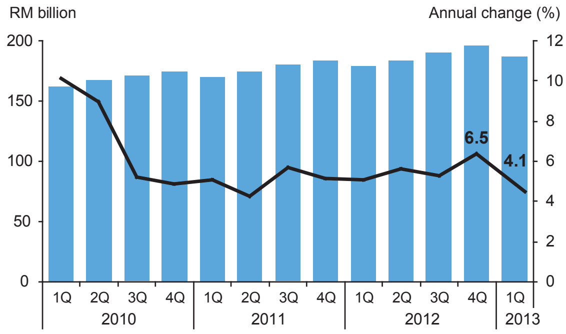
ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE FIRST QUARTER OF 2013

OVERVIEW

Strong domestic demand sustained growth amid weaker external demand in the first quarter

The global economy grew at a modest pace in the first quarter of 2013. The growth in the US remained slow, while the economic performance in most European economies remained weak amidst the ongoing policy challenges and domestic structural concerns. In Asia, economic activity continued to expand, although at a slower pace, as domestic demand continued to outweigh weakness in external demand. Amid this weaker external environment, the Malaysian economy expanded by 4.1% in the first quarter (4Q 2012: 6.5%), supported by stronger domestic demand that expanded by 8.2% during the quarter (4Q 2012: 7.8%). On the supply side, while the domestic-oriented industries continued to register sustained growth, activity in the major economic sectors was weighed down by the weak external conditions.

The economy expanded by 4.1% in the first quarter
(at constant 2005 prices)



Source: Department of Statistics, Malaysia

Domestic demand remained robust, increasing by 8.2% during the quarter (4Q 2012: 7.8%). Private consumption recorded a strong growth of 7.5% (4Q 2012: 6.2%), driven by sustained income growth and favourable labour market conditions. This was further supported by the implementation of the minimum wage policy. Growth in public consumption, however, moderated to 0.1% (4Q 2012: 1.2%), amidst lower spending on supplies and services.

Growth in gross fixed capital formation remained firm, rising by 13.2%, underpinned by capital spending by both the private and public sectors. Private investment grew by 10.9%, supported by continued capital spending in the domestic-oriented manufacturing and consumer-related services sub-sectors, in addition to the ongoing implementation of projects in the oil and gas sector. Public investment expanded by 17.3%, driven by higher capital spending by public enterprises in the oil and gas, utilities and telecommunication sectors, while Federal Government development expenditure was channelled mainly into the transportation, education, and trade and industry sectors.

On the supply side, growth in the manufacturing sector slowed, weighed down by the weak external conditions. Despite the weakness in trade-related activity, the services sector continued to expand, driven largely by sub-sectors catering to the domestic market. Growth in the agriculture sector was sustained on account of higher production of palm oil, while the mining sector declined due to lower production of crude oil. In the construction sector, growth remained firm, led mainly by the civil engineering sub-sector.

The headline inflation rate, as measured by the annual change in the Consumer Price Index (CPI), was slightly higher at 1.5% in the first quarter (4Q 2012: 1.3%). The increase was attributed mainly to higher inflation in the *food and non-alcoholic beverages* category.

In the external sector, the current account surplus narrowed in the first quarter to RM8.7 billion, equivalent to 3.9% of GNI, due to a lower goods surplus, as well as a larger services deficit and income outflows. The financial account turned around to record a net inflow of RM1 billion (4Q 2012: -RM10.3 billion), as inflows of direct and portfolio investment from non-residents outweighed outflows arising from direct and portfolio investment undertaken by residents. The overall balance of payments recorded a surplus of RM4 billion (4Q 2012: +RM5.9 billion).

The international reserves of Bank Negara Malaysia amounted to RM431.2 billion (equivalent to USD139.6 billion) as at 29 March 2013. This reserve level has taken into account the quarterly adjustment for foreign exchange revaluation changes. As at 30 April 2013, the reserves position amounted to RM433.3 billion (equivalent to USD140.3 billion), sufficient to finance 9.5 months of retained imports and is 4.3 times the short-term external debt.

Interest rates remained stable

The Overnight Policy Rate (OPR) was maintained at 3.00% during the first quarter of 2013. At the prevailing level of the OPR, monetary conditions remain supportive of economic activity.

Reflecting the unchanged OPR, the interbank rates of all maturities were relatively stable. In terms of retail interest rates, the average quoted fixed deposit (FD) rates of commercial banks were relatively unchanged during the quarter. The average base lending rate (BLR) of commercial banks remained at 6.53%, while the weighted average lending rate (ALR) on loans outstanding edged lower to 5.50% as at end-March (end-December 2012: 5.52%).

Total gross financing raised by the private sector through the banking system and the capital market amounted to RM244.7 billion (4Q 2012: RM262.2 billion). On a net basis, banking system loans and PDS outstanding expanded at an annual growth rate of 11% as at end-March (end-December 2012: 12.4%).

Net funds raised in the capital market moderated to RM16.7 billion in the first quarter (4Q 2012: RM37.7 billion), reflecting mainly the significantly higher redemption of debt securities (RM32.2 billion; 4Q 2012: RM13.1 billion). Overall gross financing from the capital market, however, remained firm for both the private and public sectors. In the private sector, RM22.6 billion of gross funds were raised through the issuance of private debt securities, while another RM1 billion was raised in the equity market. In the public sector, gross funds raised increased to RM25.3 billion (4Q 2012: RM21.6 billion).

The monetary aggregates continued to expand in the first quarter. Narrow money, or M1, increased by RM4.1 billion during the period. On an annual basis, M1 expanded by 12.7% as at end-March (end-December 2012: 11.9%). Broad money, or M3, increased by RM43.9 billion during the quarter, to record an annual growth rate of 9.1% as at end-March (end-December 2012: 9%). The expansion of M3 was mainly on account of the credit extension to the private sector, higher net claims on the Government and net trade inflows.

Movements of the ringgit and other regional currencies in the first quarter were driven mainly by the uncertainties over the timing of the withdrawal of quantitative easing measures in the US and developments in Europe. These in turn resulted in a withdrawal of funds from emerging market assets. The ringgit was also affected by domestic uncertainties during this period in the run-up to the General Elections. Overall, the ringgit depreciated by 1.0% against the US dollar, but appreciated against the Japanese yen (8.4%), pound sterling (5.2%) and euro (2.0%). The ringgit's performance against regional currencies was mixed. The ringgit appreciated against the Korean won (3.3%) and Singapore dollar (0.5%), but depreciated against the Indonesian rupiah, Chinese renminbi, Philippine peso and Thai baht by between 0.2% and 5.2%.

Between 1 April and 10 May 2013, the ringgit appreciated against the Japanese yen (10.9%), US dollar (3.4%), pound sterling (1.8%), and euro (1.7%). The ringgit strengthened against regional currencies by between 2.2% and 4.6%.

Financial stability continued to be preserved

Despite continued volatility in the global financial markets, financial stability remained intact throughout the quarter. Effective financial intermediation was supported by sound financial institutions, orderly financial market conditions and sustained confidence in the financial system.

The banking system continued to remain resilient, with strong capital buffers, sustained profitability and ample liquidity. While the new capital standards under Basel III have been phased in since January 2013, the banking system remained well-capitalised, with the Common Equity Tier 1 Capital Ratio, Tier 1 Capital Ratio and Total Capital Ratio at 12.2%, 13.1% and 14.5% respectively. Similarly, the insurance sector recorded a strong capital adequacy ratio of 221.6%, and a capital buffer in excess of RM22.7 billion.

Domestic demand to remain robust amid continued challenges in the external environment

Going forward, the global economy is expected to continue to expand, but downside risks to growth will remain. In the advanced economies, economic recovery continues to be vulnerable to policy uncertainties and the risk of contagion. The divergent policies across regions are also resulting in spillover effects on global financial conditions. Nevertheless, in Asia, growth will continue to be sustained by domestic demand, underpinned by income growth and healthy labour market conditions, and supported by continued policy flexibility.

For the Malaysian economy, domestic demand is expected to remain as the key driver of growth, driven by sustained private sector expansion and supported by the public sector. While global developments will continue to present downside risks, intra-regional trade is expected to reinforce the growth performance.