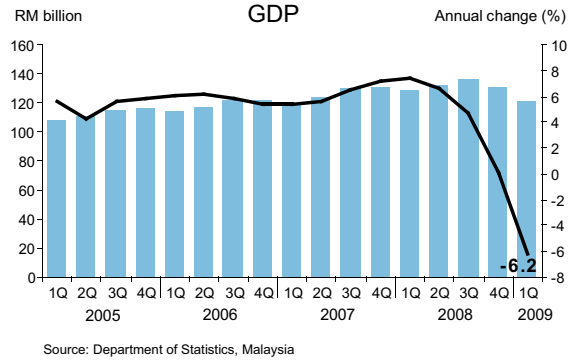
ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE FIRST QUARTER OF 2009

OVERVIEW

Growth contracted in the first quarter of 2009

The Malaysian economy contracted by 6.2% (4Q 08: +0.1%) in the first quarter of 2009, amidst a significant deterioration in external demand, following the deepening recession in advanced economies. The large inventory drawdown, particularly in the manufacturing and commodity sectors, also contributed to the decline in growth in the first quarter. Fixed investment registered a decline due to weaker business sentiment. Public sector spending, however, provided some support to growth. On the supply side, all sectors recorded contraction except for the construction sector.

Contraction in the first quarter 2009
(at constant 2000 prices)



Source: Department of Statistics, Malaysia

During the quarter, domestic demand registered a decline of 2.9% (4Q 08: 2.8%) as a result of more cautious spending by businesses and households following the weakening of overall business and economic conditions. Private consumption also declined marginally by 0.7% (4Q 08: 5.3%) as expenditure was affected by deteriorating labour market conditions. Consumer sentiments had, however, improved in March, with the MIER Consumer Sentiments Index increased to 78.9 points from 71.4 points in the fourth quarter of 2008. Meanwhile, public consumption expanded by 2.1%, underpinned by higher spending on emoluments as well as supplies and services. During the quarter, gross fixed capital formation declined by 10.8% (4Q 08: -10.2%), due mainly to the weaker private investment activity, as business confidence deteriorated amidst the decline in external demand. Nevertheless, higher public sector capital spending, particularly on education, agriculture and rural development, reflected the Government's commitment to mitigate the adverse impact of external developments on the domestic economy. Gross exports declined sharply by 20% following a sharp contraction in manufactured exports (-18%), as well as lower commodity exports. Performance of manufacturing exports was affected by lower demand for both electronics and electrical (E&E) and non-E&E products from major markets. In addition, commodity exports turned negative (-23.8%; 4Q 08: 6.1%), reflecting the impact of lower prices and weaker demand.

On the sectoral side, all economic sectors experienced contraction, except for construction. The manufacturing sector declined significantly by 17.6% (4Q 08: -8.8%), led by the 23.1% contraction in the export-oriented industries. In particular, the E&E industry contracted steeply by 41.4%. The domestic-oriented industries declined by 15.9% (4Q 08: -2%) due to weakness in both consumer- and construction-related sub-sectors. The services sector was flat following a marginal decline by 0.1% (4Q 08: 5.7%), primarily affected by sub-sectors closely linked to the manufacturing sector. The agriculture sector recorded a contraction of 4.3% (4Q 08: 0.5%) due to lower output of both palm oil and rubber, while the decline in the mining sector of 5.2% (4Q 08: -5.7%) was due to falling crude oil and natural gas production. Meanwhile, the construction sector, turned around to register a positive growth of 0.6% (4Q 08: -1.6%) due mainly to an increase in construction of office space and the high-end segment of the residential sub-sector.

Headline inflation rate, as measured by the change in the Consumer Price Index (CPI), moderated to 3.7% in the first quarter (4Q 08: 5.9%) due mainly to lower inflation in the food and non-alcoholic beverages, and transport categories. Meanwhile, inflation in the housing, water, electricity, gas and other fuels category also moderated to 1.6% (4Q 08: 1.8%), reflecting the 2.5% reduction in electricity tariffs for households which came into effect on 1 March. Headline inflation continued to moderate to 3.0% in April.

In the external sector, the trade surplus remained large at RM32.7 billion, as the contraction in imports was larger than that in exports. The larger decline in gross imports (-28.9%; 4Q 08: -12.2%) was due to lower imports of intermediate and capital goods amidst the decline in manufactured exports and the subsequent inventory adjustments as well as weaker investment activity.

On a cash basis, gross inflows of foreign direct investment (FDI) moderated to RM6.4 billion in the first quarter (4Q 08: RM9 billion), reflecting both lower inflows of equity capital and the drawdown of inter-company loans. After adjusting for gross outflows due mainly to repayment of inter-company loans, net FDI amounted to RM2.1 billion (4Q 08: RM3.4 billion), directed mainly into the manufacturing, services and oil and gas sectors. Overseas investment by Malaysian companies recorded a lower net outflow of RM3 billion (4Q 08: -RM8.1 billion), largely for investment in the services sector. Portfolio investment registered a lower net outflow of RM9.5 billion (4Q 08: -RM24.8 billion), reflecting mainly lower net liquidation of both equities and debt securities by foreign investors.

The international reserves of Bank Negara Malaysia amounted to RM320.7 billion (equivalent to USD87.8 billion) as at 31 March 2009 and remained stable at RM321.5 billion (equivalent to USD88 billion) as at 15 May 2009. The reserves position is sufficient to finance 8.3 months of retained imports and is 3.8 times the short-term external debt.

Interest rates lowered in line with OPR reductions

The Overnight Policy Rate (OPR) was reduced by 75 basis points in January 2009, and a further 50 basis points in February 2009, bringing the OPR to 2.00%. To reduce further the cost of intermediation, the Statutory Reserve Requirement (SRR) was also reduced concurrently by 150 and 100 basis points in January and February 2009 respectively. Monetary stimulus was frontloaded to support domestic demand, given the increased downside risks to growth in an environment of diminishing inflationary pressures. The OPR was left unchanged in April in line with the assessment that the accumulated monetary policy measures would be sufficient to support domestic demand.

Following the reduction in the OPR on 21 January to 2.50%, the daily weighted average overnight interbank rate decreased to stabilise at a lower range of 2.49% - 2.51% during the period 22 January – 24 February. With the further reduction in the OPR on 24 February to 2.00%, interbank rates decreased further to at a lower range of 1.99% - 2.01%. Interbank rates of other maturities also declined in line with the reductions in the OPR.

The accumulated reductions in the OPR were transmitted quickly and substantially to retail lending rates. The average base lending rate of commercial banks ended the first quarter at 5.53% (end-December 2008: 6.48%). Meanwhile, the average lending rate on loans outstanding softened to a new historic low of 5.16% in March 2009, compared to 5.86% at end-December 2008. The average quoted fixed deposit rates for tenures between 1 to 12 months decreased in the first quarter, and were within the range of 2.02% and 2.52% respectively as at end-March.

Financing of the economy remained adequate and accessible across all segments of the economy. Liquidity in the financial system was sufficient to support the demand for financing from both the public and private sectors. On a net basis, banking system loans and private debt securities (PDS) outstanding increased by 10.7% as at end-March (end-December 2008: 12.7%). Total loans outstanding expanded by an annual growth rate of 10.9%, although loans disbursed to the business sector moderated with the slowing pace of economic activity.

During the first quarter, net funds raised in the capital market amounted to RM11.6 billion. Most of the funds were raised by the public sector, amounting to RM10.8 billion. For the private sector, net funds raised through the PDS market amounted to RM698 million, while funds raised through the equity market amounted to RM144 million.

M3, or broad money, expanded at a slower annual pace of 7.3% at end-March 2009 (end-December 2008: 11.9%). On a quarter-on-quarter basis, M3 increased by RM17.7 billion. The main impetus for the increase was Government spending and net foreign inflows.

The ringgit depreciated against the US dollar by 5.0% in the first quarter. Against other major currencies, the ringgit was stronger against the Japanese yen (3.3%) and the euro (0.9%), but weaker against the pound sterling (-4.2%). The ringgit recorded a mixed performance against regional currencies. In terms of its trend path, the ringgit continued to depreciate against the US dollar coming into 2009 as the protracted uncertainty in the international financial markets and global economic slowdown dampened sentiments and sustained investors' risk aversion. The ringgit, however, stabilised in March amidst improved investor risk appetite towards financial assets in emerging markets following the considerable policy measures implemented by the advanced economies, the tentative signs of stabilisation in some US economic indicators, and expectations for normalisation in the international financial markets. Domestically, the ringgit also benefited from positive market reaction to the Second Stimulus Package announced on 10 March. During the period of 1 – 26 May 2009, the ringgit appreciated against the US dollar (4.5%) and Japanese yen (0.5%). The ringgit, however, depreciated against the pound sterling (-5.8%) and the euro (-0.9%). The ringgit recorded a mixed performance against regional currencies. The ringgit appreciated against the Chinese renminbi, the Philippine peso and the Thai baht in the range of 1.2% to 4.4%, but depreciated against the Indonesian rupiah, the Korean won, and the Singapore dollar in the range of 0.4% to 6.9%.

Banking and insurance sectors remained resilient

The banking sector remained resilient supported by strong capitalisation and stable credit quality. Although profitability has moderated by the conditions in the economy, the banking system remained financially sound, and supported by ample liquidity, is well-positioned to continue meeting the financing needs of the economy.

As at end-March 2009, the risk-weighted capital ratio (RWCR) strengthened to 13.4%, whilst core capital ratio (CCR) improved by 0.9 ppts to 11.5%. The strengthened capital ratios resulted from capital raising exercises by a number of banking institutions to boost their capital positions. Meanwhile, excess capital amounted to RM44.6 billion.

Pre-tax profit amounted to RM4.8 billion in the first quarter of 2009. The annualised average returns on assets and equity was 1.7% and 19.9% respectively.

The insurance and takaful sector sustained a sound position backed by firm capital level. Premiums and contributions were favourable contributing to the moderate level of profitability. Developments in the capital market, nonetheless, continued to pose downward pressure on profitability.

The Capital Adequacy Ratio was 211.3% at the end of March 2009 (4Q 08: 187.6%). Shareholders' equity increased to RM14.5 billion (1Q 08: RM13.4 billion) attributable to capital raising exercises by several insurers.

Excess of income over outgo moderated to RM2.1 billion in the first quarter of 2009 partly on account of higher payments of net policy benefits totalling RM2.5 billion. The moderation also resulted from the 11.3% decline in new investment-linked business.

Domestic demand remains important in supporting growth

Despite tentative signs of economic stabilisation in several economies in recent months, the major advanced economies as well as regional economies are still experiencing a sharp

economic contraction. Meanwhile, the conditions in the international financial system have yet to normalise. These developments will continue to pose risks to the outlook for global economic conditions and outlook. Nevertheless, the implementation of large stimulus measures by several economies has increased the prospects for global economic conditions to improve, particularly in the second half of 2009. Progress made in the financial sector resolution in several advanced economies has also provided support for the progression towards stabilisation of economic and financial conditions.

The Malaysian economy has been adversely impacted by these negative global developments that have resulted in the sharp decline in exports and its consequent effect on the economy in the first quarter. These effects have continued into the second quarter. The domestic economy is expected to improve in the second half of the year, supported by stabilisation in global economic conditions, and reinforced by the accelerated implementation of the fiscal measures, the further moderation in inflation, continued access to financing, as well as from the cumulative effects of the accommodative monetary environment. As exports are expected to continue to decline, growth will be supported by domestic demand, particularly by the implementation of fiscal stimulus.

The implementation of fiscal stimulus measures is expected to strengthen the domestic sources of growth as well as boost confidence of the private sector. The accommodative monetary environment following the reductions of the OPR and the SRR in the first quarter will also provide further support to domestic economic activity. Continued access to financing, particularly following the introduction of several loan guarantee facilities and the establishment of the Financial Guarantee Institution (Danajamin Nasional Berhad), and lower inflation will also lend support to the economy during this challenging period. In this environment, the Bank's efforts will continue to be directed at ensuring access to credit by all segments of the economy.