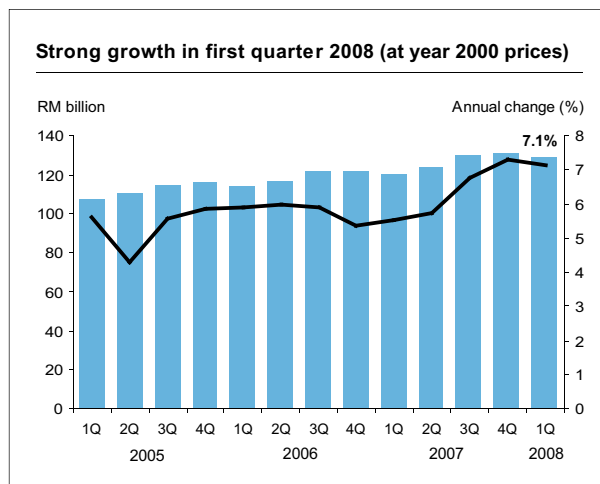


## ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE FIRST QUARTER OF 2008

### OVERVIEW

#### ***Strong GDP growth driven by strong consumption spending and external demand***

The Malaysian economy registered a strong growth of 7.1% in the first quarter of 2008. The growth momentum was led by double digit expansion in private and public consumption spending, while investment activities remained resilient. Growth was further supported by a strong contribution from external demand, following stronger growth in exports, while imports moderated further during the quarter.



On the supply side, growth was broad based with strong growth recorded in all economic sectors. The manufacturing sector expanded by 6.9%, reflecting higher growth in both export- and domestic-oriented industries. The strong domestic demand and demand from the region for resource-based products, especially petroleum and chemical products, led to the stronger expansion in the manufacturing sector. In the electronics and electrical (E&E) sector, the computer and parts segment recorded a strong performance (17.4%), driven mainly by demand from the non-US markets, in particular Europe and the Asian region. Output of semiconductor products, however, expanded at a slower pace (0.3%) due to lower global demand.

The services sector continued to be the main driver of growth, expanding by 8%. Strong consumption activities contributed to higher increase in the wholesale and retail trade, accommodation and restaurant, finance and insurance as well as transport and storage sub-sectors.

The primary commodity sector recorded a stronger performance with the agriculture sector expanding by 6.3% and the mining sector by 3.7%. The strong growth in the agriculture sector was led by higher crude palm oil output, while the higher growth in the mining sector was sustained by increased production of crude oil following higher output from the Kikeh oil field. The construction sector continued its growth momentum, supported mainly by infrastructure projects related to the oil and gas sector and the Ninth Malaysia Plan.

Domestic demand expanded at a stronger growth pace of 10.1% in the first quarter of 2008 (4Q 2007: 9.1%). Private consumption expenditure registered a growth of 11.8% supported by rising disposable income, strong export performance and favourable labour market conditions. Similarly, public consumption grew by 10.5% due to higher expenditure on emoluments, defence, and supplies and services.

Gross fixed capital formation grew at a more moderate pace of 6%. Key investment indicators such as growth in sales of commercial vehicles, loans disbursed to businesses, and imports of capital goods showed strong capital expenditure, particularly in the construction and manufacturing sectors. This is further supported by steady inflows of foreign direct investment into the manufacturing and oil and gas industries. The Government's development expenditure was steady, and continued to focus on providing essential services such as agriculture and rural development, improvement

to public utilities and transport infrastructure, as well as provision of housing, education and health services.

The headline inflation rate, as measured by the change in the Consumer Price Index (CPI), increased to 2.6% in the first quarter of 2008 (4Q 2007: 2.2%), due mainly to higher prices in the food and non-alcoholic beverages category and to a lesser extent, in the restaurants and hotels; and miscellaneous goods and services categories. In April, the CPI increased further to 3.0%.

On the external front, the trade account recorded a surplus of RM26.8 billion in the first quarter of 2008 (4Q 2007: RM28.4 billion). Gross exports expanded by 9.8%, the fastest pace since the third quarter of 2006, due mainly to the strong growth in commodity exports. Agriculture exports performed exceptionally well, driven by high prices and increased global demand for crude palm oil and rubber. Similarly, exports of crude oil and liquefied natural gas also expanded strongly. Meanwhile, manufacturing exports expanded at a more moderate pace of 0.8%, as robust growth in exports of resource-based products cushioned the contraction in E&E exports.

Gross imports expanded at a moderate pace of 6.7% due mainly to slower growth of imports of intermediate goods (8.7%), particularly inputs for the E&E industry. Imports of capital goods (excluding lumpy items) increased by 12.8%, led by strong activities in the mining and construction sectors. Imports of machinery and office equipment remained strong in tandem with sustained investment activities in the manufacturing and services sectors. Higher seasonal demand during the festivities and positive consumer sentiment led to higher imports of consumption goods (6%), particularly food and beverages, transport equipment as well as durable and semi-durable consumer goods.

In the financial account, gross inflows of foreign direct investment (FDI) on a cash basis, amounted to RM6.8 billion in the first quarter (4Q 2007: RM12.9 billion). About

half of the FDI inflows were directed into the services sector, followed by the oil and gas and manufacturing sectors. After adjustments for gross outflows due mainly to repayments of the short-term loans, net FDI inflows amounted to RM1.7 billion (4Q 2007: RM3.4 billion). Overseas investment by Malaysian companies recorded a net outflow of RM4.9 billion (4Q 2007: -RM4.8 billion). Meanwhile, portfolio investment recorded a net inflow of RM1.5 billion (4Q 2007: RM4.7 billion). Higher inflows of foreign funds for investment in debt securities more than offset outflows arising from the net liquidation of equity securities by foreign investors.

Effective from the beginning of 2008, the external debt data of Malaysia has been redefined to treat entities in Labuan International Business and Financial Centre (IBFC) as residents. Under this new definition, debt exposure of these offshore entities vis-à-vis the rest of the world will be included in Malaysia's external debt while debt exposure of residents with offshore entities in Labuan IBFC are excluded. This is aimed at facilitating a strengthened risk assessment for the economy as well as to be consistent with the international standards and best practices on the treatment of offshore entities in external data compilation. Under this new definition, Malaysia's external debt amounted to RM211.2 billion (or USD63.1 billion) as at end-2007, equivalent to 33.6% of Gross National Income (GNI), compared with RM187.4 billion (or USD56 billion) or 29.9% of GNI under the old definition. The profile of the external debt continued to be skewed towards a longer maturity structure. As at end-March 2008, Malaysia's external debt position was at RM212.8 billion (or USD65.9 billion), equivalent to 31.1% of GNI. A moderate increase in the short-term debt, due mainly to inter-bank borrowings, particularly by offshore financial entities in Labuan IBFC, was offset by a lower medium- and long-term debt attributable to the exchange revaluation gain and net repayment by the Federal Government.

The international reserves of Bank Negara Malaysia amounted to RM384.7 billion (equivalent to USD120.3 billion) as at

31 March 2008. The reserves increased to RM399.9 billion (equivalent to USD125.1 billion) as at 15 May 2008. The reserves position is sufficient to finance 9.9 months of retained imports and is 5 times the short-term external debt.

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

The Overnight Policy Rate (OPR) remained at 3.50% throughout the first quarter of 2008, as the prevailing level of the policy rate remained consistent with the outlook for economic growth and inflation.

Concurrently, interbank rates for all maturities were relatively stable during the quarter. In terms of lending rates, the average base lending rate (BLR) remained unchanged during the quarter, while the average lending rate (ALR) softened to 6.21% at end-March. Deposit rates remained relatively unchanged.

Despite the continuing uncertainties in the global financial markets, which led to some volatility in the domestic financial markets, domestic credit conditions remained favourable during the quarter. Demand for financing continued to be supported by ample liquidity in the domestic financial system. On a net basis, banking system loans and PDS outstanding expanded at a faster pace of 12.7% at end-March. Loans outstanding increased markedly by 10% at end-March due to both the business and household sectors, with loans outstanding to these sectors expanding at higher annual rates of 11.6% and 8% respectively. Loan applications, approvals and disbursements remained high across the business and household sectors, and continued to increase on an annual basis.

In the capital market, net funds raised during the quarter were significantly higher at RM12.4 billion. Net funds raised by the public sector were higher at RM10.6 billion, while net funds raised through the PDS market amounted to RM700 million. Funds raised through the equity market amounted to RM1.1 billion.

M3, or broad money, expanded significantly by RM51.6 billion or at an annual rate of 12.1% at the end of the first quarter. The increase mainly reflected net inflows stemming from trade, foreign direct investments and portfolio investments. The expansion in M3 was also supported by increased lending to the private sector and to a lesser extent, expansionary Government operations.

The ringgit experienced greater two way movements during the first quarter, reflecting volatile portfolio flows as investors reacted to events related to the turbulence in the international financial markets, and reassessed their positions on concerns that the US economic slowdown would have a spillover effect upon the region. Nevertheless, the upward trend of the ringgit as well as other regional currencies against the US dollar during this period was supported by the positive investor sentiment towards the Asian region, as well as the weakness of the US dollar arising from the deteriorating fundamentals of the US economy. Overall, while appreciating against the US dollar, the ringgit recorded a mixed performance against the other major currencies as well as against regional currencies. During the period 1 April to 27 May, the ringgit appreciated against the Japanese yen but depreciated against most other major currencies. The ringgit also appreciated against several regional currencies while depreciating against others.

### **Banking system continued to exhibit high resilience**

The banking sector continued to exhibit high resilience in the first quarter of 2008. The capitalisation of the banking system remained strong with risk-weighted capital ratio (RWCR) and core capital ratio (CCR) of 13.2% and 10.2% respectively as at end-March 2008. The banking system also registered a growth of 7.1% in unaudited pre-tax profit to RM5.7 billion. Meanwhile, the NPL level of the banking system continued to improve, with the total net NPLs based on the 3-month classification declining further by 5.2% to RM19 billion as at end of the

first quarter, to account for 3% of total net loans. As at end-April 2008, the net NPL ratio declined further to 2.9% on account of sustained repayments and recoveries.

### ***Growth to remain on a steady path into the second half of 2008***

Uncertainties in the global economic environment remain, with the global growth outlook expected to continue to be mixed, with moderation in industrial economies while growth in the Asian region is expected to be sustained. Overall, global growth is expected to moderate further going forward. In this environment, the Malaysian economy is expected to continue to remain resilient, supported by sustained growth in

domestic demand reinforced by expanding intra-regional trade. Despite rising inflationary concern, consumption activities are expected to be supported by favourable labour market conditions and high commodity prices. Key investment indicators, including imports of capital goods, loans to businesses and manufacturing investment approvals, as well as inflows of foreign direct investment, suggest that private investment activity remains positive. In addition, domestic credit conditions continue to be supportive of consumption and investment activities. Near-term indicators as well as the latest six-month smoothed growth rate of the Department of Statistics, Malaysia (DOSM) leading index indicate the underlying strength of Malaysian economy into the second half of 2008.