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

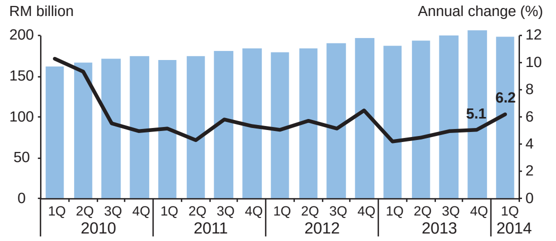
OVERVIEW

The Malaysian economy expanded by 6.2% in the first quarter of 2014

Global economic activity expanded at a moderate pace in the first quarter. The US economy experienced a slower growth, mainly due to unusually adverse weather conditions. In the euro area, the recovery was supported by modest improvements in exports, while domestic demand remained sluggish due to structural constraints. Growth in several Asian economies expanded at a slower pace as domestic demand was affected by country-specific developments.

The Malaysian economy registered a strong growth of 6.2% in the first quarter of 2014 (4Q 2013: 5.1%), driven by a stronger expansion in domestic demand and a turnaround in net exports. On the supply side, the major economic sectors grew further, supported by both domestic and trade activities. On a quarter-on-quarter seasonally-adjusted basis, the economy grew by 0.8% (4Q 2013: 1.9%).

Strong growth of 6.2% in the first quarter
(at constant 2005 prices)



Source: Department of Statistics, Malaysia

Private consumption growth remained strong at 7.1% (4Q 2013: 7.4%) in the first quarter, supported by stable employment conditions and continued wage growth. Growth in public consumption increased to 11.2% (4Q 2013: 5.2%), reflecting higher Government spending on supplies and services. Gross fixed capital formation grew by 6.3% (4Q 2013: 6.5%), driven by robust private sector capital spending amidst a decline in public investment growth. Growth in private investment remained strong at 14.1% (4Q 2013: 16.6%), underpinned by capital spending in the manufacturing and services sectors. Public investment declined by 6.4% (4Q 2013: -1.4%), reflecting the contraction in capital spending by both the Federal Government and the public enterprises.

On the supply side, growth was supported by the major economic sectors. The services sector expanded further, driven by the improvement in finance and insurance and sustained growth in consumption- and production-related services. Growth in the manufacturing sector was underpinned by the stronger performance in the export-oriented industries. The construction sector recorded stronger growth, driven mainly by the residential sub-sector. Meanwhile, the agriculture sector registered higher growth, underpinned by the production of food crops while the mining sector registered a lower decline due to a smaller contraction in the output of crude oil.

The headline inflation rate, as measured by the annual change in the Consumer Price Index (CPI), averaged at 3.4% in the first quarter of 2014 (4Q 2013: 3%). The increase was on account of higher inflation in the *housing, water, electricity, gas and other fuels* and *transport* categories.

The trade surplus amounted to RM26.4 billion in the first quarter of 2014 (4Q 2013: RM27.5 billion). Gross exports grew at a stronger pace of 10.9% (4Q 2013: 10.2%), reflecting the continued expansion of global economic activity while gross imports expanded at a more moderate pace of 5.5% (4Q 2013: 11.6%).

The international reserves of Bank Negara Malaysia (BNM) amounted to RM424.6 billion (equivalent to USD130.2 billion) as at 31 March 2014. This reserve level has taken into account the quarterly adjustment for foreign exchange revaluation changes. As at 30 April 2014, the reserves position amounted to RM427.8 billion (equivalent to USD131.2 billion), sufficient to finance 9.4 months of retained imports and is 1.3 times the redefined short-term external debt.

With effect from the first quarter of 2014, Malaysia has redefined its external debt. This is in recognition of the significant development in the depth and breadth of Malaysia's financial markets and the consequent increase in the participation of non-resident investors in ringgit-denominated domestic debt securities in recent years. Following this redefinition, non-resident holdings of ringgit-denominated debt securities, non-resident deposits, trade credits provided by foreign trade counterparts and other debt liabilities will now be included as part of Malaysia's external debt. As at end-March 2014, Malaysia's redefined external debt stood at RM700.1 billion, equivalent to USD212.5 billion or 65.2% of GDP (end-December 2013: RM694.6 billion or USD209.2 billion, equivalent to 70.4% of GDP). The increase in the external debt is due mainly to higher offshore borrowing by the private sector and non-resident holdings of ringgit-denominated debt liabilities. More than half of the total external debt has a long-term maturity profile. The short-term debt remained manageable with reserves coverage of 1.3 times as at end-March 2014. Malaysia's external position remains resilient, underpinned by sound domestic economic fundamentals. In addition, well-developed capital markets, strong financial intermediaries, and the presence of large domestic institutional investors have provided the financial system with greater resilience to effectively manage any external shocks (see Box Article on 'The Redefinition of External Debt').

Interest rates remained stable

The Overnight Policy Rate (OPR) was maintained at 3.00% during the first quarter of 2014. At the prevailing level of the OPR, monetary conditions remain supportive of economic activity.

The 3-month interbank rate was higher during the quarter following the absence of trades with BNM at the 3-month tenure as a result of the reduction in the maximum tenure of BNM's Range Maturity Auction (RMA) from 3 months to 2 months. 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. Borrowing costs were also stable. 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-March 2014: 5.39%; end-December 2013: 5.36%).

The monetary aggregates expanded at a slower pace in the first quarter of 2014. M1, or narrow money, decreased slightly by RM0.6 billion during the quarter. On an annual basis, M1 expanded by 11.4% as at end-March 2014 (end-December 2013: 13%). M3, or broad money, increased by RM19.5 billion on a quarter-on-quarter basis to record an annual growth rate of 5.9% as at end-March 2014 (end-December 2013: 8.1%). The expansion of M3 during the quarter was mainly on account of 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 RM282.2 billion in the first quarter (4Q 2013: RM302.8 billion). On a net basis, outstanding banking system loans and PDS expanded at an annual growth rate of 9.6% as at end-March 2014 (end-December 2013: 9.8%). Net funds raised in the capital market were higher at RM39.4 billion in the first quarter (4Q 2013: RM33.7 billion). The steady growth in net financing has continued to provide support to economic growth.

The ringgit and most other regional currencies continued to be affected by global developments in the first quarter of the year. The commencement of the scale-back of US Federal Reserve's (Fed) asset purchase programme, concerns over the growth outlook for several emerging market economies and geopolitical developments in Eastern Europe led to higher risk aversion and an outflow of funds from regional financial markets. Nevertheless, expectations of stimulus measures in PR China and the continued accommodative monetary policy in the US provided support for the ringgit during the quarter. Overall, the ringgit appreciated by 0.4% against the US dollar. The ringgit also appreciated against the euro (0.7%), but depreciated against the pound sterling (-0.5%) and Japanese yen (-1.5%). Performance of the ringgit against regional currencies was mixed.

Between 1 April and 14 May 2014, the ringgit appreciated against the US dollar by 1.4%. The ringgir also appreciated against the euro (1.6%), Japanese yen (0.7%), pound sterling (0.1%) and most regional currencies.

Financial stability continues to be preserved

The Malaysian financial system continued to demonstrate resilience throughout the first quarter despite volatility in the global and domestic financial markets. Financial intermediation continued to be supported by sound financial institutions, orderly financial market conditions and sustained confidence in the financial system.

The banking system remained well-capitalised 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%, 12.8% and 14.4%, 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% (4Q 2013: 246.1%), with an excess capital buffer of RM25 billion.

Global recovery and the continued strength of domestic demand will underpin growth

Going forward, recovery in the global economy is expected to continue. International trade will be supported by the continued recovery in the advanced economies. In Asia, while domestic demand is expected to moderate, it will continue to underpin the overall performance of these economies, with additional support coming from the improving external conditions. Continued uncertainty over the monetary policy in key advanced economies, economic developments in both the advanced and emerging market economies, as well as geopolitical developments, are likely to generate continued volatility in the global financial markets.

For the Malaysian economy, growth will remain anchored by domestic demand, with additional support from the improvement in the external environment. Exports will continue to benefit from the recovery in the advanced economies while private domestic demand is expected to remain the key driver of the overall growth. Going forward, the Malaysian economy is therefore expected to remain on a steady growth path.