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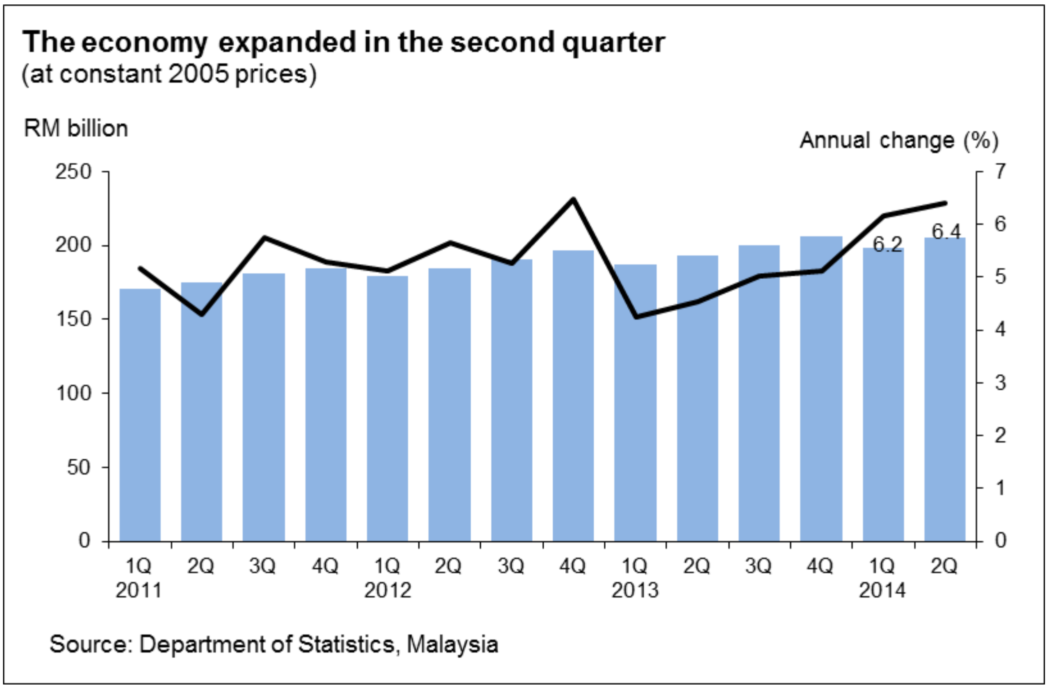
ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE SECOND QUARTER OF 2014

The Malaysian economy expanded by 6.4% in the second quarter of 2014

Global economic activity continued to expand at a moderate pace in the second quarter. The recovery in the US resumed after an unusual weather-related weakness in the first quarter. Growth in Japan was, however, affected by the implementation of the increase in the consumption tax in April. In Asia, economic activity continued to expand, albeit at a more moderate pace in most economies.



The Malaysian economy registered a strong growth of 6.4% in the second quarter of 2014 (1Q 2014: 6.2%), underpinned by higher exports and continued strength in private domestic demand. On the supply side, growth in the major economic sectors remained firm, supported by trade and domestic activity. On a quarter-on-quarter seasonally adjusted basis, the economy grew by 1.8% (1Q 2014: 0.8%).

Exports and private sector activity remained the key drivers of growth during the quarter. Private investment continued to register double-digit growth, expanding by 12.1% (1Q 2014: 14.1%), reflecting investments in the services and manufacturing sectors. Private consumption increased by 6.5% (1Q 2014: 7.1%), supported by stable employment conditions and continued wage growth. In contrast, public sector expenditure declined by 2.1% (1Q 2014: 2.7%). Public consumption declined marginally by 1.3% (1Q 2014: 11.2%), reflecting lower Government spending on emoluments, and supplies and services. Public investment declined by of 3.3% (1Q 2014: -6.4%), due to lower spending on fixed assets by both the Federal Government and public enterprises.

On the supply side, growth in the major economic sectors remained strong. The services sector recorded sustained growth, supported mainly by the trade-related sub-sectors. The manufacturing sector expanded at a faster pace underpinned by the electronics and electrical cluster, particularly semiconductors. The construction sector expanded at a more moderate pace, driven mainly by the residential and non-residential sub-sectors. Meanwhile, the agriculture sector registered strong growth, reflecting higher production of palm oil. The mining sector turned around to record positive growth, due mainly to higher production of both natural gas and crude oil.

The inflation rate, as measured by the annual change in the Consumer Price Index (CPI), averaged 3.3% in the second quarter of 2014 (1Q 2014: 3.4%). The slight decline was due to lower inflation in the *food and non-alcoholic beverages* and *housing, water, electricity, gas and other fuels* categories.

The trade surplus amounted to RM18.4 billion in the second quarter of 2014 (1Q 2014: RM26.3 billion). Gross exports grew at a stronger pace of 14.2% (1Q 2014: 10.8%), reflecting the continued expansion of global economic activity. Gross imports also increased, registering growth of 8.6% (1Q 2014: 5.5%).

The international reserves of Bank Negara Malaysia (BNM) amounted to RM423.6 billion (equivalent to USD131.9 billion) as at 30 June 2014. This reserve level has taken into account the quarterly adjustment for foreign exchange revaluation changes. As at 31 July 2014, the reserves position amounted to RM423.5 billion (equivalent to USD131.8 billion), sufficient to finance 9.0 months of retained imports and is 1.2 times the redefined short-term external debt.

Interest rates remained stable

The 3-month interbank rate continued to rise throughout the quarter due to the preference of interbank lenders for shorter-term lending, in line with the shift in their deposits toward shorter maturities. This was further reinforced by expectations for an OPR increase between May and July, which resulted in further upward movement in the interbank rates. The average interbank rate for other maturities remained relatively stable. Retail deposit rates were stable during the period. The average quoted fixed deposit (FD) rates of commercial banks were relatively unchanged. Lending rates were also broadly stable throughout the period. The average base lending rate (BLR) of commercial banks remained unchanged at 6.53% while the weighted average lending rate (ALR) on outstanding loans was stable during the period (end-June 2014: 5.37%; end-March 2014: 5.39%).

The Overnight Policy Rate (OPR) was maintained at 3.00% during the second quarter of 2014. Amid firm growth prospects and with inflation expected to remain above its long-run average, the Monetary Policy Committee (MPC) decided to raise the OPR by 25 basis points to 3.25% on 10 July 2014. The adjustment in the degree of monetary accommodation was also aimed at mitigating the risk of broader economic and financial imbalances that could undermine longer-term growth prospects of the Malaysian economy. The wholesale and retail lending and deposit rates were revised to levels that are consistent with the current OPR level. The average BLR of commercial banks increased to 6.78%, with most commercial banks revising their respective BLRs by 25 basis points. Depositors were also compensated by a higher rate of return on their savings following the increase in the OPR. The average quoted fixed deposit (FD) rates rose between 15 to 17 basis points to a higher range of 3.07% to 3.30% as at end-July. Notwithstanding the rise in the OPR, monetary conditions continue to remain supportive of economic activity.

The monetary aggregates continued to expand in the second quarter. M1, or narrow money, increased by RM2.2 billion during the quarter. On an annual basis, M1 expanded by 10.2% as at end-June (end-March 2014: 11.4%). M3, or broad money, increased by RM19.8 billion on a quarter-on-quarter basis to record an annual growth rate of 5.6% as at end-June (end-March: 5.9%). The increase in M3 during the quarter was driven by the continued expansion in credit extended to the private sector by the banking system and higher net claims on the Government.

Total gross financing raised by the private sector through the banking system and the capital market amounted to RM281 billion in the second quarter (1Q 2014: RM282.2 billion). On a net basis, outstanding banking system loans and PDS expanded at an annual growth rate of 9.1% as at end-June (end-March 2014: 9.6%). Net funds raised in the capital market were lower at RM17.2 billion in the second quarter (1Q 2014: RM39.4 billion).

The ringgit and most other regional currencies appreciated against the US dollar as sound regional growth prospects and the continued highly accommodative monetary policy in the US sustained investor interest in regional financial markets. Positive sentiments following the release of better-than-expected domestic economic data, particularly the strong first quarter economic growth and a stronger pace of export growth, also supported the ringgit. Overall, the ringgit appreciated by 1.8% against the US dollar. The ringgit also appreciated against the euro (2.6%) and Japanese yen (0.3%), but depreciated against the pound sterling (-0.6%) and Australian dollar (-0.2%). Against regional currencies, ringgit performance was mixed.

Between 1 July and 13 August 2014, the ringgit appreciated against the US dollar by 0.6%. The ringgit also appreciated against the euro (2.7%), Australian dollar (2.1%), pound sterling (2%) and Japanese yen (1.6%). The ringgit's performance against regional currencies was mixed.

Financial stability continued to be preserved

The Malaysian financial system exhibited continued resilience in the second quarter amid improved conditions in the global and domestic financial markets. Financial intermediation remained well-supported by sound financial institutions, orderly financial market conditions and sustained confidence in the financial system.

Capitalisation of the banking system remained high, with the common equity tier 1 (CET1) capital ratio, tier 1 capital ratio and total capital ratio well above the minimum regulatory levels, at 12.2%, 13% and 14.8%, respectively. The total capital buffer of the banking system stood at more than RM80 billion. Similarly, the capital adequacy ratio of the insurance sector remained strong at 249.7% (1Q 2014: 249.7%), with an excess capital buffer of RM25.7 billion.

The Malaysian economy to remain on a steady growth path

Going forward, the global economy is expected to continue on a moderate growth path. Recent improvements in economic activity suggest that a cyclical recovery remains underway in some advanced economies. This will continue to benefit international trade activity. In Asia, domestic demand is expected to remain supportive of growth. Nevertheless, country-specific developments may affect the overall pace of growth in these economies. The overall balance of risks for the global economy thus remains biased towards the downside due to uncertainty over policy adjustments in the key economies as well as geopolitical developments. Persistent geopolitical tensions in Eastern Europe and the Middle East could heighten financial market volatility and weigh down on the ongoing global economic recovery.

For the Malaysian economy, growth of exports is expected to moderate slightly in the second half of the year, partly reflecting the significant base effect in the corresponding period in 2013. Nevertheless, leading indicators suggest that private sector activity will remain as the key driver of growth. Exports will continue to benefit from the recovery in the advanced economies and from regional demand. Going forward, the Malaysian economy is expected to remain on a steady growth path.

Bank Negara Malaysia
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GDP by Economic Activity (at constant 2005 prices)

	Share 2013 (%)	2013		2014		
		2Q	1H	1Q	2Q	1H
		Annual change (%)				
Agriculture	7.1	0.3	3.2	2.3	7.1	4.6
Mining	8.1	4.4	1.3	-0.8	2.1	0.6
Manufacturing	24.5	3.8	2.1	6.8	7.3	7.1
Construction	3.8	10.0	12.0	18.9	9.9	14.3
Services	55.2	5.0	5.5	6.6	6.0	6.3
Real GDP	**100.0[1]**	**4.5**	**4.4**	**6.2**	**6.4**	**6.3**
Real GDP (q-o-q seasonally adjusted)	**-**	**1.6**	**-**	**0.8**	**1.8**	**-**

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

Source: Department of Statistics, Malaysia

GDP by Expenditure Components (at constant 2005 prices)

	2013		2014		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
Aggregate Domestic Demand (excluding stocks)	7.2	7.3	7.4	5.7	6.5
Consumption	7.8	6.6	7.8	5.0	6.4
Private sector	*6.8*	*6.6*	*7.1*	*6.5*	*6.8*
Public sector	*11.9*	*6.4*	*11.2*	*-1.3*	*4.4*
Gross Fixed Capital Formation	5.8	9.1	6.3	7.2	6.8
Private sector	*11.1*	*10.6*	*14.1*	*12.1*	*13.0*
Public sector	*-3.8*	*6.6*	*-6.4*	*-3.3*	*-4.9*
Net Exports	-37.1	-23.7	14.9	91.0	42.9
Exports of Goods and Services	*-4.4*	*-3.9*	*7.9*	*8.8*	*8.3*
Imports of Goods and Services	*-1.3*	*-1.8*	*7.1*	*3.9*	*5.5*
GDP	**4.5**	**4.4**	**6.2**	**6.4**	**6.3**
GDP (q-o-q growth, seasonally adjusted)	**1.6**	**n.a.**	**0.8**	**1.8**	**n.a.**

Source: Department of Statistics, Malaysia

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