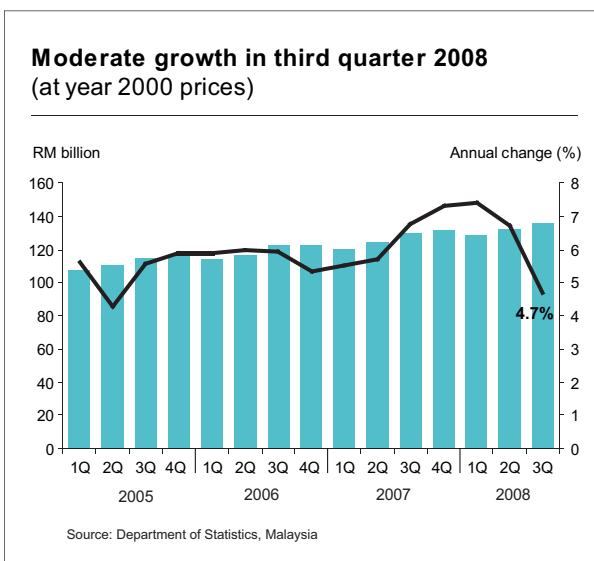


## ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE THIRD QUARTER OF 2008

### OVERVIEW

#### Growth moderated in the third quarter

The Malaysian economy registered a growth of 4.7% in the third quarter of 2008 (2Q 08: 6.7%) amidst the sharp deterioration in the global economic and international financial environment. Net real exports of goods and services declined by 14.8%, compared with a growth of 20% in the second quarter of 2008.



Growth was supported by domestic demand, which increased by 6.5% (2Q 08: 8.3%), following continued expansion in private and public consumption. The strong growth of 8.1% in private consumption (2Q 08: 9%) was supported by the effects of bonus payment to civil servants, spending during the festive season and payment of cash rebates for fuel subsidy. Meanwhile, public consumption increased by 6.9% (2Q 08: 10.9%) on continued high expenditure for emoluments and supplies and services. Gross fixed capital formation, however, expanded at a slower rate of 3.1% (2Q 08: 5.6%) as private investment activities were affected by cautious business sentiment amidst rising costs and uncertainties in the external environment. Nevertheless, investment was supported by higher public development expenditure, in particular for the transportation, agriculture and rural development, and education sectors.

The services sector sustained its strong expansion, increasing by 7.1% (2Q 08: 8.2%), on higher finance and insurance sub-sector growth, and strong consumption activities during the quarter. Growth in the manufacturing sector was weaker (1.8%; 2Q 08: 5.6%), due mainly to weakness in the export-oriented industries. However, the domestic-oriented industries continued to register strong growth, supported mainly by the transport equipment, construction-related products and food industries. The agriculture sector grew at a more moderate pace (3%; 2Q 08: 6%) following the deceleration in production of palm oil amidst the onset of a yield downcycle. Similarly, the construction sector moderated further (1.2%; 2Q 08: 3.9%) on weaker activity in the residential and civil engineering segments amidst higher prices of building materials. Growth in the mining sector was sluggish (-0.3%; 2Q 08: -0.5%) as a result of lower natural gas output.

The headline inflation rate, as measured by the change in the Consumer Price Index (CPI), increased to 8.4% in the third quarter (2Q 08: 4.8%). The higher inflation during the quarter reflected the higher retail prices for petrol and diesel following the subsidy restructuring on 4 June 2008; higher electricity tariffs from 1 July 2008; as well as higher food prices. Indicators suggest that inflation has peaked in the third quarter. Going forward, the decline in global food and commodity prices, as well as moderating growth, will rein in domestic price pressures. In addition, with the declining energy prices, the Government has lowered domestic fuel prices. Improved supply has also reduced rice prices.

On the external front, trade balance registered another record surplus (RM41.6 billion; 2Q 08: RM40.6 billion) in the third quarter. Exports growth moderated, but remained firm (16.9%; 2Q 08: 20.8%),

supported by commodities and resource-based manufactured products. Commodity exporters benefited from higher prices that were contracted before the downturn in global commodities prices, while exports of resource-based products were supported by both higher prices and sustained demand. Gross imports increased by 10.3% (2Q 08: 9.9%) due largely to higher intermediate and consumption imports. Meanwhile, growth in capital imports was lower reflecting the slower private investment activities in the domestic economy.

In the financial account, gross inflows of foreign direct investment (FDI), as recorded by Bank Negara Malaysia's Cash BOP System, increased to RM21.5 billion (2Q 08: RM12.6 billion), reflecting mainly short-term inter-company loans for centralised treasury operations which were also repaid during the same quarter. After adjusting for gross outflows due mainly to repayments of these short-term loans, net FDI amounted to RM2.7 billion (2Q 08: RM8.6 billion), channeled mainly into the services, oil and gas, and manufacturing sectors. Overseas investment by Malaysian companies recorded a larger net outflow of RM16.1 billion (2Q 08: -RM3.6 billion) for investments mainly in the services and manufacturing sectors. Portfolio investment registered a net outflow of RM38.4 billion (2Q 08: -RM31 billion) due to the continued global de-leveraging process.

The international reserves of Bank Negara Malaysia amounted to RM379.3 billion (equivalent to USD109.7 billion) as at 30 September 2008. The reserves amounted to RM343.8 billion (equivalent to USD99.7 billion) as at 14 November 2008. The reserves position is sufficient to finance 8.1 months of retained imports and is 3.7 times the short-term external debt.

### **OPR was left unchanged in the third quarter**

The Overnight Policy Rate (OPR) was left unchanged at 3.50% throughout the third quarter. The prevailing level of the policy rate remained consistent with the outlook for slower economic

growth and the expected moderation in inflation into 2009 from its current elevated level.

With the OPR unchanged, interbank rates for all maturities were stable during the quarter. In terms of lending rates, the average base lending rate remained unchanged during the quarter, while the average lending rate softened to 5.96% as at end-September. Deposit rates remained relatively stable during the period.

Notwithstanding the adverse developments in the international financial markets, the Malaysian domestic financial system remained well-capitalised in an environment of ample liquidity and continued to provide access to financing. On a net basis, banking system loans and PDS outstanding expanded by 13.4% at end-September. Total loan disbursements in the third quarter continued to rise, contributed mainly by the business sector. As a result, total loans outstanding increased by 10.6% at end-September. Loan applications and approvals, however, moderated due to lower demand for new loans from the business and household sectors.

Net funds raised in the capital market amounted to RM6.6 billion in the third quarter. In the private sector, net funds raised through the PDS market amounted to RM3.7 billion, while funds raised through the equity market rose to RM2.2 billion. In the public sector, gross funds raised amounted to RM14.8 billion during the quarter. Due to large redemptions of government securities, net funds raised amounted to RM680 million.

M3, or broad money, expanded by RM13.7 billion during the quarter, or 13.5% on an annual basis as at end-September. The growth in M3 was underpinned by the continued expansion in credit and increased spending by the Government.

Amidst the ongoing global financial turmoil, de-leveraging and risk aversion amongst investors around the world has heightened. The US dollar strengthened following the de-leveraging by US financial institutions in the international financial markets and the inflows of funds into US Treasuries. Carry trades on the Japanese yen were also unwound rapidly and substantially, causing significant reversal in the high yielding currencies, notably the New Zealand and the

Australian dollar. Against this backdrop, the ringgit depreciated by 5.5% against the US dollar and 7.3% against the Japanese yen during the third quarter. The ringgit, however, appreciated against the pound sterling (4.6%) and the euro (3.9%) amid indications of rapidly deteriorating economic conditions in the European economies. Against the regional currencies, the ringgit depreciated in the range of 0.5% and 5.7%, with the exception of the Korean won, against which the ringgit appreciated by 9.9%. During the period 1 October to 27 November 2008, the ringgit continued to depreciate against the US dollar (-4.5%) and the Japanese yen (-12.8%), and appreciated against the pound sterling (11.8%) and euro (6.1%). The ringgit appreciated against regional currencies in the range of 0.9% to 24.1%, with the exception of the Chinese renminbi (-4.7%), Philippine peso (-1.2%) and the Thai baht (-0.8%).

### Banking system remained resilient

The banking sector remained resilient, supported by strong capitalisation, sustained profitability and continued improvement in the level of non-performing loans (NPLs). As at end-September, capitalisation level remained high with risk-weighted capital ratio (RWCR) and core capital ratio (CCR) of 13% and 10.5% respectively. Banking system profitability was sustained (RM4.1 billion), with annualised average returns on assets and equity of 1.5% and 18.7% respectively. Net NPLs based on 3-month classification have declined by 4.6% to RM16.7 billion to account for 2.4% of total net loans. Net NPL ratio remained unchanged at 2.4% at end-October 2008. Given their sound balance sheets and ample liquidity in the financial system, banking institutions remained well-positioned to continue meeting the financing needs of the economy.

As a pre-emptive and precautionary move to maintain the stability of the financial system, Bank Negara Malaysia announced that effective from 16 October 2008, all ringgit and foreign currency deposits would be fully guaranteed by the Government through Perbadanan Insurans Deposit Malaysia until December 2010, while access to the Central Bank's liquidity facility would be extended to insurance companies and takaful operators.

### Economic impact of global financial crisis

Going forward, the deterioration of the global financial environment has begun to have an adverse impact on global economic activity. Global growth is weakening substantially, with several major developed economies sliding into a recession. As a result, signs of moderation in growth have surfaced in the emerging economies. Despite the aggressive injection of liquidity into the financial markets and recapitalisation of the large financial institutions in major industrial countries, international financial markets have not normalised and continue to remain highly volatile. However, with the sharp deceleration in growth and decline in commodity prices, inflationary concerns have receded.

As a highly open economy with strong financial and real economic linkages with the rest of the world, the Malaysian economy has been impacted by these external developments. The significant slowdown in global growth is expected to affect the export sector while the continued volatility across financial markets may dampen business outlook. While this more challenging period is expected to see a moderation in growth, the economy will continue to expand.

Malaysia's better resilience lies in the established strong fundamentals that have been built-up over several years. The continued significant current account surplus, low external debt, large international reserves and well-capitalised banking system, will place the economy in a stronger position to weather this challenging period. Strategies going forward will aim at sustaining domestic demand, reducing Malaysia's external vulnerabilities and ensuring that financial intermediation to proceed uninterrupted. To mitigate the impact of weak global growth on the domestic economy, the Government announced a pre-emptive RM7 billion Economic Stabilisation Plan on 4 November 2008. The additional spending will cover measures to boost private consumption and investment. As a pre-emptive measure aimed at providing a more accommodative monetary environment to support domestic demand, Bank Negara Malaysia on 24 November 2008 reduced the Overnight Policy Rate (OPR) to 3.25 percent and the Statutory Reserve Requirement (SRR) from 4% to 3.5%, with effect from 1 December 2008.