

DP01

# Monetary Economics and the Malaysian Financial System

11 APRIL 2005

1. Time allowed : Three (3) hours
2. Total number of questions : Six (6) questions
3. Number of questions to be answered : Four (4) questions  
Part A : Compulsory question [40 marks]  
Part B : Three (3) questions [20 marks each]
4. Candidates must obtain a minimum of 20 marks in Part A as well as pass the paper as a whole.
5. Begin each answer to a new question on a fresh page.
6. Answer **all** questions in **English**.
7. Blank pages are provided at the end of the question paper for rough work.

## PART A

### COMPULSORY QUESTION

1. (a) (i) Briefly explain the role of Bank Negara Malaysia's (BNM) overnight policy rate (OPR). [2]
- (ii) What is the current level of the OPR? [1]
- (iii) State **two** reasons for the introduction of the OPR. [4]
- (b) (i) Explain why BNM needs to manage the nation's foreign exchange reserves. [2]
- (ii) State **two** objectives of Malaysia's present exchange control policies. [2]
- (iii) How does BNM's monetary policy affect the economy and the inflation rate? [4]
- (c) (i) What is BNM's Monetary Policy Statement (MPS)? [3]
- (ii) Explain **three** objectives for issuing an MPS. [3]
- (iii) How frequent is an MPS issued? [2]
- (d) (i) Define gross domestic product (GDP). [2]
- (ii) What are **three** approaches of measuring the GDP? [3]
- (e) (i) In your opinion, how would the Malaysian economy perform in the next 12 months if inflation and global interest rate rise significantly? [3]
- (ii) What would be the likely stance of the monetary policy in respect to (e)(i) above? [2]
- (f) Differentiate between BNM's role as an economic adviser and a financial adviser to the Government. [4]
- (g) What are **three** functions of the National Syariah Advisory Council? [3]
- (Total:40 marks)

## PART B

### ANSWER ANY THREE (3) QUESTIONS ONLY

2. (a) Explain what Government Investment Issues (previously known as Government Investment Certificates) are. [4]
- (b) State **four** main objectives of Bank Negara Malaysia. [4]
- (c) (i) (aa) What is monetary stability? [2]
- (bb) Explain the importance of monetary stability. [2]
- (ii) (aa) What is financial stability? [2]
- (bb) Explain the importance of financial stability. [2]
- (d) Briefly explain the following Islamic banking principles:
- (i) Al-Mudharabah (profit sharing) [2]
- (ii) Al-Musarakah (joint venture) [2]
- (Total:20 marks)

3. (a) (i) State **three** effects of high inflation. [3]  
(ii) State **two** effects of deflation. [2]
- (b) Describe **three** components in each of the following:  
(i) Current account in the balance of payments [3]  
(ii) Capital account in the balance of payments [3]
- (c) (i) Why did Malaysia introduce a fixed exchange rate system in 1998? [4]  
(ii) Discuss **one** advantage and **one** disadvantage of a fixed exchange rate system. [5]  
(Total:20 marks)
4. (a) Briefly describe the objectives of the following legislation administered by Bank Negara Malaysia:  
(i) Central Bank of Malaysia Act 1958 (Revised 1994) [2]  
(ii) Banking and Financial Institutions Act 1989 [2]  
(iii) Islamic Banking Act 1983 [2]
- (b) State **four** functions of Bank Simpanan Nasional. [4]
- (c) (i) What is a unit trust? [2]  
(ii) In respect to a unit trust fund, what is the role of a trustee and a management company? [3]
- (d) What is the impact of globalisation on the financial markets? [5]  
(Total:20 marks)
5. (a) (i) What are the distinguishing features of merchant banks compared to other financial intermediaries? [2]  
(ii) State **four** wholesale financial services offered by merchant banks. [4]
- (b) Describe the financial activities offered by the International Offshore Financial Centre in Labuan. [4]
- (c) Name **four** instruments traded in the Malaysian money market. [4]
- (d) Explain the concept of financial intermediation. [6]  
(Total:20 marks)
6. (a) (i) What role does the Malaysian financial system play in the implementation of monetary policy in Malaysia? [5]  
(ii) Explain the role of the financial system in mobilising funds in Malaysia. [5]
- (b) Briefly describe the following Acts administered by Bank Negara Malaysia (BNM):  
(i) Development Financial Institutions Act 2002 [2]  
(ii) Anti-Money Laundering Act 2001 [2]
- (c) In your opinion, what would be the stance of BNM's monetary policy when the economy overheats and the threat of inflation is high? [6]  
(Total:20 marks)

## **OUTLINE ANSWERS**

The comments given in the boxes below indicate the areas of weaknesses the examiners have identified and their advice to future candidates.

### **Part A**

#### **Question 1**

- Candidates showed poor knowledge of overnight policy rate. This question falls under recent development and candidates must initiate efforts to know the major policy changes announced by Bank Negara Malaysia (BNM).
- Candidates could not explain why BNM needs to manage the nation's foreign exchange reserves.
- Candidates were unable to explain the current exchange control policies and majority of the candidates discussed about the present fixed exchange rate. Candidates' explanation on the linkage between monetary policy, the economy and inflation was shallow. Monetary policy represents one of the major tools used by the Government to manage the economy and the financial system and candidates are expected to understand this topic.
- Candidates had poor knowledge on Monetary Policy Statement. Topic on recent developments must be followed by reading BNM's annual reports, press statements or through browsing the BNM's website.
- Candidates were unable to state the approaches of measuring Gross Domestic Product.
- It is important for candidates to understand the relationship between the monetary policy and external developments.

1. (a) (i) Overnight policy rate (OPR) is the indicator of the monetary policy stance. OPR has a dual role:
- as a signalling device to indicate the monetary policy stance
  - as a target rate for the day-to-day liquidity operations of Bank Negara Malaysia (BNM).
- Any change in the monetary policy stance would be signaled by a change in the OPR. It serves as the primary reference rate in determining other market rates.
- (ii) OPR is currently set by BNM at 2.70%, the same level since its introduction on 23 April, 2004.
- (iii) Reasons for introducing OPR:
- Designed to enhance the effectiveness of monetary policy by facilitating the transmission of changes in the policy rate to the other market rates and, ultimately, to key macroeconomic objectives. This is achieved by adopting a policy rate that is closely related to other interest rates and through appropriate changes in the monetary operating procedures.
  - Designed to achieve greater efficiency in the financial markets' operation and hence, facilitate more effective and efficient pricing of financial products.
- (b) (i) BNM needs to manage the foreign exchange reserves of the country to ensure that Malaysia is able to meet its international obligations, thereby cushioning any temporary shifts in inflows and outflows in Malaysia's balance of payments and thus, promote a stable and fundamentally sound Ringgit exchange rate.
- (ii) Exchange control policies directed at ensuring the stability of the Ringgit as well as encouraging the use of the country's financial resources for productive purposes. There is generally free movement of funds into and out of the country subject to certain prudential regulations administered by BNM under the Exchange Control Act 1953.

- (iii) BNM uses a number of monetary instruments at its disposal to inject and withdraw funds to influence the level of interest rates in the financial system. Examples of these instruments would include the purchase and sale of BNM and Malaysian Government papers, changes in the statutory reserve requirements and direct lending and borrowing in the inter-bank market. Malaysia is one of the most open economies in the world. This means that the performance of the Malaysian economy is significantly influenced by developments outside its borders. The economic performance of Malaysia's trading partners would affect the demand for Malaysia's exports. By maintaining a low inflation rate relative to our trading partners, monetary policy contributes to making Malaysian goods competitive internationally.
- (c) (i) A Monetary Policy Statement (MPS) is a forward-looking statement, outlining the monetary policy stance of BNM in the near term and the rationale for the policy thrust. Any change in the OPR will be announced in MPS.
  - (ii) - MPS is a part of the overall strategy to provide greater understanding of the monetary policy objectives and measures in light of a more complex and dynamic environment.
  - MPS would help anchor expectations on growth and inflation.
  - MPS is aimed at increasing the understanding and appreciation of money market participants, and thereby, facilitating a more rapid transmission of the policy rate in the pricing of credit and longer term rates, and thus, enhancing the overall efficiency of the monetary transmission mechanism.
  - (iii) MPS is released four times a year and would coincide with the release of Malaysia's quarterly gross domestic product (GDP) performance. In the intervening period between the fixed scheduled dates, an additional MPS would be issued should there be a change in the monetary policy stance.
- (d) (i) GDP is defined as the total market value of goods and services produced by a country after deducting the cost of goods and services used up in the process of production (intermediate goods), but before deducting allowances for consumption of fixed capital (depreciation).
  - (ii) - The production approach, which involves totaling the value added by each enterprise in the economy.
  - The income approach, which involves summing factor incomes (gross returns to labour and capital), depreciation and net indirect taxes.
  - The expenditure approach, which involves the total of final domestic expenditures plus expenditures by foreign residents on Malaysian produced goods and services (exports) minus expenditures by Malaysian residents on foreign-produced goods and services (imports).
- (e) (i) The Malaysian economy expanded strongly at 7.1% in 2004. Growth was supported by strong expansion in private sector demand, both consumption and investment, and continued expansion in exports.

Going forward, the economic outlook for Malaysia for the next 12 months appears to remain favourable. The export sector is expected to continue to support growth in an environment of greater resilience of the world economy to higher oil prices and amidst expectations for a moderation in global demand for IT products.

On the domestic front, private sector demand is expected to be supported by rising disposable incomes, positive investor sentiment, stable employment conditions, favourable commodity prices and improved earnings of the corporate sector. The expansion of the Malaysian economy continues to be well supported by strong

underlying fundamentals.

Inflation, as measured by the Consumer Price Index, rose moderately at about 1.5% in 2004 while the external payment position strengthened further as reflected by the sharp rise in external reserves.

- (ii) In the light of all these developments, it is possible that the current stance of monetary policy will, therefore, be maintained to support growth. The overnight policy rate will therefore continue to remain unchanged at the current level of 2.70%.

However, if inflation and global interest rate rise were to rise significantly, the stance of monetary policy may be tightened accordingly, with domestic interest rate expected to rise to dampen inflationary pressures.

- (f) In its role as the economic and financial adviser to the Government, BNM analyses and assesses the developments in the international and domestic economy and highlights the areas that need to be addressed. BNM undertakes economic intelligence and surveillance and carries out forecasts on the economic condition of the country. Based on these assessments, BNM presents policy recommendations at regular briefings to the Minister of Finance as well as at various economic policy making forums at the national level.

As the financial adviser to the Government, BNM gives regular advice to the Government on the management of its domestic and external debts and the terms and timing of Government loan programmes. BNM also act as the agent for the Government in negotiations and concluding of loan agreements. BNM is also responsible for trading, registering, settlement and redemption of Government securities through its computerised systems.

- (g) The functions of National Syariah Advisory Council
- Act as the sole authoritative body to advise BNM on Islamic banking and takaful operations
  - Co-ordinate Syariah issues with respect to Islamic banking and finance (including takaful)
  - Analyse and evaluate Syariah aspects of new products/schemes submitted by the banking institutions and takaful companies.

## Part B

### Question 2

Candidates could not differentiate between monetary stability and financial stability. Monetary stability refers to stability in the value of Ringgit, and financial stability refers to stability of the institutions. These concepts must be understood and candidates should explain why stability in these two areas are important for central bank to monitor and manage.

2. (a) Government Investment Issues (GII) non-interest bearing certificates issued by the Government to enable participants of the Islamic banking system to hold first class liquid assets instruments to meet the statutory liquidity requirements as well as for investment.

The issuance of GII are based on the Shariah contract of *Qardh Hasan* (benevolent loan). Under this contract, the purchase of GII by any institution or individuals will be considered as a benevolent loan to the Government to undertake developmental projects for the benefit of the nation.

The Government is obliged to return the principal amount to the providers of funds (institutions or individuals) at maturity. Any return on the loans (if any) is at the absolute discretion of the Government. At maturity, the Government will redeem the GII and pay the

nominal value of the securities to the GII holders. The GII constitutes as one of the financial instruments that is actively traded in the Islamic interbank money market.

- (b) Main Objectives of Bank Negara Malaysia
- To act as a banker and financial adviser to the Government
  - To issue currency and keep reserves safeguarding the value of the currency
  - To promote monetary stability and a sound financial structure
  - To influence the credit situation to the advantage of the country
- (c) (i) (aa) Monetary stability refers to the stability of the value of the Ringgit. The best way to ensure that the value of the Ringgit is preserved is by ensuring price stability, that is, to ensure that inflation in the country remains low and stable. By maintaining monetary stability through appropriate changes in monetary policy, BNM ensures that inflation is kept low and that the purchasing power of the Ringgit is not diminished.
- (bb) Monetary stability is important because when there is monetary instability, prices are either rising (inflation) or falling (deflation) and this can result in distortions and undermine the long-term economic growth prospects of the country.
- (ii) (aa) Financial stability refers to an environment where institutions in a financial system are strong and can continue to meet their contractual obligations without interruption or without any external assistance. Market participants can also confidently enter into transactions at prices that do not change substantially over short periods when there has not been any changes in market fundamentals.
- (bb) Financial stability is important because it creates a conducive environment for businesses to undertake their activities and for savers and investors to enter into short-term or long term contracts. As the financial sector has a central role in promoting economic growth, it is important that the financial system is strong, resilient and efficient in mobilising savings and undertaking lending activities. It is vital that this intermediation process continues uninterrupted even in periods of economic difficulties.
- (d) (i) Al-Mudharabah (Profit sharing)  
Al-Mudharabah is an arrangement or agreement between a capital provider and an entrepreneur, whereby the entrepreneur can mobilise funds for its business activity. Any profits made will be shared between the capital provider and the entrepreneur according to an agreed ratio while losses are borne solely by the capital provider.
- (ii) Al-Musyarakah (Joint venture)  
This concept is normally applied for business partnerships or joint ventures. The profits made are shared on an agreed ratio while losses incurred, will be divided based on the equity participation ratio.

### Question 3

- Candidates could not state the effects of deflation.
- Candidates were unable to state the components of the current account in the Balance of Payment.

3. (a) (i) Effects of high inflation
- If inflation is too high, people will be concerned about the purchasing power of their money balances. This would result in a greater demand for real assets like houses and properties, which are thought to be more “inflation-proof”. There would be less interest to invest in productive capacity of the economy.

- Similarly, savers would be less inclined to hold savings in the financial system if they expect that the value of their savings would be diminished. Fixed income earners will find that they are able to buy less goods and services and will experience a reduction in their standard of living.
  - High inflation would also make exports more expensive to foreigners and this would reduce the competitiveness of the exports. Persistently high inflation would therefore reduce the growth potential of the economy.
- (ii) Effects of deflation
- Similarly, when there is a deflation, prices are falling and businesses find their profits shrinking. They may reduce their costs by cutting expenditure and laying-off staff.
  - Workers in turn would have less money to spend and thus reduce spending, resulting in a further reduction in the demand for goods and services. This creates a vicious circle of falling prices and contracting demand resulting in a contraction in the level of overall economic activity.
- (c) (i) Components of current account  
(Any three of the following:)
- Merchandise balance, which is simply the difference between the value of merchandise exports and imports (i.e. exports and imports of goods).
  - Balance on services, which is the difference between “services credits” (or exports of services) and “services debits”. “Services” in this context include freight and insurance costs associated with merchandise trade, expenditure by foreign tourists in Malaysia and by Malaysian tourists abroad, passenger fares, payments of interest, dividends, etc on foreign investment in Malaysia (including interest on Malaysia’s foreign debt). Income receipts comprise Malaysian investment abroad, payment of film royalties, profits of foreign-owned subsidiaries operating in Malaysia, etc.
  - Balance on goods and services, which comprise the sum of the merchandise balance and the balance on services.
  - Transfers, which comprise transactions such as foreign aid, pensions, and funds brought out from and into Malaysia by migrants.
  - Balance on the current account is the sum of the balance of goods and services and transfers.
- (ii) Components of capital account  
(Any three of the following:)
- Private long-term capital – refers to the inflow of long-term foreign financial liabilities net of the outflow of long-term financial assets in the corporate sector.
  - Official long-term capital – comprises market loans (funds raised by the government through the issue of debt securities in overseas market), project loans (direct borrowing from foreign government and international bodies for the financing of specific projects) and suppliers’ credit and loans by the non-financial public enterprises.
  - Private short-term capital – includes short-term capital for the corporate sector and commercial banks.
  - Balance on long-term capital – the sum of private long-term capital and official long-term capital.

- Basic balance – sum of the balance on current account and the balance on long-term capital.
  - Overall balance – sum of the basic balance and short-term capital flows as well as items classified as “errors and omission”.
- (c) (i) Between June 1973 and September 1998, Malaysia operated under a floating exchange rate regime. However, following the contagion impact of the Asian financial crisis, the Ringgit was subjected to excessive volatility and downward pressures due to speculative activities, which did not reflect the underlying fundamentals of the economy. Up until August 1998, external risks in the Asian region remained a real threat to the Malaysian economy. Of particular concern was the build-up of offshore rate. This became a source of instability for the Ringgit. In order to stabilise the exchange rate and facilitate economic recovery, the Malaysian Ringgit was fixed at RM3.80 per US dollar on 2 September 1998.
- (ii) The advantage is stability in the foreign exchange market, leading to more efficient productive sectors. Malaysian exports and manufacturers are, therefore, able to make decisions based on consistency and stability. If there is a favourable movement of the US dollar against the fixed Ringgit, this results in a favourable trade balance.

The disadvantage of a fixed exchange rate is the potential of the currency to be misaligned against its fundamental equilibrium position. A misalignment can be due to a change in price levels, trade barriers and relative productivity among different sectors in the economy.

#### Question 4

Generally, candidates' answers lacked elaboration.

4. (a) (i) Central Bank of Malaysia Act 1958 (Revised 1994)  
The Act provides for the administration and objectives of the central bank. It also enumerates the powers and the duties of the central bank in relation to issuance of currency, maintenance of external reserve, authorised business of the bank, specific powers to deal with ailing institutions, its relationship with the Government and financial institutions. The Act also contains general provisions on the central bank's accounts, powers to compound, etc.
- (ii) Banking and Financial Institutions Act 1989 (BAFIA)  
The BAFIA which came into force on 1 October, 1989 provides for the licensing and regulation of institutions carrying on banking, finance company, merchant banking, and discount house and money-broking businesses. It also provides for the regulation of institutions carrying on scheduled business comprising non-bank sources of credit and finance, such as credit and charge card companies, building societies, factoring, leasing companies and development finance institutions. Non-scheduled institutions which are engaged in the provision of finance may be subjected to Part X and XI of the BAFIA as the Minister of Finance may decide.
- (iii) Islamic Banking Act 1983  
The Act provides licensing and regulation for Islamic banking business. The Act *inter alia* has provisions on the financial requirements and duties of an Islamic Bank, ownership, control and management of Islamic banks, restrictions on its business, powers of supervision and control over Islamic bank and other general provisions such as penalties etc.
- (b) Functions of Bank Simpanan Nasional  
(Any four of the following:)
- To promote and mobilise savings, particularly from small savers.

- To inculcate the habit of thrift and savings.
  - To provide the means for savings by the general public.
  - To utilise the funds of the bank for investment including financing of economic development of the nation.
  - To promote the interest of its depositors and other customers.
- (c) (i) Unit trusts are a form of collective investment that allows investors with similar investment objectives to pool their funds to be invested in a portfolio of securities or other assets. A professional fund manager then invests the pooled funds in a portfolio which may include cash, bonds and deposits, shares, properties or commodities. Unit holders do not purchase the securities or financial assets in the portfolio directly.
- (ii) The unit trust is constituted through a document, known as a trust deed, which brings together and binds the various parties to the trust deed, namely the trustee, the management company and investors.

The trustee, who holds the assets of the trust on behalf on the unitholders plays a crucial role in ensuring investors interest are protected.

Meanwhile, the management company or manager, who is the “promoter” of the scheme, provides investment and administrative expertise and markets units to the public.

- (d) One of the most important changes in the world economy over the last decade has been the globalisation process, which combined with improvements in information and communication technology has resulted in a massive increase in global capital flows.

The internationalisation of markets has led to rapid expansion of markets. Evidence of the growth of global currency markets is the development of 24-hour trading in foreign exchange markets in the last decade. The expansion of currency markets has far outpaced the expansion of world trade, with cross border investment flows increasing significantly. These include increased activity by the global funds management industry and speculative activity by international hedge funds.

Not only have financial markets grown, but they have become more interrelated. At a fundamental level, the movement towards free trade has caused economies to become more open, in the process both exporting and importing more. This has increased the international interrelationship between economic growth and inflation.

#### **Question 5**

Candidates could not differentiate between money market and capital market instruments. They also failed to highlight that short-term deposits are also money market instruments. Money market instruments are short-term in nature with maturity of less than one year and therefore, candidates’ answer should exclude capital market instrument, including equity and debt markets papers.

5. (a) (i) Unlike other financial intermediaries, merchant banks have little direct involvement with the retail sector. They generally have high entry requirements for investments (e.g. minimum amounts) that exclude most depositors, except for those with large amounts capital to save or invest.

A distinguishing feature of merchant banks is that many of their activities are fee-for-service activities, rather than the business of collecting deposits and on-lending them.

- (ii) Merchant banks offer a range of wholesale financial services including:
- Money market operations – the trading, endorsement and rediscounting of commercial bills and negotiable instruments of deposit; underwriting and trading commercial papers; dealing in government securities; making short-term advances to and accepting deposits from customers.
  - Lending activities – bankers acceptance or discount facilities, term loans and syndicated loans.
  - Corporate finance – advising and underwriting of new share issues; the private placement of securities with institutions or major private investors; advising clients on raising funds; and guidance on acquisitions.
  - Investment management and advice – advice to companies on local share and real estate investment, the short-term money market. Foreign exchange dealing, funds management and unit trusts.
- (b) The offshore market is another feature of the financial landscape of Malaysia. The International Offshore Financial Centre (IOFC) in Labuan was established in October 1990. It is important to note that the offshore market deals in non-Ringgit transactions and with non-residents only. The IOFC is aimed at enhancing the attractiveness of Malaysia as the regional financial centre as well as promoting the economic development of Labuan and its vicinity. The international business activities that can be conducted by IOFC in Labuan are:
- offshore banking operations
  - offshore insurance and offshore insurance-related activities
  - corporate funding
  - investment and fund management
  - offshore investment holding companies
  - professional services and other related services
- (c) Money market brings together individuals and institutions with temporary surpluses of funds and those with temporary shortages of funds. By convention, a security or loan with a maturity of one year or less is referred to as a short-term security.

Money market hence deals in short-term deposits (such as overnight money, weekend, 7 days, 1 month, 3 months etc.) and is not a physical market, as money market activity is handled by telephone, telex, or fax and on computer screens.

Money market also trades the following:

- Treasury bills
- Bankers acceptance
- Negotiable instruments of deposit (NID)
- Government investment certificates
- Cagamas notes and floating rate NID

Apart from Government and financial institutions, short-term debt is also issued by corporations. There are two popular types of short-term commercial papers in Malaysia:

- revolving underwritten facility (RUF) which is used mainly for financing a company's working capital and drawn on 1, 2, 3 or 6 months maturities.
  - notes issuance facility which is very similar to RUF except that it is not underwritten.
- (d) Financial intermediation
- In a financial system based on intermediation, financial institutions act as the critical link between the providers and users of capital or savings, i.e. lenders and borrowers. Intermediation is also known as "indirect financing". The terms "financial institution" and "financial intermediary" are interchangeable.

The intermediary can be thought of as a facilitator or conduit and may act as a principal or as an agent. Their role is to provide a service between two parties in the financial system and package a product or services to meet the needs of the two parties.

In this way, financial intermediaries provide the channel for the flow of funds between those with money and those needing money. They do this by pooling funds of savers and investors (i.e. lenders) and distributing these funds to a number of borrowers.

The margin between the rate paid by the intermediary and the rate at which the funds are lent compensates for the risk taken by the intermediary, and the intermediary earns a profit for that risk. The intermediary might also charge a fee for its services or a commission or brokerage.

The funds that financial intermediaries receive might be used to invest in government securities, loans to businesses, housing and other consumer loans, shares, property and other securities issued by mainly business borrowers. Other intermediaries package investment products in a more convenient form for the retail market (e.g. cash management and equity trusts).

One of the main reasons of intermediation is that the mix of securities offered by businesses and other borrowers is often unattractive in terms and conditions to lenders (savers). Financial intermediaries offer “packaged” securities to investors that are more attractive than original “lumpy” securities. For example, a small investor would probably prefer the convenience of a short-term deposit with a bank to a direct investment in a lumpy long-term house mortgage, which is the ultimate investment of the bank. By depositing with the bank, the small investor has security, a moderate return on the investment and ready access to cash when required. The bank bears the risk of default on the housing loan, but obtains a higher return than the investor (depositor) with the bank.

#### Question 6

- Candidates were unable to state the roles of the Malaysian financial system in the implementation of monetary policy and in mobilising funds in Malaysia.
- Candidates could not state the new developments with regard to the formulation of new acts by Bank Negara Malaysia (BNM) in respect to the expanded role of BNM itself.

6. (a) (i) Implementation of monetary policy  
Through the financial system, the government authorities can affect holdings in financial assets and through this, exert an influence on the level of spending on goods and services. Bank Negara Malaysia (BNM) uses monetary policy to influence the level of economic activity, the rate of inflation and the level of the Malaysian Ringgit. For example, to increase economic activity and to promote economic recovery during the Asian financial crisis in 1997-1998, BNM decreased interest rates. In addition, selective exchange controls were imposed in order to curb outflows of the Ringgit.
- (ii) Role of financial system  
**Mobilisation of funds**  
The financial system aids in the mobilisation of the community’s savings, and the transfer of the resources to sectors that make productive use of them. The financial system makes efficient use of resources when:
- Funds are allocated to the most efficient users of the funds
  - Transfers are carried out at the least cost.
- By providing savers with something they find more satisfying than current spending, the financial system encourages saving and so increases the volume of resources available for investment in productive assets, for example plant and machinery. The financial system enables lenders to use their excess funds to increase the resources available to borrowers, and allows borrowers to achieve a higher level of output or

acquire more assets than would be possible without borrowed funds. In other words, the financial system encourages more productive use of both funds and resources.

- (b) (i) **Development Financial Institutions Act 2002 (DFIA)**  
The DFIA which came into force on 15 February 2002 focuses on promoting the development of effective and efficient development financial institutions (DFIs) to ensure that the roles, objectives and activities of the DFIs are consistent with the Government policies and that the mandated roles are effectively and efficiently implemented. DFIA also emphasises on efficient management and effective corporate governance, provides a comprehensive supervision mechanism and mechanism to strengthen the financial position of DFIs through the specification of prudential requirements.
- (ii) **Anti-Money Laundering Act 2001 (AMLA)**  
The AMLA, which came into force on 15 January 2002, criminalises money laundering of proceeds from the predicate offences and provides for suspicious transaction reporting, record-keeping and the functions of a financial intelligence unit that could co-operate with domestic as well as foreign enforcement agencies. In this respect, the Minister of Finance has appointed BNM as the competent authority to carry out the functions of the financial intelligence unit. The law also provides for investigation into money laundering activities, law enforcement agencies to freeze, seize and forfeit proceeds from predicate offences as well as prosecution of money launderers.
- (c) **BNM conducts its monetary policy by influencing the level of interest rates that borrowers have to pay on their loans and that depositors earn on their deposits.** When the economy is overheating and the threat of inflation is high, monetary policy will be tightened by withdrawing funds from the banking system and raising interest rates. The higher interest rates will encourage people to save more and spend less. It would also make it more expensive for people to borrow money. This will cause consumption and investment to slow down to a level that is more sustainable and reduce the prospect for high inflation.