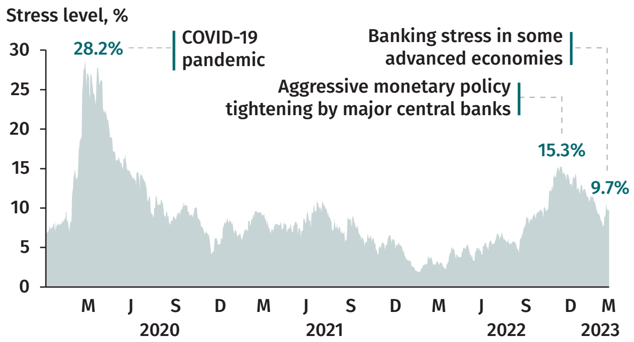
Key Highlights on
Financial Stability Review – Second Half 2022

Malaysian financial markets remained resilient despite heightened volatility in global markets

Market stress has risen amid recent developments in the global banking sector

Financial Market Stress Index (FMSI)



Orderly domestic market conditions continued to be preserved, supported by several key factors

1. Active market risk management and hedging strategies by financial institutions
2. Deep and liquid domestic markets
3. Resilient domestic institutional investors

Financial institutions remained well-positioned to support financial intermediation and sustain the economic recovery

Banks maintained healthy capital and liquidity buffers to support financial intermediation

- **18.8%** Total Capital Ratio *(Jun '22: 18.4%)*
- **118%** Net Stable Funding Ratio *(Jun '22: 119%)*
- **154%** Liquidity Coverage Ratio *(Jun '22: 148%)*

Insurers and takaful operators remained well-capitalised, above the regulatory minimum

- **226%** Capital Adequacy Ratio *(Jun '22: 224%)*

Credit risks from household and business sectors remained manageable, supported by the continued improvement in labour market conditions and business activities

Households

Household financial resilience remains intact, supported by healthy debt-servicing capacity

- Stage 2 Loans Ratio *(Jun '22: 8.0%)*: **6.7%**
- Debt under Repayment Assistance *(Jun '22: 3.2%)*: **1.9%**
- Impairment Ratio *(Jun '22: 1.2%)*: **1.2%**
- Median Outstanding Debt Service Ratio *(Jun '22: 35%)*: **37%**

Businesses

Businesses remained financially sound on aggregate, but certain sectors face downside risks from cost pressures

Debt-to-equity ratio

- **20.9%** Overall businesses *(Jun '22: 22.0%)*

Share of firms-at-risk

- **38.2%** Construction *(2015-2019 average: 23.5%)*
- **21.6%** Manufacturing *(2015-2019 average: 18.1%)*

Banks have prudent provisioning buffers to absorb increases in credit losses while the recovery in earnings has helped sustain capital buffers

- **1.7%** Total-Provisions-to Total Loans *(Jun '22: 1.8%)*
- **118.2%** Loan Loss Coverage Ratio[1] *(Jun '22: 115.3%)*
- **12.4%** Return on Equity *(Jun '22: 11.8%)*

[1] Including regulatory reserves

Source: Bank Negara Malaysia, Bloomberg, Reuters and S&P Capital IQ

Stress test reaffirms capacity of financial institutions to withstand adverse shocks and reduce the impact of economic slowdowns

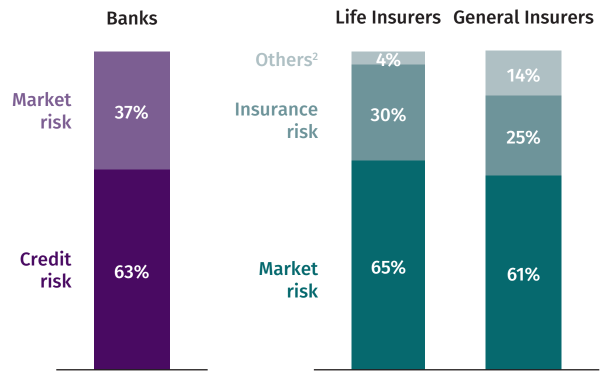
Financial institutions' resilience were assessed against two scenarios spanning over 3-years that are more severe than the 2008 Global Financial Crisis and the 2020 pandemic

Adverse Scenario 1	Sharp GDP contraction followed by a quick recovery

Adverse Scenario 2	Milder GDP contraction followed by slow growth

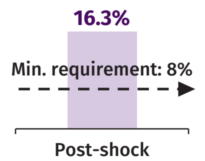
Losses in the banking system and insurance sector are largely driven by credit and market risks...

Key Loss Drivers Under AS2 (2023e-2025e)

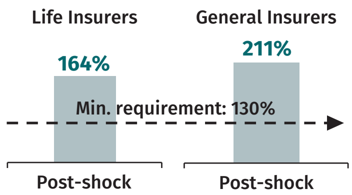


...but post-shock capital ratios remained well above regulatory minima

Banks: Total Capital Ratio Under AS2

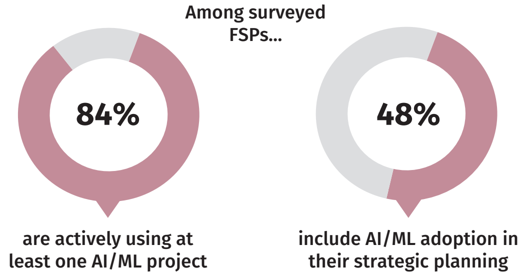


Insurers: Capital Adequacy Ratio Under AS2

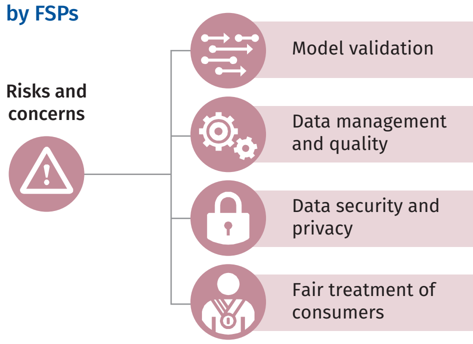


Box Article: Artificial Intelligence in the Malaysian Financial System: Opportunities, Risks, and the Way Forward

Survey shows many financial service providers (FSPs) are actively using AI/ML



BNM continues to promote responsible use of AI/ML by FSPs



Box Article: Managing Transmission of Vulnerabilities in Commodity Markets Associated with the Application of *Tawarruq* in the Islamic Banking System

***Tawarruq* transactions were exposed to supply and price shocks stemming from vulnerabilities in commodity markets...**

Geopolitical tensions

- *Military conflict in Ukraine increased volatility in metals and crude oil price*

Domestic labour shortages

- *Palm oil harvesting impacted by foreign labour scarcity due to border closures*

Climate-related risks

- *Physical and transition risks affecting mining and agri-based commodities*

...however, risks were mitigated by robust risk management, with long-term solutions in pipeline

Availability of diversified commodities and multiple commodity brokers and exchanges used in *tawarruq* transactions

All commodity transactions are conducted on a spot basis with fixed intra-day price, insulating Islamic banks from price volatility

Concerted efforts to develop alternative Shariah contracts beyond *tawarruq*

e Estimate

² Refers to losses from credit risk (including reinsurance and corporate bonds default) and underwriting risk

Source: Bank Negara Malaysia