

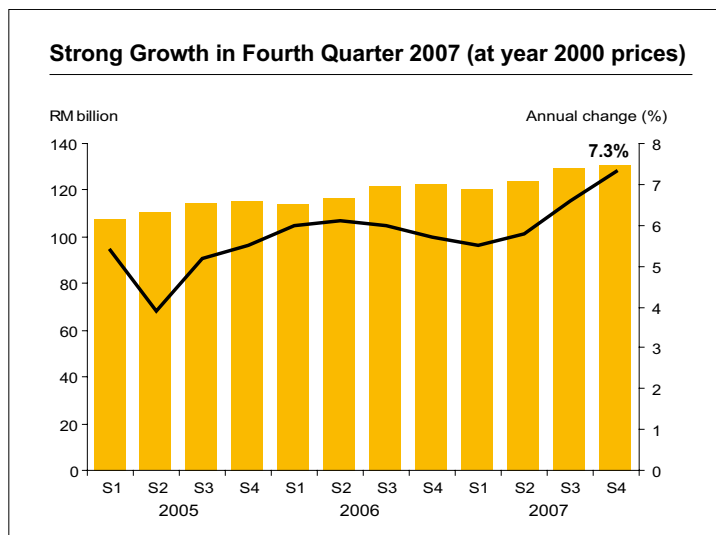
ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE FOURTH QUARTER OF 2007

OVERVIEW

Strong GDP growth in the fourth quarter

The Malaysian economy registered a strong growth in the fourth quarter of 2007. Robust domestic demand, driven by strong private consumption spending and investment activities, raised real GDP growth to 7.3%. This was reinforced by increased in public sector spending. On the supply side, growth was broad based with strong growth recorded in all economic sectors. For the whole year, real GDP expanded by 6.3%.

accommodation and restaurant; as well as finance, insurance, real estate and business services sub-sectors continued to register double-digit growth. Growth in the construction sector was sustained at 4.7% in the fourth quarter supported by activities in the civil engineering and non-residential sub-sectors.



Agriculture and mining sectors recorded robust performance during the fourth quarter. Output in the agriculture sector increased by 6.9% (3Q: 0.7%) following the expansion in crude palm oil output due to recovery in yields. This was supported by higher output of livestock. In the mining sector, the increase in crude oil output of 7.2% was mainly driven by the increased production in the Kikeh deepwater oil field. The production of natural gas, however, continued to decline due to lower external demand.

The manufacturing sector expanded by 5.6% (3Q: 3.3%), reflecting strong expansion in the domestic-oriented industries. Production of domestic-oriented industries grew by 11.1% (3Q: 4.6%) underpinned by the strong performance in transport equipment, food and beverages, and construction related industries. Similarly, production of export-oriented industries performed better during the quarter, supported by an improvement in the electronics and electrical (E&E) sector, particularly computers and parts.

Domestic demand remained strong in the fourth quarter expanding by 9.8% (3Q: 12.6%), on the strength of private sector activities, while the increased public sector spending continued to support growth. Private consumption expenditure grew by 11.1% supported by high disposable income due to strong commodity prices, salary increment in the public sector and stable employment market. The nationwide year-end sales had also encouraged consumer spending. Gross fixed capital formation continued to increase by 11% (3Q: 13.5%). Private investment indicators, namely loans approved and disbursed to the manufacturing and construction sectors as well as imports of capital goods indicated increased in capital spending by the private sector. Similarly,

The services sector continued to be the main impetus to GDP growth, expanding by 9.1%. The wholesale and retail trade,

higher disbursement for development expenditure by the Federal Government was channelled towards agriculture and rural economic activities, improving public utilities and transportation infrastructure as well as for the provisions of education and health services.

The headline inflation rate, as measured by the change in the Consumer Price Index (CPI) increased to 2.2% in the final quarter of 2007 (3Q: 1.8%), due mainly to higher prices in the food and non-alcoholic beverages category and to a lesser extent, in the restaurants and hotels, and miscellaneous goods and services categories.

On the external front, the trade account recorded a surplus of RM28.6 billion in the fourth quarter (3Q: RM28.3 billion). Gross exports strengthened by 7.5% (3Q: 0.9%), due mainly to higher commodity exports and a turnaround in manufacturing exports. Agriculture exports continued on an upward trend, driven mainly by higher prices, especially palm oil prices, following rising global demand amidst lower supply of soybean oil and rapeseed oil in the United States and Europe, respectively. Mineral exports also expanded further during the quarter, led by higher proceeds from crude oil and liquefied natural gas exports. In addition, manufacturing exports registered a positive growth of 2.9% (3Q: -2%), driven mainly by strong growth in selected resourced-based industries as well as a pick-up in E&E exports, especially computer and parts.

Gross import growth was stronger at 10.7% (3Q: 2%) with all import categories registering higher growth. Imports of capital goods (excluding lumpy items) increased by 10%, spurred by strong activity in construction and mining sectors. Capacity expansion and upgrading in the manufacturing sector led to the higher imports of machinery. Imports of intermediate goods also registered a strong growth of 13.3%, reflecting imports of inputs particularly to the E&E sector and resource-

based industries. Imports of consumption goods increased by 3.6% supported by higher imports of food and beverages, and consumer goods.

In the financial account, net inflow of foreign direct investment (FDI), 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 RM3.3 billion in the fourth quarter (3Q: RM6.8 billion). The bulk of the FDI was channelled into the services, manufacturing, and oil and gas sectors. Overseas investment recorded a net outflow of RM5.1 billion (3Q: -RM7.1 billion). Meanwhile, portfolio investment recorded a net inflow of RM6 billion (3Q: -RM21.9 billion) and largely for net purchases of debt securities by foreign investors which more than offset outflows due to purchases of equity securities abroad by residents.

The international reserves of Bank Negara Malaysia amounted to RM335.7 billion (equivalent to USD101.3 billion) as at 31 December 2007. The reserves increased to RM366.8 billion (equivalent to USD110.9 billion) as at 15 February 2008. The reserves position is sufficient to finance 9.2 months of retained imports and is 6.5 times the short-term external debt.

Monetary policy remained supportive of economic activity

The Overnight Policy Rate (OPR) remained at 3.50% throughout the fourth quarter of 2007, consistent with the medium term outlook of relative price stability and sustainable economic growth.

Concurrently, interbank rates for all maturities were relatively stable during the quarter. In terms of lending rates, the average base lending rate (BLR) remained unchanged during the quarter, while the average lending rate (ALR) softened slightly at end-December. Deposit rates remained unchanged.

Financing to the private sector continued to increase in the fourth quarter. On a net basis, banking system loans and private debt securities (PDS) outstanding expanded at a combined annual rate of 8.3% at the end of the fourth quarter. Banking system loans outstanding increased at an annual growth rate of 8.6% at the end of the fourth quarter, with loans outstanding to businesses and households expanding at annual growth rates of 10.4% and 7.3% respectively. Loan applications, approvals and disbursements remained high across the business and household sectors.

M3, or broad money, increased at an annual rate of 9.5% at the end of the fourth quarter. The increase reflected net trade and portfolio inflows during the quarter, and increased Government spending.

In the fourth quarter, gross funds raised were higher at RM46.6 billion. However, after adjusting for large redemptions, net funds raised amounted to RM567 million. The public sector recorded a net redemption of RM5.9 billion, while net funds raised through the PDS market, excluding Cagamas, amounted to RM3.9 billion. Funds raised through the equity market amounted to RM3.8 billion.

The ringgit strengthened against the US dollar during the quarter supported by trade-related inflows and renewed portfolio inflows. For the quarter as a whole, the ringgit exhibited a mixed performance against major currencies and appreciated against most regional currencies. The appreciation of the ringgit has continued into early 2008. Although the downturn in global equity markets and concerns about the impact of a slowdown in US economic growth on the region caused the ringgit to temporarily weaken against the US dollar in mid-January, it subsequently reversed following the 75 basis point cut in the Fed Funds rate by the US Federal Reserve on 22 January, and another 50 basis point cut on 30 January 2008. For the period 1 January to 26 February 2008, the ringgit appreciated

against the US dollar and the euro by 2.9% and 2.3% respectively, but depreciated against the Japanese yen by 0.8%. The ringgit strengthened against most regional currencies, except the Thai baht and the Indonesian rupiah against which the ringgit depreciated by 1.5% and 0.4% respectively.

Banking system continued to exhibit high resilience

The banking sector continued to demonstrate high resilience in the fourth quarter of 2007, supported by strong capitalisation and profitability. The capitalisation of the banking system remained strong with risk-weighted capital ratio (RWCR) and core capital ratio (CCR) of 13% and 9.9% respectively as at end of the final quarter of 2007. The banking system also registered a strong growth of 21% in unaudited pre-tax profit to RM5.2 billion (3Q: RM4.3 billion). The non-performing loans (NPLs) level of the banking system continued to improve, with the total net NPLs based on the 3-month classification declining further by 7.4% to RM20.1 billion (3Q: RM21.7 billion) as at end of the fourth quarter, to account for 3.2% of net total loans (3Q: 3.5%). This was attributed mainly to the sale of NPL and higher reclassifications of NPLs to performing status as well as continued write-offs by banking institutions. The strong balance sheets of banking institutions have positioned the banking system to strongly continue to support future economic activities.

Growth to remain on a steady path in 2008

While global growth is expected to moderate, the continued strength of domestic demand in the emerging economies, particularly in the Asian region, are expected to lend some support to global growth. Commodity producing countries will in particular, continue to benefit from high commodity prices. The growth prospect for Malaysia remains favourable. Expanding domestic demand

will continue to provide strong support for the economy. Consumption activities are expected to remain resilient in view of firm labour market conditions and high commodity prices. Underlying private business and investment activities continue to expand,

together with the implementation of projects under the Ninth Malaysia Plan. Near-term indicators as well as the latest six-month smoothed growth rate of the DOSM leading index indicate that the Malaysian economy would remain resilient in 2008.