DEVELOPMENTS IN THE BANKING SECTOR

The banking sector remained resilient, supported by strong capitalisation and strengthened risk management capability. Profitability was sustained despite a difficult economic environment. Given the strong financial buffer, reinforced by robust funding and liquidity positions, the banking sector remained well-positioned in meeting the financing needs of the economy.

Banking System

	2Q 08	1Q 09	2Q 09
Capital position			
Risk-weighted assets (RM billion)	870.9	886.7	904
Capital base (RM billion)	118.5	120.4	126.6
Risk-weighted capital ratio (%)	13.6	13.6	14
Core capital ratio (%)	10.8	11.6	12.3
Profit before tax (RM million)	4,450.1	4,733.3	4,794.7
Annualised return on equity (%)	20.6	16.7	16
Annualised return on assets (%)	1.6	1.4	1.4

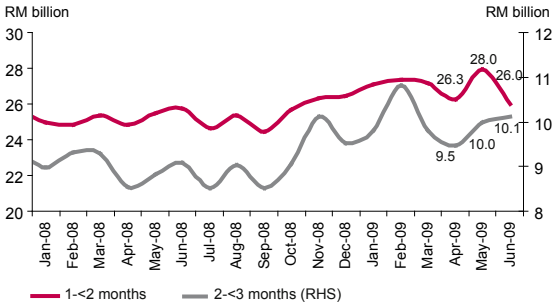
Capitalisation strengthened with capital in excess of the minimum regulatory requirement increasing to RM50.7 billion (1Q 09: RM46 billion). The strong capitalisation was attributed to higher retained earnings and proactive capital management initiatives by several banking institutions. Pre-tax profit was underscored by higher revenue from financing and fee-related businesses totalling RM7.9 billion and RM2.1 billion respectively.

Banking System: Non Performing Loans (NPL)

	2Q 08	1Q 09	2Q 09
	%		
Net NPL (RM million)	17,549.9	16,032.9	15,691.6
Net NPL ratio	2.6	2.2	2.2
Gross NPL ratio	5.4	4.6	4.5
Large Businesses	6.8	4.8	4.7
SMEs	7	6.8	6.9
Households	4.4	4.1	3.9

The quality of loan portfolio was largely sustained. The level of net NPLs registered a decline of 2.1% to RM15.7 billion attributable primarily to higher recoveries and reclassifications of loans to performing status. On the sectoral front, the lower NPL ratio was driven by the decline in NPLs in the household loan segment.

Banking System: Loan-in-arrears



Source: Bank Negara Malaysia

Improvements in the quality of loan portfolios were also evident from the moderation in loan delinquencies. Loans-in-arrears in the 1-<2 months bucket declined 4% to account for 3.5% of total loans (1Q 09: 3.7% of total loans). This underscored the rise in proportion of loans-in-arrears in the 2-<3 months bucket. Going forward, improvements in labour market conditions and business and consumer outlook will provide support to an improvement in credit risk appetite.

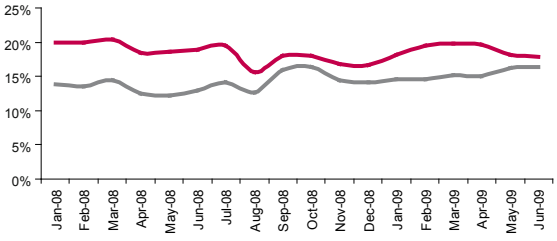
Banking System: Market Risk Exposure

	2Q 08	1Q 09	2Q 09
Duration weighted position (RM million)	5,562	6,373	4,165
As % of capital base	5.4	6.2	3.8
Net open position (RM million)	6,997	5,607	5,377
As % of capital base	5.9	4.7	4.2

Exposure to interest rate risk declined significantly in the second quarter as a result of hedging by institutions. At the same time, given the 3.5% appreciation of the ringgit against the USD, exposure to foreign exchange risk, which is largely denominated in US dollar moderated to 4.2% of capital base. The level of market risk is expected to remain manageable given the active use of hedging instruments by the banking institutions to manage overall risk exposure.

The ability of the banking system to meet demands for deposit withdrawals and other liquidity obligations remained strong. The liquidity buffer for the maturity buckets of up to one week and one month remained ample at 16.3% and 17.8% of total deposits respectively (1Q 09: 15.1% and 19.8%). Meanwhile, the industry's loan-to-deposit ratio remained satisfactory at 74.1%.

Banking System: Liquidity Mismatch to Total Deposit Ratio



Source: Bank Negara Malaysia

Developments in the insurance and takaful sector

The insurance and takaful sector remained resilient with a healthy level of capitalisation. The Capital Adequacy Ratio (CAR) improved to 214.8% (1Q 09: 210.2%).

Profitability improved, driven largely by increased premiums and contributions across all business segments. Lacklustre capital market activity, nonetheless, continued to pose downward pressure on profitability, albeit at a more moderate pace.

Excess of income over outgo rose to RM3.2 billion (1Q 09: RM2 billion) due mainly to a significant increase in capital gains and investment income. Operating profit for the general business registered a substantial improvement on account of lower underwriting loss.

Insurance and Takaful Sector: Profitability

	2008		2009		
	2Q	1H	1Q	2Q	1H
	RM million				
Life/family business					
Excess of income over outgo	2,568.9	5,072.7	2,042.1	3,204.8	5,246.9
General business					
Operating profit	-10.1	259	306.1	356.1	662.2