictions were reinstated in October 2020 for some states. The outlook for the hospitality industry remains highly dependent on the stringency and duration of interstate and international border restrictions. Restrictions on international travel could take some time to ease despite the roll-out of vaccination programmes globally. Market conditions for hotels are likely to remain modest throughout 2021 amid intense competition for a smaller pool of travellers, higher operational costs due to the imposition of standard operating procedures, and slow recovery in travel demand.

Shopping malls have fared a little better, with some recovery in footfalls especially towards the end of 2020. However, some of the shifts observed in consumer behaviour towards online purchases are likely to persist and will continue to partly weigh on demand for retail space amid pre-existing excess supply. Similarly, some businesses have also begun downsizing office space and sub-leasing unused space as work from home arrangements remain largely in place. Vacancy rates and market rentals

in these segments have deteriorated further (Chart 1.22 and Chart 1.23), with some landlords already reducing their asking rents by up to 15%.²⁷ Adjustments to incoming supply of office and retail space were also observed as some developers deferred the completion date of their projects. So far, the deferred projects have had only a limited impact on overall supply of office and retail space as they account for a relatively small share (12.5% and 9%, respectively) of incoming supply. The planned incoming supply of office and retail space in the Klang Valley over at least the next three years remains large, equivalent to 23% and 58% of the existing stock, respectively. Amid the prevailing oversupply and challenging business conditions, rental and occupancy rates for office and retail space are expected to remain depressed in the period ahead. Taken together, risks of potential losses to financial institutions from prospects of weaker debt-servicing ability and valuations as a result of depressed conditions in the non-residential property market are judged to have increased from the impact of COVID-19.

Banks' exposures to vulnerable property segments have declined, but risks remain, prompting heightened scrutiny

While the property sector remains a significant contributor (52%) to banks' total loans, exposures to the more vulnerable property segments remain low and have declined further in the second half of 2020 (Chart 1.24). The bulk of these exposures also continue to be performing. Nonetheless, a deterioration in the servicing of property construction loans and loans to purchase non-residential property has been observed in the second half of 2020 (Chart 1.25). Banks have built up adequate provisions against potential credit losses in these segments (refer to the Chapter on 'Financial Institution Soundness and Resilience' for further details).

²⁶ A household investor is defined as an individual borrower with a non-residential property loan or more than one property loan (both residential and non-residential properties are considered in this assessment).

²⁷ Source: Jones Lang Wootton.

Chart 1.20: Property Market – Housing Transactions

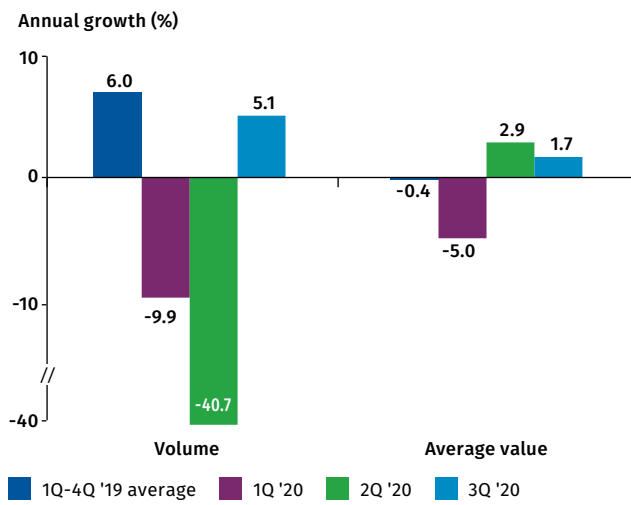


Chart 1.21: Property Market – Volume of Housing Loan Applications by Price Segment

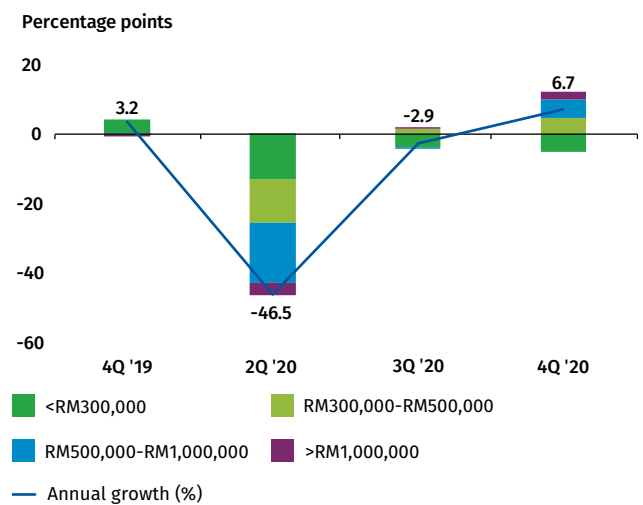


Chart 1.22: Property Market – Occupancy Rate for Hotels and Vacancy Rates for Office and Retail Space

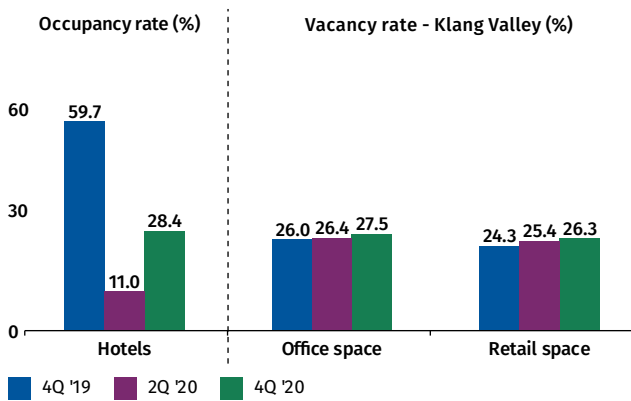


Chart 1.23: Property Market – Rentals for Prime Office and Retail Space in Kuala Lumpur

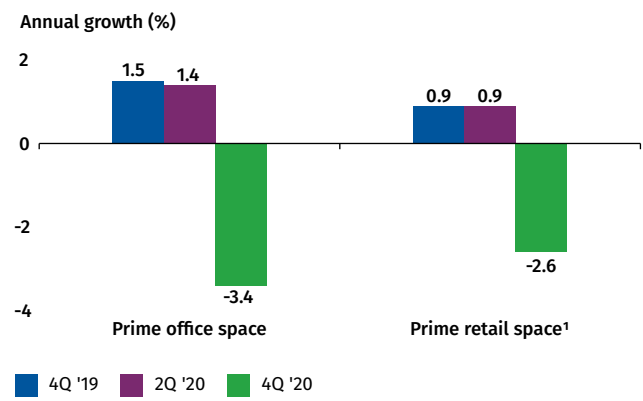


Chart 1.24: Property Market – Banking System's Exposure to Vulnerable Segments in the Property Market

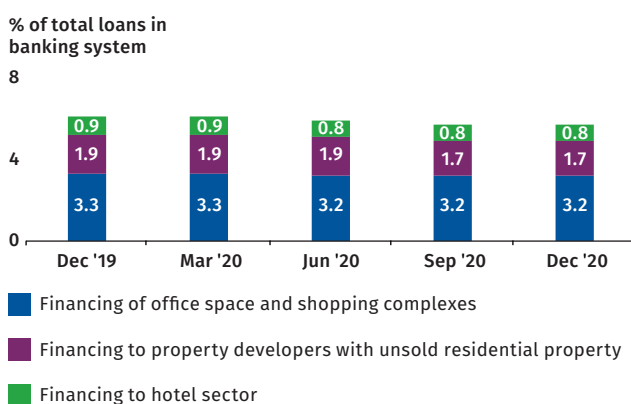
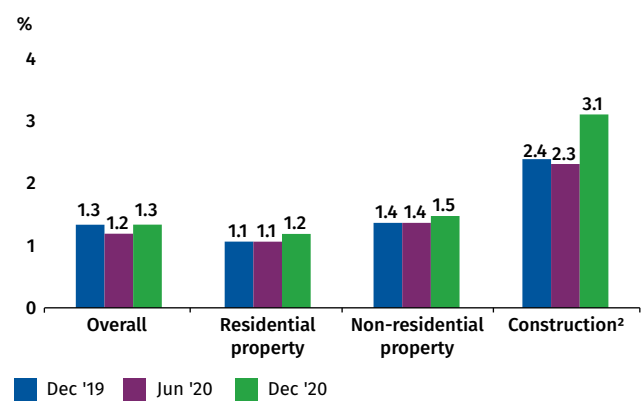


Chart 1.25: Property Market – Loan Impairment Ratios by Segment



Note: 1. Average rents of the most prominent shops in major shopping complexes
 2. Construction loans for residential and non-residential property, and working capital for firms in the real estate sector

Source: Bank Negara Malaysia, Jones Lang Wootton, Knight Frank, Malaysian Association of Hotels, Malaysia Tourism Promotion Board, National Property Information Centre (NAPIC) and Savills Malaysia