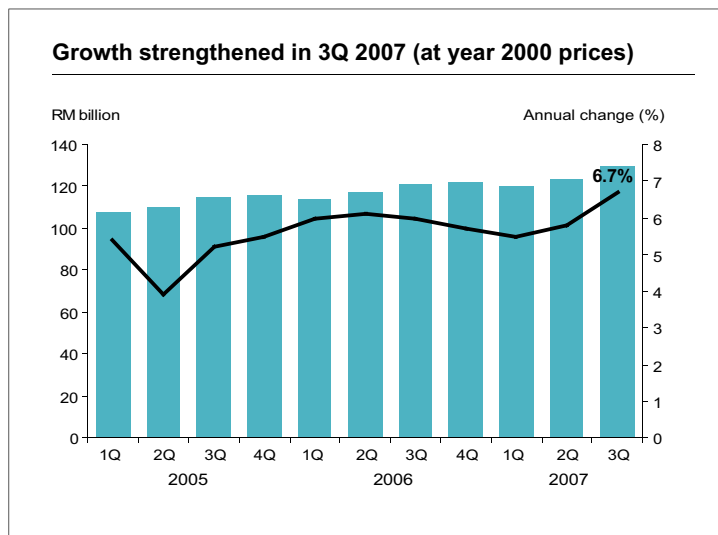


ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE THIRD QUARTER OF 2007

OVERVIEW

Economy strengthened further in the third quarter

The Malaysian economy strengthened further in the third quarter of 2007. Sustained strong domestic demand raised real GDP growth to 6.7%. Domestic demand was supported by strong private consumption spending and investment activities. This was reinforced by increased public sector spending. On the supply side, growth was led by the services sector.



The expansion in the services sector accelerated to register a double-digit growth of 10.5% supported by strong domestic demand, tourism and business activities. Of significance, the finance, insurance, real estate and business services, and the wholesale and retail trade, accommodation and restaurant sub-sectors performed well.

All other key sectors recorded positive growth in the third quarter. Growth in the manufacturing sector picked up to expand by 3.4% (2Q: 1.5%) reflecting a gradual recovery in the electronics and electrical (E&E) industry and further expansion in the domestic-oriented industries. Production of

export-oriented industries expanded by 1.4% (2Q: -1.6%), supported by the turnaround in the E&E sector amidst the increased production of semiconductors mainly to meet the demand from the People's Republic of China (PR China) and the European Union. In addition, the computers and parts segment which is closely linked to developments in the US market showed an improvement in the third quarter (0.2%; 2Q: -16.6%). Meanwhile, the domestic-oriented industries continued to expand by 4.6% (2Q: 8.6%) mainly supported by the sustained domestic construction activities and the upturn in sales of new motor vehicles following the release of new models.

The construction sector maintained its growth momentum, expanding by 4.7% in the third quarter of 2007 (2Q: 4.8%), mainly supported by the implementation of various infrastructure projects under the Ninth Malaysia Plan. The agriculture sector increased by 0.6% (2Q: -0.9%) following

the gradual improvement in crude palm oil output, after the yield downcycle in the first half of the year. There was also a favourable performance in the minor agriculture activities such as vegetables, livestock and cocoa. The mining sector expanded by 2.3% (2Q: 7.7%) supported by the increase in crude oil output amidst the commencement of production of Malaysia's first deepwater oil field at Kikeh, Sabah in mid-August 2007. The production of natural gas, however, declined marginally due to lower external demand from Korea.

Domestic demand strengthened further in the third quarter to expand at an annual growth rate of 12.6% (2Q: 10.8%), on the

strength of private sector activities. The increased public sector spending continued to provide support to growth. Private consumption expenditure registered a strong growth of 14% following rising disposable income supported by stable labour market conditions and strong commodity prices. The various promotions held during the nationwide Mega Sales Carnival from mid-June to early September had also encouraged higher household spending. Gross fixed capital formation also increased significantly by 13.5% in the third quarter (2Q: 6.6%) due to investment by both private and public sectors. Private investment indicators, namely loans approved and disbursed to the manufacturing and construction sectors trended firmly upwards suggesting greater momentum in capital spending by the private sector. Meanwhile, higher disbursement for development expenditure by the Federal Government was channelled towards high-multiplier impact economic activities in the form of projects for upgrading and construction of infrastructure to improve the transportation system as well as improving the provisions for the education services and the enhancement of the public utilities.

The headline inflation rate, as measured by the change in the Consumer Price Index (CPI) increased to 1.8% in the third quarter of 2007 (2Q: 1.5%), due mainly to higher prices for food and beverages.

On the external front, the trade account recorded a surplus of RM28.2 billion in the third quarter (2Q: RM22.6 billion). Gross exports slowed, with a marginal increase of 0.6% (2Q: 1.3%), led mainly by commodity exports, while exports of manufactured goods declined. Agriculture exports continued on an upward trend, driven mainly by palm oil exports due entirely to record high prices of RM2,599 per tonne following a rising global demand amidst lower production in Malaysia and Indonesia as well as lower supply of soybean oil and rapeseed oil in the United States and Europe, respectively. Mineral exports also expanded further during the quarter due to higher proceeds from exports of liquefied natural gas, which benefited from

the rise in prices to a record high of RM1,226 per tonne. Meanwhile, manufacturing exports declined due mainly to the decline in exports of E&E products and selected resource-based industries. While there was an improvement in demand for E&E, the continued decline in prices affected exports of the E&E products during the quarter.

Growth of gross imports was sustained at 1.7%, reflecting the increase in investment and consumer spending. Imports of capital goods (excluding lumpy items) increased by 7.2% as capacity expansion in the manufacturing sector and upgrading for fuel efficiency led to the strong growth of imports of machinery, generators, turbines and electric motors. Imports of construction and mining equipment were also higher due to increased exploration activities in the oil and gas industry. Imports of consumption goods increased by 1% during the quarter (2Q: 1.1%) due mainly to higher imports of food and beverages for household consumption during the festive season. In line with the slowdown in exports of E&E, imports of intermediate goods declined by 1% during the quarter (2Q: +6.5%).

In the financial account, net inflow of foreign direct investment, as captured by Bank Negara Malaysia's Cash BOP System (not including retained earnings and investment in the form of imported machinery and equipment) amounted to RM6.8 billion in the third quarter (2Q: RM13.6 billion). The bulk of the investment was channelled into the services, manufacturing and oil and gas sectors. Overseas investment recorded a net outflow of RM6.9 billion (2Q: -RM8.5 billion). Meanwhile, portfolio investment recorded a net outflow of RM22.3 billion (2Q: +RM14.3 billion) on account of net liquidation of both equity and debt securities by foreign investors in July and August, following turbulence in the US sub-prime credit and mortgage lending markets. Inflows, however, resumed in September and October.

The international reserves of Bank Negara Malaysia amounted to RM335.4 billion (equivalent to USD98.2 billion) as at

28 September 2007. The reserves increased to RM345.3 billion (equivalent to USD101.2 billion) as at 15 November 2007. The reserves position is sufficient to finance 8.9 months of retained imports and is 7.4 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 third quarter of 2007 as the prevailing level of the policy rate was consistent with the medium term outlook of relatively low inflation and sustained economic growth.

Reflecting the unchanged OPR, interbank rates for all maturities remained relatively stable during the quarter. In terms of lending rates, the average base lending (BLR) remained unchanged during the quarter, while the average lending rate (ALR) was considerably lower at end-September, largely reflecting the disbursement of lower priced syndicated bridging loans. Deposit rates remained relatively unchanged.

Financing to the private sector was higher in the third quarter, with banking system loans and PDS outstanding expanding at a higher combined annual rate of 8.9% at the end of the third quarter of 2007. Banking system loans outstanding increased at an annual growth rate of 9.5% at the end of the third quarter, with loans outstanding to businesses and households expanding at annual rates of 14.8% and 7.3% respectively. Loan applications, approvals and disbursements were also higher on an annual basis across the business and household sectors.

M3, or broad money, increased at an annual rate of 12.3% at the end of the third quarter (2Q: 12.6%). The expansion in M3 was driven mainly by higher claims on the private sector, on account of an expansion in bank credit and the holdings of private debt securities by the banking system.

Net funds raised in the capital market by the public and private sectors amounted

to RM12 billion. This was lower than the RM22 billion raised in the previous quarter on account of a large PDS issuance in the previous quarter for merger and acquisition (M&A) activity. Net funds raised by the public sector amounted to RM13.4 billion, while net funds raised by the private sector through the private debt securities (PDS) market, excluding Cagamas, amounted to RM0.6 billion. Meanwhile, RM383 million in funds was raised through the equity market during the quarter (2Q: RM512 million).

In the light of the turmoil in the major financial markets arising from changing investor sentiments regarding losses related to the US subprime mortgages, most currencies, including the ringgit, experienced greater volatility during the quarter. At the beginning of July, the ringgit was on an appreciating trend amid trade and investment flows. Since 25 July, however, the ringgit depreciated against the major currencies following reversals by global investors out of debts and equities triggered by the international financial market turmoil during this period. Regional currencies were similarly affected by the reassessment of risks associated with emerging market assets by global investors. However, this trend reversed in both the ringgit and other regional currencies after the U.S. Federal Open Market Committee (FOMC) first reduced the discount rate on 17 August, and subsequently reduced both the Fed Funds rate and the discount rate by 50 basis points each on 18 September. The interest rate cuts and market expectations of further interest rate reductions by the FOMC restored some degree of investor confidence. During the quarter as a whole, the ringgit strengthened against the US dollar by 1.1%. For the period 1 October – 27 November, the ringgit recorded a mixed performance against major and regional currencies.

Banking system continued to exhibit high resilience

The banking system continued to demonstrate a high resilience in the third quarter of 2007, supported by strong capitalisation, stable profitability and further improvements in

loan quality. The risk-weighted capital ratio (RWCR) was sustained at 13.1% throughout the quarter, while the pre-tax profit remained firm at RM4.28 billion (2Q: RM4.32 billion). The level of non-performing loans (NPLs) continued to improve with the total net NPLs based on the 3-month classification declining by 8.6% to RM21.9 billion as at the end of the third quarter (2Q: RM24 billion). This was attributed primarily to higher recoveries and reclassifications of NPLs to performing status as well as continued write-offs. As a result, the net NPL ratio declined further to 3.5% of net total loans (2Q: 4.1%).

Growth momentum to continue in the near term

Despite increased risks of a sharp slowdown in the US economy, greater uncertainties in global financial market conditions and high oil prices, the global growth outlook remains

supported by continued strength in emerging economies, in particular, in the Asian region. Growth prospects for the large emerging economies, including China, India, Brazil and Russia, remain strong. In the domestic economy, forward looking indicators point to continued strong domestic demand in the near term. The latest six-month smoothed growth rate of the DOSM leading index was 7.4% in August. Consumers continued to remain optimistic on income and employment prospects as reflected in the MIER Consumer Sentiments Index, which rose to 117.5 points in the third quarter of 2007 (2Q: 115.9 points). The Business Conditions Index remained high at 117.5 points, reflecting sustained confidence in the corporate sector as underlying business activity continues to expand with the execution of more Ninth Malaysia Plan projects. Overall, given the strong domestic demand, the potential remains for the economy to continue on a steady growth path.

DEVELOPMENTS IN THE THIRD QUARTER OF 2007

INTERNATIONAL ECONOMIC ENVIRONMENT

Sustained economic growth in most major regions despite moderation in housing-related activity in US

Growth in the global economy was sustained at a relatively strong pace in the third quarter of 2007. In the **US**, despite the continued slowdown in housing-related activity, preliminary estimates showed that economic growth expanded at an annualized rate of 4.9%. Consumer spending expanded by 2.7% (2Q: 1.4%) as job creation supported income growth. Growth was also supported by the trade sector (which contributed 1.4 percentage points to GDP growth) and non-residential investment.

In **Japan**, the economy grew at an annualised rate of 2.6%, supported mainly by the strong export performance during the quarter. Business investment rebounded, after contracting in the second quarter, as companies purchased more general industrial machinery. However, private residential investments fell by 7.8% in the third quarter, the third consecutive quarter of decline in 2007, due to tighter building regulations. Favourable weather conditions supported increased consumption spending.

In the **euro area**, real GDP expanded by 2.6% in the third quarter, supported by stronger business investment and also consumer spending. Growth also picked up in Germany, France and Italy in the third quarter. Meanwhile in the **UK**, the economy remained resilient, expanding by 3.2% in the third quarter. Economic expansion benefited from strong services sector activity which grew by 4%. As in the previous quarters, growth was particularly strong in business services and

finance. However, industrial output slowed due mainly to weaker manufacturing output growth.

	2006		2007			Key contributing factors for 3Q growth
	3Q	4Q	1Q	2Q	3Q	
	Annual change (%)					
US ¹	1.1	2.1	0.6	3.8 ^r	4.9 ^p	Growth was supported by higher net exports and non-residential investment.
UK	3.0	3.2	3.1	3.1 ^r	3.2 ^r	Supported mainly by the services sector especially in business services and finance.
Euro zone	2.9	3.3	3.2	2.5	2.6 ^p	Supported by stronger business investment and consumer spending.
Japan ¹	-0.2	5.5	2.6	-1.6 ^r	2.6 ^p	Supported by a rebound in investment, healthy consumer spending and strong export performance.

¹ Annualised basis
^r Revised
^p Preliminary
Source: National authorities

In the **US**, the **Federal Open Market Committee (FOMC)** cut interest rates by 50 basis points at the 18 September meeting, and another 25 basis points at the 31 October meeting. The interest rate cuts were to forestall the effects on the broader economy from the risks of financial market disruptions.

The **European Central Bank (ECB)** maintained policy rates during the quarter, pausing to evaluate the impact of the recent credit turmoil on the economy. However, medium-term inflation risk stemming from increased capacity constraints, tightening of labour markets, strong money-supply growth, and elevated oil and food prices remain a concern for the ECB. The **Bank of England** also kept rates steady at 5.75% in its November meeting despite concerns arising from the recent credit market problems as growth data in the third quarter remained strong.

Similarly, the **Bank of Japan** maintained interest rates at 0.5% on 31 October, constrained by the recent developments in prices. Recent data showed that core inflation excluding fresh foods continued to fall in September, the eighth consecutive month of decline.

In the third quarter, global **crude oil prices** recorded a high of USD83.32 per barrel on 20 September spurred by the report of the US Energy Department showing an unexpected drawdown of crude inventories in the US and concerns over bad weather. Oil prices increased further to exceed USD90 per barrel by end-October 2007 and reached a new high of USD98.03 on 20 November 2007 due to concerns ahead of the Northern Hemisphere winter and a steady reduction in inventories in recent weeks.

In the **Asian** region, economic activity remained strong despite the increased

uncertainties concerning the US economy and the global debt market turmoil. Growth was supported by sustained domestic demand and gradual recovery in E&E exports. The moderation in regional E&E exports in the first half of the year has begun to recover as reflected in improved global sales of semiconductor since July and the decline in inventories in the third quarter.

Most regional economies recorded higher inflationary pressures, mainly due to higher food prices. PR China and Korea raised interest rates to contain inflation. However, Indonesia, Thailand and the Philippines, the moderation in inflationary pressures have led to cuts in interest rates to stimulate domestic demand.

In the **foreign exchange market**, the US dollar ended the quarter weaker against major currencies. Dollar performance was mainly affected by the concern over the strength of the US economy and also interest rate differentials. In November, the pound sterling reached a 26-year high (USD2.1074) versus the dollar on 8 November 2007. Meanwhile, the US dollar also fell to record lows against the euro and a basket of six major currencies due to expectations of rate cuts by the Federal Reserve. Regional currencies also appreciated against the US dollar due to continued strong trade and portfolio inflows.

Regional Countries: Real GDP Growth

	2006		2007			Key contributing factors for 3Q growth
	3Q	4Q	1Q	2Q	3Q	
	Annual change (%)					
PR China	10.6	10.4	11.1	11.9	11.5	Driven by strong exports and investment.
Singapore	7.0	6.6	6.5	8.7	8.9	Supported by growth in the manufacturing, construction and financial services sectors.
Indonesia	5.9	6.1	6.0	6.3	6.5	Due to strong investment and exports.
Hong Kong SAR	6.4	6.9	5.6	6.6	6.2	Supported by exports and private consumption.
Korea	4.8	4.0	4.0	5.0	5.2	Supported by manufacturing and services sectors.

Source: National authorities

DEVELOPMENTS IN THE MALAYSIAN ECONOMY

The Malaysian economy strengthened further in the third quarter of 2007 led by strong performance in the services sector

The Malaysian economy strengthened further in the third quarter of 2007, with real GDP growth rising to 6.7%, led mainly by strong activities in the services sector and reinforced by sustained construction activities and a pick-up in the agriculture and manufacturing sectors. Strong domestic demand, tourism and robust business activity imparted a positive impact on the services sector, while the construction sector maintained its growth momentum underpinned by implementation of projects under the Ninth Malaysia Plan. Growth in the agriculture sector reflected an improvement in output of crude palm oil, Malaysia's key commodity, after a yield downcycle and strong performance in selected minor agriculture activities. Growth in the manufacturing sector picked up reflecting a gradual recovery in the electronics and electrical (E&E) industry and further reinforced by

Services sector the key driver of growth

The services sector expanded at a strong pace to register a double-digit growth of 10.5% in the third quarter of 2007. Growth was driven by the strong performance in

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

	Share 2006 %	2006		2007		
		3Q	4Q	1Q	2Q	3Q
		Annual change in (%)				
Intermediate Services	42.8	8.9	9.5	13.4	11.9	12.5
Transport, storage & communication	14.2	6.6	6.8	5.4	8.6	10.2
<i>Transport & Storage</i>	7.0	5.7	6.7	5.5	9.3	13.4
<i>Communication</i>	7.2	7.5	6.8	5.3	8.0	7.1
Finance, insurance, real estate & business services	28.6	10.0	10.8	17.6	13.6	13.7
<i>Finance & Insurance</i>	19.8	9.1	8.8	13.2	11.0	8.8
<i>Real Estate & Business Services</i>	8.8	12.0	15.6	27.3	19.5	24.4
Final Services	57.2	6.0	7.0	6.8	7.5	9.1
Electricity, gas & water	5.9	5.3	6.2	4.3	4.5	2.9
Wholesale & retail trade, accommodation & restaurant	26.6	6.1	6.4	8.9	11.6	14.4
<i>Wholesale & retail trade</i>	22.3	6.1	6.0	9.1	11.9	14.9
<i>Accommodation & Restaurant</i>	4.2	5.7	9.1	8.1	10.3	11.6
Government services	13.6	7.9	10.6	6.0	2.8	3.8
Other services	11.1	4.2	4.5	4.2	5.4	6.0
Total Services	100.0	7.2	8.0	9.7	9.4	10.5

Source: Department of Statistics, Malaysia

intermediate services and higher growth in final services. Of significance, the two major sub-sectors, namely finance and insurance, real estate and business services, and wholesale and retail trade, accommodation and restaurant, which account for more than 50% of the services sector performed well during the quarter.

Growth in the **finance, insurance, real estate and business services** segment was broad based. The finance segment continued to be supported by the banking intermediation activity and the increased contribution from new fee-based activities such as money transmission, unit trust fund, advisory and wealth management services. Growth was also supported by the rapid expansion in Islamic finance during the quarter. Interest in the property market by foreigners as well

Quarterly GDP by Kind of Economic Activity at Year 2000 Prices¹

	2006		2007			
	3Q	4Q	1Q	2Q	3Q	
		Annual Change in (%)				
Agriculture	5.8	5.1	2.2	-0.9	0.6	
Mining	0.1	2.1	-0.6	7.7	2.3	
Manufacturing	7.2	4.0	2.0	1.5	3.4	
Construction	-0.4	0.6	4.0	4.8	4.7	
Services	7.2	8.0	9.7	9.4	10.5	
Real GDP (Ann. Chg.)	6.0	5.7	5.5	5.8	6.7	
Real GDP (Preceding Chg.)	3.9	0.5	-1.7	3.0	4.8	

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

Source: Department of Statistics, Malaysia

expansion in the domestic-oriented industries. Meanwhile, a new oil field that came into operation during the quarter contributed to the growth in the mining sector.

as residents contributed to growth in the real estate activity, while the business services segment was supported by strong turnover in the capital market and contribution from new areas of growth such as IT services and professional services. As of end-September 2007, a total of 1,922 IT related companies have been granted Multimedia Super-Corridor status (end-2006: 1,728).

Sustained strong spending by domestic consumers and increased tourist arrivals during the summer vacation underpinned the growth in the **wholesale and retail trade, accommodation and restaurant** sub-sector. The robust performance was reflected by indicators such as consumption credit, sales of new motor vehicles and tourist arrivals.

Increased disposable income of civil servants amidst the salary revision and the Mega Sales Carnival supported higher spending in consumer durables.

The **transport, storage and communication** sub-sector also recorded a double-digit growth during the quarter, led by increased revenue in the sea transportation segment due to higher oil and gas activities. Meanwhile, the increase in subscriber base and higher usage of mobile services in response to competitive pricing among the telecommunication providers supported the telecommunications industry.

Pick up in manufacturing activity

Value-added growth in the **manufacturing sector** picked up, reflecting a gradual recovery in the electronics and electrical (E&E) sector and further expansion in domestic-oriented industries.

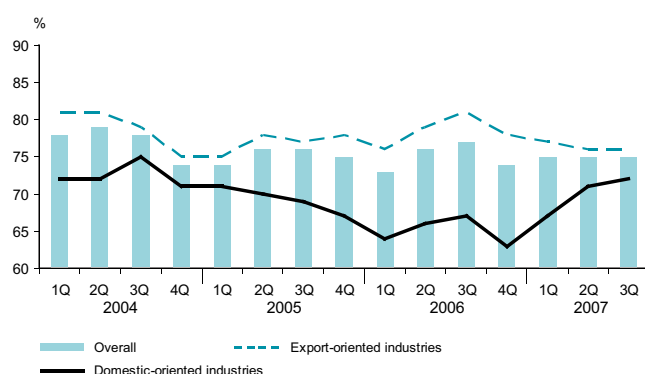
Production of **export-oriented industries** expanded by 1.4% during the quarter (2Q: -1.6%). Growth was supported by the turnaround in the electronics and electrical sector (2.2%; 2Q:-5.8%) amidst the increased production of semiconductors (5.1%; 2Q: -0.4%), mainly to meet the demand from the non-US market, namely PR China and the European Union. In addition, the computers and parts segment which is closely linked to developments in the US market showed an improvement in the third quarter (0.2%; 2Q: -16.6%). The chemical and chemical products sector recorded a marginal growth attributable to plant maintenance in the industrial gas industry and weaker external demand for plastic products.

Selected Quarterly Indicators in the Services Sector

	2006		2007		
	3Q	4Q	1Q	2Q	3Q
	Percentage at end-period (%)				
Cellular phone penetration rate	81.6	72.3	77.0	78.2	80.8
Internet subscribers penetration rate	14.0	14.0	14.0	14.2	14.3
Broadband subscribers penetration rate	2.8	3.3	3.7	4.1	4.5
	Index				
MIER Consumer Sentiment Index	107.5	110.9	124.1	115.9	117.5
MIER Retail Trade Index	95.0	99.2	118.8	129.5	145.9
MIER Tourism Market Index	129.2	127.2	133.8	131.6	131.1
	Annual change (%)				
Total consumption credit outstanding	18.0	14.9	12.8	7.1	6.9
Loans outstanding to the wholesale & retail trade, hotels & restaurants	10.9	12.0	10.1	0.0	6.2
Imports of consumption goods	14.7	12.1	8.9	1.1	1.0
Total sales of motor vehicles	-9.0	-24.8	-15.5	-7.2	2.2
Container cargo handled (Port Klang and PTP)	15.9	18.7	18.5	12.2	9.7

Source: Various sources

Capacity Utilisation in the Manufacturing Sector *



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

Performance in the Manufacturing Sector

	2006		2007		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Value Added (at year 2000 price)	7.2	4.0	2.0	1.5	3.4
Overall Production	7.1	5.3	0.7	0.4	2.0
Export-oriented industries	5.9	4.3	-0.2	-1.6	1.4
<i>Of which:</i>					
Electronics and electrical	5.1	1.9	-5.5	-5.8	2.2
Electronics	8.8	4.5	-4.0	-4.0	4.1
Electrical	-5.5	-5.5	-10.3	-11.1	-4.0
Chemicals and chemical products	-1.8	-0.6	7.3	1.3	0.6
Petroleum products ¹	18.1	12.8	5.0	11.3	1.9
Textiles, wearing apparel & footwear	-0.8	1.5	-10.4	-11.2	-5.8
Wood and wood products ²	4.2	9.7	1.6	4.1	0.5
Rubber products	13.5	15.2	16.9	2.7	3.7
Off-estate processing	9.7	9.6	-1.3	-12.7	-0.3
Domestic-oriented industries	12.2	9.9	4.8	8.6	4.6
<i>Of which:</i>					
Non-metallic mineral products	8.1	9.2	-2.0	10.9	-0.2
Iron & steel and non-ferrous metal	7.9	20.5	12.9	17.6	13.9
Food	14.4	9.7	16.2	7.6	0.6
Transport equipment	-2.6	-14.0	-21.9	-12.8	0.1
Fabricated metal products	36.1	30.1	21.9	22.0	14.2
Total Manufactured Exports	14.2	5.7	1.4	-1.1	-2.1
<i>Of which:</i>					
Electronics and electrical products	10.3	1.7	-2.0	-6.7	-5.7
Chemicals and chemical products	22.0	17.6	33.8	13.5	3.1
Petroleum products	32.0	2.5	-24.5	5.8	-5.9
Wood and wood products	34.3	26.8	15.3	8.2	-17.8
Furniture & parts	10.5	7.6	7.9	14.3	1.0
Rubber products	48.5	30.8	31.0	6.0	1.0

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** continued to expand (4.6%; 2Q: 8.6%) mainly supported by the iron and steel, concrete and cement products and fabricated metal products industries as these industries continued to benefit from improving domestic construction activities. Meanwhile, the transport equipment industry turned around after experiencing four consecutive quarters of decline supported by the upturn in sales of new motor vehicles due to the release of new models.

The overall capacity utilisation in the manufacturing sector remained unchanged at 75% in the third quarter of 2007, with both export- and domestic-oriented industries operating at 76% and 72% respectively (2Q: 76% and 71% respectively).

Positive contribution from the commodity sector

In the **primary commodity sector**, both the agriculture and mining sectors recorded positive growth during the quarter. The agriculture sector expanded by 0.6% (2Q: -0.9%) following the gradual improvement in crude palm oil output and favourable performance in the minor agriculture activities, while the growth in the mining sector (2.3%) was led by increased crude oil output.

In the **agriculture sector**, production of **crude palm oil** declined, at a slower rate of 0.1% (2Q: -13.3%) to total 4.52 million tonnes in the third quarter of 2007. The improvement was attributed to higher yields in Sabah, the largest producing state, with fresh fruit bunches (FFB) yields rising by 2.5% and the oil extraction rate (OER) increasing by 5.9% to 21.39% (national average: 20.2%). At the same time, output of minor agriculture activities such as **vegetables, livestock and cocoa** performed better. **Rubber** output declined during the quarter as tapping activities were disrupted by rainy weather conditions in the northern states of Peninsular Malaysia.

Performance in the Agriculture Sector

	2006		2007		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Value Added					
(at year 2000 prices)	5.8	5.1	2.2	-0.9	0.6
Industrial Crops	-1.8	4.2	-0.1	-5.0	-1.8
Food Crops	4.4	6.4	5.5	5.8	4.4
Production¹					
<i>Of which:</i>					
Crude palm oil	10.6	10.7	-1.4	-13.3	-0.1
Crude palm kernel oil	11.5	14.7	3.3	-13.9	-6.7
Rubber	9.4	11.2	-6.9	1.4	-10.3
Cocoa	17.8	-19.9	9.4	-10.5	21.8
Fish	7.2	10.0	5.2	2.0	4.0
Exports (RM million)	19.7	22.1	7.7	17.9	28.2
<i>Of which:</i>					
Palm oil					
(*000 tonnes)	11.4	20.9	-11.8	-6.7	-6.0
(RM/tonne)	11.0	14.7	34.0	49.4	63.1
(RM million)	23.7	38.6	18.2	39.5	53.4
Palm kernel oil					
(*000 tonnes)	36.2	15.4	40.9	14.3	7.5
(RM/tonne)	-15.8	-9.9	-3.9	22.3	63.4
(RM million)	14.7	3.9	35.4	39.8	75.6
Rubber					
(*000 tonnes)	-4.1	1.4	-12.3	-19.6	-1.8
(Sen/kilogramme)	59.5	11.1	-0.7	2.0	-12.4
(RM million)	53.0	12.7	-12.9	-18.0	-14.0
Sawn timber					
(*000 cu.metres)	-8.0	5.2	-2.1	-6.0	-11.4
(RM/cu.metre)	17.9	4.1	9.7	4.5	-1.0
(RM million)	8.4	9.5	7.4	-1.8	-12.3
Saw logs					
(*000 cu.metres)	-21.7	-3.2	-8.3	-2.5	12.3
(RM/cu.metre)	7.7	7.2	-2.5	-0.9	-4.3
(RM million)	-15.6	3.8	-10.5	-3.4	7.4
Cocoa beans					
(*000 tonnes)	321.3	-8.2	-13.5	42.1	15.7
(RM/tonne)	4.4	10.1	4.8	10.5	29.7
(RM million)	339.9	1.1	-9.3	57.0	50.0

¹ In '000 tonnes

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

Growth in the **mining sector** was driven by the 4.9% increase in the production of crude oil to 695,555 barrels per day. Of significance, crude oil production in Sabah rose by 15.1% as a result of the commencement of production of Malaysia's first deepwater oil field at Kikeh in mid-August 2007. Meanwhile, **natural gas** production declined marginally by 0.8% due to lower external demand from Korea, Malaysia's second largest importer of LNG.

Construction sector maintaining high growth momentum

The construction sector maintained its growth momentum, expanding by 4.7% in 3Q 2007 (2Q: 4.8%), mainly supported by the implementation of various infrastructure projects in the **civil engineering** sub-sector under the Ninth Malaysia Plan. Growth was also supported by the **non-residential** segment reflecting construction of new retail and office space, particularly in the Klang Valley. Meanwhile, the **residential** segment was mainly supported by demand for houses in the high-end segment.

Performance in the Mining Sector

	2006		2007		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Value Added (at year 2000 prices)	0.1	2.1	-0.6	7.7	2.3
Production					
<i>Of which:</i>					
Crude oil and condensates ('000 barrels)	-7.5	-6.5	-1.9	-7.6	4.4
Natural gas (net) (million standard cubic feet)	3.5	4.4	1.1	8.0	-0.8
Exports (RM million)	3.2	0.5	-5.3	7.5	7.7
<i>Of which:</i>					
Crude oil and condensates ('000 tonnes) (USD/barrel)	-11.1	-8.1	3.2	-3.1	1.7
(RM million)	16.7	4.2	-5.6	3.1	3.5
Liquefied natural gas ('000 tonnes) (RM/tonnes)	1.0	-8.0	-8.6	-6.1	-0.7
(RM million)	1.8	1.8	4.5	21.0	1.6
	13.0	8.7	-0.2	6.4	10.0
	15.0	10.7	4.3	28.8	11.8

Source: PETRONAS
Department of Statistics, Malaysia

Construction Indicators

	2006		2007		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
New sales and advertising permits	-21.7	-2.7	7.7	-6.3	10.6
Housing approvals	-12.6	-20.0	-9.6	-24.8	-4.7
Production of construction-related materials	8.0	12.8	2.8	13.1	4.4
Loans approved for construction	7.3	73.2	91.3	103.8	38.8
Imports of construction materials and mineral products	38.3	-8.2	12.6	8.4	-6.0 ¹

¹July-August 2007

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

Domestic demand strengthened further

Domestic demand strengthened further in the third quarter to expand at annual growth rate of 12.6% (2Q: 10.8%), driven mainly by private sector activity. Meanwhile, the public sector continued to be supportive of growth as Federal Government increased its development expenditure.

Private consumption

expenditure registered a strong growth of 14% following rising disposable income supported by stable labour market conditions and strong commodity prices. The annual nationwide Mega Sales Carnival from mid-June to early September also encouraged higher household expenditure. Major consumption indicators, such as sales of passenger cars, consumer spending on credit cards and loans disbursed for consumption purposes, remained on a positive growth trend reflecting sustained expansion in private consumption activities. The Malaysian Institute of Economic Research (MIER)'s Consumer Sentiments Index, which rose to 117.5 points in 3Q 2007 (2Q: 115.9 points) suggested that households are optimistic on income and employment prospects.

Meanwhile, **public consumption** increased by 5.3% in the third quarter (2Q:10.2%) due to higher expenditure for emoluments, defence and supplies and services.

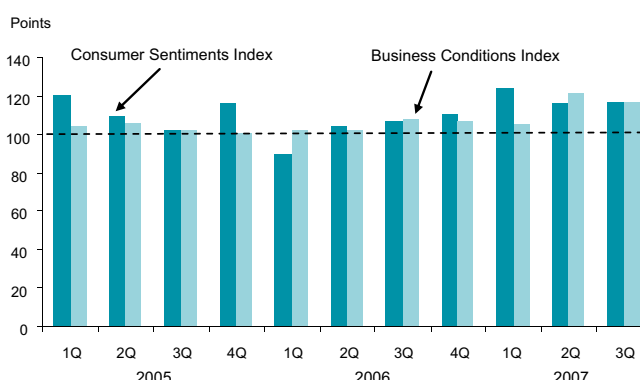
Gross fixed capital formation registered a strong growth of 13.5% in the third quarter (2Q: 6.6%) indicating a significant investment by both the private and public sectors. Business Conditions Index (BCI) compiled by the MIER remained above 100-point level since early 2005. The favourable BCI reading reflected sustained optimism in the corporate

GDP by Expenditure Components (at constant 2000 prices)

	2006		2007		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Aggregate Domestic Demand (excluding stocks)	6.4	7.1	8.7	10.8	12.6
Consumption	7.6	6.2	8.3	12.6	12.2
<i>Private sector</i>	7.0	7.0	8.6	13.1	14.0
<i>Public sector</i>	9.9	4.1	7.1	10.2	5.3
Gross Fixed Capital Formation	3.5	9.8	9.9	6.6	13.5
Exports of Goods and Services	11.9	5.2	1.9	3.0	1.2
Imports of Goods and Services	8.7	5.0	3.5	1.4	1.2
GDP	6.0	5.7	5.5	5.8	6.7

Source: Department of Statistics, Malaysia

Consumer Sentiment Improved, while Business Confidence was Sustained



sector as underlying business activity continues to expand with the execution of more Ninth Malaysia Plan projects. Capital expenditure was mainly for machinery and equipment. Private investment indicators, namely loans approved and disbursed to manufacturing and construction sectors, trended firmly upwards, suggesting greater momentum in capital spending by the private sector.

Investment activities by the public sector in the third quarter continued to be supported by the Federal Government as evident in the higher disbursement for development expenditure. Substantial capital spending was channelled towards high-multiplier impact economic activities in the form of projects for upgrading and construction of infrastructure to improve the transportation system, construction-related activities as well as improving the provisions for education

services and the enhancement of the public utility facilities.

Inflation averaged at 1.8%

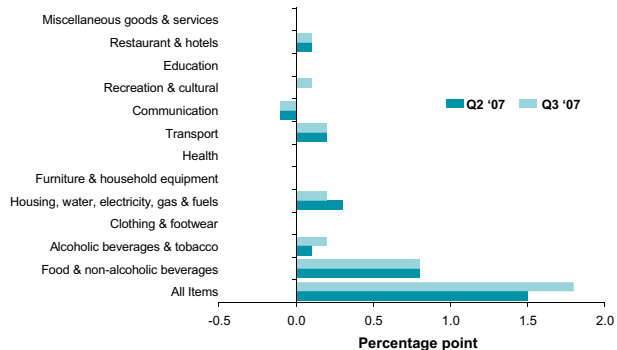
The average CPI inflation in the third quarter increased to 1.8% (2Q: 1.5%). The rise in consumer prices during the quarter was driven by higher prices in the food and non-alcoholic beverages category, and to a lesser extent, the alcoholic beverages and tobacco and restaurants and hotels categories. Domestic food price inflation was higher at 2.7% during the quarter (2Q: 2.6%), reflecting the higher prices of vegetables and meat and food consumed away from home. Meanwhile, the contribution of the alcoholic beverages and tobacco sector to CPI inflation was higher due to an increase in the excise duty imposed on cigarettes by the Government. Price increases were also observed in the restaurants and hotels sector on account of higher prices of refreshments. Meanwhile, the high number of tourist arrivals, in line with the Visit Malaysia Year 2007, resulted in higher hotel occupancy and contributed to increases in hotel room charges.

Producer price inflation rose in the third quarter to 3.5% (2Q: 2.7%), as prices in the commodity-related components rose at an average rate of 10.2% (2Q: 7.2%), in line with higher global commodity prices. The price inflation of the non-commodity-related sector, meanwhile, remained broadly unchanged at 1.1% during the period.

Labour market conditions remained healthy

In the third quarter of 2007, the **labour market** continued to be

Contribution to Consumer Price Inflation

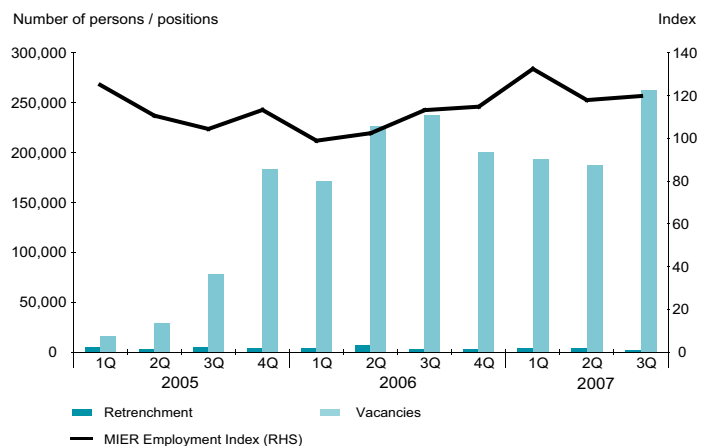


Source: Department of Statistics, Malaysia. Effective from January 2006, the base reference period for the CPI series is year 2005 = 100

resilient, with total new vacancies remaining high, while retrenchments declined further. In addition, the MIER Employment index was up by 1.9 points to 119.8, indicating an improvement in the employment conditions from the previous quarter.

Total new vacancies in the third quarter as reported via the Electronic Labour Exchange (ELX) increased to 226,036 positions (2Q: 186,779 positions), with openings mainly in the manufacturing (33% share), agriculture (32%) and services (24%) sectors. Most of the positions available were for elementary occupations¹ (56%). Meanwhile, job openings for graduates increased further

Labour Market Conditions



¹ Elementary occupations consist of maids, security guards, cleaners, construction workers, drivers and attendants

to 16,454 positions (2Q: 13,840 positions). These jobs were mainly in the services sector (78% share), in particular, finance, education services as well as other community, social and personal services segments. In addition, total job placements rose in the third quarter.

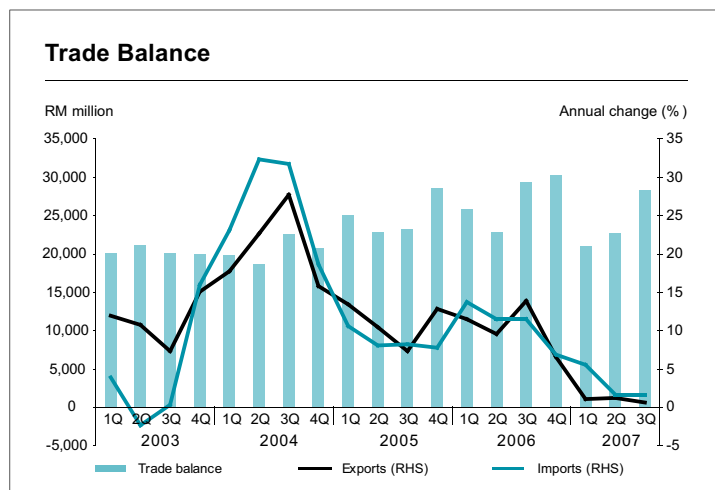
Meanwhile, retrenchments during the quarter were lower (1,308 persons; 2Q: 4,202 persons). About 50% of the laid off workers were from the manufacturing sector, especially workers from the E&E and food, beverage and tobacco industries (altogether 24% of total retrenchments), followed by the services sector (44%). In the services sector, the affected workers were mainly from the distributive trade and real estate and business services industries (29% of total retrenchments). Reduction in demand, high production cost, unmarketable products and consolidation in the corporate sector were among the main reasons cited by employers for retrenchments.

Labour productivity in the manufacturing sector, as indicated by real sales value per employee, contracted by 3.5% (2Q: -1.4%). The decline in labour productivity was due to the continued sluggish sales performance (-0.9%; 2Q: 2.4%). Despite a better outturn in the domestic-oriented industries (6.6%; 2Q: 4.8%), the overall sector's productivity performance was affected by the export-oriented industries whose productivity performance declined further (-5.5%; 2Q: -2.9%). Meanwhile, real wages for the overall sector increased by 3.8% indicating the presence of slight wage pressures in the sector.

Moderate expansion in both exports and imports

Supported by buoyant agriculture exports, the **trade account** recorded a larger surplus of RM28.2 billion in the third quarter of 2007

(2Q: RM22.6 billion). Exports expanded by 0.6% (2Q: 1.3%), while import growth was sustained at 1.7%.



Gross exports rose marginally by 0.6% in the third quarter (2Q: 1.3%) as the robust growth in agricultural and mineral exports was partially offset by the decline in exports of manufactured goods.

Manufacturing exports declined by 2.1% (2Q: -1.1%) due mainly to a decline in exports of electronics and electrical products (E&E) and selected resource-based industries, such as wood products and petroleum products. While there was an improvement in demand for E&E, the continued decline in prices affected the value of exports of E&E products during the quarter. In the resource-based products, wood products declined due to lower demand from Japan.

Agriculture exports continued on an upward trend during the quarter, rising by 28.2% (2Q: 17.9%), driven mainly by strong receipts from palm oil exports. Proceeds from palm oil strengthened by 53.4% during the quarter due entirely to record high prices of RM2,599 per tonne, an increase of 63.1% or about RM1,000 per tonne higher compared with the corresponding period in 2006 (RM1,594 per tonne). The strong price performance was a result of rising global demand for palm oil amidst lower production

in the two major palm oil producing countries, namely Malaysia and Indonesia, in addition to the lower supply of soybean oil and rapeseed oil in the United States and Europe, respectively. Meanwhile, rubber exports declined by 14% due mainly to declining prices amidst the slower global demand.

Mineral exports expanded further by 7.7% during the quarter, as exports of liquefied natural gas (LNG) rose by 11.8%, supported by the 10% rise in prices to a record high of RM1,226 per tonne. Meanwhile, crude oil exports declined marginally by 0.7%.

Strong economic activity in PR China and Vietnam led to the strong demand for Malaysian products. Exports to PR China and Vietnam increased by 13.6% and 77.6% respectively. The export growth was underpinned by demand for E&E, optical and scientific equipment and iron and steel products as well as primary commodities, particularly refined petroleum products and palm oil.

Exports to the European Union (EU) countries increased by 0.2%, led by Germany (12.8%) and the Netherlands (4.5%). Growth was underpinned by exports of palm oil, optical and scientific equipment and

Trade Account

	2006		2007		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Gross Exports	13.9	6.6	1.0	1.3	0.6
<i>Manufacturing</i>	14.2	5.7	1.4	-1.1	-2.1
<i>Agriculture</i>	19.7	22.1	7.7	17.9	28.2
<i>Minerals</i>	3.2	0.5	-5.3	7.5	7.7
Gross Imports	11.5	6.8	5.5	1.7	1.7
<i>Capital goods</i>	-4.6	4.1	-5.3	-1.1	17.3
<i>Intermediate goods</i>	12.0	7.1	9.0	6.5	-1.0
<i>Consumption goods</i>	14.7	12.1	8.9	1.1	1.0
Trade balance (RM billion)	29.4	30.2	21.1	22.6	28.2

Source: Department of Statistics, Malaysia

chemicals and chemical products. Exports to India increased by 7.5%, supported by E&E and chemicals and chemical products and palm oil. Exports to West Asia continued to expand by 30.1%, spurred by exports of E&E, optical and scientific equipment and palm oil.

Meanwhile, import components continued to be sourced from PR China, Thailand and Indonesia. Imports from regional countries grew by 3%, comprising mainly E&E and chemicals and chemical products.

Growth of **gross imports** was sustained at 1.7%, reflecting the increase in investment and consumer spending. Of significance, imports of **capital goods** expanded by 17.3%. Imports of capital goods excluding lumpy items increased by 7.2%. Capacity expansion

Malaysia: Direction of Exports

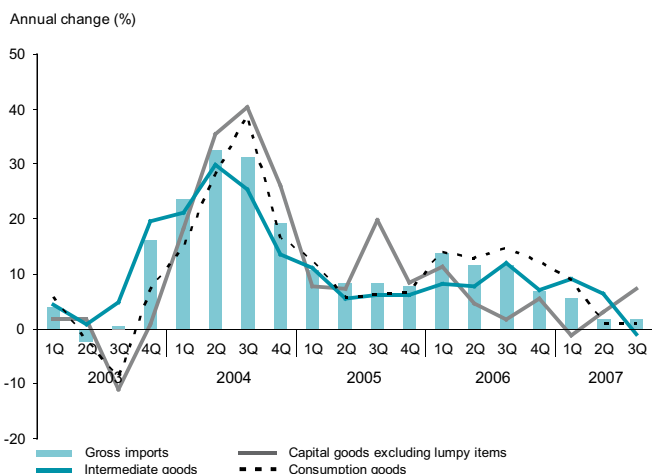
	2006					2007					2006					2007				
	3Q		4Q		1Q	2Q		3Q	3Q		4Q		1Q	2Q		3Q				
	RM billion										Share of total exports (%)									
																Annual change (%)				
United States	30.1	27.8	23.7	22.8	24.5	19.2	18.3	17.2	15.8	15.5	4.2	1.0	-3.2	-18.7	-18.7					
European Union (EU)¹	20.2	21.1	17.7	19.4	20.2	12.8	13.9	12.8	13.4	12.8	29.9	20.5	9.7	9.6	0.2					
Selected ASEAN countries²	39.9	37.5	35.6	36.0	39.6	25.4	24.7	25.8	24.8	25.0	14.5	2.2	-4.8	-4.8	-0.7					
North East Asia	29.5	28.2	27.8	28.1	30.8	18.8	18.5	20.1	19.4	19.5	20.1	4.4	10.2	7.4	4.2					
<i>People's Republic of China</i>	12.7	11.7	11.2	11.7	14.4	8.1	7.7	8.1	8.1	9.1	48.9	11.9	34.6	18.0	13.6					
<i>Hong Kong SAR</i>	7.5	6.8	6.3	6.6	7.3	4.8	4.5	4.6	4.5	4.6	-10.8	-12.6	-15.6	-10.2	-2.4					
<i>Korea</i>	4.8	5.5	6.5	5.6	4.8	3.1	3.6	4.7	3.9	3.1	28.1	17.4	5.9	14.3	0.9					
India	5.3	5.4	4.2	4.7	5.7	3.4	3.6	3.1	3.2	3.6	36.2	30.1	7.1	13.9	7.5					
Total exports	157.1	152.0	138.1	145.0	158.1	100.0	100.0	100.0	100.0	100.0	13.9	6.6	1.0	1.3	0.6					

¹ Refers to European Union (EU) 27 from 2007 onwards

² Singapore, Thailand, Indonesia, Philippines, Brunei Darussalam and Vietnam

Source: Department of Statistics, Malaysia

Import Growth



Imports of **intermediate goods** declined in line with the slowdown in exports of E&E. Lower intermediate imports reflected lower imports of electronics and parts of telecommunication products. Nevertheless, imports of primary materials for the food and beverages industry continued to grow in line with strong consumer spending. Meanwhile, imports of parts and accessories for transport equipment expanded due to higher domestic demand for motor vehicles.

During the quarter, imports of **consumption goods** increased by 1% to RM7.4 billion. In line with higher demand due to festivities, imports of food and beverages for household consumption were higher. Other consumption imports that increased included transport equipment and durables such as furniture.

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

	2006		2007		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
CAPITAL GOODS	-4.6	4.1	-5.3	-1.1	17.3
Capital goods (except transport equipment)	0.8	4.6	-4.9	6.1	10.2
Transport equipment	-39.9	-0.1	-7.7	-38.7	94.7
INTERMEDIATE GOODS	12.0	7.1	9.0	6.5	-1.0
Food and beverages, mainly for industry	24.8	18.2	4.0	11.3	36.8
Industrial supplies, n.e.s.	22.8	19.2	24.1	22.1	7.7
Fuel and lubricants	45.6	-0.5	8.8	-4.7	-19.8
Parts and accessories of capital goods (except transport equipment)	1.6	3.3	2.8	-1.1	-5.9
Parts and accessories of transport equipment	-10.2	-22.5	-18.3	9.4	21.6
CONSUMPTION GOODS	14.7	12.1	8.9	1.1	1.0
Food and beverages, mainly for household consumption	4.5	5.7	15.0	2.7	2.1
Transport equipment, non-industrial	-35.0	45.7	-12.1	3.0	54.2
Consumer goods, n.e.s.	22.4	15.1	5.8	0.2	-0.3
Durables	4.4	13.7	0.3	33.6	24.0
Semi-durables	44.4	24.5	7.1	-21.2	-17.1
Non-durables	15.8	9.3	8.0	3.7	3.6
DUAL USE GOODS	14.8	-5.7	-8.1	-6.2	4.1
OTHERS	-25.1	-3.4	15.7	16.5	73.7
RETAINED IMPORTS	9.0	6.4	6.4	4.8	2.6
RE-EXPORTS	63.3	12.5	-6.9	-36.7	-11.9
GROSS IMPORTS	11.5	6.8	5.5	1.7	1.7

Source: Department of Statistics, Malaysia

in the manufacturing sector and upgrading for fuel efficiency led to strong growth of imports of machinery as well as imports of generators, turbines and electric motors. Increased exploration activities in the oil and gas industry led to higher imports of construction and mining equipment.

Continued inflows of FDI

On a cash basis, gross inflows of **foreign direct investment (FDI)** increased to RM25.9 billion in the third quarter (2Q: RM22.3 billion) reflecting higher drawdown of inter-company loans amid continued inflows of equity capital. FDI in the form of equity capital was directed mainly into the services, manufacturing and oil and gas sectors. FDI in the services sector reflected primarily the acquisition of interests and the increased foreign participation in the finance,

insurance, real estate and business services sub-sector, as well as continued expansion in the restaurants, hotels, wholesale and retail trade sub-sector. In the manufacturing sector, FDI were mainly for acquisitions in the chemical-related industry as well as investments in the downstream petroleum-

related as well as electrical and electronics industries. Meanwhile, the inflows of inter-company loans reflected largely the extension of short-term loans by foreign MNCs in the oil and gas sector to their subsidiaries in Malaysia arising from their centralized treasury operations. The bulk of these loans were repaid during the same quarter. After adjusting for gross outflows due mainly to repayments of these short-term loans, net FDI amounted to RM6.8 billion (2Q: RM13.6 billion). It should be noted that FDI on cash basis does not include retained earnings and investment in the form of imported machinery and equipment.

Gross outflows for **overseas investment** amounted to RM12.1 billion (2Q: -RM27.7 billion), reflecting mainly investment in the form of equity capital, while extension of short-term loans to related companies abroad moderated. The overseas investments during the quarter were effected mainly by companies in the services, manufacturing and oil and gas sectors. Overseas investment in the services sector was led by companies in the finance, insurance and business sub-sector and the restaurants, hotels, wholesale and retail trade sub-sector. Meanwhile, investment abroad in the manufacturing sector was led by companies in the electrical and electronics, metal products and wood-related industries. After adjusting for gross inflows due mainly to the repayments of short-term loan from related companies abroad, overseas investment recorded a net outflow of RM6.9 billion (2Q: -RM8.5 billion).

Portfolio investment registered a net outflow of RM22.3 billion during the quarter (2Q: +RM14.3 billion), on account of net liquidation of both equity and debt securities by foreign investors. The net outflow in July and August reflected the cautious sentiment of investors following concerns over the

US sub-prime mortgage problems and the spillover among the financial institutions. Inflows, however, resumed in September and October.

Modest increase in external debt

Malaysia's total external debt amounted to RM189 billion or USD54.8 billion as at end-September 2007 (2Q: RM182 billion or USD52.2 billion), equivalent to 31.1% of GNP. The **medium and long-term external debt** was lower at RM132.8 billion, reflecting net repayment of external loans by the public sector. The larger net repayment by the Federal Government (-RM3 billion; 2Q: -RM0.1 billion) was attributable to the maturity of the sovereign Global Sukuk of USD600 million on 1 July 2007. The higher net repayment of RM2.5 billion

External Debt Outstanding			
	2006	2007	
	3Q	2Q	3Q ^P
RM billion			
Medium- and long-term debt	149.3	134.1	132.8
Public sector	83.7	70.0	64.8
Private sector	65.6	64.1	68.1
Short-term debt ¹	50.8	47.9	56.2
Total external debt	200.1	182.0	189.0
- USD billion equivalent	53.8	52.2	54.8

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

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

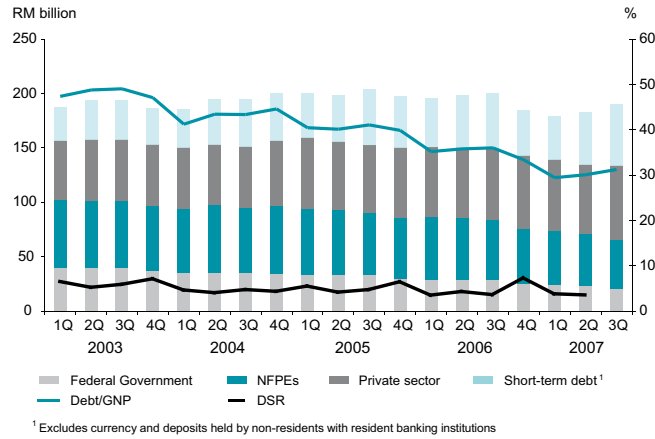
(2Q: -RM2.3 billion) by the NFPEs reflected mainly prepayments by companies in the manufacturing, oil and gas and agriculture sectors to reduce debt exposure and some scheduled principal loan repayments. Meanwhile, the private sector recorded a net drawdown of RM4.3 billion (2Q: -RM1.1 billion), reflecting higher drawdown of external loans while repayment declined. The drawdown of loans by the private sector was effected largely by companies in the manufacturing, transportation and non-bank financial sectors.

The total **short-term external debt** increased to RM56.2 billion or USD16.3 billion (2Q: RM47.9 billion), attributed largely to higher borrowings by the banking sector due to treasury operation. As at end-September 2007, the short-term external debt accounted for 29.7% of total external debt and is 16.8% of the net international reserves.

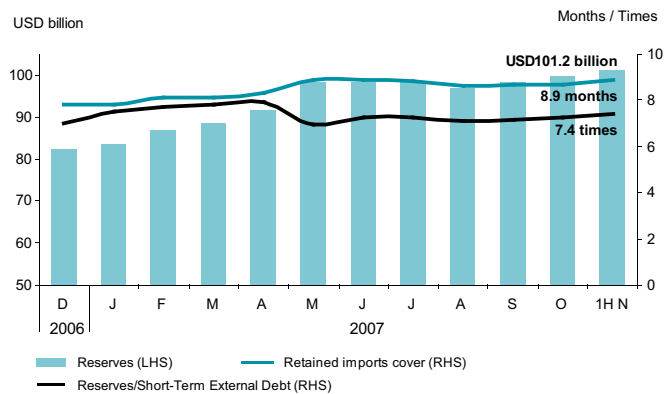
International reserves

The international reserves of Bank Negara Malaysia amounted to RM335.4 billion (equivalent to USD98.2 billion) as at 28 September 2007. The reserves level as at 28 September 2007 has taken into account the quarterly revaluation gain, following the strengthening of the major currencies against ringgit during the third quarter. The reserves increased to RM345.3 billion (equivalent to USD101.2 billion) as at 15 November 2007. The reserves position is sufficient to finance 8.9 months of retained imports and is 7.4 times the short-term external debt.

External Debt Outstanding



Net International Reserves (as at end period)



MONETARY AND FINANCIAL DEVELOPMENTS

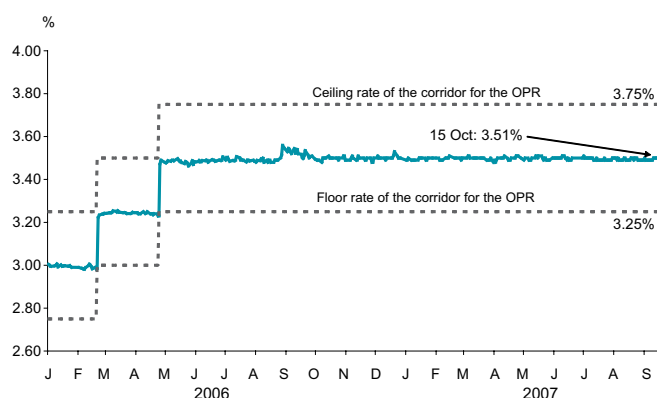
Average lending rate lower

The OPR was left unchanged at 3.50% throughout the third quarter of 2007 as the level of the policy rate was consistent with the medium term outlook of relatively low inflation and sustained economic growth.

Reflecting the unchanged OPR, the average overnight interbank rate was steady, moving within a tight range of 3.48% to 3.51% during the period 1 July – 15 October. Despite the heightened volatilities and uncertainty in global financial markets, interbank rates for other maturities also remained relatively stable, as Bank Negara Malaysia's operations contributed to stabilising the level of liquidity in the interbank market.

In terms of lending rates, the average base lending rate (BLR) of commercial banks (CBs) was unchanged at 6.72%. The average lending rate (ALR), was considerably lower at 6.30% as at end-September, compared with 6.49% at end-June, largely reflecting the disbursement of lower priced syndicated bridging loans. The average quoted fixed deposit (FD) rates of CBs for tenures between 1 and 12 month on the other hand were relatively unchanged, ranging between 3.08% and 3.70% at the end of the third quarter (2Q: 3.09% to 3.71%).

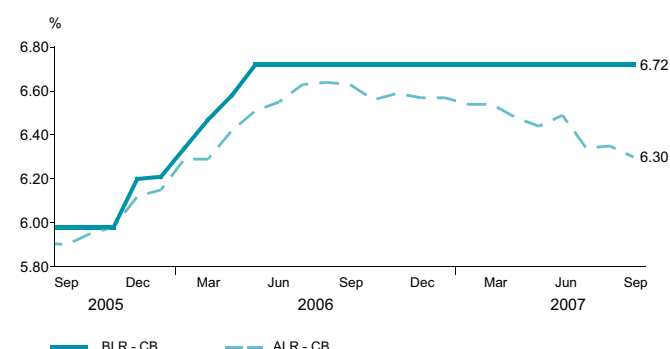
Daily Weighted Average Overnight Interbank Rate



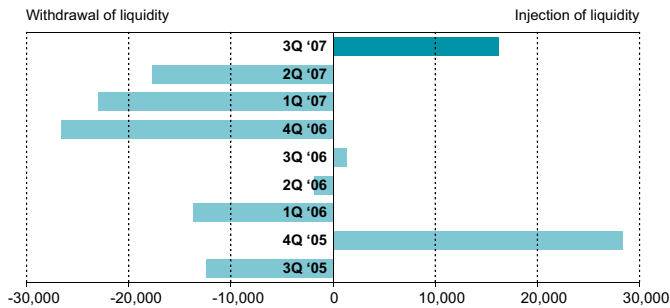
Interest Rates

	2007		
	1Q	2Q	3Q
	At end-period (%)		
Overnight Policy Rate (OPR)	3.50	3.50	3.50
Interbank rates			
Overnight	3.50	3.50	3.50
1-month	3.55	3.54	3.54
Base lending rates (BLR)			
Commercial banks	6.72	6.72	6.72
Average lending rates (ALR)			
Commercial banks	6.54	6.49	6.30
Fixed deposit rates			
Commercial banks			
3-month	3.18	3.17	3.15
12-month	3.71	3.71	3.70

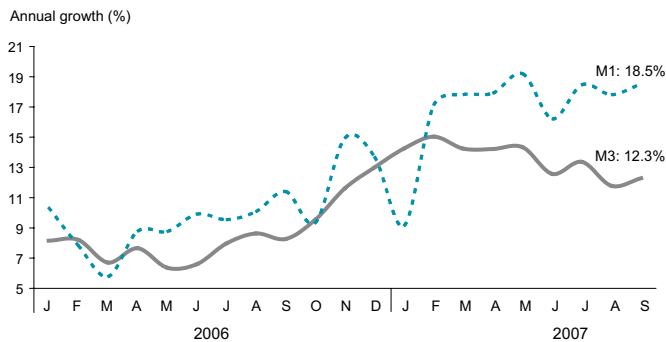
Lending Rates of Commercial Banks
(Average for the period)



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



Monetary Aggregates



Determinants of Broad Money, M3

	Change during the period				
	2006		2007		
	3Q	4Q	1Q	2Q	3Q
M3	15.7	44.0	28.9	-0.6	15.6
Net claims on Government	-2.3	19.9	1.0	-20.7	10.6
Claims on private sector	6.5	7.9	5.2	16.1	32.9
Loans	9.1	8.2	8.1	12.8	30.6
Securities	-2.6	-0.3	-2.9	3.2	2.3
Net external operations ¹	11.9	22.7	37.3	40.2	-21.2
BNM	2.0	5.2	19.9	31.5	-7.6
Banking system	9.9	17.4	17.5	8.7	-13.5
Other influences	-0.3	-6.4	-14.7	-36.1	-6.7

¹ Pre-revaluation

Source: Bank Negara Malaysia

Sustained growth in M3

M1, or narrow money, a measure of transaction balances, expanded at a stronger annual rate of 18.5% (2Q: 16.2%) due to stronger growth of both currency in circulation and demand deposits.

M3, or broad money, increased at an annual rate of 12.3% at the end of the third quarter (2Q: 12.6%). The expansion in M3 was driven mainly by higher claims on the private sector, on account of an expansion in bank credit and the holdings of private debt securities by the banking system. The effect of Government operations also contributed to the expansion in M3. During the quarter, the Government incurred higher development and operating expenditure, the latter arising from the salary increase of civil servants. These were funded by withdrawals from deposits with BNM, as well as issuance of securities, which in part were subscribed by the banking institutions.

In contrast to the previous quarters, net external operations were contractionary, following the decline in net foreign assets of both Bank Negara Malaysia and the banking system, amid outflows from the financial markets.

Increase in financing in the third quarter

Gross financing of the private sector by the banking system and capital market was higher in the third quarter, amounting to RM169.1 billion (2Q: RM155.7 billion). The increase in financing was mainly due to significantly higher loan disbursements arising from drawdown of funds from one large syndicated bridging loan facility, particularly in the month of July. There was a net redemption in the private debt securities (PDS) market during the quarter following maturity of bonds in the transport, storage and communication sector. On a net basis, banking system loans and PDS outstanding expanded at a higher combined annual rate of 8.9% at end-September (end 2Q: 6.8%).

Loan applications and approvals for the business sector in the third quarter remained at high levels. Loan disbursements increased markedly during the period, even after excluding the drawdown of the large bridging loan facility. Disbursements were broad-based, with funds channeled to the manufacturing, wholesales and retail trade, as well as agriculture sectors. Loan disbursements to SMEs have also registered sustained improvement. Of the total loans disbursed, 23% were directed to the SMEs.

Financing of the Private Sector through Banking System and Capital Market

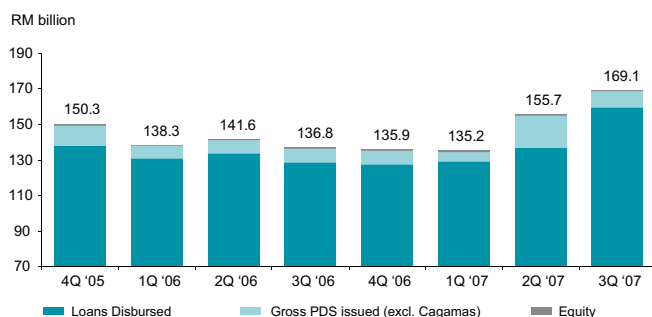
	During the period (RM billion)				Annual growth (%)		
	2006	3Q 06	2Q 07	3Q 07 ^p	2006	2Q 07	3Q 07 ^p
Gross total financing	552.6	136.8	155.7	169.1	-2.3	10.0	23.6
Loans disbursed*	519.9	128.3	136.7	159.3	-1.6	2.5	24.1
Gross PDS (excl. Cagamas)	30.7	7.9	18.5	9.5	-0.1	136.1	19.5
Equity	1.9	0.5	0.5	0.4	-69.7	33.4	-26.0
Outstanding total financing (A)+(B)	45.5	11.6	22.7	28.5	6.2	6.8	8.9
Banking system	48.1	9.6	16.5	31.4	8.1	7.3	10.7
Loans outstanding (A)	34.9	9.6	12.5	30.9	6.3	6.0	9.5
Holding of PDS	13.1	0.0	4.0	0.4	37.3	26.2	27.2
PDS outstanding (B)	10.5	2.0	10.3	-2.4	6.0	9.4	6.9
Memorandum item							
Gross PDS (incl. Cagamas)	38.2	9.2	21.0	11.9	1.8	94.5	28.8

^p Preliminary

* Banking system loans include loans sold to Cagamas

In the households sector, overall higher loan applications and approvals in the third quarter were largely for the financing of residential property and consumption credit, with the latter being largely for the purchase of passenger cars. Improved car sales during the second half of 2007, amid the launches of new models by car manufacturers, contributed to the steady increase in loans for the purchase of passenger cars. Disbursements to the household sector were also higher, mainly through credit cards loans, as well as loans for the purchase of residential property and passenger cars.

Gross Private Sector Financing through Banking System and Capital Market



Total loans outstanding rose by 9.5% on an annual basis at the end of the third quarter (end-2Q: 6%), with loans outstanding to businesses and households expanding at annual growth rates of 14.8% and 7.3% respectively (end-2Q: 6% and 7.2% respectively).

Loan Indicators

	During the period (RM billion)				Annual Growth %			
	2006	3Q 06	2Q 07	3Q 07 ^p	2006	3Q 06	2Q 07	3Q 07 ^p
Total								
Loan applications ⁿ	300.8	79.3	119.5	123.2	-1.5	-5.5	57.2	55.4
Loan approvals ⁿ	188.3	47.0	83.2	74.4	-2.0	-13.5	75.0	58.3
Loan disbursements ⁿ	519.9	128.3	136.7	159.3	-1.6	-4.8	2.5	24.1
Loan repayments ⁿ	478.2	117.7	123.0	123.6	-2.1	-3.1	2.6	5.0
Change in loan outstanding*	34.9	9.6	12.5	30.9	6.3	7.5	6.0	9.5
Of which:								
Business enterprises**								
Loan applications ⁿ	161.0	42.5	72.1	68.3	4.8	0.9	75.5	60.5
Loan approvals ⁿ	96.3	22.9	53.9	41.1	8.7	-12.0	125.4	79.1
Loan disbursements ⁿ	369.8	91.4	96.4	113.9	-1.2	-3.5	1.9	24.6
Loan repayments ⁿ	351.7	86.5	87.4	86.1	-3.9	-4.8	-2.6	-0.5
Change in loan outstanding*	11.3	2.9	6.5	23.8	5.0	4.4	6.0	14.8
SMEs**								
Loan applications ⁿ	71.4	19.5	23.9	28.7	20.0	12.8	26.4	47.0
Loan approvals ⁿ	40.2	10.4	14.3	16.2	14.9	6.0	42.4	55.6
Loan disbursements ⁿ	134.1	34.2	34.9	36.0	21.2	20.4	-5.5	5.3
Change in loan outstanding*	8.7	0.8	1.6	2.9	9.1	10.7	5.0	7.0
Large corporations								
Loan applications ⁿ	89.6	23.0	48.2	39.5	-4.7	-7.4	117.4	71.9
Loan approvals ⁿ	56.1	12.5	39.5	24.8	4.7	-22.9	185.7	98.8
Loan disbursements ⁿ	235.6	57.2	61.5	77.9	-10.7	-13.8	6.7	36.1
Change in loan outstanding*	2.6	2.0	4.9	20.9	2.0	-0.1	6.8	21.0
Households								
Loan applications ⁿ	139.8	36.7	47.4	54.9	-7.9	-12.1	35.7	49.5
Loan approvals ⁿ	92.0	24.1	29.3	33.3	-11.2	-15.0	24.0	38.4
Loan disbursements ⁿ	150.2	36.9	40.3	45.4	-2.6	-7.8	4.0	22.9
Loan repayments ⁿ	126.6	31.2	35.6	37.5	3.2	2.0	18.1	20.1
Change in loan outstanding*	26.6	7.5	5.2	8.6	8.7	10.7	7.2	7.3

* The annual growth is for end-period

** Include loans to individual businesses

ⁿ Numbers may not add up due to rounding

^p Preliminary. Data is subject to revision, arising from changes in the classification of loan indicators by economic sectors and purpose

Source: Bank Negara Malaysia

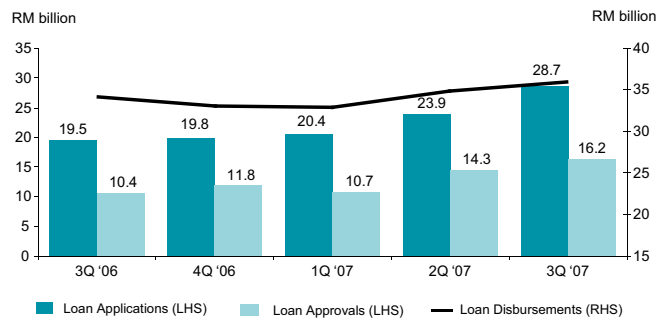
Loans by Sector

	Loans disbursed				Loans out-standing	
	During the period			Share of total	Share of total	
	2006	3Q 06	2Q 07	3Q 07		
	RM billion			%		
Business enterprises	369.8	91.4	96.4	113.9	71.5	42.1
<i>Large corporations</i>	235.6	57.2	61.5	77.9	48.9	24.7
<i>SMEs*</i>	134.1	34.2	34.9	36.0	22.6	17.3
Households	150.2	36.9	40.3	45.4	28.5	54.1
Selected sectors						
Agriculture, hunting, forestry and fishing	13.9	3.6	3.3	4.1	2.6	2.2
Mining and quarrying	2.0	0.5	0.6	0.4	0.3	0.2
Manufacturing	118.9	31.2	32.7	34.7	21.8	11.3
Construction	30.5	7.7	8.4	8.3	5.2	4.9
Real estates	10.5	2.4	3.0	3.2	2.0	2.9
Electricity, gas and water supply	2.9	0.4	0.3	0.3	0.2	0.6
Wholesale, retail, restaurants and hotels	90.7	22.7	21.7	23.8	15.0	8.6
Transport, storage and communication	10.3	2.3	4.4	19.6	12.3	4.9
Finance, insurance and business services	42.1	11.0	13.5	10.0	6.3	5.7
Consumption credit	100.4	25.4	25.1	29.5	18.5	23.1
<i>Of which:</i>						
<i>Credit cards</i>	48.9	12.7	13.1	14.7	9.2	3.3
<i>Purchase of passenger cars</i>	32.9	8.5	7.5	9.1	5.7	15.7
Total	519.9	128.3	136.7	159.3	100.0	100.0

* Include loans to individual businesses.

Source: Bank Negara Malaysia

Bank Lending to SMEs



Fund raising activity in the capital market remained strong

During the third quarter, fund raising activity in the capital market remained strong. Total net funds raised from both public and private sector amounted to RM12 billion. However, this amount is lower compared to the RM22 billion raised in the previous quarter which was significantly higher due to a large PDS issuance for a merger and acquisition (M&A) activity.

The public sector recorded total gross funds raised of RM13.4 billion through four issuances of government securities. This included an issuance of 5-year Government Investment Issues (GII) and three re-openings of 3-year, 10-year and 20-year Malaysian Government Securities (MGS). As redemptions during the quarter were negligible, the net funds raised by the public sector amounted to RM13.4 billion (2Q: RM10.7 billion).

In the private sector, at RM11.9 billion, gross funds raised from the PDS market were lower compared to the previous quarter (2Q: RM21 billion). The bulk of the funds raised was mainly for new activities, primarily in the telecommunication and transport sub-sectors. On a net basis, funds raised through the PDS market, excluding Cagamas, amounted to RM0.6 billion (2Q: RM12.4 billion).

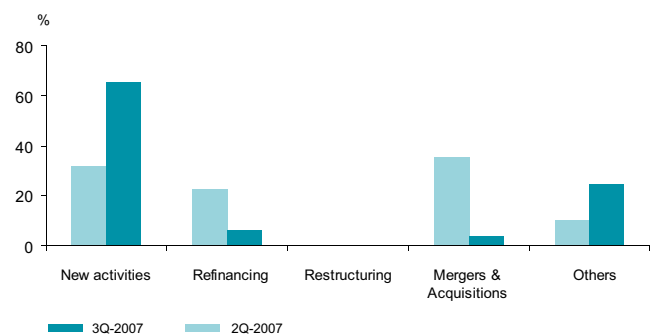
Funds raised through the equity market were lower during the third quarter. A total of RM383 million (2Q: RM512 million) was raised through four initial public offerings (IPOs); three on the main board and one on the Second Board.

Funds Raised in the Capital Market

	2005	2006		2007		
	Year	2Q	3Q	Year	2Q	3Q
RM million						
By Public Sector						
Government Securities, gross	28,276	5,741	9,324	26,830	9,107	9,924
Less Redemptions	15,800	1,300	8,200	12,850	-	-
Less Government holdings	-	-	-	-	-	-
<i>Equals</i> Net Federal receipts	12,476	4,441	1,124	13,980	9,107	9,924
Khazanah Bonds, net	833	-	-	(630)	524	-
Govt. Investment Issues, net	1,000	3,500	3,000	9,500	1,400	3,500
Merdeka Savings Bond, net	1,516	(502)	(495)	(1,931)	(375)	(386)
Net Funds Raised	15,825	7,438	3,629	20,919	10,656	13,038
By Private Sector						
Shares	6,315	384	518	1,916	512	383
Debt securities	38,196	10,784	9,233	38,887	20,971	11,891
<i>Private Debt Securities (PDS)</i>	35,656	8,819	7,933	31,737	20,571	11,891
Cagamas	2,540	1,965	1,300	7,150	400	-
Less Redemptions	18,617	7,684	9,590	31,519	10,038	13,702
Net Issues	19,579	3,099	(356)	7,368	10,934	(1,811)
<i>Net issues (excluding Cagamas)</i>	22,224	3,314	2,404	11,120	12,379	589
Net Funds Raised	25,894	3,484	161	9,284	11,446	(1,428)
Total Net Funds Raised	41,719	10,922	3,790	30,203	22,102	11,610
Short-term Papers and Notes, net ¹	1,579	1,175	(577)	2,563	1,164	(880)
Total	43,297	12,097	3,213	32,766	23,266	10,730

¹ Refers to Commercial Papers and Cagamas Notes only

Private Debt Securities Issued by Purpose (% of total)

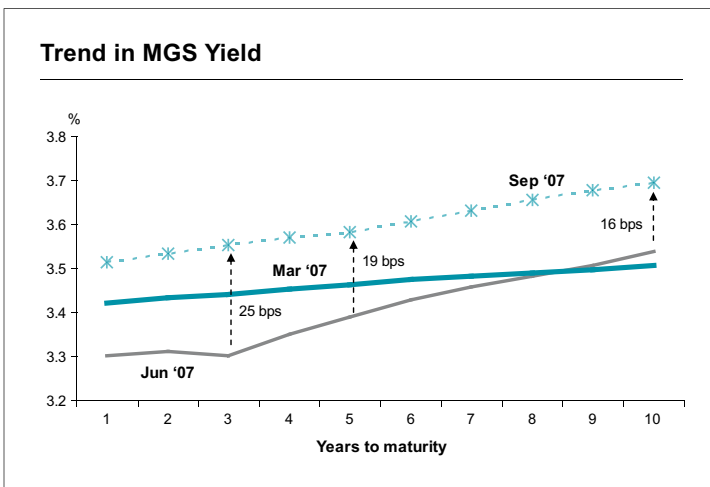
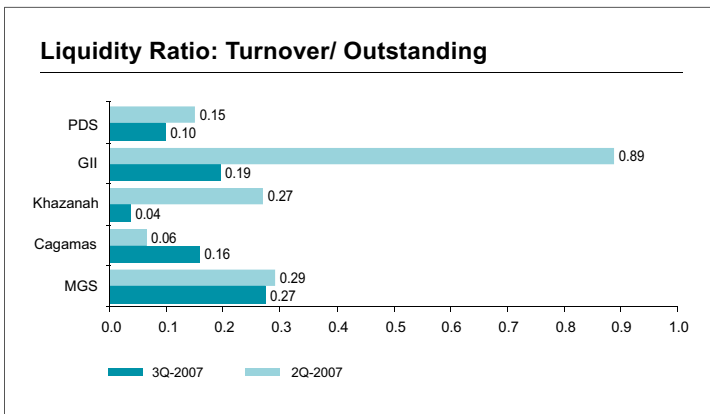


Secondary trading in the bond market

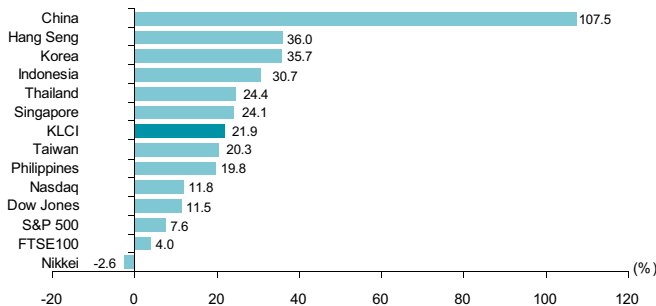
Total trading in the secondary market declined to RM81.3 billion in the third quarter (2Q: RM110.6 billion). The bulk of the total trade came from government securities (MGS and GII), accounting for 73% of the total trade, followed by private debt securities, which accounted for 24% of total trade. In terms of liquidity, the MGS was the most liquid paper, registering a liquidity ratio of 0.28, followed by the GII with a liquidity ratio of 0.21.

MGS yields rose between 16 – 25 bps across all maturities during the quarter under review. MGS yields were relatively unchanged despite the uncertainties in the subprime debt market in August. However as risk aversion among investors and volatility in financial markets escalated, MGS yields rose as investors began to reduce their exposure to emerging market securities which were

perceived to be riskier. Following the U.S. Federal Open Market Committee's (FOMC) decision to reduce the discount rate by 50 bps to 5.75% on 17 August, MGS yields began to decline. Nevertheless, the MGS yields did not decline to the levels seen prior to August. By the end of the quarter, yields across all maturities up to the 10-year MGS ended higher than during the previous quarter with the shorter-end maturity yields increasing the most.



Performance of Selected Global and Regional Markets (29 Dec 2006 - 28 Sep 2007)



Equity market rebounded after the correction in August

In the third quarter of 2007, the KLCI underwent a market correction in line with the correction in global equity markets caused by the turmoil in the US subprime debt market. After hitting a low of 1,191.6 on 17 August, the KLCI began to recover as strong domestic market fundamentals remained intact. Concerns that the US subprime

Bursa Malaysia: Turnover of Corporate Securities

	2006				2007					
	3Q		4Q		1Q		2Q		3Q	
	million units	RM million	million units	RM million	million units	RM million	million units	RM million	million units	RM million
Turnover	37,040	49,741	57,015	78,257	118,982	156,614	89,043	142,815	80,066	132,416
Of which:										
Main Board	22,422	40,720	36,338	66,458	87,148	137,851	61,619	126,501	58,242	121,284
Of which										
Consumer Products	660	2,200	977	2,665	1,796	4,695	2,020	5,100	1,685	4,724
Industrial Products	3,410	3,787	4,474	5,395	8,771	11,725	7,773	11,188	6,916	11,293
Construction	1,596	2,626	2,787	5,262	7,469	16,864	5,080	12,854	6,074	15,664
Trading/Services	5,958	15,148	10,465	26,467	20,181	44,458	16,266	43,912	16,822	41,543
Finance	2,475	7,291	3,689	12,719	8,846	28,428	5,530	21,567	4,188	19,253
Properties	4,084	2,331	5,742	3,681	16,381	11,369	12,125	13,312	12,690	13,251
Plantations	1,078	4,848	1,004	5,516	1,341	8,318	2,064	10,835	1,595	7,154
Infrastructure	469	1,146	1,196	2,512	1,539	3,231	943	2,347	2,205	4,355
Second Board	3,853	2,758	5,432	4,023	8,527	4,955	11,000	7,885	6,496	4,864
Mesdaq	10,352	6,085	10,735	4,981	17,050	8,386	9,704	6,083	8,499	4,910

Source: Bursa Malaysia

Bursa Malaysia: Selected Market Indicators

	As at end				
	2006		2007		
	3Q	4Q	1Q	2Q	3Q
Price Indices					
Composite	967.6	1,096.2	1,246.9	1,354.4	1,336.3
FBM30 ¹	6,260.4	7,059.9	7,924.6	8,587.9	8,413.5
FBMEMAS ²	6,270.7	7,169.6	8,332.8	9,107.9	8,997.5
Second Board	83.2	92.0	99.3	110.7	105.8
Mesdaq	108.1	119.9	138.5	137.7	122.9
Average daily turnover					
Volume (million units)	573.9	934.7	1,983.0	1,436.2	1,251.0
Value (RM million)	782.0	1,282.9	2,610.2	2,303.5	2,069.0
Market capitalisation (RM billion)	745.5	848.7	985.1	1,088.3	1,031.3
No. of companies listed	1,027	1,027	1,023	1,012	1,001

¹ FBM30 stands for FTSE Bursa Malaysia 30 Index

² FBMEMAS stands for FTSE Bursa Malaysia Emas Index

Source: Bursa Malaysia

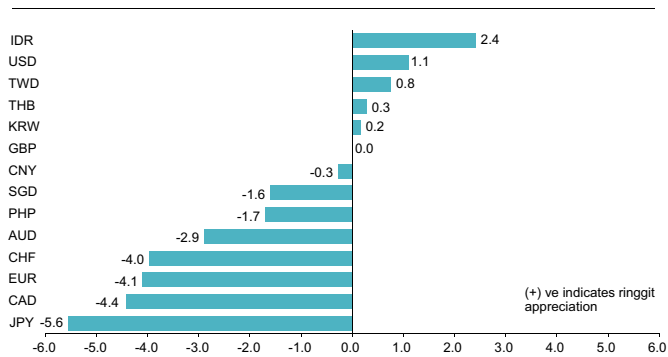
mortgage default turmoil could spread to the broader economy had prompted the Federal Reserve to loosen its monetary policy stance on 18 September. Regional markets responded positively with the KLCI recovering, supported by the strong performances of the plantation, construction and property sectors. Nonetheless, during the quarter under review, the KLCI declined 1.3% and ended the quarter at 1,336.3 points (2Q: 1,354.4). Market capitalisation was lower at RM1,031.3 billion (2Q: RM1,088.3 billion). Trading activity decreased with an average daily turnover of 959.3 million units (2Q: 1,427.8 million units).

On 8 November 2007, the KLCI reached a record high of 1,413.9 points. As at 27 November 2007, the KLCI closed at 1,365 points (since end-2006: 24.5%), with market capitalisation higher at RM1,052.2 billion (since end-2006: 24%).

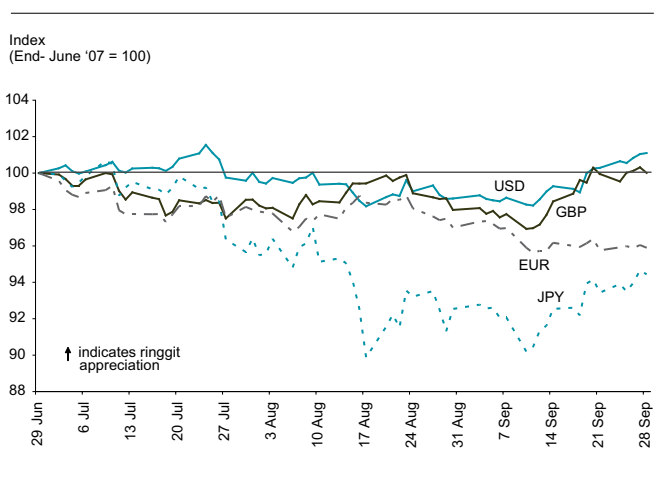
Exchange Rate Developments

In the light of the turmoil in the major financial markets arising from changing investor sentiments regarding losses related to the US subprime mortgages, most currencies, including the ringgit, experienced greater volatility during the quarter. At the beginning of July, the ringgit was on an appreciating trend amid trade and investment inflows. Since 25 July, however, the ringgit had depreciated against the major currencies following reversals by global investors out of debts and equities triggered by the international financial market turmoil during this period. Regional currencies were similarly affected by the reassessment of risks associated with emerging market assets by global investors. However, this trend reversed in the ringgit and other regional currencies following the reduction in the US discount rate on 17 August by the Federal Open Market Committee (FOMC), and the subsequent reduction in the Fed Funds rate and the discount rate by 50 basis points each on 18 September. The interest rate cuts and market expectations of further interest rate reductions by the Fed restored some degree of investor confidence. For the quarter as a whole, the ringgit strengthened against the US dollar by 1.1%. Against other major currencies, the ringgit declined by 5.6% and 4.1% against the Japanese yen and the euro respectively, and recorded an appreciation against the British pound. The ringgit exhibited a mixed performance against

Summary of Ringgit Performance Against Selected Currencies Percent Change (1 July - 30 September 2007)



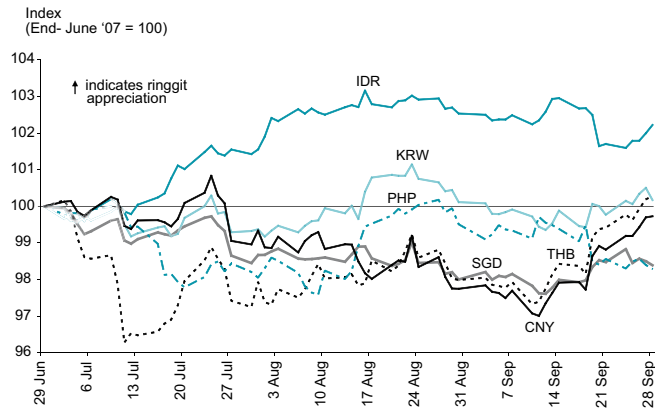
Ringgit Performance Against Major Currencies



regional currencies, appreciating against most currencies in the range of 0.2% to 2.4 %, but depreciating against the Singapore dollar (1.6%) and the Philippine peso (1.7%).

For the period 1 October – 27 November, the ringgit appreciated against the US dollar (1.4%) but depreciated against the Japanese yen (4.5%), the euro (3.4%), and the British pound (1%). Against regional currencies, the ringgit appreciated against the Indonesian rupiah (4%), Korean won (3%) and Thai baht (0.2%), but depreciated against the Philippine peso (3.5%) and the Singapore dollar (2%).

Ringgit Performance Against Regional Currencies



Performance of Ringgit Against Selected Currencies

RM per foreign currency	As at end				% change since*		
	21 Jul 05	3Q 06	2Q 07	3Q 07	21 Jul 05	3Q 06	2Q 07
US dollar	3.8000	3.6845	3.4545	3.4170	11.2	7.8	1.1
Euro	4.6212	4.6821	4.6425	4.8410	-4.5	-3.3	-4.1
Pound sterling	6.6270	6.9171	6.9171	6.9167	-4.2	0.0	0.0
100 Japanese yen	3.3745	3.1279	2.8000	2.9649	13.8	5.5	-5.6
Singapore dollar	2.2570	2.3221	2.2547	2.2916	-1.5	1.3	-1.6
100 Thai baht	9.0681	9.8109	10.000	9.9723	-9.1	-1.6	0.3
100 Philippine peso	6.8131	7.3477	7.4692	7.5992	-10.3	-3.3	-1.7
100 Indonesian rupiah	0.0386	0.0399	0.0382	0.0373	3.5	7.0	2.4
100 Korean won	0.3665	0.3901	0.3732	0.3726	-1.6	4.7	0.2
Chinese renminbi	0.4591	0.4660	0.4535	0.4548	0.9	2.5	-0.3

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

DEVELOPMENTS IN THE BANKING SECTOR

The banking system continued to demonstrate a high resilience in the third quarter of 2007, supported by strong capitalisation, stable profitability and further improvements in loan quality.

Capitalisation level remained strong

The banking system remained well-capitalised with the risk-weighted capital ratio (RWCR) sustained at 13.1% throughout the quarter. RWCR declined slightly as at end September 2007, mainly due to redemptions of Tier II capital, the distribution of profits by banks, and the growth in lending activities which attributed to an increase in risk-weighted assets.

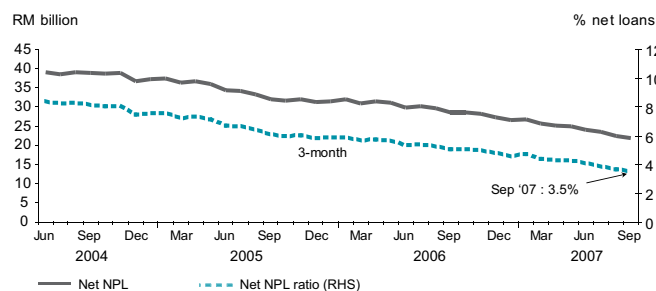
Banking System: Capital Position

	2006		2007		
	3Q	4Q	1Q	2Q	3Q
Capital					
CCR (%)	10.5	10.7	10.4	10.7	10.2
RWCR (%)	13.3	13.5	13.1	13.9	13.1

Profitability remained stable

Profitability of the banking sector remained stable with pre-tax profit remaining steady at RM4.28 billion (2Q: RM4.32 billion). Income arising from interest-related activities improved marginally by RM0.1 billion (1%) while net trading gains recorded an increase

Banking System: Non-performing Loans



of RM0.2 billion (40.5%). These were largely offset by a small decline in fee-based income (-RM0.08 billion or -4.2%). Accordingly, annualised return on average assets and equity remained strong at 1.5% and 18.7% (2Q: 1.4% and 18.6%) respectively.

NPLs continued to improve

The level of non-performing loans (NPLs) continued to improve with the total net NPLs based on the 3-month classification declining by 8.6% to RM21.9 billion (2Q: RM24 billion) as at end of the quarter. The improvement was attributed primarily to higher recoveries (+51.6%) and reclassifications of NPLs to performing status (+47.1%) as well as continued write-offs (+40%) which resulted in lower loan loss provisions (-3.4% to RM3.2 billion). Given the continuous improvement in loan quality, the net NPL ratio declined further to 3.5% of net total loans (2Q: 4.1%).

The 11th Malaysian Banking Summit - “The Malaysian Banking Industry Reinvention and Transformation” 19 July 2007, Kuala Lumpur

Keynote Address by

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

In this recent decade, the Malaysian banking sector has been significantly transformed and reinvented. The restructuring, consolidation and rationalisation efforts that were undertaken in the banking sector have placed the financial sector on a stronger foundation. This decade has also been a period of favourable performance and increased resilience. This has been achieved with the successful integration of business processes and the redeployment of resources to support new areas of growth. Financial reforms have also changed the environment. Progressive deregulation and liberalisation have increased the flexibility to financial institutions, while also resulting in new business opportunities and increased competition. These developments have also further strengthened the incentives for improved performance. Significant structural changes during this period have also reshaped the landscape. The introduction of capital market intermediaries, investment banks, an increasing presence of new international players in Islamic finance, and a significantly more developed bond market, has resulted in a significantly more diversified financial system.

The resulting payoffs for the financial system, and the economy generally, have clearly been positive. Today, the financial sector has evolved from being an enabler of growth to become an important source of growth in its own right. The sector, in the banking and insurance industries, now provides employment to more than 123,000 Malaysians. Despite conditions that have remained challenging for a large part of the decade, the banking system remained consistently on solid financial ground with a risk-weighted capital ratio of over 13%, low NPL ratios, and continued profitability for

eight consecutive years. Substantial progress has been made towards consumer retail finance and access to banking services. Such consumer lending has increased from RM134 billion in 2000 to RM343 billion in 2007 while loans disbursed to small and medium enterprises have increased from RM71 billion to RM108 billion over the same period. Domestic banking institutions are also building on their strong domestic performance to expand beyond Malaysian borders. Today, six domestic banks have presence in 10 countries around the region.

The current encouraging state of the banking system, however, should not make us complacent on the need to continually transform and reinvent. The road in front of us is likely to be significantly different from the one we have traveled on. As our previous experience has shown, we need to constantly recognize that strategies that serve well in today’s environment would not necessarily be a formula for success in tomorrow’s environment.

In looking at the future terrain of the financial sector in Malaysia, six trends are particularly important - **first**, the changing configuration of the global economy and global financial markets; **second**, regional economic and financial integration; **third**, financial sector development amidst increased liberalisation in the Asian region; **fourth**, increased role of domestic demand in the Asian economies; **fifth**, growing significance of Islamic finance in the international financial system; and **finally**, developments in the regulatory structures and approaches. It can be expected that all these trends will have a significant bearing on the future of the banking industry.

First, the global economic configuration has been altered by the emergence of several large emerging economies into the global economy. This is especially evident in Asia, where the rise of China, India and the South East Asian economies have increased Asia's global role. As a result, Asia today features four of the world's twelve largest economies and several of the fastest-growing economies. Collectively as a region, Asia contributes about 40% of global output and one-fourth of world trade. The region is also a significant net exporter of capital, holding two-thirds of the world's foreign exchange reserves and is the largest holder of the developed economies' sovereign bonds. One-quarter of Fortune's top 500 global companies are Asian corporations. This opens up tremendous business opportunities for Malaysia as a part of this dynamic growth region.

Accompanying these changes has been the prevalence of abundant liquidity in the global financial markets, resulting in an intensified search for higher yields. These trends are encouraging flows into the capital markets of emerging economies, presenting new opportunities for wholesale banking and capital market related financial services. These flows, however, also pose potential risks of reversals in financial market conditions. This increases the need to ensure that we have the capacity to absorb or adjust to changing financial flows.

A **second** significant trend shaping the future financial landscape is the intensification of regional economic and financial integration. Economic integration through trade is already well-advanced in Asia, with the share of intra-regional trade already more than half of the total trade in Asia. More recently, however, greater financial integration at the regional level has been an important development, bringing complementary and mutually-reinforcing benefits to the economies in the region. Intra-regional investments among the Asian economies have increased with an accompanying rise in cross-border financing activities. There has already been an increase in cross-border mergers and acquisition activity among Asian financial institutions in

order to reap emerging opportunities. The transformation in the financial landscape in the current environment has not been confined to the Asian region but has also involved growing ties with other emerging regions. Of significance is the rising trend of trade and financial linkages between Asia and the Middle East and other parts of the world. Malaysian banks now have the capacity to take advantage of these trends.

The trends towards regional financial integration also present significant opportunities to tap into the enlarged pool of savings in Asia. Besides institutional pools of wealth, the rapidly expanding middle class has been a key factor sustaining the high savings rate. In Asia alone, we now have more than 2.6 million high net worth individuals who collectively control an estimated USD8.4 trillion in financial assets. These trends underpin the increasing demand for more sophisticated consumer finance and wealth management products. There is also potential to tap the appetite for growing international diversification among the more developed economies in Asia, to meet the rising demand for regional financial assets. Furthermore, the continued growth momentum in the region has created demand for infrastructure. It is estimated that Asia needs USD 1 trillion worth of infrastructure investment over the next 5 years, offering huge potential for financing opportunities.

Third, reinforcing the move towards regional financial integration, authorities across the region have encouraged greater financial sector development and progressively liberalised their capital accounts. Many regional countries are moving beyond financial restructuring to promote more diversified and vibrant financial systems that embrace a broad range of service providers and asset classes, including private equity, hedge funds, structured products and Islamic finance.

In Malaysia, the gradual but progressive liberalization of foreign exchange administration rules undertaken since 2003 has led to significant benefits in terms of

providing enhanced flexibility of the financial sector, contributing to reducing the cost of doing business as well as expanding the scope of activities of the financial sector. In April this year, several liberalization measures were implemented to further increase international investors' participation in the Malaysian capital market, provide greater flexibility for resident investors to diversify into non-ringgit investments in Malaysia and overseas, and to facilitate the expansion of the domestic banks' foreign currency business.

Fourth, the trend for the growing significance of domestic demand has also become more pronounced and is expected to continue going forward. Supported by rising incomes, firm labour market conditions and a young demographic profile, private consumption activity has moved towards income-sensitive goods and lifestyle services for which the retail banking sector should be well-positioned to offer a wider range of innovative products and services to meet the requirements of increasingly more sophisticated consumers.

The change in demographic structure of the population will also have an indirect impact on the domestic financial landscape. While Malaysia's population is still relatively young, an increasing segment of the population is in the group aged 64 and above. This development will have implications for human capital, business and product strategies of banking institutions in terms of savings behaviour and demand for different types of products.

Fifth, a new area of growing significance in the international financial system is Islamic Finance as a viable and competitive form of financial intermediation. The Malaysia International Islamic Financial Centre, or MIFC, initiative, launched in August 2006, has taken Malaysia's liberalisation strategies to a new level with the aim of positioning Malaysia strategically in this new growth area. Islamic banking institutions are allowed to undertake a broader array of Islamic financial activities that include commercial banking,

consumer banking, investment banking as well as international currency business under the MIFC initiative. Financial institutions need to consider their own competitive positioning in this area and to have the appropriate strategies to participate in this dynamic growth sector.

Finally, the regulatory and supervisory paradigm will also continue to evolve. Indeed, we have over the recent decade witnessed significant global shifts in the approaches to regulation and supervision across many countries. These have ranged from radical policy responses in some countries that led to the introduction of costly regulatory systems to address the problems that have emerged, to bold deregulatory measures pursued in other countries, especially during times of exuberance and strong market conditions. A convergence towards the middle ground between these two extremes now seems to be emerging.

Two dimensions of regulatory change will be relevant to the context of the new environment. First, the emphasis on creating a strong risk management culture that is fundamental to sound banking operations will become significantly more pronounced. The transition to Basel II and the implementation of the risk-based supervisory regime are important elements of this change.

Second, regulations will continue to focus more on facilitating market-led adjustments that will allow the industry to evolve in response to market developments, while maintaining a sufficient degree of regulatory oversight to maintain financial stability and public confidence. This includes the adoption of principles-based regulations and an increased focus on harnessing market forces and discipline, as well as internal oversight functions, to reinforce prudential regulation and supervision. The aim is to promote a more efficient and responsive financial system.

In this connection, Bank Negara will soon introduce a more facilitative process for product innovations with revisions to the new

product approval framework. The changes are aimed at improving time to market for the introduction of new products by financial institutions, while ensuring that institutions put in place a sound product management programme within their respective institutions. The new framework will provide for more simplified regulatory processes and allow greater flexibility for well-managed banks and insurers to introduce new products more quickly in the market. Qualifying banks and insurers are expected to exercise this flexibility responsibly and in particular, with due regard to the interests of consumers.

The realignment of the regulatory and supervisory structures within the Central Bank in November 2006 has marked a significant turning point in consolidating these regulatory changes. As a result of the realignment, the Bank is better positioned to conduct effective surveillance of the financial system; to address regulatory overlaps and duplication within the system; to deal more strategically with the weight of multiple objectives and range of issues confronting the financial system, and more importantly, to preserve regulatory neutrality in the management of similar risks between different financial service providers.

These emerging trends in the international and regional environment will have an important bearing on the changing climate shaping the banking sector. While it brings new opportunities, it will also bring challenges. Let me return to the theme of this summit - the continued reinvention and transformation that needs to be considered for the industry going forward. I would like to focus on three main areas.

The **first** concerns human capital development. This is vitally important for the future development and growth of the financial sector. Going forward into the future this will become the pivotal factor determining the capacity to reinvent and transform. Financial institutions have two broad options. One would be to 'buy talent'. This remains a viable option as long as productivity growth

remains aligned with wage increases. Banks, however, need to be wary of bidding up wages without commensurate efficiency improvements or increases in value-add. This would not be sustainable and given the prevailing competitive market conditions, such a strategy will eventually erode the banks' competitiveness resulting from the additional costs.

The other option is to 'build talent'. This can be achieved through strategic partnerships with training providers, actively contributing towards industry-wide efforts to support the training agenda and continuous improvements to internal learning programmes.

This is also the option that is by far more challenging, but ultimately the one that provides the optimal payoff for individual institutions, for our financial sector, and the economy. The magnitude of the task, however, demands our collective efforts to secure a sustainable pool of talent that will serve both the present as well as future needs of the industry. The industry also needs to participate in the formal learning programmes by the institutions of higher learning. It is encouraging to note that several have volunteered following the recent dialogue earlier this year organised by Bank Negara Malaysia and the Ministry of Higher Education. By contributing towards positive reforms in the academic curriculum and providing other forms of practical support, the industry is making an important investment in its own future.

To take this effort further forward, Bank Negara Malaysia is initiating an extensive programme to train and prepare at least 1,000 deserving graduates for immediate placements in banking and insurance institutions. This effort will be undertaken in collaboration with the industry and training institutes and is aimed at boosting the supply of well-trained and competent personnel for the financial services industry. The selection process will be rigorous, and the training programme will be designed to produce first

grade candidates for employment at the management trainee level. It is also hoped that foreign financial institutions will draw on their extensive global network to support the programme. I urge the industry to lend its full support to this effort which will ultimately benefit the industry.

Collectively, these efforts will go a long way towards preparing students well for productive careers in the financial services industry and to provide a strong foundation for the development of the future generation of leaders and captains of industry.

The **second** area relates to financial inclusion. Strategies that are aimed towards consumer outreach and promoting financial inclusion will serve to increase access to financial services for all segments of society, promote more balanced growth, while at the same time, providing new sources of revenue for the financial industry. Significant efforts have been taken to strengthen the elements that support financial inclusion. This includes various outreach initiatives, including the consumer education programme, development of small and medium enterprises, increased public accessibility to financial information and greater access to advice and assistance.

Part of this effort is the development of a sustainable and commercially-driven microfinance industry in Malaysia. In Malaysia, there are at least 435,000 micro enterprises, but only 13% rely on financial institutions for funding. Of importance is promoting commercially viable microfinance ventures. In this connection, greater flexibility has been provided for foreign banks to enhance their presence in non-urban areas. Given the objectives of financial inclusion, it is hoped that foreign banks support this initiative given the flexibility that is being accorded to widen the outreach to segments of the economy which are currently underserved. Also embedded within the financial inclusion agenda is the responsibility that banking institutions have towards their customers, and to ensure that adequate information is

provided to consumers and investors to make informed judgments.

In the area of product development, both the interest of consumers and businesses will be taken into account. Financial institutions that demonstrate their ability to act responsibly can look forward to greater business flexibility to innovate. Financial institutions that uphold the necessary principles in their business strategies stand to reap long-term gains from enhanced franchise value, a strong reputation and positive association with socially responsible values that will engender public trust and confidence.

The **third** area relates to the need for banking institutions to enlarge their sphere of influence going forward given the changing environment. Banks will increasingly be exposed to external developments and the forces of market discipline. There are several particular areas in which banking institutions can take strategic positions to influence such developments. First is to leverage on the 'network economy' through strategic alliances. With global integration deepening further at the same time that competitive forces are exerting pressures on margins, the way forward would be to build on strategic alliances to increase capacity and expand reach, while containing costs. Strategic alliances with third parties, including those within and outside Malaysia, provides efficient opportunities to capitalize on the strengths of each partner and in the process promote development, the transfer of skills and improvement of best practices and pave the way for successful cross-border ventures.

The second relates to the area of international standard setting. With the gaining momentum of international standards in such important and pervasive areas such as capital adequacy standards, financial reporting and cross-border activities, it is important for financial institutions to participate more constructively in the standard setting process together with the regulatory community in order for such developments to take into account domestic circumstances and risks.

The third is in the area of ongoing negotiations on trade agreements. Banking institutions need to follow these developments and negotiations closely to consider implications it would have to their organisations and future business strategies.

The last area of influence relates to communication strategies. With increasing market discipline, effective communications has become more critical. Institutions will need to be more active in responding to consumer and business expectations and the building of long term customer relationships in order to be able to implement longer term business strategies. This is a significant challenge which demands deliberate, planned and well-designed communication strategies and resources dedicated for this effort.

Conclusion

This decade has demonstrated the capacity of the banking sector to reinvent and transform. Going forward, the changes

in the global economy and international financial landscape will continue to accelerate beyond expectations. The ability of financial institutions to remain relevant in the future will depend on the actions that are taken now in the current environment. The leadership of the industry will be instrumental in charting the future growth path and cultivating a performance culture that will steer financial institutions towards continued success.

There therefore needs to be an awareness of the emerging cyclical and structural forces that will impact the economy as well as their linkages with the banking industry, to anticipate new developments and opportunities, and most importantly, to be equipped to respond to the new opportunities and to remain competitive and relevant. The challenge for banking institutions is in being able to balance between demands of the immediate term with a longer term outlook and how this would feed into the organisation's continuous renewal and transformation process.

The 2nd Malaysian Islamic Finance - Issuers and Investors Forum 2007
“Malaysia as Global Sukuk Centre: Towards Greater Vibrancy of
Malaysian Sukuk Market”
13 August 2007, Kuala Lumpur

Keynote Address by

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

It gives me great pleasure to speak at the 2nd Malaysian Islamic Finance - Issuers and Investors Forum 2007 that brings together industry practitioners and investors to discuss recent developments and key issues in Islamic finance. Islamic financial markets in particular, have experienced significant evolution and rapid expansion. We are now seeing the emergence of highly innovative products and services in sukuk market. My remarks today will focus on the vast growth potential of the global sukuk market and Malaysia’s experience in strengthening our market for Global Sukuk activities.

Vast Growth Potential for sukuk

The growing role of Islamic finance in mobilising and channelling funds to productive investment activities across borders contributes to more efficient allocation of funds across borders and facilitates international trade and investment. Greater diversification of risks also contributes towards promoting international financial stability. The more recent developments in Islamic finance is the growing significance of the sukuk market to become an increasingly important component of the Islamic financial system. Five major trends are having a significant bearing on the future development of the global sukuk market.

Firstly, the bond market is now becoming key to meeting the funding requirements for both the public and private sectors in emerging market economies. This is particularly the case for the Middle East and Asia, which are among the fastest growing regions in the global economy. This includes

financial needs of the private sector following the privatisation and implementation of infrastructure projects. The development of the Islamic Bond Market, the Sukuk Market will provide opportunities for the corporate sector, the government agencies, multinational corporations and multinational development institutions to raise funds through the issuance of sukuk to meet their financing requirements. The sukuk market also serves as an important platform, complementing the conventional bond market, in enhancing the effectiveness and efficiency for the mobilisation and allocation of funds within the domestic financial system, as well as in the international financial system.

Secondly, while there has been growing interest in the issuance of sukuks by corporations, sovereigns and multinational corporations, the demand for sukuks significantly exceeds the supply. Today, the global sukuk market, denominated in international currencies, is estimated to exceed USD50 billion. Although the size of the market is modest by global standards, the sukuk market is experiencing remarkable growth, increasing at an average rate of growth of forty per cent per annum.

The significant demand for sukuks have been spurred by the high levels of surplus savings and reserves in Asia and in the Middle East. This has been reinforced by increased liquidity in the international financial system in search of higher returns and greater diversification of risk. Since the issuance of the first sovereign global Islamic sukuk by the Government of Malaysia in 2002, there has been a series of other issues by the

governments of United Arab Emirates, Qatar, Bahrain and Pakistan. An increased number of multilateral agencies have also issued sukuk to finance development projects. In addition, both government agencies and the corporate sector have considered the sukuk market as an attractive instrument of financing.

Thirdly, there is a great number of global players such as investment banks, Islamic banks and securities firms that are involved in the issuance of sukuk in the international financial markets. A large number of Western banks are also providing Islamic financial services taking advantage of the opportunities and to provide customised products and services to their customers.

Fourthly, the established international financial centres have also shown interests to have an active role in promoting the development of the sukuk market including enacting the appropriate legislative provisions. These developments would augur well for the development of the sukuk market.

Finally, the regulatory and supervisory paradigm continues to evolve. Indeed, the recent decade had witnessed significant global shifts in the approach to regulation and supervision across many countries. In addition, the harmonisation of standards and practices is also important. The establishment of the international standard setting organizations such as the Islamic Financial Services Board (IFSB) and the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), to formulate appropriate prudential and accounting standards that would not only facilitate the process of harmonisation but also contribute to the strengthening of the Islamic financial system. The IFSB has already formulated the prudential treatment for sukuk investment by the Islamic financial institutions as stipulated in the Capital Adequacy Standards.

Malaysia's Strength in the Sukuk Market

Let me now turn to Malaysia's sukuk market. Significant progress has been achieved in the development of the Malaysian sukuk market. In 2007, Malaysia accounted for about two-thirds of the global sukuk outstanding, amounting to about USD47 billion. Malaysia not only represents the largest sukuk market in terms of outstanding size, but also in terms of number of issuance.

In developing the sukuk market, Malaysia provides a total solution for sukuk activities by providing a complete sukuk issuance and trading platform, that is supported by four elements: a wide range of Islamic instruments, strong legal and regulatory infrastructure, sound Shariah governance framework and the talent supply. These elements are also further strengthened by Malaysia's comprehensive Islamic financial system with all the key components of the financial system comprising the Islamic banking, takaful, Islamic money and capital markets that are now at an advanced stage of development. These different parts of the Islamic financial system not only facilitates the issuance and the distribution of the papers but also creates a strong demand for sukuk by providing a broad investor base.

There is also a variety of Islamic instruments in the sukuk market in Malaysia that includes currency swaps and Islamic forward contracts available to facilitate hedging and other risk management activities. The Malaysian Sukuk market, is also supported by appropriate rules and regulations, and by the pool of experienced global and domestic players as well as the legal and accounting professionals including legal and tax consultancy, as well as documentation in the issuance and trading exercise.

In promoting Malaysia as an International Islamic Financial Centre (MIFC) we aim to develop Malaysia into a centre for the origination, distribution and trading of sukuk to provide further impetus to the development of an increasingly vibrant and progressive bond market in Malaysia as well as in the Asian region. This would reinforce the international dimension of the sukuk market in Malaysia by providing linkages with international issuers and investors. To deepen and widen the bond and sukuk markets, Malaysia has further liberalised the foreign exchange administration rules to allow multilateral financial institutions, multinational and other national corporations to issue both ringgit and non-ringgit denominated instruments in our capital market.

Malaysia also has in place the financial infrastructure and facilitative rules that contribute towards efficient price discovery and shorter time to market, thus providing an efficient platform for sukuk issuance and trading activities.

The established legal, regulatory and Shariah framework in the Islamic financial infrastructure in Malaysia is reinforced by the supporting financial infrastructure, including the settlement and bond information system.

To facilitate an efficient sukuk issuance process in Malaysia, an **MIFC One-stop centre** is being established as a single contact point for efficient delivery process to facilitate the issuance of sukuk. To further facilitate this process, there is no restriction on the ability to use international rating services, on the ability to hedge positions and on the ability to swap issuance proceeds into foreign currency.

As part of our ongoing efforts to position Malaysia as an attractive gateway for the issuance of sukuk, a number of legal and regulatory requirements are further customised to reduce the cost of sukuk issuance. Profits and dividends received by non-resident investors from holding of ringgit and non-ringgit Islamic instruments

issued in Malaysia are exempted from withholding tax. Special Purpose Vehicles (SPV) for Islamic financing purposes via the Islamic capital market are not subject to the administrative procedures under the Income Tax Act 1967. In addition, companies that establish these SPVs are given a tax deduction on the issuance cost of the Islamic securities incurred by the SPV. The issuance cost for all Islamic securities approved by the Securities Commission are also eligible for tax deduction. Finally, there is a stamp duty exemption for 10 years on instruments relating to Islamic securities under the MIFC.

Malaysia has also put in place an efficient platform for trading of bonds including the Real-time Electronic Transfer of Funds and Securities System (RENTAS), Fully Automated System for Issuance/Tendering (FAST), and Bond Information and Dissemination System (BIDS) to provide post-trade transparency and market liquidity on par with developed markets. Malaysia has a payment system link with Hong Kong Monetary Authority on US dollar settlements, while the Malaysian Government Securities are clearable with Clearstream.

Finally, of importance is a conducive environment for innovation and this has been put in place. In 2006, the Malaysian market continued to generate innovative products with the launch of sukuk using Mudharabah, Musyarakah and Ijarah. Landmark issuance such as exchangeable sukuk Musyarakah by Khazanah Nasional Berhad, marked the world's first issue of its kind, incorporating full convertibility features common to conventional equity-linked transactions.

An important enabling factor driving innovation is the availability of the pool of experienced talent. There are currently 9,000 staff with the Islamic financial institutions. They are also reinforced by the workforce of domestic and foreign conventional financial institutions. This expertise that resides in Malaysia allows for the development of innovative products so as to ensure that the product design and structure, as well as the

risk management aspects that are being rigorously addressed.

There is also positive response from the local and foreign financial institutions to establish International Islamic Bank, International Takaful Operator, as well as International Currency Business Unit to undertake international currency business in Islamic finance in Malaysia. To date, eight financial institutions have been granted approval to set up such International Currency Business Units in Malaysia.

Commercial banks and investment banks licensed under the Banking and Financial Institutions Act 1989 (BAFIA) are allowed to establish International Currency Business Units to carry out Islamic banking business under their existing entities.

To enhance the delivery system to facilitate their establishment, an “executive green lane” has been accorded to expedite applications by expatriates for long-term employment passes with multiple entry visas. In addition, the Foreign Investment Committee rules are also relaxed further to allow for 100 percent foreign equity ownership in these financial institutions.

The MIFC portal has also been launched as the primary source of comprehensive online information on the latest initiatives and developments, and enables convenient access to application forms, procedures and guidelines related to entrance and participation in the MIFC. This Portal, is now accessible online at www.mifc.com.

The large gathering of practitioners here for these two days to discuss the wide ranging matters that relate to issuers and investors will contribute to enhancing the collective understanding and expanding the boundaries of our knowledge on the opportunities in the sukuk market and the potential that the Malaysian sukuk market provides and its linkages with other international Islamic financial systems. This would facilitate greater cross border flows and not only contributing to enhancing greater international economic and financial integration, and thus to the global growth, but also towards financial stability of the international financial system.

Supplementary Information:

The MIFC Secretariat is pleased to announce that the MIFC Portal has been launched as a key communication platform to strengthen the global identity and branding of Malaysia as an International Islamic Financial Centre, or MIFC. The development of the MIFC Portal is an important initiative to promote awareness and global outreach of the MIFC.

The MIFC Portal provides comprehensive information on the latest initiatives, incentives and developments in the MIFC. In addition, the MIFC Portal enables convenient access to application forms, procedures and guidelines related to entrance and participation in the MIFC. The Governor of Bank Negara Malaysia announced the launch of the MIFC Portal during her keynote address at the 2nd Malaysian Islamic Finance - Investors and Issuers Forum 2007. The MIFC Portal is now accessible online at www.mifc.com.

**The Malaysia - Japan Business Forum “Enhancing New Linkages And Opportunities”
24 August 2007, Kuala Lumpur**

by

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

It is my honour and great pleasure to be here to speak at this important forum which brings together government leaders and the business community from our two countries. I would like to take the opportunity to thank the Japan External Trade Organisation (JETRO) for inviting me to speak at this Forum. JETRO has played an important role in fostering the economic relations between Malaysia and Japan. While Japan and Malaysia has established strong economic ties, the environment in which we are operating has experienced pronounced changes. These changes present the potential for new linkages and opportunities between Japan and Malaysia.

Enhancing Interlinkages and Integration in Asia

Asia today is increasingly recognised as a dynamic growth region in the global economy. Asia’s previous success was accomplished in part by strengthening its global interlinkages by exports to the rest of the world. Today, new regional interlinkages are emerging as Asia expands further its trade and investment within the region, a trend that has generated mutually reinforcing regional growth.

The Asian economic integration is now already well advanced through the intensification of intra-regional trade and investment. Trade within Asia now accounts for more than half of the total trade of the region. This change is partly the result of the rapidly growing economies in Asia, which has created a large and expanding cumulative export market. This economic integration is also the result of Asia’s participation in the globalization of production. These trends

have led to greater diversification of economic activity in the region and a reduction in the over-concentration in the traditional export markets. In the area of investment, Japan has for several decades been a major foreign direct investor in the Asian region. A more recent phenomenon is the more widespread cross-border investment undertaken in the region to capitalise on the growing opportunities arising from the diversity of economic strengths in the region.

These developments have increased the potential for Asia to be an important engine of growth in the global economy. The advancement that has been achieved in the increased economic integration needs to be reinforced by greater financial integration. Accelerating the regional financial integration process would serve as a powerful impetus, not only for reinforcing the trade and investment inter linkages, but more importantly to facilitate a more efficient international allocation of capital. In so doing it would contribute towards unlocking Asia’s full potential in the global economy. Indeed, such greater financial integration would also play an important role in facilitating the allocation of some part of Asia’s surplus funds into productive investments within the region. The more effective and efficient recycling of funds within the region will help reduce financing costs, stabilize financial prices, and increase the potential for the diversification of risks. All this would cumulatively promote stability and resilience of the financial systems in our region. The current turmoil in the global financial markets and the uncertainties it has generated underscores the need for greater financial stability and resilience of our financial systems.

There are several ways to enhance financial interlinkages, some of which are already in progress. In the financial sector, we have already seen Asian financial institutions expand beyond domestic borders, thus strengthening the regional economic linkages. The regional authorities and regulators have also come together to develop the regional financial markets, including the capital markets, the supporting regional financial infrastructure and mechanisms for crisis management and resolution. These developments have paved the way for new forms of economic partnerships and strategic alliances and advance further the regional integration process and its inter linkages with the rest of the world.

Malaysia and Japan : Interlinkages and Opportunities

Malaysia is one of the most open economies in the world, with significant global trade and investment linkages, and has become a significant profit centre for foreign direct investment for several decades. Similarly, the volume of trade activity in Malaysia is two times the size of our economy, among the highest in the world. Our outreach for trade has been with both large and small economies. For several decades Malaysia has had an extensive economic relationship with Japan, with Japanese foreign direct investment being particularly significant since the mid 1980s. Japanese investments have also been important in making Malaysia part of the regional production network. To this day, Japan remains a significant partner in trade and investment for Malaysia.

While Japan's economic relationship with Malaysia through trade and investment is well-established, going forward there is significant potential for strengthening the financial linkages. In this recent decade, Malaysia has significantly transformed our financial sector. The restructuring, consolidation and reform of the financial sector has strengthened the capacity, flexibility and resilience of the financial system. In addition, there has been the development of several new segments

of the market, including the bond market and Islamic finance. The Malaysian bond market is the largest in South East Asia with a vibrant private debt securities market. Malaysia has also continued to progressively liberalise its already open financial system to further enable free flow of funds into and out of the system. This transformation has opened up the potential for a range of new opportunities for participation in the financial sector in Malaysia and for facilitating greater financial flows within the region.

New Linkages and Opportunities Offered by Islamic Finance

This decade has also witnessed a rapid evolution and global expansion of the Islamic financial services industry. Malaysia has developed a comprehensive Islamic financial system that operates in parallel with the conventional financial system. More recently, its international dimension has gained significance as Islamic finance is becoming an increasingly important part of the international financial system. In doing so it is contributing to strengthening international interlinkages between financial markets and systems that is more widespread and inclusive. The number of Islamic financial institutions worldwide has increased to more than 300 spanning over 75 countries. Total assets of the Islamic financial system are estimated to exceed one trillion US dollars. It is among the fastest growing financial segments in the world with an estimated annual growth in the region of 15 to 20 percent. There is now a growing strong demand for Islamic financial product in the global market, far exceeding the current availability of financial products and services being provided by the Islamic financial institutions.

The global development of the Islamic financial system has become particularly important in this more challenging financial and economic environment. As the international financial system becomes more diversified and as this new form of financial intermediation develops, it has presented businesses with alternative means of

raising funds while investors are presented with new asset classes. It has contributed towards greater diversification of risks. More importantly, the very fundamental requirement of Islamic finance is that it requires an underlying economic transaction thereby avoiding emphasis on speculative purposes. It also prohibits the commoditisation of risks, which leads to its proliferation through multiple layers of leveraging and disproportionate distribution. Islamic finance as a form of financial intermediation will also contribute towards enhancing the efficient mobilisation and allocation of funds across regions. This will bring about strengthening of a more wide spread and inclusive global financial integration. The greater diversification of risks also contributes towards promoting international financial stability. The transparent nature of Islamic financial contracts and the need for underlying economic transaction reinforces the stability of the Islamic financial system.

Going forward, in the current liberalised and globalised environment, Islamic finance is at the threshold of a new dimension in strengthening financial inter-linkages between nations across the globe. Just as the Old Silk Road in the 14th century offered a route that facilitated the trade in goods from the East to the West, we can now envisage the New Silk Road that facilitates financial flows across borders between the East and West. As regional financial integration intensifies, it will be a route that will facilitate this process. The previous trade linkages between the Middle East and Asian regions also has potential to strengthen, being the two of the fastest growing regions in the global economy. While the world trade has on the average expanded by 9 percent over the period 2002-2006, Asia's trade with the Middle East has increased on the average by 30 percent. In 2006 alone, mega transactions involving corporate acquisitions and real estate purchases from the Gulf to Asia, are estimated to total more than USD18 billion. Going forward, the value of such investments are expected to increase. Over the next five years, it is estimated that Asia will need USD1

trillion in terms of infrastructure investment and is in search of new partnerships and strategic investors to co-invest in these undertakings. This trend would benefit the economic regions with high savings and surpluses such as Asia and the Middle East because it would promote intermediation of a part of the surplus funds in the region to be channelled to productive investments in the region.

Several financial centres in the West, Middle East and Asia are now introducing Islamic finance as an integral part of their financial markets to offer the wide range of financial products and services. This trend is envisaged to stretch the New Silk Road from East Asia and Middle East and extend to Europe and the rest of the world. Indeed, we are already seeing the participation of global investors and the international financial community.

The Malaysian Experience

Let me share with you Malaysia's experience in developing on Islamic financial system in a highly liberalised environment. Malaysia has developed a comprehensive Islamic financial system that includes the banking and takaful industries, and the Islamic money and capital markets - a matrix which mutually reinforces the integrity and stability of the Islamic financial system. Significant progress has in particular, been achieved, in the development of the Malaysian sukuk, or Islamic bond market. The Malaysian sukuk market has now evolved into the world's largest Islamic bond market. In 2007, Malaysia accounted for about two third of the global sukuk outstanding amounting to about USD47 billion. In 2002, the Government of Malaysia issued the first global sovereign sukuk. With this issuance, it became an international benchmark for the issuance of global sukuk. There have since been several further sovereign issues in the global capital market. The sukuk market has been an important source of financing for productive investment activities, while for investors, it provides greater potential for diversification into new asset classes.

The development of the Malaysian sukuk market has involved wide ranging initiatives to facilitate an efficient issuance process, the price discovery process, the broadening of the investor base, the establishment of a benchmark yield promoting the liquidity in the secondary market and strengthening of the regulatory framework. These initiatives have been reinforced by the legal and Shariah framework and the supporting financial infrastructure including the settlement system and the bond information system.

The international prudential standards for Islamic finance is set by the Islamic Financial Services Board (IFSB), is located in Malaysia . The IFSB thus formulates the international regulatory and supervisory standards for Islamic financial institutions aimed at achieving best practices in order to secure soundness and stability of the Islamic financial system. With the setting up of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), appropriate accounting standards have also been put in place to reflect the true and fair value of banking operations to ensure greater accountability and responsibility of the financial institutions.

With the increased maturity of our domestic bond market, further steps have been taken by Malaysia to allow foreign corporation, multinational corporations and multilateral agencies to raise funds in the Malaysian bond market with no restrictions for the utilisation of these funds. These funds maybe used to finance foreign investment activities outside the country. Following this liberalisation, the inaugural ringgit denominated sukuk issue was in 2004 by the International Finance Corporation (the investment arm of the IBRD World Bank),

followed by the issue by the IBRD World Bank in 2005. In November of 2006, our market was further liberalised to allow for the raising of foreign currency sukuks from our domestic market. More recently, a landmark issuance the 750 million dollars exchangeable sukuk Musyarakah by Khazanah Nasional, the Government's investment arm, marked the world's first issue of its kind, incorporating full convertibility features common to conventional equity-linked transactions. These issues have attracted investors from outside of Malaysia , thereby strengthening our inter-linkages with other international financial markets.

I am pleased to mention that a memorandum of understanding between the Central Bank of Malaysia and the Japan Bank for International Corporation (JBIC) has been signed this year for us to advance relations in this area between JBIC and the central Bank of Malaysia . In addition, a Japanese consumer credit company based in Malaysia marked another significant milestone by issuing an Islamic commercial papers early this year.

The changes that have occurred in the economic and financial environment in our region and the global environment have presented us with wide ranging new opportunities. The partnership between Malaysia and Japan thus not only needs to evolve not only in the trade in goods and direct investment but also needs to encompass growing financial ties. Islamic finance represents a vehicle that could further deepen our financial relationship and the regional integration process. In enhancing these new linkages and greater integration, it would contribute towards unlocking the new potential opportunities for our mutual prosperity.

**The 2007 INCEIF Global Forum “Leadership in Global Finance -
The Emerging Islamic Horizon”
30 August 2007, Kuala Lumpur**

Keynote Address by

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

It is my honour and great pleasure to be here to speak at this first INCEIF Global Forum, which has drawn together a distinguished gathering of scholars, researchers and practitioners from the financial services industry. Let me focus on the international dimension of Islamic finance which has continued to gain significance. Islamic finance now extends beyond the traditional predominantly Muslim economies to become an increasingly important part of the international financial system. Total assets of the Islamic financial system are estimated to exceed one trillion US dollars. It is among the fastest growing financial segments in the international financial system with an estimated annual growth of 15 to 20 percent. There is now a growing demand for Islamic financial products in the global market, far exceeding the supply of financial products and services that is being offered by the Islamic financial institutions.

As we advance forward, the international environment in which we are operating is also rapidly evolving to become **more complex, competitive and challenging**. In the current environment it has become more volatile and uncertain. The challenge for Islamic finance is to evolve strategies that will ensure its competitiveness, dynamism and sustainability. An aspect in the contemporary global Islamic finance that is fundamental is the ‘principled centred’ nature of Leadership in Islam, that involves “trust” (*amanah*), and with that comes “responsibility” (*taklif*) and “accountability” (*mas’-u-li-yah*¹). My remarks today will discuss the positive elements that Islamic

finance brings to the global financial system, its prospects for enhancing international integration and the potential to strengthen the socio economic aspects of Islamic finance.

Optimizing Benefits of Islamic Finance

In evolving the international dimension of Islamic finance an important aspect is the optimization of the oasis of benefits and opportunities Islamic finance has the potential to provide. Islamic finance implicitly embraces strong core values and universally beneficial characters. The fundamental requirement of Islamic finance is that it confines its activities to that which is supported by an underlying economic transaction thereby avoiding emphasis on speculative purposes. The Islamic principles require that the financial transaction be accompanied by genuine trade and business related transactions. This provides for a high level of disclosure and transparency. This thus prohibits the commoditisation of risks, which effectively leads to its proliferation through multiple layers of leveraging and disproportionate distribution. It reduces the potential for information gaps and for mispricing of risks and thus avoids the elements that could contribute to uncertainty and disruptive market conditions.

The Islamic financial system derives its strength and stability from its faculty to uphold Shariah principles. The Islamic financial system thus has an in-built dimension that promotes financial soundness and stability,

¹ ICLIF Leadership Competency Model - Syed Naquib al-Attas & Wan Mohd Nor Wan Daud

as it resides within a financial trajectory underpinned by the forces of Shariah injunctions. These Shariah injunctions interweave Islamic financial transactions with genuine productive activities and prohibit involvement in illegal and unethical activities. This intrinsic principle of governance contributes towards insulating the Islamic financial system from the potential risks of financial stress triggered by excessive leverage and speculative financial activities. Equally important is that the key components of the Islamic financial system, comprising the financial institutions, the markets and the financial infrastructure, has demonstrated its viability and robustness as a form of financial intermediation, with a mutually reinforcing role in enhancing the overall stability of the financial system. Its growing role in mobilising and channeling the funds to productive investment activities across borders brings significant benefits to the global economy. Firstly, it has the potential to contribute global growth and contributing towards some rebalancing of the global growth given that it brings about a more inclusive financial integration. Secondly, the strengthened international financial linkages allows for the potential for greater diversification of risks. The increase in the Islamic financial products, the growing number of assets classes being offered, the increased cross ownership of assets have all expanded the possibilities for greater diversification of risks and the potential for return.

The intrinsic nature of Islamic finance encourages risk management and provides confidence through explicit disclosure and transparency of the roles and responsibilities defined in the contract. The transparent nature of the Islamic financial contracts and the need for underlying economic transaction reinforces the stability of the Islamic financial system.

A vital challenge going forward is however to build a stronger, competitive and dynamic Islamic financial system that

better reflects the internalization of Shariah principles in financial transactions, in its form, spirit and substance. This epitomizes the objectives of the Shariah in promoting economic and social justice. While developing Islamic financial system with products and services mirroring the conventional counterpart is acceptable as a pragmatic approach, it needs to develop further on its own paths and merits so as to maximize the potential benefits of Islamic financial system. Key to this is having an appropriate pricing benchmark to be an indicator for Islamic securities to be efficiently priced and credible. In addition, the role of Shariah scholars who have the full understanding of the mechanics of Islamic financial products and services, are key to ensuring its continued development. At the same time, Shariah decisions, when made, needs to be disclosed. This will allow others to appreciate the juristic reasoning, which in turn would lead to a wider acceptance of Shariah decisions, particularly if they have implications on cross-border transactions.

As the Islamic financial system becomes increasingly more internationally-integrated, it is important to recognize the different regional and institutional strengths and complementarities and the need to maximize synergies. Collaboration among regional centres and key players in Islamic finance will be an important part of the process that will contribute towards greater international financial integration. Constructive engagement in the form of strategic partnerships and collaboration, as well as in market access needs to be enhanced. Allowing greater market access among players in Islamic financial centres can be a catalyst for enhanced integration and innovative elements in the Islamic financial industry.

Malaysia's experience in strengthening the international dimension of the Islamic financial system has shown positive results. This has commenced in 2002 with the inaugural issuance of a global Sukuk to the

liberalizing to allow for greater market access in Islamic banking and takaful initiatives by permitting entry of foreign players.

The third area of international integration is the liberalization of our financial markets to allow for greater foreign participation. In particular, in the sukuk market, foreign corporations, multinationals and multilateral agencies may raise ringgit and foreign currency denominated instruments in our market. Our private debt securities market is the largest in South East Asia. Malaysia also has highly liberalized exchange administration system that allows for the free inflow and outflow of funds. There is also no restriction on the utilization of the funds raised in our market. The funds may be utilized for investments outside the country.

Finally, our own financial institutions have ventured beyond our domestic borders. These cumulative developments have strengthened our linkages with other Islamic financial centres.

Another area important for Islamic finance is the investment in research and development (R&D). The promotion of international strategic alliances through smart partnerships can create greater synergy that will bring about new approaches, new technologies and new areas of specialization. Such collaborative efforts amongst Islamic financial institutions would strengthen the ability to leverage on the industry's expertise. The introduction of innovative Islamic financial products in a specific jurisdictions can be expanded to other jurisdictions, which in turn, will contribute to broaden and deepen Islamic financial markets and thus strengthen the overall development of the Islamic financial industry. In addition, collaboration between academic researchers and the practitioners will enable the practical application of such research findings. In the area of education and training in Islamic finance, there is now a critical shortage of talent in the Islamic financial industry. Collaboration between training institutions is

vital to developing the pool of expertise in Islamic finance that subscribes to common standards. Establishing a network of mutual co-operation and collaboration would strengthen the efforts among the institutions of higher learning across regions in the areas of curriculum development, research, training, exchange of ideas and information, and resources in Islamic finance. Such partnerships in connecting the knowledge communities between regions would facilitate this process.

In the area of Shariah, the progressive convergence of Shariah views and rulings, the mutual recognition of financial standards and products across jurisdictions would be major 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.

Finally this integration process also requires greater cooperation among the regulators to ensure that the Islamic financial system is not subject to vulnerabilities and abuses and thus ensuring its soundness and stability. In this respect, the sharing of information among the regulators including across borders is important especially in a more globalised and liberalised environment where financial transactions and activities have become more complex and globalised. In this regard, there is a greater need for regulators to be continuously connected to share information on key issues and developments faced in their own financial jurisdictions. In this respect, the Islamic Financial Services Board has an important role to facilitate this process.

Closer financial linkages among Islamic financial institutions from different jurisdictions is essential to contribute towards accelerating the process and towards serving as a bridge to strengthen the relationship of the international Islamic financial markets as well

as the investment and trade ties between regions. Such linkages within the industry could also lead to new product offerings and to co-arranging financing. There could also be mutual development of IT systems and other technologies including other research and development endeavours.

Finally, let me touch on the development of the socio-economic aspects of Islamic finance. While “profit motivated” Islamic financial institutions will continue to evolve and gain greater significance, this trend also needs to be complemented with similar evolution in the socio economic aspects of Islamic finance such as waqf and zakat. A stronger zakat and waqf system would not only complete the equation for a comprehensive Islamic financial system that supports a more equitable distribution of wealth to ensure fairness and equity, it will also become the user of the Islamic financial services particularly in the management and investment of the zakat and waqf funds. In

addition, access to Islamic financial services to micro enterprises would bring such activities into the economic mainstream and improve their level of performance.

Conclusion

As Islamic finance advances forward to become an integral component of the international financial system, continuous efforts are needed to further develop the domestic financial system to meet the changing requirements of a highly dynamic and rapidly evolving environment. In our quest to build a viable and sustainable Islamic financial system, the aim is to contribute to the channeling of capital flows to productive investments, create wealth and promote economic activities, that conforms to the principles and values of Shariah. With this, the Islamic financial system will ultimately bring benefit not just among Muslims but with the rest of humanity, Inshaallah.

CALENDAR OF EVENTS July-September 2007

6 July 2007

The Bank announced the establishment of BNMTELELINK, a new contact centre to complement the existing walk-in counter services of BNMLINK. Both centres provide prompt and efficient response to members of the public on matters related to conventional and Islamic banking, insurance and takaful, advisory services for small and medium enterprises, foreign exchange administration and other matters under the Bank's jurisdiction. Members of the public can contact the BNMTELELINK via telephone, fax, letter or email.

19 July 2007

At the 11th Malaysian Banking Summit themed "The Malaysian Banking Industry Reinvention and Transformation", Governor announced the introduction of a framework to facilitate the process for product innovation. Dr. Zeti said that the new framework would simplify regulatory processes and allow for greater flexibility to banks and insurers to introduce new products more quickly in the market and at the same time place a sound product management programme within their respective institutions. She highlighted that qualified banks and insurers are expected to exercise this flexibility responsibly by safeguarding the interests of consumers.

On the same day, the Bank issued three types of commemorative coins in conjunction with the Installation of His Majesty The Yang di-Pertuan Agong Al-Wathiqu Billah Tuanku Mizan Zainal Abidin Ibni Al-Marhum Sultan Mahmud Al-Muktafi Billah Shah.

24 July 2007

At its fifth meeting, the Bank's Monetary Policy Committee (MPC) maintained the Overnight Policy Rate (OPR) at 3.50 percent and kept the rate at the same level at its subsequent meeting on 24 August.

30 July 2007

The Bank issued three types of commemorative coins to commemorate the 50th Anniversary of Malaysia's Independence.

13 August 2007

At the 2nd Malaysian Islamic Finance - Issuers and Investors Forum 2007, Governor, spoke on the vast growth potential of the global sukuk market. She said the growing role of Islamic finance in mobilising and channelling funds to productive investment activities across borders has contributed to more efficient allocation of funds and facilitated international trade and investment. Dr. Zeti noted that Malaysia took the lead in Islamic financing globally, accounting for two-thirds, or about USD47 billion, of the global sukuk outstanding. Malaysia also accounted for the largest number of issuance. Malaysia provides a total solution for sukuk activities by providing a complete sukuk issuance and trading platform, supported by four main elements; a wide range of Islamic instruments, strong legal and regulatory infrastructure, sound Shariah governance

framework and experienced talent supply. These elements are supported by comprehensive Islamic financial system with key components comprising the Islamic banking, takaful, Islamic money and capital market that are now at an advanced stage of development.

29 August 2007

The Bank announced that the Malaysian economy expanded by 5.7% in the second quarter of 2007 (1Q: 5.5%). The growth was driven by domestic demand led by resilient private sector activity and reinforced by increased public sector spending. On the supply side, growth was supported by sustained strong performance in the services sector and higher activities in the mining and construction sectors.

5 September 2007

The Bank announced the establishment of Financial Sector Talent Enrichment Programme (FSTEP) to address the shortage of skilled talents in the financial industry. The one-year intensive programme provides technical financial industry training, simulations, workshops, case studies and on-the-job training exposure through internship with financial institutions. Selected applicants will be offered attractive scholarship into the programme and upon completion, successful participants will be absorbed into the financial sector.

13 September 2007

The Bank as the Secretariat of the National SME Development Council (NSDC) released the SME Annual Report 2006. The report provides information on the performance of SMEs, as well as highlights major programmes undertaken by the Government to promote the development of SMEs. It also highlights success stories of SMEs which had benefited from Government programmes and incentives. The NSDC also announced several key initiatives to further promote a competitive and resilient SME sector such as the establishment of the SME Central Coordinating Agency, development programmes for Agro-based industry and developing innovative SMEs.

25 September 2007

The Bank's Shariah Advisory Council made a resolution that the distribution of surplus from tabarru' fund in takaful scheme and the application of wakalah contract in deposit instrument is permissible from the Shariah perspective. Following this approval, it is expected that the Islamic financial institutions would be able to diversify their Shariah-compliant products and be more creative and innovative in their product offerings.