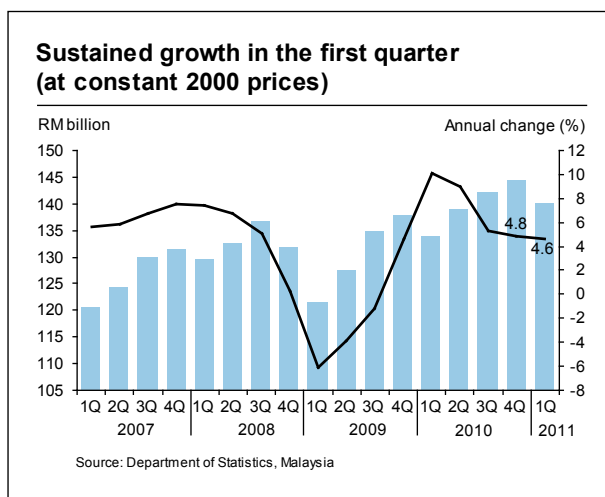


ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE FIRST QUARTER OF 2011

OVERVIEW

Sustained growth momentum in the first quarter of 2011

The Malaysian economy registered a growth rate of 4.6% in the first quarter of 2011 (4Q 10: 4.8%). The expansion in domestic demand was supported by higher private sector spending, while external demand also recorded a stronger growth during the quarter, mainly as a result of regional demand for commodities and non-E&E products. On the supply side, all major economic sectors, except the primary commodity sector, continued to expand during the quarter, albeit at a more moderate pace.



Domestic demand grew by 6.6% in the first quarter (4Q 10: 5.9%), supported mainly by the expansion in private sector spending and public consumption. Private consumption registered a strong growth of 6.7% (4Q 10: 6.4%) supported by favourable labour market conditions, positive consumer sentiments and continued income growth. Public consumption increased by 6.1% (4Q 10: 0.1%), due to higher expenditure on emoluments and supplies and services. Growth in gross fixed capital formation (6.5%; 4Q 10: 10%) was driven by private sector capital spending amid high capacity utilisation rates and the implementation of planned capital investment projects. Public sector capital investment was channelled mainly into the transportation, education and industrial sectors.

On the supply side, most major economic sectors recorded continued expansion during the first quarter. Growth in the services sector was sustained at 5.9% (4Q 10: 6.1%) with favourable expansion across most sub-sectors, supported by the improvement in domestic and external demand conditions. The manufacturing sector expanded by 5.4% (4Q 10: 6.2%), supported mainly by growth in the export-oriented industries and the sustained performance of selected domestic-oriented industries. The construction sector registered growth of 3.8% (4Q 10: 5.6%), supported by continued expansion across all sub-sectors. Output in the agriculture sector fell at a slower pace of -0.3% in the first quarter (4Q 10: -3.9%), reflecting the decline in crude palm oil output given continued unfavourable weather conditions. Meanwhile the mining sector contracted further by 3% (4Q 10: -1.2%) following lower production of crude oil due to scheduled maintenance and upgrading works.

The headline inflation rate, as measured by the change in the Consumer Price Index (CPI), rose by 2.8% on an annual basis in the first quarter of 2011 (4Q 10: 2.0%), due primarily to the increase in global commodity and food prices. The increase in consumer prices was contributed largely by the *food and non-alcoholic beverages* category, which rose by 4.3% (4Q 10: 2.9%). Prices in the *transport* category also registered an increase of 4.4% (4Q 10: 2.5%) in the first quarter, due to the upward adjustments in the price of RON97 in January and February as a result of higher global crude oil prices.

In the external sector, the trade surplus widened to RM36.1 billion in the first quarter (4Q 10: RM25.5 billion). Both gross exports and imports registered stronger growth of 7.5% and 12.4% respectively (4Q 10: 3.4% and 10.1% respectively). The stronger growth in exports reflected a broad-based expansion in all major export sectors, in particular, a turnaround in the growth of manufactured exports. Imports of intermediate goods rose due to the pick-up in manufactured exports, and contributed to the faster pace of increase in gross imports.

On a cash basis, gross inflows of foreign direct investment (FDI)* amounted to RM7.8 billion in the first quarter following the exceptional volume of RM13 billion recorded in the fourth quarter of 2010. After adjusting for gross outflows due mainly to the repayment of inter-company loans, net FDI was also lower at RM4.6 billion (4Q 10: +RM8.6 billion). Gross FDI inflows were channelled mainly into the manufacturing, services and mining sectors. Direct investment abroad (DIA)* by Malaysian companies recorded a net outflow of RM3.8 billion in the first quarter (4Q 10: -RM3.9 billion), reflecting mainly lower outflows of equity capital, which more than offset the larger net extension of inter-company loans to subsidiaries abroad. These investments were largely undertaken by companies in the finance and insurance, business services and communications industries in the services sector. Portfolio investment recorded a larger net inflow of RM4.7 billion in the first quarter (4Q 10: +RM3.3 billion), reflecting stronger foreign participation in the domestic capital market, particularly the debt market.

The international reserves of Bank Negara Malaysia amounted to RM344.5 billion (equivalent to USD113.8 billion) as at 31 March 2011. The reserves level has taken into account the quarterly adjustment for foreign exchange revaluation changes. As at 29 April 2011, the reserves position amounted to RM393.2 billion (equivalent to USD130 billion), sufficient to finance 9.3 months of retained imports and is 4.3 times the short-term external debt.

Monetary policy supported economic activity

The OPR was left unchanged at 2.75% in the first quarter of 2011. On 5 May 2011, the Monetary Policy Committee (MPC) raised the OPR by 25 basis points to 3.00 percent to adjust the degree of monetary accommodation. At the current OPR level, the stance of monetary policy remains supportive of growth.

The average overnight interbank rate was stable, moving within a range of 2.67% to 2.75% during

the period 1 January – 31 March 2011. Interbank rates of other maturities were also stable. In terms of retail interest rates, the average quoted fixed deposit (FD) rates of commercial banks, average base lending rate (BLR) of commercial banks (CBs), and average lending rate (ALR) on loans outstanding were stable.

In the first quarter, financing conditions remained supportive of economic activity. The continued access to financing in the financial system supported the demand for financing from the private sector. Total gross financing raised by the private sector through the banking system and the capital market was sustained at RM202 billion in the first quarter (4Q 10: RM221 billion). On a net basis, banking system loans and PDS outstanding rose at an annual rate of 12.5% as at end-March (4Q 10: 11.3%). Major loan indicators remained strong in the first quarter.

Net funds raised in the capital market by both the public and private sectors amounted to RM29.7 billion (4Q 10: RM30.5 billion). The bulk of funds were raised by the public sector's issuance of 10.5-year and 3.5-year Malaysian Government Securities (MGS), and a 7.5-year and 3.5-year Government Investment Issues (GII), as well as the re-opening of a 5.5-year MGS.

Monetary aggregates continued to grow at a sustained pace in the first quarter. M3, or broad money, expanded at a faster annual growth rate of 8.2% as at end-March 2011 (end-Dec 2010: 7.0%).

For the quarter as a whole, the ringgit appreciated by 1.9% against the US dollar. The positive growth outlook in Asia relative to the developed economies boosted investors' interest in the regional economies, providing continued support to the ringgit and the regional currencies. The release of better-than-expected figures for domestic GDP growth for the fourth quarter also provided the impetus for the ringgit's strength. Against other major currencies, the ringgit strengthened against the Japanese yen (3.5%)

* The statistics for FDI and DIA on a cash basis does not include retained earnings.

but depreciated against the euro (-4.6%) and pound sterling (-1.8%). During the period between 1 April to 16 May 2011, the ringgit depreciated by 0.4% against the US dollar. The ringgit also depreciated against the Japanese yen (-2.4%), the euro (-0.1%) and the pound sterling (-0.9%). Within the region, the ringgit depreciated in the range of -0.4% to -2.0%, as factors specific to other countries led to faster appreciation of their currencies relative to the ringgit.

Financial stability continues to be preserved

Financial system stability was sustained, underpinned by a resilient financial sector and the orderly functioning of the financial markets, which continued to provide support for financial intermediation in the domestic economy. During the quarter, financial sector resilience was reinforced by the manageable level of risk exposures. The resilience of the sector was evident in the sound level of capitalisation, firm profitability and stable quality of assets. The core capital ratio and risk-weighted capital ratio of the banking sector stood at 12.7% and 14.3% respectively, while the capital adequacy ratio of the insurance sector remained firm at 225.7%. To further reinforce the soundness of the household sector and the stability of the financial system, the Bank introduced a number of policy measures during the quarter. These include the issuance of a new Credit Card Guideline, raising the capital charges on housing loans where the loan-to-value (LTV) ratio exceeds 90% and for longer-tenured personal financing. This is to promote responsible lending practices by financial institutions, in particular for retail financing. A financial education programme known as the POWER! Programme has also been introduced to raise the level of financial literacy.

Growth of the domestic economy to be sustained amid heightened uncertainties in the global economy

The global economic recovery continued to strengthen in the first quarter of the year. Growth however continues to be highly uneven. More recently, several developments in the global economic environment and the international financial system have highlighted the fragility of global growth. However, in the event of higher commodity prices being sustained over an extended period, the escalation of fiscal conditions in the advanced economies and possible global supply disruptions following the developments in Japan, the downside risks to growth may increase. The growth prospects in the emerging economies continue to remain positive. These economies however are confronted with increasing challenges from rising inflationary pressures and continued large and volatile capital flows.

The sustained expansion in the first quarter underscores the steady pace of growth of the Malaysian economy, underpinned by the continued expansion of domestic demand amid improving external demand arising from higher commodity exports and stronger regional demand. Going forward, growth is expected to be sustained. Growth in private consumption will continue to be firm, given the favourable employment conditions and income growth, while private investment is expected to strengthen further amid an improving outlook for the domestic economy and the further expansion of new growth industries. Being a highly open economy however, the domestic economy may be affected by developments in the global environment. Nevertheless, Malaysia's strong economic fundamentals and policy flexibility have increased our resilience and improved our ability to manage these challenges.