DEVELOPMENTS IN THE MALAYSIAN ECONOMY

Higher growth supported by stronger domestic demand and improving trade

The Malaysian economy registered a higher growth of 6.2% in the first quarter of 2014 (4Q 2013: 5.1%). Growth was driven by a stronger expansion in domestic demand and a turnaround in net exports. Private sector activity remained the main driver of growth in the first quarter, with sustained strong growth in both consumption and investment activities. Real exports of goods and services grew at a faster pace while real imports of goods and services was sustained, resulting in a positive growth in net exports. On a quarter-on-quarter seasonally adjusted basis, the economy grew by 0.8% (4Q 2013: 1.9%).

Domestic demand registered stronger growth

Domestic demand grew by 7.4% in the first quarter of 2014 (4Q 2013: 6.7%). Both private consumption and private investment continued to sustain strong performance, with private investment recording a double-digit growth rate. Public sector spending recorded a stronger expansion as higher consumption spending offset the decline in public investment.

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.

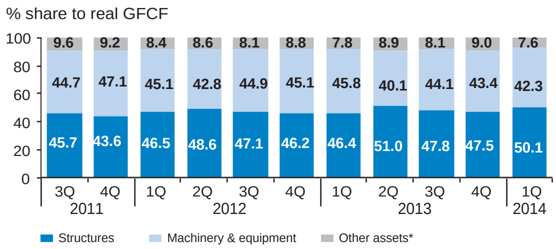
Gross fixed capital formation grew by 6.3% (4Q 2013: 6.5%), driven by robust private sector capital spending amidst a decline in public investment growth. Growth in private investment remained strong at 14.1% (4Q 2013: 16.6%), underpinned by capital spending in the manufacturing and services sectors. Public investment declined by 6.4% (4Q 2013: -1.4%) due to a contraction in capital spending by both the Federal Government and public enterprises. By type of assets, investment activity was driven mainly by robust spending on structures (14.7%; 4Q 2013: 9.6%), which more than offset the decline in machinery and equipment investment (-1.8%; 4Q 2013: +2.7%).

GDP by Expenditure Components
(at constant 2005 prices)

	2013			2014
	1Q	4Q	Year	1Q
	Annual change (%)			
Aggregate Domestic Demand (excluding stocks)	7.5	6.7	7.4	7.4
Consumption	5.3	6.8	7.0	7.8
Private sector	*6.4*	*7.4*	*7.2*	*7.1*
Public sector	*0.6*	*5.2*	*6.3*	*11.2*
Gross Fixed Capital Formation	13.0	6.5	8.5	6.3
Private sector	*10.0*	*16.6*	*13.1*	*14.1*
Public sector	*18.4*	*-1.4*	*2.2*	*-6.4*
Net Exports	-12.9	-6.8	-12.6	14.9
Exports of Goods and Services	*-3.4*	*5.7*	*0.6*	*7.9*
Imports of Goods and Services	*-2.2*	*7.1*	*2.0*	*7.1*
GDP	**4.2**	**5.1**	**4.7**	**6.2**
GDP (q-o-q growth, seasonally adjusted)	**-0.3**	**1.9**	**-**	**0.8**

Source: Department of Statistics, Malaysia

GFCF by Type of Assets



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

Strong growth in major economic sectors

On the supply side, growth was supported by the major economic sectors. The services sector expanded further, driven by the improvement in the finance and insurance and sustained growth in the 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 recorded a lower decline due to a smaller contraction in the output of crude oil.

GDP by Economic Activity (at constant 2005 prices)

	Share 2013 (%)	2013 1Q	2013 4Q	2013 Year	2014 1Q
		Annual change (%)			
Agriculture	7.1	6.2	0.2	2.1	2.3
Mining	8.1	-1.5	-1.2	0.7	-0.8
Manufacturing	24.5	0.4	5.2	3.5	6.8
Construction	3.8	14.2	9.8	10.9	18.9
Services	55.2	6.1	6.4	5.9	6.6
Real GDP	**100.0[1]**	**4.2**	**5.1**	**4.7**	**6.2**
Real GDP (q-o-q seasonally adjusted)	**-**	**-0.3**	**1.9**	**-**	**0.8**

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

Source: Department of Statistics, Malaysia

The **services sector** continued to expand in the first quarter of 2014 (6.6%; 4Q 2013: 6.4%), supported by an improvement in the finance and insurance sub-sector and favourable performance in consumption- and production-related services. Growth in the finance and insurance sub-sector improved (2.4%; 4Q 2013: 0.5%), due mainly to the turnaround in the insurance segment. The wholesale and retail trade sub-sector registered a sustained performance (8.6%; 4Q 2013: 8.4%), supported by continued household spending during the quarter. In the communication sub-sector, growth remained robust (10.1%; 4Q 2013: 10.3%), supported by continued demand for data communication services.

Performance of the Services Sector (value added at constant 2005 prices)

	Share 2013 (%)	2013 1Q	2013 4Q	2013 Year	2014 1Q
		Annual change (%)			
Intermediate Services	**40.8**	**6.4**	**4.9**	**5.1**	**5.7**
Finance & insurance	16.6	6.3	0.5	1.8	2.4
Real estate & business services	10.3	6.5	8.3	7.5	8.6
Transport & storage	6.6	3.8	5.4	4.6	4.8
Communication	7.4	9.0	10.3	10.0	10.1
Final Services	**59.2**	**5.9**	**7.5**	**6.4**	**7.1**
Wholesale & retail trade	26.1	5.7	8.4	6.4	8.6
Accommodation & restaurant	4.5	6.4	5.8	5.7	6.0
Utilities	4.5	3.9	4.4	4.1	3.2
Government services	15.0	7.1	8.6	8.3	7.7
Other services	9.1	5.2	5.1	5.1	4.8
Total Services	**100.0[1]**	**6.1**	**6.4**	**5.9**	**6.6**

[1] Numbers do not add up due to rounding

Source: Department of Statistics, Malaysia

Selected Quarterly Indicators in the Services Sector

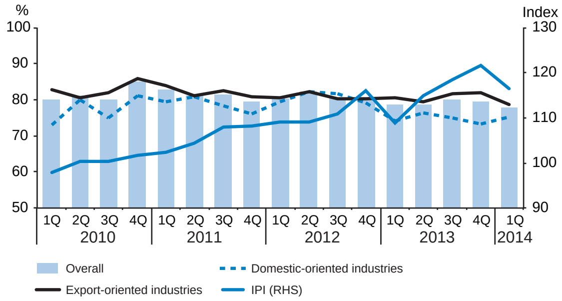
	2013 1Q	2013 4Q	2013 Year	2014 1Q
	Index			
MIER Consumer Sentiments Index	122.9	82.4	104.3	96.8
MIER Retail Trade Index	101.0	81.7	98.9	86.3
MIER Tourism Market Index	115.5	140.3	126.8	115.8
	Annual change (%)			
Tourist arrivals	15.9	1.2	2.7	-
Total passenger traffic at all airports	9.1	24.1	19.0	18.9
Total consumption credit outstanding	7.7	6.2	6.2	4.8
Total loans outstanding	10.6	10.6	10.6	10.2
Loans outstanding to the wholesale & retail trade, hotels & restaurants	14.2	11.1	11.1	5.6
Imports of consumption goods	3.0	9.3	8.7	15.6
Total sales of motor vehicles	13.9	-0.9	4.5	1.4
Container cargo handled (Port Klang and PTP)	-0.4	2.7	1.5	3.7

Source: Various sources

The **manufacturing sector** expanded by 6.8% in the first quarter of 2014 (4Q 2013: 5.2%), supported by stronger performance of the export-oriented industries and continued expansion of the domestic-oriented industries. The export-oriented industries advanced by 6.9% (4Q 2013: 3.8%), in line with better external trade performance during the quarter. Growth was driven primarily by the electronics and electrical (E&E) cluster, particularly semiconductors. Domestic-oriented industries grew by 7.2% (4Q 2013: 8%), supported by the consumer-related cluster, particularly transport equipment.

Overall capacity utilisation rate in the manufacturing sector was sustained at 78% (4Q 2013: 80%). Export- and domestic-oriented industries were operating at 79% and 75% of total capacity, respectively (4Q 2013: 82% and 73%, respectively).

Capacity utilisation rate in the manufacturing sector*



* Beginning 2012, the capacity utilisation rate in the manufacturing sector has been rebased from value-add in year 2006 to value-add in year 2009

Source: Bank Negara Malaysia & Department of Statistics, Malaysia

Performance of the Manufacturing Sector

	Share 2013 (%)	2013 1Q	2013 4Q	2013 Year	2014 1Q
		Annual Change (%)			
Value Added (RM million at constant 2005 prices)		**0.4**	**5.2**	**3.5**	**6.8**
Overall Manufacturing Production[1]	**100.0**	**-0.2**	**4.9**	**4.2**	**7.0**
Export-oriented industries	**74.8**	**-1.3**	**3.8**	**3.3**	**6.9**
Electronics and electrical products cluster	**24.2**	**2.8**	**16.9**	**10.0**	**15.5**
Of which:					
Electronics	15.3	10.2	25.4	18.6	19.8
Electrical products	8.9	-9.2	1.2	-5.1	7.1
Primary-related cluster	**50.7**	**-3.0**	**-1.8**	**0.3**	**2.9**
Of which:					
Chemicals and chemical products	14.3	-3.9	-1.1	-0.7	1.4
Petroleum products	21.0	-8.5	-4.0	0.2	6.5
Rubber products	2.5	13.8	6.8	8.2	-0.8
Off-estate processing	4.5	10.9	-1.5	1.7	0.7
Domestic-oriented industries	**25.2**	**2.9**	**8.0**	**6.8**	**7.2**
Construction-related cluster	**11.3**	**5.0**	**3.5**	**4.9**	**2.9**
Of which:					
Construction-related products	8.2	1.7	2.2	1.3	1.1
Fabricated metal products	3.1	11.6	5.8	12.2	6.3
Consumer-related cluster	**13.8**	**1.2**	**11.6**	**8.5**	**10.8**
Of which:					
Transport equipment	5.5	-1.6	23.4	13.8	17.1
Food, beverage & tobacco products	7.3	4.7	1.1	4.9	5.3

[1] Industrial Production Index (2010=100)

Source: Department of Statistics, Malaysia

The **construction sector** experienced robust growth during the quarter (18.9%; 4Q 2013: 9.8%), driven mainly by the residential sub-sector. Stronger growth performance in the non-residential and civil engineering sub-sectors provided further support to the sector. The strong growth in the residential sub-sector was supported by construction of high-rise projects, particularly in the Klang Valley, Penang and Johor. Growth in the non-residential sub-sector was underpinned by the construction of commercial and industrial projects. Meanwhile, expansion in the civil engineering sub-sector reflected continued progress in rail, utility, and road projects such as the Klang Valley MRT, the LRT extension, Tanjung Bin and Janamanjung power plants and the expansion of lanes at the North-South Expressway.

Indicators for the Construction Sector

	2013			2014
	1Q	4Q	Year	1Q
	Annual change (%)			
Value of construction work done	16.3	11.3	12.7	21.1
Residential	10.8	18.3	19.6	33.1
Non-residential	-1.4	18.1	6.6	19.9
Civil engineering[1]	40.6	2.8	13.3	14.5
Housing approvals	-19.4	-31.2	-24.5	-47.6
Production[2] of construction-related materials	5.0	3.5	4.9	2.9
Hydraulic cement	3.1	6.2	4.2	1.3
Other articles of concrete, cement and plaster n.e.c	-2.2	25.5	5.3	37.0
Other porcelain and ceramic products	-9.4	3.1	-5.6	15.2
Prefabricated structural components for building or civil engineering of cement, concrete or artificial stone	1.7	6.5	1.7	2.6
Capital imports (excluding lumpy items)	7.3	-2.2	-0.8	-3.3
Loans for the construction sector				
Approval	-28.9	0.6	-10.5	-32.8
Disbursement	23.5	17.9	14.4	20.1

[1]Includes special trade 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

Performance of the Agriculture Sector

	Share 2013 (%)	2013			2014
		1Q	4Q	Year	1Q
		Annual change (%)			
Value Added (at constant 2005 prices)	**7.7**	**6.2**	**0.2**	**2.1**	**2.3**
Industrial Crops	**4.2**	**5.6**	**-2.9**	**-1.3**	**-1.0**
Of which:					
Oil palm	2.8	14.6	-1.2	2.6	1.6
Rubber	0.7	-0.9	-14.4	-10.1	-12.1
Food Crops	**3.5**	**6.8**	**4.6**	**6.3**	**6.1**
Of which:					
Fishing	1.1	7.7	-3.3	1.6	2.1
Livestock	0.8	6.4	10.6	9.4	7.9

Source: Department of Statistics, Malaysia

Value-added of the **agriculture sector** grew by 2.3% (4Q 2013: 0.2%), on account of higher production of food crops. The **mining sector** recorded a lower decline (-0.8%, 4Q 2013: -1.2%) due to a smaller contraction in output of crude oil.

Performance of the Mining Sector

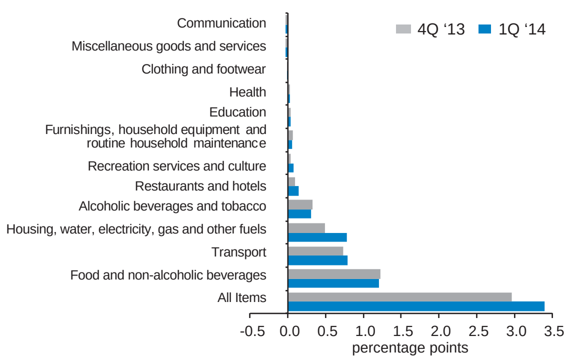
	Share 2013 (%)	2013			2014
		1Q	4Q	Year	1Q
		Annual change (%)			
Value Added (at constant 2005 prices)	**8.8**	**-1.5**	**-1.2**	**0.7**	**-0.8**
Production					
Of which:					
Crude oil and condensates	-	-3.5	-8.3	-2.9	-2.4
Natural gas	-	0.3	3.2	4.4	0.3

Source: PETRONAS
Department of Statistics, Malaysia

Inflation averaged 3.4% in the first quarter

The inflation rate, as measured by the annual change in the Consumer Price Index (CPI) averaged 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. During the quarter, higher rental and electricity tariffs contributed to higher inflation in the *housing, water, electricity, gas and other fuels* category. In the *transport* category, the price of RON97 petrol was adjusted upwards three times during the quarter by a total of 15 sen/litre. Meanwhile, inflation in the *food and non-alcoholic beverages* category was stable at 4% during the quarter (4Q 2013: 4%). Higher inflation in the *food away from home* sub-category was offset by lower inflation in the *food at home* sub-category.

Contribution to Consumer Price Inflation



Source: Bank Negara Malaysia

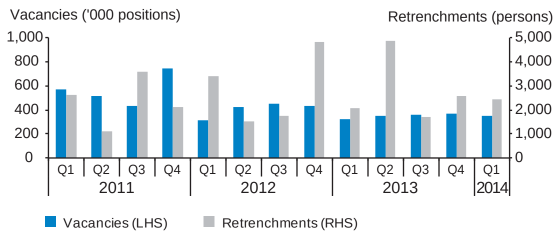
The Producer Price Index (PPI) recorded an increase of 3% on an annual basis in the first quarter (4Q 2013: 2.2%). In terms of composition, prices of commodity-related components increased by 6.8% (4Q 2013: 6.3%) while prices of non-commodity-related components increased by 0.9% (4Q 2013: 0.1%) during the quarter. Meanwhile, prices of local and imported components grew by 4.1% and 0.4%, respectively (4Q 2013: 3.4% and -0.5%, respectively).

Unemployment rate at 3.1%

Employment conditions remained stable, with total employment of 13.5 million persons during the first quarter of 2014 (4Q 2013: 13.7 million persons). The unemployment rate was sustained at 3.1% in the first quarter (4Q 2013: 3.2%).

Total retrenchments reported to the Ministry of Human Resources decreased to 2,437 persons (4Q 2013: 2,584 persons), which took place mainly in the manufacturing sector. Labour demand moderated, as reflected in the lower number of job vacancies posted in the JobsMalaysia Portal (353,030 positions; 4Q 2013: 366,203 positions). Aggregate real wages in the manufacturing sector recorded a slower growth of 3.7% (4Q 2013: 6.5%), weighed down by slower wage growth in the domestic-oriented industries.

Labour Market Conditions



Note: Vacancies data from 2012 onwards is not comparable to previous years due to a reclassification exercise

Source: Ministry of Human Resources

External position improved in the first quarter

The current account surplus increased to RM19.8 billion in the first quarter, equivalent to 7.9% of GNI (4Q 2013: RM14.8 billion or 5.8% of GNI), due to a sustained surplus in the goods account and a lower deficit in the services and income accounts.

Balance of Payments[1]

	2013			2014
	1Q	4Q	Year	1Q
	RM billion			
Current Account	**13.2**	**14.8**	**39.9**	**19.8**
(% of GNI)	*5.8*	*5.8*	*4.2*	*7.9*
Goods	28.0	33.3	108.2	33.6
Services	-2.6	-4.1	-16.7	-2.7
Primary income	-8.0	-10.0	-34.1	-6.4
Secondary income	-4.2	-4.4	-17.5	-4.6
Financial Account	**1.2**	**-9.7**	**-15.8**	**-37.6**
Direct investment	-2.8	-4.0	-5.5	-14.6
Assets	*-11.6*	*-6.5*	*-41.2*	*-20.4*
Liabilities	*8.8*	*10.4*	*35.7*	*5.8*
Portfolio investment	3.9	-0.8	-3.0	-13.4
Assets	*-5.3*	*-5.4*	*-32.1*	*-7.6*
Liabilities	*9.2*	*4.6*	*29.1*	*-5.8*
Financial derivatives	0.2	0.4	-0.3	-1.5
Other investment	-0.2	-13.3	-7.1	-8.1
Errors & omissions[2]	-10.3	-7.8	-9.4	0.4
Overall Balance	**4.0**	**-2.7**	**14.6**	**-17.3**

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 2013 (%)	2013			2014
		1Q	4Q	Year	1Q
		Annual change (%)			
Gross Exports	**100.0**	**-2.6**	**10.2**	**2.4**	**10.9**
Manufactured	67.1	-3.2	10.0	2.7	13.0
E&E	*32.9*	*-4.9*	*13.1*	*2.4*	*12.5*
Non-E&E	*34.2*	*-1.5*	*7.0*	*3.0*	*13.3*
Resource based	*14.9*	*-2.3*	*2.2*	*0.0*	*8.7*
Non-resource based	*19.3*	*-0.8*	*10.9*	*5.5*	*17.2*
Commodities	32.2	-1.8	12.0	2.4	7.1
Minerals	*22.6*	*6.2*	*22.8*	*11.6*	*9.2*
Agriculture	*9.6*	*-17.0*	*-8.3*	*-14.4*	*2.0*
Gross Imports	**100.0**	**6.4**	**11.6**	**7.0**	**5.5**
Intermediate goods	58.4	0.0	10.5	4.3	4.4
Capital goods	15.2	13.8	1.5	2.8	-6.5
Consumption goods	7.3	3.0	9.3	8.7	15.6
Re-exports and dual-use goods	19.0	26.6	25.5	19.7	15.7
Trade balance (RM billion)	–	**16.3**	**27.5**	**70.7**	**26.4**

Source: MATRADE and Department of Statistics, Malaysia

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 expansion in gross exports was broad-based. The strong performance of manufactured exports was attributed to both E&E and non-E&E products, and a low base from the first quarter of 2013. E&E exports continued to grow at a double-digit pace, driven by strong demand for semiconductors, while the improvement in non-E&E exports was reflected across both resource and non-resource based products. Commodity exports continued to expand, albeit at a more moderate pace. These were supported by higher prices of palm oil and LNG. In terms of destination, exports to PR China remained strong while exports to the major advanced economies improved. Within the region, exports to the ASEAN economies were lower, in line with the moderation in domestic activity in these economies.

The moderation in gross imports in the first quarter was due mainly to the decline in capital imports. This reflected the base effect arising from high imports of transport equipment in the first quarter of last year. Intermediate imports continued to expand but at a more moderate pace, supported by the strong performance of manufactured exports during the quarter. The double-digit growth in imports for re-exports reflected the continued expansion of storage activities in southern Johor, catering mainly to refined petroleum and metals. Meanwhile, the faster growth in imports of consumption goods was attributed to higher imports of durable and non-durable consumer goods as well as processed food and beverages.

The services account recorded a smaller deficit of RM2.7 billion in the first quarter (4Q 2013: -RM4.1 billion). The lower deficit was mainly attributable to an increase in the net travel receipts and a smaller deficit in the transportation account. While travel receipts was slightly higher relative to the previous quarter, the increase in net receipts was driven mainly by the lower travel payments, as the number of Malaysian residents travelling abroad was smaller compared to the holiday season in the previous quarter. Meanwhile, the lower deficit in the transportation account was due mainly to the decrease in payments for transport services, in line with the moderation in gross imports during the quarter.

The deficit in the primary income balance narrowed to RM6.4 billion (4Q 2013: -RM10 billion), as investment income accrued to foreign direct investors in Malaysia decreased while investment income accrued to Malaysian companies investing abroad was sustained.

The financial account recorded a net outflow of RM37.6 billion in the first quarter of 2014 (4Q 2013: -RM9.7 billion), attributable to the large outflows from outward direct investment, portfolio investment and other investments.

Malaysia: Direction of Exports

	Share 2013 (%)	2013			2014
		1Q	4Q	Year	1Q
		Annual change (%)			
United States	**8.1**	**-2.9**	**-2.5**	**-4.5**	**4.2**
European Union (EU)	**9.1**	**-6.4**	**14.7**	**5.0**	**18.5**
Japan	**11.1**	**-9.5**	**4.9**	**-4.4**	**9.2**
Selected ASEAN countries[1]	**27.6**	**9.9**	**7.4**	**7.3**	**2.9**
North East Asia	**24.4**	**-5.3**	**23.5**	**5.6**	**20.2**
People's Republic of China	*13.5*	*-1.7*	*30.8*	*9.2*	*15.3*
Hong Kong SAR	*4.3*	*-9.0*	*30.1*	*3.9*	*35.0*
Korea	*3.6*	*-4.0*	*15.5*	*3.0*	*15.9*
Chinese Taipei	*2.9*	*-16.7*	*-4.6*	*-3.7*	*28.1*
West Asia[2]	**3.4**	**-1.3**	**-1.2**	**0.3**	**-0.5**
India	**3.6**	**-3.0**	**-17.7**	**-12.2**	**10.2**
Total exports	**100.0**	**-2.6**	**10.2**	**2.4**	**10.9**

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

Source: Department of Statistics, Malaysia

Inward direct investment (direct investment liabilities) registered an inflow of RM5.8 billion (4Q 2013: +RM10.4 billion) supported by continued extensions of equity capital and lower earnings retained for reinvestment. Inflows of direct investment were undertaken mainly by companies in the mining and services sectors, including in real estate acquisitions in the Iskandar region.

Outward direct investment (direct investment assets) was particularly large during the quarter, registering outflows amounting to RM20.4 billion (4Q 2013: -RM6.5 billion). This was due to higher extensions of intercompany loans and equity capital to subsidiaries of Malaysian companies operating abroad. The investments were undertaken primarily by companies in the mining and services sectors.

Portfolio investments also recorded net outflows during the quarter amounting to RM13.4 billion (4Q 2013: -RM0.8 billion), partly reflecting some reversals of non-resident portfolio investment. At the beginning of the quarter, the commencement of the scale-back of the Fed's asset purchase programme and concerns over country-specific developments in the emerging economies, and geopolitical tensions prompted sizeable outflows of non-resident portfolio investments. However, this was partially mitigated by improved investors' confidence following reaffirmed commitment by the Fed to maintain its accommodative monetary policy and expectations of policy measures to support economic activity in PR China towards the end of the quarter. The net outflow position was also attributable to the higher acquisitions of portfolio assets abroad by resident institutional investors during the quarter.

Other investments recorded a net outflow of RM8.1 billion (4Q 2013: -RM13.3 billion), mainly reflecting domestic banking sector's placements of deposits abroad.

Following these developments, the overall balance of payments registered a deficit of RM17.3 billion in the first quarter of 2014 (4Q 2013: -RM2.7 billion), as the larger outflows in the financial account more than offset the higher current account surplus. Errors and omissions amounted to RM0.4 billion (0.1% of total trade) and partly reflected foreign exchange revaluation gains on international reserves, as the ringgit depreciated against selected major currencies during the quarter.

Manageable external debt

Given 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, Malaysia is redefining its external debt in line with the best international practice. 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 (see Box Article on 'The Redefinition of External Debt').

Malaysia's redefined external debt stood at RM700.1 billion, equivalent to USD212.5 billion or 65.2% of GDP as at end-March 2014 (end-December 2013: RM694.6 billion or USD209.2 billion, equivalent to 70.4% of GDP). The higher external debt was attributed largely to the higher offshore borrowing by the private sector and non-resident holdings of ringgit-denominated debt securities, mainly the holdings of Malaysian Government Securities.

Offshore borrowing increased to RM327.9 billion during the quarter (end-December 2013: RM324.1 billion). The higher medium- and long-term offshore borrowing reflects mainly the net borrowing by private sector companies, which offset the net repayment by the public sector. Meanwhile, short-term offshore borrowing remained stable during the quarter. The rise in offshore borrowing during the quarter was partly offset by the strengthening of the ringgit against selected regional and major currencies. Non-resident holdings of ringgit-denominated debt securities issued by the Federal Government, BNM and corporations also registered an increase during the quarter. Higher non-resident holdings of domestic debt securities, which is mainly in medium- and long-term securities, reflecting investors' confidence in the Malaysian economy, as well as the attraction of the higher yields of these maturities. The high non-resident participation in Malaysia's bond market is also a reflection of the deeper, more open and more vibrant domestic financial markets.

Overall, more than half of the total external debt has a long-term maturity profile. The short-term external debt remained manageable with a reserves coverage of 1.3 times.

The Redefinition of External Debt

There are several accepted conventions in the classification of the external debt of a country. One is to emphasise on the foreign currency obligations owed by residents to non-residents. This was the standard practice when most cross-border debt flows were accounted for by residents raising financing in foreign currencies in more developed financial markets. This was in fact the practice adopted by Malaysia, where external debt consisted only of foreign currency-denominated debt, namely loans raised, and bonds and notes issued offshore.

The International Monetary Fund (IMF), et al. (2013)[1] have proposed a wider coverage for external debt, which takes into account the non-resident holdings of local-currency denominated debt papers and other debt-related non-resident financial flows, such as trade credits, currency and deposits, and other loans and liabilities (see Table 1). Under this definition, the external debt would include all liabilities that require payment of principal and/or interest at some point in the future, and are owed to non-residents by residents of an economy irrespective of the currency denomination of the debt.

Table 1: Components of Malaysia's previous and redefined external debt

External debt by maturity & instruments	Previous	Redefined
Short-term		
Inter-bank borrowing (FX)+	✓	✓
Inter-company borrowing (FX)+	✓	✓
Other loans* (FX)+	✓	✓
Trade credits		✓
NR++ holdings of domestic money market instruments		✓
Currency and deposits		✓
Other liabilities**		✓
Long-term		
Bonds issued abroad (FX)+	✓	✓
Inter-company borrowing (FX)+	✓	✓
Other loans* (FX)+	✓	✓
Trade credits		✓
NR++ holding of domestic bonds		✓
Other liabilities**		✓

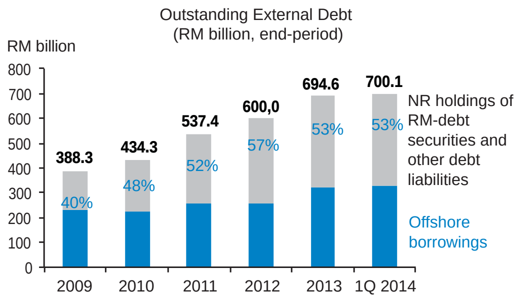
* Includes non-related company borrowing
**Other liabilities refer to IMF allocation of SDRs, and liabilities of pension funds and life insurance companies to NR
+ FX: Foreign currency
++ NR: Non-resident

Over the last decade, Malaysia's financial markets have developed significantly amid progressive liberalisation of the financial system. Consequently, Malaysia's bond market is now the largest in Southeast Asia and the second largest in Asia ex-Japan, while non-resident participation in domestic financial markets has increased significantly.

[1] International Monetary Fund (IMF), Bank for International Settlements (BIS), the Commonwealth Secretariat (Comsec), Eurostat, the Organization for Economic Co-operation and Development (OECD), the Paris Club Secretariat, the United Nations Conference on Trade and Development (UNCTAD) and the World Bank, 2013, External Debt Statistics: Guide for Compilers and Users, Washington, D.C.

With this redefinition, Malaysia's external debt stood at RM700.1 billion (USD212.5 billion or 65.2% of GDP) as at end-March 2014, compared to RM327.9 billion or 30.5% of GDP under the previous definition. The higher redefined external debt reflects the high level of non-resident holdings of ringgit-denominated debt securities, accounting for about two-thirds of the increase in the external debt following the redefinition. This is the outcome of the greater depth, openness and attractiveness of Malaysia's financial markets

Chart 1 : Malaysia's Redefined External Debt



Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Since these debt securities are ringgit-denominated obligations, the potential for currency mismatches in the country's external indebtedness is reduced. It is also crucial to note that the Federal Government debt remains unchanged. The redefinition of external debt is a prudential measure which allows the Government to better assess its exposure to non-residents. Importantly, although the redefined external debt level is higher, Malaysia's external indebtedness indicators remain within the international benchmark for prudence and external soundness.

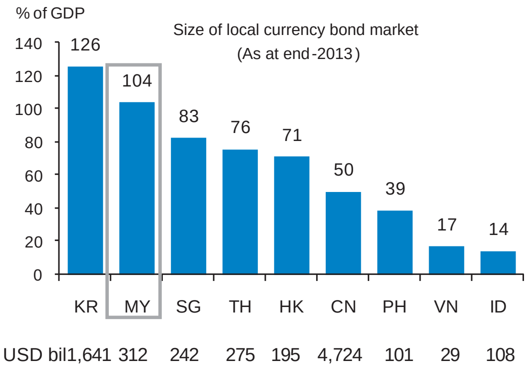
Table 2: Malaysia's external indebtedness indicators

	Standard international threshold	Malaysia's external debt, end-March 2014	
		Previous definition	Redefined
Reserves / ST external debt (times)	1.0	3.3	1.3
Total external debt / GDP (%)	60-90	30.5	65.2
ST external debt / Total external debt (%)	n.a	39.2	47.7
ST external debt / Exports of goods & services (%)	Smaller is better	15.1	39.3

Source: Reinhart. Carmen and Kenneth Rogoff, *"Growth in a Time of Debt"*, American Economic Review, May 2010; Guidotti-Greenspan rule and Bank Negara Malaysia

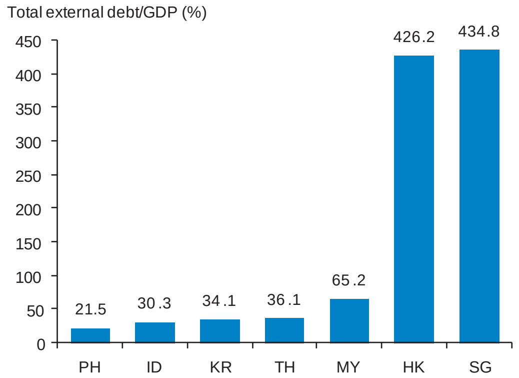
The redefinition of external debt, in essence, consolidates debt statistics that are already publicly available. Moreover, given the rapid deepening and diversification of the Malaysian financial market (Chart 2), the published data would be disaggregated to indicate the nature of Malaysia's external debt position, particularly the growing participation of non-residents in the markets. It is noteworthy that the prevalence of higher external debt amid the growing depth and sophistication of domestic capital markets is a general observation for countries moving to more developed financial markets, as is the case with Hong Kong SAR and Singapore (Chart 3).

Chart 2: Malaysia's local bond market among the largest in Asia excluding Japan



Source: ADB Asian Bonds Monitor, March 2014

Chart 3: Malaysia's external debt position relative to other regional countries



Source: World Bank Quarterly External Debt Statistics, International Monetary Fund

External Robustness

Malaysia's external position remains robust, underpinned by the country's strong economic fundamentals:

- **Growing participation of domestic institutional players in Malaysia's capital market:** In the event of a sell-off by non-residents, domestic players, particularly the well diversified institutional investors, have the capacity to absorb the ringgit-denominated papers. This would mitigate the risk of disruptive price movements in the financial markets. Malaysia now has several large institutional investors, a more developed insurance industry and a larger fund and wealth management industry that would absorb these ringgit-denominated papers.

- **Greater ability to withstand market and financial shocks:** Given the more developed financial system and stronger financial intermediaries, the country would be less susceptible to any financial stress stemming from volatile capital flows. In addition, an adequate level of reserves to finance such short-term external debt (reserves-to-short-term external debt ratio of 1.3 times, higher than the 1:1 minimum international ratio), the continued current account surplus, coupled with sizeable liquid foreign assets in the banking sector, would also provide additional buffers against any external shocks to the economy.

The robustness of Malaysia's external position was evident following the Fed's announcement of its intentions to scale back its quantitative easing measures in May 2013. Amid high global financial market volatility and uncertainty in response to the announcement, emerging market economies, including Malaysia, experienced large capital reversals. Nevertheless, Malaysia's financial system remained resilient and financial stability remained intact with no disruption to financial intermediation.

The redefinition of Malaysia's external debt is, therefore, assessed to be timely, so as to better consolidate Malaysia's external financial obligations in a transparent manner, and to reflect the extent of the advancement in Malaysia's financial markets over this recent decade.

External Debt Outstanding

	2013		2014
	end-Mar	end-Dec	end-Mar
	RM billion		
Offshore borrowing[1]	269.8	324.1	327.9
Medium- and long-term debt	*168.7*	*196.0*	*199.2*
Public sector	87.1	98.9	97.9
Private sector	81.6	97.1	101.3
Short-term	*101.0*	*128.1*	*128.7*
NR holdings of dom. debt securities	222.0	229.7	231.3
Medium- and long-term debt	*150.1*	*151.1*	*156.3*
Short-term	*71.9*	*78.6*	*75.0*
NR deposits	54.8	77.3	77.5
Others[2]	63.1	63.5	63.3
Medium- and long-term debt	*9.4*	*10.0*	*10.3*
Short-term	*53.7*	*53.5*	*53.0*
Total external debt	**609.7**	**694.6**	**700.1**
USD billion equivalent	*195.4*	*209.2*	*212.5*
External Debt (Previous definition)			
Total debt/GDP (%)	27.3	32.8	30.5
Short-term debt[3]/Total debt (%)	37.5	39.5	39.2
Reserves/Short-term debt[3] (times)	4.3	3.4	3.3
External Debt (Redefined)			
Total debt/GDP (%)	61.8	70.4	65.2
Short-term debt[4]/Total debt (%)	46.2	48.6	47.7
Reserves/Short-term debt[4] (times)	1.5	1.3	1.3

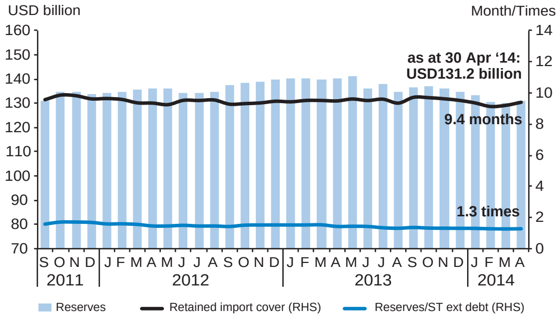
[1] Equivalent to the external debt as previously defined, comprised mainly foreign currency loans raised, and bonds and notes issued offshore.
[2] Comprise trade credits, IMF allocation of SDRs and miscellaneous.
[3] Equivalent to short-term offshore borrowing
[4] Short-term offshore borrowing, NR holdings of short-term domestic debt securities, NR deposits and other short-term debt
Note: NR refers to non-resident

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

International reserves remained high

The international reserves of BNM amounted to RM424.6 billion (equivalent to USD130.2 billion) as at 31 March 2014. This reserves 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 USD 131.2 billion), sufficient to finance 9.4 months of retained imports and is 1.3 times the redefined short-term external debt (end-December 2013: 9.5 months of retained imports; 1.3 times the redefined short-term external debt).

Net International Reserves (as at end period)



Source: Bank Negara Malaysia

Lower Government deficit

The Federal Government recorded a lower fiscal deficit of 5.1% of GDP in the first quarter of 2014. This was due to higher revenue collection, mainly from higher individual income tax and non-tax revenue. Total expenditure recorded an increase of 5.9% on an annual basis, contributed by higher operating expenditure. Most of the increase in spending under operating expenditure was accounted for by payments for emoluments and debt service. Development expenditure was lower across the sectors. As at end-March 2014, total outstanding debt of the Federal Government amounted to RM560.6 billion or 52.2% of the estimated 2014 GDP.

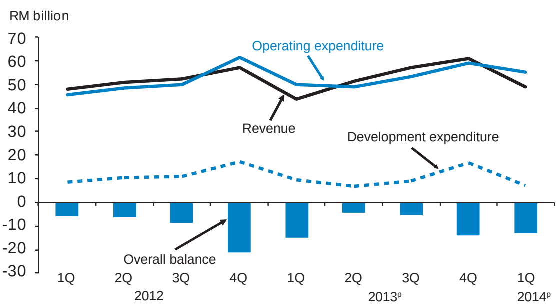
Federal Government Finance[p]

	2013			2014
	1Q	4Q	Year	1Q
	RM billion			
Revenue	43.8	61.1	213.4	49.2
% annual growth	*-8.6*	*6.8*	*2.6*	*12.4*
Operating expenditure	49.9	58.8	211.3	55.2
% annual growth	*9.4*	*-4.6*	*2.8*	*10.6*
Current account	**-6.1**	**2.3**	**2.1**	**-6.0**
% of GDP	***-2.6***	***0.9***	***0.2***	***-2.3***
Net development expenditure	8.8	16.0	40.7	7.0
% annual growth	*8.3*	*-3.4*	*-8.2*	*-20.9*
Overall balance	**-14.9**	**-13.8**	**-38.6**	**-13.0**
% of GDP	***-6.4***	***-5.2***	***-3.9***	***-5.1***
Memo item:				
Total net expenditure	58.7	74.8	252.0	62.2
% annual growth	*9.3*	*-4.4*	*0.8*	*5.9*
Total Federal Government debt (as at end-period)	508.9	539.9	539.9	560.6
% of GDP	*51.6*	*54.7*	*54.7*	*52.2*
Domestic debt	352.2	381.5	381.5	398.5
% of GDP	*35.7*	*38.7*	*38.7*	*37.1*
External debt[1]	156.7	158.4	158.4	162.1
% of GDP	*15.9*	*16.1*	*16.1*	*15.1*
Non-resident holdings of RM-denominated Federal Government debt[2]	*140.5*	*141.7*	*141.7*	*145.7*
% of GDP	*14.3*	*14.4*	*14.4*	*13.6*
Offshore borrowing	*16.2*	*16.8*	*16.8*	*16.5*
% of GDP	*1.6*	*1.7*	*1.7*	*1.5*

[p] Preliminary
[1] Refers to the redefined external debt (see Box Article on the 'Redefinition of External Debt')
[2] Refers to non-resident holdings of ringgit-denominated Government debt (MGS, GII, T-bills etc.), which was classified as domestic debt under the previous definition

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Federal Government Finance



[p] Preliminary
Source: Ministry of Finance, Malaysia