MANAGING RISKS TO FINANCIAL STABILITY

Financial stability remained intact

Overall, domestic financial stability had been preserved throughout the third quarter, supported by strong financial buffers both at the system and at the institutional levels. Financial market conditions continued to remain orderly as volatile portfolio flows were well intermediated by the markets. Confidence in the financial system remained intact during the quarter as financial intermediation continued to function efficiently to support domestic economic activity.

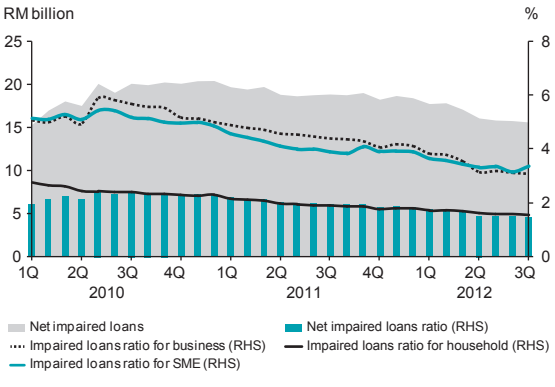
The stable operating environment during the quarter provided favourable support to credit exposures of financial institutions. The quality of the financing portfolio of banks improved with net impaired loans ratio at 1.4% (2Q 12: 1.5%), while loans-in-arrears were stable at 3.5% of total loans (2Q 12: 3.4%). The amount of capital charges by insurers for credit risks was stable at 3.4% of insurers' total capital.

The growth in household debts increased by 3.2% (2Q 12: 2.9%) attributable mainly to higher growth in financing for the purchase of residential properties (3.2%; 2Q 12: 2.9%). Accumulation of debts by households continued to be supported by a commensurate expansion in financial assets of 3.2% (2Q 12: 2.5%). As a result, household financial buffers were sustained at the aggregate level with household financial assets accounting for 2.3 times of household debts. The impairment level remained unchanged at 1.6% of household loans whilst arrears between one month and less than three months account for 2.7% of household loans, demonstrating households' continued ability to meet their debt obligations. Overall, household debt-to-GDP stood at 76.7% as at end-September 2012 (2Q 12: 75.4%).

Credit to businesses grew at a much slower pace of 1.9% during the quarter after a firm expansion of 6.6% during the previous quarter. The impaired loans ratio remained low and sustained at 3.1% of business loans with improvement in the debt servicing capacity of businesses as reflected by the higher interest coverage ratio (2Q 12: 6%; 1Q 12: 5.1%).

The outlook for credit risk remains firm, supported by sound economic fundamentals, sustained debt servicing capacity of borrowers, and continued sound risk management practices observed by financial institutions. The strong financial buffers of households is expected to provide continued flexibility for households to adjust to any changes in the income levels. Similarly, the strong financials of businesses, underpinned by low gearing levels and healthy cashflow positions, is expected to provide strong support to businesses to favourably manage any adverse developments in the business and operating environment. This is also affirmed by the improvement in the level of expected default frequency to 0.51% (2Q 12: 0.58%).

Banking System: Loan quality



Source: Bank Negara Malaysia

Exposures of financial institutions to market risk remained modest. Volatility in the domestic equity market eased further during the quarter to 7.3% (2Q 12: 7.9%), supported by positive market sentiments locally amidst a resumption in portfolio inflows. Trading liquidity in the equity market remained intact with the turnover ratio remained stable at 1.9 (2Q 12: 2.0), in line with sustained risk appetite. While yields were higher for the Malaysian Government Securities partly on account of portfolio rebalancing activities into equities, trading liquidity was sustained as demonstrated by stable turnover ratio and bid-ask spreads. The composition of banks' treasury assets in both ringgit and foreign currency denominations was largely unchanged. Banking system exposures to interest rate and equity risks remained stable at 4.8% and 0.6% of capital base respectively (2Q 12: 4.7%; 0.8%). The net open position in foreign currency exposures of banks was sustained at 6.7% of capital base (2Q 12: 6.6%). Similarly, interest rate and equity risks were well-contained for the insurance sector, declining to 3.2% and 6.4% (2Q 12: 3.3%; 6.7%) of total capital available respectively.

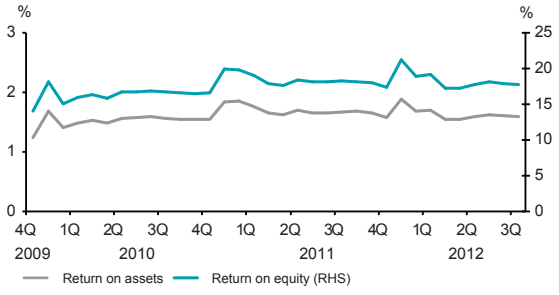
Potential risks arising from deleveraging by European financial institutions remained low. The domestic operations of the locally incorporated European banks in Malaysia showed no evidence of scaling back. The market share of assets, loans and deposits of these entities have remained stable and continued to be supported by strong operating performance and returns. Direct credit exposures of Malaysian financial institutions to European counterparties are limited, accounting for less than 8% of capital base for banks and 0.3% of capital available for insurers. Furthermore, the operations of Malaysian banks continue to be mainly supported by domestic funding sources.

The financial sector remained resilient amidst challenging environment

The capacity of the domestic financial sector to withstand potential economic and financial shocks continues to be well supported by strong capitalisation. Both the core capital ratio and risk-weighted capital ratio remained sound at 13% (2Q 12: 13.4%) and 14.8% (2Q 12: 15.1%) respectively. Banks' capital buffers (i.e. capital in excess of the minimum regulatory level of 8%) stood at more than RM70 billion. Banks continued to maintain high quality capital, in line with the expectations under the Basel III environment, with about 88.2% in Tier 1 capital, comprising mainly paid-up capital, share premium and reserves. Similarly, the insurance sector recorded a strong capital adequacy ratio of 218.6% (2Q 12: 216.7%) and a capital buffer in excess of RM20 billion.

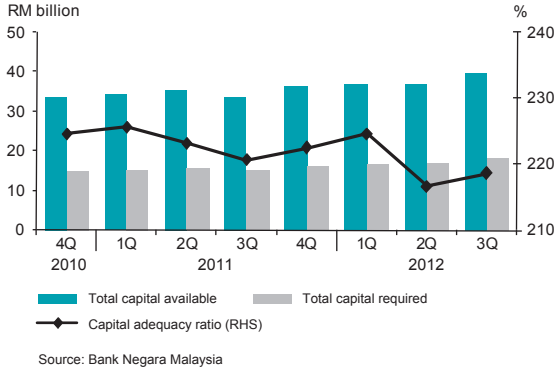
Profitability of the banking system was sustained, with returns on assets and equity of 1.6% (2Q 12: 1.6%) and 17.7% (2Q 12: 17.7%) respectively. Pre-tax profit for the quarter improved to RM7.4 billion (2Q 12: RM6.8 billion) attributable mainly to higher revenue from continued growth in financing activities and lower overhead costs. Net trading and investment income rose by 9.1% (2Q 12: -37.1%) amid improved general market sentiments.

Banking System: Profitability



Source: Bank Negara Malaysia

Insurance Sector: Capitalisation

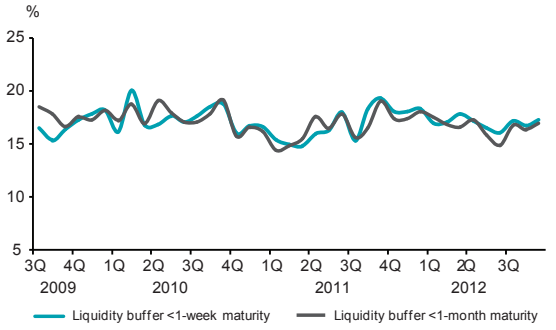


Source: Bank Negara Malaysia

The life insurance and family takaful businesses recorded higher excess of income over outgo totalling RM5.2 billion (2Q 12: RM4.1 billion) due to exceptional capital gains from the realisation of investments by one insurer. Excluding this exceptional gains, the excess of income over outgo was lower in the quarter at RM3.7 billion. The general insurance and takaful sector recorded lower profitability with underwriting and operating profits of RM359.7 million and RM688.4 million respectively (2Q 12: RM398.6 million; RM703.0 million respectively). This was attributed mainly to lower gross premium income from the marine, aviation & transit (MAT) business. The claims ratio for the Motor 'Act' cover (mandatory insurance cover required under the Road Transport Act 1987) continued to weigh on underwriting results, remaining high at 242.2% (2Q 12: 241.6%).

Banking sector resilience was further reinforced by the continued availability of ample liquidity to meet demands for deposit withdrawals and other liquidity obligations. Liquidity buffers to meet liquidity needs within 1 month improved to 17% of total deposits (2Q 12: 14.9%). The foreign currency liquidity mismatch positions of banks remained manageable in tandem with the further easing of onshore US dollar liquidity conditions. Banks maintained a positive mismatch position in the less than one week maturity bucket, while the negative mismatch position in the less than one month maturity bucket improved substantially to a shortfall of RM4.1 billion from a shortfall of RM7.9 billion in the second quarter, representing 2.3% of the capital base (2Q 12: 4.4%).

Banking System: Liquidity Buffer to Total Deposit Ratio



Source: Bank Negara Malaysia

Insurance and Takaful Sectors: Indicators

	2011		2012			
	2Q	3Q	1Q	2Q	3Q	3Q
	RM million					Annual Change (%)
Life Insurance & Family Takaful						
Excess of Income Over Outgo	3,780.0	1,315.0	3,912.9	4,115.7	5,240.7	298.5
General Insurance & General Takaful						
Operating profit	557.2	441.7	652.6	703.0	688.4	55.9
Claims ratio (%)	61.4	62.5	60.6	59.1	58.7	-3.8 (ppt)

Source: Bank Negara Malaysia