Monetary and Financial Developments

HIGHLIGHTS

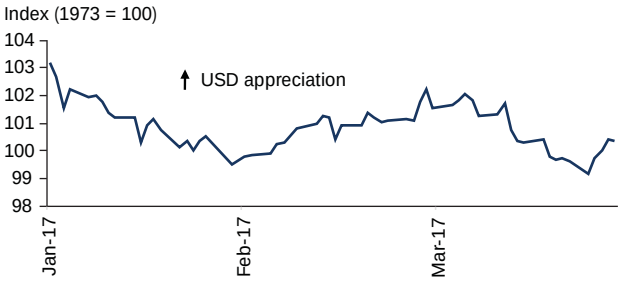
- **Ringgit performed better against the US dollar during the quarter.**
- **Despite non-resident outflows from the bond market, MGS yields remained stable due to strong demand by domestic institutional investors.**
- **Real interest rates turned negative but this is likely to be transitory.**

Ringgit recovery driven primarily by external factors

The ringgit and most regional currencies appreciated against the US dollar during the quarter amid the broad weakening of the US dollar. Despite reaching the highest level in 14 years in early January, the dollar index went on a downward trend during the quarter. The weaker US dollar sentiments were driven mainly by market uncertainties on the direction and implication of policies in the US. Regional currencies were also supported by renewed investor interest in financial assets of regional countries following the Federal Reserve's decision to maintain the path of interest rate normalisation in March. In addition, the ringgit showed more stability during the quarter compared to the previous quarter following the measures announced by the Financial Market Committee of Bank Negara Malaysia in December 2016.

Chart 25: USD Index

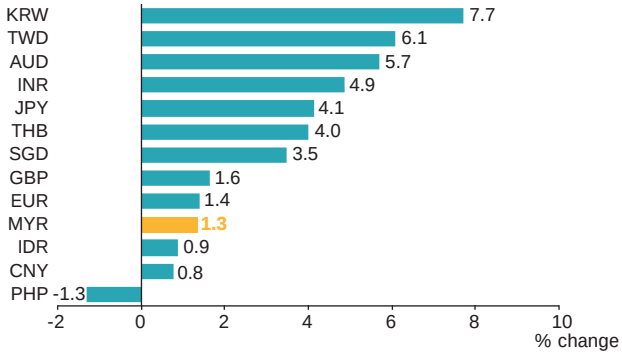
Weaker US Dollar during the Quarter



Source: Bloomberg

Chart 26: Summary of Performance of Regional and Major Currencies Against USD (1 Jan - 31 March 2017)

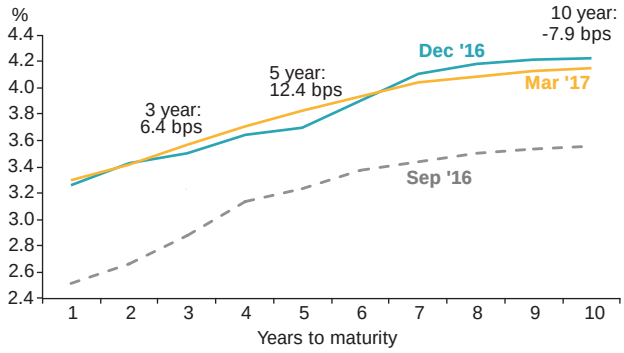
Most Major and Regional Currencies Appreciated Against the US Dollar



Source: Bank Negara Malaysia

Chart 27: Trend in MGS Yields

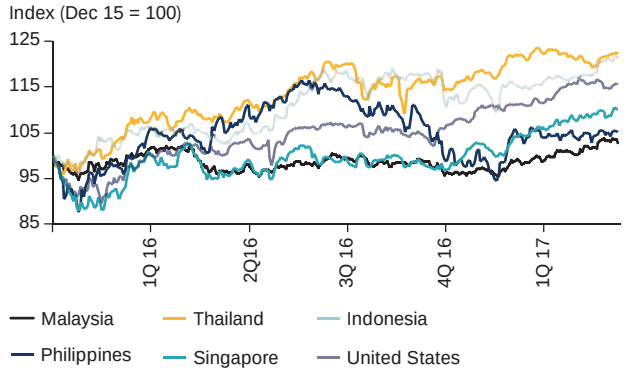
Bond Yields Remained Stable Amid Sustained Demand from Domestic Investors



Source: Bank Negara Malaysia

Chart 28: Selected Equity Indices

Gains in Domestic Equity Market in Line with Regional Trend



Source: Bloomberg

Domestic monetary and financial conditions remained supportive of economic activity

Overall domestic monetary and financial conditions remained supportive of economic activity during the period. Bond yields remained stable due to the support from domestic institutional investors that contained the impact of non-resident outflows. Liquidity conditions continued to remain sufficient while stable retail funding costs continued to provide support to private sector financing.

The cost of fund raising in the bond market remained stable despite non-resident outflows

During the quarter, non-resident holdings of government bonds fell by RM34.3 billion (4Q 2016: -RM18.3 billion). The bulk of these outflows was from the Malaysian Government Securities (MGS) and occurred at the end of the quarter, partly due to MGS redemptions in March. In addition, outflows were largely from shorter-term papers attributed to the unwinding of NDF positions by non-resident financial institutions, coinciding with higher 3-year and 5-year MGS yields during the quarter. Despite the large non-resident outflows, strong demand from domestic institutional investors led to the decline of 7.9 basis points in the 10-year MGS yield.

Positive sentiments drove equity market returns

The domestic equity market experienced strong buying from non-resident investors during the period driven mainly by positive sentiments in global stock markets arising from external developments.

The KLCI index was also supported by buying of selected blue-chip stocks following the announcement of better-than-expected economic growth of 4.5%, stronger corporate earnings in 4Q 2016 and news of potential mergers and acquisitions. Subsequently, the FBM KLCI increased by 6.0% to close at 1,740.1 points at end-March (end-December 2016: 1,641.7 points).

Due to higher inflation, real fixed deposit rates have turned negative

Both retail and wholesale borrowing costs remained stable throughout the quarter. The 3M KLIBOR was steady, ranging between 3.42% and 3.43%. In the retail market, the weighted average base rate (BR) was also steady at 3.62% and correspondingly, the weighted average lending rates (ALR) on outstanding loans remained stable throughout the quarter (end-March: 5.20%).

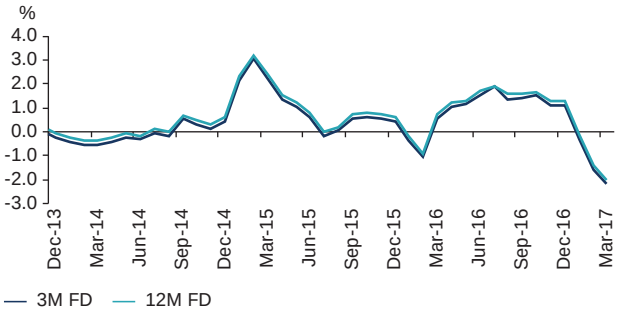
Reflecting the higher inflation, real fixed deposit (FD) rates turned negative in January and remained so throughout the quarter (end-March: real 12M FD: -2.0%; real 3M FD: -2.2%). Real weighted average lending rates (ALR) on outstanding loans have also declined (end-March: 0.1%). Nevertheless, with the currently high level of inflation expected to be transitory, the real deposit rates are estimated to turn positive towards the end of the year.

Overall liquidity conditions remained sufficient for financial intermediation

In the banking system, liquidity conditions remained sufficient at both the institutional and system-wide levels. The level of surplus liquidity placed with BNM moderated, reflecting continued portfolio outflows during the quarter, which did not lead to pressures in the interbank market. At the institutional level, most banks continued to maintain surplus liquidity positions.

Chart 29: Real FD Rates (by Maturity), as at End-period

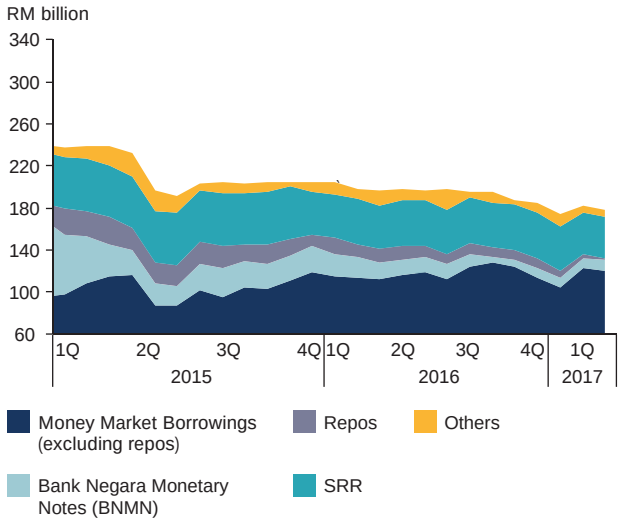
Real Deposit Rates have Turned Negative due to High Inflation



Source: Bank Negara Malaysia

Chart 30: Outstanding Ringgit Liquidity Placed with BNM, as at End-period

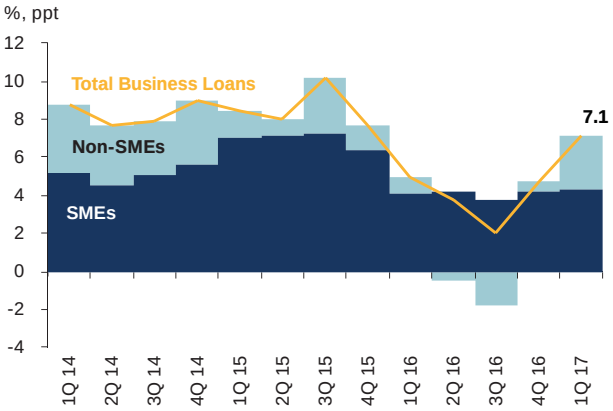
Outstanding Liquidity Placed with BNM Moderated in the First Quarter



Source: Bank Negara Malaysia

Chart 31: Contribution to Annual Growth of Outstanding Business Loans

Business Loan Growth Increased, Driven by Both SMEs and Non-SMEs



Source: Bank Negara Malaysia

Growth of business loans increased significantly from the last quarter

The growth of net financing increased to 6.8% in 1Q 2017 (4Q 2016: 5.5%) driven by both the growth in loans extended by the banking system and development financial institutions (DFIs) (1Q 2017: 6.0%; 4Q 2016: 5.3%), and the growth of net outstanding issuances of corporate bonds (1Q 2017: 9.3%; 4Q 2016: 6.1%).

Given healthy supply conditions with continued loan disbursements to all segments of borrowers, higher financing activity reflected the improved demand conditions during the quarter. In particular, growth of outstanding business loans increased to 7.1% (4Q 2016: 4.8%), reflecting improvement in both SMEs and other businesses during the quarter. The growth of SME loans increased (1Q 2017: 9.2%; 4Q 2016: 9.0%), with continued expansion in loans extended to the *transport, storage and communication; manufacturing; wholesale and retail trade, and restaurants and hotels;* and *construction* sectors. The growth of outstanding household loans continued to moderate to 5.3% (4Q 2016: 5.5%) with broad-based moderation across most loan types.