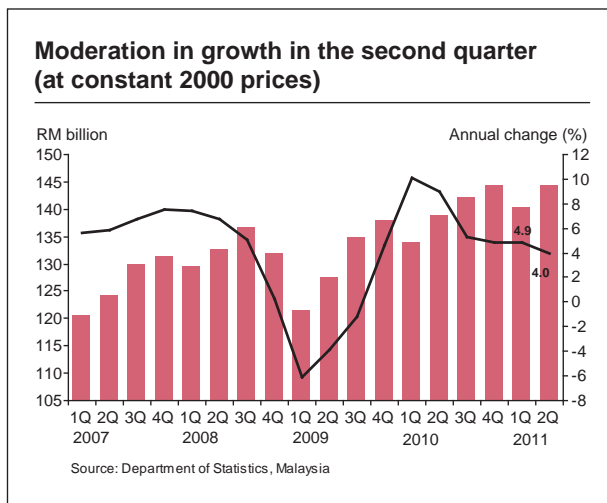


## ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE SECOND QUARTER OF 2011

### OVERVIEW

#### Growth moderated in the second quarter

The pace of growth of the Malaysian economy moderated in the second quarter (4.0%; 1Q 11: 4.9%) following a weaker external environment. The overall weakness in the advanced economies and the disruptions in the global manufacturing supply chain stemming from the disaster in Japan, were reflected in the slowdown in the manufacturing sector. Nevertheless, overall growth continued to be underpinned by the sustained expansion of private domestic demand. This was further supported by the strong exports of commodities and resource-based products given the favourable regional demand and high commodity prices.



Domestic demand increased by 5.2% (1Q 11: 6.9%), supported mainly by sustained growth in private sector spending. Private consumption increased by 6.4% (1Q 11: 6.7%). Sustained expenditure on emoluments and supplies and services supported the growth in public consumption (4.0%; 1Q 11: 8.9%). Growth in gross fixed capital formation moderated to 3.2% (1Q 11: 6.5%), due mainly to lower public investment. Private capital spending, however, was sustained by expansion in production capacity and investment in new growth areas in the manufacturing sector as well as exploration and development activity in the oil and gas

sector. During the quarter, Federal Government development expenditure was lower, and was focussed on the education, transportation and trade and industry sectors.

On the supply side, growth in most economic sectors moderated during the quarter. The manufacturing sector slowed to 2.1% (1Q 11: 5.5%) due mainly to the weaker global environment and the production disruptions following the disaster in Japan in March. Nevertheless, the services sector was sustained at 6.3% (1Q 11: 6.4%), supported by continued domestic private sector spending. The agriculture sector turned around to expand by 6.9% (1Q 11: -0.2%), due mainly to higher output of both crude palm oil and natural rubber following an improvement in weather conditions. Meanwhile, growth in the construction sector moderated to 0.6% (1Q 11: 3.8%) due to delays in the implementation of infrastructure projects. The mining sector continued to contract (-9.2%; 1Q 11: -4.2%), reflecting the lower production of crude oil following the shutdown of production facilities for maintenance.

The headline inflation rate, as measured by the change in the Consumer Price Index (CPI), rose to 3.3% on an annual basis during the quarter (1Q 11: 2.8%), driven by supply factors. The increase in consumer prices was reflected mainly in the food and non-alcoholic beverages category, which rose by 4.7% (1Q 11: 4.3%). Prices in the transport category also registered an increase of 5.7% (1Q 11: 4.4%), due to the upward adjustments in the price of RON97 petrol in April and May following higher global crude oil prices.

The external sector recorded a trade surplus of RM27.1 billion in the second quarter (1Q 11: RM31.8 billion). Gross exports expanded by 8.3%, while import growth moderated to 7.1% (1Q 11: 4.8% and 12.4% respectively). Export growth was supported by the continued expansion in the exports of commodities and non-E&E products, due mainly to the firm commodity prices and robust regional demand.

Meanwhile, exports of E&E registered a contraction as exports of computer and parts remained weak. Growth in gross imports was weighed down by lower imports of intermediate goods, which were affected by the global supply disruptions. The import of capital goods moderated due mainly to lower imports of machineries, while the import of consumption goods continued to expand.

On a cash basis, both gross and net inflows of foreign direct investment\* were higher at RM13.4 billion and RM6.2 billion respectively (1Q 11: +RM7.6 billion and +RM4 billion respectively). The inflows were broad-based and channelled mainly into the finance, insurance and business services sub-sector, manufacturing and oil and gas sectors. Direct investment abroad\* by Malaysian companies recorded a larger net outflow of RM9.4 billion (1Q 11: -RM3.7 billion). These investments were largely undertaken by companies in the finance and insurance, business services and communications sub-sectors. Net inflows of portfolio investment also increased to RM37.6 billion (1Q 11: +RM8.1 billion), reflecting the strong foreign interests in the domestic capital market, particularly the debt securities markets.

The international reserves of Bank Negara Malaysia amounted to RM406.3 billion (equivalent to USD134.3 billion) as at 30 June 2011. The reserves level has taken into account the quarterly adjustment for foreign exchange revaluation. As at 29 July 2011, the reserves position amounted to RM409.6 billion (equivalent to USD135.4 billion), sufficient to finance 9.6 months of retained imports and is 4.4 times the short-term external debt.

### **Monetary policy is supportive of economic activity**

On 5 May 2011, the Monetary Policy Committee (MPC) raised the Overnight Policy Rate (OPR) by 25 basis points to 3.00%. The degree of monetary accommodation was adjusted as a pre-emptive move to prevent a build-up of financial imbalances. At the July meeting,

the MPC decided to pause the normalisation and leave the OPR unchanged due to the heightened uncertainties arising from global developments which had created greater downside risks to growth.

Following the increase in the OPR in May, the average overnight interbank rate traded higher and interbank rates of other maturities rose accordingly. In terms of the commercial banks' lending rates, both the average base lending rate and the average lending rate were revised upwards. The average fixed deposit (FD) rate also increased in tandem.

Financing conditions remained supportive of economic activity during the quarter, with financing continuing to remain available to all segments of the economy. Total gross financing raised by the private sector through the banking system and the capital market increased to RM225.6 billion (1Q 11: RM202 billion). On a net basis, banking system loans and private debt securities (PDS) outstanding rose by an annual rate of 12.9% as at end-June (end-March 11: 12.1%). The major loan indicators also remained strong in the second quarter.

Net funds raised in the capital market amounted to RM20.8 billion (1Q 11: RM29.7 billion), of which, 83%, or RM17.3 billion was raised by the private sector, mainly via PDS. Meanwhile, net funds raised by the public sector amounted to RM3.5 billion during the quarter.

Private sector liquidity, as measured by broad money (M3), expanded at a higher annual rate of 12.4% as at end-June (end-March 11: 8.0%), reflecting the higher extension of credit to the private sector by the banking system and increased non-resident inflows.

The ringgit's appreciating trend against the US dollar in the first quarter of 2011 continued into the beginning of the second quarter, as the favourable growth outlook in Asia relative to the advanced economies continued to attract investors towards the regional financial markets. For the quarter as a whole, the ringgit

\* Excludes retained earnings.

appreciated marginally by 0.2% against the US dollar. Against other major currencies, the ringgit appreciated against the pound sterling (0.1%), but depreciated against the euro (-2.4%) and the Japanese yen (-2.5%). Against the regional currencies, the ringgit strengthened against the Thai baht (1.7%), but depreciated against the Chinese renminbi (-1.2%), Indonesian rupiah (-1.2%), Singapore dollar (-2.4%) and Korean won (-2.8%). The ringgit remained unchanged against the Philippine peso. During the period between 1 July and 15 August 2011, the ringgit appreciated against the US dollar (1.2%), euro (2.7%) and pound sterling (0.1%), but depreciated against the Japanese yen (-3.4%). Against regional currencies, the ringgit strengthened against the Korean won (2.2%), Indonesian rupiah (0.6%) and Chinese renminbi (0.1%) but depreciated against the Singapore dollar (-0.6%), Philippine peso (-0.9%) and Thai baht (-1.5%).

### **Financial stability remained intact**

Domestic financial system stability was maintained, underpinned by sound financial system and institutions and orderly financial markets which continue to support efficient financial intermediation and sustained public confidence in the financial system. The level of risk exposures of the financial sector continued to be manageable during the quarter. The resilience of the financial sector was evident in the sound capitalisation, firm profitability and stable quality of assets. Core capital ratio and risk-weighted capital ratio remained strong at 12.3% and 13.9% respectively. As for the insurance and takaful sector, the capital position remained strong with capital adequacy ratio of

224.1% and excess capital of RM19.5 billion. Liquidity remained ample to meet the demand for deposit withdrawals and other liquidity obligations.

### **Growth of the domestic economy to improve in the second half**

While the moderation in the global growth in the second quarter was mainly due to temporary factors arising from global supply chain disruptions and high commodity prices, fiscal and debt conditions in several of the advanced economies had also contributed to increased uncertainties and heightened financial market volatilities which affected overall confidence. Going forward, global growth is expected to remain positive, supported by economic activity in most of the emerging economies and the improvement in the global supply chain. The overall global recovery, however, will continue to be constrained by the structural weakness in the advanced economies. In addition, prolonged uncertainty in the financial markets could also weigh down on real economic activity.

In Malaysia, while the global supply disruptions affected production and trade in the second quarter, the underlying strength of the domestic economy remained intact as domestic demand continued to support growth. Going forward, the downside risks to external demand have increased following heightened uncertainties in the external environment. Nevertheless, domestic demand is expected to remain resilient and support growth amidst sustained private consumption, strong private investment and faster pace of implementation of public sector projects in the second half of the year.