ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE THIRD QUARTER OF 2016

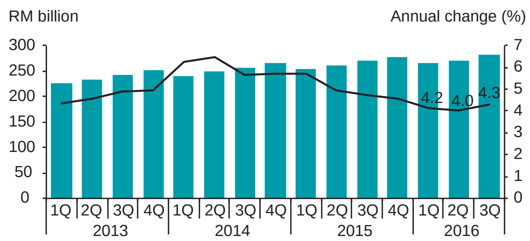
OVERVIEW

In the third quarter of 2016, the global economy continued to experience moderate growth. The latest data pointed to modest economic activity in the advanced economies. In Asia, domestic demand remained an important source of growth amid persistent weakness in external demand. While pressures in the international financial markets receded following major central banks' easing actions, a number of important policy issues in major economies continued to pose uncertainties to global growth prospects. Amid subdued growth outlook and low inflation, several major and regional central banks increased the degree of monetary accommodation.

The Malaysian economy expanded by 4.3% in the third quarter of 2016

The Malaysian economy expanded by 4.3% in the third quarter of 2016 (2Q 2016: 4.0%), underpinned mainly by continued expansion in private sector spending and additional support from net exports. On the supply side, growth continued to be driven by the major economic sectors. On a quarter-on-quarter seasonally-adjusted basis, the economy recorded a growth of 1.5% (2Q 2016: 0.7%).

The economy expanded by 4.3% in the third quarter (at constant 2010 prices)



Source: Department of Statistics, Malaysia

Overall, domestic demand grew at a more moderate pace, as the sustained growth in private sector activity was more than offset by the slower growth in public spending. Private consumption grew by 6.4% (2Q 2016: 6.3%), supported by continued wage and employment growth as well as the increase in minimum wage effective 1 July 2016. Private investment registered a growth of 4.7% in the third quarter (2Q 2016: 5.6%), supported primarily by continued capital spending in the services and manufacturing sectors. Growth of public consumption moderated to 3.1% during the quarter (2Q 2016: 6.5%) due to lower spending on supplies and services, which partially offset the higher spending on emoluments. Public investment growth contracted by 3.8% (2Q 2016: 7.5%), attributable mainly to lower spending on fixed assets by the Federal Government.

On the supply side, growth in the third quarter was supported mainly by the services and manufacturing sectors, while the agriculture sector remained weak. The expansion in the services sector was underpinned primarily by private consumption activity, while growth in the manufacturing sector was supported by export-oriented industries. In the construction sector, growth continued to be driven by civil engineering activity, while the mining sector expanded at a faster pace on account of higher crude oil production. Growth in the agriculture sector, however, remained in contraction, attributable largely to the lagged impact of El Niño on crude palm oil (CPO) yields.

Inflation, as measured by the annual change in the Consumer Price Index (CPI), moderated further to 1.3% in the third quarter of 2016 (2Q 2016: 1.9%). During the quarter, inflation in the *food and non-alcoholic beverages* category was lower at 3.4% (2Q 2016: 4.2%). Inflation in the *transport* category also registered a larger decline of 7.4% in the third quarter of 2016 (2Q 2016: -6.6%).

In 3Q 2016, the current account surplus of the balance of payments widened due mainly to a larger goods surplus, which more than offset the higher deficit in the services and investment income accounts.

As at 31 October 2016, the reserves position amounted to USD97.8 billion (equivalent to RM405.5 billion). The international reserves remain ample to facilitate international transactions. They are sufficient to finance 8.4 months of retained imports, significantly higher than the 3-month international threshold. The reserves level is also adequate to meet external obligations given the reserves to short-term external debt coverage of 1.2 times. It is important to note that not all short-term external debt creates a claim on reserves given the availability of external assets and export earnings of borrowers.

Interest rates lowered in line with OPR reduction

The Monetary Policy Committee (MPC) reduced the Overnight Policy Rate (OPR) by 25 bps to 3.00% in July 2016 and subsequently kept the policy rate unchanged in September 2016. The adjustment to the OPR was intended to ensure that the degree of monetary accommodativeness remained consistent with the policy stance for the domestic economy to continue on a steady growth path amid stable inflation, supported by continued healthy financial intermediation in the economy. Reflecting the reduction in the OPR, interbank rates trended lower during the quarter and the 3-month KLIBOR decreased from 3.65% to 3.40%. Correspondingly, the weighted average base rate (BR) of commercial banks ended the third quarter lower at 3.60% (end-June 2016: 3.83%). The weighted average lending rate (ALR) on outstanding loans was lower at 5.27% as at end-September 2016, compared to 5.42% at end-June 2016. In addition, fixed deposit (FD) rates declined during the quarter by an average of 21 bps for tenures 1-year and below.

M3, or broad money, increased by RM6.4 billion on a quarter-on-quarter basis to record an annual growth rate of 2.2% as at end-September (end-June: 1.9%). The increase in M3 during the quarter was driven mainly by the continued expansion of credit extended to the private sector by the banking system. The level of surplus liquidity placed with BNM remained ample and was relatively stable during the quarter.

Total gross financing raised by the private sector through the banking system, development financial institutions (DFIs), and the capital market amounted to RM293.8 billion (2Q 2016: RM292.9 billion). On a net basis, the growth of loans extended by the banking system, DFIs, and outstanding issuances of corporate bonds expanded by 6.5% as at end-September (end- June 2016: 6.9%). On an annual basis, although outstanding business loans grew at a slower pace of 2.0% as at end-September (end-June 2016: 3.8%), the annual growth in outstanding SME loans was sustained at 8.2% (end-June 2016: 9.2%). The growth of outstanding household loans moderated to 5.8% as at end-September (end-June 2016: 6.2%), reflecting mainly the moderation in outstanding loans for the *purchase of passenger cars; purchase of non-residential property; purchase of residential property; and personal financing*. Net funds raised in the capital market moderated to RM13.5 billion in the third quarter of 2016 (2Q 2016: RM33.4 billion) due mainly to the large redemptions of Government debt securities.

The ringgit depreciated against most major and regional currencies during the quarter. This was a reflection of the shift in investor sentiments and the rebalancing activity of portfolio investors throughout the quarter, driven mainly by external events. While all regional currencies were affected by the continued uncertainty over the timing of US interest rate normalisation, the ringgit and the currencies of other commodity-exporting countries were faced with additional adjustments due to the highly volatile global crude oil prices during the quarter.

Overall, the ringgit depreciated by 3.0% against the US dollar during the quarter. The ringgit also depreciated against the euro (-3.9%), the Japanese yen (-4.2%) and the Australian dollar (-5.5%), but appreciated against the pound sterling (0.2%). The ringgit also depreciated against all regional currencies except the Philippine peso, by between 1.8% and 7.3%.

Domestic financial stability continued to be preserved

The Malaysian financial system remains resilient. This resilience is expected to be maintained in the period ahead. While businesses and households continue to adjust to the more challenging operating conditions and higher cost of living, these adjustments are expected to have modest impact on financial institutions' earnings and asset quality. Supported by strong capital and liquidity positions, the Malaysian financial system is well-positioned to continue performing its intermediation function in an effective and efficient manner. Going forward, external events will continue to weigh heavily on investor sentiments and volatility in the domestic financial markets. These include increased uncertainty over policy adjustments and growth in the major economies, volatile commodity prices and developments in the United Kingdom (UK) post the European Union (EU) referendum. Domestic financial system stability is nonetheless expected to be maintained.

Financial institutions are well-capitalised with combined capital buffers of RM160.8 billion. For banks, more than 90% of total capital consists of retained earnings, paid-up capital and reserves which have strong loss-absorbing quality. This reflects the high capital ratios – common equity tier-1, tier-1 and total capital ratios of banks stood at 13.3%, 14.2% and 16.7%, respectively (2Q 2016: 13.4%, 14.3% and 16.8% respectively). Similarly, the capital adequacy ratio for the insurance and takaful sectors remained high at 226.4% (2Q 2016: 228.1%).

Domestic demand will remain the key driver of growth

Looking ahead, overall global economic conditions will likely continue to be challenging, with subdued growth prospects despite unprecedented easing of monetary conditions in major and regional economies. The pace of expansion in the advanced economies is expected to remain modest, while in Asia, domestic demand will continue to underpin growth. Downside risks remain high, arising from the uncertainties over the timing and outcome of the UK-EU negotiations following the UK's EU referendum, persistence of low energy and commodity prices as well as possible disorderly market conditions arising from policy shifts in major economies. Against this backdrop, international financial market conditions will likely continue to be vulnerable to setbacks and changes in sentiments.

The Malaysian economy is expected to expand by 4-4.5% in 2016. Domestic demand, particularly private sector activity will continue to be the key driver of growth. Private consumption is expected to remain supported by wage and employment growth, with additional impetus coming from announced Government measures to increase disposable income. Investment activity will continue to be anchored by the on-going implementation of infrastructure projects and capital spending in the manufacturing and services sectors. On the external front, export growth is expected to remain weak following subdued demand from Malaysia's key trading partners. Overall, while domestic conditions remain resilient, uncertainties in the external environment may pose downside risks to Malaysia's growth prospects.

DEVELOPMENTS IN THE THIRD QUARTER OF 2016

INTERNATIONAL ECONOMIC ENVIRONMENT

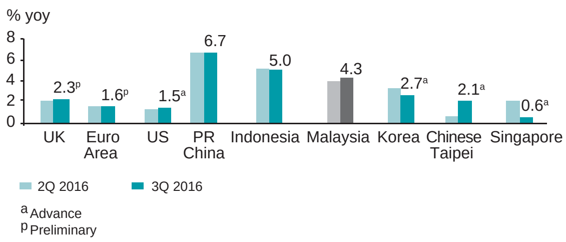
In the third quarter of 2016, the global economy continued to experience moderate growth. While volatility in the international financial markets receded following major central banks' easing actions, a number of important policy issues in major economies, such as the US monetary policy normalisation and election as well as UK-EU negotiations timeline following the UK's EU referendum, continued to pose uncertainties to global growth prospects. Amid a subdued growth outlook and low inflation, several major and regional central banks increased the degree of monetary accommodation.

Moderate growth in the global economy

The latest data pointed to modest economic activity in the advanced economies. In Asia, domestic demand remained an important source of growth amid persistent weakness in external demand.

Economic activity in the US and the UK expanded by 1.5% and 2.3%, respectively in the third quarter (2Q 2016: 1.3% and 2.1%, respectively). On a quarter-on-quarter seasonally adjusted annualised basis, growth momentum in the US economy rose to 2.9% (2Q 2016: 1.4%). The improvement came from better exports as well as inventory investment following a sizeable reduction in the previous quarter. The US economy continued to be characterised by two-speed growth, whereby sustained growth in private consumption was partially offset by weaker growth in private fixed investments. Private consumption remained the key driver of growth, underpinned by stronger labour market conditions and improving wage growth. In the UK, the immediate impact from the UK's EU referendum remained limited, as a faster expansion in the services sector more than offset a more moderate growth in the manufacturing and construction sectors. Nevertheless, uncertainty persisted, as indicated by weaker business sentiments. The depreciation in pound is expected to feed into inflation, hence affecting households' real income. The adverse impact of the UK's EU referendum is likely to be more evident when there is greater clarity on UK's upcoming post-EU referendum negotiations.

Global Real GDP Growth (Annual Change, %)



Source: National authorities

In the euro area and Japan, economic indicators pointed to subdued economic activity. While growth in the euro area was supported by domestic demand amid better credit conditions, business sentiments were weaker reflecting the uncertainty surrounding the UK-EU negotiations, which are expected to begin next year when the UK government invokes Article 50 of the Treaty on European Union. On the external front, exports remained in contraction due to lower shipments of raw materials and manufactured products. In Japan, consumption activity moderated following lower wage growth. Underscoring a decline in corporate profits amid the continued appreciation of the yen, Japan's largest manufacturers maintained their pessimistic business outlook. Similar to the euro area, export growth contracted, on account of lower shipments of car, electronics parts and steel.

Economic activity expanded at a moderate pace in emerging Asia amid persistent weakness in external demand. The Chinese economy registered a steady growth of 6.7%. While growth in the primary and services sectors were higher at 4.0% and 7.6%, respectively (2Q 16: 3.1% and 7.5%, respectively), this was offset by lower growth in the industrial sector (6.1%, 2Q 16: 6.3%). The stabilisation in overall growth was due mainly to monetary and fiscal stimulus by the Chinese Government. In particular, investment activity was supported by post-flood reconstruction activity, as well as increased financing for the infrastructure and property sectors. In the ASEAN economies, growth continued to be underpinned by domestic demand amid some policy support.

Global financial market volatility decreased during the quarter

In July, global equities trended higher as the fallout from the UK's EU referendum appeared to be contained. The Bank of England (BOE) and the European Central Bank's commitment to mitigate any adverse spillovers from the UK's EU referendum also lifted sentiments in the financial markets. In the second half of the quarter, while global equity markets declined as sentiments were affected by expectations of an imminent interest rate increase by the US Federal Reserve (Fed), most major and regional equity markets resumed their upward trend after the Fed left interest rates unchanged on 18 September. Against this environment, most currencies ended the quarter slightly higher against the US dollar. The pound sterling, however, depreciated towards the end of the quarter due to renewed concerns about the UK's exit from the EU.

Although the average Brent crude oil price remained steady during the quarter at USD47 per barrel (2Q 2016: USD47 per barrel), price movements during the quarter were volatile, reflecting news-driven shifts in market sentiments. At the beginning of the quarter, Brent crude oil price trended lower, as concerns of a global market oversupply re-emerged. This was triggered primarily by selected data releases in the US, which indicated unusually high gasoline inventory levels during the summer driving season and rising shale oil rig counts. Subsequently, Brent crude oil price increased, supported mainly by the expectations, and eventual announcement, of a tentative agreement to cut oil production amongst the OPEC member countries.

Subdued inflation in the advanced and Asian economies

During the quarter, while there were slight improvements to headline inflation in the US, UK and euro area, price pressures were relatively subdued. Of significance, prices in these economies continued to be weighed down by weak energy prices. In Japan, headline inflation (excluding fresh food) contracted further following a sharper decline in prices of housing.

Likewise, inflationary pressures remained subdued in most Asian economies. In Indonesia, PR China, Thailand and Chinese Taipei, inflation was weighed down by lower food prices, while an overall decrease in the cost of utility led to lower inflation in Korea. In Singapore, inflation contracted at a slower pace, due mainly to higher costs of transportation.

Global monetary policy stance remained accommodative

Overall monetary policy stance in the advanced economies remained highly accommodative, with several central banks conducting further easing measures. Following the outcome of the UK's EU referendum results, the BOE reduced the bank rate by 25 bps to a record low of 0.25% in August 2016. The BOE also launched a new stimulus package, which includes a new Term Funding Scheme, the purchase of up to GBP10 billion of UK corporate bonds and an expansion of the asset purchase scheme for UK government bonds of GBP60 billion. The Reserve Bank of Australia (RBA) also lowered the cash rate by 25 bps to 1.50% in August 2016, following weaker-than-expected inflation. In September, the Bank of Japan (BOJ) announced a new monetary policy framework called the "Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control" as it seeks to achieve the price stability target of 2% at the earliest possible time. The new policy framework consists of controlling the yield curve and an inflation-overshooting commitment. The framework will entail the BOJ setting short-term as well as long-term interest rates as operating targets and conducting purchases of Japanese Government Bonds to achieve the target levels. The BOJ has also committed to maintaining an increase in the monetary base until inflation exceeds the target of 2%.

In the region, a few central banks lowered policy rates during the quarter. In September, Bank Indonesia (BI) cut its key policy rate, the seven-day reverse repo rate from 5.25% to 5.00% as domestic inflationary pressures eased. BI also reduced the lending facility rate and the deposit facility rate by 25 bps each to 5.75% and 4.50%, respectively. Similarly, the Reserve Bank of India (RBI) cut its key policy rate in October, from 6.50% to 6.25%, citing a marked slowdown in global growth. This was the first decision by the recently appointed monetary policy committee, which pushed policy rates to a five-year low. All other central banks across the region maintained key policy rates.

Global growth prospects continue to be challenging going forward

Looking ahead, overall global economic conditions will likely continue to be challenging, with subdued growth prospects despite unprecedented easing of monetary conditions in major and regional economies. The pace of expansion in the advanced economies is expected to remain modest, while in Asia, domestic demand will continue to underpin growth. Downside risks remain high, arising from the uncertainty over the post-referendum future of the UK in the EU, persistence of low energy and commodity prices as well as possible disorderly market conditions arising from policy shifts in major economies. In this regard, international financial market conditions will likely continue to be vulnerable to setbacks and changes in sentiments.

DEVELOPMENTS IN THE MALAYSIAN ECONOMY

The Malaysian economy grew by 4.3% in the third quarter

The Malaysian economy expanded by 4.3% during the quarter (2Q 2016: 4.0%), underpinned mainly by sustained growth in private sector activity (6.0%; 2Q 2016: 6.1%). Public sector spending, however, expanded at a slower pace. As a result, growth in domestic demand moderated as the improvement in private sector activity was outweighed by the slower growth in public expenditure. On the external front, net exports provided some impetus to growth as real imports of goods and services contracted at a faster pace (-2.3%; 2Q 2016: 2.0%) compared to real exports (-1.3%; 2Q 2016: 1.0%). On a quarter-on-quarter seasonally-adjusted basis, the economy recorded a growth of 1.5% (2Q 2016: 0.7%).

GDP by Expenditure Components
(at constant 2010 prices)

	Share 2015 (%)	2015 3Q	2015 4Q	2016 1Q	2016 2Q	2016 3Q
		Annual change (%)				
Aggregate Domestic Demand (excluding stocks)	91.6	4.1	4.0	3.6	6.3	4.7
Private Sector	69.2	4.4	4.9	4.5	6.1	6.0
Consumption	*52.4*	*4.1*	*4.9*	*5.3*	*6.3*	*6.4*
Investment	*16.9*	*5.5*	*4.9*	*2.2*	*5.6*	*4.7*
Public Sector	22.4	2.9	2.1	0.4	6.9	0.3
Consumption	*13.5*	*3.6*	*3.3*	*3.8*	*6.5*	*3.1*
Investment	*8.9*	*1.8*	*0.4*	*-4.5*	*7.5*	*-3.8*
Net Exports	8.6	3.4	4.3	-12.4	-7.0	5.9
Exports of Goods and Services	*72.9*	*3.2*	*4.0*	*-0.5*	*1.0*	*-1.3*
Imports of Goods and Services	*64.3*	*3.1*	*4.0*	*1.3*	*2.0*	*-2.3*
GDP[1]	**100.0**[1]	**4.7**	**4.5**	**4.2**	**4.0**	**4.3**
GDP (q-o-q growth, seasonally adjusted)	**-**	**0.9**	**1.2**	**1.0**	**0.7**	**1.5**

[1] Numbers do not add up due to rounding and exclusion of stocks
Source: Department of Statistics, Malaysia

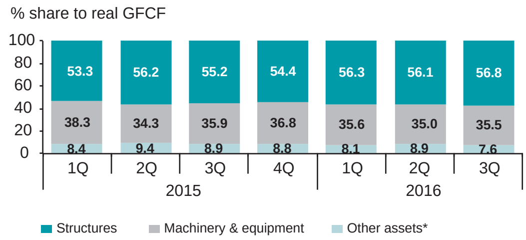
Slower expansion in domestic demand

Domestic demand grew by 4.7% in the third quarter of the year (2Q 2016: 6.3%), as the sustained growth in private sector activity (6.0%; 2Q 2016: 6.1%) was more than offset by the slower expansion in public sector expenditure (0.3%; 2Q 2016: 6.9%). **Private consumption** expanded by 6.4% (2Q 2016: 6.3%), supported by continued wage and employment growth as well as the increase in minimum wage effective 1 July 2016. **Private investment** grew by 4.7% (2Q 2016: 5.6%), underpinned mainly by continued capital spending in the services and manufacturing sectors. Businesses remained cautious in expanding capacity, following headwinds from the external front, including the UK's EU referendum and volatility in both financial and commodity markets.

Public consumption growth moderated to 3.1% (2Q 2016: 6.5%), as a result of lower spending on supplies and services. Growth of **public investment** contracted by 3.8% (2Q 2016: 7.5%), attributable mainly to lower spending on fixed assets by the Federal Government.

In terms of total investment, **gross fixed capital formation (GFCF)** growth moderated to 2.0% (2Q 2016: 6.1%), on account of a contraction in public investment and a moderation in private investment. By type of assets, the moderation in total investment was due to broad-based slower growth of capital spending in structures (5.0%; 2Q 2016: 5.9%), machinery and equipment (0.9%; 2Q 2016: 8.1%) and other type of assets (-12.5%; 2Q 2016: 0.8%).

GFCF by Type of Assets



*Other assets include mineral exploration, research & development , etc
Source: Department of Statistics, Malaysia

Major economic sectors continued to expand

On the supply side, growth in the third quarter was supported mainly by the services and manufacturing sectors, while the agriculture sector remained weak. The expansion in the services sector was underpinned primarily by private consumption activity, while growth in the manufacturing sector was supported by the export-oriented industries. In the construction sector, growth continued to be driven by civil engineering activity, while the mining sector expanded at a faster pace on account of higher crude oil production. Growth in the agriculture sector, however, remained in contraction, attributable largely to the lagged impact of El Niño on CPO yields.

The **services sector** expanded by 6.1% (2Q 2016: 5.7%), driven largely by private consumption activity. The growth in wholesale and retail trade; food & beverages and accommodation sub-sectors benefited from continued household spending. In the information and communication sub-sector, growth remained robust, reflecting strong demand for data communication services. Growth in the finance and insurance sub-sector improved, supported mainly by better performance in the life insurance segment and improvement in fee income growth. Amid slower trade activity, the transportation and storage sub-sector was supported mainly by passenger travel, as reflected in higher growth in airport passenger traffic during the quarter.

GDP by Economic Activity (at constant 2010 prices)

	Share 2015 (%)	2015		2016		
		3Q	4Q	1Q	2Q	3Q
		Annual change (%)				
Services	53.5	4.4	5.0	5.1	5.7	6.1
Manufacturing	23.0	4.9	5.0	4.5	4.1	4.2
Mining	9.0	5.1	-1.3	0.3	2.6	3.6
Agriculture	8.9	2.3	1.5	-3.8	-7.9	-5.9
Construction	4.4	9.9	7.4	7.9	8.8	7.9
Real GDP	**100.0[1]**	**4.7**	**4.5**	**4.2**	**4.0**	**4.3**
Real GDP (q-o-q seasonally adjusted)	**-**	**0.9**	**1.2**	**1.0**	**0.7**	**1.5**

[1] Numbers do not add up due to rounding and exclusion of import duties component

Source: Department of Statistics, Malaysia

Performance of the Services Sector (value added at constant 2010 prices)

	Share 2015 (%)	2015		2016		
		3Q	4Q	1Q	2Q	3Q
		Annual change (%)				
Intermediate Services	**38.1**	**3.7**	**4.1**	**4.7**	**5.5**	**6.1**
Finance & insurance	12.9	-3.1	-1.5	0.1	1.6	5.0
Real estate & business services	8.0	6.5	6.1	6.4	6.8	7.0
Transport & storage	6.6	5.7	6.0	5.8	5.9	5.2
Information & communication	10.6	9.5	9.2	8.5	8.8	7.6
Final Services	**61.9**	**4.7**	**5.4**	**5.4**	**5.8**	**6.1**
Wholesale & retail trade	27.4	5.7	6.4	5.2	6.6	6.7
Food & beverages and accommodation	5.2	5.8	5.8	6.2	6.9	7.4
Utilities	4.8	3.1	3.2	6.7	5.4	5.0
Government services	16.3	3.2	4.7	5.3	4.9	5.5
Other services	8.2	4.8	4.6	4.6	4.4	5.1
Total Services	**100.0[1]**	**4.4**	**5.0**	**5.1**	**5.7**	**6.1**

[1] Numbers do not add up due to rounding

Source: Department of Statistics, Malaysia

Selected Quarterly Indicators in the Services Sector

	2015		2016		
	3Q	4Q	1Q	2Q	3Q
	Index				
MIER Consumer Sentiments Index	70.2	63.8	72.9	78.5	73.6
MIER Retail Trade Index	93.3	77.9	65.9	105.0	111.6
MIER Tourism Market Index	116.5	89.8	93.0	99.5	112.1
	Annual change (%)				
Tourist arrivals	-3.8	-2.3	2.8	4.6	4.1[1]
Total passenger traffic at all airports	6.1	-3.0	3.8	0.4	8.2[1]
Total consumption credit outstanding	2.7	3.1	1.9	1.8	1.2
Total loans outstanding	9.7	7.9	6.4	5.6	4.2
Loans outstanding to the wholesale & retail trade, hotels & restaurants	10.3	8.2	7.0	5.2	3.1
Imports of consumption goods	27.2	38.1	24.6	10.0	-0.8
Total sales of motor vehicles	2.5	4.1	-22.0	-6.3	-12.4
Container cargo handled (Port Klang and PTP)	7.7	5.4	6.3	5.1	-3.7

[1] July-August 2016

Source: Various sources

The **manufacturing sector** registered a growth of 4.2% in 3Q 2016 (2Q 2016: 4.1%). Growth continued to be driven mainly by the export-oriented industries. This reflected the higher production of chemical-related products resulting from sustained regional demand as well as continued strength in the electronics segment, particularly semiconductors in line with recent recovery in global semiconductor sales. In the domestic-oriented industries, growth was underpinned by the production of food and construction-related products. However, the transport equipment segment remained weak as reflected by the contraction in the production of passenger cars during the quarter due to subdued consumer demand.

Performance of the Manufacturing Sector

	Share in 2015 (%)	2015		2016		
		3Q	4Q	1Q	2Q	3Q
		Annual Change (%)				
Overall Value Added (at constant 2010 prices)	**100.0**	**4.9**	**5.0**	**4.5**	**4.1**	**4.2**
Export-oriented industries	63.6	5.8	5.4	4.5	7.0	5.6
Domestic-oriented industries	36.4	3.2	4.1	4.6	-0.4	1.7
Overall Manufacturing Production[1]	**100.0**	**4.7**	**4.8**	**4.3**	**3.9**	**4.0**
Export-oriented industries	**77.6**	**5.2**	**4.7**	**4.2**	**4.2**	**4.1**
Electronics and electrical products cluster	**25.0**	**10.6**	**10.7**	**5.9**	**8.5**	**6.2**
Of which:						
Electronics	15.3	3.5	5.7	6.0	9.8	8.9
Electrical products	7.6	27.7	24.7	6.4	7.8	2.2
Primary-related cluster	**52.6**	**2.3**	**1.5**	**3.2**	**1.8**	**2.9**
Of which:						
Chemicals and chemical products	14.3	1.6	1.9	3.3	4.9	5.7
Petroleum products	21.0	2.1	-0.2	1.2	5.0	3.1
Rubber products	2.5	6.9	7.0	6.9	4.7	2.9
Off-estate processing	6.4	-0.9	-1.9	2.7	-21.4	-7.2
Domestic-oriented industries	**22.4**	**3.0**	**5.0**	**4.6**	**2.8**	**3.3**
Construction-related cluster	**11.3**	**3.9**	**4.8**	**4.9**	**5.0**	**4.0**
Of which:						
Construction-related products	8.2	3.7	3.7	4.7	4.5	3.3
Fabricated metal products	3.1	4.2	6.9	5.4	5.9	5.2
Consumer-related cluster	**11.1**	**2.1**	**5.1**	**4.2**	**0.9**	**2.7**
Of which:						
Transport equipment	5.5	2.2	3.7	2.0	-7.4	-2.0
Food, beverage & tobacco products	5.4	2.5	7.4	7.3	13.0	8.3

[1] Industrial Production Index (2010=100)

Source: Department of Statistics, Malaysia

The **construction sector** sector grew by 7.9% (2Q 2016: 8.8%), supported mainly by activity in the civil engineering sub-sector following progress in existing petrochemical, transport and utility projects. The residential sub-sector recorded higher growth, supported by new and ongoing construction activity in the mass-market housing segments, while growth in the non-residential sub-sector was affected by the lower activity for commercial projects. In the special trade sub-sector, growth moderated reflecting slower early-work activities, such as earthworks and land reclamation works.

Growth in the **agriculture sector** remained in contraction (-5.9%; 2Q 2016: -7.9%), as the lagged impact of El Niño on CPO yields continued to affect production. From January to September 2016, fresh fruit bunch (FFB) yields declined by 15%, compared to the same period last year. The **mining sector** grew by 3.6% (2Q 2016: 2.6%), supported by higher crude oil production, particularly in Sabah.

Performance of the Agriculture Sector

	Share in 2015 (%)	2015		2016		
		3Q	4Q	1Q	2Q	3Q
		Annual change (%)				
Value Added (at constant 2010 prices)	**100.0**	**2.3**	**1.5**	**-3.8**	**-7.9**	**-5.9**
Industrial Crops	**61.0**	**3.5**	**1.7**	**-9.2**	**-16.3**	**-12.0**
Of which:						
Oil palm	46.9	4.1	1.2	-10.0	-19.3	-13.8
Rubber	7.2	5.3	26.9	-13.0	-4.5	-9.2
Food Crops	**39.0**	**0.5**	**1.2**	**3.5**	**5.3**	**3.9**
Of which:						
Fishing	10.7	-3.2	2.4	-2.1	6.6	3.2
Livestock	10.7	2.0	0.4	5.0	4.9	4.2

Source: Department of Statistics, Malaysia

Performance of the Mining Sector

	2015		2016		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Value Added (at constant 2010 prices)	**5.1**	**-1.3**	**0.3**	**2.6**	**3.6**
Production					
Of which:					
Crude oil and condensates	7.3	0.2	-0.3	0.6	6.0
Natural gas	1.5	-5.0	0.0	3.9	0.4
Other mining and support services	15.4	14.4	6.5	8.6	6.9

Source: Department of Statistics, Malaysia

Indicators for the Construction Sector

	Share 2015 (%)	2015		2016		
		3Q	4Q	1Q	2Q	3Q
		Annual change (%)				
Value of construction work done	100.0	14.0	11.2	11.1	11.7	10.7
Residential buildings	29.4	8.3	8.7	8.4	12.5	16.4
Non-residential buildings	34.0	13.9	3.6	3.8	2.1	-1.4
Civil engineering	31.8	19.0	23.3	21.3	21.6	19.3
Special Trade[1]	4.7	17.5	4.4	17.3	13.5	4.2
Housing approvals		-44.5	-18.5	-22.1	-36.6	26.6
Production[2] of construction-related materials		3.9	4.8	4.9	5.0	4.0
Hydraulic cement		14.7	11.9	-7.9	-8.1	-8.3
Other porcelain and ceramic products		17.1	12.2	0.7	7.1	10.7
Prefabricated structural components for building or civil engineering of cement, concrete or artificial stone		-8.2	21.1	21.7	21.1	26.2
Capital imports (excluding lumpy items)		7.9	2.7	-7.8	3.7	0.1
Loans for the construction sector						
Approval		-24.0	-5.5	0.4	-14.1	34.4
Disbursement		5.4	-13.4	-2.8	5.3	7.7

[1] Works such as site preparation, electrical installation and painting
[2] Industrial Production Index (2010=100)

Source: Department of Statistics, Malaysia, Ministry of Urban Wellbeing, Housing and Local Government and Bank Negara Malaysia

Headline inflation moderated further in the third quarter

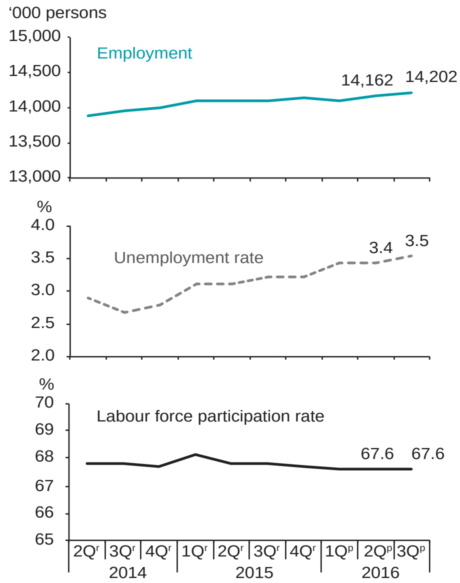
Inflation, as measured by the annual change in the Consumer Price Index (CPI), moderated further to 1.3% in the third quarter of 2016 (2Q 2016: 1.9%). During the quarter, inflation in the *food and non-alcoholic beverages* category was lower at 3.4% (2Q 2016: 4.2%). This was due mainly to an increase in the supply of *vegetables* and *fish and seafood* following an improvement in the weather conditions. Inflation in the *transport* category also registered a larger decline of 7.4% in the third quarter of 2016 (2Q 2016: -6.6%) due mainly to a larger increase in the prices of RON 97 and RON 95 petrol during the base period in the third quarter of 2015 (3Q 2016: average increase of 3 sen/litre; 3Q 2015: average increase of 7 sen/litre).

The Producer Price Index (PPI) declined in the third quarter of 2016 by 0.6% (2Q 2016: -2.1%). The slower pace of decline was due mainly to the increase in prices of *crude materials for further processing*, reflecting higher prices of crude palm oil. Crude palm oil prices rose significantly in the third quarter following rising global demand amid constrained supply as production recovered from El Niño.

Softer labour market conditions

Total employment continued to expand modestly during the quarter, registering a net gain of 40,500 jobs (2Q 2016: 65,700 jobs). Employment gains were supported mainly by the services sub-sectors, particularly in the educational, professional, scientific and technical as well as business services. Nonetheless, the gains in employment remained insufficient to absorb the growth in new labour entrants, contributing to an increase in the unemployment rate to 3.5% (2Q 2016: 3.4%). This was slightly higher than its medium-term average of 3.1% between 2010 and 2015. Based on insights from the Bank's industrial engagements, firms remained cautious in hiring new workers, due to moderate domestic growth, and weak external environment. However, retrenchments remained localised to specific industries, particularly in the oil & gas, E&E manufacturing, and the financial services industries, which are being affected by restructuring plans of global and regional players. Job postings on JobStreet.com remained high at 60,688 positions (2Q 2016: 65,964 positions, 2010-2015 average: 56,683 positions), reflecting employers' continued demand for workers. The labour force participation rate remained stable at 67.6% (2Q 2016: 67.6%).

Labour Market Indicators*



*The Labour Force Survey (LFS) figures for 1Q 2015 onwards reflect new current population estimates by DOSM

p Preliminary   r Revision

Source: Department of Statistics, Malaysia

Consumer Price Index

Category	Weights (%) (2010=100)	2Q 2016	3Q 2016
		Annual change, %	
Total	**100**	**1.9**	**1.3**
Food and non-alcoholic beverages	30.2	4.2	3.4
Housing, water, electricity, gas and other fuels	23.8	2.5	2.2
Transport	13.7	-6.6	-7.4
Others	32.3	2.8	2.7

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Wages in key economic sectors grew favourably, providing support to household spending. Growth was partly supported by the new minimum wage, which took effect in July 2016[1]. In the distributive trade services sub-sector[2], wage growth was slightly higher at 5.2% (2Q 2016: 4.7%). Aggregate wages in the manufacturing sector also grew at a stronger pace (6.9%; 2Q 2016: 5.0%), supported by higher wage growth in the E&E, petrochemicals and rubber industries.

External position remained resilient in the third quarter

In 3Q 2016, the **current account** surplus widened due mainly to a larger goods surplus, which more than offset the higher deficit in the services and investment income accounts.

In the trade account, gross export growth declined by 2.3% in 3Q 2016 (2Q 2016: 1.6%), as the broad-based contraction in manufactured exports more than offset the smaller drag from commodity exports. Gross import growth contracted by 0.1% (2Q 2016: 2.8%), reflecting weaknesses across all major import categories, except capital goods. As a result, the trade surplus remained sustained at RM18.0 billion (2Q 2016: RM17.9 billion).

Balance of Payments[1]

	2015		2016		
	3Q	4Q	1Q	2Q	3Q
	RM billion				
Current Account	**4.7**	**10.5**	**5.0**	**1.9**	**6.0**
(% of GNI)	*1.7*	*3.6*	*1.8*	*0.6*	*2.0*
Goods	27.2	31.1	23.5	19.8	26.5
Services	-6.0	-6.4	-6.8	-4.6	-5.1
Primary income	-10.6	-9.1	-6.7	-8.2	-10.8
Secondary income	-5.9	-5.0	-4.9	-5.1	-4.6
Financial Account	**-30.7**	**3.9**	**5.8**	**9.5**	**-6.3**
Direct investment	-0.2	5.8	3.7	5.3	3.0
Assets	*-6.7*	*-2.9*	*-11.2*	*-3.8*	*-11.3*
Liabilities	*6.5*	*8.6*	*14.9*	*9.1*	*14.3*
Portfolio investment	-24.4	15.9	13.1	0.1	-10.6
Assets	*0.7*	*5.6*	*-5.9*	*-4.7*	*-7.1*
Liabilities	*-25.1*	*10.3*	*19.0*	*4.8*	*-3.5*
Financial derivatives	-0.1	-0.1	0.5	0.0	-0.1
Other investment	-5.9	-17.6	-11.5	4.1	1.4
Errors & omissions[2]	43.0	-20.4	-38.4	-2.7	14.9
Overall Balance	**17.0**	**-6.0**	**-27.6**	**8.8**	**14.6**

Assets: (-) denotes outflows due to the acquisition of assets abroad by residents
Liabilities: (+) denotes inflows due to the incurrence of foreign liabilities
[1] In accordance with the Sixth Edition of The Balance of Payments and International Investment Position Manual (BPM6) by the International Monetary Fund (IMF)
[2] Includes unrealised foreign exchange revaluation gains/losses on international reserves

Source: Department of Statistics, Malaysia

Trade Account

	Share 2015 (%)	2015		2016		
		3Q	4Q	1Q	2Q	3Q
		Annual change (%)				
Gross Exports	**100.0**	**5.6**	**8.0**	**2.3**	**1.6**	**-2.3**
Manufactured	80.5	10.8	12.5	6.5	4.7	-1.1
E&E	*35.8*	*14.2*	*9.6*	*3.6*	*3.5*	*-0.7*
Non-E&E	*44.7*	*8.1*	*14.9*	*8.8*	*5.7*	*-1.5*
Resource based	*22.4*	*-0.6*	*2.7*	*1.7*	*6.4*	*-0.5*
Non-resource based	*22.3*	*18.6*	*29.5*	*16.2*	*5.1*	*-2.5*
Commodities	19.0	-12.3	-7.7	-13.4	-12.9	-8.2
Minerals	*10.3*	*-24.0*	*-15.1*	*-25.9*	*-23.0*	*-17.7*
Agriculture	*8.7*	*3.4*	*3.8*	*6.6*	*-2.8*	*1.2*
Gross Imports	**100.0**	**2.9**	**3.4**	**-0.4**	**2.8**	**-0.1**
Intermediate goods	58.3	-5.3	-1.7	-3.2	-1.0	-0.3
Capital goods	13.9	4.4	0.2	-12.7	10.9	15.6
Consumption goods	9.1	27.2	38.1	24.6	10.0	-0.8
Others (including re-exports and dual-use goods	18.7	20.7	8.9	8.8	5.2	-9.5
Trade balance (RM billion)	**–**	**22.4**	**30.6**	**23.9**	**17.9**	**18.0**

Source: MATRADE and Department of Statistics, Malaysia

After several quarters of positive growth, manufactured exports registered a contraction, attributable mainly to a decline in major resource- and non-resource based manufactured products. Nonetheless, the weakness in manufacturing exports was partially offset by continued positive growth in semiconductor exports. Commodity exports posed a smaller drag on exports due to higher demand for most major commodities and improved price of crude oil.

In terms of destination, export growth to key trading partners, such as Japan and the EU were affected by slower manufactured exports, particularly E&E products. Exports to PR China remained weak, as a result of lower exports of petroleum products, optical and scientific equipment, and E&E products. The moderation in exports to ASEAN countries was due mainly to slower exports of crude oil. Export performance to the US also moderated owing to the broad-based decline in agriculture goods.

[1] The upward revision of the minimum wage sets the level at RM1,000 per month in Peninsular Malaysia and RM920 per month in Sabah and Sarawak (Previous: RM900 and RM800, respectively)
[2] The distributive trade services sub-sector consists of the wholesale trade, retail trade, and motor vehicles industries

Gross imports registered a slight contraction during the quarter (-0.1%; 2Q 2016: 2.8%), weighed down by intermediate and consumption goods. Intermediate import growth remained weak, due mainly to lower demand for production inputs, particularly fuel-related products, in tandem with slower manufactured export growth. The contraction in consumption goods imports was due to slower imports of food and beverages, and semi-durable goods, particularly garments and footwear. Nonetheless, capital import growth was stronger in the third quarter, driven mainly by the delivery of a large gas vessel in July.

Malaysia: Direction of Exports

	Share 2015 (%)	2015		2016		
		3Q	4Q	1Q	2Q	3Q
		Annual change (%)				
European Union (EU)	**10.2**	**13.8**	**12.9**	**7.9**	**-0.1**	**-3.5**
Japan	**9.4**	**-6.7**	**-6.9**	**-16.1**	**-8.1**	**-13.0**
United States	**9.5**	**20.3**	**18.4**	**13.1**	**17.4**	**4.8**
ASEAN[1]	**28.2**	**5.5**	**8.5**	**6.5**	**5.6**	**3.3**
North East Asia	**23.9**	**10.1**	**6.9**	**-1.8**	**-9.3**	**-7.7**
People's Republic of China	*13.1*	*25.7*	*10.9*	*1.3*	*-16.6*	*-8.3*
Hong Kong SAR	*4.7*	*-0.9*	*1.0*	*-3.2*	*2.8*	*-1.4*
Korea	*3.2*	*-4.2*	*-9.8*	*-6.5*	*1.1*	*-16.2*
Chinese Taipei	*3.0*	*-13.4*	*22.6*	*-6.1*	*-4.8*	*-6.1*
West Asia[2]	**2.8**	**5.5**	**-3.3**	**5.2**	**5.6**	**-9.4**
India	**4.1**	**-14.4**	**7.8**	**3.0**	**-1.1**	**1.4**
Total exports	**100.0**	**5.6**	**8.0**	**2.3**	**1.6**	**-2.3**

[1] Singapore, Thailand, Indonesia, Philippines, Brunei Darussalam, Vietnam, Cambodia, Myanmar and Laos
[2] United Arab Emirates, Saudi Arabia, Oman, Iraq, Qatar, Kuwait, Jordan, Lebanon, Bahrain, Syria, Palestine, Yemen and Iran

Source: Department of Statistics, Malaysia

The deficit in the services account was larger at RM5.1 billion in the third quarter of 2016 (2Q 2016: a deficit of RM4.6 billion) due mainly to the higher payments for personal, cultural, and recreational services as residents engaged foreign service providers in hosting some international events. Higher payments for construction services and outbound tourism also contributed to the larger deficit. The former was due to payments for construction work done in projects related to oil and gas sector, the latter was due to residents travelling abroad for Hajj and participation in international sport events.

The deficit in the primary income account was larger at RM10.8 billion in the third quarter of 2016 (2Q 2016: a deficit of RM8.2 billion) as investment income accrued to foreign investors in Malaysia remained large while income accrued to Malaysian firms with ventures abroad were lower. During the quarter, FDI firms in the manufacturing, services and mining sectors continued to declare sizeable profits following higher demand and better commodity prices compared to 2Q 2016. Of importance, the FDI companies retained a larger portion of investment incomes for reinvestment in Malaysia. Similarly, the net payments in the secondary income account were lower at RM4.6 billion in the third quarter of 2016 (2Q 2016: net payment of RM5.1 billion), due mainly to lower outward remittances.

In the third quarter of 2016, the **financial account** recorded a net outflow of RM6.3 billion (2Q 2016: net inflow of RM9.5 billion), as net outflows in the portfolio investment account had more than offset the net inflows in the direct and other investment accounts.

Direct investment account continued to register a net inflow, albeit smaller at RM3.0 billion (2Q 2016: net inflow of RM5.3 billion), as the incurrence of direct investment liabilities continued to outpace the accumulation of direct investment assets.

On the assets side, outward direct investment amounted to RM11.3 billion (2Q 2015: net outflow of RM3.8 billion). Of these, Direct Investment Abroad (DIA) by Malaysian companies amounted to RM3.6 billion (2Q 2016: net outflow of RM3.5 billion), due mainly to sustained equity capital injections to subsidiaries abroad. The bulk of DIA was undertaken by companies in the services sector, particularly the finance and insurance and telecommunication sub-sectors, followed by the manufacturing sector.

On the liabilities side, inward direct investment was higher at RM 14.3 billion (2Q 2016: net inflow of RM9.1 billion). Of these, Foreign Direct Investment (FDI) moderated to RM6.5 billion (2Q 2016: net inflow of RM8.8 billion), as sustained equity capital injection and higher reinvested earnings were partially offset by a net extension of loans by subsidiaries in Malaysia to their parent companies. FDI inflows were largely channelled into the mining sector, followed by the services sector, mainly the finance and insurance and real estate sub-sectors.

During the quarter, portfolio investment recorded a significant outflow of RM10.6 billion (2Q 2016: net inflow of RM0.1 billion). Portfolio investment by non-residents recorded a net outflow of RM3.5 billion (2Q 2016: net inflow of RM4.8 billion), reflecting mainly the maturity of foreign currency-denominated Wakala Global Sukuk by the Federal Government and Bank Negara Monetary Notes (BNMN). This had more than offset the net purchase of equity securities during the quarter. Portfolio investment by residents also registered a higher outflow of RM 7.1 billion (2Q 2016: net outflow of RM4.7 billion), following higher net acquisition of foreign debt and equity securities, particularly by domestic institutional investors.

Other investment account registered a smaller net inflow of RM1.4 billion (2Q 2016: net inflow of RM4.1 billion), as the repatriation of maturing interbank placements abroad by domestic banks were mostly offset by the maturity of non-resident financial institutions' deposits in domestic banks.

Following these developments, the overall balance of payments registered a surplus of RM14.6 billion in the third quarter (2Q 2016: surplus of RM8.8 billion). Errors and omissions amounted to RM 14.9 billion or 4% of total trade, mostly reflecting the foreign exchange revaluation changes in international reserves arising from the strengthening of major currencies against the ringgit during the quarter. Excluding these revaluation changes, actual errors and omissions amounted to 0.5% of total trade.

Manageable external debt

Malaysia's external debt increased by RM17.0 billion to RM865.3 billion, equivalent to USD206.6 billion or 70.2% of GDP as at end-September 2016 (end-June 2016: RM848.2 billion or USD209.0 billion, equivalent to 68.8% of GDP). The increase was attributed to valuation effects following the weakening of the ringgit against most currencies during the quarter. About 80% of the foreign exchange valuation changes were accounted by offshore borrowing. Nonetheless, the offshore borrowing remained low at 38.3% of GDP as at end-September compared to 60% of GDP during the Asian Financial Crisis (AFC) in 1997-98.

In aggregate, the impact of foreign exchange fluctuations is mostly contained, as about 40% of total external debt is denominated in ringgit. The remaining portion denominated in foreign currency is largely hedged, either naturally through foreign currency earnings, or through the use of financial instruments.

Excluding valuation effects, Malaysia's external debt position increased marginally from the previous quarter. The increase in non-resident holdings of domestic debt securities and deposits in the domestic banking system was largely mitigated by net repayment of interbank borrowing and the redemption of the maturing Wakala Global Sukuk issued by the Federal Government in 2011.

Overall, Malaysia's external debt remains manageable, with medium- to long-term external debt accounting for more than half of the outstanding position (61.4%). The share of short-term external debt was reduced slightly to account for only 38.6% of the total external debt (end-June 2016: 39.3%) during the quarter. The international reserves were adequate to cover the short-term external debt by 1.2 times. About two-thirds of the short-term external debt is held by the banking sector, whereby not all pose a claim on international reserves given that this debt is partly covered by the banks' corresponding external assets. The bulk of the remaining short-term external debt is accounted for by trade credits and intercompany loans. The former are largely backed by export earnings, while the latter are generally on flexible and concessionary terms, such as no fixed repayment schedule and zero or low interest rate.

Outstanding External Debt

	2015	2016	
	end-Sept	end-June	end-Sept
		RM billion	
Offshore borrowing[1]	488.7	466.7	472.1
USD billion equivalent	*108.8*	*115.0*	*112.7*
Medium- and long-term	*294.4*	*288.4*	*295.8*
Public sector	135.3	121.7	120.4
Private sector	159.1	166.7	175.4
Short-term	*194.3*	*178.4*	*176.3*
NR holdings of dom. debt securities	198.9	232.3	237.1
Medium- and long-term	*171.7*	*215.8*	*223.5*
Short-term	*27.2*	*16.5*	*13.6*
NR deposits	82.8	77.3	82.6
Others[2]	80.2	71.9	73.5
Medium- and long-term	*12.5*	*11.0*	*11.8*
Short-term	*67.7*	*60.9*	*61.7*
Total external debt	**850.6**	**848.2**	**865.3**
USD billion equivalent	*189.4*	*209.0*	*206.6*
External debt (Redefined)			
Total debt/GDP (%)	73.5	68.8	70.2
Short-term debt[3]/Total debt (%)	43.7	39.3	38.6
Reserves/Short-term debt[3] (times)	1.1	1.2	1.2[5]
External debt (Previous definition)			
Total debt/GDP (%)	42.2	37.9	38.3
Short-term debt[4]/Total debt (%)	39.8	38.2	37.3
Reserves/Short-term debt[4] (times)	2.1	2.2	2.3[5]

[1] Equivalent to the external debt as previously defined, comprised mainly foreign currency loans raised, and bonds and notes issued offshore.
[2] Comprise trade credits, IMF allocation of SDRs and miscellaneous.
[3] Short-term offshore borrowing, NR holdings of short-term domestic debt securities, NR deposits, short-term trade credits and miscellaneous.
[4] Equivalent to short-term offshore borrowing.
[5] Based on international reserves as at 31 October 2016.

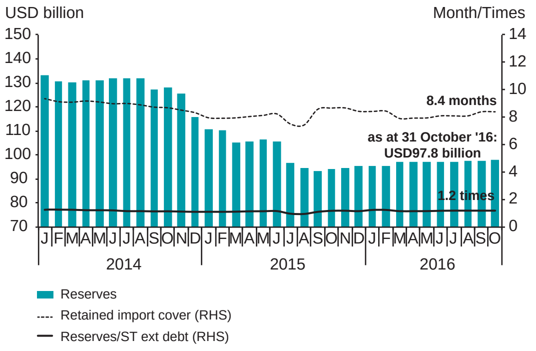
Note: NR refers to non-resident

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

International reserves remain ample to facilitate international transactions

As at 31 October 2016, the reserves position amounted to USD97.8 billion (equivalent to RM405.5 billion). The international reserves remain ample to facilitate international transactions. They are sufficient to finance 8.4 months of retained imports, significantly higher than the 3-month international threshold. The reserves level is also adequate to meet external obligations given the reserves to short-term external debt coverage of 1.2 times. It is important to note that not all short-term external debt creates a claim on reserves given the availability of external assets and export earnings of borrowers.

Net International Reserves (as at end period)

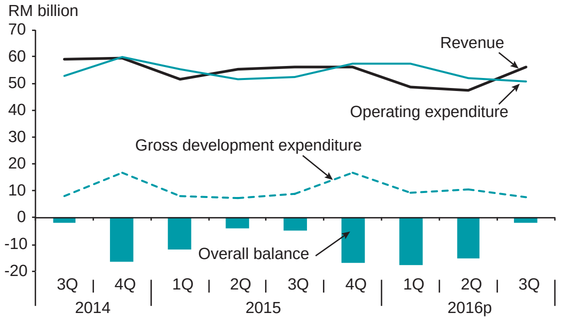


Source: Bank Negara Malaysia

Lower fiscal deficit

The Federal Government recorded a lower fiscal deficit of 0.6% of GDP in the third quarter (2Q 2016: -5.0% of GDP), due to higher revenue collection and a decline in total expenditure. Revenue increased by 0.1% on an annual basis (2Q 2016: -14.0%), supported by higher tax collections. Operating expenditure declined by 3.0% on an annual basis (2Q 2016: +0.5%) due mainly to lower expenditures on subsidies and transfers to statutory bodies. Development expenditure also recorded a decline on an annual basis. The bulk of the expenditure during the quarter was disbursed primarily to the transportation and public amenities sectors. As at end-September 2016, total outstanding debt of the Federal Government amounted to RM643.6 billion or 52.2% of the estimated 2016 GDP. In October, the Government tabled the 2017 Budget outlining a lower fiscal deficit target of 3.0% of GDP for 2017, reflecting its continued commitment on fiscal consolidation.

Federal Government Finance



p Preliminary
Source: Ministry of Finance, Malaysia

Federal Government Finance

	2015		2016p		
	3Q	4Q	1Q	2Q	3Q
	RM billion				
Revenue	56.3	56.0	48.8	47.5	56.3
% annual growth	*-4.9*	*-6.0*	*-5.3*	*-14.0*	*0.1*
Operating expenditure	52.3	57.5	57.4	52.1	50.7
% annual growth	*-1.2*	*-3.8*	*3.5*	*0.5*	*-3.0*
Current account	**4.0**	**-1.4**	**-8.6**	**-4.6**	**5.6**
% of GDP	***1.4***	***-0.5***	***-2.9***	***-1.5***	***1.8***
Net development expenditure	8.7	15.5	9.2	10.4	7.4
% annual growth	*7.5*	*-5.7*	*16.1*	*43.9*	*-15.1*
Overall balance	**-4.7**	**-16.9**	**-17.7**	**-15.0**	**-1.8**
% of GDP	***-1.6***	***-5.6***	***-6.1***	***-5.0***	***-0.6***
Memo item:					
Total net expenditure	61.0	72.9	66.5	62.5	58.1
% annual growth	*-0.1*	*-4.2*	*5.1*	*5.8*	*-4.7*
Total Federal Government debt[1]					
(as at end-period)	623.3	630.5	626.9	655.7	643.6
% of GDP	*53.9*	*54.5*	*50.9*	*53.2*	*52.2*
Domestic debt	435.1	433.1	416.7	424.9	411.4
% of GDP	*37.6*	*37.4*	*33.8*	*34.5*	*33.4*
External debt	188.3	197.4	210.2	230.8	232.2
% of GDP	*16.3*	*17.1*	*17.1*	*18.7*	*18.8*
Non-resident holdings of RM-denominated Federal Government debt	*166.0*	*176.0*	*190.2*	*206.2*	*211.8*
% of GDP	*14.3*	*15.2*	*15.4*	*16.7*	*17.2*
Offshore borrowing	*22.2*	*21.5*	*19.9*	*24.7*	*20.4*
% of GDP	*1.9*	*1.9*	*1.6*	*2.0*	*1.7*

p Preliminary
[1] A portion of the Housing Loan Fund debt amounting to RM21.9 billion (1.8% of estimated 2016 GDP) has been transferred to the new statutory body for civil servant housing loans (Public Sector Home Financing Board, LPPSA) beginning 2016
Note: Beginning first quarter of 2015, GDP has been rebased from base year 2005 to base year 2010
Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

MONETARY AND FINANCIAL DEVELOPMENTS

Interest rates lowered in line with OPR reduction

The Monetary Policy Committee (MPC) reduced the Overnight Policy Rate (OPR) by 25 bps to 3.00% in July 2016 and subsequently kept the policy rate unchanged in September 2016. The adjustment to the OPR was intended for the degree of monetary accommodativeness to remain consistent with the policy stance to ensure that the domestic economy continues on a steady growth path amid stable inflation, supported by continued healthy financial intermediation in the economy.

Reflecting the reduction in the OPR, interbank rates trended lower during the quarter. During the period 1-12 July, the average overnight interbank rate traded within a range of 3.05%-3.19%. Following the reduction in OPR on 13 July, the average overnight interbank rate decreased and stabilised at a lower range of 2.81%-3.00%. Interbank rates of longer maturities also declined in line with the reduction in OPR. For the quarter as a whole, the 3-month KLIBOR decreased from 3.65% to 3.40%.

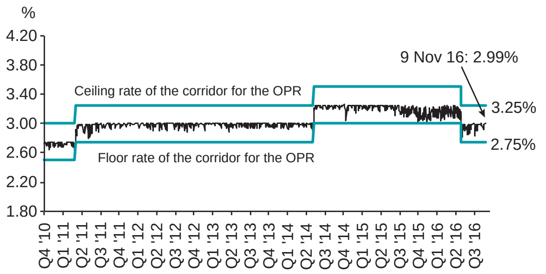
Following the reduction in OPR and interbank rates, retail lending rates also declined during the quarter. The weighted average base rate (BR) of commercial banks decreased by 23 bps and ended the third quarter at its lowest level since the BR was introduced in January 2015 (end-September: 3.60%; end-June 2016: 3.83%; January 2015: 3.81%). Correspondingly, the weighted average lending rate (ALR) on outstanding loans was lower at 5.27% as at end-September 2016, compared to 5.42% at end-June 2016. In addition, fixed deposit (FD) rates declined during the quarter by an average of 21 bps for tenures 1-year and below.

Interest Rates

	2015	2016	
	3Q	2Q	3Q
	At end-period (%)		
Overnight Policy Rate (OPR)	3.25	3.25	3.00
Interbank rates			
Overnight	3.12	3.13	2.99
1-month	3.60	3.44	3.08
Base lending rate (BLR)			
Commercial banks	6.79	6.81	6.65
Weighted average base rate (BR)			
Commercial banks	3.77	3.83	3.60
Weighted average lending rate (ALR)			
Commercial banks	5.38	5.42	5.27
Fixed deposit rates			
Commercial banks			
1-month	3.08	3.08	2.87
12-month	3.31	3.29	3.07

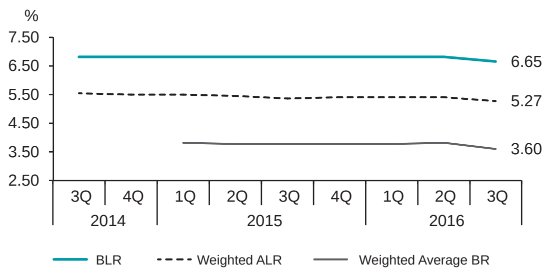
Source: Bank Negara Malaysia

Daily Weighted Average Overnight Interbank Rate



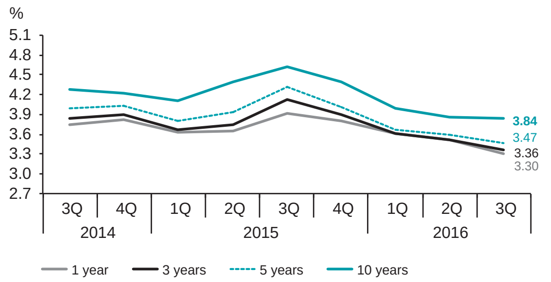
Source: Bank Negara Malaysia

Lending Rates of Commercial Banks (At end-period)



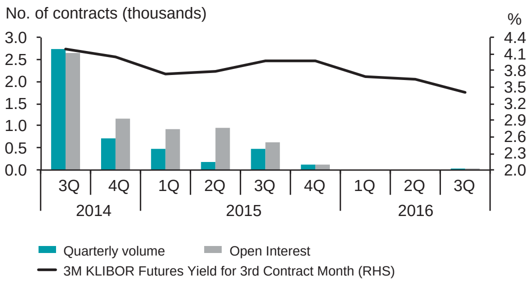
Source: Bank Negara Malaysia

Interest Rate Swap: Rates



Source: Bloomberg

3 Month KLIBOR Futures



Source: Bursa Malaysia

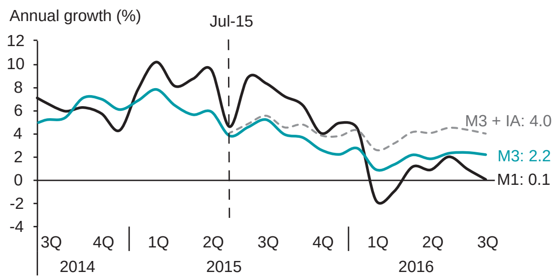
M3 expanded during the quarter

M1, or narrow money, decreased by RM5.6 billion during the quarter. On an annual basis, M1 recorded a growth rate of 0.1% as at end-September (end-June: 0.9%). M3, or broad money, increased by RM6.4 billion on a quarter-on-quarter basis to record an annual growth rate of 2.2% as at end-September (end-June: 1.9%).

The increase in M3 during the quarter was driven mainly by the continued expansion of credit extended to the private sector by the banking system. The expansion, however, was partially offset by *other influences*, reflecting the continued growth of Islamic Investment Accounts, issuance of equity by banks and foreign exchange revaluation effects.

In the banking system, liquidity conditions remained ample at both the institutional and system-wide levels. The level of surplus liquidity placed with BNM remained relatively stable during the quarter.

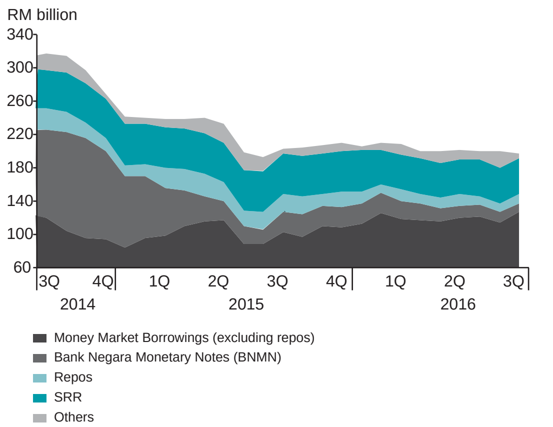
Monetary Aggregates



Note: From July 2015 onwards, the compilation of M3 is adjusted to exclude Islamic Investment Accounts (IA) due to a data reclassification exercise. This is reflected as a negative contribution through *'other influences'*. The dotted line represents M3 growth had this reclassification not taken place

Source: Bank Negara Malaysia

Outstanding Liquidity Placed with Bank Negara Malaysia (At end-period, RM billion)



Source: Bank Negara Malaysia

Determinants of Broad Money, M3

	Change during the period				
	2015		2016		
	3Q	4Q	1Q	2Q	3Q
	RM billion				
M3	**0.7**	**12.1**	**9.4**	**7.1**	**6.4**
Net claims on Government	11.1	5.1	-0.9	-1.9	2.0
Claims on private sector	37.0	31.6	11.2	22.3	23.5
Loans	*32.9*	*25.7*	*10.6*	*16.9*	*18.7*
Securities	*4.1*	*5.9*	*0.6*	*5.5*	*4.8*
Net foreign assets[1]	19.6	-0.2	-19.7	2.6	1.3
BNM	*15.8*	*-5.7*	*-26.9*	*8.6*	*14.4*
Banking System	*3.8*	*5.5*	*7.2*	*-6.0*	*-13.1*
Other influences	-66.9	-24.4	18.8	-15.9	-20.4

[1] Post-revaluation
Note: Numbers may not add up due to rounding

Source: Bank Negara Malaysia

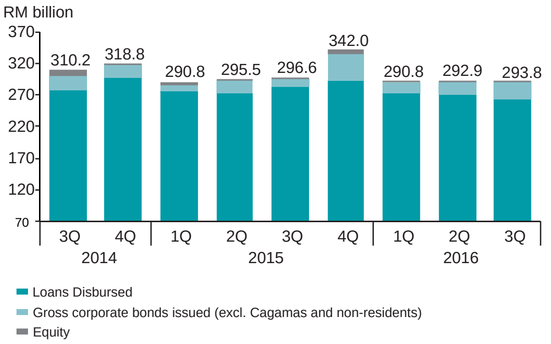
Private sector financing was sustained in the third quarter

In the third quarter, total gross financing raised by the private sector through the banking system, development financial institutions (DFIs), and the capital market amounted to RM293.8 billion (2Q 2016: RM292.9 billion). On a net basis, the growth of loans extended by the banking system, DFIs, and outstanding issuances of corporate bonds expanded by 6.5% as at end-September (end- June 2016: 6.9%).

Net lending to businesses by the banking system and DFIs increased by RM7.8 billion during the quarter (2Q 2016: RM3.1 billion). On an annual basis, although outstanding business loans grew at a slower pace of 2.0% as at end-September (end-June 2016: 3.8%), the annual growth in outstanding SME loans was sustained at 8.2% (end-June 2016: 9.2%). Similarly, while the level of loans disbursed by the banking system and DFIs to overall businesses slowed down to RM187.1 billion during the quarter (2Q 2016: RM195.2 billion), the level of loans disbursed to SMEs remained strong at RM66.7 billion during the quarter (2Q 2016: RM66.4 billion) with loans extended mainly to the *manufacturing; wholesale and retail trade, and restaurants and hotels; construction* and *education, health and other* sectors.

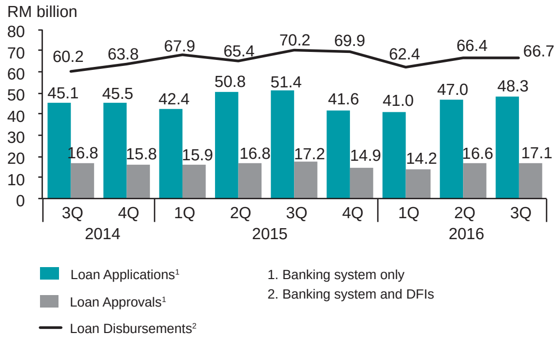
Net financing to the household sector expanded by RM12.1 billion during the quarter (2Q 2016: RM12.4 billion). On an annual basis, the growth of outstanding household loans moderated to 5.8% as at end-September (end-June 2016: 6.2%), reflecting mainly the moderation in outstanding loans for the *purchase of passenger cars; purchase of non-residential property; purchase of residential property;* and *personal financing.*

Gross Private Sector Financing through the Banking System, Development Financial Institution (DFIs) and Capital Market



Source: Bank Negara Malaysia

Lending to SMEs



Source: Bank Negara Malaysia

Financing of the Private Sector through the Banking System, DFIs and Capital Market

	2015		2016			2015		2016		
	3Q	4Q	1Q	2Q	3Q	3Q	4Q	1Q	2Q	3Q
	During the period (RM billion)					Annual growth (%)				
Gross total financing	**296.6**	**342.0**	**290.8**	**292.9**	**293.8**	**-4.4**	**7.3**	**0.0**	**-0.9**	**-0.9**
Loans disbursed	282.2	293.9	271.8	270.8	263.6	1.6	-0.9	-1.2	-0.5	-6.6
Gross Corporate bond (CB)[1]	11.8	40.6	17.9	20.1	27.0	-49.8	91.4	63.0	0.1	128.03
Equity	2.5	7.5	1.1	2.1	3.2	-72.0	681.5	-76.8	-37.4	28.0
Net total financing	**43.5**	**55.2**	**11.5**	**24.9**	**39.9**	**8.5**	**8.4**	**7.5**	**6.9**	**6.5**
Outstanding loans (Banking system* and Development Financial Institution (DFIs))	38.6	23.0	4.6	17.2	21.9	9.3	7.7	6.3	5.5	4.3
Outstanding CB	5.0	32.2	7.0	7.7	17.9	6.0	10.7	11.4	11.5	14.2
Memorandum item										
Gross CB[2]	20.5	13.1	18.4	20.1	27.6	10.8	-47.1	60.5	-1.9	109.8

* Include loans sold to Cagamas
[1] Excluding Cagamas and foreign issuances
[2] Including Cagamas and foreign issuances
Note: Numbers may not add up due to rounding

Source: Bank Negara Malaysia

Loan Indicators

	During the period (RM billion)					Annual growth (%)				
	2015		2016			2015		2016		
	3Q	4Q	1Q	2Q	3Q	3Q	4Q	1Q	2Q	3Q
Total										
Loan applications[1]	224.8	215.6	187.7	212.6	204.0	2.6	2.6	5.1	2.1	-9.3
Loan approvals[1]	96.5	100.2	76.7	89.5	87.6	-8.7	-5.8	-18.4	-12.7	-9.2
Loan disbursements[2]	282.2	293.9	271.8	270.8	263.6	1.6	-0.9	-1.2	-0.5	-6.6
Loan repayments[2]	264.8	276.6	275.8	265.5	257.9	1.7	3.4	3.4	5.4	-2.6
Change in outstanding loans*[,2]	38.6	23.0	4.6	17.2	21.9	9.3	7.7	6.3	5.5	4.3
Of which:										
Business enterprises[3]										
Loan applications	112.9	107.6	87.8	102.7	93.9	4.2	7.2	12.0	5.0	-16.9
Loan approvals	44.0	49.0	35.7	43.7	40.0	0.1	6.2	-10.4	-7.0	-9.1
Loan disbursements	205.3	212.1	195.9	195.2	187.1	3.1	-1.2	1.4	0.5	-8.9
Loan repayments	195.2	205.7	201.0	193.3	185.2	1.9	4.4	3.2	6.1	-5.1
Change in outstanding loans*	17.6	5.4	-4.8	3.1	7.8	10.2	7.7	4.9	3.8	2.0
SMEs										
Loan applications	51.4	41.6	41.0	47.0	48.3	13.9	-8.6	-3.3	-7.5	-5.9
Loan approvals	17.2	14.9	14.2	16.6	17.1	2.8	-5.6	-10.9	-1.5	-0.9
Loan disbursements	70.2	69.9	62.4	66.4	66.7	16.5	9.6	-8.1	1.6	-4.9
Loan repayments	67.0	67.6	61.8	67.5	67.4	12.3	14.8	0.9	8.1	0.6
Change in outstanding loans*	7.0	5.9	2.9	8.1	4.9	16.7	14.6	9.0	9.2	8.2
Non-SMEs[3]										
Loan applications	61.5	66.0	46.8	55.7	45.5	-2.6	20.3	29.9	18.5	-26.0
Loan approvals	26.8	34.1	21.6	27.1	22.9	-1.5	12.3	-10.0	-10.1	-14.4
Loan disbursements	135.2	142.2	133.5	128.8	120.4	-2.8	-5.7	6.6	-0.1	-10.9
Loan repayments	128.2	138.2	139.2	125.8	117.8	-2.8	0.0	4.3	5.0	-8.1
Change in outstanding loans*	10.6	-0.5	-7.7	-5.0	2.9	5.2	2.3	1.5	-0.9	-3.3
Households										
Loan applications	111.9	108.0	99.9	109.9	110.1	1.0	-1.5	-0.2	-0.5	-1.6
Loan approvals	52.5	51.2	41.0	45.8	47.6	-15.1	-15.0	-24.3	-17.6	-9.3
Loan disbursements	76.9	81.8	75.9	75.6	76.5	-2.0	-0.3	-7.4	-3.0	-0.5
Loan repayments	69.6	70.8	74.8	72.2	72.7	1.1	0.6	3.7	3.5	4.4
Change in outstanding loans*	14.2	18.4	8.5	12.4	12.1	7.9	7.6	6.5	6.2	5.8

* The annual growth is for end-period
[1] Loan applications and approvals for all segments include only banking system loans
[2] Loan disbursements, repayments and change in outstanding loan for all segments includes banking system and development financial institutions (DFIs)
[3] Includes domestic non-bank financial institutions, domestic financial institutions, government, domestic other entities and foreign entities
Note: Numbers do not add up due to rounding

Source: Bank Negara Malaysia

Loans by Sector (Banking System and DFIs)

	Loans disbursed						Outstanding Loans
	During the period (RM billion)					Share of total	Share of total
						(%)	
	3Q 2015	4Q 2015	1Q 2016	2Q 2016	3Q 2016		
Business enterprises[1,*]	**205.3**	**212.1**	**195.9**	**195.2**	**187.1**	**71.0**	**42.5**
Non-SMEs[1]	*135.2*	*142.2*	*133.5*	*128.8*	*120.4*	*45.7*	*24.6*
*SMEs**	*70.2*	*69.9*	*62.4*	*66.4*	*66.7*	*25.3*	*17.9*
Selected sectors[1]							
Agriculture, hunting, forestry and fishing	11.1	11.4	12.0	12.4	12.4	4.7	2.7
Mining and quarrying	3.7	6.2	1.8	2.1	2.2	0.8	0.7
Manufacturing	55.0	54.4	49.9	50.0	51.9	19.7	6.4
Construction	16.2	17.1	17.2	16.6	17.5	6.6	4.6
Real estate	14.8	13.3	12.6	14.7	13.4	5.1	6.5
Electricity, gas and water supply	2.0	2.8	2.4	2.7	2.0	0.7	0.8
Wholesale, retail, restaurants and hotels	51.9	54.0	49.1	51.1	50.7	19.2	6.9
Transport, storage and communication	5.8	4.4	5.6	8.4	5.6	2.1	2.5
Finance, insurance and business services	24.7	32.0	28.7	26.6	21.7	8.2	3.2
Households	**76.9**	**81.8**	**75.9**	**75.6**	**76.5**	**29.0**	**57.5**
Purchase of residential properties	20.3	21.9	20.3	19.7	18.8	7.1	27.7
Consumption credit	47.0	49.8	45.9	46.8	48.7	18.5	19.6
Of which:							
Credit cards	*25.3*	*27.5*	*26.3*	*26.2*	*27.2*	*10.3*	*2.2*
Purchase of passenger cars	*10.4*	*10.2*	*8.7*	*8.6*	*9.2*	*3.5*	*9.0*
Others	9.6	10.1	9.7	9.1	9.0	3.4	10.1
Total	**282.2**	**293.9**	**271.8**	**270.8**	**263.6**	**100.0**	**100.0**

* Include loans to individual businesses.
[1] Include domestic non-bank financial institutions, domestic financial institutions, government, domestic other entities and foreign entities.
Note: Numbers do not add up due to rounding

Source: Bank Negara Malaysia

Lower net financing from the capital market

Net funds raised in the capital market moderated to RM13.5 billion in the third quarter of 2016 (2Q 2016: RM33.4 billion). The decline was due mainly to the large redemptions of Government debt securities.

In the public sector, gross funds raised were generally lower in the third quarter across all issuances of Government debt securities. In addition, large redemptions amounting to RM28.0 billion (2Q 2016: RM2.2 billion), particularly for Malaysian Government Securities (MGS), offset the issuances and resulted in net redemptions of RM7.2 billion in the third quarter (net funds raised in the 2Q 2016: RM23.6 billion).

In the private sector, net funds raised were substantially higher at RM20.7 billion (2Q 2016: RM9.8 billion), driven mainly by higher net issuances of corporate bonds and equities. Funds raised in the private bond market were primarily from the *finance, insurance, real estate and business services* and *Government and other services sectors*, and were mainly used for refinancing activities and for funding infrastructure projects.

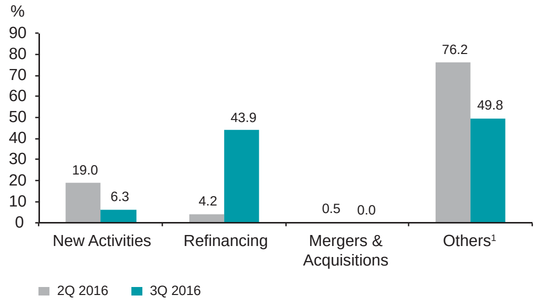
Net Funds Raised in the Capital Market

	2015		2016		
	3Q	4Q	1Q	2Q	3Q
	RM billion				
By Public Sector	**(10.0)**	**13.5**	**18.7**	**23.6**	**(7.2)**
Government securities, Gross	21.5	21.7	25.7	25.8	20.8
Malaysian Government Securities	14.5	10.9	12.1	16.2	11.9
Government Investment Issues	6.5	10.9	13.6	9.6	8.9
Sukuk Pinjaman Perumahan Kerajaan	0.5	-	-	-	-
Less: Redemptions	31.5	8.2	7.0	2.2	28.0
Malaysian Government Securities	21.0	8.2	-	2.2	24.0
Government Investment Issues	10.5	-	7.0	-	4.0
Sukuk Pinjaman Perumahan Kerajaan	-	-	-	-	-
By Private Sector	**7.4**	**37.9**	**6.7**	**9.8**	**20.7**
Shares	2.5	7.5	1.1	2.1	3.2
Corporate bonds, Net	5.0	30.5	5.6	7.7	17.5
Corporate bonds, Gross	*13.1*	*40.6*	*18.4*	*20.1*	*27.6*
Less: Redemptions	*8.2*	*10.1*	*12.7*	*12.4*	*10.0*
Total	**(2.6)**	**51.4**	**25.4**	**33.4**	**13.5**

Note: Numbers may not add up to total due to rounding

Source: Bank Negara Malaysia and Bursa Malaysia

Corporate Bond Issued by Purpose (% of total)



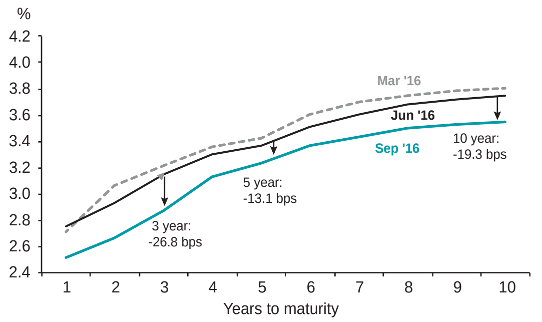
[1] Includes issuance for the purpose of capital expenditure, working capital and general business activities as well as issuance by non-residents and Cagamas

Source: Bank Negara Malaysia

Bond yields declined further in the third quarter

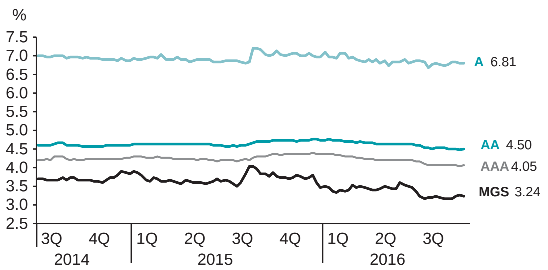
MGS yields continued to decline in the third quarter of 2016, reflecting sustained non-resident demand for Malaysian sovereign bonds. During the quarter, the share of non-resident holdings increased to 51.3% of total MGS outstanding (2Q 2016: 49.8%). As a result, the 3-year, 5-year and 10-year MGS yields declined by 27, 13 and 19 bps, respectively. In the private bond market, yields declined on account of sustained demand by domestic investors. The yields on the 5-year AAA and AA-rated corporate bonds declined by 12 and 11 bps, respectively during the period.

Trend in MGS Yields



Source: Bank Negara Malaysia

5 year MGS and 5 year Corporate Bond Yields

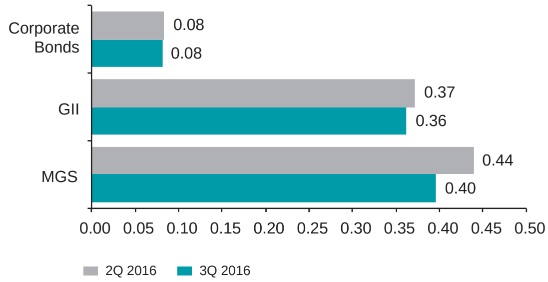


Source: Bank Negara Malaysia

Lower trading in the bond market

Despite the sustained demand for Malaysian bonds, total trading in the secondary market was lower at RM269.1 billion during the quarter (2Q 2016: RM286.9 billion) as investors traded cautiously amid the continued uncertainty over the timing of US interest rate normalisation. Correspondingly, all segments recorded slightly lower liquidity ratios compared to the previous quarter. The MGS, Government Investment Issue (GII) and corporate bond segments registered liquidity ratios of 0.40, 0.36 and 0.08, respectively.

Liquidity Ratio: Value of Bonds Traded / Outstanding



Source: Bank Negara Malaysia

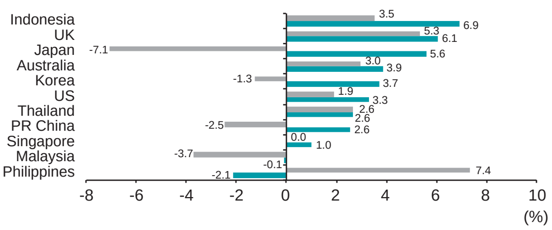
FBM KLCI declined marginally during the quarter

During the third quarter of 2016, the FBM (FTSE Bursa Malaysia) KLCI declined marginally by 0.1% to close at 1,652.6 points at end-September (end-June 2016: 1,654.1 points). During the first half of the quarter, the index was on an increasing trend driven by strong buying by non-resident investors as investor concerns over the negative impact of the EU referendum in the UK subsided along with increased expectations of additional monetary easing and fiscal stimulus measures by key advanced economies. The improvement in global oil prices, particularly in mid-August, also supported sentiments in the equity market. The gain in the index was subsequently offset in the second half of the quarter as equity markets across the region were affected by uncertainties over the timing of US interest rate normalisation and declining global oil prices.

Overall, market capitalisation increased to RM1.69 trillion as at end-September 2016 (end-June 2016: RM1.66 trillion) while the daily average turnover increased to 1.87 billion units (2Q 2016: 1.77 billion units) during the quarter.

On 9 November 2016, the KLCI ended lower at 1647.6 points (since end-September 2016: -0.3%), with a market capitalisation of RM1.68 trillion (since end-September 2016: -0.6).

Performance of Selected Global and Regional Markets in 2016 (% growth QoQ)



Source: Bloomberg and Bank Negara Malaysia calculations

Bursa Malaysia: Selected Market Indicators

	2015		2016		
	As at end				
	Sep	Dec	Mar	Jun	Sep
Price Indices					
Composite	1,621.0	1,692.5	1,717.6	1,654.1	1,652.6
FBMEMAS[1]	11,201.6	11,793.7	11,920.8	11,530.2	11,687.6
ACE Market[2]	5,567.6	6,389.2	5,637.0	5,145.1	5,219.9
Market capitalisation (RM billion)	1,597.4	1,695.2	1,707.4	1,660.3	1,686.2
No. of companies listed	904	903	904	905	905
	During the period				
	3Q	4Q	1Q	2Q	3Q
Average daily turnover					
Volume (million units)	1,899.2	2,234.0	1,875.8	1,770.6	1,870.0
Value (RM million)	2,005.6	2,149.7	2,052.2	1,996.4	1,876.7

[1] FBMEMAS stands for FTSE Bursa Malaysia EMAS Index
[2] From 3 August 2009, MESDAQ market was replaced with ACE Market

Source: Bursa Malaysia

Bursa Malaysia: Market Turnover

	2015				2016					
	3Q		4Q		1Q		2Q		3Q	
	Billion units	RM billion	Billion units	RM billion	Billion units	RM billion	Billion units	RM billion	Billion units	RM billion
Turnover	117.8	124.3	138.5	133.3	112.5	124.1	111.5	125.8	114.1	114.5
Of which:										
Main Board	68.0	111.4	82.5	121.4	76.3	117.0	75.3	118.9	73.2	107.8
Of which										
Consumer Products	6.3	6.2	7.0	6.8	8.8	7.3	8.1	6.9	4.9	6.1
Industrial Products	12.9	14.7	19.1	21.8	14.6	19.3	14.2	15.7	14.2	14.1
Construction	4.2	5.4	3.9	4.6	4.1	5.3	3.9	5.2	3.4	4.7
Trading/Services	28.4	45.5	32.4	51.3	30.7	48.0	30.9	51.5	31.9	47.4
Finance	3.5	22.3	2.9	17.7	3.1	20.1	3.6	23.6	4.1	18.2
Properties	5.5	4.1	7.5	5.0	6.4	3.4	5.6	3.3	4.6	4.9
Plantations	1.3	3.7	1.7	5.0	1.6	5.9	1.5	5.6	1.7	5.7
Infrastructure	1.1	4.7	1.0	4.3	0.8	3.2	0.7	2.8	0.7	2.5
ACE Market[1]	21.0	5.1	36.7	8.3	20.5	4.1	23.2	4.5	19.2	3.4

[1]From 3 August 2009, MESDAQ market was replaced with ACE Market

Source: Bursa Malaysia

Ringgit weakness driven primarily by external factors

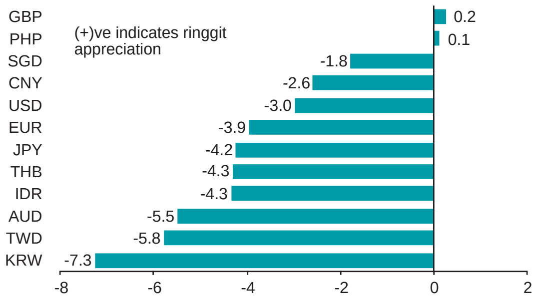
The ringgit depreciated against most major and regional currencies during the quarter. This was a reflection of the shifts in investor sentiments and rebalancing of portfolio investments activity throughout the quarter driven mainly by external events. While all regional currencies were affected by the continued uncertainty over the timing of US interest rate normalisation, the ringgit and the currencies of other commodity-exporting countries also faced additional adjustments due to the highly volatile global crude oil prices during the quarter.

Overall, the ringgit depreciated by 3.0% against the US dollar during the quarter. The ringgit also depreciated against the euro (-3.9%), the Japanese yen (-4.2%) and the Australian dollar (-5.5%), but appreciated against the pound sterling (0.2%). The ringgit also depreciated against all regional currencies except the Philippine peso, by between 1.8% and 7.3%.

Between 1 October and 9 November 2016, the ringgit depreciated against the US dollar (-1.8%). The ringgit also depreciated against the Japanese yen (-1.3%), the Australian dollar (-1.7%), and the euro (-1.9%), but appreciated against the pound sterling (2.0%).The ringgit also depreciated against most regional currencies.

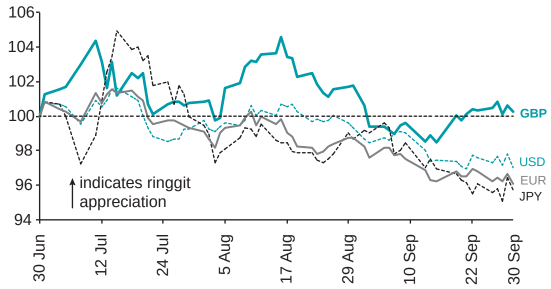
Summary of Ringgit Performance against Selected Currencies

Percent Change (1 July - 30 September 2016)



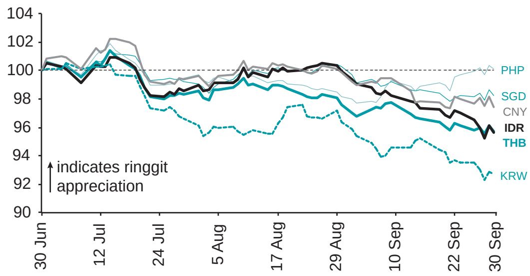
Source: Bank Negara Malaysia

Ringgit Performance against Major Currencies



Source: Bank Negara Malaysia

Ringgit Performance against Regional Currencies



Source: Bank Negara Malaysia

Performance of Ringgit against Selected Currencies

RM per foreign currency	As at end			% change since*	
	3Q 2015	2Q 2016	3Q 2016	3Q 2015	2Q 2016
US dollar	4.4455	4.0225	4.1455	7.2	-3.0
Euro	5.0052	4.4664	4.6500	7.6	-3.9
Pound sterling	6.7412	5.3910	5.3775	25.4	0.2
Australian dollar	3.1176	2.9899	3.1632	-1.4	-5.5
100 Japanese yen	3.7084	3.9145	4.0881	-9.3	-4.2
Singapore dollar	3.1191	2.9816	3.0359	2.7	-1.8
100 Thai baht	12.223	11.428	11.943	2.3	-4.3
100 Philippine peso	9.5050	8.5599	8.5492	11.2	0.1
100 Indonesian rupiah	0.0303	0.0305	0.0319	-4.9	-4.3
100 Korean won	0.3740	0.3489	0.3762	-0.6	-7.3
100 New Taiwan dollar	13.516	12.472	13.236	2.1	-5.8
Chinese renminbi	0.6994	0.6054	0.6215	12.5	-2.6

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

Source: Bank Negara Malaysia

Foreign exchange derivatives activities were lower in the third quarter of 2016 as volatility in the financial market was subdued

Foreign exchange derivatives volume were lower during the quarter compared to the same period in the previous year (-11.1%, Q2 2016: -2.9%). Lower volumes were observed for FX swap activities (-18.6%) and cross-currency swap (-5.3%). The reduction in volume was attributed to the decrease in resident's hedging activities amid lower volatility in the local market during the period. Oil prices stabilised and there were more certainties in the path of the Federal Reserves' interest rate decision. The expectation of a hike in interest rates by the Federal Reserves before the end of 2016 is higher after series of improvements in US economic and labour data.

The 5-year USD/MYR cross-currency swap narrowed to 55 bps from the previous quarter's closing of 83 bps. The narrowing in basis was attributed to ample US dollar liquidity in the domestic market, with risks remaining over the impact of the UK's EU referendum.

MANAGING RISKS TO FINANCIAL STABILITY

The Malaysian financial system remains resilient. This resilience is expected to be maintained in the period ahead. While businesses and households continue to adjust to the more challenging operating conditions and higher cost of living, these adjustments are expected to have modest impact on financial institutions' earnings and asset quality. Supported by strong capital and liquidity positions, the Malaysian financial system is well-positioned to continue performing its intermediation function in an effective and efficient manner. Going forward, external events will continue to weigh heavily on investor sentiments and volatility in the domestic financial markets. These include increased uncertainty over policy adjustments and growth in the major economies, volatile commodity prices and developments in the UK post the EU referendum. Domestic financial system stability is nonetheless expected to be maintained.

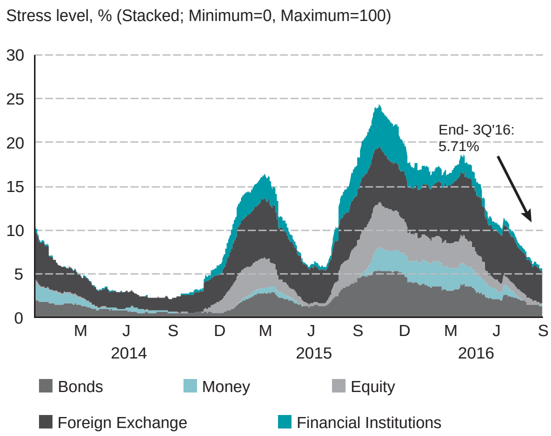
Domestic financial market conditions remained orderly

Conditions in the domestic financial markets remained orderly throughout the quarter. Overall volatility in the equity, money and ringgit foreign exchange markets was lower as implied by the Financial Market Stress Index. In the MGS market however, average volatility for the 10-year yields edged higher (3Q 2016: 10.3%; 2Q 2016: 9.5%) following the reduction in domestic OPR in July and subsequently, remained elevated amid continuous uncertainty on the timing of the next adjustment of the US interest rate ahead of the Federal Open Market Committee meeting.

Portfolio investments recorded a net outflow position of RM10.6 billion (2Q 2016: net inflow of RM77 million), mainly attributable to higher acquisitions of portfolio assets abroad by domestic institutional investors. Non-resident portfolio investment also registered a net outflow mainly driven by maturing foreign currency-denominated government sukuk and BNMN. As at end-3Q 2016, non-residents held about half of total outstanding MGS (51.3%; 2Q 2016: 49.8%), with 55.8% of the holdings maturing within the next 5 years (2Q 2016: 59.2%). Correspondingly, the 3, 5 and 10-year MGS yields eased to 2.88%, 3.24% and 3.55% respectively (2Q 2016: 3.15%, 3.37% and 3.74% respectively). In the equity market, non-resident holdings remained largely unchanged at 22.8% of total market capitalisation (2Q 2016: 22.9%).

Trading liquidity declined in the MGS and equity markets. The monthly turnover ratio averaged lower to 12.4% for MGS and 1.7% for FBM KLCI (2Q 2016: 14.9% and 2.1%, respectively). The bid-ask spreads were unchanged at 0.1% of mid-price for MGS and 0.4% of mid-price for FBM KLCI. In the currency market, ringgit depreciated by 3% against the US dollar to end the quarter at RM4.1455 per US dollar (2Q 2016: RM4.0225). The 5-year cross-currency basis swap spread narrowed to 55 bps (2Q 2016: 83 bps), while the 5-year sovereign credit default swap spread narrowed to 122.4 bps (2Q 2016: 156.1 bps).

Financial Market: Financial Market Stress Index (FMSI)



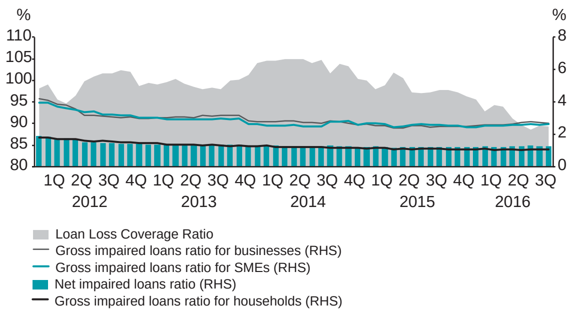
Note:
1. The FMSI is a risk monitoring tool for financial markets, developed based on the European Central Bank's (ECB's) Composite Indicators of Stress Index (CISS). It is constructed from indicators of volatility in five components of domestic financial markets - bonds, money, equity, foreign exchange and financial institutions.
2. The FMSI at a specific date is expressed as a value between 0 and 100, which signifies the lowest to highest stress level.

Source: Bloomberg and internal computation

Credit risk exposures are manageable amid sustained debt servicing capacity

At this juncture, credit risk exposures of financial institutions are stable. Asset quality continued to be supported by sustained debt servicing capacity of borrowers. For banks, this also reflects sustained credit underwriting and risk management practices. Delinquencies, measured by loans-in-arrears of between one and three months, increased marginally to 2.1% (2Q 2016: 2.0%) of total bank loans. Impaired loans, net of individual impairment provisions, was however unchanged at 1.3% of net loans in September 2016. Banks' loan loss coverage ratio[3] stood at 89.4%. In recent period, the ratio has been trending downwards (2Q 2016: 89.6%; 1Q 2016: 94.2%). This decline is supported by higher regulatory reserves thus positioning banks to manage potential losses from deterioration in credit portfolio. Taking into account regulatory reserves for loans and financing, banks have sufficient buffers[4] for potential credit losses. In the insurance and takaful industry, credit exposures were broadly stable at 4.0% of total capital available (2Q 2016: 4.2%).

Banking System: Loan Quality



Source: Bank Negara Malaysia

Household borrowings grew more moderately at 5.8% for the quarter (2Q 2016: +6.2%). House financing, the key driver of increase in household debt, expanded by 9.7% (2Q 2016: +10.2%) led mainly by sustained demand for affordable housing. Stable income and labour market conditions continued to support adjustments by some households to higher cost of living, particularly those living in urban areas. The share of total household debt borne by vulnerable borrowers[5] declined further to 22.6% (2014: 24.3%; 2013: 28.4%) of total bank and non-bank lending to households. For lenders, the risk of large losses from the household portfolio was also mitigated by improved affordability assessments and sustained underwriting practices. 73% of new loan accounts have a debt service ratio (DSR) of less than 60%.

Impaired loans for both banks and non-banks remained low and stable at 1.6% (2Q 2016: 1.6%) while delinquencies increased slightly to 1.5% of total household debt (2Q 2016: 1.4%). This came from lower income households whose variable income has been adversely affected. The potential risks to domestic financial stability, particularly from the vulnerable borrowers, however, remained mitigated and well within the excess capital buffers of banks.

For businesses, total debt grew by 3.7% (2Q 2016: 8.1%) y-o-y. This was mainly driven by fund raising from the capital market (+RM40.7 billion or 12.9%) and external borrowings (+RM28.4 billion or 10.9%). About 60% of the increase in external borrowings was attributed to exchange rate valuation effects with the remaining driven by net new borrowings in the second quarter of 2016. Outstanding business loans by banks recorded a slower growth of 2.0% as at end-3Q 2016 (2Q 2016: 4.2%) amid moderation in demand for financing, mainly in the real estate, oil and gas and palm oil sectors. Growth in financing to SMEs continued to be robust at 8.5% (2Q 2016: 9.9%). The supply of credit to businesses reflected the level of economic activity with limited evidence of broad-based tightening in access to financing especially by the banking industry.

[3] Refers to ratio of individual plus collective impairment provisions to total impaired loans
[4] Banks are required to maintain total collective impairment provisions and regulatory reserves of no less than 1.2% of net loans.
[5] Defined as borrowers with a monthly income of less than RM3,000.

Overall debt servicing capacity of Malaysian businesses[6] remained intact. This supported the low and steady level of expected default frequency for businesses at 0.62% (2Q 2016: 0.61%). The median interest coverage ratio (ICR) rebounded to 5.5 times in the second quarter from improved profitability in some export-oriented sectors (1Q 2016: 4.2 times). Leverage, as measured by the median debt-to-equity ratio, was only marginally higher at 42.8% in 2Q 2016 (1Q 2016: 41.9%). This was supported by satisfactory liquidity positions. The median current assets-to-current liabilities ratio (current ratio) and cash-to-short-term debt ratio (CASTD) were unchanged at 1.7 times and 1.1 times respectively (1Q 2016: 1.7 times and 1.1 times respectively). Although higher delinquencies and impairments were observed in the construction and manufacturing sectors, overall asset quality of banks' overall businesses portfolio remained sound. The ratio of impaired loans and delinquent loans stood unchanged at 2.7% and 0.3% of total bank lending to businesses respectively. Despite uncertainty in global demand condition, the export-oriented sectors also showed continued financial resilience, supported by strong financial buffers and modest leverage.

The outlook for the oil and gas (O&G) sector remains weak amid the low and volatile global crude oil price. This explained the weaker financial performance observed for O&G firms. The overall median ICR of the sector weakened in 2Q 2016 to 1.2 times (1Q 2016: 2.3 times). Liquidity position, on the other hand, improved marginally to 0.9 times (1Q 2016: 0.7 times). Financing to the O&G sector remained largely stable. Outstanding bank exposures (loans and corporate bonds) registered a negative growth of -4.9% to RM13.2 billion as at end 3Q 2016. In terms of concentration risk, banks' exposures to this sector are small, comprising only about 2.1% of total exposures to businesses. Impaired loans for this sector remained stable at 1.8% of total bank lending to businesses while delinquency ratios improved to 0.01% of total bank lending to businesses (2Q 2016: 1.7% and 0.4% respectively).

The housing market remained soft in both the primary and secondary markets. Housing transactions declined both in volume and value terms by 12.5% to 52,487 units (1Q 2016: -16.6% to 49,609 units) and 9.7% to RM16.7 billion (1Q 2016: -10.9% to RM15.9 billion) respectively. This trend was observed across all house price segments, particularly in major states such as Kuala Lumpur, Selangor, Johor and Penang. In the affordable housing segment, both volume and value of transactions recorded negative growth of 16.9% and 18.0% respectively (1Q 2016: -21.9% and -16.9% respectively) amid cautious sentiment and smaller number of newly launched units during the quarter. On the other hand, demand for home financing remained intact, supported by stable approval rate across all house price segments. Credit-induced speculative purchases of residential properties remained subdued. The growth in the number of borrowers with at least three outstanding housing loans (a proxy used for speculative house purchases) expanded at 1.7% in 3Q 2016 (2Q 2016: 1.9%) and accounted for only 2.8% of housing loan borrowers.

Market risk exposures supported by risk management and hedging strategies

Banks' exposures to market risks were mainly in the form of foreign exchange risk. At end-September, foreign exchange (FX) net open position of banks declined to 6.7% of total capital (2Q 2016: 7.1%), as banks continued to actively manage FX exposures amid ringgit volatility. Exposures to interest rate risk in the trading book and equity risk accounted for only 1.2% and 1.0% of total capital, respectively (2Q 2016: 1.2% and 0.8%, respectively). For the insurance and takaful industry, market risk exposures edged higher to 14.4% (2Q 2016: 13.7%) of total capital available, driven by increase in equity and interest rate risk. Equity risk, which forms the bulk of insurers' market risk exposures, rose to 7.6% (2Q 2016: 7.4%) of total capital available.

[6] Based on 160 companies listed on Bursa Malaysia with market capitalisation of 80% (excluding financial institutions) covering 10 key economic sectors.

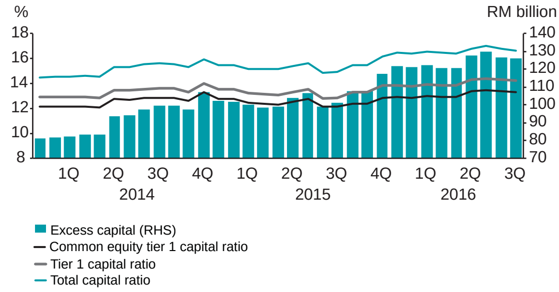
Sustained strength and resilience of financial institutions

Financial institutions are well-capitalised with combined capital buffers of RM160.8 billion. For banks, more than 90% of total capital consists of retained earnings, paid-up capital and reserves which have strong loss-absorbing quality. This reflects the high capital ratios – common equity tier-1, tier-1 and total capital ratios of banks stood at 13.3%, 14.2% and 16.7%, respectively (2Q 2016: 13.4%, 14.3% and 16.8% respectively). Similarly, the capital adequacy ratio for the insurance and takaful sectors remained high at 226.4% (2Q 2016: 228.1%).

Financing (including interest) margin net of operating costs and loss provisions of banks was unchanged at 0.59 percentage points (ppts) (2Q 2016: 0.56 ppts). Similarly, returns on assets and equity were largely stable at 1.39% and 12.9% respectively (2Q 2016: 1.40% and 13.1%, respectively) despite lower profitability. Pre-tax profit for the banking system declined to RM8.1 billion in 3Q 2016 (2Q 2016: RM9 billion), driven by lower fee-based income and dividend income from subsidiaries.

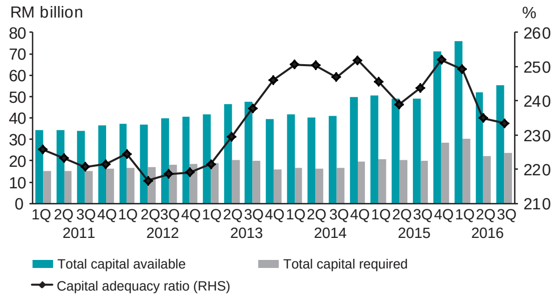
In the insurance and takaful sector, improved claims ratio, particularly in motor businesses, led to higher operating profit (3Q 2016: RM886.7 million; 2Q 2016: RM809.6 million) for the general insurers and takaful operators. The life insurers and family takaful operators, on the other hand, benefited from higher valuation of the bond market. Excess income over outgo rose to RM5.3 billion (2Q 2016: RM2.6 billion), mainly from higher net capital gains from the bond portfolio.

Banking System: Basel III Capitalisation



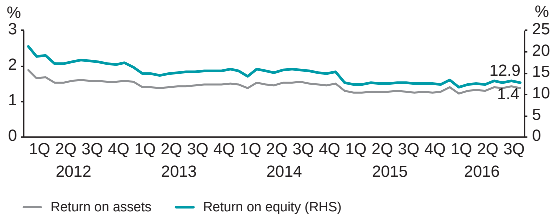
Source: Bank Negara Malaysia

Insurance Sector: Capitalisation



Source: Bank Negara Malaysia

Banking System: Profitability



Source: Bank Negara

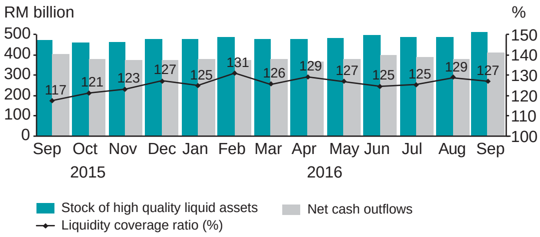
Insurance and Takaful Sectors: Indicators

	2015		2016		
	3Q	4Q	1Q	2Q	3Q
			RM million		
Life insurance & family takaful					
Excess of income over outgo	-417	5,246	4,622	2,637	5,325
General insurance & general takaful					
Operating profit	556	679	821	809	887
Claims ratio (%)	65.5	60.6	54.0	56.5	56.4
			Annual change (%)		
Life insurance & family takaful					
Excess of income over outgo	-110.9	147.4	-11.9	43.0	1377.7
General insurance & general takaful					
Operating profit	-29.5	-10.6	5.1	18.6	59.6
Claims ratio (percentage points)	3.3	1.1	3.7	-8.4	-2.2

Source: Bank Negara Malaysia

Banking system liquidity was ample and supportive of financing activities. The banking system has RM181.6 billion of liquidity with Bank Negara Malaysia. Such liquidity takes the form of direct placements, reverse repos and statutory reserves with Bank Negara Malaysia. The banking system Basel III Liquidity Coverage Ratio (LCR)[7] stood at 127.0% in September 2016 (2Q 2016: 124.7%), well surpassing the current minimum regulatory requirement of 70%. About 80% of banks recorded LCR levels above 100%.

Banking System: Basel III Liquidity Coverage Ratio



Source: Bank Negara Malaysia

Domestic funding conditions remained stable during the quarter. Average cost of deposits for banks was unchanged at 2.62% while the 3-month KLIBOR eased to 3.4% (2Q 2016: 3.65%), reflecting the change in OPR. On aggregate, banking system deposits recorded a positive growth of 0.8% (2Q 2016: -0.5%). Household deposits maintained a healthy expansion (3Q 2016: +4.6%; 2Q 2016: +4.4%), offsetting the decline in deposits from businesses (3Q 2016: -4.7%; 2Q 2016: -0.8%).

Banks' funding in the form of total deposits and investment accounts[8] accepted by banks expanded by 2.6% annually as at September 2016 (2Q 2016: +3.3%).

Banks' funding structure remains predominantly deposit-based (70.2% of total funding) reflecting the nation's high savings characteristics. Almost 90% of the funding is in local currency. In recent years, banks have begun to issue medium-term ringgit and foreign currency denominated funding instruments. This is intended to reduce maturity and currency mismatches in bank funding structures. As at September 2016, such instruments accounted for 4.7% of total liabilities (2Q 2016: 4.7%; end-2011: 3.5%). Taking into account the broadened funding structure, the loan-to-funds ratio[9] (LTF)improved to 83.4% during the quarter (2Q 2016: 82.6%).

Net external liabilities of banks expanded at RM146 billion at end-2Q 2016 (1Q 2016: RM128 billion), driven by higher interbank placements from related entities abroad. Malaysian banks' exposures to counterparties in Singapore and PR China are limited, at about 3% and less than 1% of total banking system assets respectively. This limits the prospect of an immediate contagion to the domestic banking system arising from developments in either country. Exposures via the currency channel were also contained. External claims denominated in Singapore dollar and Chinese renminbi accounted for 10% and 2% of total banking system capital respectively.

[7] The Basel III LCR has been phased in since June 2015, with initial compliance set at 60% and progressive increments of 10% each year until 100% with effect from 2019. The current minimum requirement is set at 70%.
[8] Under the Islamic Financial Services Act 2013, Islamic banking institutions are required to reclassify Islamic deposits under the repealed Islamic Banking Act 1983 into Islamic deposits and investment accounts. A two-year transition period was accorded to banking institutions to ensure a seamless and effective process of reclassification. This transition period ended on 30 June 2015.
[9] Fund comprises deposits and all debt instruments (including subordinated debt, debt certificates/ sukuk issued, commercial papers and structured notes).