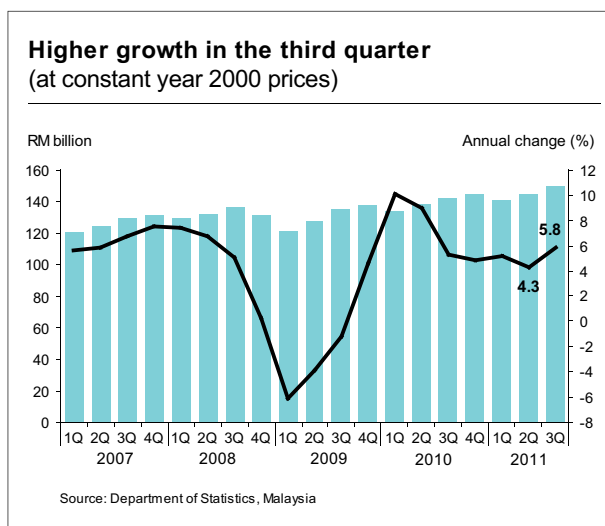


ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE THIRD QUARTER OF 2011

OVERVIEW

Growth improved in the third quarter

In the third quarter of 2011, the global economy continued to face a challenging environment. Continuing uncertainties in financial markets, unfavourable fiscal conditions and weaknesses in labour markets in the advanced economies continued to pose risks to growth in emerging economies, such as Malaysia. Despite the challenging environment, the Malaysian economy registered a higher growth of 5.8% (2Q 11: 4.3%), due to stronger domestic demand. The robust domestic demand was driven by an expansion in both household and business spending as well as higher public sector expenditure. On the supply side, most economic sectors recorded improvements in growth during the quarter, with the manufacturing sector recording a significantly better performance supported by firm regional demand for resource-based products, coupled with the normalisation in supply chain disruptions arising from the Japan natural disaster.



Domestic demand expanded by 9.0% (2Q 11: 5.6%), driven by the expansion in private sector spending and higher public sector expenditure. Private consumption increased by 7.3% (2Q 11: 6.4%), in line with favourable income growth while public consumption expanded by 21.7% (2Q 11: 6.6%) following higher expenditure on emoluments and supplies and services, as well

as bonus payments during the quarter. Gross fixed capital formation increased by 6.1% in the third quarter (2Q 11: 3.2%), supported by higher public sector capital spending, particularly the non-financial public enterprises, and continued expansion in private sector investment. Federal Government development expenditure during the quarter was mostly channelled into the public utilities, education, transportation, and trade and industry sectors. The private sector investment was underpinned by capital spending in the oil and gas industry; telecommunication sector and new growth areas such as renewable energy and medical equipment.

On the supply side, growth in most economic sectors strengthened in the third quarter. In the services sector, growth was supported mainly by domestic-driven activity. Higher growth in the manufacturing sector reflected the improvement in the supply chain and the robust performance of domestic-oriented industries. The construction sector registered a higher growth, led by the civil engineering sub-sector. The agriculture sector expanded on account of strong production of both crude palm oil and natural rubber. However, the mining sector continued to contract, albeit at a smaller pace, as output of crude oil was affected by shutdowns of production facilities.

The headline inflation rate, as measured by the change in the Consumer Price Index (CPI), rose to 3.4% on an annual basis in the third quarter (2Q 11: 3.3%). The increase in consumer prices was largely the result of higher prices in the *food and non-alcoholic beverages* category, which rose by 4.8% (2Q 11: 4.7%). Prices in the *transport* category registered a slower increase of 4.3% (2Q 11: 5.7%), in the absence of further adjustments to the prices of RON95 petrol and diesel in 2011.

In the external sector, the current account recorded a larger surplus of RM26.6 billion, equivalent to 12.5% of GNI due to a higher goods surplus and lower income deficits. The goods surplus widened to RM38.2 billion in the

3Q 2011 as export expansion outpaced import growth. Gross exports recorded a stronger growth of 11.4% (2Q 11: 8.8%), reflecting further expansion in exports of non-E&E manufactured products and commodities. Import growth was sustained at 7.4% (2Q 11: 7.4%).

The financial account turned around from a net inflow position to record a net outflow of RM23.3 billion (2Q 11: +RM44.5 billion), due to large net outflows of portfolio investments and lower net inflows of foreign direct investments. During the quarter, direct investments abroad by Malaysian companies increased further, while other investments reverted to record a net inflow, mainly by the private sector. Overall balance of payments remained strong, recording a surplus of RM10.9 billion in the third quarter (2Q 11: RM61.7 billion), as the higher surplus in the current account more than offset the net outflow position in the financial account.

The international reserves of Bank Negara Malaysia amounted to RM417.2 billion (equivalent to USD131 billion) as at 30 September 2011. The reserves level has taken into account the quarterly adjustment for foreign exchange revaluation. As at 31 October 2011, the reserves position had increased to RM429.1 billion, equivalent to USD134.8 billion, sufficient to finance 9.9 months of retained imports and is 4.1 times the short-term external debt.

Monetary policy is supportive of economic activity

The Overnight Policy Rate (OPR) was left unchanged at 3.00% in the third quarter of 2011, following a 25 basis points increase in May. At the prevailing level, the OPR remains supportive of economic activity. The stance of monetary policy is consistent with the assessment of heightened uncertainties arising from global developments that have created greater downside risks to growth.

Reflecting the unchanged OPR, the average overnight interbank rate and interbank rates of other maturities were stable. In terms of retail interest rates, the average quoted fixed deposit (FD) rates, average base lending rate (BLR) and weighted average lending rate (ALR) on

loans outstanding of commercial banks were relatively unchanged. With retail lending rates still below pre-crisis levels, the cost of financing to the economy continues to remain supportive of the economy.

Financing activity in the third quarter remained resilient. Total gross financing raised by the private sector through the banking system and the capital market was sustained at RM223.9 billion in the third quarter (2Q 11: RM224.9 billion). On a net basis, banking system loans and PDS outstanding rose by an annual rate of 13.4% as at end-September (end-June 11: 12.8%). The major loan indicators remained healthy during the third quarter.

Net funds raised in the capital market amounted to RM12.7 billion during the quarter (2Q 11: RM20.8 billion), of which, 88%, or RM11.1 billion were raised by the private sector, especially through private debt securities. The net funds raised by the public sector amounted to RM1.6 billion in the third quarter.

The monetary aggregates continued to grow at a sustained pace during the third quarter. M3, or broad money registered an annual growth rate of 12.5% as at end-September 2011 (end-June 11: 12.4%).

The ringgit depreciated against the US dollar in the third quarter, in line with other regional currencies. The depreciation, mostly in September 2011, reflected mounting concerns over the European sovereign debt crisis and the sustainability of global economic recovery, which led to higher risk aversion and prompted some investors to unwind holdings of emerging market assets. Overall, the ringgit depreciated by 5.3% against the US dollar. Against other major currencies, the ringgit appreciated against the euro (1.5%), but depreciated against the pound sterling (-2.2%) and the Japanese yen (-9.9%). Against regional currencies, the ringgit strengthened against the Korean won (4.5%) and Singapore dollar (0.2%), but depreciated against other currencies in the range of 2.9% and 6.3%. During the period between 1 October and 16 November 2011, the ringgit appreciated against the US dollar (0.8%), Japanese yen (1.4%) and euro (1.3%) but depreciated against the pound

sterling (-0.4%). Against regional currencies, the ringgit strengthened against the Indonesian rupiah (3.3%), Singapore dollar (0.4%) and Chinese renminbi (0.1%) but depreciated against the Philippine peso (-0.1%), Thai baht (-0.3%) and Korean won (-3.0%).

Financial stability remained intact

Financial stability remained intact throughout the third quarter, underpinned by sound financial institutions and orderly financial markets which continued to provide support for efficient financial intermediation in the domestic economy. Overall risks to financial stability remained low even under a more challenging external environment.

The banking sector remained highly resilient, with strong capital buffers, sustained profitability and ample liquidity. The core capital ratio and risk-weighted capital ratio of the banking system were sustained at a prudent level of 12.5% and 14.6% respectively. Similarly, the insurance and takaful sector exhibited the same resilience with a strong capital adequacy ratio of 221.1%.

Domestic economy to register growth amidst more challenging external environment

Global economic recovery continued in the third quarter, albeit at a more modest and uneven pace. Global growth outlook has become significantly more uncertain following heightened downside risks. In particular, the possible escalation of the ongoing fiscal concerns in the advanced economies could add further strains to the international financial system and undermine the prospects for continued global growth.

In the Malaysian economy, the higher growth in the third quarter was underpinned by the stronger domestic demand and an improvement in the external sector arising from firm regional demand. Going forward, the more challenging international environment could present greater downside risks to Malaysia's growth prospects. Nevertheless, growth in domestic demand is expected to continue to be the anchor of growth, supported by expansion in private consumption and private investment. Public spending and investment activity are also expected to lend support to growth.