

DEVELOPMENTS IN THE MALAYSIAN ECONOMY

Growth moderated in the third quarter

In the third quarter of 2008, the Malaysian economy registered a growth of 4.7% (2Q 08: 6.7%) amidst a significantly weaker global economic growth and volatile international financial environment. While net external demand declined by 14.8% (2Q 08: 20%), growth was supported by relatively strong domestic demand. On the supply side, growth moderated across most sectors of the economy.

Domestic demand moderated

Domestic demand registered a growth of 6.5% (2Q 08: 8.3%) in the third quarter, led by strong private and public consumption.

GDP by Expenditure Components (at constant 2000 prices)

	2007		2008		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Aggregate Domestic Demand (excluding stocks)	11.9	9.1	10.5	8.3	6.5
Consumption	11.6	8.7	12.2	9.3	7.8
<i>Private sector</i>	13.0	10.2	11.7	9.0	8.1
<i>Public sector</i>	6.0	4.2	14.7	10.9	6.9
Gross Fixed Capital Formation	12.8	10.2	6.0	5.6	3.1
Net Exports	1.4	-12.3	26.4	20.0	-14.8
<i>Exports of Goods and Services</i>	2.9	7.8	6.0	9.7	5.1
<i>Imports of Goods and Services</i>	3.1	11.0	3.4	8.4	8.2
GDP	6.7	7.3	7.4	6.7	4.7

Source: Department of Statistics, Malaysia

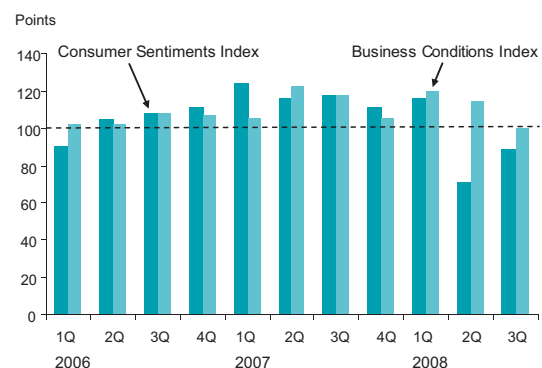
Private consumption sustained a strong growth of 8.1%, supported by the effects of bonus payment to civil servants, spending during the festive season and payment of cash rebates for fuel subsidy. Major consumption indicators such as imports of consumption goods, consumer spending on credit cards and sales of new passenger cars continued to show positive trends. However, growth in real private consumption moderated due to the higher increase in prices of

consumer goods, with inflation averaging 8.4% during the quarter. The MIER Consumer Sentiment Index was higher at 88.9 points in the third quarter (2Q 08: 70.6 points).

Meanwhile, **public consumption** continued to expand, recording a growth rate of 6.9% in the third quarter driven by higher expenditure for emoluments and, supplies and services.

Gross fixed capital formation increased by 3.1% in the third quarter, mainly on account of higher public spending. Higher government development expenditure in the third quarter was mainly in transportation, agriculture and rural development, and education sectors. Meanwhile, private investment activities were affected by cautious business sentiment due to the further deterioration of conditions in the external environment and higher global and domestic prices. The third quarter MIER Business Conditions Index dropped below 100-points (99.6 points; 2Q 08: 114.1 points), reflecting a less optimistic business outlook. In addition, slower expansion in indicators such as loans disbursed to businesses and imports of capital goods pointed to weaker private investment activities.

Less optimistic business sentiment



Source: Department of Statistics Malaysia

Moderation in activity across most sectors

On the **supply side**, growth moderated across most sectors. The slowdown in global demand led to a moderation in growth of the manufacturing sector due to the weak performance of the export-oriented industries. However, the domestic-oriented industries sustained their expansion. Output in the agriculture sector slowed, mainly reflecting deceleration in palm oil production arising from a yield downturn. The mining sector was sluggish due to the decline in natural gas output. Meanwhile, the construction sector moderated further, influenced by the lower activity in the residential and civil engineering segments. However, the services sector grew by 7.1% (2Q 08: 8.2%) reflecting the higher finance and insurance sub-sector growth, and expansion in consumption activities during the quarter.

Quarterly GDP by Kind of Economic Activity (at year 2000 prices)

	2007		2008		
	3Q	4Q	1Q	2Q	3Q
	Annual change in (%)				
Agriculture	1.9	4.7	6.3	6.0	3.0
Mining	2.5	3.5	3.7	-0.5	-0.3
Manufacturing	3.3	5.6	7.0	5.6	1.8
Construction	4.7	4.7	5.3	3.9	1.2
Services	10.5	9.3	8.5	8.2	7.1
Real GDP (Annual Change)	6.7	7.3	7.4	6.7	4.7
Real GDP (Preceding Change)	5.0	0.8	-1.5	2.3	3.1

Source: Department of Statistics, Malaysia

Services sector continued to be the key driver of growth

The **services sector** continued to be the key driver of growth, contributing 3.8 percentage points to overall GDP growth. Of significance, the **finance and insurance** sub-sector recorded a stronger growth of 10% (2Q 08: 7.5%), primarily supported by higher insurance activity and sustained bank lending during the quarter. Reflective of robust consumer spending, growth in the **wholesale and retail trade** sub-sector was strong at 9.4%. The communication sub-sector continued on its strong growth momentum underpinned by firm demand for mobile services, while activity in the **transport and storage**, and **electricity, gas and water** sub-sectors was more moderate in line with the subdued manufacturing activities during the quarter.

Manufacturing sector supported by domestic-oriented industries

Value-added growth in the **manufacturing sector** slowed to 1.8% (2Q 08: 5.6%), as a result of the effects of the slowing global economy. Nevertheless, the diversified industrial base provided some support as the domestic-oriented industries continued to expand, compensating in part for the slowdown in the export-oriented industries.

Output of **export-oriented industries** declined by 0.7% (2Q 08: +2.4%), weighed down mainly by the weaker performance of the electronics

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

	Share 2007 (%)	2007		2008		
		3Q	4Q	1Q	2Q	3Q
		Annual change in (%)				
Intermediate Services	43.7	12.3	10.2	8.4	6.9	6.2
Finance & insurance	19.9	9.3	10.0	9.9	7.5	10.0
Real estate & business services	9.8	22.2	11.1	4.8	3.9	-1.8
Transport & storage	7.0	12.7	12.4	9.9	8.1	5.9
Communication	7.0	7.2	7.2	7.5	7.9	7.4
Final Services	56.3	9.2	8.6	8.6	9.2	7.8
Electricity, gas & water	5.6	2.7	3.0	4.6	4.1	1.7
Wholesale & retail trade	22.8	15.2	12.9	11.9	12.6	9.4
Accommodation & restaurant	4.4	12.6	12.3	10.0	7.3	4.6
Government services	12.9	3.8	5.0	7.5	10.0	11.2
Other services	10.6	5.9	5.4	5.0	5.0	5.0
Total Services	100.0	10.5	9.3	8.5	8.2	7.1

Source: Department of Statistics, Malaysia

Selected Quarterly Indicators in the Services Sector

	2007		2008		
	3Q	4Q	1Q	2Q	3Q
Index					
MIER Consumer Sentiment Index	117.5	110.7	115.5	70.6	88.9
MIER Retail Trade Index	145.9	141.2	106.1	94.5	116.5
MIER Tourism Market Index	131.1	133.6	120.3	107.5	109.2
Annual change (%)					
Total consumption credit outstanding	7.1	7.3	7.6	9.6	9.7
Loans outstanding to the wholesale & retail trade, hotels & restaurants	6.1	7.2	10.1	15.4	14.0
Imports of consumption goods	1.2	3.8	5.6	21.3	16.3
Total sales of motor vehicles	4.9	19.0	24.6	27.1	10.5
Container cargo handled (Port Klang and PTP)	9.7	14.4	9.7	9.4	16.4

Source: Various sources

and electrical (E&E) industry. Output of both semiconductors and computer and parts segments contracted, affected by lower demand from developed economies, which offset the sustained growth in electrical products.

Resource-based industries such as petroleum, wood and off-estate processing also recorded a more subdued performance. This was partly due to the effects of high input prices in the earlier months of the year. In the case of off-estate processing, it was on account of the moderation in output of key commodities. Meanwhile, the chemical products industry grew strongly, supported by demand for plastic products from the domestic automotive industry.

Output of **domestic-oriented industries** expanded by 6.9% (2Q 08: 12.6%), supported mainly by the strong growth in the transport equipment industry following the sustained demand for new motor vehicles. The growth was also attributable to expansion in construction-related products due to higher exports, while the expansion in the food industry was sustained by domestic demand.

Overall capacity utilisation rate in the manufacturing sector was at 78% in the third quarter (2Q 08: 78%), with the export-and domestic-oriented industries operating at 79% and 75% respectively (2Q 08: 79% and 75% respectively).

Weak performance in commodities

The **agriculture sector** grew at a more moderate pace of 3% (2Q 08: 6%) due to a significant deceleration in production of palm oil

Performance in the Manufacturing Sector

	2007		2008		
	3Q	4Q	1Q	2Q	3Q
Annual change (%)					
Value Added (Constant Price)	3.3	5.6	7.0	5.6	1.8
Overall Production	1.8	4.8	6.6	4.5	0.8
Export-oriented industries	1.1	3.3	4.7	2.4	-0.7
<i>Of which:</i>					
Electronics and electrical	2.1	5.5	3.1	3.0	-4.1
Electronics	3.9	10.3	3.9	2.9	-6.8
Electrical	-3.9	-9.5	0.5	3.3	5.6
Chemicals and chemical products	0.3	-1.4	4.3	2.5	7.7
Petroleum products ¹	1.9	3.7	8.2	-2.0	-1.7
Rubber products	3.4	1.6	2.4	7.2	2.7
Off-estate processing	-0.3	12.0	20.2	18.1	3.5
Domestic-oriented industries	4.6	10.9	14.8	12.6	6.9
<i>Of which:</i>					
Construction-related materials ²	4.4	5.1	14.6	10.0	7.6
Fabricated metal products	15.0	19.0	16.0	8.7	-7.0
Transport equipment	-0.6	15.3	25.7	28.5	26.5
Food	0.1	8.3	8.9	12.4	5.9

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

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

(4.9%; 2Q 08: 21.8%) amidst the onset of a yield downcycle, as well as lower output of rubber. Production in the **mining sector** slowed (-0.3%; 2Q 08: -0.5%) as a result of the decline in natural gas output despite the higher output of crude oil.

Continued moderation in the construction sector

The **construction sector** grew at a slower pace of 1.2% during the quarter (2Q 08: 3.9%). This was due to the moderation in the residential and civil engineering segments amidst higher prices for building materials. However, this was partly mitigated by the higher growth in the non-residential segment, supported by construction of office space, especially in the Klang Valley.

Inflation increased in the third quarter

Headline inflation rose to 8.4% in the third quarter (2Q 08: 4.8%). The main contributors to higher inflation were the *transport and food and non-alcoholic beverages* categories, which together accounted for 83.4% of total rise in inflation during the quarter. Prices in the transport category increased by an average of 20.9% in the third quarter (2Q 08: 7.1%) following the fuel price adjustment announced by the Government on 4 June 2008. Prices in the *housing, water, electricity, gas and other fuels* category also increased at a faster pace compared with the previous quarter following the higher electricity tariffs from 1 July 2008. Prices in the *food and non-alcoholic beverages* category rose by 11.7% during the period (2Q 08: 8%).

Indicators suggest that inflation has peaked in the third quarter. Going forward, the decline in global

	2007		2008		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
New sales and advertising permits	10.6	-3.1	-6.4	10.9	-30.1
Housing approvals	-4.7	-6.0	10.4	28.5	-51.5
Production of construction-related materials	4.4	5.1	14.6	10.0	7.6
Loans approved for construction	38.8	27.7	74.4	-12.4	-13.4
Imports of construction materials and mineral products	-2.0	38.8	8.3	10.6	5.9 ¹

¹July-Aug 2008
Source: Ministry of Housing and Local Government and Department of Statistics, Malaysia

Performance in the Agriculture Sector

	2007		2008		
	3Q	4Q	1Q	2Q	3Q
Annual change (%)					
Value Added (at year 2000 prices)	1.9	4.7	6.3	6.0	3.0
Industrial Crops	-4.0	6.1	9.1	7.2	0.6
Food Crops	11.4	2.8	2.5	4.3	6.4
Production					
<i>Of which:</i>					
Crude palm oil	-0.1	12.9	23.9	21.8	4.9
Rubber	-11.0	-7.6	-2.1	-7.8	-4.4
Fish	-2.6	4.9	0.4	1.9	10.7
Livestock	2.7	6.5	0.9	4.1	9.9
Exports (RM million)					
<i>Of which:</i>					
Palm oil	58.2	65.2	100.9	84.5	50.0
Rubber	-14.0	2.9	30.8	21.8	23.8
Sawn timber	-3.8	-21.4	-16.5	-18.2	-27.6
Saw logs	8.0	-18.7	-1.7	10.5	-2.8

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

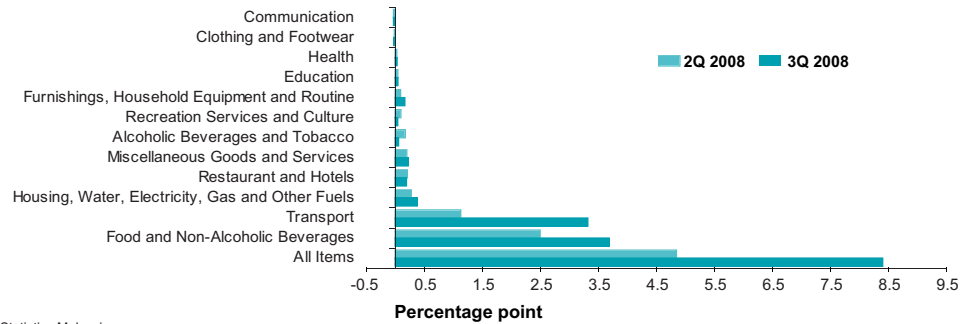
	2007		2008		
	3Q	4Q	1Q	2Q	3Q
Annual change (%)					
Value Added (at year 2000 prices)	2.5	3.5	3.7	-0.5	-0.3
Production					
<i>Of which:</i>					
Crude oil and condensates	2.4	5.8	7.0	3.6	3.5
Natural gas (net)	-1.9	-1.8	-1.2	-6.8	-6.4
Exports (RM million)					
<i>Of which:</i>					
Crude oil and condensates	-3.2	32.1	45.0	56.1	52.7
Liquefied natural gas	11.8	8.3	24.7	34.8	51.2

Source: PETRONAS
Department of Statistics, Malaysia

food and commodity prices, and moderation in 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.

Producer price inflation (PPI) moderated slightly to 11.4% (2Q 08: 12.3%) due to the slower rate of price increase in the commodity-based components of the PPI following the decline in global commodity prices. Meanwhile, prices in the non-commodity-based components of the PPI continued to increase, mainly driven by price increases in the *food and live animals; chemical related products; and manufactured goods classified chiefly by material categories*.

Contribution to Consumer Price Inflation



Source: Department of Statistics Malaysia

In terms of composition, both the local and imported components of the PPI recorded slower rates of price increases. Inflation in the local component of the PPI was marginally lower at 15% (2Q 08: 15.4%) while inflation in the imported component of the PPI moderated to 4.3% (2Q 08: 6.1%).

Exchange remained relatively high (282,006 positions; 2Q 08: 292,934 positions), mainly led by strong demand in the manufacturing sector. Labour productivity in the manufacturing sector increased by 6.5% (2Q 08: 12.2%).

Stable labour market conditions

Overall **labour market conditions** remained stable as the total demand for labour outpaced retrenchments. While total retrenchments reported by the Ministry of Human Resources rose to 11,561 persons during the quarter, actual retrenchments after taking into account re-employment of about 7,500 workers by the new owner following the sale of a company, were 3,997 persons (2Q 08: 2,821 persons). Almost two-thirds of the retrenchments were in the manufacturing sector. Meanwhile, other indicators in the labour market continued to remain firm. Vacancies in the Electronic Labour

Slight moderation in export growth

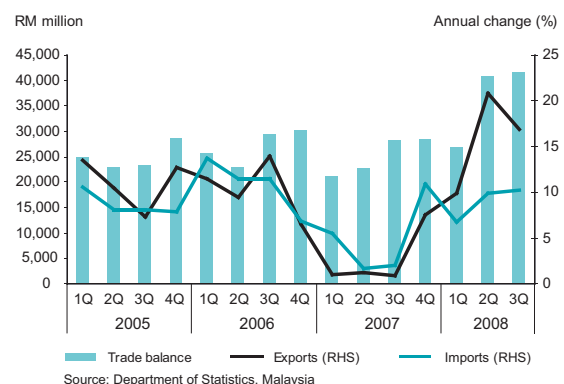
Gross export expanded by 16.9% in the third quarter (2Q 08: 20.8%), due mainly to the continued increase in commodities and resource-based manufactured exports, that was further reinforced by exports of electrical products. Export demand emanated mainly from the non-US markets, particularly the regional economies as well as Japan, Australia and European Union (EU). Meanwhile, exports to the US market declined further. Import growth was higher at 10.3%. As export growth continued to outpace imports, the **trade surplus** increased to another record surplus of RM41.6 billion.

Labour Market Conditions



* Reflects adjusted retrenchments for 3Q '08
Source: Ministry of Human Resources

Trade Balance



Source: Department of Statistics, Malaysia

Malaysia: Direction of Exports

	2007		2008			2007		2008		
	3Q	4Q	1Q	2Q	3Q	3Q	4Q	1Q	2Q	3Q
	Annual change (%)					Share of total exports (%)				
United States	-18.6	-15.8	-17.5	0.0	-9.9	15.5	14.3	12.9	13.0	11.9
European Union (EU)¹	0.5	-3.2	2.3	-3.5	1.0	12.8	12.5	11.9	10.7	11.1
Selected ASEAN countries²	-0.6	15.0	13.9	23.9	20.7	25.0	26.4	26.7	25.5	25.8
North East Asia	4.9	19.2	3.5	35.7	26.8	19.6	20.5	18.9	21.8	21.1
<i>People's Republic of China</i>	15.0	32.5	12.5	55.3	35.4	9.2	9.5	8.3	10.4	10.7
<i>Hong Kong SAR</i>	-2.1	13.1	-13.7	34.9	9.4	4.6	4.7	3.6	5.1	4.3
<i>Chinese Taipei</i>	-7.5	1.6	-4.5	6.3	14.2	2.7	2.6	2.4	2.6	2.6
<i>Korea</i>	1.0	11.5	9.5	17.9	38.1	3.1	3.7	4.7	3.8	3.6
West Asia	30.2	2.6	25.5	38.5	54.6	3.4	2.9	3.4	3.8	4.5
India	8.3	2.5	24.1	39.8	19.1	3.6	3.4	3.5	3.7	3.7
Total exports	0.9	7.6	9.9	20.8	16.9	100.0	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

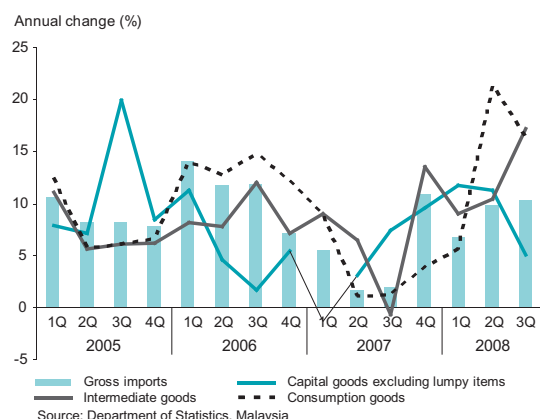
Trade Account

	2007		2008 ¹		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Gross Exports	0.9	7.6	9.9	20.8	16.9
Manufactured	-1.8	1.2	-1.9	12.3	8.5
E&E	-6.5	-2.5	-12.2	10.7	4.5
Non-E&E	6.2	7.0	12.1	14.4	14.2
Agriculture	28.6	37.7	61.2	58.8	37.5
Minerals	3.5	27.4	52.1	51.6	55.8
Gross Imports	2.0	10.9	6.8	9.9	10.3
Capital goods	17.5	17.3	7.8	11.3	-1.0
Intermediate goods	-0.7	13.6	9.0	10.4	17.2
Consumption goods	1.2	3.8	5.6	21.3	16.3
Trade balance (RM billion)	28.3	28.4	26.8	40.6	41.6

¹Malaysia's trade classification has been revised to reflect the revisions of the international trade codes i.e. Harmonised System (HS), ASEAN Harmonised Tariff Nomenclature (AHTN) and Standard International Trade Classification (SITC)

Source: Department of Statistics, Malaysia

Import Growth



The strong growth in **agriculture and mineral** exports was due mainly to higher forward contracted prices, despite the softening of global commodity prices since July. **Manufactured exports** grew at a more moderate pace, supported mainly by exports of resource-based products and electrical products. Exports of resource-based products such as chemicals and chemical products, rubber products and wood products increased further, benefiting from strong commodity prices and sustained demand. Exports of manufactures of metal and plastics lent further support to the growth in manufactured exports. Stronger exports of electrical products were attributed to higher demand from the PR China, Korea, Japan and US. Meanwhile, electronic exports recorded a negative growth due mainly to lower demand for computers and parts.

Gross imports registered a slightly stronger growth of 10.3% (2Q 08: 9.9%), due largely to higher **intermediate imports**, particularly intermediate inputs for resource-based industries, such as chemicals, fuel and lubricants, and inputs for the E&E industry. Growth in **consumption imports** was supported mainly by demand for processed food and beverages as well as durable consumer goods. Meanwhile, **capital imports** moderated during the quarter.

Larger net outflows of portfolio funds and overseas investment

On a cash basis, gross inflows of **foreign direct investment (FDI)**² increased to RM21.5 billion in the third quarter (2Q 08: RM12.6 billion), due mainly to higher inflows of inter-company loans. Inflows of equity capital moderated during the quarter which largely reflected the extension of short-term financing by foreign MNCs in the oil and gas sector to their subsidiaries in Malaysia. After adjusting for gross outflows following the repayments of these short-term loans, net FDI amounted to RM2.7 billion (2Q 08: RM8.6 billion). Net FDI was channeled mainly into the services, oil and gas, and manufacturing sectors. In the services sector, the inflows were concentrated in the finance, real-estate and business services, as well as wholesale and retail trade sub-sectors. Meanwhile, in the manufacturing sector, the inflows were directed to the E&E and downstream petroleum-related industries.

Overseas investment by Malaysian companies recorded a larger increase amounting to RM16.1 billion (2Q 08: -RM3.6 billion), mainly into the services and manufacturing sectors. Overseas investments in the services sector reflected mainly the acquisition of strategic stakes in the finance sector of Indonesia and Vietnam, as well as the investment in the real-estate and business services sector. Meanwhile, overseas investments in the manufacturing sector were channelled mainly into the E&E and cement industries.

Portfolio investment registered a larger net outflow of RM38.4 billion during the quarter (2Q 08: -RM31 billion), largely on account

of the more intense de-leveraging process following the failure of major financial institutions in the US and Europe. This has resulted in a reduction in the exposure of foreign investors in the domestic equity and bond markets arising from this de-leveraging process.

External debt remains low

As at end-September 2008, Malaysia's total external debt amounted to RM248.8 billion or USD71.3 billion (end-June 2008: RM236 billion or USD71.5 billion), equivalent to 35.5% of GNI. The higher **medium- and long-term external debt** of RM152.7 billion reflected mainly a net drawdown by the private sector (+RM2.7 billion) and exchange revaluation losses arising from the depreciation of the ringgit against the major currencies during the quarter. Meanwhile, the public sector continued to record a net repayment (-RM0.4 billion).

The total **short-term external debt** increased slightly to RM96.1 billion or USD27.5 billion due mainly to exchange revaluation loss and higher inter-bank borrowings arising from treasury operations.

External Debt Outstanding		
	2008	
	2Q	3Q ^P
RM billion		
Medium- and long-term debt	143.1	152.7
Public sector	75.0	78.9
Private sector	68.1	73.8
Short-term debt ¹	92.9	96.1
Total external debt	236.0	248.8
- USD billion equivalent	71.5	71.3

¹ Excludes currency and deposits held by non-residents with resident banking institutions
^P Preliminary

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

² The statistics for FDI on a cash basis does not include retained earnings and investment in the form of imported machinery and equipment

