

ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE FIRST QUARTER OF 2007

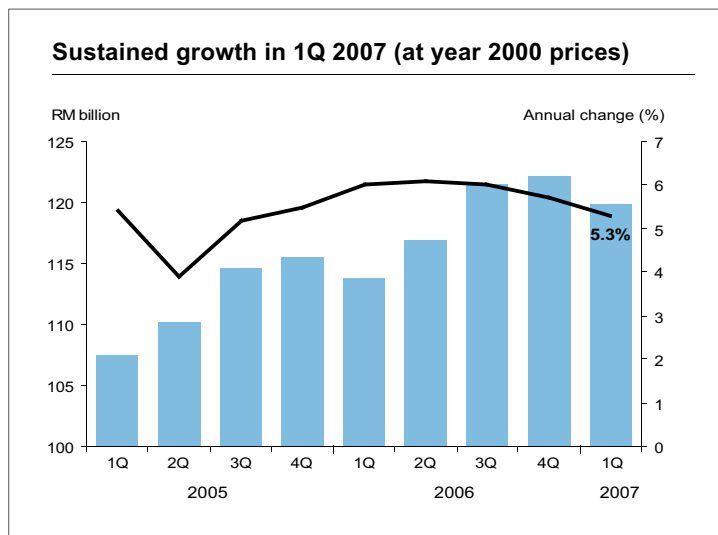
OVERVIEW

Growth supported by resilient domestic demand

The Malaysian economy continued to expand by 5.3% in the first quarter of 2007 (4Q 2006: 5.7%). Domestic demand, driven by private sector consumption and investment activities, was reinforced by increased public investment spending. On the supply side, growth was supported by strong expansion in the services sector and higher construction activity.

Plan. The sector was also underpinned by increased activity in the non-residential sector.

Despite the moderation in growth in the electronics and electrical (E&E) sector, the manufacturing sector recorded a positive growth of 1.7%. Growth was supported by the more diversified base of the manufacturing sector, with growth in resource-based industries and selected domestic-oriented industries offsetting the effects of the weakness in the E&E sector. Output of export-oriented industries increased by 0.1% during the quarter (4Q 2006: 4.3%) due mainly to the expansion in the resource-based industries such as chemicals and rubber products, and to a lesser extent wood and petroleum products. Meanwhile, the strong domestic demand, particularly for construction-related materials, fabricated metal, and food industries provided support to the domestic-oriented industries.



The services sector strengthened significantly to expand at an accelerated pace of 9.6% (4Q 2006: 8%), driven by an increase in consumption-related activities, finance and business services. This was reflected in the strong growth in the wholesale and retail trade, accommodation and restaurant as well as in the finance, insurance, real estate and business services sub-sectors. The services sector remained the key driver of growth, contributing five percentage points to overall GDP growth. The construction sector gained further momentum in the first quarter of 2007, supported by the better performance in the civil-engineering sub-sector following the launch of projects under the Ninth Malaysia

The agriculture sector continued to expand by 2% in the first quarter, supported mainly by growth in other minor agricultural activities such as fish, livestock, forestry, cocoa and fruits and vegetables. Meanwhile, the mining sector contracted by 1.1% (4Q 2006: 2.1%) due to the lower production of crude oil.

Domestic demand strengthened further in the first quarter to record an annual growth of 7.6% (4Q 2006: 7.1%), underpinned by strong private consumption and increased public investment spending. The steady increase in disposable income in an environment of stable labour market conditions and firm commodity prices contributed to the continued

strong growth in private consumption of 8.6%. Gross fixed capital formation recorded a growth of 5.4% (4Q 2006: 9.8%) reflecting the positive growth in investment expenditure by both the private and public sectors. The bulk of the public sector spending was channelled towards improving essential services including transportation, agriculture, rural development and public utilities.

The headline inflation rate, as measured by the change in the Consumer Price Index (CPI), continued to moderate, averaging 2.6% in the first quarter of 2007 (4Q 2006: 3%). The slower increase in prices mainly reflected the lower contribution of the transport category to the headline inflation rate, following the lapse of the effects of the March 2006 increase in the prices of retail petroleum products.

On the external front, the surplus on trade account narrowed to RM21.3 billion (4Q 2006: RM30.2 billion) as growth in imports of 5.4% (4Q 2006: 6.8%) outpaced growth in exports of 1.1% (4Q 2006: 6.6%). Despite the moderation in demand for computers and parts, manufactured exports grew by 1.5%. Growth was supported by the continued growth in exports of semiconductor chips to the non-US market, expansion in resource-based products such as chemical and rubber products, as well as the sustained growth in exports of consumer products. Meanwhile, agriculture exports rose by 7.7% during the quarter, supported mainly by the substantial rise in palm oil exports attributable to the strong increase in export prices. This is largely due to the continued high global demand for palm oil, particularly from the People's Republic of China (PR China), European Union (EU) and the US, amidst declining production and stocks, as well as the rise in soybean oil prices due to switching of the crops to corn planting in the US to fulfil domestic demand for biofuel. Receipts from mineral exports declined during the quarter due to lower exports of crude oil arising from the decline in prices, while export volume continued to increase.

Gross imports increased further in the first quarter reflecting higher imported inputs for manufactured exports and sustained increase in consumption products. Imports of intermediate goods increased by 8.8%, while imports of consumption goods grew by 8.9%. Imports of capital goods remained high at RM15 billion due mainly to higher imports of machinery and equipments in the agriculture, services as well as oil and gas sectors.

In the financial account, foreign direct investment (FDI), as captured by Bank Negara Malaysia's Cash BOP System (does not include retained earnings and investment in the form of imported machinery and equipment), recorded a net inflow of RM0.9 billion in the first quarter, reflecting inflows of equity capital mainly into the manufacturing, services and oil and gas sectors. The strong foreign participation in the domestic equity market during the first quarter is reflected in the significant net inflow in portfolio investment of RM26.9 billion. Meanwhile, overseas investment recorded a larger net outflow of RM3.8 billion (4Q 2006: -RM1.6 billion).

The international reserves of Bank Negara Malaysia amounted to RM305.9 billion or equivalent to USD88.6 billion as at 30 March 2007. As at 15 May 2007, the reserves amounted to RM326.5 billion or equivalent to USD94.5 billion, sufficient to finance 8.6 months of imports and is 9.6 times the short-term external debt.

Monetary policy remained supportive of economic activity

The overnight policy rate (OPR) was left unchanged at 3.50% throughout the first quarter of 2007 as the prevailing level of the policy rate is consistent with the medium term outlook of relatively low and stable inflation and steady pace of economic growth.

Reflecting the unchanged OPR, interbank rates of all maturities remained stable during

the quarter. Retail lending and deposit rates also remained relatively unchanged. The real fixed deposit rates, however, rose significantly in March following the decline in inflation.

Financing to the private sector remained firm, with banking system loans and private debt securities (PDS) outstanding expanding at a combined annual rate of 6.1% at the end of the first quarter. Banking system loans outstanding increased at an annual rate of 6.2%, with loans outstanding to businesses and households expanding by 6.3% and 7.8% respectively. The major loan indicators were higher on an annual basis. Loan applications and approvals were notably higher, driven by increased demand by businesses.

Net funds raised in the capital market by the public and private sectors increased to RM9.4 billion during the quarter. Although gross funds raised in the PDS market were lower than in the previous quarter, net funds raised were significantly higher at RM1.2 billion, due to the lower redemptions during the quarter. Funds raised in the equity market were also higher, amounting to RM795 million.

M1, or narrow money, increased at a stronger annual rate of 17.9% as at the end of the first quarter of 2007, reflecting mainly the increase in demand deposits placed by business enterprises and, to a lesser extent, the higher amount of currency held by the private sector. The growth in M3 was sustained at 12.8%. The expansion in M3 during the quarter was driven mainly by the increase in net foreign assets following higher inflows in the form of export proceeds, net foreign direct investment and portfolio investments.

The ringgit appreciated against the major currencies in the first quarter of 2007. The ringgit appreciation was generally in line with the major regional trading partners. The ringgit appreciated against all regional

currencies, except the Thai baht, in the first quarter.

For the period 1 April – 28 May 2007, the ringgit appreciated against the major currencies. The ringgit recorded a mixed performance against regional currencies. The ringgit appreciated against the Singapore dollar (2.7%), Korean won (0.9%), Chinese renminbi (0.9%) and Thai baht (0.9%), but depreciated against the Philippine peso (2.9%) and Indonesian rupiah (2.7%).

High resilience in the banking sector

The banking system continued to demonstrate strong resilience, as supported by high level of capitalisation and improved profitability. The risk-weighted capital ratio (RWCR) stood at 13.1% as at end-March 2007, while the pre-tax profit registered an increase of 17.8% compared with the corresponding period of 2006 to amount to RM3.7 billion. Asset quality of the banking system continued to improve during the quarter as reflected in the further decline in the total net non-performing loans (NPLs) based on the 3-month classification. Consequently, the net NPL ratio declined further to 4.6% of net loans (4Q 2006: 4.8%).

Stronger growth in the second half of 2007

Going forward, the Malaysian economy is expected to record stronger growth in the second half-year. On the external front, indicators point to favourable growth performance for Europe, Japan and Asia, PR China and India. In addition, the current moderation in the E&E sector is expected to be temporary as forward-looking indicators such as the book-to-bill ratio and the US tech pulse index point towards an improvement in the electronics industry in the second half of the year. On the domestic front, forward-looking indicators show that private consumption and investment will continue

to support domestic demand. The MIER Consumer Sentiments Index for the first quarter 2007 increased to 124.1 points, the highest level recorded since 3Q 2000, indicating that overall consumer confidence remained on the prospects for the economy. The sustained income growth due to firm commodity prices and stable employment conditions are expected to continue to support household consumption. Meanwhile, the MIER Business Confidence Index has

remained above the 100-point threshold, suggesting a steady expansion in investment activities. On the production front, the more rapid implementation of projects under the Ninth Malaysia Plan, the commencement of production of Kikeh Oil Field and full commencement of MLNG-2 plant after an upgrade and the expected significant increase in tourist arrivals during the peak summer travel season are expected to contribute to the growth in the second half of 2007.

DEVELOPMENTS IN THE FIRST QUARTER OF 2007

INTERNATIONAL ECONOMIC ENVIRONMENT

Sustained growth in most major regions despite moderation in US

Global economic growth continued on a positive growth momentum, supported by continued recovery in Japan and euro area as well as sustained expansion in the Asian region, despite further moderation in the US economy.

The **US** economy expanded at its slowest pace in four years in the first quarter of 2007, growing by 1.3%, amid continued weakness in the residential property and automotive sectors. Residential property investment continued to be a major impediment to growth, falling for the sixth consecutive quarter. The weakness in the housing market is evidenced from the continued decline in home sales and rising home inventories. In addition, the merchandise trade deficit widened as exports growth recorded its first decline since the second quarter of 2003. Nevertheless, consumer spending remained resilient, supported by job creation, low unemployment and rising wages.

In **Japan**, the economy remained on a recovery trend in 1Q, growing by 2.4%. The continued expansion was driven by healthy private consumption and robust external demand. Household spending grew in the first three months of 2007 supported by consumption expenditure on transportation and communication services, despite some weakness in retail sales. In addition, export activity continued to underpin economic growth against the background of sustained demand from abroad, especially from PR China. The latest Tankan survey released in April indicated that businesses remained optimistic with plans to increase capital spending in the near future. Meanwhile, the

euro area sustained its growth momentum in the 1Q. Consumer sentiment continued to improve in the euro area with most sentiment indicators trending upwards. A rebound in retail sales indicated resilient private consumption activity. Improvement in labour market conditions and expansion in capital investment lent support to growth. Growth in the **UK** economy was sustained at 2.8% in the 1Q. Growth was supported by the buoyant services sector, led by the business services and finance sub-sectors. Moderation in manufacturing output was offset by increased output in both mining and quarrying sectors and energy supply. The Confederation of

Industrial countries: Real GDP Growth

	2006			2007	Key contributing factors for 1Q growth
	1Q	4Q	Year	1Q	
	Annual change (%)				
US ¹	5.6	2.5	3.3	1.3 ^a	Slower-than-expected growth due largely to declines in residential property investment and exports. Nevertheless, consumer spending was sustained.
UK	2.4	3	2.8	2.8 ^p	Services sector, especially business services and finance, continued to be the driver of growth.
Euro zone	2.2	3.3	2.8	3.1 ^p	Supported by business investments and net trade.
Japan ¹	3.1	5.0 ^r	2.2	2.4 ^p	Supported by healthy private consumption and robust export activity.

¹ Annualised basis
^a Advance estimates
^r Revised
^p Preliminary

Source: National authorities

British Industry's (CBI) retail survey for April indicated that consumers were still spending, despite the higher cost of living and rising borrowing costs.

Most central banks maintained their tightening bias in terms of **monetary policy** stance. In the **US**, the **Federal Open Market Committee** (FOMC) maintained interest rates at 5.25% at its meeting on 21 March

and 9 May 2007. Inflation continued to be a concern. Both core consumer price index and personal consumption expenditure index had edged downwards in March, but remained above the Fed's comfort zone of 1-2%. The **European Central Bank** kept interest rates unchanged at 3.75% in April, after raising by 25 basis points in March amid concerns over inflationary pressure arising from rapid money and credit growth. The **Bank of England** (BoE) raised its policy rate in January and May by 25 basis points each time to 5.5%, due to concerns over inflation. Inflation data for March recorded an increase of 3.1%, more than a percentage point above the BoE's 2% target. The **Bank of Japan** maintained interest rates at 0.5% on 27 April, due to concerns over the declining inflationary trend after two months of falling consumer prices.

Global **crude oil prices** edged up towards the end of first quarter, closing at USD65.87 per barrel on 30 March, the highest level in two months, amid concerns over supplies in Nigeria and continued tension between Iran and the US. On 29 May, oil prices closed at USD63.15.

In the first quarter, PR China recorded a stronger expansion supported by continued expansion in exports and investment. Sustained domestic demand provided support to growth in other economies in the region as growth in exports, particularly electrical and electronic products, moderated.

Most regional countries experienced lower inflationary pressures, in response to generally lower oil prices compared to the previous quarter. The lower inflation prompted Indonesia and Thailand to reduce their policy rates to stimulate domestic demand. Meanwhile, PR China and India raised interest rates to contain strong credit growth.

In the **foreign exchange market**, the US dollar ended the quarter weaker against major currencies. While interest rate differentials remained the major factor influencing the US dollar performance, concerns over the strength of the US economy also affected the dollar performance. On 18 April, the US dollar hit a 26-year low against the pound sterling followed by a record low against the euro on 27 April. These developments reflected market expectations for a rate cut in the US and further rate hikes in Europe. Meanwhile, most regional currencies ended the quarter stronger compared to the fourth quarter of 2006, due to strong trade and investment inflows. In the equity markets, performance continued to be supported by strong inflows of foreign portfolio funds.

Regional Countries: Real GDP Growth

	2006			2007	Key contributing factors for 1Q growth
	1Q	4Q	Year	1Q	
	Annual change (%)				
PR China	10.4	10.4	10.7	11.1	Driven by exports and investment.
Singapore	10.1	6.6	7.9	6.1	Supported by construction and financial services.
Indonesia	4.8	6.1	5.5	6.0	Supported by investment and exports.
Hong Kong SAR	8.0	7.0	6.8	5.6	Supported by private consumption and exports.
Korea	6.3	4.0	5.0	4.0 ^a	Supported by exports, investment and private consumption.

^a Advance estimates

Source: National authorities

DEVELOPMENTS IN THE MALAYSIAN ECONOMY

Economic expansion supported by strong growth in the services sector and higher construction activity

Real GDP growth expanded by 5.3% in the first quarter of 2007 supported by strong growth in the services sector and higher construction activity. Growth in the services sector was driven by consumption-related activities, finance and business services, while the construction sector gained further momentum underpinned by projects launched

	2006			2007
	1Q	4Q	Year	1Q
	Annual Change in (%)			
Agriculture	5.9	5.1	5.2	2.0
Mining	-2.7	2.1	-0.4	-1.1
Manufacturing	8.8	4.0	7.1	1.7
Construction	-1.9	0.6	-0.5	4.0
Services	6.6	8.0	7.2	9.6
Real GDP (Ann. Chg.)	6.0	5.7	5.9	5.3
Real GDP (Preceding Chg.)	-1.6	0.5	5.9	-1.9

¹ The GDP has been rebased from 1987 prices to 2000 prices
Source: Department of Statistics, Malaysia

under the Ninth Malaysia Plan as well as by increased activity in the non-residential segment. The manufacturing sector continued to expand as the diversified industrial base provided support, with growth in resource-based industries and selected domestic-oriented industries offsetting the effects of the weakness in the electronics and electrical sector. The current moderation in the electronics sector is assessed to be a temporary phenomenon, as forward-looking indicators in the US such as the book-to-bill ratio and the tech pulse index showed that the electronics industry is expected to pick up during the course of the year. The agriculture sector continued to expand, supported mainly by the minor crops, while the performance in the mining sector was subdued due entirely to lower crude oil production.

Services sector remained the main driver of growth

The services sector strengthened significantly to expand at a higher pace of 9.6% (4Q 2006: 8%), led mainly by the intermediate services segment. The growth in the sector was supported by robust consumption, finance and business activities.

The performance of the **finance, insurance, real estate and business services** sub-sector was exceptionally strong at 17.6% (4Q 2006: 10.8%). Increased contribution from fee-based activity, as well as higher lending activities in both conventional and Islamic banking led to the higher growth in the finance segment. Further developments included the opening of another new Islamic foreign bank in Malaysia and the introduction of new products during the quarter. Increased interest in investment-linked insurance products led to higher growth in insurance activities. The sub-sector was further driven by strong expansion in the business services segment, mainly benefiting from the favourable developments in the stock market and increase in IT-related activities.

Growth in the **wholesale and retail trade, accommodation and restaurant** sub-sector also strengthened to 8.9% (4Q 2006: 6.4%). Strong domestic consumption during the festive period as well as higher tourist arrivals as a result of the programmes launched in conjunction with the 2007 Visit Malaysia Year supported growth in the distributive trade, hospitality and air transportation activities. The strength was reflected in indicators such as imports of consumption goods and credit card spending as well as the MIER Retail Trade Index and Tourism Market Index. The Retail Trade Index recorded its highest level since the third quarter of 2005, while the Tourism Market Index recorded its highest

level since the third quarter of 2004. Only the automotive trade industry was subdued due to the “wait-and-see” attitude by the consumers amidst the weakness in the second-hand car market, and in anticipation of the launch of new models during the later part of the year.

due to the festivities during the quarter. Higher revenue was also generated by the airlines industry following an increase in international passengers induced by tourism activities. In addition, higher revenue from port-related activities particularly transshipment also contributed favourably to the growth of the transportation industry. Meanwhile, the telecommunications industry was supported by the continued expansion in the cellular segment emanating from the enlarged subscriber base as well as higher usage of voice and data services, particularly the short messaging service (SMS). Growth was also augmented by the increase in total Internet subscribers, as well as broadband users which rose close to 1 million subscribers as of end-March 2007.

The **utilities** sub-sector was supported by increased demand for electricity from the commercial and household sub-sectors, while growth in **Government services** reflected increases in emoluments, including allowances paid to civil servants during the quarter.

Continued expansion in the manufacturing sector...

Value-added in the **manufacturing sector** recorded a positive growth of 1.7% (4Q 2006: 4%) despite the moderation in growth in the E&E sector. Output of **export-oriented industries** increased by 0.1% during the quarter (4Q 2006: 4.3%) due mainly to the expansion in the resource-based industries such as chemicals and rubber products, and to a lesser extent wood and

petroleum products, which compensated for the decline experienced by the E&E sector (-5.0%; 4Q 2006: 1.9%). The performance of the E&E sector was mainly affected by the weaker demand from the US market, particularly for computers and parts (-18.7%;

Performance in the Services Sector (Value Added at Year 2000 Prices)

	Share 2006	2006			2007
		1Q	4Q	Year	1Q
	%	Annual change in (%)			
Intermediate Services	42.8	5.2	9.5	7.6	13.4
Transport, storage & communication	14.2	4.6	6.8	6.0	5.4
<i>Transport & Storage</i>	7.0	3.8	6.7	5.2	5.5
<i>Communication</i>	7.2	5.4	6.8	6.8	5.3
Finance, insurance, real estate & business services	28.6	5.6	10.8	8.4	17.6
<i>Finance & Insurance</i>	19.8	6.1	8.8	7.7	13.2
<i>Real Estate & Business Services</i>	8.8	4.5	15.6	9.9	27.3
Final Services	57.2	7.7	7.0	7.0	6.7
Electricity, gas & water	5.9	4.5	6.2	5.2	4.1
Wholesale & retail trade, accomodation & restaurant	26.6	8.3	6.4	6.9	8.9
<i>Wholesale & retail trade</i>	22.3	9.2	6.0	7.1	9.1
<i>Accomodation & Restaurant</i>	4.2	4.0	9.1	6.0	8.1
Government services	13.6	10.1	10.6	9.8	6.0
Other services	11.1	5.4	4.5	4.7	4.1
Total Services	100.0	6.6	8.0	7.2	9.6

Source: Department of Statistics, Malaysia

Selected Quarterly Indicators in the Services Sector

	2006			2007
	1Q	4Q	Year	1Q
	Percentage at end-period (%)			
Cellular phone penetration rate	77.7	72.3	72.3	77.0
Internet subscribers penetration rate	13.9	14.0	14.0	14.0
Broadband subscribers penetration rate	2.2	3.3	3.3	3.7
	Annual change (%)			
Total passenger traffic at all airports	6.5	0.2	2.2	-0.9
Total consumption credit outstanding	19.0	14.9	14.9	12.8
Loans outstanding to the wholesale & retail trade, hotels & restaurants	7.5	12.0	12.0	10.1
Imports of consumption goods	14.0	12.1	13.4	8.9
Total sales of motor vehicles	-2.5	-24.8	-11.2	-15.4
SMS traffic	118.9	32.1	52.7	56.9
Container cargo handled (Port Klang and PTP)	7.8	18.7	14.2	18.5
Cargo revenue (Railway)	-1.5	12.3	5.1	8.8

Source: Various sources

The **transport, storage and communication** sub-sector continued to expand by 5.4% (4Q 2006: 6.8%) supported by the telecommunication industry and selected transport segments. Land transport benefited from an increase in travel activities

4Q 2006: -6.1%). Meanwhile, the production of semiconductor chips continued to increase (1%; 4Q 2006: 7.4%) supported by demand from the non-US region.

Within the resource-based industries, the chemical sector turned around to register a positive growth during the quarter arising from higher output of industrial gases and plastic products. The improvement in the plastic segment was supported by higher production of construction-related products such as plastic pipes and tubes. Meanwhile, the rubber products industry continued to record a strong double-digit growth, underpinned by demand for natural rubber gloves and benefiting from higher production of tyre products following the transition by some manufacturers into higher quality tyres. The off-estate processing industry declined during the quarter, in line with the lower production of crude palm oil.

Performance in the Manufacturing Sector

	2006			2007
	1Q	4Q	Year	1Q
Annual change (%)				
Value Added (at year 2000 prices)	8.8	4.0	7.1	1.7
Overall Production	8.9	5.3	7.5	0.4
Export-oriented industries	10.8	4.3	7.5	0.1
Of which:				
Electronics and electrical	17.4	1.9	7.9	-5.0
Electronics	23.1	4.5	11.8	-3.4
Electrical	2.4	-5.5	-2.9	-10.1
Chemicals and chemical products	5.6	-0.6	3.2	7.1
Petroleum products ¹	8.7	12.8	13.6	5.9
Textiles, wearing apparel & footwear	10.6	1.5	6.1	-10.4
Wood and wood products ²	3.3	9.7	3.8	1.5
Rubber products	-7.3	15.2	7.2	16.1
Off-estate processing	-4.9	9.6	5.7	-1.2
Domestic-oriented industries	1.1	9.9	7.2	2.0
Of which:				
Non-metallic mineral products	-5.0	9.2	3.3	-3.0
Iron & steel and non-ferrous metal	-9.8	20.5	3.0	13.0
Food	-1.6	9.7	6.7	14.0
Transport equipment	6.7	-14.0	-1.5	-27.9
Fabricated metal products	15.2	30.1	26.5	18.0
Total Manufactured Exports	10.6	5.7	10.1	1.5
Of which:				
Electronics and electrical products	8.4	1.7	6.4	-1.9
Chemicals and chemical products	-6.9	17.6	10.7	34.0
Petroleum products	40.3	2.5	27.2	-25.2
Wood and wood products	-3.7	26.8	16.7	15.3
Furniture & parts	8.0	7.6	7.9	7.9
Rubber products	17.7	30.8	34.3	29.2

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

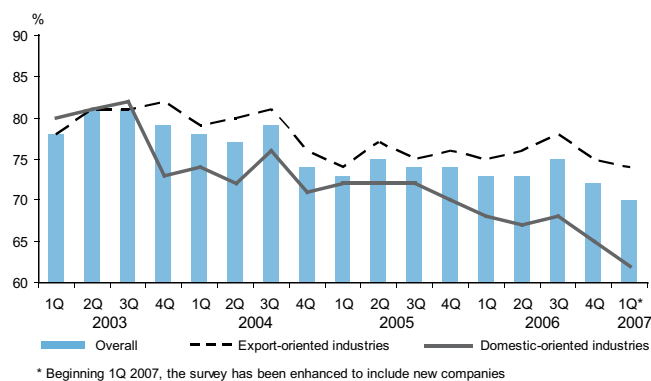
² Output of furniture and parts are not captured in the wood production data

Source: Department of Statistics, Malaysia

Output of **domestic-oriented industries** rose by 2% during the quarter. The growth was led by the food and fabricated metal product industries. Meanwhile, the positive effects from higher construction-related activity on related manufacturing industries was to some extent muted by the decline in the glass product segment. This is due mainly to transition by some television manufacturers shifting away from the production of cathode ray tube (CRT) televisions, to higher-end flat panel televisions. Meanwhile, the transport equipment industry continued to remain weak in tandem with the trends in demand for new vehicles, which was affected by the decline in car prices in the second hand car market.

Overall, the manufacturing sector was operating at the **capacity utilisation rate** of 70% during the quarter (4Q 2006: 72%), with both the export- and domestic-oriented industries averaging 74% and 62% respectively (4Q 2006: 75% and 65% respectively).

Capacity Utilisation in the Manufacturing Sector



Continued expansion in the agriculture sector...

The **agriculture sector** expanded by 2% reflecting increases in fish, livestock, cocoa, forestry, fruits and vegetables segments, which was partly offset by the decline in crude palm oil and rubber activities.

Production of **crude palm oil** declined by 1.4% to 3.19 million tonnes, signalling the end of the high production cycle which began in May 2006. Yields per hectare declined to 4 tonnes per hectare (1Q 2006: 4.12 tonnes per hectare). Output was also affected by the disruption in crop and harvest activity brought about by adverse weather conditions in March in key producing regions.

Rubber output declined by 5.2% during the quarter (4Q 2006: 11.2%). The low production is due to the yearly wintering season, which occurs during February to mid-May that has a significant effect on yields. Given the tight supply conditions, rubber prices rose to average 707 sen per kilogramme during the quarter (4Q 2006: 608 sen per kilogramme), with prices hitting a peak of 750 sen per kilogramme on 9 February 2007.

The expansion in the agriculture sector was mainly supported by other agriculture activities such as fish, livestock, cocoa, fruits and vegetables. **Fish** production increased further by 5.2% to 360,900 tonnes, due mainly to increase in marine fish landings, including a substantial rise in deep sea fishing. Meanwhile, **cocoa** production rebounded to increase by 2.9% to 9,748 tonnes due to higher yields.

Performance in the Agriculture Sector

	2006			2007
	1Q	4Q	Year	1Q
	Annual change (%)			
Value Added (at year 2000 prices)	5.9	5.1	5.2	2.0
Production ¹				
Of which:				
Crude palm oil	-5.4	10.7	6.1	-1.4
Crude palm kernel oil	-8.9	14.7	6.1	3.3
Rubber	27.4	11.2	13.3	-5.2
Cocoa	24.1	-19.9	14.2	2.9
Fish	9.2	10.0	8.3	5.2
Exports (RM million)	4.5	22.1	12.5	7.7
Of which:				
Palm oil				
(⁰⁰⁰ tonnes)	2.7	20.9	7.2	-11.2
(RM/tonne)	-4.6	14.7	6.0	34.1
(RM million)	-2.0	38.6	13.7	19.2
Palm kernel oil				
(⁰⁰⁰ tonnes)	-45.8	15.4	-10.1	65.0
(RM/tonne)	-12.4	-9.9	-16.1	2.1
(RM million)	-52.6	3.9	-24.6	68.5
Rubber				
(⁰⁰⁰ tonnes)	3.0	1.4	1.3	-12.3
(Sen/kilogramme)	43.9	11.1	40.5	-0.7
(RM million)	48.2	12.7	42.3	-12.9
Sawn timber				
(⁰⁰⁰ cu.metres)	-19.6	5.2	-9.9	-5.9
(RM/cu.metre)	37.2	4.1	18.8	-1.8
(RM million)	10.3	9.5	7.0	-7.6
Saw logs				
(⁰⁰⁰ cu.metres)	-19.4	-3.2	-17.1	-8.3
(RM/cu.metre)	18.1	7.2	10.7	-2.4
(RM million)	-4.8	3.8	-8.3	-10.5
Cocoa beans				
(⁰⁰⁰ tonnes)	101.1	-8.2	45.8	-13.5
(RM/tonne)	0.1	10.1	3.7	4.8
(RM million)	101.2	1.1	51.2	-9.3

¹ In ⁰⁰⁰ tonnes, except for saw logs in ⁰⁰⁰ cubic metres

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

In the **mining sector**, growth was mainly influenced by lower output of crude oil (including condensates), which declined by 3.8% to 680,153 barrels per day during the quarter (1Q 2006: 707,294 barrels per day). Nevertheless, **natural gas** output rose by

1.1% to 6,040 million standard cubic feet per day (1Q 2006: 5,974 million standard cubic feet per day) supported by continued demand for power generation in Malaysia and higher LNG exports to Japan and Korea.

Performance in the Mining Sector

	2006			2007
	1Q	4Q	Year	1Q
	Annual change (%)			
Value Added (at year 2000 prices)	-2.7	2.1	-0.4	-1.1
Production				
<i>Of which:</i>				
Crude oil and condensates ('000 barrels)	-0.5	0.3	-0.5	-3.8
Natural gas (net) (million standard cubic feet)	-6.0	4.4	-0.4	1.1
Exports (RM million)	23.0	0.5	8.6	-3.6
<i>Of which:</i>				
Crude oil and condensates ('000 tonnes)	-7.3	-8.1	-8.0	3.8
(USD/barrel)	40.8	4.2	21.3	-6.0
(RM million)	28.1	-8.0	8.1	-8.5
Liquefied natural gas ('000 tonnes)	-2.6	1.8	-1.9	4.5
(RM/tonnes)	19.6	8.7	14.2	-0.2
(RM million)	16.4	10.7	12.0	4.3

Source: PETRONAS
Department of Statistics, Malaysia

Construction Indicators

	2006			2007
	1Q	4Q	Year	1Q
	Annual change (%)			
New sales and advertising permits	-23.6	-2.7	-17.6	7.7
Housing approvals	-43.4	-20.0	-23.2	-9.6
Production of construction-related materials	-6.6	12.8	3.2	2.2
Loans approved for construction	-33.5	73.2	13.0	91.3
Imports of construction materials and mineral products	2.6	-8.2	7.8	0.3 ¹

¹ Jan-Feb 2007

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

Increased construction activity...

Construction activity strengthened further during the quarter to expand by 4% (4Q 2006: 0.6%). The improvement was underpinned by the better performance in the civil engineering sub-sector as the effects from the launch of the Ninth Malaysia Plan projects began to filter into the economy. This was further augmented by activity in the non-residential sub-sector, supported by construction of a number of new office accommodation and large shopping complexes mainly in the Klang Valley. Meanwhile, performance in the residential segment continued to be supported mainly by construction of high-end property. Activity in the sub-sector is expected to gain momentum in the coming months in response to the recent initiatives introduced by the Government, such as the relaxation on rulings on foreign ownership of property in the country, exemption on real property gains tax, creation of a one stop centre to expedite development of housing projects and attractive incentives to encourage the application of the Build-then-Sell (BTS) method in building residential properties.

Domestic demand remained resilient...

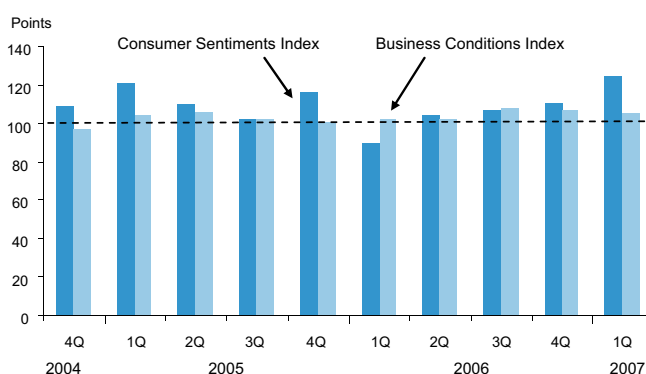
Domestic demand remained resilient, strengthening further in the first quarter to record an annual growth of 7.6% (4Q 2006: 7.1%), driven by private consumption and investment activities, and reinforced by increased public sector expenditure.

GDP by Expenditure Components (at year 2000 prices)

	2006			2007
	1Q	4Q	Year	1Q
	Annual change (%)			
Aggregate Domestic Demand (excluding stocks)	7.1	7.1	7.0	7.6
Consumption	5.6	6.2	6.6	8.3
Private sector	6.6	7.0	7.1	8.6
Public sector	1.2	4.1	5.0	7.3
Gross Fixed Capital Formation	11.4	9.8	7.9	5.4
Exports of Goods and Services	7.0	5.2	7.4	1.9
Imports of Goods and Services	11.9	5.0	8.6	3.5
GDP	6.0	5.7	5.9	5.3

Source: Department of Statistics, Malaysia

Consumer Sentiments Improved, while Business Confidence was Sustained



Source: Malaysian Institute of Economic Research (MIER)

Private consumption spending continued to be strong, growing at 8.6% in the quarter (4Q 2006: 7.6%). The trends of major consumption indicators, such as imports of consumption goods and loans approved and disbursed for consumption purposes pointed to sustained momentum in household spending. The main factor that contributed to the sustained growth in consumer spending

was the steady increase in disposable income, stable labour market conditions and firm commodity prices. The MIER Consumer Sentiment Index (CSI) rose strongly by 13.2 points to 124.1 points in the first quarter (4Q 2006: 110.9 points), signifying sustained positive outlook for consumer spending in the coming quarters.

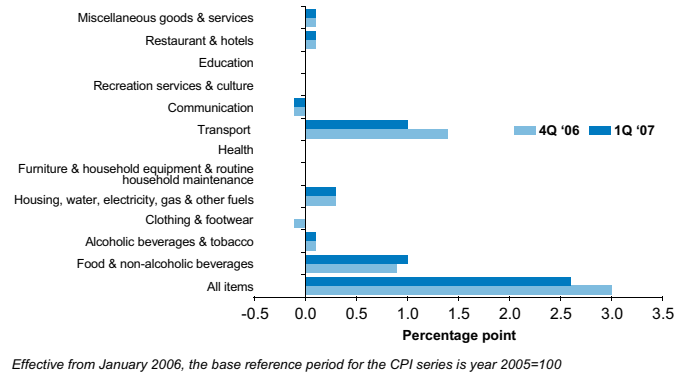
Meanwhile, **public consumption** grew by 7.3% during the quarter (4Q 2006: 4.1%) due mainly to higher expenditure for emoluments and supplies and services.

Gross fixed capital formation recorded a growth of 5.4% in the first quarter of 2007 (4Q 2006: 9.8%). Investment activities by the public sector continued to be sustained at a high level as the Federal Government continued to increase its pace of disbursement of development expenditure. The spending was mainly channelled towards improving essential services including transportation, agriculture and rural development and public utilities. At the same time, private sector capital spending was sustained, as evidenced by the trends of major investment indicators such as loans approved and disbursed to businesses, especially to the manufacturing and construction sectors. The MIER Business Conditions Index (BCI) also remained above the 100-point threshold at 105.5 points, suggesting a steady expansion in private investment activities.

Inflation continued to moderate in the first quarter

The headline inflation rate, as measured by the change in the Consumer Price Index (CPI), continued to moderate, averaging 2.6% in the first quarter of 2007 (4Q 2006: 3%). The slower increase in prices reflected the

Contribution to Consumer Price Inflation



lower contribution of the transport category to the headline inflation rate, following the lapse of the March 2006 increase in the prices of retail petroleum products. Price increases for the food and non-alcoholic beverages category were slightly higher compared to the previous quarter due to transitory factors such as the tighter supply conditions following the severe floods in Johor early this year, and the impact of seasonal factors and festivities. Competition among producers and sellers has continued to sustain the decline in prices for the clothing and footwear and communication categories.

Producer price inflation moderated to 4.4% in the first quarter (4Q 2006: 5.6%), as prices in the non commodity-related category rose at a slower pace of 4.9% (4Q 2006: 7%). Inflation in the commodity-related category, in contrast, increased by 2.9% (4Q 2006: 1.7%), reflecting price increases for crude palm oil and natural rubber during the quarter.

Labour market conditions remained healthy

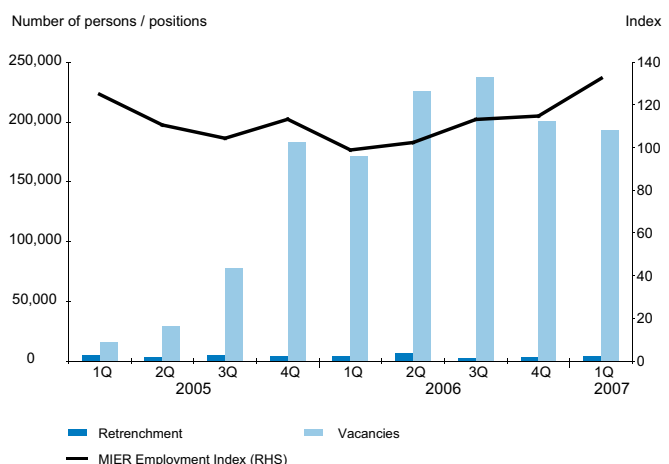
Labour market conditions in the first quarter of 2007 continued to be stable. The favourable employment outlook was also reflected in the

MIER Employment Index, which rose by 17.7 points to 132.5 points in the first quarter.

Total vacancies in the first quarter reported via the Electronic Labour Exchange (ELX) remained high at 193,188 positions, (4Q 2006: 200,523 positions), with significant levels of job openings reported in the manufacturing (35%), services (26%) and agriculture (21%) sectors. The bulk of the positions advertised in the ELX were mainly for

lower skilled jobs which are more suitable for non-executives, such as elementary occupations (59%). This development could be due to the Government's regulation that requires employers to advertise with the ELX if they intend to engage foreign migrant labour. Nonetheless, the Ministry of Human Resource's efforts to widen the use of ELX appear to yield some results, as more companies are utilising ELX to advertise higher skilled jobs, that are more suitable for graduates. The number of positions available for graduates increased by 30% to 17,764 (9% of total job vacancies) in the first quarter from 13,682 (7% of total job vacancies) in the

Labour Market Conditions



previous quarter. Most job openings for graduates are found in the services sector (86%).

Total number of retrenchments rose to 4,180 (4Q 2006: 2,613 persons). About 81% of the layoffs were in the manufacturing sector, affecting mainly workers from the electronics and electrical industry (64% of total retrenchments). The retrenchments mainly involved plant and machine operators and assemblers and general workers as well as craft and related trade workers (54% share). The main reason for the retrenchments cited by most companies is the reduction in demand.

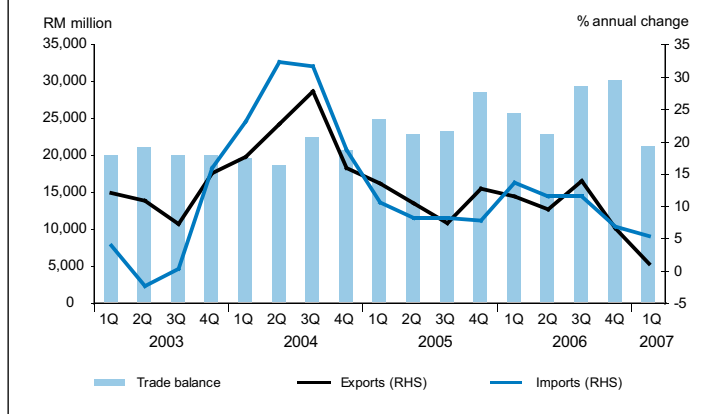
In the first quarter of 2007, labour productivity as indicated by real sales value per employee in the manufacturing sector fell by 4.6% (4Q 2006: -0.5%). The decline in labour productivity growth reflected the lower growth in real sales (-0.1%) amidst higher employment growth (4.7%). Meanwhile, real wages continued to decline (-0.4%), indicating that wage pressures remained weak.

Moderate expansion in both exports and imports

The **trade account** surplus narrowed to RM21.3 billion (4Q 2006: RM30.2 billion) in the first quarter of 2007, as import growth of 5.4% outpaced export growth of 1.1%.

Manufactured exports expanded, albeit at a more moderate pace of 1.5%, due mainly to the slowdown in demand for E&E products, particularly exports of computers and parts to the US market. Exports of electrical products were also affected during the quarter due to the phasing out of some of the lower-end products such as the cathode ray tube televisions and radios. Part of the impact was moderated by continued growth in exports of resource-based products such as chemical and rubber products which registered double-digit growth during the quarter. Exports of consumer products such as food,

Trade Balance



beverages and tobacco were also sustained due to stable demand.

Agriculture exports rose by 7.7%

during the quarter, supported mainly by the substantial rise in palm oil exports of 19.2%. The strong performance was attributable to the increase in export prices by 34.1% to RM1,905 per tonne. Higher prices reflected continued high global demand for palm oil, especially from PR China, EU and the US, amidst declining production and stocks during the quarter. This was further supported by the rise in soybean oil prices following reduction in output in the US as farmers switched to planting corn to fulfil domestic demand for biofuel. Meanwhile, rubber exports declined by 12.9% during the quarter (4Q 2006: 12.7%) due to both lower volume and prices, which declined by 12.3% and 0.7% respectively.

Trade Account

	2006			2007
	1Q	4Q	Year	1Q
	Annual change (%)			
Gross Exports	11.5	6.6	10.3	1.1
Manufacturing	10.6	5.7	10.1	1.5
Agriculture	4.5	22.1	12.5	7.7
Minerals	23.0	0.5	8.6	-3.6
Gross Imports	13.7	6.8	10.8	5.4
Capital goods	27.8	4.1	7.4	-4.7
Intermediate goods	8.2	7.1	8.8	8.8
Consumption goods	14.0	12.1	13.4	8.9
Trade balance (RM billion)	25.8	30.2	108.2	21.3

Source: Department of Statistics, Malaysia

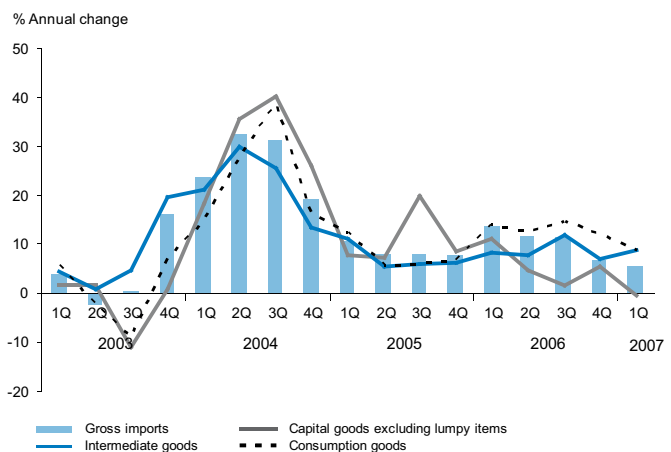
Export receipts from minerals declined during the quarter due to lower exports of crude oil arising from the decline in prices (-6% to USD61.18 per barrel; 1Q 2006: USD65.24 per barrel). Meanwhile, LNG exports expanded further supported by higher offtake from traditional buyers.

Malaysia's exports to the regional countries (excluding Japan), which accounted for 45.9% of Malaysia's exports, increased by 1.4%. These exports were mainly to PR China, Korea and Indonesia, underpinned by demand for exports of E&E products, as well as chemicals and chemical products. Exports to the EU expanded by 9.7%, led by exports to the United Kingdom, Germany, the Netherlands, France and Italy, comprising mainly E&E products, crude rubber and rubber products, palm oil as well as wood products. Export growth to West Asia and India also strengthened by 22.3% and 7.1% respectively.

On the imports side, Malaysia continued to source import components from Singapore, Hong Kong SAR, Korea and PR China. Imports from the regional countries increased by 9.6%, reflecting imports of E&E products, chemicals and chemical products, iron and steel products as well as manufactures of metal.

Gross imports increased by 5.4% (4Q 2006: 6.8%), reflecting higher imported inputs for manufactured exports and higher imports of consumption goods. Imports of **intermediate goods** strengthened by 8.8% (4Q 2006: 7.1%), driven by imports of metal and metal products, chemicals, electronics as well as parts of telecommunication products. In addition, imports of primary and processed materials used by the fuel and lubricant industry continued to grow strongly. Lower domestic demand for motor vehicles led to a decline in imports of parts and accessories of transport equipment.

Import Growth



Malaysia: Direction of Exports

	2006				2007				2006				2007			
	1Q		Year		1Q		1Q		1Q		Year		1Q			
	RM billion				Share of total exports (%)				Annual change (%)							
United States	24.5	27.8	110.6	23.7	17.9	18.3	18.8	17.2	13.4	1.0	5.3	-3.2				
European Union (EU) ¹	16.1	21.1	74.9	17.7	11.8	13.9	12.7	12.8	10.0	20.5	19.7	9.7				
Selected ASEAN countries ²	37.4	37.5	152.5	35.7	27.3	24.7	25.9	25.8	14.7	2.2	10.7	-4.5				
North East Asia	25.2	28.2	109.1	27.8	18.4	18.5	18.5	20.1	7.3	4.4	10.0	10.2				
People's Republic of China	8.3	11.7	42.7	11.2	6.1	7.7	7.2	8.1	4.4	11.9	21.1	34.6				
Hong Kong SAR	7.5	6.8	29.1	6.3	5.5	4.5	4.9	4.6	6.2	-12.6	-6.6	-15.6				
Chinese Taipei	3.3	4.1	16.0	3.8	2.4	2.7	2.7	2.7	7.2	2.8	8.3	15.4				
Korea	6.1	5.5	21.3	6.5	4.5	3.6	3.6	4.7	12.9	17.4	18.6	5.9				
India	4.0	5.4	18.8	4.2	2.9	3.6	3.2	3.1	8.3	30.1	25.5	7.1				
Total exports	136.7	152.0	588.9	138.2	100.0	100.0	100.0	100.0	11.5	6.6	10.3	1.1				

¹ Refers to European Union (EU) 27 from 2007 onwards
² Singapore, Thailand, Indonesia, Philippines, Brunei Darussalam and Vietnam
Source: Department of Statistics, Malaysia

Imports of **capital goods** amounted to RM15 billion. Capacity expansion amidst high agriculture prices spurred imports of agriculture machinery and equipment during the quarter. Increased development activity and upgrading for fuel efficiency led to higher growth in imports of generators, turbines and machinery in the services as well as oil and gas sectors. Meanwhile, imports of telecommunication equipment remained strong, in line with continued capacity expansion and upgrading activities by the telecommunication industry.

Consistent with strong private consumption, imports of **consumption goods** grew by 8.9%. Consumption imports were supported mainly by higher imports of primary

Larger inflows of portfolio investment

On a cash basis¹, gross inflows of **foreign direct investment (FDI)** amounted to RM7.3 billion in the first quarter of 2007, reflecting inflows of both the equity capital and drawdown of inter-company loans from parent companies abroad. FDI in the form of equity capital were mainly in the manufacturing sector, followed by the services and oil and gas sectors. In the manufacturing sector, FDI were channelled mainly into the petroleum-related products, chemical-related industries, as well as the paper and paper-product industry following the acquisition of a Malaysian company. Meanwhile, FDI in the services sector were directed primarily into the finance, insurance, real estate and business services as well as the restaurants, hotels, wholesale and retail trade sub-sectors. After adjustments for gross outflows due mainly to repayments of inter-company loans, net FDI amounted to RM0.9 billion.

Overseas investment by Malaysian companies recorded a gross outflow of RM24.8 billion, reflecting largely short-term loan extended by non-resident controlled companies in the services and manufacturing sectors 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 larger net outflow of

RM3.8 billion (4Q 2006: -RM1.6 billion). Overseas investments in the form of equity capital were effected mainly by companies in the manufacturing and services sectors. In the manufacturing sector, overseas investment were channelled mainly into the

Malaysia: Imports by End Use And Broad Economic Categories (BEC) Classification

	2006			2007
	1Q	4Q	Year	1Q
	Annual change (%)			
CAPITAL GOODS	27.8	4.1	7.4	-4.7
Capital goods (except transport equipment)	16.1	4.6	5.4	-4.1
Transport equipment	173.3	-0.1	23.5	-7.4
INTERMEDIATE GOODS	8.2	7.1	8.8	8.8
Food and beverages, mainly for industry	29.0	18.2	24.9	4.1
Industrial supplies, n.e.s.	1.2	19.2	11.1	23.9
Fuel and lubricants	21.1	-0.5	25.7	8.8
Parts and accessories of capital goods (except transport equipment)	9.2	3.3	5.1	2.5
Parts and accessories of transport equipment	8.8	-22.5	-8.7	-18.2
CONSUMPTION GOODS	14.0	12.1	13.4	8.9
Food and beverages, mainly for household consumption	3.4	5.7	4.8	14.8
Transport equipment, non-industrial	23.6	45.7	9.4	-11.7
Consumer goods, n.e.s.	20.9	15.1	18.8	5.9
Durables	31.3	13.7	9.8	1.1
Semi-durables	27.4	24.5	34.6	7.1
Non-durables	11.6	9.3	12.6	7.8
DUAL USE GOODS	23.2	-5.7	7.8	-8.1
OTHERS	12.0	-3.4	-2.7	15.7
RETAINED IMPORTS	11.6	6.4	8.7	6.4
RE-EXPORTS	52.7	12.5	50.6	-7.3
GROSS IMPORTS	13.7	6.8	10.8	5.4

Source: Department of Statistics, Malaysia

and processed food as well as beverages for household consumption. Imports of household electrical products, furniture, cameras, jewellery and medicine also increased during the quarter.

¹ The FDI data on cash basis does not include retained earnings and investment in the form of imported machinery and equipment.

External Debt Outstanding

	2006		2007
	1Q	4Q	1Q ^P
	RM billion		
Medium- and long-term debt	150.5	141.4	139.0
Public sector	86.9	75.7	73.5
Private sector	63.7	65.7	65.5
Short-term debt ¹	44.9	41.8	38.9
Total external debt	195.4	183.1	178.0
- USD billion equivalent	52.5	51.4	51.0

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

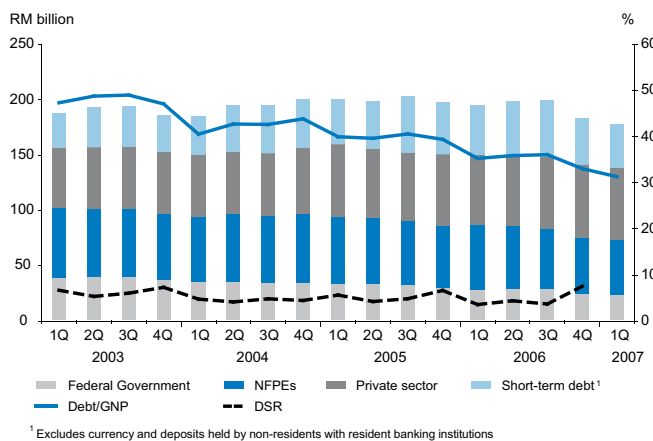
Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

also contributed to the positive investor sentiment.

Further improvement in external debt position

Malaysia's total external debt declined further to RM178 billion or USD51 billion as at end-March 2007 (end-2006: RM183.1 billion or USD51.4 billion), equivalent to 31.3% of GNP. The improvement in the external debt position was attributed to declines in both the medium- and long-term and short-term external debt. The lower **medium- and long-term external debt** (RM139 billion; end-2006: RM141.4 billion) reflected mainly the exchange revaluation gain following the appreciation of the ringgit against major currencies, particularly the US dollar. The public sector continued to register a net repayment of external loans during the quarter, reflecting both lower gross borrowings and repayments by the Federal Government and NFPEs. The net repayment by NFPEs was attributed mainly to companies in the oil and gas and transportation sectors. Meanwhile, the private sector recorded a smaller net drawdown of external loans of RM1.3 billion, mainly by companies in the agriculture, wholesale and retail trade, and transportation sectors.

External Debt Outstanding



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

food processing and automotive industries. Meanwhile, overseas investments by the services sector were led by companies in the finance, insurance, real estate and business services sub-sector.

Portfolio investment registered a net inflow of RM26.9 billion in the first quarter of 2007. The inflows of portfolio funds reflect mainly the strong foreign participation in the domestic equity market, supported by continued positive investor sentiment due to stronger fundamentals and expectations of stronger corporate earnings. Announcements to further liberalise the foreign exchange administration measures, removal of the real property gains tax and special incentives to promote investment in the Iskandar Development Region (IDR)

The total short-term external debt declined to RM38.9 billion or USD11.2 billion (end-2006: RM41.8 billion or USD11.7 billion), reflecting lower short-term borrowings by both banking and non-bank sectors. As at end-March 2007, the short-term debt accounted for only 21.9% of total external debt and was 12.7% of the net international reserves.

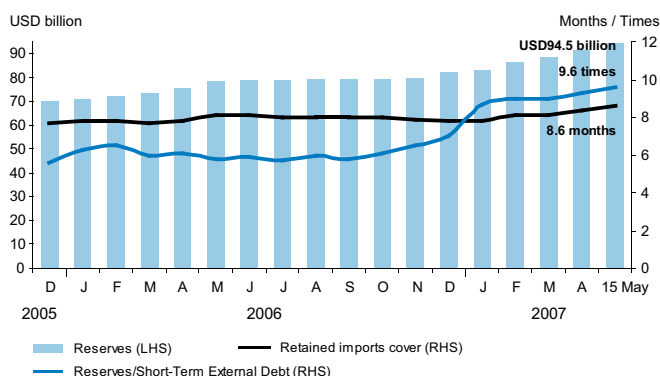
International reserves

The international reserves of Bank Negara Malaysia amounted to RM305.9 billion or equivalent to USD88.6 billion as at 30 March 2007. The reserves level as at 30 March 2007 has taken into account the quarterly revaluation loss, following the strengthening of ringgit against the major currencies during the first quarter. The reserves increased to RM326.5 billion or equivalent to USD94.5 billion as at 15 May 2007. The reserves position is sufficient to finance 8.6 months of retained imports and is 9.6 times the short-term external debt.

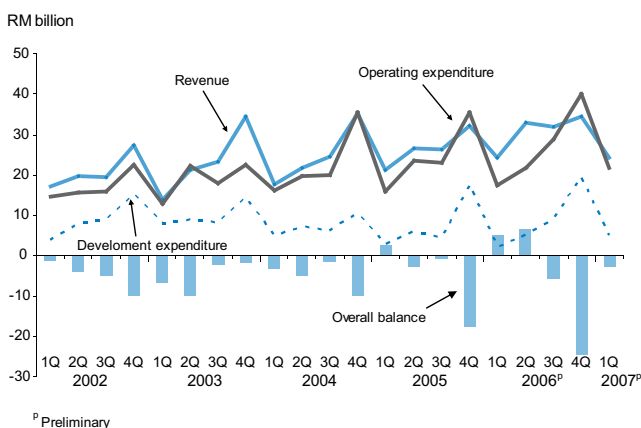
Expansionary budgetary operations

In the first quarter of 2007, total expenditure rose at an annual rate of 38.7%. Development spending increased at a faster pace compared with the first quarter of 2006, reflecting the pick-up in momentum in the implementation of the Ninth Malaysia Plan. Together with stable revenue collection during the quarter, the Federal Government's financial position recorded a deficit of RM2.6 billion or 1.8% of GDP during the quarter (1Q 2006: fiscal surplus of 3.6% of GDP). The deficit was financed mainly by domestic borrowings. As at end-March 2007, total outstanding debt of the Federal Government amounted to RM250 billion or 42.4% of the estimated 2007 GDP.

Net International Reserves (as at end period)



Federal Government Finance



Federal Government Finance^P

	2006			2007
	1Q	4Q	Year	1Q
	RM billion			
Revenue	24.2	34.4	123.5	24.2
% growth	14.5	6.9	16.2	0.1
Operating expenditure	17.3	40.0	107.7	21.7
% growth	8.9	12.8	10.2	25.2
Current account	6.9	-5.6	15.9	2.5
% of GDP	5.1	-3.8	2.8	1.8
Gross development expenditure	2.1	19.4	35.8	5.3
% growth	-23.0	11.0	17.3	148.4
Overall balance	4.9	-24.6	-19.1	-2.6
% of GDP	3.6	-16.6	-3.3	-1.8
Memo item:				
Total gross expenditure	19.5	59.4	143.5	27.0
% growth	4.2	12.2	11.9	38.7
Total Federal Government debt (as at end-period)	232.2	242.2	242.2	250.0
% of GDP	40.6	42.3	42.3	42.4 ¹
Domestic debt	203.3	217.2	217.2	225.9
% of GDP	35.5	37.9	37.9	38.3 ¹
External debt	28.9	25.0	25.0	24.1
% of GDP	5.1	4.4	4.4	4.1 ¹

^P Preliminary
¹ GDP at 1987 prices

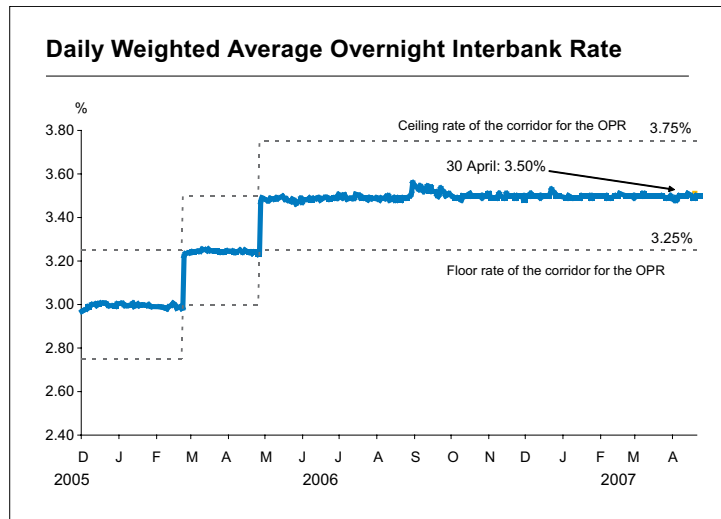
MONETARY AND FINANCIAL DEVELOPMENTS

Lending rates remained stable while real FD rates for all maturities rose

The OPR was left unchanged at 3.50% throughout the first quarter of 2007 as the prevailing level of the policy rate is consistent with the medium term outlook of relatively low and stable inflation and steady pace of economic growth.

Reflecting the unchanged OPR, the average overnight interbank rate remained stable, moving within a tight range of 3.48% to 3.51% during the period 1 January – 25 April. Interbank rates of other maturities also remained relatively stable.

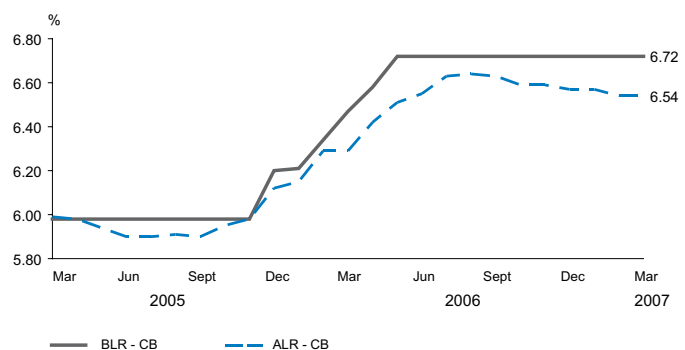
In terms of lending rates, the average base lending rate (BLR) of commercial banks (CBs) remained unchanged at 6.72%. However, the average lending rate (ALR) declined marginally to 6.54% as at end-March, from 6.57% as at end-2006. The average quoted fixed deposit (FD) rates of CBs for the 1-month and 12-month maturities ranged between 3.10% and 3.71% at the end of the first quarter (4Q 2006: 3.11% to 3.73%). Of significance, the real FD rates for all maturities rose significantly in March following the decline in inflation.



Interest Rates

	2006			2007
	1Q	4Q	Year	1Q
	At end-period (%)			
Overnight Policy Rate (OPR)	3.25	3.50	3.50	3.50
Interbank rates				
Overnight	3.25	3.50	3.50	3.50
1-month	3.25	3.58	3.58	3.55
Base lending rates (BLR)				
Commercial banks	6.47	6.72	6.72	6.72
Average lending rates (ALR)				
Commercial banks	6.29	6.57	6.57	6.54
Fixed deposit rates				
Commercial banks				
3-month	3.06	3.19	3.19	3.18
12-month	3.70	3.73	3.73	3.71

Lending Rates of Commercial Banks (Average for the period)

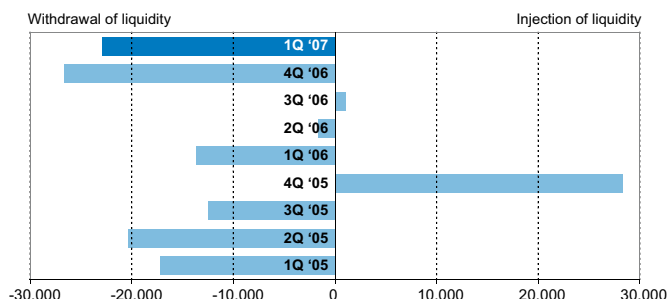


Sustained growth in broad money

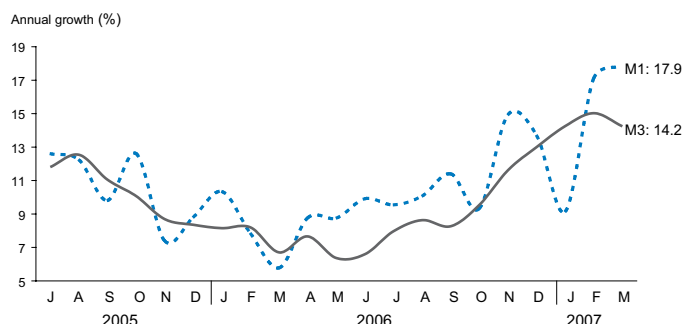
M1, or narrow money, expanded at a higher annual rate of 17.9% at the end of the first quarter of 2007 (4Q 2006: 13.8%), reflecting mainly the increase in demand deposits placed by business enterprises and, to a lesser extent, the higher amount of currency held by the private sector.

M3, or broad money, increased at a rate of 14.2% at the end of the first quarter of 2007 (4Q 2006: 13%). During the quarter, the expansion in M3 was driven mainly by the increase in net foreign assets following higher inflows in the form of export proceeds, net foreign direct investment and portfolio investments. Claims on the private sector expanded on account of the increase in loans outstanding. These were, however, offset to some extent by the lower holdings of private debt securities by the banking institutions. In contrast with the seasonally high spending at the end of the year, net claims on the Government had a more moderate expansionary impact on M3 in the first quarter as the drawdown of Government deposits with Bank Negara Malaysia was relatively smaller.

Bank Negara Malaysia Liquidity Operations (During the quarter, RM million)



Monetary Aggregates



Determinants of Broad Money, M3

	Change during the period			
	2006			2007
	1Q	4Q	Year	1Q
	RM billion			
M3	18.0	44.0	87.5	28.9
Net claims on Government	2.8	19.9	8.3	1.0
Claims on private sector	5.6	7.9	34.7	5.2
Loans	7.5	8.2	36.8	8.1
Securities	-1.9	-0.3	-2.1	-2.9
Net external operations ¹	13.9	22.7	59.8	37.3
BNM	10.8	5.2	32.2	19.9
Banking system	3.1	17.4	27.6	17.5
Other influences	-4.3	-6.4	-15.3	-14.7

¹ Pre-revaluation

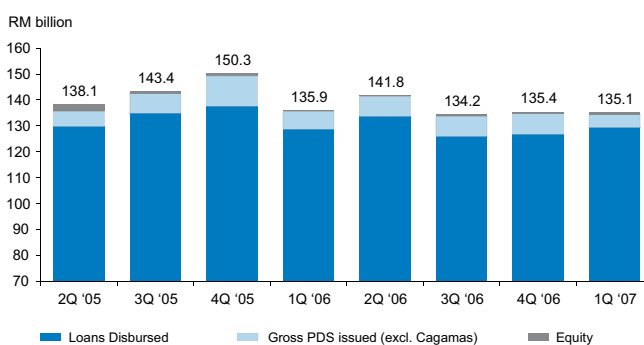
Financing of the Private Sector through Banking System and Capital Market

	During the period (RM billion)				Annual growth (%)		
	2006	1Q 06	4Q 06	1Q 07 ^p	2006	4Q 06	1Q 07 ^p
Gross total financing	547.3	135.9	135.4	135.1	-3.2	-9.9	-0.6
Loans disbursed*	514.7	128.7	126.7	129.2	-2.6	-7.9	0.4
Gross PDS (excl. Cagamas)	30.7	6.9	8.1	5.1	-0.1	-31.0	-25.5
Equity	1.9	0.4	0.6	0.8	-69.7	-39.4	108.5
Outstanding total financing (A)+(B)	45.4	11.1	6.3	11.0	6.2	6.2	6.1
Banking system	46.7	9.9	9.5	9.4	7.9	7.9	7.7
Loans outstanding (A)	34.9	8.2	4.0	8.6	6.3	6.3	6.2
Holding of PDS	11.8	1.6	5.5	0.8	33.4	33.4	29.8
PDS outstanding (B)	10.5	2.9	2.3	2.4	6.0	6.0	5.6
Memorandum item							
Gross PDS (incl. Cagamas)	38.2	10.6	8.3	7.6	1.8	-45.3	-28.3

^p Preliminary

* Banking system loans include loans sold to Cagamas

Gross Private Sector Financing through Banking System and Capital Market



Major loan indicators were higher in the first quarter

In the first quarter of 2007, gross financing of the private sector through the banking system and capital market amounted to RM135.1 billion (4Q 2006: RM135.4 billion). Gross financing was relatively stable compared with the preceding quarter amid higher loan disbursements and slightly lower private debt securities (PDS) issuances. Nevertheless, with gross financing through loans and PDS exceeding repayments and redemptions, there was a continued increase in net financing. On a net basis, banking system loans and PDS outstanding expanded at a steady combined annual rate of 6.1% at end-March (end-2006: 6.2%).

The major loan indicators were higher on an annual basis. Loan applications and approvals were notably higher, driven by increased demand by businesses. The manufacturing sector recorded higher loan applications, approvals and disbursements. In the household sector, loan indicators recorded an increase on an annual basis, particularly in terms of loans for the purchase of residential property.

Total loans outstanding expanded by 6.2% on an annual basis at the end of the first quarter of 2007 (end-4Q 2006: 6.3%), with loans outstanding to businesses and households increasing at an annual rate of 6.3% and 7.8% respectively (end-4Q 2006: 4.2% and 9.4% respectively).

Loan Indicators

	During the period (RM billion)				Annual Growth %			
	2006	1Q 06	4Q 06	1Q 07 ^p	2006	1Q 06	4Q 06	1Q 07 ^p
Total								
Loan applications ^a	300.6	69.8	76.8	83.5	-1.6	1.9	6.5	19.6
Loan approvals ^a	190.7	45.3	49.7	53.1	-0.8	6.2	4.2	17.2
Loan disbursements ^a	514.7	128.7	126.7	129.2	-2.6	1.7	-7.9	0.4
Loan repayments ^a	480.3	119.4	121.8	118.0	-1.7	1.2	-5.2	-1.1
Change in loan outstanding ^c	34.9	8.2	4.0	8.6	6.3	8.4	6.3	6.2
Of which:								
Business enterprises								
Loan applications ^a	158.8	36.2	40.9	44.4	3.8	3.1	16.7	22.7
Loan approvals ^a	96.6	22.0	28.0	29.7	9.4	14.4	23.3	35.2
Loan disbursements ^a	362.5	91.4	89.5	90.0	-3.3	0.9	-8.3	-1.6
Loan repayments ^a	347.5	87.0	87.9	81.3	-5.3	-1.4	-9.3	-6.6
Change in loan outstanding ^c	9.4	-0.7	1.1	4.0	4.2	2.7	4.2	6.3
SMEs^b								
Loan applications ^a	67.0	10.9	19.4	19.9	n.a.	n.a.	n.a.	n.a.
Loan approvals ^a	39.5	7.9	11.8	10.6	n.a.	n.a.	n.a.	n.a.
Loan disbursements ^a	132.6	29.8	32.9	32.7	n.a.	n.a.	n.a.	n.a.
Change in loan outstanding ^c	6.5	6.3	-1.0	2.8	n.a.	n.a.	n.a.	n.a.
Large corporations^b								
Loan applications ^a	91.8	25.3	21.5	24.5	n.a.	n.a.	n.a.	n.a.
Loan approvals ^a	57.1	14.1	16.3	19.2	n.a.	n.a.	n.a.	n.a.
Loan disbursements ^a	229.9	61.7	56.7	57.3	n.a.	n.a.	n.a.	n.a.
Change in loan outstanding ^c	2.9	-7.0	2.1	1.2	n.a.	n.a.	n.a.	n.a.
Households								
Loan applications ^a	141.8	33.5	35.9	39.0	-6.9	0.7	-3.2	16.3
Loan approvals ^a	94.1	23.3	21.6	23.3	-9.4	-0.6	-13.2	0.1
Loan disbursements ^a	152.2	37.2	37.1	39.2	-0.9	3.6	-6.9	5.3
Loan repayments ^a	132.8	32.3	33.9	36.7	9.3	8.9	7.4	13.5
Change in loan outstanding ^c	28.7	8.3	5.8	3.8	9.4	14.5	9.4	7.8

^a The annual growth is for end-period

^b Following reclassifications under the Financial Institutions Statistical System (FISS) effective April 2006, in order to maintain comparability on an annual basis for loan applications, approvals, disbursements and repayments, the category business enterprises has been expanded to include loans to other customers, namely non-bank financial institutions, Government, domestic non-business entities and foreign entities. These loans account for a relatively small share of the total compared with business enterprises. Trend wise, growth rates remain similar to those under the previous definition

^c From 1Q 2006, loan indicators for SMEs and large corporations are not comparable on an annual basis as beginning March 2006, financial institutions have begun adopting the Standard SME Definitions as approved by the National SME Development Council, resulting in some reclassification between SMEs and large corporations

^d Numbers may not add up due to rounding

^e Preliminary. Data is subject to revision, arising from changes in the classification of loan indicators by economic sectors and purpose
n.a. Not applicable

Source: Bank Negara Malaysia

Loans by Sector

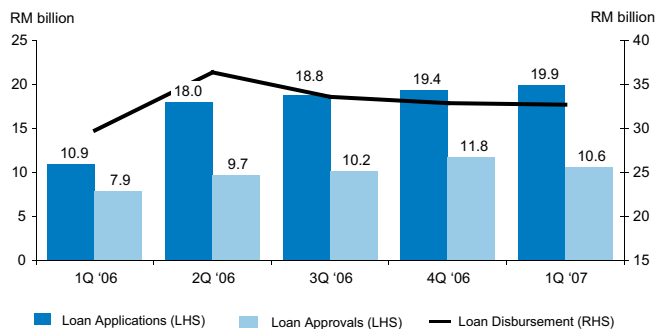
	Loans disbursed					Loans out- standing
	During the period				Share of total	Share of total
	2006	1Q 06	4Q 06	1Q 07**		
	RM billion				%	
Business enterprises	362.5	91.4	89.5	90.0	69.7	39.7
<i>Large corporations*</i>	229.9	61.7	56.7	57.3	44.4	22.2
<i>SMEs*</i>	132.6	29.8	32.9	32.7	25.3	17.5
Households	152.2	37.2	37.1	39.2	30.3	56.0
Selected sectors						
Agriculture, hunting, forestry and fishing	13.3	3.0	3.3	3.1	2.4	2.2
Mining and quarrying	2.0	0.6	0.3	0.3	0.3	0.2
Manufacturing	119.6	29.2	30.4	32.5	25.1	11.4
Construction	30.7	7.4	7.9	7.6	5.9	5.2
Real estates	10.2	2.7	2.0	2.4	1.9	2.9
Electricity, gas and water supply	2.8	1.8	0.4	0.3	0.2	0.8
Wholesale, retail, restaurants and hotels	89.9	22.8	21.2	20.5	15.9	8.7
Transport, storage and communication	10.4	2.6	2.8	2.5	2.0	1.9
Finance, insurance and business services	40.5	9.5	9.6	10.3	8.0	6.1
Consumption credit	100.3	24.5	24.7	25.4	19.7	23.8
<i>Of which:</i>						
<i>Credit cards</i>	49.1	11.3	13.6	13.8	10.7	3.3
<i>Purchase of passenger cars</i>	32.3	8.2	6.8	7.2	5.6	16.5
Total	514.7	128.7	126.7	129.2	100.0	100.0

* From 1Q 2006, loan indicators for SMEs and large corporations are not comparable on an annual basis as beginning March 2006, financial institutions have begun adopting the Standard SME Definitions as approved by the National SME Development Council, resulting in some reclassification between SMEs and large corporations

** Based on New FISS reporting system

Source: Bank Negara Malaysia

Bank Lending to SMEs



* From 1Q 2006, loan indicators for SMEs and large corporations are not comparable on an annual basis as beginning March 2006, financial institutions have begun adopting the Standard SME Definitions as approved by the National SME Development Council, resulting in some reclassification between SMEs and large corporations.

Higher financing activity in the capital market

Funds raised in the capital market increased significantly during the quarter. Total net funds raised by the public and private sectors amounted to RM9.4 billion (4Q 2006: RM7.5 billion).

Gross funds raised by the public sector through four issuances of Government securities amounted to RM13.6 billion. This includes an issuance of 10-year callable Malaysian Government Securities (MGS), the re-opening of the 5-year MGS and an issuance of Government Investment Issues (GII). After adjusting for redemptions, the net funds raised by the public sector was marginally higher than in the previous quarter, amounting to RM7.4 billion (4Q 2006: RM7.3 billion).

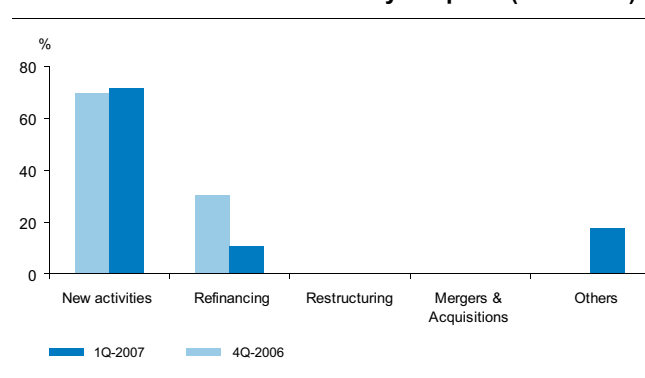
In the private sector, gross funds raised from the PDS market, which amounted to RM7.6 billion, were lower compared to the previous quarter (RM8.3 billion). Excluding Cagamas, the gross funds raised amounted to RM6.2 billion (4Q 2006: RM8.1 billion). The bulk of the funds were raised from the issuance of medium-term notes, which accounted for 84% of the total PDS issued during the quarter. This includes an issuance by a multilateral development bank amounting to RM500 million. Despite the lower gross funds raised, net

Funds Raised in the Capital Market

	2005	2006		2007
	Year	1Q	4Q	Year
	RM million			
By Public Sector				
Government Securities, gross	28,276	5,265	6,500	26,830
Less Redemptions	15,800	500	2,850	12,850
Less Government holdings	-	-	-	-
<i>Equals</i> Net Federal receipts	12,476	4,765	3,650	13,980
Khazanah Bonds, net	833	(1,700)	1,070	(630)
Govt. Investment Issues, net	1,000	-	3,000	9,500
Merdeka Savings Bond, net	1,516	(500)	(433)	(1,931)
Net Funds Raised	15,825	2,564	7,287	20,919
By Private Sector				
Shares	6,315	381	632	1,916
Debt securities	38,196	10,574	8,297	38,887
<i>Private Debt Securities (PDS)</i>	35,656	6,889	8,097	31,737
Cagamas	2,540	3,685	200	7,150
Less Redemptions	18,617	5,498	8,747	31,519
Net Issues	19,579	5,076	(451)	7,368
<i>Net issues (excluding Cagamas)</i>	22,224	2,993	2,409	11,120
Net Funds Raised	25,894	5,457	182	9,284
Total Net Funds Raised	41,719	8,022	7,469	30,203
Short-term Papers and Notes, net ¹	1,579	1,312	653	2,563
Total	43,297	9,334	8,122	32,766

¹ Refers to Commercial Papers and Cagamas Notes only

Private Debt Securities Issued by Purpose (% of total)



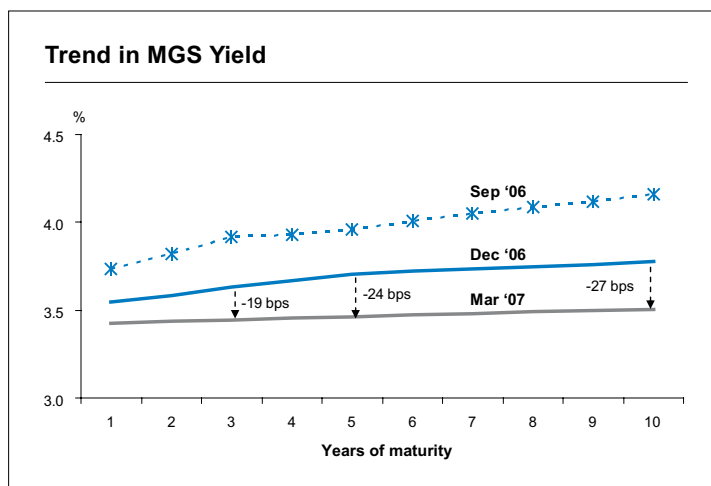
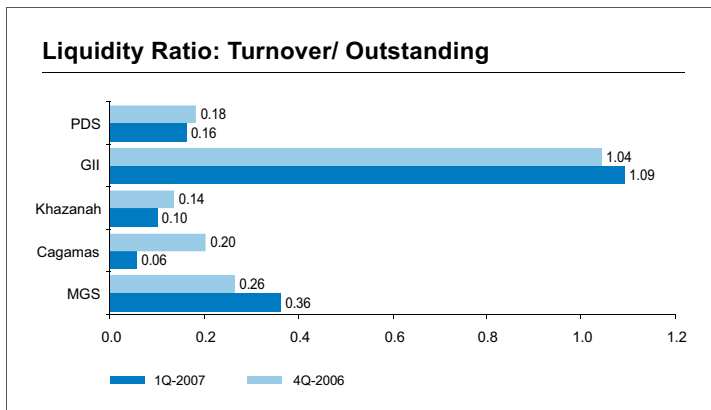
funds raised through the PDS market were significantly higher at RM1.2 billion (4Q 2006: net redemption of RM451 million), on account of the lower redemptions during the quarter.

Funds raised in the equity market during the quarter increased to RM795 million (4Q 2006: RM632 million). Most of the funds were raised through 12 initial public offerings (IPOs) totaling about RM572 million. For the first time, an Islamic plantation REIT was introduced to the market in January. During the quarter, there were

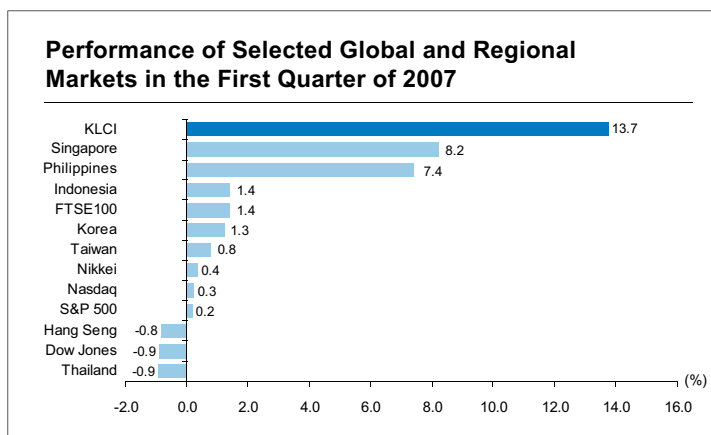
six new listings on Bursa Malaysia: three on the Main Board, two on the Second Board and one on the MESDAQ Market.

Higher secondary trading in the bond market

Total trading in the secondary market increased to RM120.2 billion in the first quarter of 2007 (4Q 2006: RM105.1 billion). Government Securities (MGS and GII) continued to account for the bulk of the trades (73% of total trading), followed by PDS (26%). In terms of liquidity, the GII was the most liquid paper, with a liquidity ratio of 1.09, followed by the MGS.



During the quarter, the MGS benchmark yield curve shifted downwards by 12 – 27 basis points across the tenures. The decline in yields has caused the yield curve to flatten significantly since December 2006. As a result of higher demand following the continuous inflows, MGS yields for maturities of up to the 9-years declined below the OPR of 3.5% for the first time since the introduction of the OPR in April 2004. Consequently, the yield spreads for the 3-year, 5-year and 10-year MGS declined by 19, 24 and 27 basis points respectively compared to the previous quarter.



The KLCI strengthened further

The KLCI began the first quarter of 2007 on a positive note arising from improved market sentiments. The growing momentum in the implementation of Ninth Malaysia Plan projects, mergers and acquisitions activity, as well as

Bursa Malaysia: Turnover of Corporate Securities

	2006						2007	
	1Q		4Q		Year		1Q	
	million units	RM million	million units	RM million	million units	RM million	million units	RM million
Turnover	45,988	53,671	57,015	78,257	197,819	250,331	118,982	156,614
Of which:								
Main Board	26,565	42,744	36,338	66,458	121,666	204,801	87,148	137,851
Of which								
Consumer Products	1,808	4,834	977	2,665	4,765	13,945	1,796	4,695
Industrial Products	3,147	3,133	4,474	5,395	16,232	17,747	8,771	11,725
Construction	3,048	3,120	2,787	5,262	11,107	15,807	7,469	16,864
Trading/Services	6,191	14,985	10,465	26,467	31,469	76,299	20,181	44,458
Finance	2,711	9,046	3,689	12,719	12,092	38,618	8,846	28,428
Properties	4,106	2,040	5,742	3,681	21,022	10,981	16,381	11,369
Plantations	518	2,708	1,004	5,516	3,384	17,190	1,341	8,318
Mining	0	1	33	68	34	87	32	43
Second Board	5,837	4,532	5,432	4,023	21,914	16,617	8,527	4,955
Mesdaq	13,438	6,288	10,735	4,981	48,712	25,559	17,050	8,386

Source: Bursa Malaysia

continued strong corporate earnings exerted a positive influence on the KLCI. Following developments in the global equity markets, the KLCI experienced a sharp correction from 27 February to 5 March, during which the KLCI declined by 12.8%. Nevertheless, the KLCI subsequently rebounded, buoyed by renewed investor interest following the announcements of the liberalisation of foreign exchange administration policies and the abolishment of real property gains tax.

Bursa Malaysia: Selected Market Indicators

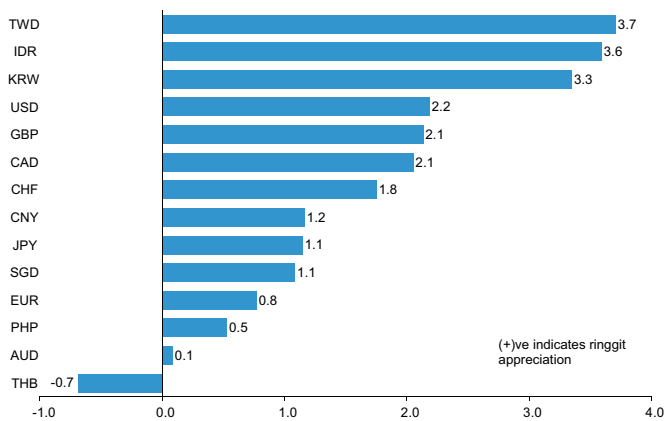
	As at end			
	2006			2007
	1Q	4Q	Year	1Q
Price Indices				
Composite	926.6	1,096.2	1,096.2	1,246.9
FBM30 ¹	6,000.0	7,059.9	7,059.9	7,924.6
FBMEMAS ²	6,000.0	7,169.6	7,169.6	8,332.8
Second Board	91.1	92.0	92.0	99.3
Mesdaq	111.2	119.9	119.9	138.5
Average daily turnover				
Volume (million units)	779.5	934.7	802.9	1,983.0
Value (RM million)	909.7	1,282.9	1,018.9	2,610.2
Market capitalisation (RM billion)	732.9	848.7	848.7	985.1
No. of companies listed	1,025	1,027	1,027	1,023

¹ FBM30 stands for FTSE Bursa Malaysia 30 Index

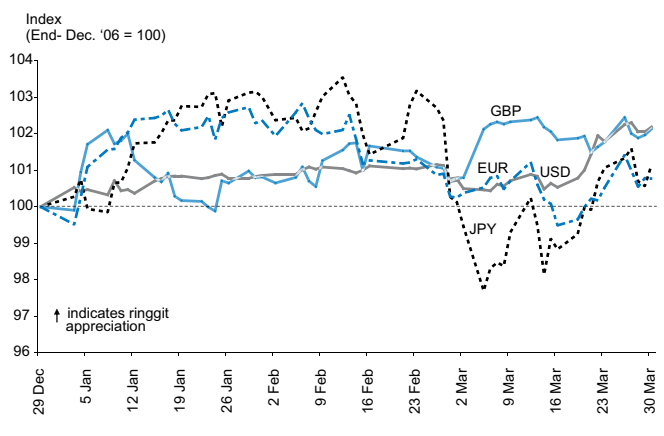
² FBMEMAS stands for FTSE Bursa Malaysia Emas Index

Source: Bursa Malaysia

Summary of Ringgit Performance Against Selected Currencies Percent Change (1 January - 30 March 2007)



Ringgit Performance Against Major Currencies



The KLCI ended the first quarter at 1,246.87 points (4Q 2006: 1,096.24 points). Market capitalisation was higher at RM985.1 billion (4Q 2006: RM848.7 billion). Trading activity rose with average quarterly turnover of 1,983 million units (4Q 2006: 934.68 million units).

As at 29 May 2007, the KLCI closed higher at 1,343 points (+22.5% since end-2006), with market capitalisation of RM1,067.3 billion (+25.8% since end-2006).

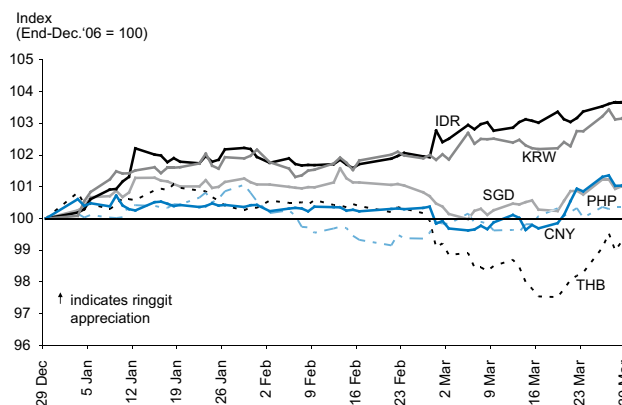
Exchange Rate Developments

In the first quarter of 2007, the ringgit appreciated against the major currencies amidst net trade and investment inflows. The ringgit appreciation was generally in line with the major regional trading partners. During the quarter, the US dollar declined following the release of weak economic data and expectations of a potential reduction in the US policy rate. The Japanese yen weakened on market expectations that the policy rate in Japan would remain unchanged in the near-term. Against regional

currencies, the ringgit appreciated in the range of 0.5% - 3.6%, the exception being a slight depreciation against the Thai baht (0.7%).

For the period 1 April – 28 May 2007 the ringgit appreciated against the major currencies. The ringgit recorded a mixed performance against regional currencies. The ringgit appreciated against the Singapore dollar (2.7%), Korean won (0.9%), Chinese renminbi (0.9%) and Thai baht (0.9%), but depreciated against the Philippine peso (2.9%) and Indonesian rupiah (2.7%).

Ringgit Performance Against Regional Currencies



Performance of Ringgit Against Selected Currencies

RM per foreign currency	As at end				% change since*		
	21 Jul 05	1Q 06	4Q 06	1Q 07	21 Jul 05	1Q 06	4Q 06
US dollar	3.8000	3.6860	3.5315	3.4560	10.0	6.7	2.2
Euro	4.6212	4.4829	4.6460	4.6105	0.2	-2.8	0.8
Pound sterling	6.6270	6.4337	6.9315	6.7867	-2.4	-5.2	2.1
100 Japanese yen	3.3745	3.1397	2.9675	2.9339	15.0	7.0	1.1
Singapore dollar	2.2570	2.2778	2.3028	2.2781	-0.9	0.0	1.1
100 Thai baht	9.0681	9.4914	9.8111	9.8785	-8.2	-3.9	-0.7
100 Philippine peso	6.8131	7.2077	7.2027	7.1649	-4.9	0.6	0.5
100 Indonesian rupiah	0.0386	0.0407	0.0393	0.0379	1.9	7.3	3.6
100 Korean won	0.3665	0.3781	0.3797	0.3674	-0.3	2.9	3.3
Chinese renminbi	0.4591	0.4599	0.4523	0.4471	2.7	2.9	1.2

* (+) indicates appreciation of ringgit against respective currency and (-) indicates depreciation.

DEVELOPMENTS IN THE BANKING SECTOR

The banking system continued to demonstrate strong resilience in the first quarter of 2007, as supported by high level of capitalisation and improved profitability. The banking system lending activities continued to grow amidst further improvement in loan quality.

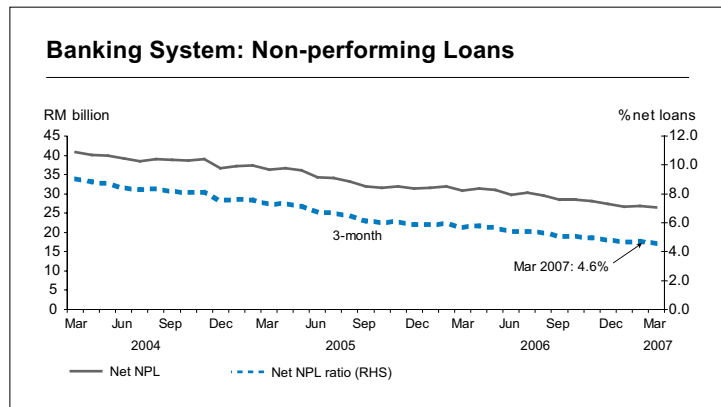
Banking institutions remained well-capitalised

The capitalisation of the banking system remained strong throughout the first quarter albeit higher lending activities. Capital base strengthened by 1.5% following the inclusion of three new investment banks. The risk-weighted capital ratio (RWCR) and core capital ratio (CCR) stood at 13.1% and 10.5% respectively as at end-March 2007.

	2006				2007
	1Q	2Q	3Q	4Q	1Q
Capital					
CCR (%)	10.0	10.0	10.5	10.7	10.5
RWCR (%)	13.1	12.8	13.3	13.5	13.1

Profitability improved on account of higher income

Pre-tax profit registered an increase of 17.8% compared with the corresponding period of 2006 to amount to RM3.7 billion (1Q 2006:



RM3.2 billion and 4Q 2006: 4.3 billion). The favourable performance was attributed mainly to higher income derived from interest related activities (+RM0.8 billion or +13.9%) and fee-based activities (+0.5 billion or +38.3%) as well as treasury business (+RM1 billion or +114.2%). The return on average assets and equity remained unchanged at 1.3% and 16.9% respectively (1Q 2006: 1.3% and 17%).

Continued downtrend in NPLs

Asset quality of the banking system continued to improve during the quarter. Based on the 3-month classification, total net NPLs recorded a decline of 3.4% to RM26.4 billion (4Q 2006: RM27.4 billion). The improvement was attributed primarily to higher recoveries (+12.5%) and reclassifications of NPLs to performing status (+5.9%) as well as continued write-offs. The net NPL ratio consequently declined to 4.6% of net loans (4Q 2006: 4.8%).

International Symposium by the Center for Monetary Cooperation in Asia
Session 1 : Changes After the Crisis:
ASEAN's Economic Dynamism and Prospects
22 January 2007, Tokyo

by

Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz
Governor, Bank Negara Malaysia

Ten years after the crisis, ASEAN stands out as a dynamic region with diverse strengths. With a growing population of over 550 million, ASEAN remains one of the fastest growing regions in the world (2005: 5.6%; world: 4.9%). The combined GDP of the ASEAN economies is expected to exceed USD 1 trillion in 2007. This growth has been extensive and includes all the developing economies in the group.

The ASEAN economies have always been highly open economies, with total trade accounting for more than 130 percent of GDP and the value of trade flows now exceeding USD 1 trillion. In view of this high degree of openness, ASEAN has also always been vulnerable to external developments. The ASEAN economies have however demonstrated, time and again, their capacity to rebound from adverse shocks, and to do so within a short period of time. While the 1997 – 1998 crisis was devastating, most ASEAN economies were able to restore stability and resume growth just after a year. ASEAN has also continued to weather other both regional and international shocks that have since occurred.

While the current global and regional environment has since the last ten years changed dramatically, bringing with it new risks and challenges, the region has emerged strengthened with greater economic and financial resilience. Strong macroeconomic fundamentals have been sustained, and reinforced by enhanced economic flexibility. The financial and corporate sector restructuring and reform that were undertaken during the ten years have also supported

these developments. Equally important is the aggressive development of the domestic financial infrastructure and financial markets. The ASEAN economies have also developed complementarities with the major regional economies in the Asian region including China, Japan, South Korea and India that has contributed to deepening of regional economic integration, reinforcing further the strong trade and investment linkages that was already present in the region.

The issue before us now, is whether the South East Asian nations can rise to the challenge of sustaining its dynamism and prospects in this more challenging global environment. Allow me to elaborate on the elements that have facilitated the ability of the ASEAN economies previously to successfully adjust to shocks and to take account of the recent developments that have further strengthened their capacity and capability to deal with future shocks and thus sustain their dynamism.

Improved macroeconomic fundamentals

While the macroeconomic fundamentals were favourable just before the crisis, in the current environment, the external position of the regional economies have strengthened further. The current account balances are in surplus, the foreign currency reserves are at record highs and the external debt levels are at significantly lower levels, with improved maturity profiles. Government budget positions are broadly stronger with ongoing measures towards consolidation. Inflation has generally been contained, despite the recent

adjustments due to the high oil prices. More flexible exchange rate regimes are also now in place allowing for the potential for smooth adjustments to external shocks.

In this environment, Foreign direct investment (FDI) has also continued to increase reflecting confidence in the ASEAN economies. In 2005, Foreign direct investment to the ASEAN economies reached USD 37 billion, exceeding the pre-crisis peak of USD 34 billion in 1997.

Economic flexibility in ASEAN has been enhanced

Economic flexibility has always been one of ASEAN's strengths. It has been a major element that has facilitated adjustment to the changing global environment and to external shocks. This economic flexibility of the ASEAN economies has ten years later been further augmented. This has been achieved by the increased labour and capital mobility, financial market development, a strengthened financial system, and the extensive institutional developments that have taken place.

Economic flexibility has been important in enabling the ASEAN economies to shift to new areas of comparative advantage. Significant changes in economic structures have taken place and shifts to new sectors have occurred in response to the changing global competitive dynamics. Diverse new sources of growth have now emerged across ASEAN, with the economies now moving beyond their traditional reliance on manufactured exports to expanding the production of resource-based products, and increasingly to the services sector and thus providing greater flexibility to respond to shifts in external demand.

There has also been a rebalancing of the sources of growth between domestic and external demand. The role of private consumption has strengthened in the ASEAN economies. ASEAN now possesses a burgeoning consumer market that is valued at

more than USD 330 billion. With high savings rate continuing to prevail, there is potential for this trend to be sustained. Consumption demand has also been supported by rising incomes, with GDP per capita having increased to over USD 1,500 compared to USD 1,157 in 2000. In the long-term, these trends are expected to be reinforced by the positive demographic structure in the ASEAN region. ASEAN's population is not only large but also young with 55% at less than 30 years old and becoming increasingly urbanized.

There is also greater involvement of the private sector in the economy following the period of adjustment post-crisis. Private investment which was initially slow to adjust has now shown prospects for a stronger recovery. The potential for greater investment is driven by the rising infrastructure requirements throughout the region that is estimated at USD 160 billion for the period 2006-2010. There has also been growing interest in resource-based industries. The investment climate has also improved amidst the better economic conditions and more efficient functioning systems that have been put in place.

Financial and corporate reforms and restructuring have supported these developments

An area in which the payoff has been significant is the financial sector. The banking sectors in the ASEAN region as a whole have increased their resilience and ability to manage risks as reflected by their profitability, asset quality and capitalization, all which have generally strengthened since the Asian crisis. The renewed strength in the banking sectors have been underpinned by recapitalisation programmes, rationalization and consolidation and improvements in banking supervision and regulation. The implementation of financial reforms has not only increased the capacity but the resilience of the financial system.

Similarly, corporate balance sheets across the region have strengthened considerably with significantly improved

standards of corporate governance. With the more positive investment climate, it has resulted in a resumption of investment activities. A major development since the crisis has been the development of the capital markets, in particular, the bond market. This has led to greater diversification of sources of financing for the corporate sector. In Malaysia, the bond market now accounts for almost 90% of GDP with the size of the corporate debt securities market now exceeding the public debt securities market. There has also been increased attention to greater financial inclusion, to reduce income disparities and achieve more balance growth.

The stronger domestic financial sectors in the ASEAN economies have also allowed for greater liberalization and deregulation to occur. This has not only enhanced the range of business opportunities for the financial institutions but also their potential to expand beyond domestic borders and building further on regional linkages.

Increased Asian regional complementarities

Post-crisis, ASEAN has further increased intra-regional trade and investment linkages within ASEAN and with the other major economies in the region. Intra-Asian trade now accounts for more than half of the total trade of the region. The emergence of China and India have created new export markets for ASEAN, thus diversifying the ASEAN export market from over-concentration in the traditional markets. ASEAN is among the few regions to have a significant and growing trade surplus with China, reaching about USD 20 billion in 2005. Meanwhile, the total trade between the ASEAN-5 and India has expanded by more than tenfold from only USD 2 billion in 1990 to USD 21 billion in 2005.

In investment activities, Japanese investors have had an early presence in most of the ASEAN economies. This has generally reflected the diverse comparative advantage of ASEAN economies that range from labour

cost advantages to natural resources and the increasingly more deregulated and liberalised regimes. Foreign investors have also leveraged their supply chain networks on the ASEAN platform to take advantage of this diverse comparative advantage. Even within ASEAN, there has been an increasing trend of outward direct investment especially by Malaysia and Singapore, being undertaken to leverage on regional growth opportunities.

Greater regional financial integration

While there has been a high level of economic integration, a more recent development has been the acceleration of regional financial integration. As high savings economies, this would facilitate a more efficient allocation of part of the surplus funds of the region into productive investments in the region. This would contribute towards lower financing costs in the region and reducing the risks while at the same time promoting the economic potential of the region.

To facilitate financial integration, the liberalization of foreign exchange rules, the harmonization of standards and the removal of impediments to cross-border investment have been undertaken. The ASEAN Roadmap on Capital Market Development has been formulated to foster alliances and linkages in the equity and bond markets among ASEAN exchanges, including the harmonisation of regulations. In the equity markets, multiple listings are being promoted as regional bourses attract domestic companies in the region to list on their exchanges. The FTSE/ASEAN Index and the FTSE/ASEAN – 40 Index, launched in 2005, also serves to increase the integration of the regional bourses and to promote ASEAN as an asset class. In the bond markets, the Asian Bond Funds (ABF 1 and ABF 2) initiated by the central banks aim to broaden and deepen the regional bond markets. Meanwhile, the Asian Bond Markets Initiatives (ABMI) aims to enhance the infrastructure, which includes plans to develop a regional credit guarantee mechanism, a regional credit rating agency and a regional settlement link to facilitate

cross-border transactions. Specifically, the ASEAN Roadmap on Capital Account Liberalization, launched in 2003, aims to gradually achieve a freer flow of capital over the medium-term. Malaysia has since progressively further liberalised its rules for foreign exchange transactions culminating in the removal of most of the rules in April 2005.

Strengthened Regional Financial Cooperation

During the 1997/1998 crisis, Asia did not come together to collaboratively and cumulatively act to contain the crisis and subsequently to facilitate its resolution. Perhaps, it was due to the nature of the crisis, its severity on the financial markets and the economies. Domestic stability had to be first restored before time could be taken to formulate a holistic crisis management solution. The instability in the currency markets lasted for about one and a half years. There was also no entity in the region during that period that provided any authoritative assessment on whether the programmes that were subsequently being implemented would in fact produce the desired outcomes.

While efforts to strengthen the domestic economies and the financial systems will continue, this has now being reinforced by the improved regional surveillance including on cross border financial flows, and by institutional arrangements that would contribute towards crisis containment and management. The regional cooperative efforts going forward will continue to gain momentum. These efforts should not be seen as attempting to substitute but rather as efforts to complement the existing international arrangements. The objective to be achieved is the same, that is, to build the regional capacity to be better positioned to prevent, contain and resolve any potential crisis at minimum costs to our financial systems and to our economies.

In conclusion, the cumulative effect of the changes since the Asian crisis has transformed ASEAN – opening up new opportunities and making the region resilient and a dynamic centre of growth. The ASEAN “tigers” are back, and poised to leap on to the next wave of economic advancement and prosperity.

INCEIF Inaugural Intellectual Discourse 23 February 2007

“Islamic Finance: Issues and Challenges of Co-existence in an Entrenched Conventional System”

Welcoming Remarks by

Tan Sri Dato’ Sri Dr. Zeti Akhtar Aziz
Governor, Bank Negara Malaysia

It is my great pleasure to welcome you to INCEIF Inaugural Intellectual Discourse Series. INCEIF has made remarkable progress within a period of less than a year. In 2006, INCEIF has gained the university status, it has currently enrolled 756 students from 39 countries, and it has entered into strategic alliances with a number of industry training and education providers from the Middle East, South East Asia and the West. Indeed, INCEIF has received an overwhelming response. As an institution of higher learning dedicated to the development of human capital for the growing global Islamic finance industry, INCEIF will have an important role in meeting the increased demand for talent and expertise for the industry.

The topic for today’s deliberation, “Issues and Challenges of the Co-existence of Islamic Finance in an Entrenched Conventional System”, is most relevant in the currently highly competitive financial services industry where new challenges and opportunities are continuously emerging in this era of globalisation and of rapid change that is also driven by advances in technology.

Today’s initiative brings together Islamic finance experts and scholars to deliberate the issues confronting Islamic finance in an environment where the conventional finance is dominant and highly entrenched. The primary objective of today’s Inaugural

Intellectual Discourse is to explore the prospects for Islamic finance which has now reached a stage of development in which it is now no longer regarded as a niche product serving a specialised market. Today, it is a robust industry that operates in more than 60 countries, and it is a viable form of financial intermediation that is competitive and resilient. Islamic finance, nevertheless faces many challenges with respect to its product offering, its distinctive ethical and moral dimension, and its relevance to all customers.

The Islamic financial system in Malaysia has evolved as a competitive component of the overall financial system, complementing the conventional financial system as a driver of economic growth and development. Malaysia will continue to foster the expansion of the dual banking system where both, the Islamic and conventional systems operate in parallel to deliver innovative and competitive financial products and services. The global experience has however shown that institutional and development financial infrastructure, the broadening and deepening of the financial markets, and a rigorous legal and regulatory framework is vital for the soundness, stability and resilience of the financial system. Developments in both domestic and international economic and financial conditions have from time to time tested the resilience of financial systems. Thus, Islamic financial institutions will not only be assessed by their Shariah aspects, but also by other factors including their

effectiveness and efficiency, their resilience and their ability to evolve and reinvent to meet the challenges of the continuously changing demands as we advance forward.

After more than two decades of experience in the development of Islamic finance, we are now seeing the international dimension of our Islamic financial system gain significance. This has followed the increased foreign presence and participation in our domestic Islamic financial system. Malaysia has also ventured to participate in international financial markets and in term of presence beyond our domestic borders. More specifically, three new foreign Islamic banks are now participating in our domestic financial system. Following further liberalisation measures, there is also increased foreign participation in our domestic Islamic financial institutions. Our takaful industry has also become one of the success stories in Islamic finance. In the four new licences issued recently, it has comprised of joint ventures with foreign participation. The Malaysian bond market has also been liberalised to enable foreign entities to raise funds in our domestic market. Our experience in launching the first Sukuk has drawn significant interest by corporates and sovereigns for raising long-term financing based on Islamic structure instruments.

Following these developments we are now entering a new phase in the development of Islamic financial system in Malaysia with the new initiatives to promote Malaysia as an International Islamic Financial Centre. This aims at strengthening our economic and financial inter-linkages and thus promoting greater trade and investment across borders. This is therefore the beginning of a new phase of development for Islamic finance in Malaysia as it becomes more integrated with the international financial system.

We have set high standards in market coverage and broadening of Islamic financial products being offered to the market. The

challenge is for the financial institutions to have a more extensive outreach. Islamic finance must promote greater financial inclusion involving all levels of the community. Opportunities also need to be created for Islamic financial products to have an outreach to the small and medium-sized enterprises. Moreover, financial instruments structured under the Salam, Istisna' and Musyarakah contracts need to be designed to stimulate activities in those sectors such as agriculture and manufacturing where there is limited participation by conventional finance. We need to reach those segments of society and economic activities that have not fully benefited from the success of Islamic finance.

As part of the global development of Islamic finance, of equal importance is the supporting international architecture that is evolving. Both AAOIFI and IFSB have contributed significantly to the development and the harmonisation of accounting and prudential standards. This will allow for the potential of strengthening the inter-linkages across borders to take place.

The conventional banking as a more matured market has also continued to grow and prosper in Malaysia. Since the beginning, it has attracted dominant global players. There are fourteen 100% owned banks in our financial system that accounts for almost one third of the market share. In the insurance sector the foreign participation is even greater. In conventional finance, Malaysia is therefore already highly integrated with the international financial system. This has been reinforced by the progressive liberalisation of our capital account which now allows for the free inflow and outflow of funds. Our financial system has therefore facilitated Malaysia's strong international economic and financial linkages which have for several decades contributed to our economic growth and development.

In this competitive global environment, new challenges and risks can be expected to continuously emerge. The growing world

wide participation in Islamic finance as a form of financial intermediation in this highly challenging environment has demonstrated its viability and competitiveness. This dynamic environment in which we operate will thus require continued developments to be pursued on all fronts.

The discourse among the expertise in the field will not only provide us with further insights into the issues and challenges of coexistence not only in our domestic systems but also in the international financial system. This will contribute to the awareness and understanding of the journey for the sustainable development of Islamic finance.

GIFF Investors & Issuers Forum: “Islamic Finance: The New Silk Road” 28 March 2007

Special Address by

Tan Sri Dato’ Sri Dr. Zeti Akhtar Aziz
Governor, Bank Negara Malaysia

Up until the 14th century, the Silk Road served as a major global conduit between ancient civilizations in the East and West. It created mutual prosperity, encouraged knowledge transfer and enhanced understanding between civilisations through trade, cultural and technological exchange. Now in the 21st century, globalisation and liberalisation, and the emergence of new financial centres and their increased integration have created an environment of flourishing activity reminiscent of the Old Silk Road.

Indeed, it suggests that a New Silk Road has emerged. This new route not only carries flows of oil, manufactured goods, and technological innovation, but also flows of direct investment, portfolio capital, private equity and human capital. Previously, silk was one of the main commodities traded on this route. Now, the emergence of Islamic financial products and services has brought together financial services providers across continents to trade on this new route. The emergence of the New Silk Road reflects the increasing and evolving economic and financial relationships and inter-linkages, with Islamic finance well positioned to further facilitate these linkages to offer mutually-reinforcing benefits to those who participate in it. Indeed, the New Silk Road opens up the prospect of exciting opportunities for economic progress and prosperity for us all.

I first made reference to the New Silk Road at the 2nd World Islamic Economic Forum (WIEF) on “Unleashing the Potential of Emerging Markets” in Islamabad, Pakistan in November 2006.

It is my pleasure today to share some thoughts on the potential role of Islamic finance in strengthening the New Silk Road. My remarks will focus on four areas that is the emergence of the New Silk Road; how the linkages on the New Silk Road have built on the comparative advantages of Asia and the Middle East; how Islamic finance is able to foster the linkages along the New Silk Road; and finally, how we can extend the New Silk Road to the rest of the world to advance global economic stability and prosperity.

The Emergence of a New Silk Road

Today, signs that a New Silk Road is flourishing are abundant. The economic and financial linkages between Asia and the Middle East are growing. While the world trade has on the average expanded by 10% over the period 2001-2005, Asia’s trade with the Middle East has increased on the average by 24%. More than half of the exports from the Gulf states¹ goes to Asia and more than one-fifth of its imports are from Asia. The Gulf is the major supplier of fuel to Asia, while Asia in turn supplies manufactured goods and food to the Gulf.

¹ The Gulf Cooperation Council represents Saudi Arabia, UAE, Bahrain, Qatar, Oman and Kuwait

Recent trends in investment activities have been equally significant. Investment projects amounting to more than USD160 billion to be financed by the Gulf states in Asia have been announced since 2005². In 2006 alone, mega-deals³ involving corporate acquisitions and real estate purchases from the Gulf to Asia, are estimated to total more than USD18 billion, including multi-billion dollar IPO purchases in financial institutions in China, large oil refineries and telecom companies. The value of such investments are expected to increase to between USD20-30 billion in 2007.

For economic regions with high savings and surpluses such as Asia and the Middle East, the challenge is to recycle part of these surplus funds to productive investments in the region. The supply of savings in Asia and the Middle East is by far higher than in any other part of the world. Savings rates here in Asia are expected to remain in the region of 30-40% of GDP for some years to come. Similarly, savings in the Middle East economies have been rising in the recent decade and is expected to average about 30-35% of GDP in the coming years. In 2006, the current account surpluses as percentage of GDP for Asia and the Middle East were about 5% and 23% respectively⁴. With Asian official foreign currency reserves exceeding USD2 trillion, and Middle East oil revenues exceeding USD1 trillion since 2000, the management of surplus savings and reserves in both regions will offer significant investment opportunities.

Besides the institutional pool of wealth, the rapidly expanding middle class in both regions is a further trend sustaining the high savings rate and the increased demand for more sophisticated financial products and services including consumer finance and

wealth management. In Asia alone, we now have more than 2.4 million high net worth individuals⁵, not far behind the US with 2.9 million and Europe with 2.8 million, and these Asian individuals control an estimated amount of USD7.2 trillion financial assets. The size of this group in Asia is estimated to be increasing at 7% per year, second only to those in the Middle East, numbering 300,000 and growing at 9% per year. Traditionally, investors in Asia and the Middle East have looked to the developed Western markets to meet their investment needs, in view of the more developed financial markets and the range of asset classes. Increasingly however, there is growing interest and search for improved returns on investment in other parts of the world. This has been a global phenomenon for some years now, characterised by excess liquidity and low yields in the traditional markets.

The New Silk Road creates linkages that build on the comparative advantages between Asia and the Middle East

Historically, trade and investment in Asia and the Middle East has been linked to the developed economies. However, it is now increasingly recognised that there are significant complementarities between our two dynamic regions. These complementarities provide a platform for two-way flows that enhances income and wealth creation. The different demand patterns of each respective region reinforces the significance of the complementarities.

The Middle East investors have a greater need for diversification, both in terms of geographical allocation and asset classes, beyond the traditional investments in the US and Europe. Asia in turn, the home to some

² "A route to riches on the new Silk Road", Financial Times, 21 Dec 2006

³ Worth more than USD1 billion

⁴ Refers to IMF data

⁵ Refers to individuals with at least USD1 million in financial assets. Sourced from Merrill Lynch - Capgemini World Wealth Report 2006

of the fastest growing economies in the world, offers highly diverse investment opportunities, ranging from in Vietnam to Japan, and in a broad scope of industries, ranging from natural resource producers to established high-tech brands. Such investment opportunities continue to support the growth momentum in the region. At the same time, Middle East domestic infrastructure requirements are estimated to total USD500 billion for the next five years, and Asian companies have demonstrated the capacity to provide the technology, expertise and human capital to meet these infrastructure demands.

Asia's relentless march towards development offers new opportunities for the Middle East. Asia's continued need for productive capital and uninterrupted energy supply to sustain its high growth matches the Middle East's resource endowments. It is estimated that Asia needs USD 1 trillion worth of infrastructure investment over the next five years, and is in search of new partnerships and strategic investors to co-invest in these undertakings.

In focussing on the respective comparative advantages and connecting via the New Silk Road, it contributes to expanding the opportunities in both the regions. Essentially, this extends the production possibility frontiers to create new areas of growth. The participation of a wider pool of investors also enables better risk sharing and consequently, increases the viability of projects as well as the returns to the investment. New value is also created in mutually beneficial collaborations, such as in downstream energy activities. Products resulting from hybrid ideas are also evident in innovations in several areas, including in Islamic finance, with the early global sukuk being issued from Asia and the Middle East economies.

Islamic Finance: Strengthening the financial linkages between Asia and the Middle East

Islamic finance has demonstrated its viability and competitiveness in a more liberalised and globalised financial environment and has become important in strengthening the linkages between the two regions. While the sizeable Muslim populations in both regions have been attracted to the unique features of Islamic finance, it has also attracted interest and participation from non-Muslims within these regions. At present, there are more than 100⁶ Islamic banks in both regions, while Islamic financial transactions involving sovereigns and corporations have amounted to USD 35 billion during the period 2004 and 2006⁷.

Several factors have supported this trend. The orientation of Islamic finance towards real underlying assets is aligned to the nature of the investment opportunities in both regions. Infrastructure and project finance in both regions are particularly suited for Islamic finance.

The emphasis in Islamic finance on risk-sharing and the equity-oriented nature of such financing also suits the requirements. The Islamic financial structures clearly distinguish the roles and responsibilities as well as risk and profit-sharing profiles of the parties involved. This clear delineation of the roles also promotes greater transparency and the appropriate governance. The nature of the structures also enables the risks to be transferred to those more able to contribute towards value creation.

In addition, the use of Islamic finance promotes stability in the financial markets and the financing flows, which is important for emerging market economies such as those in

⁶ Estimates based on the listing of Islamic financial institutions provided by the Institute of Islamic Banking and Insurance, London.

⁷ Data sourced from Islamic Finance Information Service website. The Islamic financial deals mostly based on Murabahah, Ijarah, Mudharabah, Istisna principles.

Asia and the Middle East. In Islamic finance, strategies to minimize and manage the risks involve integrating with the risk in the real activities. The real activities therefore need to generate sufficient wealth to compensate for such risks. In contrast, conventional instruments generally separate the risks from the underlying assets. As a result, risk management and wealth creation may at times move in different or even opposite directions. Conventional financial instruments also allow for the commoditisation of risks, leading to its proliferation through multiple layers of leveraging and disproportionate distribution. These could result in higher systemic risks, increasing the potential for instability and inequitable concentration of wealth. The adoption of Islamic financial principles encourages financing to be primarily adopted as a means to facilitate real underlying economic transactions and not for speculative purposes.

There are also clear value propositions in Islamic finance for both investors and issuers from both regions. For investors, Islamic financial products offer portfolio diversification and new investment opportunities as they avail themselves to a new asset class. They also encourage risk management and provide confidence through explicit disclosure and transparency of the roles and responsibilities defined in the contract. For issuers, Islamic finance allows access to a new source of funds and liquidity besides providing new risk management options and new mechanisms for price discovery.

Islamic finance is well positioned to be a vehicle on the New Silk Road, as the enabling supporting infrastructure is already in place. The required regulatory and legal frameworks for Islamic finance have been established, not only in a growing number of countries in both regions but also at the international level through standard-setting bodies such as the International Financial Services Board and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). Efforts towards the harmonisation of Shariah interpretations and issues concerning mutual recognition are at an advanced stage. The

platforms for extending regional linkages and cross-border initiatives, including to the Middle East, are already in place within Asia, where there has been a significant degree of regional financial and economic integration.

Malaysia as an intermediary destination along the New Silk Road

Malaysia is committed to and extensively engaged in strengthening linkages through Islamic finance. In collaboration with the participation of the industry representing the banking, takaful and capital markets in Malaysia, the regulators have worked towards enhancing the inter-linkages with the global Islamic financial markets, not only by the further development of the Islamic financial infrastructure but also through increased liberalisation and through the implementation of measures to increase competitiveness of the financial services sector. This has included further liberalisation of the capital account of the balance of payments and the implementation of tax neutrality measures. Just as historical Malacca was a key port along the ancient trade routes between Asia and the Middle East, it is envisaged that Malaysia would serve as a key destination along the New Silk Road.

Today, as part of Malaysia's efforts to further spur the infrastructure development of the Islamic financial system, it is my pleasure to announce that Bank Negara Malaysia, the Securities Commission, Bursa Malaysia and industry players have worked collaboratively towards establishing a mechanism referred to as the Commodity Murabahah House. This mechanism which uses crude palm oil as the underlying commodity will facilitate Islamic financing applying the concept of murabahah or tawarruq.

BNM commodity murabahah acceptance

As part of these efforts to promote development of products to meet the diversified requirements of investors, Bank Negara Malaysia is pleased to announce

the introduction of a new Islamic monetary instrument, Commodity Murabahah Programme (CMP) as part of its diverse range of policy instruments in managing the short-term liquidity in the Malaysian Islamic inter-bank money market. Unique to Malaysia is that the CMP is designed to be the first ever commodity-based transaction that utilises the Crude Palm Oil based contracts as its underlying asset. The Bank has executed CMP master agreements with the eight Islamic banking institutions including the three foreign owned banking institutions to promote the use of the instrument for liquidity management. Several CMP transactions have now been conducted between the Central Bank and the respective Islamic Banks.

As commodity murabahah is widely used in other Islamic centres, it is envisaged that this CMP will promote increased linkages between Malaysia and these centres.

BNM Sukuk Murabahah/tawaruq short-term securities

The Central Bank also intends to diversify the issuance concept of the existing Islamic monetary notes from being based on Bai Inah and Ijarah into murabahah. Currently, the outstanding amount of the respective notes is RM 8 billion. This initiative is the continuation from the commodity murabahah acceptance initiative as the issuance involves the securitisation of the acceptance facility. There are several key benefits of issuing the Islamic Monetary Notes under this structure. It provides Islamic financial institutions an additional instrument to manage liquidity risk on a short-term basis. It is also a financial instrument whose structure has been widely used for retail banking and syndication products in the Middle East. Finally, it provides an opportunity for new investors to invest in Islamic financial papers in the Malaysian market, thus diversifying the investor base.

As part of the initiative to be linked to the global Islamic financial markets, this instrument will be promoted to the international financial market.

Islamic Derivative Master Agreement (IDMA)

Recognising the importance to develop Islamic hedging products for Islamic financial market to mitigate investment risks, Malaysia has introduced the first global Islamic Derivative master agreement to document Islamic derivative transactions. The effort is initiated by Bank Negara Malaysia and driven by the financial industry via the Persatuan Pasaran Kewangan Malaysia. The implementation of the agreement is expected to improve the risk management practices, balance sheet management, increase fund mobilisation efficiency and enhance their investment banking capability of the Islamic banking institutions. With the introduction of IDMA, the rights and obligations of contracting parties are clearly stated, thus creating an environment that is more transparent. As IDMA also incorporates best practices in market conduct, this document serves as an important catalyst for the future linkages between financial markets that offer Islamic financial market instruments.

Extending the New Silk Road to the world

While the New Silk Road is enhancing linkages between Asia and the Middle East, both regions have always extended the Silk Road to the rest of the world to participate in these exciting developments on this route. Indeed, global investors and the international financial community are already drawing the benefits from the increased diversification of asset classes while riding on the dynamism of the two regions. As Islamic finance expands further, reinforced by the activities on the New Silk Road, there will be greater convergence towards ethical or socially responsible-type of investments (SRI) in the global financial community. Islamic investment guidelines share significant similarities with the SRI principles. The focus of Islamic investment not only involves the avoidance of riba-free activities but also extends to include issues related to ethical values, such as fair trade and environmental protection. Furthermore,

the prospects of increased stability for financing flows and the focus on the role of real sector economic activities have ignited interest in utilising Islamic finance for sustainable development.

This overwhelming gathering of so many issuers and investors here today provides some indication of the growing interest in Islamic finance, reinforcing the potential increased activity on the New Silk Road. We all have a part in the making of the New Silk

Road into a vibrant source of wealth and prosperity in the global economy.

In closing, Malaysia is committed to be part of the New Silk Road to facilitate greater cross border economic and financial flows for increased inter-regional trade and investment transactions. Insyah-Allah, the greater inter-regional economic and financial linkages would bring greater benefits which will be mutually reinforcing and contribute towards raising the prospects for greater global shared prosperity.

Third IFSB Seminar on Legal Issues: Surveys on Legal & Shariah Issues in the Islamic Financial Services Industry 28 March 2007

Opening Remarks by

Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz
Governor, Bank Negara Malaysia

A strong legal and Shariah framework as a pillar to Islamic finance

The need to continually strengthen the legal framework for the financial services industry is imperative given the powerful forces of change continually transforming the functioning of the global economy and the international financial system. A legal framework which is aligned with market developments lends certainty and predictability to financial transactions and innovative products and instils public confidence in the financial system.

The legal and Shariah framework is a vital pillar in the sustainable development of Islamic finance. It provides the legislative framework that unambiguously defines the conduct of Islamic financial institutions. It also gives due protection to the consumers of Islamic finance, ensures the enforceability of Islamic financial contracts and provides an effective mechanism for legal redress.

The legal framework for Islamic finance also needs to address any specific elements that could result in a comparative disadvantage to the industry. More specifically, in a world in which finance has long been defined by conventional practices and laws, the features that are unique to the requirements of Islamic finance need to be taken into account to ensure neutrality of treatment.

In Malaysia, the rapid evolution of Islamic finance has been supported by the development of a comprehensive legal infrastructure. A series of legislation since 1983 has provided the foundation

for a regulatory regime for Islamic banks, takaful operators, the Shariah Council for Islamic finance, Islamic finance windows in conventional banks and the various forms of bond and money market instruments. In addition, the corporate, securities and insolvency laws and guidelines are compatible with the Shariah. These legislation have been reinforced by the establishment of a dedicated High Court bench to provide a comprehensive adjudicative system to deal with disputes involving Islamic finance. In addition, the new Islamic Finance Arbitration Rules of the Kuala Lumpur Regional Centre for Arbitration provides a customised mechanism for the resolution of disputes in the Islamic financial services sector.

The development of an efficient and vibrant Islamic financial market

Equally important to the development of Islamic finance is not only the financial intermediaries but also the Islamic financial markets. The demand for Islamic financial products and instruments is expanding at increasingly significant rates in predominantly Muslim countries in the Middle East and Asia as well as in the non-Muslim economies in the West. The rapid growth of the Islamic financial markets has seen the development of a wide range of products including money, debt and capital market instruments. Such markets are important for the effective management of investment portfolios and for the diversification of risks.

Today, the global demand for Islamic capital market products is served by the existence of the Dow Jones Islamic Index whose market capitalisation now exceeds

USD 10 trillion. About 350 Shariah-compliant funds have already been established across the globe.

In Malaysia, the sukuk market has been a leading segment of growth in the domestic bond market accounting for half of our domestic bond market and two thirds of the total global outstanding sukuk. A wide range of new Islamic financial instruments has been developed including the Bank Negara Malaysia Sukuk Ijarah, Bank Negara Malaysia Monetary Notes, the Islamic residential mortgage-backed securities and most recently the Commodity Murabahah Programme for managing short-term liquidity in the inter-bank money market.

While Islamic finance practitioners and scholars continue to draw from the source of fiqh muamalat to create new and innovative instruments, the legal framework however, needs to be further strengthened to ensure continued acceptance and utility of the financial instruments. In Malaysia, the progress in this area has been facilitated by the common law which forms the foundation of the legal system. More specifically, the concept of "trust" under the common law has facilitated the issuance of Islamic securities such as sukuk and Islamic Real Estate Investment Trust (REIT). Since "trust" as an inherent notion embedded in the common law system is not generally found in the jurisprudence of civil law, some civil law countries have enacted specific legislation to provide for the introduction of trust so as to align their legal systems with the requirements of Islamic finance.

The challenges brought by the integration of Islamic finance with the international financial system

While legal issues within a domestic financial system can be resolved by the home regulators and Shariah authorities, the integration of Islamic finance with the international financial system brings with it many challenges. There is a need for mutual recognition of financial standards and

products across jurisdictions. The progressive harmonisation of Shariah, in this respect, needs to be viewed as a driver towards greater international financial integration.

Such a convergence and harmonisation can only happen with greater engagement among the regulators, practitioners and scholars in Islamic finance in the international community. The Annual International Shariah Scholars' Dialogue that has been taking place since 2005 is aimed at achieving this objective. This Dialogue has served to promote interactions between Shariah scholars from around the world contributing towards greater understanding and international convergence.

In Malaysia, the efforts to enhance the international dimension of our Islamic financial system have been intensified in the more recent period to facilitate greater international trade and cross-border investment flows. The new initiatives that have been announced allow the establishment of new International Islamic financial institutions that will be permitted to offer the full range of Islamic financial services to residents and non-residents in international currencies. These initiatives also aim to serve as a catalyst for the development of the domestic financial markets as well as the development of talent and knowledge in Islamic finance. Collaboration with other emerging regional centres in Islamic finance will be an important part of this process that will contribute towards greater international financial integration.

The establishment of the Islamic Financial Services Board in 2002 represents a major structural enhancement in building the international financial architecture for Islamic finance. The achievements thus far by the Islamic Financial Services Board in developing the prudential standards that can be universally applied have been very encouraging. The efforts represent a testimony of the collective capacity for greater international collaboration which has contributed towards strengthening the fabric of Islamic finance.

While the legal framework and rules are constantly being reviewed to ensure that they remain relevant for the new areas of financial activity, it should not only be undertaken for the domestic Islamic financial system but also in the context of the international financial system.

Conclusion

In closing, I would like to take this opportunity to congratulate the Islamic Financial Services Board for commissioning the “Surveys on Legal and Shariah Issues in the Islamic Financial Services Industry”. The survey

findings represent an important contribution towards augmenting the literature on the existing legal and Shariah framework across different jurisdictions. It serves as a useful source of reference for countries that are interested in establishing a legal and Shariah framework for their Islamic financial system. Deliberation on the survey results and the exchange of views and experiences among lawyers, Shariah scholars and Islamic finance practitioners will be important in contributing to increasing the efficiency in Islamic finance and facilitating its robustness as an integral component in the global financial system.