DEVELOPMENTS IN THE MALAYSIAN ECONOMY

Strong GDP growth led 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 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 import growth moderated further during the quarter.

Growth was broad based, with all sectors recording strong performance. The manufacturing sector recorded higher growth led by expansion in domestic-oriented and resource-based industries. Similarly, the agriculture sector also registered a stronger performance driven by double-digit expansion in crude palm oil output amidst the recovery in yields, while the expansion in the mining sector was contributed by increased production of crude oil. Meanwhile, strong domestic demand and finance-related activity underpinned the growth in the services sector. The construction sector continued its growth momentum, supported mainly by civil engineering activity related to the oil and gas sector, and implementation of the Ninth Malaysia Plan projects.

Quarterly GDP by Kind of Economic Activity at Year 2000 Prices[1]

	2007			2008
	1Q	4Q	Year	1Q
	Annual change in (%)			
Agriculture	3.8	4.7	2.2	6.3
Mining	-0.4	3.5	3.3	3.7
Manufacturing	2.0	5.6	3.1	6.9
Construction	4.1	4.7	4.6	5.3
Services	9.4	9.3	9.7	8.0
Real GDP (Annual Change)	**5.5**	**7.3**	**6.3**	**7.1**
Real GDP (Preceding Change)	**-1.6**	**0.8**	**6.3**	**-1.8**

[1] The GDP has been rebased from 1987 prices to 2000 prices

Source: Department of Statistics, Malaysia

Manufacturing sector led by domestic-oriented and resource-based industries

The strong domestic demand and demand for resource-based products from the regional countries supported the higher expansion in the **manufacturing sector** of 6.9% during the quarter (4Q 2007: 5.6%).

Performance in the Manufacturing Sector

	2007			2008
	1Q	4Q	Year	1Q
	Annual change (%)			
Value Added (Constant Price)	**2.0**	**5.6**	**3.1**	**6.9**
Overall Production	**0.7**	**4.9**	**1.9**	**6.4**
Export-oriented industries	**-0.2**	**3.4**	**0.7**	**4.5**
Of which:				
Electronics and electrical	-5.5	5.5	-0.9	2.9
Electronics	-4.0	10.3	1.5	3.6
Electrical	-10.3	-9.5	-8.7	0.7
Chemicals and chemical products	7.3	-1.4	1.8	4.0
Petroleum products[1]	5.0	3.7	5.4	8.2
Rubber products	16.9	1.6	5.9	3.3
Off-estate processing	-1.3	12.0	-0.5	20.1
Domestic-oriented industries	**4.9**	**10.9**	**6.8**	**14.0**
Of which:				
Construction-related materials[2]	3.3	5.1	5.0	14.5
Fabricated metal products	21.9	19.0	19.4	16.4
Transport equipment	-21.9	15.3	-6.0	20.8
Food	16.2	8.3	7.6	8.2
Total Manufactured Exports	**1.4**	**3.0**	**0.3**	**0.8**
Of which:				
Electronics and electrical products	-2.0	-2.1	-4.2	-9.4
Chemicals and chemical products	33.8	9.1	13.8	6.7
Petroleum products	-24.5	43.7	3.8	93.4
Rubber products	31.0	20.6	13.4	21.9
Furniture & parts	7.9	1.5	5.9	0.6

[1] Under the new Industrial Production Index (2000=100), LNG has been reclassified as petroleum products (previously classified as chemicals and chemical products). Consequently, petroleum products have been reclassified as export-oriented industries

[2] Includes iron & steel and non-ferrous metal as well as non-metallic mineral products

Source: Department of Statistics, Malaysia

In the **export-oriented industries**, while growth in the electronics and electrical (E&E) sector was dampened by weaker external demand, resource-based industries continued to be supported by demand from the region, especially for petroleum and chemicals products. Activity in the off-estate industry was also stronger in line with higher output of commodities during the quarter. In the E&E sector, output of computer and parts segment recorded a strong performance (17.4%), supported mainly by demand from the non-US markets, especially Europe and the Asian region. Output of semiconductor products, however, expanded at a slower pace (0.3%; 4Q 2007: 8.8%) due to lower global demand.

Performance of **domestic-oriented industries** strengthened further during the quarter, reflecting broad based expansion across all segments. Industries related to the construction sector registered double-digit expansion, benefiting from the robust domestic construction activity as well as regional demand. Meanwhile, strong sales in new motor vehicles supported growth in output of the non-metallic mineral products and transport-equipment industry.

During the quarter, the manufacturing sector was operating at a capacity utilisation rate of 78%, with the capacity utilisation rate for export- and domestic-oriented industries averaging at 79% and 74% respectively.

Capacity Utilisation Rate in the Manufacturing Sector *

* Beginning 2004, the capacity utilisation rate in the manufacturing sector has been rebased from value-add in year 2000 to value-add in year 2004

Services sector the main driver of growth

The services sector remained the main driver of growth during the quarter, contributing 4.3 percentage points of overall GDP growth. The expansion was led by wholesale and retail trade, accommodation and restaurant, finance and insurance, and transport and storage sub-sectors.

Performance in the Services Sector (value added at year 2000 prices)

	Share 2007	2007			2008
		1Q	4Q	Year	1Q
	%	Annual change in (%)			
Intermediate Services	**43.7**	**12.8**	**10.2**	**11.7**	**8.3**
Finance & insurance	19.9	13.8	10.0	11.1	9.9
Real estate & business services	9.8	22.5	11.1	18.2	4.5
Transport & storage	7.0	5.6	12.4	10.0	9.8
Communication	7.0	5.4	7.2	7.0	7.5
Final Services	**56.3**	**6.8**	**8.6**	**8.1**	**7.8**
Electricity, gas & water	5.6	4.1	3.0	3.9	4.6
Wholesale & retail trade	22.8	9.2	12.9	12.5	12.4
Accommodation & restaurant	4.4	7.8	12.3	10.8	10.0
Government services	12.9	6.3	5.0	4.5	2.8
Other services	10.6	3.7	5.4	5.0	5.2
Total Services	**100.0**	**9.4**	**9.3**	**9.7**	**8.0**

Source: Department of Statistics, Malaysia

Selected Quarterly Indicators in the Services Sector

	2007				2008
	1Q	2Q	3Q	4Q	1Q
	Percentage at end-period (%)				
Cellular phone penetration rate	77.0	78.2	80.8	85.1	87.9
Internet subscribers penetration rate	14.0	14.2	14.3	14.3	14.5
Broadband subscribers penetration rate	3.7	4.1	4.5	5.0	5.4
	Index				
MIER Consumer Sentiment Index	124.1	115.9	117.5	110.7	115.5
MIER Retail Trade Index	118.8	129.5	145.9	141.2	106.1
MIER Tourism Market Index	133.8	131.6	131.1	133.6	120.3
	Annual change (%)				
Total consumption credit outstanding	7.8	7.4	7.1	7.3	7.2
Loans outstanding to the wholesale & retail trade, hotels & restaurants	1.8	-0.2	6.1	7.2	10.5
Imports of consumption goods	8.9	1.1	1.2	3.8	6.0
Total sales of motor vehicles	-15.3	-9.1	4.9	19.0	24.7
Container cargo handled (Port Klang and PTP)	18.5	12.2	9.7	14.4	9.7

Source: Various sources

Growth in the **wholesale and retail trade**, and **accommodation and restaurant** sub-sectors were sustained at a high level supported by strong domestic consumption activities, as reflected in the high growth of consumption imports (10.1%), loans outstanding to the wholesale and retail sector (10.5%) and sales of new motor vehicles (24.7%) during the quarter.

Meanwhile, the **finance and insurance** services sub-sector was driven by higher intermediation activity as well as continued expansion in fee-based activity in the banking sector. Growth was further supported by the insurance segment. Meanwhile, the **transport and storage** sub-sector sustained a strong double-digit growth led by both the cargo and passenger segments, amidst strong trade activity and increased travel by Malaysians and foreign tourists.

Higher growth in commodities

The **agriculture sector** expanded strongly by 6.3% in the first quarter, driven by high production of crude palm oil following the recovery of the yield cycle, with yields rising by 15.8%. The growth was also supported by the favourable performance in the other agriculture segment, namely fruits and vegetables, as well as livestock. Meanwhile, the **mining sector** saw an increased output of crude oil (including condensates) of 5.5% to 709,640 barrels per day, on account of higher output from the Kikeh

Performance in the Agriculture Sector

	2007			2008
	1Q	4Q	Year	1Q
	Annual change (%)			
Value Added (at year 2000 prices)	**3.8**	**4.7**	**2.2**	**6.3**
Industrial Crops	**3.8**	**6.1**	**0.0**	**9.1**
Food Crops	**3.8**	**2.8**	**5.3**	**2.5**
Production				
Of which:				
Crude palm oil	-1.4	12.9	-0.4	23.9
Rubber	-6.9	-7.6	-6.6	-1.6
Fish	3.8	4.9	0.2	0.4
Livestock	18.1	6.5	9.9	1.0
Exports (RM million)	**7.7**	**37.8**	**24.4**	**66.2**
Of which:				
Palm oil	18.2	65.2	47.8	104.3
Rubber	-12.9	2.9	-10.9	30.8
Sawn timber	7.4	-21.4	-5.4	-21.6
Saw logs	-10.5	-18.7	-6.6	-1.8

Source: Malaysian Palm Oil Board (MPOB)
Malaysian Rubber Board (MRB)
Fisheries Department Malaysia
Veterinary Services Department, Malaysia
Department of Statistics, Malaysia

Performance in the Mining Sector

	2007			2008
	1Q	4Q	Year	1Q
	Annual change (%)			
Value Added (at year 2000 prices)	**-0.4**	**3.5**	**3.3**	**3.7**
Production				
Of which:				
Crude oil and condensates	-1.9	7.2	4.3	5.5
Natural gas (net)	1.1	-2.2	1.4	0.8
Exports (RM million)	**-5.3**	**21.3**	**7.5**	**40.2**
Of which:				
Crude oil and condensates	-8.6	32.1	3.5	50.9
Liquefied natural gas	4.3	8.3	12.3	24.7

Source: PETRONAS
Department of Statistics, Malaysia

oil field. Meanwhile, natural gas production rose marginally by 0.8% during the quarter.

Continued growth momentum in the construction sector

The **construction** sector continued its growth momentum, expanding by 5.3% in the first quarter. Growth was supported by activity in the civil engineering sub-sector related to infrastructure projects in the oil and gas sector, and under the Ninth Malaysia Plan. The sector's performance was further enhanced by the non-residential segment, particularly construction of office space in the Klang Valley.

Construction Indicators

	2007			2008
	1Q	4Q	Year	1Q
	Annual change (%)			
New sales and advertising permits	7.7	-3.1	2.0	-6.4
Housing approvals	-9.6	-6.0	-11.5	10.6
Production of construction-related materials	3.3	5.1	5.0	14.5
Loans approved for construction	81.7	27.7	54.8	73.0
Imports of construction materials and mineral products	12.6	38.8	12.9	31.6[1]

[1] January-February 2008

Source: Ministry of Housing and Local Government and Department of Statistics, Malaysia

Domestic demand recorded a strong growth

Domestic demand recorded a strong growth of 10.1% in the first quarter (4Q 2007: 9.1%).

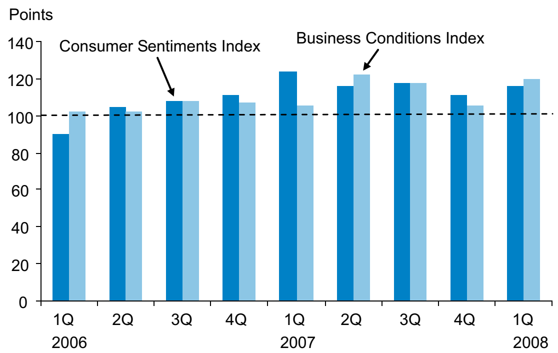
Private consumption expenditure registered a double digit growth of 11.8% for the quarter. Despite concerns of rising prices, consumer spending was supported by rising disposable income, strong export performance and favourable labour market conditions. Major consumption indicators pointed to sustained expansion in consumer spending activities during the quarter, with double-digit growth in credit card spending, sales of passenger cars, and loans approved and disbursed to households, as well as to businesses in the wholesale and retail trade sector. Reflecting consumers' continued positive outlook on the domestic economy, the MIER Consumer Sentiment Index rose to 115.5 points in the

GDP by Expenditure Components (at constant 2000 prices)

	2007			2008
	1Q	4Q	Year	1Q
	Annual change (%)			
Aggregate Domestic Demand (excluding stocks)	8.1	9.1	9.8	10.1
Consumption	7.6	8.7	9.9	11.6
Private sector	*7.6*	*10.2*	*10.8*	*11.8*
Public sector	*7.3*	*4.2*	*6.6*	*10.5*
Gross Fixed Capital Formation	9.5	10.2	9.6	6.0
Net Exports	-12.7	-12.3	-3.8	26.4
Exports of Goods and Services	*2.4*	*7.8*	*4.2*	*6.0*
Imports of Goods and Services	*4.7*	*11.0*	*5.4*	*3.4*
GDP	**5.5**	**7.3**	**6.3**	**7.1**

Source: Department of Statistics, Malaysia

Consumer Sentiment and Business Confidence Improved



first quarter (4Q 2007: 110.7 points). Similarly, **public consumption** grew by 10.5% during the quarter (4Q 2007: 4.2%) due to higher expenditure on emoluments, defence and supplies and services.

Meanwhile, **gross fixed capital formation** registered a more moderate growth of 6% in the first quarter of 2008 (4Q 2007: 10.2%). Major investment indicators suggested strong capital expenditure pattern, including robust growth in sales of commercial vehicles, loans disbursed to businesses, particularly the construction and manufacturing sectors, as well as imports of capital goods. Steady gross inflows of foreign direct investment of RM6.8 billion, especially into the manufacturing and oil and gas sectors further supported the expansion in private sector capital spending. Positive business sentiments as indicated by the MIER Business

Conditions Index which climbed to 119.9 points (4Q 2007: 105.5 points), and high capacity utilisation rates in the manufacturing sector also sustained investment growth. The Government's development expenditure 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.

Headline inflation rose in the first quarter of 2008

The average headline inflation increased to 2.6% during the quarter (4Q 2007: 2.2%). Prices in most categories of the Consumer Price Index (CPI) were higher compared to the previous quarter. For the food and non-alcoholic beverages category, the inflation rate was 4.4%, and it was a major contributor to the higher inflation, accounting for 1.4 percentage points of the overall inflation rate. Domestic food prices rose in response to the increase in global food prices. Prices in the restaurants and hotels category continued to increase, as prices for refreshments at restaurants and cafés increased further. Higher global prices for precious metals also pushed up prices in the miscellaneous goods and services category. The increase in overall inflation was partially mitigated by declining prices in the communication; and clothing and footwear categories, due in part to strong competition in these sectors.

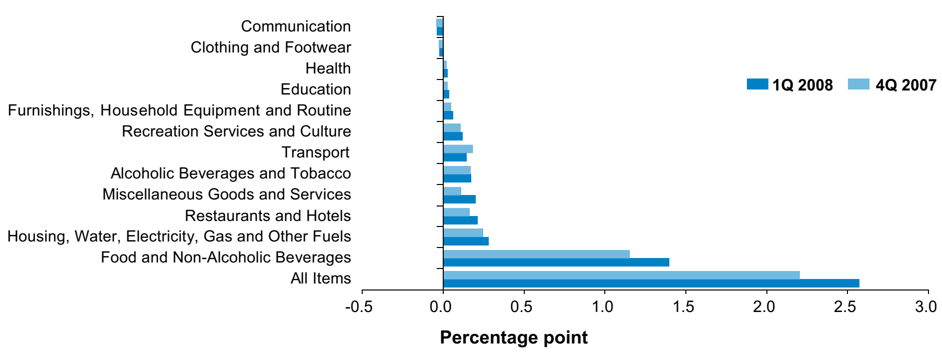
Producer price inflation remained relatively high at 9.8% (4Q 2007: 10%) signifying continued cost pressures. Prices for commodity-based Producer Price Index (PPI) components rose higher as global prices for raw commodities such as crude oil, rubber and crude palm oil continued to increase during the quarter. The non-commodity based components of the PPI did however show a moderation in price increases, especially in the machinery and transport equipment category.

Favourable labour market conditions

Labour market conditions tightened in the first quarter as total retrenchments declined sharply while demand for labour rose further. The MIER Employment Index increased by 6.1 points from the previous quarter to 119.2 points, suggesting continued optimism in employment prospects.

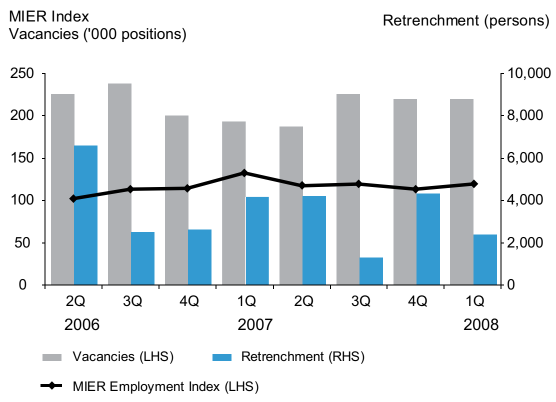
Total retrenchments fell by 45% quarter-on-quarter to 2,397 persons (4Q 2007: 4,345 persons), reflecting mainly lower retrenchments in the manufacturing and services sectors. Almost half of those retrenched involved the lower skilled workers such as plant and machine operators (27%) and general workers (22%), while professionals and technical workers accounted for another 15%. Overall, employers cited high production cost, reduction in demand and unmarketable products to be the key reasons for the retrenchments.

Contribution to Consumer Price Inflation



Meanwhile, the number of active vacancies reported via the Electronic Labour Exchange (ELX) edged upwards in the first quarter to 219,366 positions (4Q 2007: 219,179 positions), with job openings recorded mainly in the agriculture (31%), manufacturing and services (29% each) sectors. The bulk of vacancies advertised in the ELX was for elementary occupations such as labourers in the manufacturing, agriculture, construction and services sectors as well as domestic helpers and cleaners. Graduate-level vacancies increased by 48% from the previous quarter to 20,501 positions, with most jobs posted in the services sector, in particular the finance industry, real estate and business services as well as education.

Labour Market Conditions

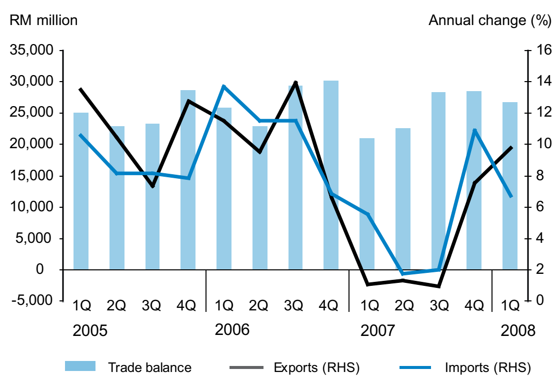


Growth in real labour productivity in the manufacturing sector rebounded in the first quarter to 9.7% (4Q 2007: 0.1%) and surpassed real wage per worker growth. Labour productivity was supported by higher manufacturing sales in both domestic and export-oriented industries (23.1% and 12.6% respectively) amidst a stable headcount growth (1.3% for the whole sector). Meanwhile, growth in real wage per worker was sustained at 3.3% (4Q 2007: 3.2%), providing some support to consumption spending.

Stronger exports supported by commodities

The **trade account** recorded a surplus of RM26.8 billion in the first quarter (4Q 2007: RM28.4 billion). **Gross exports** rose by 9.8%, the fastest pace since 3Q 2006, due mainly to strong performance in commodity exports. Meanwhile, import growth moderated to 6.7% (4Q 2007: 10.9%) due mainly to slower growth in intermediate imports.

Trade Balance



Agriculture exports performed exceptionally well during the quarter, rising by 66.2%, lifted mainly by high prices as well as higher volume of exports. In particular, export receipts from palm oil more than doubled due to record high prices (RM3,159 per tonne), as well as rising export volume (23.1%). Besides the strong fundamentals, the sharp increase in crude oil prices also attributed to the increased prices in crude palm oil and rubber.

In line with the upward trend in global crude oil prices, **mineral exports** rose by 40.2% during the quarter, reflecting the increase in export prices of Malaysian crude oil to an average of USD95.28 per barrel. Growth was further supported by a 24.7% rise in the exports of liquefied natural gas due to higher prices.

Manufacturing exports continued to expand in the first quarter, albeit at a more moderate pace of 0.8% (4Q 2007: 3%), as the robust growth in resource-based products cushioned the contraction in E&E exports. Besides the weaker demand from the major markets for semiconductors, exports of E&E products were also influenced by price attrition as reflected by the contraction in average selling prices of both semiconductors and computers and parts. Meanwhile, exports of selected resource-based products, namely petroleum, rubber and food products, registered robust performance as selling prices were influenced by the high input costs of commodities.

Trade Account

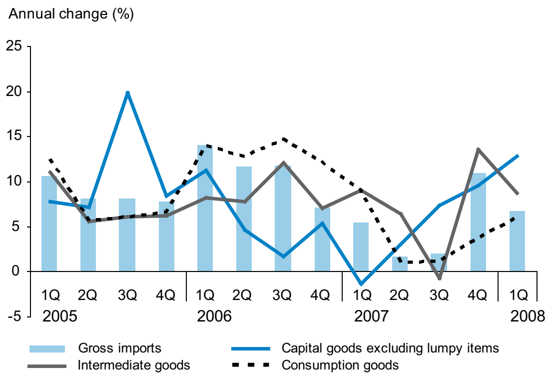
	2007			2008
	1Q	4Q	Year	1Q
	Annual change (%)			
Gross Exports	1.0	7.6	2.7	9.8
Manufacturing	*1.4*	*3.0*	*0.3*	*0.8*
Agriculture	*7.7*	*37.8*	*24.4*	*66.2*
Minerals	*-5.3*	*21.3*	*7.5*	*40.2*
Gross Imports	5.5	10.9	5.0	6.7
Capital goods	*-5.3*	*17.3*	*7.2*	*8.5*
Intermediate goods	*9.0*	*13.6*	*6.9*	*8.7*
Consumption goods	*8.9*	*3.8*	*3.6*	*6.0*
Trade balance (RM billion)	21.1	28.4	100.3	26.8

Source: Department of Statistics, Malaysia

In the first quarter, exports to Australia and India increased significantly (37.9% and 23.7% respectively), led by strong demand for crude petroleum, refined petroleum products and E&E products. Exports to the European Union, comprising mainly exports of E&E products, chemicals and chemical products, and optical and scientific equipment, improved to record a positive growth of 2.2%. Meanwhile, regional exports (excluding Japan) continued to expand strongly (9.2%), underpinned mainly by demand for non-E&E products and commodities. On the other hand, exports to the US declined further, reflecting mainly lower demand for E&E products.

Gross imports expanded at a moderate pace of 6.7% in the first quarter (4Q 2007: 10.9%), due mainly to slower growth in imports of **intermediate goods** (8.7%; 4Q 2007: 13.6%), particularly inputs for the E&E industry. Excluding lumpy items, imports of **capital goods** increased by 12.8% (4Q 2007: 9.6%). Increased upstream and downstream activities in the oil and gas sector led to higher imports of construction and mining equipment. Imports of machinery and office equipment

Import Growth



Malaysia: Direction of Exports

	2007			2008	2007			2008
	1Q	4Q	Year	1Q	1Q	4Q	Year	1Q
	Annual change (%)				Share of total exports (%)			
United States	-3.2	-15.8	-14.5	-17.6	17.2	14.3	15.6	12.9
European Union (EU)[1]	9.7	-3.2	3.6	2.2	12.8	12.5	12.9	11.9
Selected ASEAN countries[2]	-4.8	15.0	1.2	13.7	25.8	26.4	25.5	26.7
North East Asia	10.2	19.2	10.4	3.5	20.1	20.5	19.9	18.9
People's Republic of China	*34.6*	*32.5*	*24.3*	*12.5*	*8.1*	*9.5*	*8.8*	*8.3*
Hong Kong SAR	*-15.6*	*13.1*	*-4.0*	*-13.7*	*4.6*	*4.7*	*4.6*	*3.6*
Chinese Taipei	*15.4*	*1.6*	*2.6*	*-4.4*	*2.7*	*2.6*	*2.7*	*2.4*
Korea	*5.9*	*11.5*	*8.2*	*9.4*	*4.7*	*3.7*	*3.8*	*4.7*
India	7.1	2.5	7.6	23.7	3.1	3.4	3.3	3.5
Total exports	1.0	7.6	2.7	9.8	100.0	100.0	100.0	100.0

[1] Refers to European Union (EU) 27 from 2007 onwards
[2] Singapore, Thailand, Indonesia, Philippines, Brunei Darussalam and Vietnam

Source: Department of Statistics, Malaysia remained strong in tandem with continued investment activities in the manufacturing and services sectors. Higher demand for the festivities and positive consumer sentiment also led to higher imports of **consumption goods** (6%; 4Q 2007: 3.8%), particularly food and beverages, transport equipment as well as durable and semi-durable consumer goods.

Malaysia: Imports by End-Use[1]

	2007			2008
	1Q	4Q	Year	1Q
	Annual change (%)			
CAPITAL GOODS	**-5.3**	**17.3**	**7.2**	**8.5**
Capital goods (except transport equipment)	-4.9	9.7	5.6	14.7
Transport equipment	-7.7	78.6	17.8	-24.7
INTERMEDIATE GOODS	**9.0**	**13.6**	**6.9**	**8.7**
Food and beverages, mainly for industry	4.0	32.4	21.0	53.3
Industrial supplies, n.e.s.	24.1	15.9	17.0	11.4
Fuel and lubricants	8.8	32.9	2.0	24.3
Parts and accessories of capital goods (except transport equipment)	2.8	6.1	0.4	-0.3
Parts and accessories of transport equipment	-18.3	37.7	11.4	32.2
CONSUMPTION GOODS	**8.9**	**3.8**	**3.6**	**6.0**
Food and beverages, mainly for household consumption	15.0	7.1	6.8	5.2
Transport equipment, non-industrial	-12.1	2.0	9.7	61.5
Consumer goods, n.e.s.	5.8	2.1	1.8	5.7
OTHERS[2]	**5.3**	**11.4**	**5.3**	**7.0**
GROSS IMPORTS	**5.5**	**10.9**	**5.0**	**6.7**

[1] Classified by Broad Economic Categories under the System of National Accounts
[2] Others refer to dual use goods, retained imports, re-exports and others.
n.e.s. Not elsewhere specified

Source: Department of Statistics, Malaysia

Continued inflows of FDI while portfolio investment remained strong

On a cash basis, gross inflows of **foreign direct investment (FDI)** amounted to RM6.8 billion in the first quarter (4Q 2007: RM12.9 billion), reflecting mainly lower drawdown of inter-company loans. The FDI inflows were mainly into the services sector (47.3%), followed by the oil and gas (20.7%) and manufacturing (19.6%) sectors. FDI in the services sector were diversified and chanelled into the communication; wholesale and retail trade; finance and insurance; as well as real estate and business services sub-sectors. In the manufacturing sector, the E&E, downstream petroleum-related and paper-related industries received the bulk of the FDI inflows. After adjustments for gross outflows due mainly to repayments of the short-term loans, net FDI amounted to RM1.7 billion (4Q 2007: RM3.4 billion). The statistics for FDI on a cash basis does not include retained earnings and investment in the form of imported machinery and equipment.

Overseas investment by Malaysian companies recorded a gross outflow of RM56.7 billion (4Q 2007: -RM20.2 billion), reflecting mainly larger short-term inter-company loans extended by non-resident controlled companies in the oil and gas sector to their related companies abroad arising from their centralised treasury operations. These outflows were offset largely by inflows arising from repayment of short-term inter-company loans during the quarter. After adjusting mainly for these inflows, overseas investment recorded a net outflow of RM4.9 billion (4Q 2007: -RM4.8 billion). Overseas investments were undertaken mainly by companies in the manufacturing, services, oil and gas, and construction sectors. In the manufacturing sector, overseas investment were channelled mainly into the E&E, resource-based and construction-related industries. Overseas investments in the services sector were led by investment holding companies as well as wholesale and retail trade, and real estate and business services sub-sectors. In the oil and gas sector, investments by PETRONAS were channelled mainly into its subsidiaries in West Asia, Vietnam and Africa. Meanwhile, overseas investments in the construction sector were mainly for development projects in the Middle East, South Asia and Vietnam.

Portfolio investment registered a net inflow of RM1.5 billion in the first quarter (4Q 2007: RM4.7 billion). The heightened concerns of a slowdown in the US economy and increased volatility in the global financial markets led to a net liquidation of equity securities by foreign investors. This development was broadly in line with the performance of the regional equity markets. Nevertheless, these outflows were more than offset by higher inflows of foreign funds for investment in the debt securities.

External debt remained at prudential level

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. Further information is provided in the Box Article "Compilation of Malaysia's External Debt: Treatment of Offshore Entities in Labuan International Business and Financial Centre as Residents".

As at end-March 2008, Malaysia's external debt position amounted to RM212.8 billion or USD65.9 billion (end-2007: RM211.2 billion or USD63.1 billion), equivalent to 31.1% of GNI. The **medium- and long-term external debt** was lower (RM132.4 billion; end-2007: RM134 billion) as the exchange revaluation gain arising from the appreciation of ringgit against major currencies, particularly the US dollar, and net repayment by the Federal Government more than offset the net loan drawdown by the NFPEs. The net loan drawdown of RM1.5 billion by the NFPEs was largely by companies in the finance and insurance subsector as well as electricity, gas and water sector.

The total **short-term external debt** increased marginally to RM80.4 billion or USD24.9 billion (end-2007: RM77.2 billion or USD23.1 billion) due mainly to the inter-bank borrowings, particularly by the offshore financial entities in Labuan IBFC for treasury operations. As at end-March 2008, the short-term debt remained low and is 20.9% of the net international reserves.

External Debt Outstanding

	2007	2008
	4Q	1Q[p]
	RM billion	
Medium- and long-term debt	134.0	132.4
Public sector	74.2	74.5
Private sector	59.8	57.9
Short-term debt[1]	77.2	80.4
Total external debt	211.2	212.8
- USD billion equivalent	63.1	65.9

[1] Excludes currency and deposits held by non-residents with resident banking institutions
[p] Preliminary

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Compilation of Malaysia's External Debt: Treatment of Offshore Entities in Labuan International Business and Financial Centre as Residents

As part of the continuous efforts to improve the compilation and dissemination of external debt data in conformity with the international standards and best practices[1], the external debt data of Malaysia has been redefined to treat entities in Labuan International Business and Financial Centre (IBFC) as residents starting with the first quarter of 2008. 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.

The treatment of offshore entities in Labuan IBFC as residents is strictly applicable only to the external debt data compilation. The offshore entities in Labuan IBFC would continue to be treated as non-residents for foreign exchange administration purposes, and thus, are not subject to foreign exchange administration rules that are applicable to residents.

Implication on Malaysia's External Debt

Table 1 provides a comparison of Malaysia's external debt position with offshore entities in Labuan IBFC being treated as non-residents (old definition) and as residents (new definition). Under the new definition, Malaysia's total external debt as at end-2007 was marginally higher at RM211.2 billion (equivalent to USD63.1 billion) or 33.6% of GNI, compared with RM187.4 billion (equivalent to 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, with medium- and long-term external debt accounting for 63.4% of the total external debt.

Table 1:
External Debt Outstanding

	Offshore Entities in Labuan IBFC as		
	Non-Resident	Resident (new definition)	
	RM billion		
	End-4Q 07	End-4Q 07	End-1Q 08p
Total external debt (ED)	**187.4**	**211.2**	**212.8**
(USD billion equivalent)	*56.0*	*63.1*	*65.9*
Medium- and long-term (MLTD)	133.0	134.0	132.4
Federal Government	*19.6*	*18.7*	*18.2*
NFPEs	*41.9*	*55.5*	*56.3*
Private Sector	*71.5*	*59.8*	*57.9*
Bank	*1.4*	*13.2*	*12.3*
Non-bank	*70.1*	*46.6*	*45.6*
Short-term (STD)[1]	54.5	77.2	80.4
Bank	*42.1*	*69.9*	*73.5*
Non-bank	*12.3*	*7.3*	*6.9*
	(percent)		
ED/GNI	29.9	33.6	31.1
STD/ED	29.1	36.6	37.8
STD/Reserves	16.2	23.0	20.9

[1] Excludes currency and deposits held by non-residents with resident banking institutions
p Preliminary

The larger external debt under the new definition reflected mainly higher short-term inter-bank borrowings of offshore financial entities in Labuan IBFC arising from their loan extension, investment activities and treasury operations. Despite an increase in the short-term debt, the ratio of Malaysia's short-term debt to reserves remained low at 23% (16.2% under old definition).

[1] The Fifth Edition of the Balance of Payments Manual (BPM 5) of the IMF classifies offshore entities in an economy as residents for compilation of external data, including external debt data. Similarly, the External Debt Statistics Guide for Compilers and Users (2003), also states that **'The residence of offshore enterprises**—including those engaged in the assembly of components manufactured elsewhere, those engaged in trade and financial operations, and those located in special zones—**is attributed to the economies in which they are located.'** As such, the debt liabilities of offshore entities that are owed to non-residents are to be included as part of an economy's external debt.

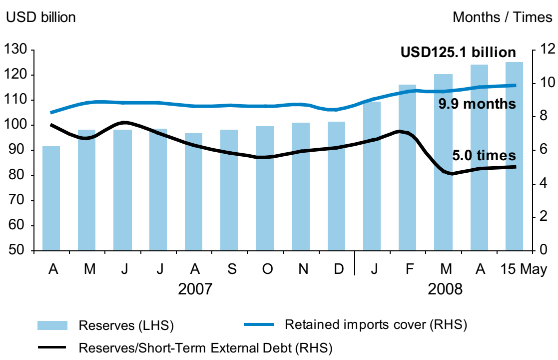
Of significance, the short-term debt of the non-bank private sector was lower at RM7.3 billion and accounted for only 9.5% of the total short-term external debt.

The medium- and long-term external debt was marginally higher at RM134 billion (equivalent to USD40 billion) under the new definition (RM133 billion or USD39.7 billion under old definition), as the inclusion of borrowings by offshore entities (including by subsidiaries of NFPEs operating in Labuan IBFC) from non-residents more than offset lower external borrowings by the Federal Government and non-bank private sector following the reclassification of loans sourced from the offshore entities in Labuan IBFC as part of domestic borrowing.

International reserves

The **international reserves** of Bank Negara Malaysia amounted to RM384.7 billion (equivalent to USD120.3 billion) as at 31 March 2008. The reserves level as at 31 March 2008 has taken into account the quarterly adjustment of the foreign exchange revaluation loss, following the strengthening of ringgit against the major currencies during the first quarter. 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.

Net International Reserves (as at end period)

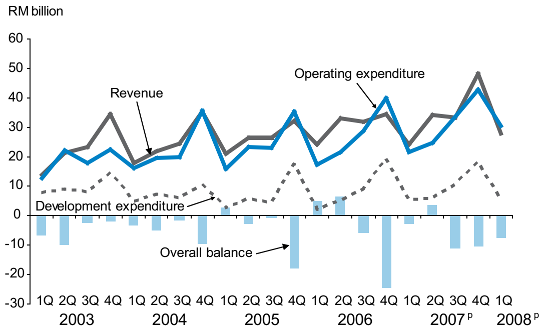


Note: With effect from end-March 2008, the short-term external debt refers to the external debt under the new definition, with offshore entities in Labuan IBFC being treated as residents.

Higher Federal Government spending

In the first quarter of 2008, total expenditure rose at an annual rate of 32.3%, due mainly to higher emoluments and the transfer of funds to statutory bodies, as reflected by the higher operating expenditure (1Q 2007: 38.7%). At the same time, the bulk of the development expenditure continued to be channelled to the economic and social services sectors. The Federal Government's revenue also grew during the quarter as a result of better revenue collection. During the quarter, the Federal

Federal Government Finance



p Preliminary
Source : Ministry of Finance

Federal Government Finance p

	2007			2008
	1Q	4Q	Year	1Q
	RM billion			
Revenue	24.2	48.2	139.9	28.0
% growth	*0.1*	*40.0*	*13.2*	*15.4*
Operating expenditure	21.7	42.9	123.1	30.4
% growth	*25.2*	*7.3*	*14.3*	*40.3*
Current account	**2.5**	**5.3**	**16.8**	**-2.5**
% of GDP	***1.8***	***3.0***	***2.6***	***-1.4***
Gross development expenditure	5.3	18.2	40.6	5.3
% growth	*148.4*	*-6.0*	*13.3*	*-0.3*
Overall balance	**-2.6**	**-10.5**	**-20.7**	**-7.7**
% of GDP	***-1.8***	***-5.9***	***-3.2***	***-4.4***
Memo item:				
Total gross expenditure	27.0	61.1	163.6	35.7
% growth	*38.7*	*3.0*	*14.0*	*32.3*
Total Federal Government debt				
(as at end-period)	250.0	266.7	266.7	275.1
% of GDP	*39.0*	*41.6*	*41.6*	*39.3*
Domestic debt	225.9	247.1	247.1	256.8
% of GDP	*35.2*	*38.5*	*38.5*	*36.7*
External debt	24.1	19.6	19.6	18.2
% of GDP	*3.8*	*3.1*	*3.1*	*2.6*

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Government's financial position recorded a fiscal deficit of RM7.7 billion (4.4% of GDP). The deficit was financed mainly from domestic borrowings. As at end-March 2008, total outstanding debt of the Federal Government amounted to RM275.1 billion or 39.3% of the estimated 2008 GDP.