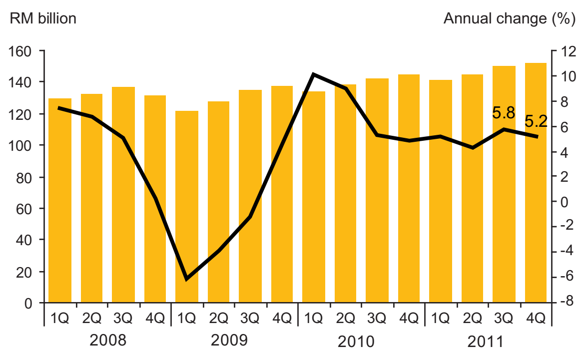
ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE FOURTH QUARTER OF 2011

OVERVIEW

Growth of the Malaysian economy remained favourable in the fourth quarter

The global economic and financial conditions continued to experience stress in the fourth quarter of 2011, following heightened concerns over the resolution of the European sovereign debt crisis. Growth in the advanced economies was affected by high unemployment, weak housing markets and fiscal issues while growth in Asia was affected by weaker external demand. Despite the challenging external environment, the Malaysian economy expanded by 5.2% (3Q 11: 5.8%), with growth being underpinned by domestic demand. The favourable domestic demand conditions were supported by both private and public sector spending. On the supply side, the services sector recorded slower growth, while the manufacturing sector grew at a similar pace to the previous quarter, reflecting the weaker external environment amid sustained growth in domestic activity. Other sectors, however, recorded improvements during the quarter, while the agriculture sector continued to record strong growth. For the whole year, the Malaysian economy expanded by 5.1%.

Growth remained favourable in the fourth quarter (at constant year 2000 prices)



Source: Department of Statistics, Malaysia

Domestic demand expanded by 10.5% during the quarter (3Q 11: 9.0%), driven by the continued expansion in household and business spending, and public sector expenditure. Private consumption increased by 7.1% (3Q 11: 7.3%), supported by favourable income growth while public consumption expanded by 23.6% (3Q 11: 21.7%) following higher expenditure on emoluments and supplies and services. Gross fixed capital formation increased by 8.5% (3Q 11: 6.1%), supported by continued expansion in capital spending by the private sector and the non-financial public enterprises. The Federal Government development expenditure during the quarter was mostly channelled into the transportation, and trade and industry sectors.

On the supply side, activity in the services sector moderated in the fourth quarter, while the manufacturing sector expanded at a similar pace to the previous quarter. This trend reflected the weaker external environment amid strong performance in domestic-oriented activity. The agriculture sector continued to expand on account of strong production of crude palm oil, while mining output recorded a slower contraction. The construction sector registered higher growth, supported by the implementation of major infrastructure projects.

The headline inflation rate, as measured by the annual change in the Consumer Price Index (CPI), declined to 3.2% in the fourth quarter (3Q 11: 3.4%). Inflation in the *transport* category was lower at 3.2% (3Q 11: 4.3%) as the impact of the one-off adjustment to the prices of RON95 petrol, diesel and LPG in December 2010 wore off. Inflation in the *food and non-alcoholic beverages* category, however, rose to 5.3% during the quarter (3Q 11: 4.8%), mainly due to higher prices in the *fish and seafood* subcategory.

In the external sector, the current account surplus narrowed in the fourth quarter, but remained large at RM22 billion, equivalent to 10.1% of GNI. The lower surplus reflected the lower goods surplus, higher trade deficits and larger income outflows. The goods surplus was slightly lower at RM36.9 billion as gross exports expanded at a more moderate pace (9.8%; 3Q 11: 11.4%), while import growth was sustained (7.6%; 3Q 11: 7.4%).

The financial account turned around from a net outflow position to record a small net inflow of RM0.2 billion in the fourth quarter (3Q 11: -RM23.3 billion), due to the significantly smaller net outflow of portfolio funds and higher net inflow of other investments. During the quarter, foreign direct investment recorded a higher net inflow of RM6.5 billion (3Q 11: +RM5.2 billion), supported by higher retained earnings by the multinational companies (MNCs) in Malaysia and higher inflow of equity capital. Direct investments abroad by Malaysian companies increased further to -RM14.4 billion (3Q 11: -RM12.9 billion), reflecting higher outflow of equity capital and larger earnings retained abroad for reinvestment purposes. The overall balance of payments continued to remain strong, recording a surplus of RM6.3 billion in the fourth quarter (3Q 11: RM10.9 billion), as the current account surplus remained high and the financial account registered a net inflow position.

The international reserves of Bank Negara Malaysia amounted to RM423.4 billion (equivalent to USD133.6 billion) as at 31 December 2011. The reserves level as at 31 December 2011 has taken into account the quarterly adjustment of the foreign exchange revaluation loss, following the strengthening of the ringgit against some major currencies during the quarter. As at 31 January 2012, the reserves position amounted to RM424.8 billion (equivalent to USD134.1 billion), sufficient to finance 9.6 months of retained imports and is 4.1 times the short-term external debt.

Monetary policy remained supportive of economic activity

The Overnight Policy Rate (OPR) was left unchanged at 3.00% in the fourth quarter of 2011 given the higher downside risks to growth and lower upside risks to inflation. At the prevailing level, the OPR remains supportive of economic activity.

Reflecting the unchanged OPR, the average overnight interbank rate and interbank rates of other maturities were relatively stable. In terms of retail interest rates, the average quoted fixed deposit (FD) rates of commercial banks were stable during the quarter. The average base lending rate (BLR) of commercial banks decreased slightly to 6.53% as at end-December due to the inclusion of a new foreign bank with a lower BLR in December. The weighted average lending rate (ALR) on loans outstanding moderated slightly to 5.66% as at end-December 2011 (end-September 5.70%). The cost of borrowing for businesses and households is still below pre-crisis levels and remains supportive of the economy.

In the fourth quarter, total gross financing raised by the private sector through the banking system and the capital market increased to RM240.6 billion (3Q 11: RM223.9 billion). The higher financing reflected increased loan disbursements during the quarter. On a net basis, banking system loans and PDS outstanding expanded at an annual growth rate of 12.5% as at end-December (3Q 11: 13.4%). The major loan indicators posted strong performances in the fourth quarter.

Net funds raised in the capital market increased to RM19.4 billion during the quarter (3Q 11: RM12.7 billion). Of this amount, RM15.9 billion was raised by the public sector. There was a significantly lower amount of redemptions by the public sector during the quarter. In the private sector, fund raising activity remained healthy. After adjusting for redemptions, net funds raised by the private sector amounted to RM3.5 billion.

The monetary aggregates grew at a stronger pace during the fourth quarter. M3, or broad money, expanded at a faster annual growth rate of 14.4% as at end-December (end-September 2011: 12.5%).

The global foreign exchange markets remained volatile in the final quarter of the year as uncertainty surrounding the European sovereign debt crisis continued to dampen investor sentiments towards emerging market assets. In general, exchange rate performance was largely news-driven, as markets reacted to developments in Europe. Overall, in line with the regional trend, the ringgit appreciated by 0.4% against the US dollar in the fourth quarter. Against other major currencies, the ringgit appreciated against the euro (5.0%), Japanese yen (1.7%) and the pound sterling (1.6%). Against regional currencies, the ringgit strengthened against the Indonesian rupiah (4.5%), Thai baht (2.3%), Singapore dollar (0.4%) and the Philippine peso (0.4%) but depreciated against the Chinese renminbi (-0.9%) and Korean won (-1.5%). During the period 1 January - 13 February 2012, the ringgit appreciated against the Japanese yen (5.1%), US dollar (5.0%), euro (2.6%) and the pound sterling (2.5%). The ringgit broadly strengthened against regional currencies, appreciating in the range of 1.3% and 4.9%.

Risks to financial stability remained manageable

Financial stability remained intact throughout the fourth quarter despite the persistent uncertainties and challenging external environment. Well-capitalised financial institutions and orderly functioning of the financial markets continued to provide support for financial intermediation activities in the domestic economy.

The banking system exhibited strong performance during the quarter. Sustained profitability continued to support the capital strength of banks. Liquidity in the banking system remained ample and sufficient to meet the demand for financing and other liquidity obligations. The core capital ratio and risk-weighted capital ratio of the banking system were at 12.9% and 14.9% respectively. Similarly, the insurance sector remained resilient with a strong capital adequacy ratio of 222.5%.

The Financial Sector Blueprint 2011 – 2020 was launched during the quarter, charting the future direction and initiatives to develop the financial sector to best serve the economy and to facilitate the economic growth and transformation over the next ten years. These include initiatives to promote inclusive access to financial services; encourage further development of financial institutions, products and markets that facilitate and drive the development of new domestic sources of growth; and accelerate Malaysia’s regional and international connectivity.

Growth may moderate amidst more challenging external environment

The global economic recovery continued in the fourth quarter, albeit at a more modest pace. Growth prospects, however, have become increasingly uncertain with the emergence of greater downside risks. In particular, policy uncertainty on the resolution of the ongoing sovereign debt crisis in Europe amid fiscal consolidation in the advanced economies could add further strains to the international financial system, thus affecting the prospects for continued global growth.

For the Malaysian economy, the favourable growth in the fourth quarter was underpinned by sustained domestic demand amid weaker external demand. Going forward, the more challenging external environment could present greater downside risks to Malaysia’s growth prospects. Nevertheless, domestic demand is expected to continue to be the key driver of growth, supported primarily by the continued expansion of private sector activity. Public sector expenditure is also expected to lend strong support to the overall growth performance.