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

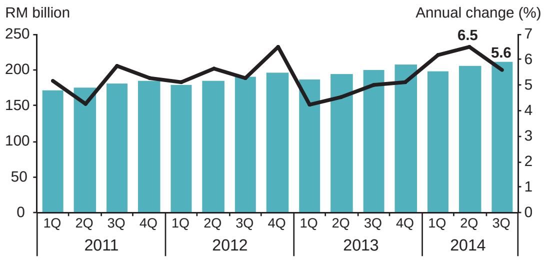
OVERVIEW

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.