BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Ref. No.: 02/09/14

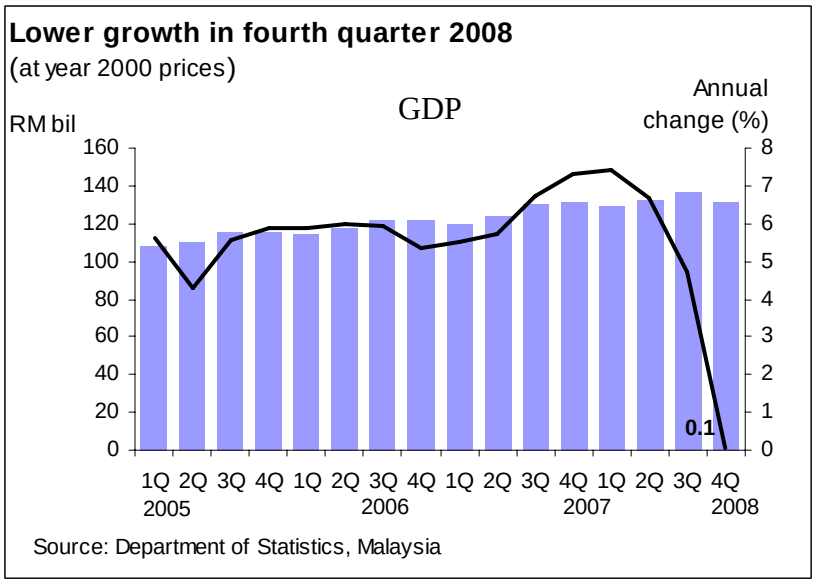
EMBARGO: Not for publication or broadcast before 1800 hours on Friday, 27 February 2009

ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE FOURTH QUARTER OF 2008

OVERVIEW

Growth slowed in the fourth quarter

Growth of the Malaysian economy slowed to 0.1% (3Q 08: 4.7%) in the fourth quarter of 2008 as global economic conditions worsened significantly. Growth was affected by the sharply weaker external demand, that has resulted in a further decline in net real exports of goods and services by 40.1% (3Q 08: -14.8%). Nevertheless, domestic demand continued to provide support to growth, driven mainly by private consumption and public spending. For the year as a whole, the Malaysian economy expanded by 4.6% (2007: 6.3%).



During the quarter, domestic demand expanded at 3.1% (3Q 08: 6.5%). Growth in private consumption moderated to 5.3% (3Q 08: 8.1%) as spending activity was constrained by higher retrenchments in the manufacturing sector, reduction in smallholders' income arising from the significant decline in commodity prices as well as lower consumer confidence. Public consumption, however, increased strongly by 13.8% (3Q 08: 6.9%), underpinned by higher expenditure on emoluments as well as supplies and services. Meanwhile, subdued investment activity led to a negative growth in gross fixed capital formation (-10.2%; 3Q 08: 3.1%) in the fourth quarter.

On the supply side, the slowdown was across all economic sectors, led by a sharp decline in the manufacturing sector (-8.8%; 3Q 08: 1.8%), particularly the export-oriented industries (-12.3%; 3Q 08: -1.1%) due to the significant contraction in global demand. Meanwhile, the domestic-oriented industries recorded a negative growth of 2.5% (3Q 08: 8.4%) as production of construction-related materials declined. The agriculture sector registered a lower growth of 0.5% (3Q 08: 3.0%) due to a moderation in production of palm oil while output for rubber declined. The mining sector contracted by 5.7% (3Q 08: -0.3%), following lower output of oil and gas. Meanwhile, construction activities declined by 1.6% (3Q 08: 1.2%) due to lower activity in the civil engineering sub-sector. During the quarter, the services sector remained the key driver of growth, expanding by 5.6% (3Q 08: 7.1%). The growth in the services sector was supported by the wholesale and retail trade, and accommodation and restaurant sub-sectors. Real estate and business services as well as utilities sub-sectors, however, experienced a contraction in view of the lower stock market and manufacturing activities.

Headline inflation moderated to 5.9% in the fourth quarter of 2008 (3Q 08: 8.4%), due mainly to a series of downward adjustments of retail fuel prices by the Government. The downward trend in inflation is expected to continue in 2009. Slowing economic growth is expected to contain both supply and demand pressures and rein in domestic price increases. This trend is confirmed by the numbers for the month of January 2009 during which inflation moderated to 3.9%.

In the external sector, the trade balance recorded a lower surplus of RM32.8 billion in the fourth quarter (3Q 08: RM41.8 billion). Exports declined (-7.4%; 3Q 08: 16.8%), reflecting the sharp contraction in manufactured exports. Performance of manufacturing exports was affected by lower demand for both E&E and non-E&E products from the major markets as well as weaker global semiconductor prices. Growth in commodity exports (6.1%; 3Q 08: 48.1%) also moderated significantly, reflecting a lower growth in mineral exports while agriculture exports declined sharply due mainly to lower prices. The decline in gross imports (-12.3%; 3Q 08: 10.1%) was due to lower imports of intermediate and capital goods following weaker export performance and slower private investment activities.

On a cash basis, gross inflows of foreign direct investment (FDI) were lower at RM9.3 billion in the fourth quarter (3Q 08: RM21.6 billion), due mainly to a decline in inter-company borrowings. After adjusting for gross outflows due mainly to repayment of inter-company loans, net FDI amounted to RM3.4 billion (3Q 08: RM2 billion). The bulk of the net FDI was directed into the oil and gas sector as well as the services and manufacturing sectors. Overseas investment by Malaysian companies recorded a lower net outflow of RM6.6 billion (3Q 08: -RM16 billion), mainly for investment in the services and manufacturing sectors. Portfolio investment registered a lower net outflow of RM24.8 billion (3Q 08: -RM38 billion), as the major move to re-align asset allocation by fund managers has largely been completed.

The international reserves of Bank Negara Malaysia amounted to RM316.8 billion (equivalent to USD91.3 billion) as at 31 December 2008 and remained stable at RM317.7 billion (equivalent to USD91.6 billion) as at 13 February 2009. The reserves position is sufficient to finance 7.6 months of retained imports and is 4 times the short-term external debt.

OPR reduced as pre-emptive measure

The Overnight Policy Rate (OPR) was reduced by 25 basis points in November 2008 and by another 75 basis points in January 2009. To reduce further the cost of intermediation, the Statutory Reserve Requirement (SRR) was also reduced concurrently by 50 basis points and 150 basis points respectively. These significant respective downward adjustments were to frontload the monetary stimulus to support domestic demand, given the increased downside risk to growth in an environment of rapidly diminishing inflationary pressures. The sharper deterioration of the global economy in the fourth quarter and the increased risk of contraction of the domestic economy prompted the further reduction in the OPR by 50 basis points on 24 February 2009, and the SRR by 100 basis points.

Reflecting the change in the OPR in November 2008, interbank rates for all maturities fell accordingly and remained stable at their new levels thereafter. In terms of lending rates, the average base lending rate (BLR) of commercial banks (CBs) was lower at 6.48% as at end-December 2008 (end-September 2008: 6.72%). The average lending rate (ALR) on loans outstanding declined to 5.86% at end-December 2008, compared to 5.96% at end-September 2008. The reduction in fixed deposit (FD) rates was most pronounced at the 12 month tenure, as the floor was revised lower by 20 basis points to 3.5%. As at end-December 2008, the average quoted FD rates for tenures between 1 to 12 months were within the range of 3.01% and 3.5% respectively.

In the fourth quarter, credit conditions in Malaysia remained orderly despite the deteriorating global financial and economic conditions. While loan indicators showed some slowing in the demand for credit, demand for financing by businesses and households continued to be supported by the domestic banking institutions. On a net basis, banking system loans and PDS outstanding rose by 12.7% at end-2008. Total loans disbursements increased by 5.3% during the quarter, mainly accounted for by the business sector. Total loans outstanding increased at a higher pace at 12.8%. Although initially demonstrating cautiousness in extending credit, banking institutions have continued to be forthcoming in extending credit facilities.

Net funds raised in the capital market were significantly higher at RM14.3 billion in the fourth quarter. The increase was largely due to higher net funds raised by the public sector, which amounted to RM13.9 billion. In the private sector, net funds raised through the PDS market amounted to RM229 million, while funds raised through the equity market amounted to RM222 million.

M3, or broad money, expanded moderately by RM19 billion in the fourth quarter of 2008, or 11.9% on an annual basis at end-December 2008 amidst large external outflows arising from the de-leveraging process by global investors.

The ringgit depreciated against the US dollar during the fourth quarter following continued global de-leveraging activities. The ringgit weakened to RM3.6375 against the US dollar on 5 December 2008, representing a 13.9% decline from the 23 April 2008 peak of RM3.1315. Towards the end of the year, the ringgit experienced some recovery with the ringgit-US dollar exchange rate at 3.4640, as at 31 December 2008, 4.5% lower than the end-2007 level. Against other major currencies during the fourth quarter, the ringgit was stronger against the pound sterling by 24.5% and by 1.8% against the euro amid growing concerns over deteriorating economic conditions in the UK and euro area. The ringgit also appreciated against most regional currencies in the range of 0.3% to 15.9% during the period. The exception was the Chinese renminbi, against which the ringgit depreciated by 0.5%. During the period of 1 January to 24 February 2009, the ringgit depreciated against the US dollar by 5.6%, the pound sterling by 6.4% and the Japanese yen by 0.7%, but appreciated against the euro by 4.5%. The ringgit depreciated against regional currencies in the range of 0.2% to 5.6%, with the exception of the Korean won, the Indonesian rupiah and the Singapore dollar, against which the ringgit appreciated by 13.2%, 3% and 0.4% respectively.

Banking system remained sound

The financial position of the banking sector remained sound with the capacity to continue to support the financing needs of the economy. As at end-December 2008, the banking system's risk-weighted capital ratio (RWCR) and core capital ratio (CCR) were maintained at high levels of 12.7% and 10.6% respectively. Pre-tax profit (PBT) increased to RM5.1 billion (3Q 08: RM4 billion) with annualised average returns on assets and equity of 1.5% (3Q 08: 1.5%) and 18.6% (3Q 08: 18.7%) respectively. Net NPLs improved by 5% to RM15.8 billion (3Q 08: RM16.6 billion) to account for a lower share of total net loans as at end-2008 (2.2%; 3Q 08: 2.4%).

Domestic demand is key as global crisis deepens

Latest developments show that the impact of the global financial crisis on the global economy is far broader and more severe than earlier anticipated. Its depth and contagion across the global economy was unprecedented with several of the large industrial countries and a number of the regional economies having slipped into recession. While global efforts have been intensified to counter the effects of the slowdown, risks remain on the downside and recovery is likely to be slow and protracted. Under these circumstances, the Asian economies have been adversely affected. The impact is already evident in export performance of several of the regional countries.

Being an integral part of the global economy, Malaysia has already felt the impact of the global slowdown. As exports declined, growth has increasingly relied on domestic demand, particularly private consumption and government spending. Continued access to financing, high savings and lower inflation would continue to lend support to the economy during this challenging period. The timely implementation of the fiscal stimulus and providing the necessary policy support to strengthen the domestic sources of growth will also be vital to supporting the overall growth. Bank Negara Malaysia also reduced the OPR by 75 basis points to 2.5% on 22 January 2009 and the Statutory Reserve Requirement (SRR) by 150 basis points to 2% effective 1 February 2009. On 24 February 2009, the OPR was reduced to 2%, while the SRR was reduced further to 1%. The Bank's efforts will continue to focus on ensuring access to credit. On 23 January 2009, Bank Negara Malaysia announced the establishment of the RM2 billion SME Assistance Guarantee Scheme.

Bank Negara Malaysia
27 February 2009