

CF01

Introduction To Monetary Economics And The Malaysian Financial System

6 MAY 2002

1. Time allowed : Three (3) hours
2. Total number of questions : Seven (7) questions
3. Number of questions to be answered : Five (5) questions
Part A : Two (2) questions [20 marks each]
Part B : Three (3) questions [20 marks each]
4. Candidates must obtain a minimum of 30 marks in Part B 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**.

PART A

ANSWER TWO (2) QUESTIONS ONLY

1. (a) Define price elasticity of supply and explain how it is measured. [3]
- (b) Using examples, list and explain **four** factors that affect the price elasticity of demand. [8]
- (c) (i) Explain the law of demand. [3]
- (ii) Explain **three** conditions where the exceptional demand curve (that is, a demand curve that does not follow the law of demand) exists. [6]
- (Total:20 marks)

2. (a) Consider a hypothetical economy that produces only **three** goods – steaks, eggs and soft drinks. Information on the quantities and prices of each good sold for **two** years is given below:

	1986	2001
Output		
Steak (pounds)	10	11
Eggs (dozens)	10	15
Soft drinks (bottles)	8	14
Price		
Steak (per pound)	RM2.80	RM3.20
Eggs (per dozen)	RM0.70	RM0.90
Soft drinks (per bottle)	RM4.00	RM4.60

For this hypothetical economy, calculate each of the following for years 1986 and 2001:

- (i) Nominal Gross Domestic Product (GDP) [4]
- (ii) Real GDP in constant 1986 ringgit (that is, 1986 is the base year) [5]
- (b) Why do economists prefer real GDP to nominal GDP as a measure of output growth? Explain your answer. [5]
- (c) (i) Explain the difference between GDP and Gross National Product (GNP). [3]
- (ii) What do you understand by the term “net factor payment”? [3]
- (Total:20 marks)
3. (a) Assume that Mr A deposits RM1,000 with Bank Y. If the cash ratio (statutory reserve ratio) is assumed to be 10%, answer the following questions stating any assumptions made and showing your answers using the partial balance sheet of the bank, where applicable:
- (i) Explain the process of credit creation. [11]
- (ii) Calculate the size of the money multiplier. [3]
- (b) What are the qualities of a good medium of exchange? [6]
- (Total:20 marks)

PART B

ANSWER THREE (3) QUESTIONS ONLY

4. The Central Bank of Malaysia Act 1958 (Revised – 1994) defined Bank Negara Malaysia as the bank which constitutes the apex of the monetary and banking structure of the country with the objectives to:

- issue currency and manage the nation's international reserves;
- act as a banker and financial adviser to the Government;
- promote monetary stability and a sound financial structure; and
- influence the credit situation to the advantage of Malaysia.

Describe each of the above **four** objectives.

(Total:20 marks)

5. In order to achieve its monetary policy objectives, Bank Negara Malaysia (BNM) has at its disposal several monetary policy instruments, which include:

- direct borrowing and lending in the money market;
- open market operations;
- statutory reserve requirements; and
- centralisation of deposits of the Government and the Employees Provident Fund (EPF) with BNM.

Explain each of the above **four** instruments.

(Total:20 marks)

6. (a) Write short notes on the following topics:

(i) The objectives of the merger programme for the domestic banking sector [5]

(ii) The objectives of the Financial Sector Masterplan 2001 – 2010 [5]

(b) Elaborate on the services provided by merchant banks. [10]

(Total:20 marks)

7. (a) Briefly describe any **five** of the following Syariah principles used in Islamic banking:
- (i) Al-Wadiah Yad Dhamanah (savings with guarantee) [2]
 - (ii) Al-Mudharabah (profit-sharing) [2]
 - (iii) Al-Musyarakah (joint venture) [2]
 - (iv) Al-Murabahah (cost-plus financing) [2]
 - (v) Bai'al-Dayn (debt trading) [2]
 - (vi) Al-Ijarah Thumma al-Bai' (leasing and subsequently purchase) [2]
 - (vii) Al-Qardhul Hasan (benevolent loan) [2]
 - (viii) Al-Kafalah (guarantees) [2]
- (b) Write short notes on the activities of the following groups of financial institutions:
- (i) development finance institutions [5]
 - (ii) savings institutions [5]
- (Total:20 marks)

- END OF QUESTION PAPER -

OUTLINE ANSWERS

PART A

Question 1

Candidates' major weakness in this question was their failure to recognise the difference between factors affecting the price elasticity of demand and factors affecting demand. Many candidates were also unable to explain the law of demand. However, they were able to illustrate the three conditions where the exceptional demand curve exists with a variety of examples.

1. (a) The price elasticity of supply can be defined as the degree of responsiveness of the sellers with regard to the quantity supplied to changes in price, i.e. when price changes, what will happen to the quantity supplied.

$$Es = \frac{\% \text{ change in quantity supplied}}{\% \text{ change in price}}$$

- (b) The following factors cause individuals to change their economic behaviour thus affecting the price elasticity of demand:

- *The presence of close substitutes for a good tends to make its demand more elastic.*
As the price of a particular good goes up, consumers tend to substitute away the more expensive good. For example, if people consider Darlie toothpaste to be a close substitute for Colgate toothpaste, then if the price of Colgate increases, *ceteris paribus*, many consumers will defect to Darlie. Hence, the elasticity of demand for Colgate is quite elastic.

- *The commodity's share in the consumer's budget.*
In general (although not always), the smaller the fraction of income absorbed by a commodity, the less elastic the demand, *ceteris paribus*. We don't expect people to cut back their purchases of safety pins when safety pins become more expensive. In contrast, if auto prices increase, many families will purchase fewer cars.

For goods which are an important part of the consumer's life (i.e., necessity goods), and whose cost constitute a major portion of an individual's income, consumers are unlikely to reduce such consumption significantly when prices increase, *ceteris paribus*. In other words, demand for such goods is quite inelastic.

- *The time frame of the analysis*
The elasticity of demand for a commodity may be greater in the long run than in the short run. Consider an increase in the price of a commuter ticket. In the short run, consumers have little choice but to take the same trip as before. In the long run, given time, a consumer can respond to an increase in price by joining a car pool, moving to a new residence that is closer to work, or buying a car. Thus, given a longer time horizon, the elasticity of demand for public transportation may be considerably greater than the short-run elasticity.
- *Habits*
Habitual smokers and drinkers tend to be inelastic in their demand for cigarettes and alcohol as these goods have almost become part of their life.
- *Income level*
People in the high-income bracket tend to be more elastic in their demand than the lower-income group.
- *Prices of goods*
Demand for lower priced goods tend to be more inelastic compared to that for expensive ones.

- (c) (i) The demand curve is a schedule showing quantities demanded at varying prices, at a given point in time. The law of demand shows an inverse relationship between price and quantity demanded, i.e.
- the higher the price, the lower the demand
 - the lower the price, the higher the demand
- (ii) Demand curves can be positively sloped due to the following reasons:
- *Giffen (Necessity) goods*
These are normally poor quality goods. When the prices of these products rise, real income falls. Given a lower real income, consumers will buy more of them and less of the other goods. Therefore, when the price rises the demand for Giffen goods also rises. Example: rice
 - *Festive seasons*
During festive seasons the prices of goods and services tend to increase. However, due to the consumers' needs to celebrate the festivals, their demand will tend to rise even when prices increase. Example: Fashion clothing
 - *Goods for snobs or ostentatious goods*
In the case of expensive jewellery, ownership portrays status in the society. Therefore, the higher the price the higher the demand. Example: Luxury cars
 - *Panic situation*
In situations such as emergencies and war, the demand for certain goods will increase tremendously. Prices will tend to increase due to limited supply. Increase in demand will therefore cause an increase in prices. Examples: Staple food and even items such as gold.

Question 2

This question was poorly answered. Most candidates reflected a weak understanding of the concepts of nominal GDP, real GDP, GNP and net factor payment.

2. (a) (i) Nominal GDP 1986 = $10(\text{RM}2.80) + 10(\text{RM}0.70) + 8(\text{RM}4.00)$
= RM67.00

Nominal GDP 2001 = $11(\text{RM}3.20) + 15(\text{RM}0.90) + 14(\text{RM}4.60)$
= RM113.10

(ii) Real GDP 1986 = $10(\text{RM}2.80) + 10(\text{RM}0.70) + 8(\text{RM}4.00)$
= RM67.00

Real GDP 2001 = $11(\text{RM}2.80) + 15(\text{RM}0.70) + 14(\text{RM}4.00)$
= RM97.30

- (b) Nominal GDP is the sum of the quantities of final goods and services produced times their current prices. An increase in nominal GDP can be caused by two reasons:
- An increase in the total production
 - An increase in prices

Therefore, we do not know whether nominal GDP is changing because of changes in the amount of goods and services produced or in that of prices.

Real GDP is calculated using market price from a base year, therefore it will not face the problems of the Nominal GDP.

- (c) (i) GDP is the total value of goods and services produced in a country like Malaysia. The amount will include goods and services produced by both Malaysians and foreigners in Malaysia. On the other hand, GNP takes into account goods and services produced by Malaysians in Malaysia and overseas.
- (ii) Net factor payment is the difference between the value of goods and services produced by foreigners in Malaysia and the value of goods and services produced by Malaysians overseas. When the net factor payment is negative, it means that the foreigners in Malaysia are earning more than what Malaysians are earning in foreign countries, and vice versa.

Question 3

Some candidates did reasonably well in answering part (a) of this question on the process of credit creation and the money multiplier. Part (b) required candidates to list the qualities of a good medium of exchange, but most candidates discussed the important functions of money instead.

3. (a) (i) The following assumptions will have to be made to explain the process of credit creation:
- The economy is closed
 - There is only one bank in the banking system
 - All people in the economic system will deposit all their money and take loans from this bank.

When Mr A deposits RM1,000, Bank Y will have an excess cash reserve of RM900 (based on 0% SRR assumption). The bank's books of ledger (partial) will look something like this:

Liabilities		Assets	
Deposits – Mr A	RM 1,000	Cash	RM1,000

Assume that Bank Y gives Mr B a loan of RM900. This loan is represented only by a book entry. There is no movement of cash as shown in the bank's ledger below:

Liabilities		Assets	
Deposits – Mr A	RM 1,000	Cash	RM1,000
Deposits – Mr B	RM 900	Loans – Mr B	RM 900

The money supply is now RM1,900. The excess cash reserve is RM810 (RM900 x 90%). Assume that this excess cash reserve of RM810 is lent out to Mr C. Bank Y's ledger is shown as below:

Liabilities		Assets	
Deposits – Mr A	RM 1,000	Cash	RM1,000
Deposits – Mr B	RM 900	Loans – Mr B	RM 900
Deposits – Mr C	RM 810	Loans – Mr C	RM 810

The money supply is now RM2,710. The process of credit creation will continue until the total money supply equals to RM10,000.

(ii) Money multiplier = $1/\text{cash ratio} = 1/0.10 = 10$
Therefore, an original deposit of RM1,000 will expand the money supply until RM10,000. In other words, the amount of money created is equal to RM9,000.

- (b) The qualities of a good medium of exchange are:
- Acceptability – it has to be accepted as a medium of exchange;
 - Durability – it can be kept for a considerable period of time;
 - Divisibility – it is readily divisible into smaller units;
 - Recognition – it is easily recognisable;
 - Uniformity – it is similar in terms of weight and size;
 - Portability – it is easily carried around; and
 - Scarcity – it is scarce.

PART B

Question 4

Candidates still had a very poor understanding of this question despite the topic's importance as it represented the core aspect of central banking and the question being asked frequently. Most candidates failed to highlight that currency issue is the privilege of a central bank. They also did not understand how a nation accumulates reserves and where they are kept.

4. (a) **Issues currency and manages the nation's international reserves**

In performing its function of issuing currency, BNM is required by law to maintain a minimum cover of 80.59% in external assets against its notes and coins in circulation. In practice, BNM has always maintained a cover well above 100% of BNM's currency liabilities, reflecting its commitment to maintain full gold and foreign exchange backing for the Malaysian Ringgit. As at the end of 2001, the cover was approximately 530%.

Maintaining a strong reserves position is also important to both the short-term objective of economic recovery as well as the long-term aim to maintain a sustainable external position. A large reserves cushion is indeed a key element in protecting the country against unforeseen destabilising developments. This is important to sustain market confidence and stability, enhance credit worthiness and at the same time, provide the Government with greater flexibility in the conduct of domestic policies.

The traditional policy for the Ringgit exchange rate has been for market forces to determine the rate and reflect underlying economic fundamentals. Interventions are conducted only to smooth excessively volatile fluctuations. The onset of the Asian financial crisis in July 1997 however prompted the introduction of selective exchange controls on September 1 1998 and fixing of the exchange rate at RM3.80 per US\$1 effective September 1, 1998.

(b) **Banker and financial adviser to the Government**

BNM's business includes managing the Government's liabilities, both in Malaysia and abroad. It advises the Government on its loan programmes, including the terms and timing of the loans and issue of new types of securities. In addition, BNM is responsible for trading, registering, settlement and redemption of Government securities through its computerised trading and settlement system.

The Central Bank Act of Malaysia also empowers BNM to provide temporary advances, known as "ways and means" advances, to the Government to cover any deficit in the budget revenue. However, there are legal limitations to the amount and the duration of loans that BNM can make available to the Government. The main underlying philosophy of these legal limitations is to prevent the Government from resorting to deficit financing. It is essentially legally impossible for deficit financing to occur in Malaysia.

As the Government's adviser, BNM also maintains a close relationship with the Ministry of Finance. In addition, BNM's relationship with the Government is also maintained through the participation of the Governor and BNM officials at various Government committees.

(c) **Promote monetary stability and a sound financial structure**

The ultimate objective of monetary policy in most economies increasingly points towards a common goal of attaining monetary or price stability. Price stability is a key prerequisite for sustained economic growth, in the absence of which the mobilisation of resources and the efficient channelling of resources to productive investment would be adversely affected. For more than four decades, the maintenance of price stability has contributed towards the Malaysian economy's structural transformation and its achieving sustainable economic growth.

The other side of the coin to monetary stability is financial stability. This conforms to the view that a sound and stable financial system is necessary for the conduct of monetary policy. Maintaining financial stability, in turn, requires stable monetary conditions so that the balance sheets of corporations and financial institutions are not adversely affected by conditions of macroeconomic stress. Having appropriate policies in place is important to ensure a sound banking system that provides a mechanism for the intermediation process to enable the economy to function efficiently.

An essential element for promoting financial stability is the existence of a strong and effective prudential framework. This will ensure that banking institutions operate in a prudent manner, thereby minimising the risk of bank failures, which could be disruptive with adverse implications on economic activities. BNM, as the lender of last resort, has to ensure that the level of risks assumed by the banking system is kept to a prudent level. BNM is also the sole authority regulating the banking industry in Malaysia.

(d) **Influence the credit situation to Malaysia's advantage**

BNM is also responsible to the Government for influencing the credit situation to help achieve the nation's overall economic objectives. BNM is obliged to ensure that the supply of money and volume of credit are sufficiently elastic to the demands of the domestic economy, without creating undue pressure on resources and prices. It regulates the volume of money and credit generation by the banking system through a range of instruments, including guidelines on lending to priority sectors and selective credit and administrative measures.

The imposition of guidelines on lending to priority sectors and selective administrative measures are meant to target only specific sectors of the economy. The guidelines on lending to the priority sectors are necessary to ensure that the economic and social objectives met are consistent with national objectives. In the case of selective credit measures, such credit controls are imposed to influence the direction of lending activities to specific sectors without affecting the availability of funds in the system and the prevailing level of interest rates.

As these guidelines would have a less desirable impact on the efficiency of distribution of resources in the economy in the longer run, such guidelines are introduced only under compelling circumstances and for limited periods. A case in point were the pre-emptive measures of 1997 to address the imbalances in the resources channelled to the property sector, consumption spending and the purchase of stocks and shares.

Question 5

Candidates lacked an understanding of monetary policy; in particular the concept of liquidity and how it influences interest rates and economic activities. Many candidates had the impression that BNM's action in the money market meant direct participation in real economic activity. For this reason, the candidates were unable to answer the question of centralisation of Government and Employees Provident Fund (EPF) deposits correctly, as they thought the Government and EPF funds parked at BNM were meant for investment.

5. (a) **Direct borrowing and lending in the money market**

Direct borrowing and lending in the money market represents one of the methods BNM uses in its money market operations to influence the level of interest rates. Direct lending and borrowing are conducted through principal dealers (PDs). This approach will allow BNM to focus on the need for liquidity in the system as a whole, rather than responding to the needs of each individual institution. Only under special circumstances, in its capacity as lender of last resort, does BNM provide direct access to its rediscount window to individual institutions, including non-principal dealers.

Presently, direct borrowing and lending – conducted in the form of money market tenders – is the most important instrument in steering the interest rate level and direction. Its role in influencing interest rates is further reinforced by the intervention rate. While the intervention rate will only be announced whenever there is a change in the policy stance, money market tendering is conducted on a daily basis.

BNM actively deals in market operations through the PDs, who then deal with the rest of the money market players. The market players will submit their bids/offer through PDs. BNM normally focuses its operations in the shorter tenor of one month or less, and occasionally in three-month maturity. Such operations are conducted on a clean basis, without requiring any collateral.

(b) **Open market operations (OMO)**

OMO are transacted mainly via the sale and purchase of Government securities and other papers either directly or through repurchase agreements (repo)/reverse repo. The scope for active OMO however has been constrained by the limited availability of Government papers (Government securities, Treasury bills and Government Investment Issues). Government papers are thinly traded as they have mainly been held by a captive market to meet statutory investment requirements.

At the same time, the diminishing supply of the papers, reflects the Government's improved financial position since 1993 and the downsizing of its operations. With the limited supply of papers, OMO have been largely used to provide a discount window facility to banking institutions as a last resort in times of liquidity needs.

In addition to the Government papers, other papers eligible for rediscounting at the window facility include Cagamas bonds/notes, BNM bills and selected private debt securities. BNM has the option of conducting OMO either through direct transactions or through repurchase agreements. As in the case of direct lending/borrowing, BNM only deals with the PDs.

(c) **Statutory reserve requirements (SRR)**

The SRR is one of the oldest monetary instruments deployed by BNM to control the liquidity situation in the banking system. Banking institutions are required to maintain a certain percentage of their reserves with the Central Bank. SRR is defined in terms of a bank's eligible liabilities (EL). The EL base comprises deposits (including negotiable certificates of deposit and repurchase agreements) and net interbank borrowings. All banking institutions are required to place a certain percentage of their EL as cash reserves with BNM.

The SRR is a powerful instrument available to BNM because it affects the level of deposits and loans that a bank can legally support given the size of its reserves. A restrictive monetary

policy stance can be pursued through increasing the ratio. This will reduce the level of excess reserves available to the banking institutions, thereby leading to a contraction of loans and deposits. As such reserves do not earn interest, the cost is usually passed on to the customers through higher lending rates. This will discourage borrowings, particularly for conspicuous spending.

Conversely, a lower ratio will increase the lending ability of the banking institutions. Although the SRR has been used as a monetary policy instrument, its imposition is part of the safety net put in place for the protection of depositors. Variations in the SRR was only implemented under circumstances when it was absolutely necessary to either mop-up or inject large amounts of liquidity in a single step.

(d) **Centralisation of Government and EPF deposits with BNM**

The Money Market Operations (MMO) Account of the Accountant-General (AG) provides BNM with an effective instrument for monetary management, not only in controlling liquidity at source but more importantly, to ensure that Government operations are consistent with the objectives of monetary policy.

The MMO Account of the AG – reactivated in 1990 – was one of the key measures implemented in the 1990-96 period to ensure that the Government deposits with the banking system did not accumulate unnecessarily as that would negate the tight monetary policy stance BNM adopted during that period. Under this arrangement, BNM manages the Government's funds, consistent with the desired interest rate level and underlying excess liquidity conditions. During a tight liquidity situation, BNM could recycle these deposits to the banking system.

A similar arrangement was also made with the EPF, since October 1992. In line with a more market-oriented approach to monetary policy management, the interest paid on both accounts is based on market rates.

Question 6

Few candidates knew the objectives and rationale of the merger programme and FSMP. Part (b) on the services the merchant banks provide was well answered.

6. (a) (i) Merger programme for the domestic banking sector

The merger programme for the domestic banking sector was initiated in July 1999. The initial programme envisaged the creation of six large and strong domestic financial groups from 21 domestic commercial banks, 25 finance companies and 12 merchant banks. Subsequently, all domestic banking institutions were given the flexibility to form their own merger groups and choose their own leader in each group to lead the merger process. In response to this approach, approval was granted for the formation of ten banking groups. By end-2001, their merger exercises were almost completed.

The recent regional currency crisis and the threat from globalisation and liberalisation have triggered the initiation of the merger programme. During the 1997-98 financial crisis, it was evident that a fragmented banking sector was highly vulnerable to shocks that could pose systemic risks to it.

Growing competition and strong pressures from the external front to further liberalise the banking sector have also clearly shown that the domestic banking sector can no longer remain protected. The financial liberalisation envisaged under the General Agreement on Trade in Services (GATS) to gradually remove barriers to entry and access among the WTO members has highlighted a crucial need. The domestic banking sector must gear itself to be able to meet the challenges and competition arising from increasing globalisation and technological advancements.

(ii) Financial Sector Masterplan

The Financial Sector Masterplan (FSMP) released by BNM in March 2001, provides a blueprint for the development of an effective, competitive, resilient and dynamic financial system with best practices that support and contribute positively to the growth of the economy. The FSMP also provides a blueprint for developing a core of strong and forward-looking domestic financial institutions that are more technology driven and ready to face the challenges of liberalisation and globalisation.

While opportunities have emerged in this new environment, the challenges of globalisation and technology advancements are having an unprecedented impact on the approach of banking and financial businesses. It is, therefore, vital for the financial system, particularly the domestic financial institutions to be resilient and efficient for the Malaysian financial sector to remain effective and responsive in the face of a more globalised, liberalised and complex domestic economy.

The recommendations in the FSMP have, therefore, focused on enhancing domestic capacity and capability prior to the introduction of an increasingly more competitive environment and subsequently moving towards greater international integration.

(b) Services Provided by Merchant Banks

Merchant banks were specifically formed to service the needs of the corporate sector and to complement the facilities offered by commercial banks which mainly focus on providing short-term credit for working capital and trade financing. As such, the operations of merchant banks hinge mainly on providing advisory and management services to corporations as well as conducting wholesale lending and deposit taking activities.

Specifically, merchant banks play a role in the short-term money market and capital raising activities including financing, specialising in syndication, corporate finance and management advisory services, arranging for the issue and listing of shares, as well as investment portfolio management.

As a matter of policy, merchant banks were required to generate 30% of their total income in the form of fee income, and this minimum fee income requirement was uplifted in December 1996. Most of the fee income were generated from the traditional fee-based activities of the merchant banks namely, loan syndication and management of consortium loans, corporate advisory services, underwriting services and portfolio management. The level of fee-based income generated by the merchant banks has increased substantially over the decade in line with the increase in corporate activities.

Apart from engaging in the fee-based activities, merchant banks also extend credit to the economy. As the merchant banking industry's business focuses mainly on the corporate sector, it operates mostly on a wholesale basis and is largely involved in project-based financing. As such, a large chunk of the merchant banks' total loans are in the form of term loans. However, the industry also provides financing for the operational activities of corporate clients mainly in the form of revolving credits.

On top of the traditional mode of credit extensions, merchant banks have also been involved in venture capital financing to finance high-risk businesses built on the strength of innovative ideas/products, as opposed to the traditional debt and collateral-based financing. This augurs well for the economy as the development of such businesses play a vital role in providing the necessary impetus for industrialisation and achieving the objectives of transforming Malaysia into an industrialised nation.

Question 7

Answers for both parts were acceptable, although there were candidates who were confused about the differences between Islamic and conventional banking products.

7. (a) Syariah principles in Islamic banking – choose any five
- (i) **Al-Wadiah Yad Dhamanah (savings with guarantee)**
Refers to goods or deposits, which have been deposited with another person, who is not the owner, for safekeeping. As Wadiah is a trust, the depository becomes the guarantor and, therefore guarantees repayment of the whole amount of the deposits, or any part thereof, outstanding in the account of depositors, when demanded. The depositors are not entitled to any share of the profits but the depository may provide returns to the depositors as a token of appreciation.
 - (ii) **Al-Mudharabah (profit-sharing)**
Refers to an agreement made between a party, who provides the capital and another party (entrepreneur), to enable the entrepreneur to carry out business projects, which will be on a profit sharing basis, according to a pre-determined ratio agreed upon earlier. In the case of losses, the losses are borne by the provider of the funds.
 - (iii) **Al-Musyarakah (joint venture)**
Refers to a partnership or joint venture for a specific business with a profit motive, whereby the distribution of profits will be apportioned according to an agreed ratio. In the event of losses, both parties will share the losses on the basis of their equity participation.
 - (iv) **Al-Murabahah (cost plus)**
Refers to the sale of goods at a price, which includes a profit margin as agreed to by both parties. Such sales contracts are valid on condition that the price, other costs and the profit margin of the seller are stated at the time of the agreement of sale.
 - (v) **Bai' al-Dayn (debt trading)**
Refers to debt financing, i.e. the provision of financial resources required for production, commerce and services by way of sale/purchase of trade documents and papers. Only documents evidencing real debts arising from bona fide merchant transactions can be traded.
 - (vi) **Al-Ijarah Thumma al-Bai' (leasing and subsequently purchase)**
Al-Ijarah contract (leasing/renting) and Al-Bai' contract (purchase). Under the first contract, the hirer leases the goods from the owner at an agreed rental over a specified period. Upon expiry of the leasing period, the hirer enters into a second contract to purchase the goods from the owner at an agreed price.
 - (vii) **Al-Qardhul Hasan (benevolent loan)**
Refers to an interest free loan. The borrower is only required to repay the principal amount borrowed, but he may pay an extra amount at his absolute discretion, as a token of appreciation.
 - (viii) **Al-Kafalah (guarantee)**
Refers to the guarantee a person provides to the owner of goods, who has placed or deposited his goods with a third party, whereby the guarantor and the third party must meet any subsequent claim by the owner for his goods.

(b) (i) Development Finance Institutions (DFIs)

Established by the Government to promote development programmes in the agricultural, industrial and international trade and export sectors, the DFIs continue to play a complementary role to the banking institutions in the intermediation process. They maintain their role as niche providers of specialist capital financing for projects which require medium to long-term financing in the agriculture, industrial and manufacturing sectors. DFIs have traditionally relied heavily on borrowings to fund asset growth as they are not licensed to mobilise deposits from the public. These institutions have access to resources at concessionary rates from the Government and foreign and international institutions.

Examples of DFIs are:

- Bank Pertanian Malaysia
- Bank Industri Malaysia Berhad
- Bank Pembangunan & Infrastruktur Malaysia Berhad
- Export-Import Bank of Malaysia Berhad
- Malaysian Industrial Development Finance Berhad
- Sabah Development Bank Berhad
- Malaysian Industrial Estates Berhad
- Borneo Development Corporation (Sabah) Sdn. Bhd.
- Borneo Development Corporation (Sarawak) Sdn. Bhd.

(ii) Savings Institutions

Savings institutions complement banking institutions in their role as major deposit-taking institutions. These savings institutions play a particularly important role in the promoting and mobilising savings among the middle and lower-income groups, especially in areas, which banking institutions do not adequately serve. Savings institutions source funds mainly from deposits largely to extend loans and investments.

Examples of savings institutions are:

- Bank Simpanan Nasional
- Bank Rakyat
- Other co-operative societies