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

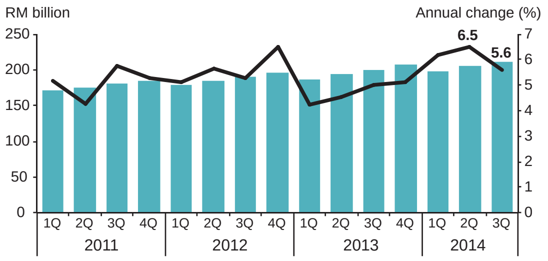
OVERVIEW

The Malaysian economy expanded by 5.6% in the third quarter of 2014

The global economy continued to expand at a moderate pace in the third quarter of 2014, with uneven growth performances across economies. While the US economy continued to show broader signs of improvements, growth in the euro area remained subdued amid persistent structural constraints and weakening sentiments. In Asia, economic activity continued to expand, although growth was more moderate in several economies.

The Malaysian economy registered a growth of 5.6% in the third quarter of 2014 (2Q 2014: 6.5%), supported by private sector demand and continued positive growth in net exports of goods and services. On the supply side, growth in the major economic sectors was sustained, supported by trade and domestic activities. On a quarter-on-quarter seasonally adjusted basis, the economy grew by 0.9 % (2Q 2014: 1.9%).

The economy expanded in the third quarter
(at constant 2005 prices)



Source: Department of Statistics, Malaysia

Private sector activity remained the key driver of growth during the quarter. Private consumption registered a growth of 6.7% in the third quarter (2Q 2014: 6.5%), supported by stable labour market conditions and continued wage growth. Private investment expanded at a slower pace of 6.8% (2Q 2014: 12.1%), attributed to a decline in spending on machinery and equipment, particularly in the transportation segment. Public consumption turned positive to 5.3% (2Q 2014: -0.5%), reflecting higher Government spending on supplies and services. Public investment, however, declined further by 8.9% (2Q 2014: -3.3%), attributed mainly to the near completion of a few projects by public enterprises and the continued contraction in the Federal Government development expenditure. Going forward, investment activity will be supported by continued flow of ongoing and new projects by the private and public sectors.

On the supply side, positive growth was experienced across all economic sectors in the third quarter. The services sector recorded sustained growth, supported mainly by the consumption- and production-related services sub-sectors. Similarly, growth in the construction sector also remained sustained, driven by the residential and non-residential sub-sectors. After an exceptionally strong performance in the second quarter, the manufacturing sector expanded at a more moderate pace amid slower domestic-oriented activity. The agriculture sector registered a slower growth following weaker output of palm oil and rubber, while the mining sector grew at a more moderate pace amidst lower production of natural gas and condensates.

The inflation rate, as measured by the annual change in the Consumer Price Index (CPI), averaged lower at 3.0% in the third quarter (2Q 2014: 3.3%). The decline was mainly attributed to the lower inflation in the *transport* category (3.7%, 2Q 2014: 5.4%), reflecting the lapse in the impact of the price adjustment made in September 2013 for RON95 petrol and diesel.

The trade surplus narrowed to RM16.8 billion (2Q 2014: RM18.5 billion). Gross exports grew at a slower pace of 1.5% (2Q 2014: 14.4%), arising from a higher base in the third quarter of 2013. Gross imports also moderated, registering a growth of 2.6% in the third quarter (2Q 2014: 8.5%).

The international reserves of Bank Negara Malaysia (BNM) amounted to RM416.9 billion (equivalent to USD127.3 billion) as at 30 September 2014. This reserves level has taken into account the quarterly adjustment for foreign exchange revaluation changes. As at 31 October 2014, the reserves position amounted to RM419.7 billion (equivalent to USD128.1 billion), sufficient to finance 8.8 months of retained imports and is 1.2 times the short-term external debt.

Interest rates adjusted upwards following the increase in the OPR

On 10 July 2014, the Monetary Policy Committee (MPC) raised the Overnight Policy Rate (OPR) by 25 basis points to 3.25%. Interbank rates rose in the third quarter reflecting the increase in OPR. The daily weighted average overnight interbank rate (AOIR) traded higher in a range of 3.18% to 3.25% from 11 July to 30 September. Interbank rates of other maturities also rose accordingly. The average quoted fixed deposit (FD) rates of commercial banks for the 1 to 12 months tenures rose between 15 to 25 basis points to a higher range of 3.07% to 3.30% as at end-July. The average base lending rate (BLR) of commercial banks increased by 25 basis points to 6.79%, while the weighted average lending rate (ALR) on outstanding loans trended higher to 5.52% as at end-September. The overall cost of borrowing, however, remained supportive of economic activity and overall lending rates continued to be below the levels prior to the Global Financial Crisis.

The monetary aggregates continued to expand in the third quarter. M1, or narrow money, increased by RM1.2 billion during the quarter. On an annual basis, M1 expanded by 6.7% as at end-September (end-June 2014: 10.2%). M3, or broad money, increased by RM10.5 billion on a quarter-on-quarter basis to record an annual growth rate of 5.2% as at end-September (end-June 2014: 5.6%). The increase in M3 during the quarter was driven mainly 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 RM302.1 billion in the third quarter (2Q 2014: RM281.0 billion). On a net basis, outstanding banking system loans and private debt securities (PDS) expanded by 8.9% as at end-September (end-June 2014: 9.1%). Net funds raised in the capital market were slightly lower at RM17.1 billion in the third quarter (2Q 2014: RM17.2 billion).

The ringgit was on an appreciating trend against most major and regional currencies during the earlier part of the quarter, mainly driven by higher demand for Malaysian bonds following the release of strong data on the domestic economy. The ringgit, however, reversed its trend towards the end of the quarter due to external developments, in tandem with most other regional currencies. Expectations for a faster-than-expected policy rate increase in the US following releases of strong US economic data led to the shift towards US financial assets and an outflow of funds from regional financial markets, particularly from equity markets.

Overall, the ringgit depreciated 1.9% against the US dollar but appreciated against the Japanese yen (5.9%), the Australian dollar (5.6%), euro (5.5%) and the pound sterling (2.8%). The ringgit exhibited a mixed performance against regional currencies.

Between 1 October and 12 November 2014, the ringgit depreciated against the US dollar by 2.1%. The ringgit appreciated against the Japanese yen (3.7%) and the pound sterling (0.1%), but depreciated against the euro (0.3%) and the Australian dollar (1.3%). Against regional currencies, the ringgit strengthened against the Korean won (2.3%), but depreciated against other currencies by between 0.5% and 2.4%.

Domestic financial stability continued to be well preserved

The Malaysian financial system remained resilient despite continued volatility in the domestic financial market arising from uncertainties in the external environment, prevalent in the latter half of September. Financial intermediation remained well-supported by sound financial institutions, orderly financial market conditions and sustained confidence in the financial system. While the period ahead is expected to remain challenging, the outlook for domestic financial stability continues to be positive.

Financial soundness indicators of banks and insurers were strong as reflected in high capitalisation, profitable business and ample liquidity. The common equity tier 1 (CET1) capital ratio, tier 1 capital ratio and total capital ratio of the banks were well above the minimum regulatory levels, at 12.8%, 13.5% and 15.5%, respectively. More than 80% of the banks' total capital consists of high quality capital, as represented by the strong CET1 level in the form of paid-up capital, retained earnings and reserves. Total capital buffers for banks, which are in excess of the minimum total regulatory capital requirement stood at more than RM90 billion. The Capital Adequacy Ratio of insurers stood at 246.9% (2Q 2014: 249.7%) with an excess capital buffer of RM24.4 billion (2Q 2014: RM25.7 billion).

The Malaysian economy to remain on a steady growth path

Going forward, global growth is expected to remain moderate. Growth across the advanced economies is expected to remain uneven. In Asia, growth will be underpinned by a continued expansion in domestic demand and exports. Nevertheless, there remains considerable downside risks to global growth. These include prolonged weakness in domestic demand and low inflation in a number of major economies, uncertainty over monetary policy adjustments in the key advanced economies and persistent geopolitical tensions that could heighten financial market volatility.

While risks to growth have increased, the Malaysian economy is expected to remain on a steady growth path. Although exports will benefit from the recovery in the advanced economies and from regional demand, the trend is likely to moderate reflecting both the high base effect from 2013 and lower commodity prices. While private consumption may moderate, investment activity will be supported by continued flow of ongoing and new projects by the private and public sectors. Going forward, domestic demand will remain the key driver of growth.

DEVELOPMENTS IN THE THIRD QUARTER OF 2014

INTERNATIONAL ECONOMIC ENVIRONMENT

Moderate global economic expansion

The global economy continued to expand at a moderate pace in the third quarter of 2014, with uneven growth performances across economies. While the US economy continued to show broader signs of improvements, growth in the euro area remained subdued amid persistent structural constraints and weakening sentiments. In Asia, economic activity continued to expand, although growth was more moderate in several economies. Global monetary conditions remained accommodative, but the direction of monetary policy diverged across both the advanced and emerging economies.

Financial market volatility increased in the third quarter, particularly in the latter half of September. Although additional monetary easing by the European Central Bank (ECB) provided some support to market sentiments, overall investor confidence was weighed down by weaker-than-expected data, particularly in the euro area and Japan, expectations for a more rapid pace of increase in US interest rates, and ongoing geopolitical developments. In Asia, most Asian equities trended lower following growing concerns on global growth prospects and higher investor risk aversion. Nevertheless, Japanese equities improved, as the weaker yen supported market expectations for a stronger export performance.

The US economy continued to expand, although at a more moderate pace, in the third quarter (2.3%; 2Q 2014: 2.6%), supported by both private consumption and investment activity. Government spending also contributed positively to growth for the first time in 16 quarters. On a seasonally adjusted annualised basis, the economy grew by 3.5% (2Q 2014: 4.6%). The labour market recorded further improvements. Job creation continued to increase (702,000; 2Q 2014: 800,000), while long-term unemployment and involuntary part-time workers declined. Headline inflation moderated to 1.8% (2Q 2014: 2.1%), amid lower cost of energy and medical services.

Recovery in the euro area was subdued in the third quarter. While overall demand conditions were supported by more accommodative monetary conditions, growth remained weak amid high unemployment, low capacity utilisation and ongoing balance sheet adjustments by both the private and public sectors. Business confidence was further affected by geopolitical developments in Eastern Europe, which in turn weighed down on private investment. Inflation moderated further to 0.3% (2Q 2014: 0.6%), due mainly to the lower cost of food and energy, and increased concerns on the risk of deflation.

Economic activity in the UK expanded by 3% in the third quarter (2Q 2014: 3.2%). The services sector remained the key contributor to growth, particularly the transport, and business services and finance sectors. The inflation rate moderated to 1.4% (2Q 2014: 1.7%), amid lower prices of food and transport.

In Japan, economic activity improved, although the strength of growth remained weak following larger-than-expected impact from the consumption tax increase in April. Private consumption was underpinned by higher retail sales amid better employment conditions. Investment was supported by improving business sentiments. In the external sector, exports expanded at a faster pace (3.2%; 2Q 2014: 0.1%), supported by higher shipments to Asia and the US. Inflation (excluding fresh food) moderated slightly (3.2%; 2Q 2014: 3.3%), as the effects of the consumption tax increase began to diminish. Core inflation (excluding food and energy), nevertheless, remained unchanged (2.3%; 2Q 2014: 2.3%).

Advanced Economies: Real GDP Growth

	2013		2014		
	3Q	4Q	1Q	2Q	3Q
	Annual Change (%)				
US[1]	4.5	3.5	-2.1	4.6	3.5[a]
UK	1.7[r]	2.7	2.9[r]	3.2[r]	3.0[p]

[1] Annualised basis
[a] Advance estimate
[p] Preliminary
[r] Revised

Source: National authorities

The overall monetary policy stance in the advanced economies remained highly accommodative across economies, despite continued divergence in monetary policy direction in the third quarter. In the US, the Federal Reserve (Fed) continued to reduce the pace of its asset purchases by USD10 billion following each meeting, ending the quantitative easing programme (QE-3) in October. In addition, latest official projections on the median policy rate indicated that the pace of interest rate increase could be faster than expected, with the federal funds rate reaching 1.4% by end-2015 (previous: 1.1%) and 2.9% in 2016 (previous: 2.5%). In the UK, the Bank of England (BoE) also signalled the potential for monetary policy normalisation to start in 2015 should economic activity and labour market conditions improve further.

In contrast, the ECB implemented further monetary easing in September and October, to support growth and reduce the risk of deflation in the euro area. The main refinancing operations (MRO) rate and deposit rate were reduced by 10 basis points (bps) each in September, to 0.05% and -0.20% respectively (previous: 0.15% and -0.10% respectively). The ECB also introduced new purchase programmes for asset-backed securities and covered bonds, beginning in October and lasting for at least two years. Meanwhile, the Bank of Japan (BoJ) increased its annual asset purchases to JPY80 trillion (previous target range: JPY60~70 trillion), amid continued disinflationary concerns.

In PR China, the economy grew by 7.3% (2Q 2014: 7.5%), driven mainly by growth in the tertiary industry (which includes, among others, hotel and catering, wholesale and retail trade, and financial intermediation) and the secondary industry (industry and construction). Inflation moderated to 2% (2Q 2014: 2.2%), attributable to the lower price of food, transport and housing.

In Asia, economic activity continued to expand, albeit at a more moderate pace in several economies. Growth in Indonesia moderated to 5% (2Q 2014: 5.1%), on account of lower exports and investment. In Korea, economic activity grew at a slower pace (3.2%; 2Q 2014: 3.5%) due mainly to weaker net exports. In Singapore, growth was sustained at 2.4% (2Q 2014: 2.4%), supported by the manufacturing and services sectors. In Chinese Taipei, the economy grew at a slightly faster pace (3.8%; 2Q 2014: 3.7%), underpinned by an improvement in domestic demand.

Regional Countries: Real GDP Growth

	2013		2014		
	3Q	4Q	1Q	2Q	3Q
	Annual Change (%)				
PR China	7.8	7.7	7.4	7.5	7.3
Indonesia	5.6	5.7	5.2	5.1	5.0
Singapore	5.0	4.9	4.8	2.4	2.4[a]
Korea	3.4	3.7	3.9	3.5	3.2[a]
Chinese Taipei	1.3	2.9	3.2	3.7	3.8[a]

[a] Advance estimate

Source: National authorities

Headline inflation moderated in most Asian economies on account of lower price increases in the food as well as transportation and communication sectors, particularly in Chinese Taipei, Indonesia, Korea, Singapore and Thailand. Nevertheless, inflation rose in Hong Kong and the Philippines due to higher cost of housing and utilities, and food respectively.

During the quarter, the direction of monetary policy decisions by regional central banks diverged. Bangko Sentral ng Pilipinas (BSP) raised its key policy rates in July and September by a total of 50 basis points, to 4.00% for the overnight borrowing or reverse repurchase facility and 6.00% for the overnight lending or repurchase facility. Inflationary pressures and inflation expectations were assessed to be elevated amid tight supply conditions and possible price adjustments in the energy and utilities sectors. In contrast, the Bank of Korea (BOK) lowered its base rate in August and October by 25 basis points each to 2.00%, amid tepid growth in investment and subdued inflationary pressures.

Brent crude oil prices moderated to an average of USD103 per barrel in the third quarter (2Q 2014: USD110 per barrel), amid higher global supply and subdued demand from several key economies, including PR China. During the quarter, the price premium on crude oil eased, as supply from the key oil-producing regions were not disrupted despite continued geopolitical developments. Meanwhile, non-OPEC countries contributed more to supply. The US, in particular, increased its supply of shale oil. Oil prices ended the quarter at USD94 per barrel, and declined further to USD86 per barrel as of 27 October 2014, the lowest level since November 2010.

Most major and regional currencies depreciated against the US dollar during the quarter due to weaker-than-expected data, expectations for a faster increase in US interest rates and ongoing geopolitical developments. In the advanced economies, the euro and Japanese yen were lower following weaker-than-expected economic activity. The announcement of additional monetary easing by the ECB also weighed down on the euro. Meanwhile, the pound sterling was affected by uncertainty surrounding the 2014 Scottish independence referendum. In Asia, investors' expectations for a more rapid increase in US interest rates, together with the escalation of street demonstrations in Hong Kong, weakened sentiments in the regional markets. Nevertheless, the Chinese renminbi remained on an appreciating trend, as investor confidence was supported by several policy announcements to support growth, including the easing of property-related measures.

Going forward, global growth is expected to remain moderate. Growth in the advanced economies is expected to remain uneven. In Asia, growth will be underpinned by a continued expansion in domestic demand and exports. Nevertheless, there remain considerable downside risks to global growth. These include prolonged weakness in domestic demand and low inflation in a number of major economies, uncertainty over monetary policy adjustments in key advanced economies and persistent geopolitical tensions that could heighten financial market volatility.

DEVELOPMENTS IN THE MALAYSIAN ECONOMY

Continued expansion in third quarter

The Malaysian economy expanded by 5.6% in the third quarter of 2014 (2Q 2014: 6.5%). Overall, growth was supported by private domestic demand, amid continued contraction in public expenditure. As real exports of goods and services recorded a positive growth amid a slower pace of expansion in real imports of goods and services, net exports continued to contribute positively to growth during the quarter. On a quarter-on-quarter seasonally-adjusted basis, the economy grew by 0.9% (2Q 2014: 1.9%).

Domestic demand supported by sustained private sector activity

Domestic demand grew by 4.8% in the third quarter (2Q 2014: 5.8%), with private sector activity being the key driver of growth. Public sector spending declined further during the quarter as the contraction in public investment more than offset the improvement in public consumption.

Private sector activity grew by 6.7% (2Q 2014: 8.1%), driven by stronger growth in **private consumption** of 6.7% (2Q 2014: 6.5%). Household spending remained supported by stable employment conditions and continued wage growth. **Private investment** expanded at a slower pace of 6.8% (2Q 2014: 12.1%), attributed to a decline in spending on machinery and equipment, particularly in the transportation segment. Going forward, investment activity will be supported by continued flow of ongoing and new projects by the private and public sectors.

GDP by Expenditure Components
(at constant 2005 prices)

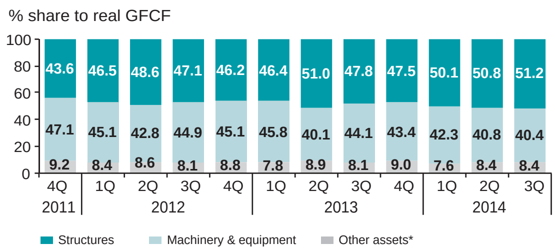
	2013		2014		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Aggregate Domestic Demand (excluding stocks)	8.4	6.7	7.5	5.8	4.8
Private Sector	9.8	9.1	8.8	8.1	6.7
Consumption	*8.0*	*7.4*	*7.1*	*6.5*	*6.7*
Investment	*15.6*	*16.6*	*14.1*	*12.1*	*6.8*
Public sector	4.1	2.1	3.3	-1.6	-1.2
Consumption	*7.8*	*5.2*	*12.3*	*-0.5*	*5.3*
Investment	*-0.1*	*-1.4*	*-6.4*	*-3.3*	*-8.9*
Net Exports	9.9	-6.8	14.9	91.0	11.4
Exports of Goods and Services	*4.6*	*5.7*	*7.9*	*8.8*	*2.8*
Imports of Goods and Services	*4.2*	*7.1*	*7.1*	*3.9*	*2.2*
GDP	**5.0**	**5.1**	**6.2**	**6.5**	**5.6**
GDP (q-o-q growth, seasonally adjusted)	**1.7**	**1.9**	**0.9**	**1.9**	**0.9**

Source: Department of Statistics, Malaysia

Public sector expenditure registered a negative growth of 1.2% (2Q 2014: -1.6%). **Public consumption** turned around to register a positive growth of 5.3% (2Q 2014: -0.5%), reflecting higher Government spending on supplies and services. **Public investment**, however, declined further by 8.9% (2Q 2014: -3.3%), attributed mainly to the near completion of a few projects by public enterprises and the continued contraction in the Federal Government development expenditure.

In terms of total investment, **gross fixed capital formation** expanded at a more moderate pace of 1.1% (2Q 2014: 7.2%). By type of assets, spending on structures remained firm (8.3%; 2Q 2014: 6.7%), while spending on machinery and equipment declined by 7.5% (2Q 2014: 9.1%). In the first three quarters of 2014, structures, and machinery and equipment investment accounted for 51% and 41% of total gross fixed capital formation, respectively.

GFCF by Type of Assets



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

Positive growth across all sectors

On the supply side, positive growth was experienced across all economic sectors in the third quarter. The services sector recorded sustained growth, supported by the continued expansion in both the consumption- and production-related services. In the manufacturing sector, after an exceptionally strong performance in the second quarter, the sector expanded at a more moderate pace amid slower domestic-oriented activity.

GDP by Economic Activity (at constant 2005 prices)

	Share 2013 (%)	2013 3Q	2013 4Q	2014 1Q	2014 2Q	2014 3Q
		Annual change (%)				
Agriculture	7.1	2.0	0.2	2.3	7.1	4.0
Mining	8.1	1.4	-1.2	-0.8	2.1	1.4
Manufacturing	24.5	4.3	5.2	6.8	7.3	5.3
Construction	3.8	10.2	9.8	18.9	9.9	9.6
Services	55.2	6.0	6.4	6.6	6.2	6.1
Real GDP	**100.0[1]**	**5.0**	**5.1**	**6.2**	**6.5**	**5.6**
Real GDP (q-o-q seasonally adjusted)	**-**	**1.7**	**1.9**	**0.9**	**1.9**	**0.9**

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

Source: Department of Statistics, Malaysia

Similarly, growth in the agriculture sector recorded a slower growth following weaker output of palm oil and rubber, while the mining sector moderated as well. Activity in the construction sector, however, grew at a sustained pace, driven by the residential and non-residential sub-sectors.

Growth in the **services sector** was sustained at 6.1% in the third quarter (2Q 2014: 6.2%). The wholesale and retail trade sub-sector grew by 8.2% (2Q 2014: 9.2%), in tandem with the continued expansion in household spending. In the communication sub-sector, growth remained robust (9.6%; 2Q 2014: 9.8%), driven by continued strong demand for data communication services. Growth in the real estate and business services sub-sector remained high (7.1%; 2Q 2014: 7.4%), underpinned mainly by the business services segment. The transport and storage sub-sector expanded by 4.9% (2Q 2014: 4.6%) supported by strong highway, airport and port activity. The finance and insurance sub-sector registered a higher growth of 2.6% (2Q 2014: 0.7%) mainly reflecting the higher growth in net interest income.

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

	Share 2013 (%)	2013 3Q	2013 4Q	2014 1Q	2014 2Q	2014 3Q
		Annual change (%)				
Intermediate Services	**40.8**	**5.0**	**4.9**	**5.8**	**4.7**	**5.4**
Finance & insurance	16.6	0.9	0.5	2.4	0.7	2.6
Real estate & business services	10.3	8.1	8.3	8.6	7.4	7.1
Transport & storage	6.6	5.1	5.4	4.8	4.6	4.9
Communication	7.4	10.8	10.3	10.2	9.8	9.6
Final Services	**59.2**	**6.6**	**7.5**	**7.2**	**7.2**	**6.7**
Wholesale & retail trade	26.1	6.1	8.4	8.6	9.2	8.2
Accommodation & restaurant	4.5	5.8	5.8	6.1	5.6	5.1
Utilities	4.5	3.9	4.4	3.2	2.7	4.4
Government services	15.0	9.6	8.6	8.1	7.3	6.2
Other services	9.1	5.0	5.1	4.8	4.5	4.9
Total Services	**100.0[1]**	**6.0**	**6.4**	**6.6**	**6.2**	**6.1**

[1] Numbers do not add up due to rounding

Source: Department of Statistics, Malaysia

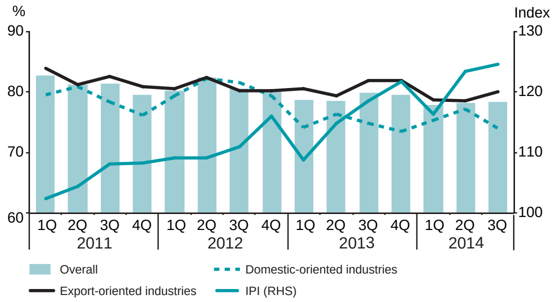
Selected Quarterly Indicators in the Services Sector

	2013 3Q	2013 4Q	2014 1Q	2014 2Q	2014 3Q
	Index				
MIER Consumer Sentiment Index	102.0	82.4	96.8	100.1	98.0
MIER Retail Trade Index	107.9	81.7	86.3	89.6	130.0
MIER Tourism Market Index	138.8	140.3	115.8	96.7	115.2
	Annual change (%)				
Tourist arrivals	-4.9	1.2	10.0	11.1	6.1
Total passenger traffic at all airports	23.0	24.1	18.9	5.9	-2.0
Total consumption credit outstanding	6.9	5.9	4.8	4.4	2.9
Total loans outstanding	9.5	10.6	10.2	9.3	9.0
Loans outstanding to the wholesale & retail trade, hotels & restaurants	12.2	11.3	6.4	6.4	7.3
Imports of consumption goods	9.7	9.6	15.6	7.1	-1.0
Total sales of motor vehicles	11.0	-0.9	1.4	11.2	-8.8
Container cargo handled (Port Klang and PTP)	3.0	2.7	3.7	7.2	9.2

Source: MIER, Ministry of Tourism and Culture Malaysia, and other sources

Growth in the **manufacturing sector** moderated to 5.3% in the third quarter (2Q 2014: 7.3%) amid slower growth in the domestic-oriented industries, particularly in the consumer-related industries. However, sustained performance in the export-oriented industries (4.6%, 2Q 2014: 5.0%), particularly the electronics and electrical (E&E) cluster, supported growth.

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

Overall capacity utilisation rate in the manufacturing sector was sustained at 78% (2Q 2014: 78%), driven by increased capacity utilisation in the export-oriented industries (80%, 2Q 2014: 79%). However, this was offset by the moderation in capacity utilisation in the domestic-oriented industries (74%, 2Q 2014: 77%).

Growth in the **construction sector** remained sustained during the quarter (9.6%; 2Q 2014: 9.9%), driven mainly by the residential and non-residential sub-sectors. The residential sub-sector continued to record firm growth, supported by the construction of high-end properties in the Klang Valley, Penang and Johor, while on-going construction of offices and retail projects and storage facilities contributed to growth in the non-residential sub-sector. Meanwhile, the civil engineering sub-sector continued to provide support to the sector owing to new and existing infrastructure projects.

Performance of the Manufacturing Sector

	Share 2013 (%)	2013		2014		
		3Q	4Q	1Q	2Q	3Q
		Annual Change (%)				
Value Added (at constant 2005 prices)	**100.0**	**4.3**	**5.2**	**6.8**	**7.3**	**5.3**
Export-oriented industries	61.5	4.1	4.7	6.9	5.0	4.6
Domestic-oriented industries	38.5	4.6	6.0	6.7	10.9	6.6
Overall Manufacturing Production[1]	**100.0**	**6.9**	**4.9**	**6.9**	**7.4**	**5.1**
Export-oriented industries	**74.8**	**6.6**	**3.8**	**6.6**	**5.4**	**4.3**
Electronics and electrical products cluster	**24.2**	**11.8**	**16.9**	**14.6**	**13.9**	**10.0**
Of which:						
Electronics	15.3	20.8	25.4	19.1	15.1	3.7
Electrical products	8.9	-4.7	1.2	5.4	11.2	24.6
Primary-related cluster	**50.7**	**4.1**	**-1.8**	**3.0**	**1.2**	**1.3**
Of which:						
Chemicals and chemical products	14.3	1.7	-1.1	1.2	-2.1	7.2
Petroleum products	21.0	9.5	-4.0	6.5	-0.5	-5.4
Rubber products	2.5	7.8	6.8	1.3	-1.6	-4.2
Off-estate processing	4.5	-0.1	-1.5	0.9	12.2	4.3
Domestic-oriented industries	**25.2**	**7.7**	**8.0**	**7.8**	**13.0**	**7.5**
Construction-related cluster	**11.3**	**5.1**	**3.5**	**3.2**	**4.6**	**5.7**
Of which:						
Construction-related products	8.2	2.5	2.2	1.2	6.6	7.1
Fabricated metal products	3.1	10.2	5.8	6.9	0.9	3.2
Consumer-related cluster	**13.8**	**10.0**	**11.6**	**11.8**	**20.5**	**8.9**
Of which:						
Transport equipment	5.5	9.1	23.4	19.1	29.8	11.6
Food, beverage & tobacco products	7.3	11.2	1.1	5.7	14.9	7.2

[1] Industrial Production Index (2010=100)

Source: Department of Statistics, Malaysia

Indicators for the Construction Sector

	2013	2014			
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Value of construction work done	12.0	11.3	21.1	10.8	10.7
Residential	23.6	18.3	33.1	18.1	21.5
Non-residential	9.9	18.1	19.9	14.5	10.9
Civil engineering	6.5	1.9	10.5	1.8	2.2
Special Trade[1]	8.2	9.4	49.3	9.8	7.4
Housing approvals	-1.0	-31.2	-47.6	-10.5	-6.8
Production[2] of construction-related materials	5.1	3.5	3.2	4.6	5.7
Hydraulic cement	2.7	6.2	1.3	7.3	7.8
Other articles of concrete, cement and plaster n.e.c	-0.7	25.5	36.9	43.5	25.8
Other porcelain and ceramic products	-12.0	3.1	15.2	17.5	20.7
Prefabricated structural components for building or civil engineering of cement, concrete or artificial stone	-1.8	6.5	2.6	-6.4	2.6
Capital imports (excluding lumpy items)	-1.9	-3.3	-3.3	0.9	-1.0
Loans for the construction sector					
Approval	-1.4	0.6	-32.8	-16.7	25.9
Disbursement	-4.3	22.2	23.3	4.4	4.8

[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

Performance of the Agriculture Sector

	Share 2013 (%)	2013		2014		
		3Q	4Q	1Q	2Q	3Q
		Annual change (%)				
Value Added (at constant 2005 prices)	**100**	**2.1**	**0.2**	**2.3**	**7.1**	**4.0**
Industrial Crops	**53.8**	**-1.9**	**-2.9**	**-1.0**	**9.3**	**1.1**
Of which:						
Oil palm	36.6	-0.6	-1.2	1.6	14.9	5.2
Rubber	7.0	-0.1	-14.4	-12.1	-15.0	-24.1
Food Crops	**46.2**	**7.0**	**4.6**	**6.1**	**4.3**	**7.3**
Of which:						
Fishing	14.4	1.6	-3.3	2.1	0.4	3.0
Livestock	11.7	11.7	10.6	7.9	6.1	7.7

Source: Department of Statistics, Malaysia

Performance of the Mining Sector

	Share 2013 (%)	2013		2014		
		3Q	4Q	1Q	2Q	3Q
		Annual change (%)				
Value Added (at constant 2005 prices)	**100.0**	**1.4**	**-1.2**	**-0.8**	**2.1**	**1.4**
Production						
Of which:						
Crude oil	-	-0.4	-8.3	-3.5	4.0	5.7
Condensates	-	-0.9	0.1	-0.9	-5.5	-10.0
Natural gas	-	4.3	2.0	1.2	1.6	-1.1

Source: Department of Statistics, Malaysia

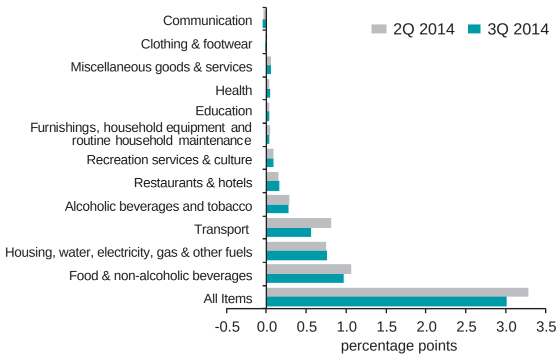
The **agriculture sector** recorded a slower growth of 4.0% (2Q 2014: 7.1%), mainly due to slower growth in industrial crops amid lower prices, particularly palm oil and rubber. Meanwhile, the **mining sector** grew at a more moderate pace (1.4%; 2Q 2014: 2.1%), caused by lower output of natural gas and condensates.

Inflation continued to decline in the third quarter

The inflation rate, as measured by the annual change in the Consumer Price Index (CPI), averaged lower at 3.0% in the third quarter (2Q 2014: 3.3%). The decline was mainly attributed to the lower inflation in the *transport* category (3.7%, 2Q 2014: 5.4%), reflecting the lapse in the impact of the price adjustment made in September 2013 for RON95 petrol and diesel. Inflation in the *food and non-alcoholic beverages* category also declined to 3.2% (2Q 2014: 3.5%). This was partly due to the lower cost of production in the poultry industry following the decline in the global price of corn.

The Producer Price Index (PPI) recorded a slower growth of 0.9% on an annual basis in the third quarter (2Q 2014: 3.2%). This mainly reflected the decline in prices in the *mineral, fuels and lubricants* category following the moderation in global oil prices. Correspondingly, prices of commodity-related components increased at a slower pace of 0.9% (2Q 2014: 7.2%). Prices of non-commodity related components increased at a relatively stable rate of 1.0% during the quarter (2Q 2014: 1.2%). Prices of local and imported components grew by 1.0% and 0.8% respectively (2Q 2014: 4.2% and 1.0% respectively).

Contribution to Consumer Price Inflation



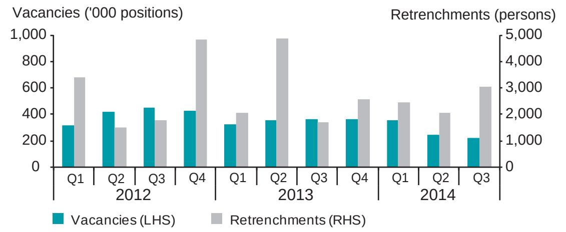
Source: Bank Negara Malaysia

Stable labour market conditions

Labour market conditions remained stable during the third quarter[1] as reflected by the low unemployment rate of 2.7% (2Q 2014: 2.8%). Employment was sustained at 13.6 million persons (2Q 2014: 13.5 million).

Retrenchments reported to the Ministry of Human Resources increased to 3,028 persons (2Q 2014: 2,051 persons), mostly in the services and manufacturing sectors. Job vacancies posted in the JobsMalaysia Portal moderated to 223,128 positions (2Q 2014: 246,884 positions). Aggregate real wages in the manufacturing sector grew at 2.6% (2Q 2014: 4.5%), supported by continued wage growth in the export- and domestic-oriented industries.

Labour Market Conditions



Source: Ministry of Human Resources

External position remained resilient in the third quarter

The current account surplus narrowed to RM7.6 billion in the third quarter, equivalent to 2.9% of GNI in 3Q 2014 (2Q 2014: RM16.0 billion or 6.3% of GNI). The current account surplus was lower on account of a smaller surplus in the goods account, and higher deficits in the services and income accounts.

In the third quarter, the trade surplus narrowed to RM16.8 billion (2Q 2014: RM18.5 billion). Gross exports grew at a slower pace of 1.5% (2Q 2014: 14.4%), arising from a higher base in the third quarter of 2013. Gross imports also moderated, registering a growth of 2.6% in the third quarter (2Q 2014: 8.5%).

The moderation in gross export growth was broad-based. Manufactured exports slowed from the double-digit pace of expansion observed in the first half of 2014, due to a higher base from the third quarter of last year. E&E exports grew at a more modest pace, attributed mainly to a slower but continued expansion in demand for semiconductors during the quarter. The moderation in non-E&E export growth was due mainly to a decline in exports of petroleum products and manufactures of metal. Commodity exports declined, due mainly to lower prices of crude petroleum, palm oil and LNG. Lower demand for LNG and rubber also weighed on commodity export growth during the quarter. In terms of destination, exports to the US grew at a slower pace in line with a moderation in economic activity in the US. Exports to the regional economies also slowed during the quarter.

[1] Based on preliminary data

Balance of Payments[1]

	2013		2014		
	3Q	4Q	1Q	2Q	3Q
	RM billion				
Current Account	**10.0**	**14.8**	**19.8**	**16.0**	**7.6**
(% of GNI)	*4.1*	*5.8*	*7.9*	*6.3*	*2.9*
Goods	27.2	33.3	33.6	30.1	28.7
Services	-4.8	-4.1	-2.7	-3.6	-6.4
Primary income	-8.0	-10.0	-6.4	-7.7	-9.4
Secondary income	-4.4	-4.4	-4.6	-2.8	-5.3
Financial Account	**-11.7**	**-9.7**	**-37.6**	**-11.8**	**-2.8**
Direct investment	1.6	4.0	-14.6	-4.4	2.1
Assets	*-7.6*	*-6.5*	*-20.4*	*-16.6*	*-6.2*
Liabilities	*9.2*	*10.4*	*5.8*	*12.2*	*8.3*
Portfolio investment	-9.5	-0.8	-13.4	6.9	-11.0
Assets	*-10.1*	*-5.4*	*-7.6*	*-10.6*	*-10.3*
Liabilities	*0.6*	*4.6*	*-5.8*	*17.6*	*-0.7*
Financial derivatives	0.6	0.4	-1.5	0.2	0.1
Other investment	-4.4	-13.3	-8.1	-14.5	6.1
Errors & omissions[2]	13.4	-7.8	0.4	-5.2	-11.5
Overall Balance	**11.8**	**-2.7**	**-17.3**	**-1.0**	**-6.7**

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 Balance of Payments and International Investment Position Manual (BPM6) by the International Monetary Fund (IMF)
[2] Includes unrealised foreign exchange revaluation on gain/losses on international reserves

Source: Department of Statistics, Malaysia

Trade Account

	Share 2013 (%)	2013		2014		
		3Q	4Q	1Q	2Q	3Q
		Annual change (%)				
Gross Exports	**100.0**	**7.5**	**10.4**	**10.8**	**14.4**	**1.5**
Manufactured	*76.1*	*8.8*	*12.9*	*12.5*	*13.8*	*1.9*
E&E	*32.9*	*5.5*	*13.2*	*12.5*	*13.0*	*2.7*
Non-E&E	*43.2*	*11.6*	*12.7*	*12.5*	*14.4*	*1.3*
Resource based	*24.0*	*11.3*	*14.2*	*9.1*	*15.1*	*2.2*
Non-resource based	*19.3*	*11.9*	*10.9*	*17.0*	*13.7*	*0.3*
Commodities	23.2	4.5	4.7	6.1	16.7	0.4
Minerals	*13.6*	*18.6*	*16.1*	*8.8*	*25.2*	*-2.5*
Agriculture	*9.6*	*-10.8*	*-8.3*	*2.1*	*5.6*	*4.4*
Gross Imports	**100.0**	**7.5**	**11.4**	**5.5**	**8.5**	**2.6**
Intermediate goods	58.5	4.1	10.4	4.4	2.6	11.0
Capital goods	15.1	3.2	-0.4	-6.6	8.4	-9.9
Consumption goods	7.3	9.7	9.8	15.6	7.1	-1.0
Re-exports and dual-use goods	19.0	21.8	26.1	15.7	31.5	-10.6
Trade balance (RM billion)	**-**	**18.5**	**28.3**	**26.3**	**18.5**	**16.8**

Note: Refined petroleum products has been reclassified as manufactured goods from mining goods, effective May 2014.

Source: MATRADE and Department of Statistics, Malaysia

Gross import growth moderated in the third quarter due to a decline in imports across all categories, except intermediate imports. Capital imports contracted due mainly to a decline in imports of transport equipment. Imports of consumption goods registered negative growth, reflecting the high base from the third quarter of last year, in particular non-durable consumer products. Amid lower commodity prices during the quarter, re-export activity also moderated. Meanwhile, intermediate imports expanded at a stronger pace amid a continued expansion in manufacturing activity.

The deficit in the **services** account widened to RM6.4 billion (2Q 2014: -RM3.6 billion), driven primarily by lower net travel receipts as a result of lower number of tourists to Malaysia, amid higher outbound travel for education and pilgrimage purposes. The transport account remained in deficit, in line with the sustained trade activity and higher outbound tourism during the quarter.

The **primary income** deficit widened to RM9.4 billion (2Q 2014: -RM7.7 billion), reflecting a higher investment income accrued to foreign direct investors, particularly in the services, manufacturing and mining sectors. Investment income accrued to Malaysian companies investing abroad was broadly sustained, mainly supported by income accrued to the mining sector and the services sector, in particular the finance and insurance sub-sector. Meanwhile, the bigger deficit in the **secondary income** account (3Q 2014: -RM5.3 billion; 2Q 2014: -RM2.8 billion) was due mainly to larger outward remittances.

The **financial account** registered a lower net outflow of RM2.8 billion in the third quarter 2014 (2Q 2014: -RM11.8 billion), mainly accounted by a turnaround in both direct investment and other investment accounts.

Direct investment turned to register a small net inflow of RM2.1 billion (2Q 2014: -RM4.4 billion), due mainly to smaller asset outflows.

On the assets side, **outward direct investment** moderated, recording outflows of RM6.2 billion (2Q 2014: -RM16.6 billion). Of these, **Direct Investment Abroad (DIA)** recorded outflows of RM5.6 billion (2Q 2014: -RM14.6 billion), due to lower extensions of equity capital and intercompany loans, and lower earnings retained abroad for reinvestment. These investments were undertaken mainly in the services sector, particularly the financial services and information and communications services sub-sectors. Malaysian companies also invested in the mining and agriculture sectors during the quarter.

On the liabilities side, **inward direct investment** registered smaller inflows of RM8.3 billion (2Q 2014: +RM12.2 billion). Of these, **Foreign Direct Investment (FDI)** amounted to RM7.7 billion (2Q 2014: +RM10.2 billion), supported by sustained inflows of equity capital amid lower retained earnings. FDI was channelled primarily into

Malaysia: Direction of Exports

	Share 2013 (%)	2013		2014		
		3Q	4Q	1Q	2Q	3Q
		Annual change (%)				
United States	**8.1**	**-7.7**	**-2.5**	**4.2**	**13.4**	**9.0**
European Union (EU)	**9.1**	**16.2**	**14.7**	**18.5**	**15.9**	**5.5**
Japan	**11.0**	**-3.3**	**6.0**	**8.5**	**12.5**	**-4.4**
Selected ASEAN countries[1]	**27.6**	**11.2**	**7.4**	**2.9**	**13.7**	**2.1**
North East Asia	**24.5**	**14.4**	**24.0**	**20.1**	**14.7**	**-6.0**
People's Republic of China	*13.5*	*17.6*	*30.9*	*15.3*	*3.3*	*-15.0*
Hong Kong SAR	*4.3*	*4.3*	*30.1*	*35.0*	*41.5*	*11.9*
Korea	*3.6*	*9.2*	*17.0*	*15.5*	*10.6*	*0.6*
Chinese Taipei	*3.0*	*21.5*	*-3.0*	*28.0*	*28.7*	*1.3*
West Asia[2]	**3.4**	**-2.0**	**-1.2**	**-0.7**	**-9.1**	**-9.4**
India	**3.6**	**-15.8**	**-17.7**	**9.1**	**18.7**	**51.7**
Total exports	**100.0**	**7.5**	**10.4**	**10.7**	**14.4**	**1.5**

[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 the mining sector, while the services sector received substantial inflows as well, particularly the financial services, and distributive trade services sub-sectors.

Portfolio investment recorded a net outflow of RM11.0 billion in the third quarter (2Q 2014: +RM6.9 billion). This was attributable to residents' portfolio investment abroad, due mainly to sustained domestic institutional investors' acquisition of foreign portfolio assets. Meanwhile, non-resident portfolio investment turned around to register a marginal net outflow. During the quarter, there were continued non-resident purchases of domestic debt and equity securities. This was, however, offset by outflows arising largely from maturing offshore debt securities.

Other investments turned around to register a net inflow of RM6.1 billion (2Q 2014: -RM14.5 billion), as inflows from the banking sector outweighed outflows from the non-bank sector. These inflows were mainly due to continued placements of interbank deposits by non-resident financial institutions.

Following these developments, the **overall balance of payments** registered a deficit of RM6.7 billion in the third quarter (2Q 2014: -RM1.0 billion). Errors and Omissions (E&O) amounted to -RM11.5 billion, partly reflecting foreign exchange revaluation losses on international reserves, as the ringgit appreciated against selected major and regional currencies during the quarter.

Manageable external debt

Malaysia's external debt[1] stood at RM740.7 billion, equivalent to USD223.9 billion or 68.7% of GDP as at end-September 2014 (end-June: RM729.5 billion or USD224.8 billion, equivalent to 67.7% of GDP). The higher external debt was attributed to the increase in non-resident holdings of ringgit-denominated debt securities as well as higher offshore borrowing.

Offshore borrowing increased to RM347.6 billion as at end-September 2014 (end-June: RM337.4 billion) due mainly to the increase in short-term interbank borrowing. The medium- and long-term offshore borrowing was lower on account of net repayment of external debt by the public sector following, in particular, the maturity of several bonds and sukuk of public enterprises, which offset net borrowing by private sector companies.

The non-resident holdings of ringgit-denominated debt securities issued by the Federal Government, Bank Negara Malaysia and corporations increased to RM247 billion as at end-September 2014 (end-June: RM243.8 billion), with the increase mainly in the short-term debt securities due to higher yields, amid sustained holdings of long-term debt securities. The high non-resident participation in Malaysia's debt securities market is a reflection of the deeper, more open and more vibrant domestic financial markets.

Overall, slightly more than half of the total external debt has a long-term maturity profile. The short-term external debt remained manageable with reserves coverage of 1.2 times.

Outstanding External Debt

	2013	2014	
	end-Sept	end-June	end-Sept
	RM billion		
Offshore borrowing[1]	312.4	337.4	347.6
Medium- and long-term	*192.2*	*204.8*	*199.0*
Public sector	98.6	98.7	89.1
Private sector	93.6	106.2	109.9
Short-term	*120.2*	*132.6*	*148.6*
NR holdings of dom. debt securities	226.5	243.8	247.0
Medium- and long-term	*143.6*	*167.3*	*167.6*
Short-term	*82.9*	*76.6*	*79.5*
NR deposits	70.1	84.4	80.5
Others[2]	65.5	63.9	65.6
Medium- and long-term	*10.8*	*9.8*	*10.2*
Short-term	*54.8*	*54.0*	*55.4*
Total external debt	**674.6**	**729.5**	**740.7**
USD billion equivalent	*205.1*	*224.8*	*223.9*
External Debt (Previous definition)			
Total debt/GDP (%)	31.6	31.3	32.2
Short-term debt[3]/Total debt (%)	38.4	39.3	42.8
Reserves/Short-term debt[3] (times)	3.7	3.2	2.8[5]
External Debt (Redefined)			
Total debt/GDP (%)	68.3	67.7	68.7
Short-term debt[4]/Total debt (%)	48.6	47.6	49.1
Reserves/Short-term debt[4] (times)	1.4	1.2	1.2[5]

[1] Equivalent to the external debt as previously defined, comprised mainly foreign currency loans raised, and bond 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.
[5] Based on international reserves as at 31 October 2014.
Note: NR refers to non-residents

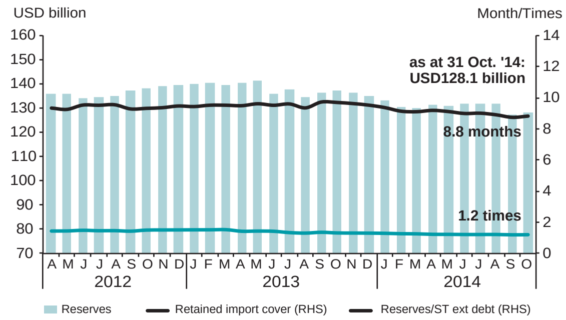
Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

[1] This refers to the external debt as redefined, effective from the first quarter of 2014. Apart from the offshore borrowing covered under the previous definition, the redefined external debt also includes non-resident holdings of ringgit debt securities, non-resident deposits with the banking system and other debt liabilities to non-residents. For more information, please refer to the box article entitled 'The Redefinition of External Debt' in the Quarterly Bulletin on Economic and Financial Developments in the Malaysian Economy in the First Quarter of 2014.

International reserves remained ample

The international reserves of BNM amounted to RM416.9 billion (equivalent to USD127.3 billion) as at 30 September 2014. This reserves level has taken into account the quarterly adjustment for foreign exchange revaluation changes. As at 31 October 2014, the reserves position amounted to RM419.7 billion (equivalent to USD128.1 billion), sufficient to finance 8.8 months of retained imports and is 1.2 times the short-term external debt.

Net International Reserves (as at end period)



Source: Bank Negara Malaysia

Higher revenue and lower expenditure contributed to a lower fiscal deficit

The Government fiscal deficit declined to -0.7% during the quarter. This was supported by a higher revenue collection and a decline in operating expenditure. Federal Government revenue increased by 3.8% on an annual basis, driven by higher collection from corporate and indirect taxes, reflecting sustained economic activity. Federal Government operating expenditure declined by 0.9% on an annual basis due to lower expenditures on fuel subsidies and grants and transfers to statutory bodies. As at end-September 2014, total outstanding debt of the Federal Government amounted to RM569.3 billion or 52.8% of estimated 2014 GDP. In October, the Government tabled the 2015 Budget outlining a lower fiscal deficit target of 3% of GDP for 2015, reflecting its firm commitment to the fiscal consolidation path.

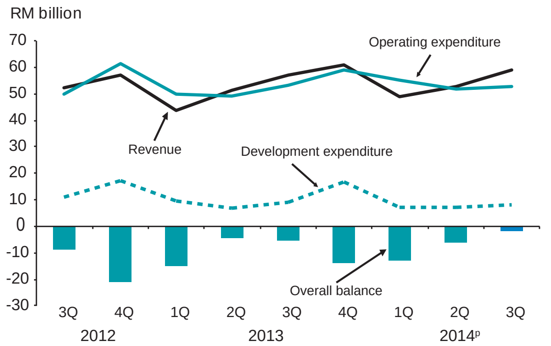
Federal Government Finance

	2013		2014[p]		
	3Q	4Q	1Q	2Q	3Q
	RM billion				
Revenue	57.0	61.1	49.2	52.7	59.1
% annual growth	*9.4*	*6.8*	*12.4*	*2.1*	*3.8*
Operating expenditure	53.4	58.8	55.2	51.7	52.9
% annual growth	*6.7*	*-4.6*	*10.6*	*5.2*	*-0.9*
Current account	**3.6**	**2.3**	**-6.0**	**0.9**	**6.2**
% of GDP	***1.4***	***0.9***	***-2.3***	***0.4***	***2.3***
Net development expenditure	9.0	16.0	7.0	7.0	8.1
% annual growth	*-16.5*	*-3.4*	*-20.9*	*2.7*	*-10.3*
Overall balance	**-5.4**	**-13.8**	**-13.0**	**-6.1**	**-1.9**
% of GDP	***-2.2***	***-5.2***	***-5.0***	***-2.3***	***-0.7***
Memo item:					
Total net expenditure	62.4	74.8	62.2	58.7	61.0
% annual growth	*2.6*	*-4.4*	*5.9*	*4.9*	*-2.2*
Total Federal Government debt (as at end-period)	529.2	539.9	560.6	568.9	569.3
% of GDP	*53.6*	*54.7*	*52.0*	*52.8*	*52.8*
Domestic debt	379.9	381.4	398.4	397.0	397.2
% of GDP	*38.5*	*38.7*	*37.0*	*36.8*	*36.8*
External debt[1]	149.3	158.4	162.1	171.9	172.1
% of GDP	*15.1*	*16.1*	*15.0*	*15.9*	*16.0*
Non-resident holdings of RM-denominated Federal Government debt[2]	*132.4*	*141.7*	*145.7*	*155.6*	*156.0*
% of GDP	*13.4*	*14.4*	*13.5*	*14.4*	*14.5*
Offshore borrowing	*16.9*	*16.8*	*16.5*	*16.2*	*16.1*
% of GDP	*1.7*	*1.7*	*1.5*	*1.5*	*1.5*

[p] Preliminary
[1] Refers to the redefined external debt
[2] Refers to non-resident holdings of ringgit-denominated Government debt (MGS, GII, T-bills and SPK), 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

MONETARY AND FINANCIAL DEVELOPMENTS

Interest rates remained stable

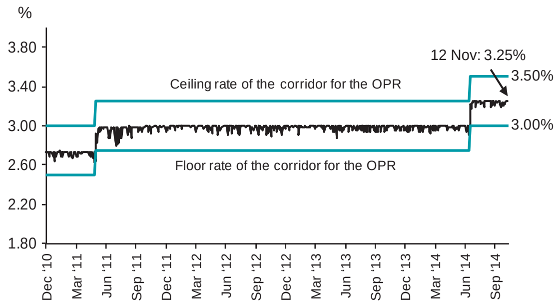
Amid firm growth prospects and with inflation expected to remain above its long-run average, the Monetary Policy Committee (MPC) decided to raise the Overnight Policy Rate (OPR) by 25 basis points to 3.25% on 10 July 2014. The adjustment in the degree of monetary accommodation was also aimed at mitigating the risk of broader economic and financial imbalances that could undermine the longer term growth prospects of the Malaysian economy. The OPR was subsequently maintained at the MPC meeting in September. At the prevailing level of the OPR, monetary conditions remain supportive of economic activity.

Interbank rates rose in the third quarter reflecting the increase in the OPR. The daily weighted average overnight interbank rate (AOIR) traded higher in a range of 3.18% to 3.25% from 11 July to 30 September. Interbank rates of other maturities also increased accordingly.

Similarly, rates on interest rate swaps and 3-month KLIBOR futures rose between 1 July and 18 September, but moderated towards the end of the quarter as market expectation for a further OPR increase was tempered by the MPC's decision to maintain the OPR at 3.25% in September.

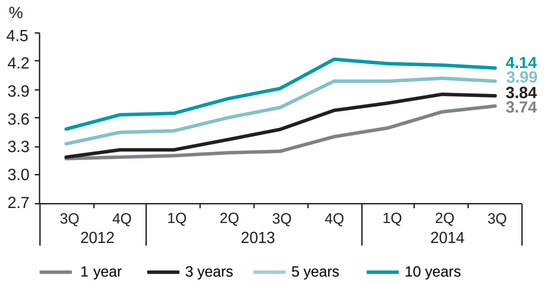
Depositors were also compensated by a higher rate of return on their savings following the increase in the OPR. The average quoted fixed deposit (FD) rates of commercial banks for the 1 to 12 months tenures rose between 15 to 25 basis points to 3.07% to 3.30% as at end-July. Banks also competed to attract deposits by launching deposit campaigns that offered higher deposit rates for large deposit placements at selected maturities.

Daily Weighted Average Overnight Interbank Rate



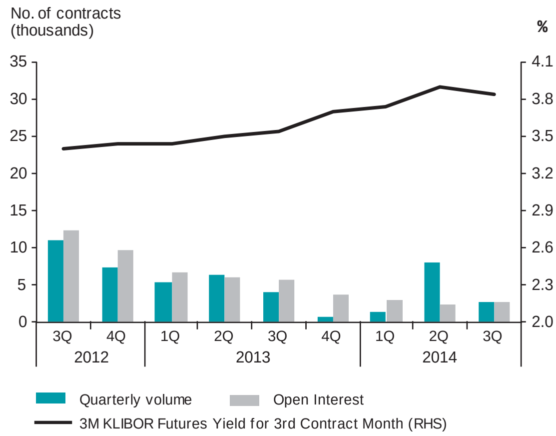
Source: Bank Negara Malaysia

Interest Rate Swap: Rates



Source: Bloomberg

3 Month KLIBOR Futures



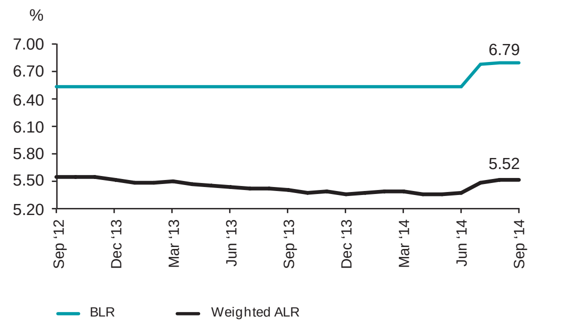
Source: Bursa Malaysia

Interest Rates

	2013	2014	
	3Q	2Q	3Q
	At end-period (%)		
Overnight Policy Rate (OPR)	3.00	3.00	3.25
Interbank rates			
Overnight	2.93	3.00	3.20
1-month	3.07	3.54	3.41
Base lending rate (BLR)			
Commercial banks	6.53	6.53	6.79
Weighted average lending rate			
Commercial banks	5.40	5.37	5.52
Fixed deposit rates			
Commercial banks			
1-month	2.91	2.91	3.07
12-month	3.15	3.15	3.30

Source: Bank Negara Malaysia

Lending Rates of Commercial Banks (At end-period)



Source: Bank Negara Malaysia

Similarly, retail lending rates were revised upwards. The average base lending rate (BLR) of commercial banks increased by 25 basis points to 6.79%, while the weighted average lending rate (ALR) on outstanding loans trended higher to 5.52% as at end-September. However, lending rates continued to be below the levels prior to the Global Financial Crisis.

M3 continued to expand

The monetary aggregates continued to expand in the third quarter. M1, or narrow money, increased by RM1.2 billion during the quarter. On an annual basis, M1 expanded by 6.7% as at end-September (end-June 2014: 10.2%). M3, or broad money, increased by RM10.5 billion on a quarter-on-quarter basis to record an annual growth rate of 5.2% as at end-September (end-June: 5.6%).

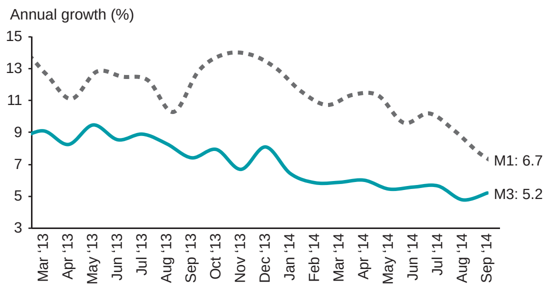
The increase in M3 during the quarter was driven mainly by the continued expansion in credit extended to the private sector by the banking system and higher net claims on the Government.

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

Private sector financing activity was sustained in the third quarter

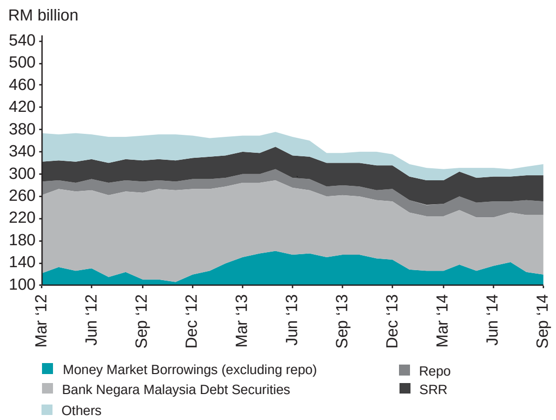
In the third quarter, total gross financing raised by the private sector through the banking system and the capital market amounted to RM302.1 billion (2Q 2014: RM281.0 billion). On a net basis, outstanding banking system loans and PDS expanded by 8.9% as at end-September (end-June 2014: 9.1%).

Monetary Aggregates



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				
	2013		2014		
	3Q	4Q	1Q	2Q	3Q
	RM billion				
M3	**16.3**	**23.3**	**21.7**	**19.5**	**10.5**
Net claims on Govt	15.7	-5.0	7.0	3.1	6.3
Claims on private sector	23.7	41.6	24.7	28.9	23.8
Loans	*23.9*	*33.2*	*24.9*	*26.3*	*22.0*
Securities	*-0.2*	*8.4*	*-0.2*	*2.6*	*1.9*
Net foreign assets[1]	-8.8	4.3	-4.7	-6.5	1.3
BNM	*-4.6*	*-4.0*	*-18.0*	*3.1*	*-0.6*
Banking System	*-4.2*	*8.3*	*13.3*	*-9.6*	*1.9*
Other influences	-14.1	-17.5	-5.3	-6.0	-20.8

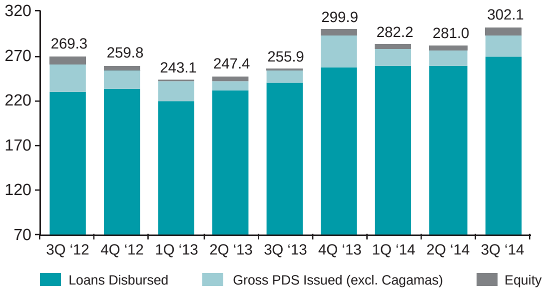
[1] Pre-revaluation
Note: Numbers may not add up due to rounding

Source: Bank Negara Malaysia

Net lending to businesses by the banking system expanded by a lower amount of RM5.3 billion during the quarter (2Q 2014: RM8.0 billion). Nonetheless, loans disbursed to businesses increased during the quarter, with higher funds channelled to the *electricity, gas and water supply; wholesale and retail trade, and restaurants and hotels;* and *real estate* sectors. On an annual basis, outstanding business loans increased at a higher rate of 7.8% as at end-September (end-June 2014: 7.2%). Demand for new financing by businesses remained strong, with higher loan applications compared to the previous quarter by both large corporates and SMEs. This was matched by higher loan approvals to both segments.

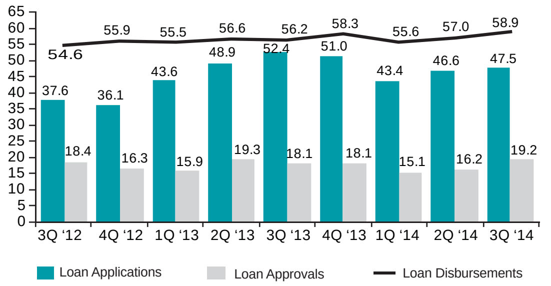
Net financing to the household sector expanded by RM16.4 billion during the quarter (2Q 2014: RM18.6 billion). On an annual basis, outstanding household loans moderated to 10.7% as at end-September (end-June 2014: 11.5%).

Gross Private Sector Financing through the Banking System and Capital Market



Source: Bank Negara Malaysia

Bank Lending to SMEs



Source: Bank Negara Malaysia

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

	During the period (RM billion)					Annual growth (%)				
	2013		2014			2013		2014		
	2Q	3Q	1Q	2Q	3Q	2Q	3Q	1Q	2Q	3Q
Gross total financing	**247.4**	**255.9**	**282.2**	**281.0**	**302.1**	**-8.6**	**-5.0**	**16.1**	**13.6**	**18.0**
Loans disbursed*	231.5	240.2	258.4	258.1	269.6	-3.1	4.6	17.4	11.5	12.2
Gross PDS[1]	11.1	12.9	19.6	17.7	23.6	-43.5	-59.4	-11.1	59.8	83.0
Equity	4.8	2.8	4.2	5.2	8.8	-60.0	-64.9	320.7	7.2	217.7
Net total financing (A)+(B)	**32.6**	**31.7**	**32.3**	**28.8**	**30.7**	**9.2**	**8.8**	**9.6**	**9.1**	**8.9**
Banking system	31.2	26.5	22.1	27.8	27.2	9.7	9.3	9.7	9.2	9.0
Loans outstanding (A)	*32.8*	*27.2*	*21.0*	*25.8*	*25.7*	*9.1*	*9.5*	*10.2*	*9.3*	*9.0*
Holding of PDS	*-1.6*	*-0.7*	*1.1*	*1.9*	*1.5*	*18.1*	*6.4*	*3.4*	*7.4*	*10.0*
PDS outstanding (B)	-0.3	4.5	11.3	3.0	5.1	9.4	6.9	7.7	8.5	8.6
Memorandum item										
Gross PDS[2]	11.8	13.4	20.5	18.5	24.9	-42.6	-42.6	-9.1	56.5	85.7

* Banking system loans 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 (%)				
	2013		2014			2013		2014		
	2Q	3Q	1Q	2Q	3Q	2Q	3Q	1Q	2Q	3Q
Total										
Loan applications	208.7	214.2	185.7	207.2	219.1	-5.8	18.0	-0.8	-0.7	2.3
Loan approvals	103.9	103.2	91.2	98.1	105.7	-6.8	9.4	4.3	-5.6	2.5
Loan disbursements	231.5	240.2	258.4	258.1	269.6	-3.1	4.6	17.4	11.5	12.2
Loan repayments	207.6	217.9	245.9	239.7	252.3	1.1	-0.4	18.4	15.5	15.8
Change in loans outstanding*	32.8	27.2	21.0	25.8	25.7	9.1	9.5	10.2	9.3	9.0
Of which:										
Business enterprises[1,2]										
Loan applications	91.6	93.6	86.3	91.2	108.3	-20.5	15.0	1.9	-0.4	15.7
Loan approvals	42.9	40.4	34.8	35.1	44.0	-25.9	-2.5	0.9	-18.1	8.8
Loan disbursements	158.5	163.3	184.0	180.9	195.5	-9.4	2.0	23.3	14.1	19.7
Loan repayments	144.9	153.3	179.5	175.8	187.8	-2.8	-3.0	24.4	21.3	22.5
Change in loans outstanding*	13.7	2.5	11.0	8.0	5.3	8.1	6.7	8.8	7.2	7.8
SMEs[1]										
Loan applications	48.9	52.4	43.4	46.6	47.5	10.2	39.3	-0.5	-4.8	-9.3
Loan approvals	19.3	18.1	15.1	16.2	19.2	-27.0	-1.5	-5.3	-15.8	5.8
Loan disbursements	56.6	56.2	55.6	57.0	58.9	-0.8	2.8	0.2	0.7	4.9
Loan repayments	51.4	53.6	52.7	53.9	58.4	12.8	6.7	2.1	4.7	9.0
Change in loans outstanding*	7.8	2.6	7.1	5.4	5.4	13.1	11.0	13.0	11.2	12.6
Large corporations[2]										
Loan applications	42.7	41.2	42.8	44.6	60.8	-39.7	-5.9	4.5	4.6	47.5
Loan approvals	23.6	22.3	19.8	18.9	24.8	-24.9	-3.2	6.3	-20.0	11.3
Loan disbursements	101.9	107.2	128.4	123.8	136.5	-13.6	1.5	37.0	21.6	27.4
Loan repayments	93.5	99.8	126.8	122.0	129.4	-9.7	-7.6	36.9	30.5	29.7
Change in loans outstanding*	5.9	-0.1	3.9	2.5	-0.1	4.6	3.5	5.7	4.2	4.2
Households										
Loan applications	117.1	120.6	99.4	116.0	110.8	10.1	20.4	-3.1	-0.9	-8.1
Loan approvals	61.0	62.8	56.3	63.0	61.8	13.8	18.7	6.5	3.2	-1.6
Loan disbursements	73.0	76.9	74.4	77.3	74.2	14.1	10.8	5.1	5.8	-3.6
Loan repayments	62.7	64.6	66.3	63.9	64.5	11.6	6.6	4.7	1.9	-0.1
Change in loans outstanding*	17.2	19.6	15.9	18.6	16.4	11.7	11.8	11.6	11.5	10.7

* The annual growth is for end-period.
[1] Include loans to individual businesses.
[2] Include domestic financial institutions, government, domestic other entities and foreign entities, except for loan outstanding which refers to businesses only.
Note: Numbers do not add up due to rounding

Source: Bank Negara Malaysia

Loans by Sector

	Loans disbursed						Loans outstanding
	During the period (RM billion)					Share of total (%)	Share of total (%)
	2Q 13	3Q 13	1Q 14	2Q 14	3Q 14	3Q 14	3Q 14
Business enterprises[1,*]	**158.5**	**163.3**	**184.0**	**180.9**	**195.5**	**72.5**	**42.7**
Large corporations[1]	*101.9*	*107.2*	*128.4*	*123.8*	*136.5*	*50.6*	*26.0*
*SMEs**	*56.6*	*56.2*	*55.6*	*57.0*	*58.9*	*21.9*	*16.6*
Selected sectors[1]							
Agriculture, hunting, forestry and fishing	8.2	7.9	8.7	7.2	7.0	2.6	2.5
Mining and quarrying	2.3	2.2	3.5	3.9	1.8	0.7	0.6
Manufacturing	48.0	47.5	54.4	52.8	51.5	19.1	7.7
Construction	13.9	14.3	16.8	14.5	15.0	5.5	4.2
Real estate	10.9	12.3	12.9	11.7	12.7	4.7	6.0
Electricity, gas and water supply	3.5	2.1	2.6	2.1	7.2	2.7	1.0
Wholesale, retail, restaurants and hotels	43.9	43.7	53.7	52.8	54.9	20.3	7.4
Transport, storage and communication	3.8	4.3	5.7	7.4	6.7	2.5	2.5
Finance, insurance and business services	17.1	22.5	18.9	21.2	27.0	10.0	6.5
Households	**73.0**	**76.9**	**74.4**	**77.3**	**74.2**	**27.5**	**57.3**
Purchase of residential properties	18.4	18.8	19.7	20.0	20.0	7.4	27.4
Consumption credit	41.5	45.1	40.3	42.1	41.4	15.4	18.0
Of which:							
Credit cards	*23.3*	*25.4*	*24.2*	*24.5*	*24.3*	*9.0*	*2.6*
Purchase of passenger cars	*10.1*	*11.2*	*9.0*	*9.6*	*9.4*	*3.5*	*10.8*
Others	13.1	13.0	14.4	15.2	12.8	4.7	11.9
Total	**231.5**	**240.2**	**258.4**	**258.1**	**269.6**	**100.0**	**100.0**

*Include loans to individual businesses.
[1] Include 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 funds raised in the capital market

Net funds raised in the capital market were slightly lower at RM17.1 billion in the third quarter (2Q 2014: RM17.2 billion). The decline was due mainly to lower net funds raised by the public sector.

Gross funds raised by the public sector during the quarter moderated to RM22 billion (2Q 2014: RM24.6 billion). Funds were raised mainly through re-opening of a 3-year, 5-year, 7-year and 30-year Malaysian Government Security (MGS), and the re-opening of a 5-year, 10-year and 15-year Government Investment Issue (GII). Additionally, funds were raised via a RM1.5 billion issuance of the Government Housing Sukuk. During the quarter, redemptions of government securities were also higher at RM19.9 billion (2Q 2014: RM16 billion). Overall, net funds raised by the public sector were lower at RM2.1 billion (2Q 2014: RM8.5 billion).

In the private sector, new issuances of private debt securities (PDS) were higher at RM24.9 billion (2Q 2014: RM18.5 billion). Funds raised were mainly driven by issuances in the *finance, insurance, real estate and business services* sector, for working capital and general corporate purposes. Of note, this quarter also witnessed the largest Chinese renminbi issuance of RMB1.5 billion by a Malaysian issuer, which was also the largest renminbi bond issuance in South East Asia. Funds raised from the equity market during the quarter amounted to RM8.8 billion (2Q 2014: RM5.2 billion). The higher amount of funds raised during the quarter was mainly driven by two large rights issuances from firms in the *finance* and *trading and services* sectors. After adjusting for redemptions, net funds raised by the private sector increased to RM15.0 billion (2Q 2014: RM8.7 billion).

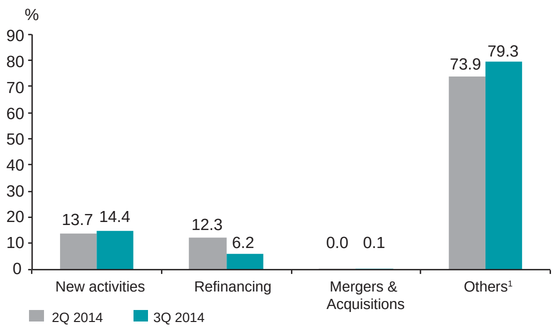
Net Funds Raised in the Capital Market

	2013		2014		
	3Q	4Q	1Q	2Q	3Q
	RM billion				
By Public Sector	**11.4**	**14.3**	**24.0**	**8.5**	**2.1**
Government securities, *net*	8.7	14.3	20.0	5.9	0.6
Malaysian Government Securities	13.9	11.4	14.5	11.9	12.3
Government Investment Issues	10.0	9.0	9.0	10.0	8.2
Less: Redemptions	*15.2*	*6.1*	*3.5*	*16.0*	*19.9*
Savings Bonds, *net*	-	-	-	-	-
Government Housing Sukuk, *net*	2.7	-	4.0	2.6	1.5
By Private Sector	**6.4**	**19.5**	**15.4**	**8.7**	**15.0**
Shares	2.8	7.4	4.2	5.2	8.8
Debt securities, *net*	3.6	12.0	11.2	3.5	6.2
Private Debt Securities	*13.4*	*36.0*	*20.5*	*18.5*	*24.9*
Less: Redemptions	*9.7*	*24.0*	*9.4*	*15.0*	*18.7*
Total	**17.8**	**33.7**	**39.4**	**17.2**	**17.1**

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

Source: Bank Negara Malaysia and Bursa Malaysia

Private Debt Securities Issued by Purpose (% of total)



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

Source: Bank Negara Malaysia

Bond yields declined in the third quarter

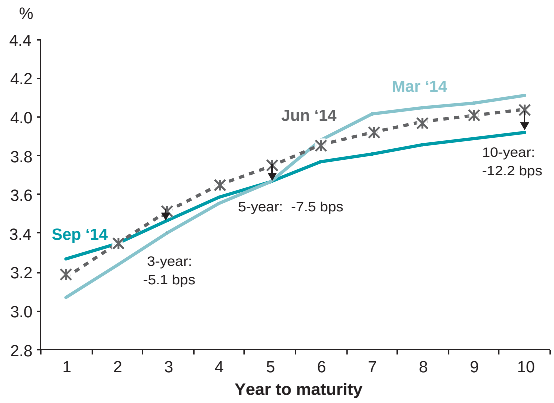
In the third quarter, MGS yields were broadly on a downward trend following sustained interest from investors, especially in the medium- to longer-tenured papers. Bond yields, however, increased temporarily in mid-August due to market expectations for another OPR increase following the release of better-than-expected 2Q 2014 GDP data. For the quarter as a whole, yields on the 3-year, 5-year and 10-year MGS declined by 5, 8, 12 basis points respectively.

In the PDS market, corporate bond yields increased marginally. The 5-year AAA, AA, and A-rated yield recorded an increase of 0.4, 0.2 and 3 basis points respectively from the previous quarter.

Higher secondary trading in the bond market

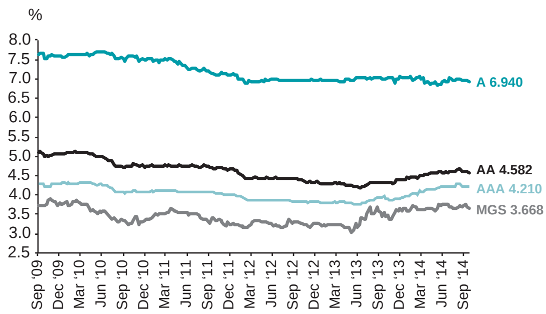
Total trading in the secondary market increased to RM160 billion during the quarter (2Q 2014: RM152 billion). The increase in turnover was mainly concentrated in the trading of GII and PDS which registered higher liquidity ratios of 0.26 and 0.07 respectively. The MGS segments, however, registered a lower liquidity ratio of 0.25.

Trend in MGS Yields



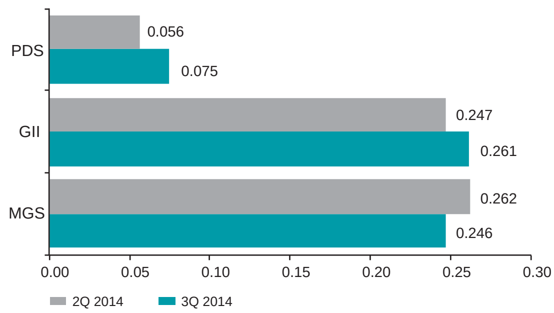
Source: Bank Negara Malaysia

5-year MGS and 5-year PDS Yields



Source: Bank Negara Malaysia

Liquidity Ratio: Value of Bond Traded / Outstanding

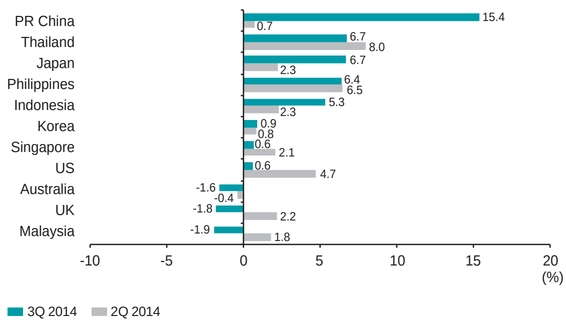


Source: Bank Negara Malaysia

FBM KLCI declined during the quarter

In the third quarter, the FBM (FTSE Bursa Malaysia) KLCI declined by 36.4 points, to close at 1,846.3 points (end-June 2014: 1,882.7 points). After reaching a new high of 1,892.7 points on 8 July, the index declined during the quarter. The decline was mainly driven by unwinding of investment by non-residents due to expectations for a faster-than-expected policy rate increase in the US and geopolitical uncertainties in the Middle East and Eastern Europe.

Performance of Selected Global and Regional Equity Markets in 2014 (% growth QoQ)



Source: Bloomberg and Bank Negara Malaysia calculations

Overall, market capitalisation increased slightly to RM1.774 trillion as at end-September 2014 (end-June 2014: RM1.770 trillion) while the daily average turnover increased to 2.77 billion units (2Q 14: 1.88 billion units) during the quarter.

On 12 November 2014, the KLCI ended lower at 1816.2 points (since end-Sep 2014: -1.6%), with market capitalisation of RM1.742 trillion (since end-Sep 2014: -1.8%).

Bursa Malaysia: Selected Market Indicators

	2013		2014		
	As at end				
	Sept	Dec	Mar	June	Sept
Price Indices					
Composite	1,768.6	1,867.0	1,849.2	1,882.7	1,846.3
FBMEMAS[1]	12,289.7	12,853.6	12,797.6	13,049.8	12,924.7
ACE Market[2]	5,537.2	5,675.8	6,661.3	6,668.8	7,278.9
Market capitalisation (RM billion)	1,611.2	1,702.2	1,719.1	1,770.4	1,774.1
No. of companies listed	910	911	907	906	906
	During the period				
	3Q	4Q	1Q	2Q	3Q
Average daily turnover					
Volume (million units)	1,739.8	1,704.7	2,046.4	1,876.3	2,773.9
Value (RM million)	2,083.1	2,330.2	2,158.8	2,192.4	2,300.3

[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

	2013				2014					
	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	109.4	131.2	107.4	146.8	120.7	127.4	118.2	138.1	169.2	140.3
Of which:										
Main Board	85.0	126.4	80.0	140.7	91.3	119.7	91.4	131.8	128.9	132.3
Of which										
Consumer Products	6.1	5.4	7.3	5.5	8.4	7.1	6.2	6.0	9.7	7.9
Industrial Products	13.6	10.3	9.6	9.7	18.9	13.1	16.2	12.5	23.6	15.4
Construction	4.9	7.2	2.8	4.6	4.0	5.9	5.1	7.1	6.5	7.7
Trading/Services	31.5	50.8	34.6	81.0	33.9	51.9	36.4	54.8	59.6	55.6
Finance	4.3	28.4	4.0	18.2	3.4	18.8	3.9	27.0	3.5	20.4
Properties	8.6	9.4	8.8	6.7	10.5	7.8	11.9	9.7	12.6	10.7
Plantations	1.4	4.4	1.7	5.6	1.7	5.4	1.5	5.5	1.9	5.3
Infrastructure	1.7	4.9	1.9	5.0	1.5	4.7	1.5	4.4	1.1	3.7
ACE Market[1]	21.2	4.4	24.4	5.5	26.8	7.0	22.9	5.5	35.5	7.2

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

Source: Bursa Malaysia

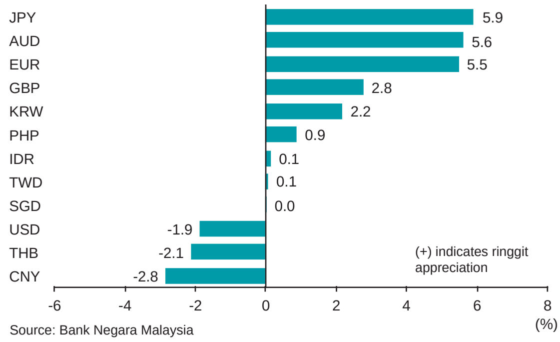
Ringgit movement driven by both external and domestic factors

The ringgit was generally on an appreciating trend against most major and regional currencies during the earlier part of the quarter. The ringgit's strength during this period was mostly driven by higher demand for Malaysian bonds following the release of strong data on the domestic economy. The ringgit, however, reversed its trend towards the end of the quarter, in tandem with most other regional currencies. Expectations for a faster-than-expected policy rate increase by the Federal Reserve led to the shift towards US financial assets and an outflow of funds from regional financial markets, particularly from equity markets.

Overall, the ringgit depreciated 1.9% against the US dollar but appreciated against the Japanese yen (5.9%), the Australian dollar (5.6%), euro (5.5%) and the pound sterling (2.8%). The ringgit exhibited a mixed performance against regional currencies.

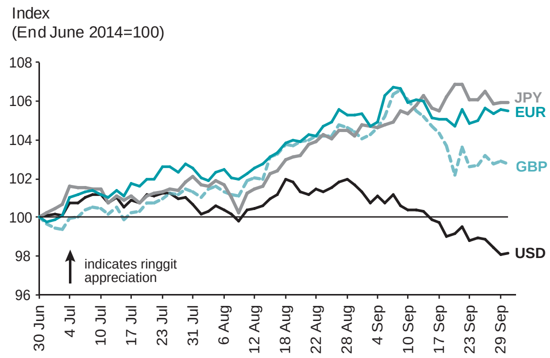
Between 1 October and 12 November 2014, the ringgit depreciated against the US dollar by 2.1%. The ringgit appreciated against the Japanese yen (3.7%) and the pound sterling (0.1%), but depreciated against the euro (0.3%) and the Australian dollar (1.3%). Against regional currencies, the ringgit strengthened against the Korean won (2.3%), but depreciated against other currencies by between 0.5% and 2.4%.

Summary of Ringgit Performance against Selected Currencies Percent Change (1 July - 30 September 2014)



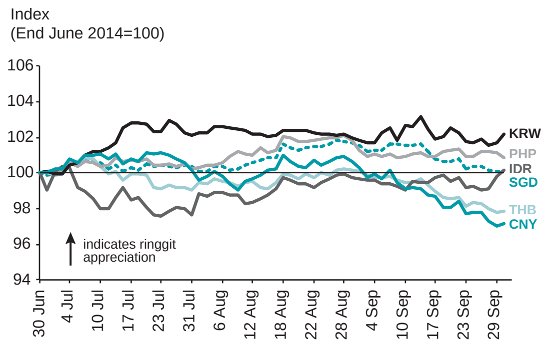
Source: Bank Negara Malaysia

Ringgit Performance against Major Currencies



Source: Bank Negara Malaysia

Ringgit Performance against Regional Currencies



Source: Bank Negara Malaysia

Volume of foreign exchange derivatives rose moderately in the third quarter

The volume of foreign exchange swaps, forwards and options was higher in the third quarter at USD312.7 billion, an increase of 6.4% from the previous quarter. The increase was partly driven by hedging activities by local exporters, proactively managing their foreign currency exposure through the forward selling of the US dollar, to take advantage of the US dollar appreciation against most other currencies, especially towards end of the quarter. US dollar swap against third currency activities (other than ringgit) also increased, as banks were actively managing their positions in higher yielding currencies such as offshore Chinese renminbi and the Australian dollar, to improve returns. Funding of activities via relatively cheaper cost currencies such as the Japanese yen and the euro was also observed.

The 5-year USD/MYR cross-currency swaps, which reflect the cost of borrowing US dollar through the cross-currency swap market, remained low throughout the months of July and August, trading around 68 to 70 bps. This subsequently rose to around 90 bps towards the end of September due to higher demand for US dollar during the period of volatile portfolio flows, triggered by increased expectations for a faster-than-expected interest rate hike in the US.

Performance of Ringgit against Selected Currencies

RM per foreign currency	As at end				% change since*		
	21 Jul 05	3Q 13	2Q 14	3Q 14	21 Jul 05	3Q 13	2Q 14
US dollar	3.8000	3.2575	3.2105	3.2715	16.2	-0.4	-1.9
Euro	4.6212	4.3988	4.3806	4.1527	11.3	5.9	5.5
Pound sterling	6.6270	5.2666	5.4672	5.3193	24.6	-1.0	2.8
Australian dollar	2.8823	3.0332	3.0235	2.8632	0.7	5.9	5.6
100 Japanese yen	3.3745	3.3255	3.1690	2.9922	12.8	11.1	5.9
Singapore dollar	2.2570	2.5912	2.5703	2.5702	-12.2	0.8	0.0
100 Thai baht	9.0681	10.378	9.8937	10.107	-10.3	2.7	-2.1
100 Philippine peso	6.8131	7.4825	7.3589	7.2959	-6.6	2.6	0.9
100 Indonesian rupiah	0.0386	0.0279	0.0269	0.0269	43.9	4.0	0.1
100 Korean won	0.3665	0.3031	0.3173	0.3106	18.0	-2.4	2.2
100 New Taiwan dollar	11.890	11.017	10.751	10.743	10.7	2.6	0.1
Chinese renminbi	0.4591	0.5324	0.5172	0.5323	-13.8	0.0	-2.8

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

Source: Bank Negara Malaysia

MANAGING RISKS TO FINANCIAL STABILITY

Domestic financial stability continued to be well-preserved

The Malaysian financial system remained resilient despite continued volatility in the domestic financial market arising from uncertainties in the external environment, prevalent in the latter half of September. Financial intermediation remained well-supported by sound financial institutions, orderly financial market conditions and sustained confidence in the financial system. While the period ahead is expected to remain challenging, the outlook for domestic financial stability continues to be positive.

Credit risk remained manageable supported by sustained debt servicing capacity of borrowers

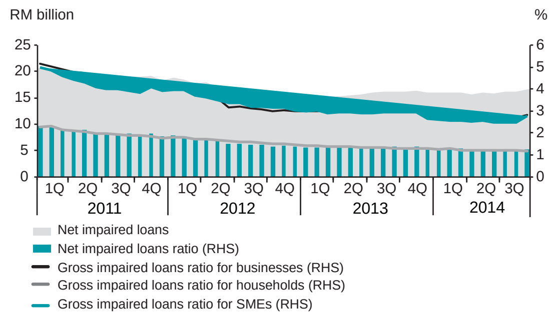
Credit risk in the banking system remained stable as the debt servicing capacity of majority of the borrowers remained intact. Loan impairment levels were unchanged at 1.3% of net loans (2Q 2014: 1.3%), while arrears between one to three months improved to 2.5% of total loans (2Q 2014: 2.7%). For insurers, the size of credit risk exposures, which largely emanate from holdings of private debt securities, stood at 3.8% of total capital base (2Q 2014: 3.5%).

Aggregate household borrowings via banks and major non-banks grew at a slower pace of 2.3% for the quarter (2Q 2014: 2.5%) to amount to RM918.2 billion (2Q 2014: RM897.8 billion), as the series of measures to contain household debt continue to take effect. The moderation in household borrowings was attributed to financing for the purchase of motor vehicles which grew at a slower pace of 0.7% during the quarter (2Q 2014: 0.9%). On a year-on-year basis, aggregate household debt continued to grow at a stable pace of 10.4% (2Q 2014: 10.3%). The risk to financial stability arising from high household indebtedness remained manageable, supported by prudent debt servicing ratio (DSR) associated with new household debt. Impaired loans were unchanged at 1.2% (2Q 2014: 1.2%) while loans-in-arrears of between one to three months stood at 1.9% (2Q 2014: 2.0%) of total household borrowings from the banking sector. These developments were underpinned by stable employment conditions and wage growth that supported the sustained trend in the ratio of loan repayments-to-disbursements. At the aggregate level, household financial assets remained healthy at 2.2 times of household debt, although at the lower end of the income spectrum, households are having to adjust to rising costs of living with smaller financial buffers available.

During the quarter, domestic borrowings (loans, private debt securities and sukuk) by the business sector grew by 1.6% (2Q 2014: 1.1%), driven mainly by the property sector. External borrowings were almost unchanged in the second quarter (2Q 2014: 0.1%; 1Q 2014: 2.0%). This contributed to a moderation in the year-on-year growth in external borrowings to 13.9% as at end of the second quarter (1Q 2014: 20.4%). The bulk of external borrowings was by businesses operating in the more capital-intensive economic sectors such as the oil and gas, telecommunications and power sectors. The quality of banking system credit exposures to businesses remained healthy despite a slight increase of 0.1 percentage point in impaired loans to 2.8% of total business loans (2Q 2014: 2.7%). Loans-in-arrears of between one and three months improved to 0.3% of total business loans (2Q 2014: 0.5%). The risk of delinquency, as measured by the expected default frequency, remained low at 0.14% (2Q 2014: 0.15%) on the back of sustained financial performance of businesses. Potential losses from banks' credit exposures to businesses were also minimised by the strong financial buffers accumulated by businesses against adverse changes in the operating environment. As at end of second quarter 2014, current assets of businesses stood at 1.7 times of current liabilities (1Q 2014: 1.8 times), while the leverage position of businesses, as measured by the debt-to-equity ratio, was little changed at 40.7% (1Q 2014: 40.2%). The interest coverage ratio of businesses stood at 6.5 times (1Q 2014: 7.2 times), remaining sufficiently above prudent levels despite lower operating profits recorded by some businesses in the manufacturing, and trading and services industries.

In the property market, the series of macroprudential and other measures introduced since 2010 to curb speculative activities in the domestic housing market continued to yield the intended outcomes. Annual growth of the Malaysian House Price Index (MHPI) has been stable for the past two quarters at 9.6% in the first quarter of 2014 (4Q 2013: 9.6%; 3Q 2013: 12.2%). The preliminary MHPI data also indicated that the annual growth in house prices moderated further to 6.6% in the second quarter. New launches and sales in the primary housing market continued to remain soft as developers adopt a more cautious approach given the series of measures. Credit-induced speculative house purchases remained well contained, with the number of multiple loan borrowers (i.e. those with three or more outstanding housing loans) expanding at a slower annual growth rate of 3.6% (2Q 2014: 3.7%). The loan-to-value ratio has also effectively capped such borrowers to about 3% of total housing loan borrowers.

Banking System: Loan Quality



Source: Bank Negara Malaysia

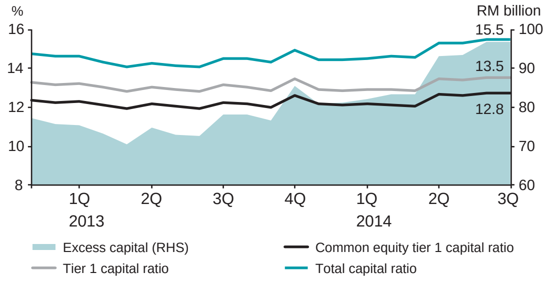
Domestic financial market conditions remained orderly

Portfolio investments recorded a net outflow position during the quarter amounting to RM11.0 billion (2Q 2014: net inflow of RM6.9 billion), mainly attributable to higher acquisitions of portfolio assets abroad by domestic institutional investors. Volatility in the financial markets eased although uncertainties in the external environment continued to affect market sentiment. The average volatility of 10-year MGS yield and FBM KLCI eased to 5.9% and 5.2% respectively (2Q 2014: 6.6% and 6.4% respectively) on account of the positive outlook on the domestic economy and improvements in market sentiment, arising from accommodative monetary policy actions in advanced economies. Yields for 10-year MGS declined slightly to 3.9% (2Q 2014: 4.0%), as investors' interests in ringgit denominated securities were sustained. In the equity market, the FBM KLCI rallied and hit a record high of 1,892.6 points on 8 July, before ending the quarter lower at 1,846.3 points (2Q 2014: 1,882.7 points). The price-to-earnings ratio of the FBM KLCI remained broadly stable at 16.8 times (2Q 2014: 17.1 times), underpinned by the strong economic fundamentals. Trading liquidity, both in terms of price and volume, remained intact. The bid-ask spreads of MGS and FBM KLCI were unchanged at 0.1% and 0.4% of the mid-price respectively (2Q 2014: 0.1% and 0.4% respectively). The turnover ratio for MGS and FBM KLCI was also stable at 8.5% and 1.7% respectively (2Q 2014: 8.5% and 2.0% respectively) reflecting continued and steady trading activities by domestic institutional investors and financial institutions.

Financial institutions' exposures to market risks were well-contained

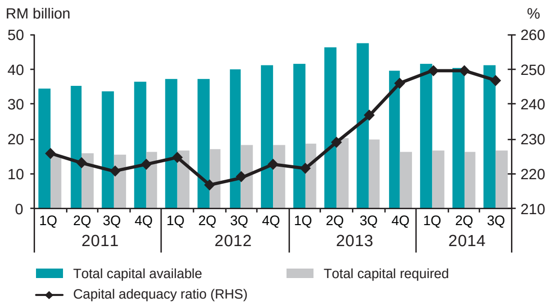
Overall risk taking behaviour of financial institutions was broadly unchanged. There was no material change in the proportion and composition of financial institutions' treasury portfolio. About 98.1% (2Q 2014: 97.8%) of the banking system treasury portfolio is in the form of fixed income securities. The size of banking system exposure to interest rate risk in the trading book declined slightly to 1.5% of total capital (2Q 2014: 1.6%), while exposure to equity risk was at 1.4% of total capital (2Q 2014: 1.2%). The banks' foreign exchange net open position narrowed marginally to 5.8% of total capital (2Q 2014: 5.9%) as banks maintained continued prudence in managing foreign currency exposures especially in light of volatility that has been experienced in the recent period. The market risk exposure of the insurance industry similarly remained within manageable levels, accounting for 12.7% of total capital (2Q 2014: 12.5%). Equity risk continues to form the bulk of insurers' market risk exposure at 8.5% of total capital (2Q 2014: 8.0%), amid the increase in equities holdings (3Q 2014: RM44.7 billion; 2Q 2014: RM43.8 billion). Fixed income securities represent 70% of the insurance industry's treasury portfolio.

Banking System: Basel III Capitalisation



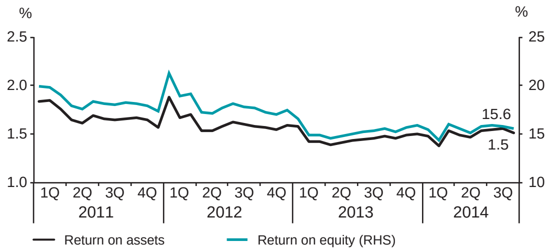
Source: Bank Negara Malaysia

Insurance Sector: Capitalisation



Source: Bank Negara Malaysia

Banking System: Profitability



Source: Bank Negara Malaysia

Financial institutions' soundness was sustained

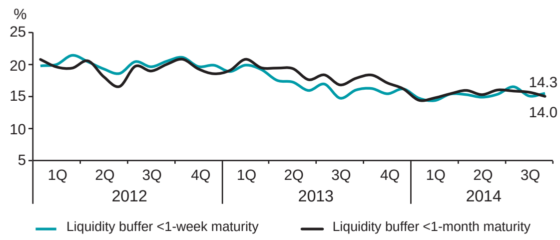
Financial soundness indicators of banks and insurers were strong as reflected in high capitalisation, profitable business and ample liquidity. The common equity tier 1 (CET1) capital ratio, tier 1 capital ratio and total capital ratio of the banks were well above the minimum regulatory levels, at 12.8%, 13.5% and 15.5% respectively. More than 80% of the banks' total capital consists of high quality capital, as represented by the strong CET1 level in the form of paid-up capital, retained earnings and reserves. Total capital buffers for banks, which are in excess of the minimum total regulatory capital requirement stood at more than RM90 billion. The Capital Adequacy Ratio of insurers stood at 246.9% (2Q 2014: 249.7%) with an excess capital buffer of RM24.4 billion (2Q 2014: RM25.7 billion).

Banks recorded RM8.1 billion in pre-tax profits for the quarter (2Q 2014: RM8.1 billion), with returns on assets and equity standing at 1.5% and 15.6% respectively (2Q 2014: 1.5% and 15.8% respectively). In the insurance industry, general insurance and takaful business recorded lower operating profits of RM788.3 million (2Q 2014: RM804 million) driven by lower underwriting profits. Excess income over outgo of the life insurers and family takaful operators declined to RM3.8 billion (2Q 2014: RM4.6 billion) amid lower net investment gains and new business premium across all products.

Liquidity in the banking system remained largely unchanged. The excess liquidity over the 1-week and 1-month horizons amounted to 14.3% and 14% of total deposits respectively (2Q 2014: 14.2%

and 14.6% respectively). In addition, banking institutions have net placements totalling RM103 billion (2Q 2014: RM 115 billion) with Bank Negara Malaysia, which can be drawn to meet additional and unanticipated liquidity needs. USD liquidity recorded a shortfall of RM3.4 billion in the less than 1-week maturity bucket following a higher amount of net outflows from maturing interbank borrowings and FX derivative contracts payable, but recorded a higher surplus of RM1.2 billion in the less than 1-month maturity bucket (2Q 2014: surplus of RM3.7 billion and RM0.7 billion respectively).

Banking System: Liquidity Buffer to Total Deposit Ratio



Source: Bank Negara Malaysia

Insurance and Takaful Sectors: Indicators

	2013		2014		
	2Q	3Q	1Q	2Q	3Q
	RM million				
Life insurance & family takaful					
Excess income over outgo	*4,617.1*	*1,433.2*	*3,164.8*	*4,592.7*	*3,835.9*
General insurance & general takaful					
Operating profit	*772.0*	*663.8*	*823.8*	*804.0*	*788.3*
Claims ratio (%)	*57.9*	*58.8*	*56.1*	*58.0*	*56.8*
	Annual Change (%)				
Life insurance & family takaful					
Excess income over outgo	*12.1%*	*72.6%*	*-15.2%*	*-0.7%*	*167.6%*
General insurance & general takaful					
Operating profit	*9.8%*	*-2.4%*	*11.4%*	*4.3%*	*18.8%*
Claims ratio (percentage points)	*-1.2*	*-0.4*	*-3.4*	*-0.1*	*-2.0*

Source: Bank Negara Malaysia