ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE FIRST QUARTER OF 2012

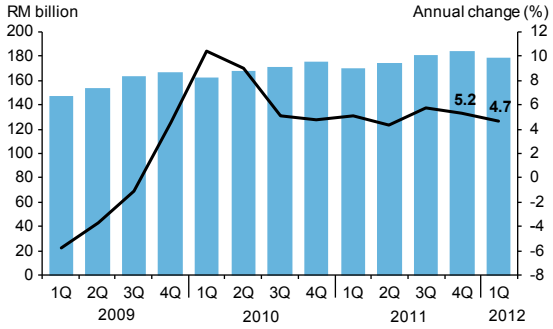
OVERVIEW

Growth of the Malaysian economy moderated in the first quarter

Global economic growth expanded at a slower pace in the first quarter of 2012. While growth in the US improved, several European economies slipped into recession. In Asia, economic activity continued to expand, albeit at a moderate pace, due to the slower export growth during the quarter. Domestic demand continued to provide support to economic activity. Notwithstanding the challenging external environment, growth of the Malaysian economy was sustained at 4.7% (4Q 11: 5.2%). Domestic demand remained firm, supported by both private and public sector economic activity, while exports moderated amid weaker external demand. On the supply side, growth in most major economic sectors moderated in the first quarter, as the more modest growth in export-oriented activity more than offset the sustained growth in domestic-oriented activity.

Domestic demand remained resilient, increasing by 9.6% (4Q 11: 10.4%). Growth of private consumption remained strong at 7.4% (4Q 11: 7.3%), supported mainly by continued income expansion and stable labour market conditions and reinforced by high commodity prices, improved consumer sentiments, and the disbursement of the income support programmes. Public consumption grew by 5.9% (4Q 11: 22.9%) amid continued expansion in spending on emoluments and supplies and services. Gross Fixed Capital Formation increased at a faster pace of 16.1% (4Q 11: 8.4%), supported by capital spending by both the private and public sectors. Private investment expanded strongly, supported by the implementation of investment projects, particularly in the oil and gas sector. For public investment, the Federal Government's development expenditure was mainly channeled into the trade and industry, and public utilities sectors, while capital spending by the non-financial public enterprises (NFPEs) was channeled mainly into the transportation and mining sectors.

The economy moderated in the first quarter (at constant 2005 prices)



Source: Department of Statistics, Malaysia

On the supply side, both the services and manufacturing sectors moderated further in the first quarter, reflecting the more modest growth in trade-related activity and continued expansion in domestic-related activity. Growth in the construction sector strengthened further, supported by the implementation of civil engineering projects and development of residential projects. The agriculture sector moderated on account of slower production of crude palm oil and rubber, while the mining output turned around to record a marginal growth.

The headline inflation rate, as measured by the annual change in the Consumer Price Index (CPI), moderated to 2.3% in the first quarter of 2012 (4Q 11: 3.2%). Inflation in the *food and non-alcoholic beverages* category was lower due mainly to a smaller increase in meat prices and a decline in the price of vegetables. Inflation in the *transport* category moderated as the impact from the adjustment to the price of RON97 petrol in January and February 2011 tapered off.

In the external sector, the current account surplus narrowed in the first quarter, but remained sizeable at RM18.1 billion, equivalent to 8.4% of GNI. The lower surplus reflected the smaller goods surplus and larger income outflows. The goods surplus narrowed to

RM35.8 billion as import growth outpaced the expansion in exports.

The financial account recorded a larger net outflow of RM10.3 billion during the quarter (4Q 11: -RM0.2 billion), due mainly to net outflows in other investments which more than offset the large inflows of foreign portfolio funds. FDI increased further to RM7.5 billion (4Q 11: +RM6.5 billion) during the quarter, supported by larger inflows of equity capital and higher earnings retained by the existing multinational companies (MNCs) operating in Malaysia. Direct investment abroad by Malaysian companies increased further to RM16.9 billion in the first quarter (4Q 11: -RM14.7 billion), reflecting substantially higher extensions of inter-company loans to subsidiaries abroad and higher outflows of equity capital. The overall balance of payments turned around to record a deficit of RM7.2 billion in the first quarter (4Q 11: +RM6.2 billion), following a lower current account surplus and a higher net outflow from the financial account.

The international reserves of Bank Negara Malaysia amounted to RM416.1 billion (equivalent to USD135.7 billion) as at 30 March 2012. The reserves level has taken into account the quarterly adjustment for foreign exchange revaluation loss, following the strengthening of ringgit against major and regional currencies during the quarter. As at 15 May 2012, the reserves position amounted to RM417.5 billion (equivalent to USD136.1 billion), sufficient to finance 9.3 months of retained imports and is 4.1 times the short-term external debt.

Monetary policy remained supportive of economic activity

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

Reflecting the unchanged OPR, the average 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 stable during the quarter. The average base lending rate (BLR) of commercial banks was unchanged at 6.53% throughout the period. The weighted average lending rate (ALR) on loans outstanding remained stable, standing at 5.62% as at end-March 2012 (end-December 2011: 5.65%). The cost of borrowing for businesses and households remained below pre-crisis levels.

In the first quarter, total gross financing raised by the private sector through the banking system and the capital market increased to RM259.9 billion (4Q 11: RM240.6 billion). The higher financing was attributable mainly to the increase in net private debt securities (PDS) issuances. On a net basis, banking system loans and PDS outstanding expanded at an annual growth rate of 13.3% as at end-March (4Q 11: 12.5%).

Net funds raised in the capital market increased to RM43.5 billion during the quarter (4Q 11: RM19.4 billion). The bulk of funds were raised by the private sector, particularly through the issuance of private debt securities. After adjusting for redemptions, net funds raised by the private sector amounted to RM29.8 billion (4Q 11: RM3.5 billion). In the public sector, net funds raised amounted to RM13.7 billion (4Q 2011: RM15.9 billion).

The monetary aggregates continued to grow in the first quarter. M3, or broad money, recorded an annual growth rate of 15% as at end-March (end-December 2011: 14.4%), reflecting the continued extension of credit to the private sector.

The ringgit appreciated by 3.6% against the US dollar in the first quarter, in line with the trend of other regional currencies. Better-than-expected economic data, particularly from the US, resulted in increased investors' optimism and renewed interest for financial assets in the region. Against other major currencies, the ringgit appreciated against the Japanese yen (9.6%) and the euro (0.4%), but depreciated against the pound sterling (-0.1%). The ringgit also strengthened against other regional currencies in the range of 0.1% to 3.8%. During the period of 1 April to 21 May 2012, the ringgit appreciated against the euro (2.3%), but depreciated against the Japanese yen (-5.4%), the US dollar (-2.0%) and the pound sterling (-1.1%). Against regional currencies, the ringgit

appreciated against the Korean won (0.7%), but depreciated against the Thai baht, Singapore dollar, Indonesian rupiah, Philippine peso and Chinese renminbi by between -0.6% and -1.6%.

Financial stability continued to be preserved

Financial stability was maintained throughout the first quarter of the year, underpinned by sound financial institutions and orderly financial market conditions. The continued effective functioning of financial intermediation has provided a supportive environment for economic activity.

The banking sector remained resilient during the quarter, continuing to maintain healthy prudential buffers, profitability and liquidity positions. The core capital ratio and risk-weighted capital ratio of the banking system remained firm at 13.0% and 14.7% respectively. Similarly, the insurance sector remained resilient with a strong capital adequacy ratio of 224.8%.

Recovery to continue at a modest pace but downside risks remain

Going forward, the European sovereign debt crisis remains a risk to the global economy. The continued high oil prices, driven mainly by geopolitical tensions, further adds to uncertainty in the global environment. Nevertheless, the ongoing gradual recovery in the US is expected to provide an upside potential to global growth prospects. For Asia, while economic activity may be affected by external developments, growth will continue to be underpinned by sound domestic macroeconomic fundamentals and policy flexibility.

For the Malaysian economy, while the challenging external environment will remain a risk to Malaysia's growth prospects, domestic demand is expected to remain resilient. The continued expansion in spending by the private sector, further supported by public sector expenditure, are expected to underpin the overall growth performance.

DEVELOPMENTS IN THE FIRST QUARTER OF 2012

INTERNATIONAL ECONOMIC ENVIRONMENT

Modest global growth amid improvement in financial market conditions

Global economic growth expanded at a slower pace in the first quarter of 2012. While growth in the US improved, several European economies slipped into recession. In Asia, economic activity continued to expand, albeit at a moderate pace, due to the slower export growth during the quarter. Domestic demand continued to provide support to economic activity.

International financial market conditions improved in the first quarter but remained volatile. In the earlier half of the quarter, markets were particularly affected by intensified concerns of investors over the potential of a Greek default. Nonetheless, market optimism subsequently improved following several policy actions taken by the EU leaders. These included the agreement for a second €130 billion bailout programme for Greece and the finalisation of its debt restructuring plan, and the increase in the combined lending capacity of the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM) to €700 billion from €500 billion. The second round of long-term refinancing operations by the European Central Bank in February also provided additional liquidity support to banks and alleviated financial market tensions. Nevertheless, the effect of these measures were temporary, as by end-March, financial market volatility re-emerged, driven by renewed fiscal sustainability concerns in Portugal and Spain. Furthermore, higher uncertainty in the financial markets was compounded by rising geopolitical risks in the Middle East and North Africa (MENA) region, which translated into a significant rise in oil prices during the quarter.

In the first quarter, the **US** economy grew at a faster pace of 2.1% in annual terms (4Q 11: 1.6%). On a seasonally adjusted annualised basis, the economy expanded by 2.2% (4Q 11: 3%), supported by private domestic spending. Consumption rose in response to an improvement in employment conditions and net financial wealth, increase in credit, a lower savings rate and favourable weather conditions. However, the pace of consumption growth remained constrained by the high household debt, a weak housing market and elevated gasoline prices. Private fixed investment expanded at a lower rate of 1.4% (4Q 11: 6.3%). The contraction in non-residential investment and a deceleration of capital spending in equipment and software offset the increase in residential construction activity. Government spending decreased as fiscally-constrained state and local governments cut spending and employment. Inflation grew at a slower rate of 2.8% (4Q 11: 3.3%) on account of a high base last year.

The **euro area** economy stagnated on both a quarterly (4Q 11: -0.3%) and annual basis (4Q 11: 0.7%). Growth performance continued to diverge between the economies in the region amid the unresolved sovereign debt crisis. While Germany experienced strong growth in the quarter, economic activity in the affected economies including Italy and Spain, continued to deteriorate. This is attributed mainly to weaker domestic demand and fragile banking sector conditions. Consumer spending also continued to decline as credit growth and private sector sentiments remained weak. Higher unemployment and additional austerity measures imposed on fiscal spending in the affected economies further weighed down on domestic economic activity. Inflation moderated slightly to 2.7% (4Q 11: 2.9%), but remained heightened amid higher energy prices.

The **UK** economy fell into a recession as real GDP contracted by 0.2% (4Q 11: -0.3%) on a quarter-on-quarter basis. On an annual basis, the economy stagnated in the first quarter (4Q 11: 0.5%). The deterioration in economic activity was mainly attributable to a continued decline in the manufacturing and construction sectors. Domestic demand continued to be weighed down by fiscal austerity measures, weak private sector sentiments and high consumer prices. The pace of inflation moderated

significantly to 3.5% (4Q 11: 4.6%), reflecting the normalisation from the impact of the value-added tax rate increase in January 2011. The rate of inflation however, remained above the central bank's 2% target.

The **Japanese** economy rebounded strongly in the first quarter, expanding by 2.7% (4Q 11: -0.5%). On a seasonally adjusted annualised basis, the economy grew by 4.1% (4Q 11: -1.1%). Export growth increased by 0.8% (4Q 11: -2.4%) following increased exports of transport equipment and higher shipments to the US in February and March amid the weaker yen. On the domestic front, household spending recorded positive growth, driven by government subsidies for the purchases of fuel efficient cars. Disposable income and wage growth also increased from a year earlier, supporting a moderate recovery in consumption. Sentiments were boosted by the setting up of the Reconstruction Agency in February, signalling some progress in the post-disaster reconstruction efforts. Core consumer prices (excluding fresh food) returned to the positive territory at 0.1% (4Q 11: -0.1%) amid higher energy prices.

Advanced Economies: Real GDP Growth

	2011			2012
	1Q	4Q	Year	1Q
	Annual change (%)			
US[1]	0.4	3.0	1.7	2.2[a]
Japan[1]	-9.8	-1.1	-0.7	4.1[p]
Euro area	2.4	0.7	1.5	0.0[a]
UK	1.6	0.5	0.7	0.0[p]

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

Source: National authorities

Monetary policy remained accommodative in the advanced economies, with further measures being undertaken given the continued weak growth prospects. In the US, the **Federal Open Market Committee** (FOMC) maintained the target range for the federal funds rate at 0-0.25% and revised its expectations of exceptionally low interest rates to remain through at least until late-2014, as compared to its previous expectations of low rates through mid-2013. The FOMC also announced the adoption of an inflation target of 2%. Amid heightened financial market uncertainty and higher risks to growth in the euro area, the **European Central Bank** (ECB) maintained its policy rate at 1% while embarking on its second round of three-year refinancing operations in February, aimed at providing liquidity to the banking sector and to support lending activity in the region. The **Bank of England** expanded its quantitative easing measures by increasing the size of its asset purchase programme in February by £50 billion to £325 billion, while keeping its policy rate at 0.5% in view of the modest state of economic recovery. Similarly, the **Bank of Japan** (BoJ) announced several measures to support its weak domestic economy. This included formalising an inflation goal of 1%, expanding its asset purchase programme by ¥10 trillion in February to ¥65 trillion, and increasing the loan scheme targeting growth industries by ¥2 trillion to ¥5.5 trillion. In April, the BoJ also extended the remaining maturity of Japanese government bonds to be purchased under the Programme from "one to two years" to "one to three years". The BoJ increased its asset purchase programme by an additional ¥5 trillion through the purchase of Japanese government bonds to address deflation and support the economy's return to sustainable growth.

Regional Countries: Real GDP Growth

	2011			2012
	1Q	4Q	Year	1Q
	Annual change (%)			
PR China	9.7	8.9	9.2	8.1
Indonesia	6.5	6.5	6.5	6.3
Korea	4.2	3.3	3.6	2.8[a]
Singapore	9.1	3.6	4.9	1.6
Chinese Taipei	6.6	1.9	4.0	0.4[a]
Hong Kong SAR	7.6	3.0	5.0	0.4
Thailand	3.2	-8.9[r]	0.1	0.3

[a] Advance estimate
[r] Revised

Source: National authorities

In **Asia**, domestic demand was generally sustained, supported by favourable labour market conditions, continued access to financing and steadily rising incomes. The overall economic activity, however, was affected by the slower external demand. **PR China's** economy expanded at a slower pace of 8.1% (4Q 11: 8.9%), as activity across the agricultural,

manufacturing and services sectors moderated. **Indonesia**'s economic growth moderated slightly, but remained robust at 6.3% (4Q 11: 6.5%), underpinned by resilient domestic demand. The **Korean** economy grew by 2.8% (4Q 11: 3.3%), supported mainly by public consumption and a rebound in investment activity. Growth in **Singapore** moderated to 1.6% (4Q 11: 3.6%) following a contraction in manufacturing activity which was also contributed by the high base in the previous year. In **Chinese Taipei**, growth slowed to 0.4% (4Q 11: 1.9%) mainly on account of a contraction in investment and exports. **Hong Kong's** growth moderated to 0.4% (4Q 11: 3.0%) following weak export performance. In **Thailand**, growth improved to 0.3% (4Q 11: -8.9%) as domestic demand rebounded while export growth contracted at a slower pace.

Headline inflation in the region moderated following slower increases in food prices, but remained elevated during the quarter. Amidst ongoing uncertainties in the global economy and lower inflationary pressures, several central banks in the region began to shift their policy focus towards supporting economic growth. **Bangko Sentral ng Pilipinas** lowered its key policy rate by a total of 50 basis points (bps) in two consecutive meetings to 4%. Similarly, **Bank Indonesia** cut its benchmark interest rate by 25bps to 5.75% in February. In an effort to mitigate the impact of the severe flooding on the economy, the **Bank of Thailand** further reduced its key policy rate by 25bps to 3% in January. The **Reserve Bank of India** cut its key lending rate by 50bps to 8% in April – the first rate cut in three years – in an effort to stimulate growth amid slowing inflation. This followed the Bank's decision to reduce its cash reserve ratio requirement by a total of 125bps to 4.75% in January and March to ease liquidity in the banking system. The **People's Bank of China** reduced the reserve requirement ratio by a total of 100bps to 20% in February and May to improve bank lending and support growth. The **Monetary Authority of Singapore** (MAS) maintained its policy of a modest and gradual appreciation of the S$NEER policy band. The slope, however, was increased slightly and MAS restored a narrower policy band to manage inflation expectations, ensure medium-term price stability and keep growth on a sustainable path.

Prices of **crude oil**[1] continued to trend upwards in the first quarter, averaging USD118 per barrel (4Q 11: USD109 per barrel). A confluence of factors, including geopolitical tensions in the MENA region, lower risk aversion and the onset of winter weather pushed oil prices to an 11-month high in mid-March. Nonetheless, in April, crude oil prices reversed the rising trend, although it remained above USD100 per barrel amid increasing signs of optimism following talks between Iran and key global powers. The release of unfavourable US economic data also suggested continued weak demand conditions. On 18 May, crude oil prices closed at USD107.14.

In the **foreign exchange markets**, most major and Asian currencies appreciated against the US dollar during the quarter, as global risk aversion receded following the progress made in addressing the sovereign debt crisis and the continued modest recovery in the US economy. The Japanese yen strengthened against the US dollar at the beginning of the quarter due to safe haven flows. Nevertheless, the trend was subsequently reversed as a result of the improvement in market sentiments and the BoJ's easing measures. The announcement by the FOMC in January to maintain its highly accommodative monetary policy stance until 2014 also provided some motivation for investors to return to the region in search for higher-yielding assets, providing further support for the appreciation in Asian currencies. Nevertheless, regional currencies weakened in March due mainly to concerns over the strength of growth prospects in PR China that could dampen the demand for the exports of regional economies.

Going forward, the European sovereign debt crisis remains a risk to the global economy. The continued high oil prices, driven mainly by geopolitical tensions, further adds to uncertainty in the global environment. Nevertheless, the ongoing gradual recovery in the US is expected to provide an upside potential to global growth prospects. For Asia, while economic activity may be affected by external developments, growth will continue to be underpinned by sound domestic macroeconomic fundamentals and policy flexibility.

[1] Refers to Brent one-month futures on the Intercontinental Exchange (ICE).

DEVELOPMENTS IN THE MALAYSIAN ECONOMY

Growth moderated in the first quarter

Growth of the Malaysian economy continued to remain steady, growing at a more moderate pace of 4.7% (4Q 11: 5.2%). While domestic demand remained firm, growth was weighed down by the continued contraction in net exports. Domestic demand was supported by both private and public sector economic activity. This was reflected in the stronger growth of capital imports and the sustained growth in imports of consumption goods. Private consumption remained strong, supported mainly by continued income expansion and stable labour market conditions and reinforced by high commodity prices, improved consumer sentiments, and the disbursement of the income support programmes. Private investment expanded strongly, supported by the implementation of investment projects, particularly in the oil and gas sector. However, net exports contracted further as the growth of exports moderated following the slower growth in exports of resource-based products and commodities, mainly arising from the lower prices of soft commodities. On the supply side, most major economic sectors moderated further, as the weaker growth in export-oriented activity more than offset the sustained growth in domestic-oriented activity.

GDP by Expenditure Components
(at constant 2005 prices)

	2011			2012
	1Q	4Q	Year	1Q
	Annual change (%)			
Aggregate Domestic Demand (excluding stocks)	8.2	10.4	8.2	9.6
Consumption	7.7	11.1	8.9	7.1
Private sector	*6.9*	*7.3*	*7.1*	*7.4*
Public sector	*11.1*	*22.9*	*16.1*	*5.9*
Gross Fixed Capital Formation	9.8	8.4	6.5	16.1
Private sector	*24.9*	*18.8*	*12.2*	*19.8*
Public sector	*-8.2*	*1.9*	*-0.3*	*10.3*
Net Exports	-27.4	-10.5	-7.4	-20.8
Exports of Goods and Services	*1.9*	*5.5*	*4.2*	*2.8*
Imports of Goods and Services	*9.3*	*7.8*	*6.2*	*6.8*
GDP	**5.1**	**5.2**	**5.1**	**4.7**

Source: Department of Statistics, Malaysia

Domestic demand remained firm

Domestic demand registered a firm growth of 9.6% in the first quarter (4Q 11: 10.4%). Growth was supported by the continued expansion of expenditure by both the private and public sectors, particularly in the form of investments.

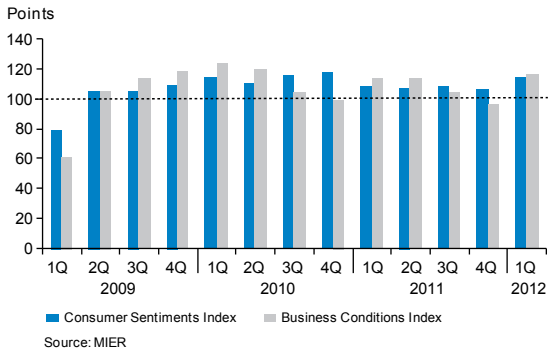
Private consumption remained strong at 7.4% (4Q 11: 7.3%), supported by continued income expansion and stable labour market conditions and reinforced by high commodity prices, improved consumer sentiments and lower inflation. The disbursement of the income support programmes provided further support to private consumption during the quarter. The sustained expansion in consumer spending was reflected in the strong growth of imports of consumption goods, sales of food and beverages, and credit card spending. The MIER Consumer Sentiments Index rose to 114.3 points (4Q 11: 106.3 points), reflecting improved consumer confidence.

Public consumption grew by 5.9% (4Q 11: 22.9%) as a result of the continued expansion in Government spending on emoluments and supplies and services.

Gross fixed capital formation grew at a faster pace of 16.1% (4Q 11: 8.4%), supported by capital spending by both the private and public sectors. Private sector investment grew by 19.8% (4Q 11: 18.8%), underpinned by the implementation of investment projects, particularly in the oil and gas, and manufacturing sectors. Major investment indicators such as the imports of capital goods, sales of construction-related materials and loan disbursements to businesses recorded strong performance, pointing to further expansion in private investment activity. Of significance, the MIER Business Conditions Index strengthened to 116.5 points (4Q 11: 96.6 points) and capacity utilisation in the manufacturing sector remained high. Public investment registered a growth of 10.3% (4Q 11: 1.9%), driven by higher growth in the Federal Government development expenditure and continued high capital spending by the non-financial public enterprises (NFPEs) in the transportation and mining sectors. The higher Federal Government's development expenditure

was mainly channelled into the trade and industry, and public utilities.

Consumer and business confidence improved



Source: MIER

Steady growth in most economic sectors

On the supply side, both the services and manufacturing sectors moderated further in the first quarter of 2012, reflecting the more modest growth in the external sector despite continued expansion in the domestic economy. Growth in the construction sector strengthened further, supported mainly by the civil engineering and residential sub-sectors. In commodities, growth in the agriculture sector moderated, while the mining sector turned around to record a marginal growth.

The **services sector** registered a growth of 5% in the first quarter (4Q 11: 6.6%), contributing 2.7 percentage points to the overall GDP growth. Growth was supported by the wholesale and retail trade; real estate and business services; and communication sub-sectors, in line with the favourable domestic demand conditions.

Growth in the **wholesale and retail trade** sub-sector was sustained at 6.4% (4Q 11: 6.8%), mainly driven by the retail segment, as household consumption spending remained strong amidst improvements in consumer sentiments. The **communication** sub-sector grew further to 9.4% (4Q 11: 8.8%), due to sustained robust demand for both mobile data and broadband services. The higher expansion in the **real estate and business services** sub-sector (6.9%; 4Q 11: 4.4%) mainly reflected the increase in professional services, benefiting from the construction and mining sectors. In the **transport and storage** sub-sector, growth was sustained at 5.9% (4Q 11: 6%), driven mainly by land transportation, as continued domestic production more than offset the moderation in trade-related transport activity. Growth in the **finance and insurance** sub-sector moderated to 2% (4Q 11: 7.1%), as net interest margin narrowed due to intense competition among financial institutions to attract deposits and to increase lending activities. Fee based income also moderated, in line with the lower value of market transactions in Bursa Malaysia.

GDP by Economic Activity (at constant 2005 prices)

	2011			2012
	1Q	4Q	Year	1Q
	Annual change (%)			
Agriculture	-0.2	6.9	5.9	2.1
Mining	-3.9	-3.8	-5.7	0.3
Manufacturing	5.7	5.2	4.7	4.2
Construction	5.1	7.5	4.6	15.5
Services	7.1	6.6	7.0	5.0
Real GDP (Annual Change)	**5.1**	**5.2**	**5.1**	**4.7**
Real GDP (Preceding Change)	**-2.7**	**1.8**	**5.1**	**-3.2**

Source: Department of Statistics, Malaysia

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

	Share 2011 (%)	2011			2012
		1Q	4Q	Year	1Q
		Annual change (%)			
Intermediate Services	**40.6**	**6.5**	**6.7**	**6.2**	**5.1**
Finance & insurance	17.0	7.7	7.1	6.5	2.0
Real estate & business services	10.0	5.7	4.4	5.5	6.9
Transport & storage	6.8	4.1	6.0	5.4	5.9
Communication	6.8	6.2	8.8	7.6	9.4
Final Services	**59.4**	**7.7**	**6.4**	**7.5**	**4.9**
Wholesale & retail trade	26.6	6.6	6.8	7.1	6.4
Accommodation & restaurant	4.5	4.8	6.3	6.0	6.1
Utilities	4.7	1.7	3.6	3.1	5.0
Government services	14.3	14.5	10.4	12.4	2.3
Other services	9.4	4.9	2.5	4.7	4.3
Total Services	**100.0**	**7.1**	**6.6**	**7.0**	**5.0**

Source: Department of Statistics, Malaysia

Selected Quarterly Indicators in the Services Sector

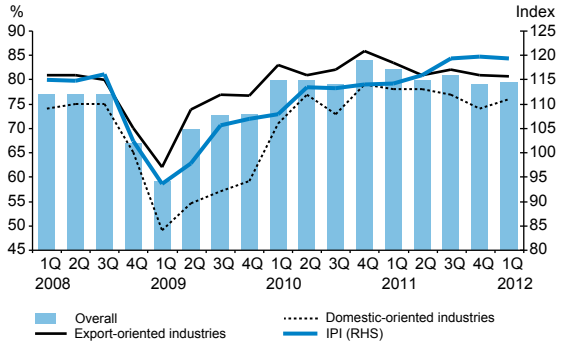
	2010	2011				2012
	4Q	1Q	2Q	3Q	4Q	1Q
	Index					
MIER Consumer Sentiments Index	117.2	108.2	107.9	108.7	106.3	114.3
MIER Retail Trade Index	132.0	99.1	120.8	150.0	92.6	85.3
MIER Tourism Market Index	124.6	113.1	125.4	115.2	126.0	125.2
	Annual change (%)					
Tourist arrivals	1.7	-3.9	-5.2	4.3	4.9	n.a.
Total passenger traffic at all airports	6.3	11.8	13.4	10.8	7.0	6.4
Total consumption credit outstanding	9.8	9.5	8.7	8.5	9.5	7.8
Loans outstanding to the wholesale & retail trade, hotels & restaurants	7.5	7.2	6.8	9.6	11.5	11.2
Imports of consumption goods	6.9	5.8	17.5	26.5	25.4	20.3
Total sales of motor vehicles	9.3	7.5	-9.7	0.6	-1.5	-12.6
Container cargo handled (Port Klang and PTP)	9.6	14.4	9.6	9.8	11.5	7.4

Source: Various sources

Growth in the **manufacturing sector** moderated to 4.2% (4Q 11: 5.2%), mainly reflecting the modest growth in the export-oriented industries. Performance of the **export-oriented industries** was weighed down by the continued contraction in the electronics and electrical products (E&E) cluster. Weak global demand for semiconductors more than offset the positive growth in the electrical segment, which was supported by higher demand from the ASEAN region. Growth in the primary-related cluster moderated, given slower demand for plastics used in E&E and as packaging materials, and lower regional demand for rubber tyres. Nonetheless, growth in the **domestic-oriented industries** remained steady. The construction-related cluster benefited from sustained construction activity, while growth in the consumer-related cluster was driven by higher production in the food, beverages and tobacco industry, in tandem with the firm growth in private consumption.

Overall, capacity utilisation in the manufacturing sector was higher at 80% (4Q 11: 79%). Export- and domestic-oriented industries operated at 80% and 77% of total capacity respectively during the quarter (4Q 11: 81% and 74% respectively).

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

Performance of the Manufacturing Sector

	2011			2012
	1Q	4Q	Year	1Q
	Annual Change (%)			
Value Added (RM million at constant 2005 prices)	**5.7**	**5.2**	**4.7**	**4.2**
Overall Manufacturing Production[1]	**5.9**	**5.3**	**4.7**	**4.4**
Export-oriented industries	**5.1**	**2.9**	**3.4**	**2.7**
Electronics and electrical products cluster	**-5.3**	**-3.0**	**-3.6**	**-0.1**
Of which:				
Electronics	-18.1	-10.3	-11.7	-3.7
Electrical products	17.9	6.5	8.4	4.4
Primary-related cluster	**11.3**	**6.1**	**7.4**	**4.1**
Of which:				
Chemicals and chemical products	5.5	14.1	8.8	8.4
Petroleum products	26.0	-1.1	6.2	3.8
Rubber products	12.4	9.5	13.9	2.2
Off-estate processing	-7.4	13.8	8.7	2.2
Domestic-oriented industries	**8.9**	**12.8**	**8.9**	**9.8**
Construction-related cluster	**22.1**	**12.3**	**17.6**	**10.3**
Of which:				
Construction-related products	15.3	8.3	13.0	1.0
Fabricated metal products	32.0	17.5	23.8	21.9
Consumer-related cluster	**-0.3**	**13.2**	**2.6**	**9.4**
Of which:				
Transport equipment	-3.9	15.1	-1.0	7.1
Food, beverage & tobacco products	6.7	9.8	5.9	9.7

[1] Industrial Production Index (2005=100)

Source: Department of Statistics, Malaysia

Growth in the **construction sector** strengthened significantly during the quarter (15.5%; 4Q 11: 7.5%), driven mainly by the civil engineering and residential sub-sectors. Growth was supported by the progress of major infrastructure projects such as the Second Penang Bridge, KLIA 2, Sabah-Sarawak Gas Pipeline, Melaka Regasification Terminal and Ipoh-Padang Besar Electrified Double Tracking project. The residential sub-sector also registered sustained growth due a significant increase in the number of housing projects. Improvement in the non-residential segment was underpinned by the construction of commercial buildings, factories, hospitals and learning institutions.

Indicators for the Construction Sector

	2011			2012
	1Q	4Q	Year	1Q
	Annual change (%)			
Value of construction work done	8.8	12.9	5.7	14.2
New sales and advertising permits	25.1	22.4	16.1	12.5
Housing approvals	31.6	29.8	32.2	75.6
Production[1] of construction-related materials	22.1	12.3	17.6	10.3
Loans approved for construction	29.3	64.4	26.0	38.2
Imports of construction-related materials	-1.2	9.4	13.9	9.5

[1] Industrial Production Index (2005=100)

Source: Ministry of Housing and Local Government, Department of Statistics, Malaysia and Bank Negara Malaysia

Value-added growth of the **agriculture sector** moderated to 2.1% (4Q 11: 6.9%), as a result of lower output of rubber and fish, arising from adverse weather conditions. The **mining sector** turned around to expand by 0.3% (4Q 11: -3.8%), reflecting positive growth in crude oil output, following efforts to enhance recovery in production from the existing oil fields.

Performance of the Agriculture Sector

	2011			2012
	1Q	4Q	Year	1Q
	Annual change (%)			
Value Added (at constant 2005 prices)	**-0.2**	**6.9**	**5.9**	**2.1**
Industrial Crops	**-6.9**	**7.8**	**5.8**	**1.4**
Food Crops	**9.2**	**5.6**	**6.1**	**2.8**
Production				
Of which:				
Crude palm oil	-7.7	16.2	11.3	3.2
Rubber	2.8	-7.4	6.1	-9.6
Livestock	-6.3	11.1	4.4	25.5

Source: Malaysian Palm Oil Board (MPOB)
Malaysian Rubber Board (MRB)
Department of Veterinary Services, Malaysia
Department of Statistics, Malaysia

Performance of the Mining Sector

	2011			2012
	1Q	4Q	Year	1Q
	Annual change (%)			
Value Added (at constant 2005 prices)	**-3.9**	**-3.8**	**-5.7**	**0.3**
Production				
Of which:				
Crude oil and condensates	-8.2	-6.6	-10.7	0.1
Natural gas	-0.6	0.7	0.0	-0.2

Source: PETRONAS
Department of Statistics, Malaysia

Rebasing of the Malaysian GDP from Base Year 2000 to 2005 Prices

The Department of Statistics, Malaysia compiles Malaysia's Gross Domestic Product (GDP) data and publishes it within six weeks from the end of each respective quarter. With effect from 1Q 2012, the estimates of the Malaysian Gross Domestic Product (GDP) in constant terms is rebased to 2005 prices from the 2000 prices. The rebasing exercise by DOSM also reflects the enhancement of data sources and the incorporation of the latest international guidelines in the System of National Accounts 2008 (SNA 2008) statistical framework[1].

Purpose of Rebasing Exercise

The SNA 1993 recommends that the base year for constant price series should be changed every five years. In addition, the United Nations Statistical Office has recommended that the base year should end in zero or five, for example, the year 2000 or 2005. Therefore, the practice of rebasing GDP is a standard exercise by statistical agencies worldwide. Among others, US, Japan, Italy, South Korea and Singapore are currently using 2005 as their new base year, while Chinese Taipei is using 2006 base year prices. The rebasing of GDP is necessary to ensure that the national accounts statistics reflect the most recent underlying changes in the economic structure and relative prices in the economy. By maintaining relative prices constant, GDP in constant terms would reflect only changes in the volume of economic activity. However, relative prices of goods and services do change over time due to the changing demand conditions, which in itself will result in greater allocation of resources and production towards certain economic sectors relative to other sectors. Consequently, the relative weights of the old base year prices would become less representative of the current structure of the economy.

In addition, the rebasing exercise incorporated conceptual and methodological improvements as recommended by the SNA 2008. For instance, if in the past, research and development (R&D) activity was treated as an intermediate input in production, now it is reflected as an output in Malaysia's GDP, thus quantifying the contribution of R&D to the economy. This is important as R&D is a critical component of investment spending in driving growth. Also, there is a change in the calculation of FISIM[2], where the usage of services of financial intermediation is now rightly distributed across the sectors, giving a better picture of actual value-added of the various economic sectors. Overall, the new GDP base will allow a better comparison between the national accounts of Malaysia and other countries which have adopted the new method.

The improvement in data sources and more comprehensive information on industries also lead to a more accurate representation of the economy. The completion of the Supply and Use Table and Input-Output Table 2005 provides the necessary framework for checking the consistency of statistics on flows of goods and services obtained from other latest DOSM surveys and censuses (e.g. Economic Census, Annual Industry Surveys, and Household Income and Expenditure Survey). In addition, the inclusion of new industries, such as the oil terminal in the transport and storage services sub-sector and Jatropha, bird nest and kenaf in the agriculture sector, also enhances the coverage of the latest national accounts statistics.

[1] The previous publication of System of National Accounts manual was in 1993. Other industrialised and regional economies have also begun adopting selected recommendations from SNA 2008.

[2] FISIM stands for Financial Intermediation Services Indirectly Measured, which is an indirect measure of the value of financial intermediation services provided but for which financial institutions do not charge explicitly. (Source: OECD)

Table 1 outlines some of the key changes in the rebased series.

Table 1: Key Changes and Improvements to Latest Compilation of National Accounts

	Key Changes and Improvements	Description
1	Change in conceptual treatment according to SNA 2008	• Capitalisation of Research and Development (R&D) - From the demand side, R&D is reflected in gross fixed capital formation - From the supply side, R&D is reflected across all sectors • Previously, R&D was not reflected in the national accounts, as it was treated as an intermediate input in production
		• FISIM is calculated based on loans and deposits using the reference rate method on an annual basis instead of the difference between interest received and interest paid
		• Public expenditure on weapon systems is now capitalised
2	Improvement in methodology	• FISIM element is now distributed across all sectors. Previously due to data limitations, FISIM was calculated explicitly
3	Improvement in data sources and information	• Availability of Economic Census 2006, the Supply Use and Input-Output Table 2005, Household Expenditure Survey 2004-05, various annual surveys and industry specific censuses • New activities are included, such as the oil terminal in the transport and storage services sub-sector, and Jatropha, bird nest and kenaf in the agriculture sector

Key implications

GDP in nominal terms is higher compared to before, reflecting new information and improvement in data sources. Malaysia's nominal GDP increased to RM881 billion in 2011 (previous: RM853 billion), implying a gross national income (GNI) per capita of RM29,661 (previous: RM29,094). The increase in nominal GDP after rebasing is in line with the revisions made by other countries after their respective exercises (Table 2).

On the supply side, the services sector accounts for the largest share, followed by manufacturing, mining, agriculture and construction. The commodity sector has a bigger share, reflecting the higher commodity prices relative to non-commodity prices in 2005 compared to that in 2000 (Table 3). On the demand side, gross fixed capital formation comprises a bigger share of GDP, while private consumption share is slightly lower at 49.8% (2000 base year: 54.1%) (Table 4).

Table 2: Nominal GDP of Selected Countries (during the year of rebase)

Country	Nominal GDP Before Rebasing	Nominal GDP After Rebasing	Revision (%)
South Korea (bil won)	**810,516** (2000=100)	**865,241** (2005=100)	**6.8**
Philippines (bil PHP)	**3,355** (1985=100)	**3,581** (2000=100)	**6.7**
Malaysia (bil RM)	**522** (2000=100)	**544** (2005=100)	**4.0**
Singapore (bil $S)	**202** (2000=100)	**209** (2005=100)	**3.4**
Chinese Taipei (bil NT$)	**11,918** (2001=100)	**12,243** (2006=100)	**2.7**
United States (bil USD)	**12,422** (2000=100)	**12,638** (2005=100)	**1.7**

Table 3: Real GDP by Economic Activity (2011)

	2011 share of GDP (%)	
	2000 prices	2005 prices
Agriculture	**7.3**	**7.7**
Mining & Quarrying	**6.3**	**8.8**
Manufacturing	**27.5**	**25.1**
Construction	**3.2**	**3.0**
Services	**58.6**	**54.2**
Overall GDP	**100.0**	**100.0**
Less: FISIM	*4.2*	-
Plus: Import duties	*1.3*	*1.2*

Conclusion

Malaysia's GDP was rebased to 2005 prices to reflect the latest changes in economic structure and relative prices in the economy. In addition, improvements in concepts and methodology which are in line with the latest international standards will place Malaysia on par with the practices of other countries.

Table 4: Real GDP by Expenditure (2011)

	2011 share of GDP (%)	
	2000 prices	2005 prices
Private consumption	**54.1**	**49.8**
Public consumption	**14.9**	**13.2**
Gross fixed capital formation	**22.1**	**23.5**
Private investment	*12.0*	*13.4*
Public investment	*10.1*	*10.1*
Change in stocks[1] (RM billion, constant prices)	**7.8**	**3.2**
Net exports of goods & services	**7.7**	**13.1**
Exports	*108.4*	*100.6*
Imports	*100.7*	*87.5*
Overall GDP	**100.0**	**100.0**

[1] Includes statistical discrepancies

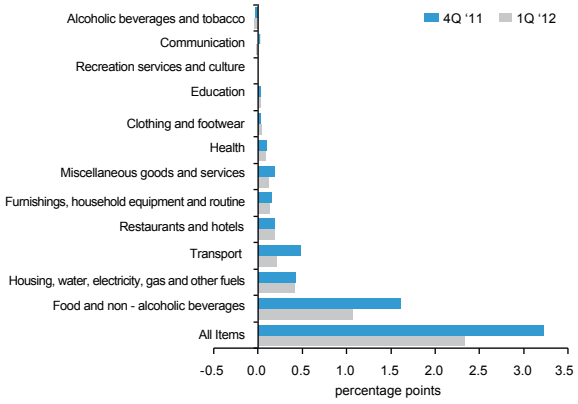
Inflation moderated in the first quarter

The headline inflation rate, as measured by the annual change in the Consumer Price Index (CPI), moderated to 2.3% in the first quarter (4Q 11: 3.2%), reflecting lower inflation in the *food and non-alcoholic beverages* and *transport* categories.

Inflation in the *food and non-alcoholic beverages* category moderated to 3.5% during the quarter (Q4 11: 5.3%) due mainly to a smaller increase in meat prices (1.1%, 4Q 11: 8.5%) and a decline of 3.7% in the price of vegetables (4Q 11: +1.9%). The lower food inflation reflected the implementation of festive season price controls on selected food products by the Government in January, the oversupply of poultry, and the better-than-expected harvests and cheaper imports of vegetables in February and March.

Inflation in the *transport* category moderated to 1.4% (4Q 11: 3.2%) during the quarter as the impact from the adjustment to the price of RON97 petrol in January and February 2011 tapered off.

Contribution to Consumer Price Inflation



Source: Bank Negara Malaysia

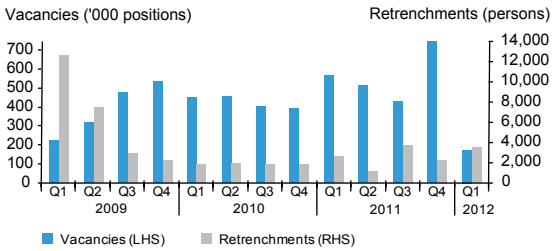
The Producer Price Index (PPI) increased at a slower rate of 3.8% on an annual basis in the first quarter (4Q 11: 7.5%). In terms of composition, prices of the commodity-related components and non-commodity-related components recorded lower growth of 9.2% and 0.8% respectively (4Q 11: 18.3% and 2.1% respectively). Prices of the local components of the PPI experienced a slower increase of 4.8% (4Q 11: 9.7%) while prices of the imported components of the PPI also moderated by 1.4% (4Q 11: 2.4%).

Labour market conditions remained favourable during the quarter

Overall labour market conditions remained favourable in the first quarter, as the unemployment rate remained low at 3% (4Q 11: 3%). Average total employment during the quarter was 12.4 million, representing a net job creation of 232.4 thousand persons compared to the fourth quarter of 2011. Total retrenchment during the quarter increased to 3,388 persons (4Q 11: 2,119 persons), mainly attributable to two company takeovers in the manufacturing and construction sectors. The workers retrenched from the takeovers are expected to be absorbed fully by the acquiring companies.

During the quarter, there were 316,016 job vacancies posted in the JobsMalaysia Portal. Due to a technical review of the system which took effect in January 2012, this figure is not comparable to the 745,205 positions posted in the fourth quarter. The manufacturing sector recorded the largest share of job openings (38%), followed by the services (24%) and agriculture (23%) sectors. Real wages in the manufacturing sector recorded a higher growth as compared to the preceding quarter (7.1%; 4Q 11: 5.3%).

Labour Market Conditions



Note: Beginning 2012, vacancies data reflected a technical review
Source: Ministry of Human Resources

Current account surplus remained sizeable

The **current account** surplus narrowed in the first quarter, but remained sizeable at RM18.1 billion, equivalent to 8.4% of GNI. The lower surplus was due mainly to the smaller goods surplus and larger income outflows. The goods surplus narrowed to RM35.8 billion as import growth outpaced the expansion in exports. Gross exports expanded at a slower pace of 4.4% (4Q 11: 9.8%), due mainly to the moderation in exports of commodity and non-E&E manufactured products. Growth in gross imports was slightly lower at 6.9% (4Q 11: 7.6%) following the contraction in imports of intermediate goods.

Exports grew at a more moderate pace in the first quarter due mainly to the lower growth in exports of non-E&E and commodities. Exports of resource-based non-E&E and commodities moderated mainly on account of lower prices of soft commodities amidst firm regional demand. Mineral exports was sustained, reflecting increased demand for crude oil and higher prices of both crude oil and natural gas. Exports of E&E registered a lower contraction following the improvement in external demand for computer and parts and electrical appliances.

The lower growth in gross **imports** was mainly attributable to the decline in imports of intermediate goods. The contraction in intermediate imports was largely in tandem with the moderation in manufactured exports. However, capital and consumption imports continued to expand. The strong expansion in capital imports was due mainly to higher

Balance of Payments

	2011			2012
	1Q	4Q	Year	1Q
	RM billion			
Current Account	**24.3**	**22.4**	**97.1**	**18.1**
(% of GNI)	*11.9*	*10.0*	*11.3*	*8.4*
Goods	37.6	36.8	148.1	35.8
Services	-2.2	-3.8	-8.0	-3.8
Income	-6.0	-5.3	-22.0	-8.6
Current transfers	-5.0	-5.4	-21.0	-5.3
Financial Account	**-6.6**	**-0.2**	**22.3**	**-10.3**
Direct investment abroad	-11.1	-14.7	-46.7	-16.9
Foreign direct investment	11.3	6.5	36.6	7.5
Portfolio investment	8.4	-2.7	25.8	25.3
Financial derivatives	0.1	-0.3	-0.1	0.0
Other investment	-15.3	11.0	6.6	-26.1
- Official sector	*-0.5*	*-0.1*	*-1.3*	*-0.5*
- Private sector	*-14.7*	*11.1*	*7.9*	*-25.6*
Errors & omissions	-1.9	-15.9	-24.5	-14.9
Overall Balance	**15.9**	**6.2**	**94.7**	**-7.2**

Source: Department of Statistics Malaysia

Trade Account

	2011			2012
	1Q	4Q	Year	1Q
	Annual change (%)			
Gross Exports	**4.9**	**9.8**	**8.7**	**4.4**
Manufactured	-0.6	2.1	2.0	0.9
E&E	*-7.5*	*-5.0*	*-5.4*	*-1.7*
Non-E&E	*7.5*	*10.2*	*10.7*	*3.4*
Commodities	19.5	29.0	26.5	11.7
Agriculture	*26.5*	*18.9*	*32.6*	*-8.0*
Minerals	*14.8*	*36.9*	*22.3*	*26.0*
Gross Imports	**12.5**	**7.6**	**8.6**	**6.9**
Capital goods	16.7	8.2	9.7	21.0
Intermediate goods	12.5	2.3	5.4	-1.3
Consumption goods	5.8	25.4	19.0	20.3
Trade balance (RM billion)	**31.8**	**31.1**	**120.3**	**29.8**

Source: MATRADE and Department of Statistics, Malaysia

Malaysia: Direction of Exports

	2011			2012	2011			2012
	1Q	4Q	Year	1Q	1Q	4Q	Year	1Q
	Annual change (%)				Share of total exports (%)			
United States	**-8.0**	**-3.5**	**-5.5**	**5.5**	**8.3**	**8.0**	**8.3**	**8.3**
European Union (EU)	**5.3**	**3.9**	**4.7**	**-10.4**	**10.7**	**10.2**	**10.4**	**9.1**
Selected ASEAN countries[1]	**0.1**	**5.6**	**5.4**	**9.3**	**24.6**	**24.3**	**24.3**	**25.8**
North East Asia	**2.5**	**9.6**	**8.9**	**-2.0**	**24.4**	**24.2**	**24.6**	**22.9**
People's Republic of China	*3.9*	*15.3*	*13.9*	*-3.2*	*12.9*	*12.9*	*13.1*	*11.9*
Hong Kong SAR	*0.0*	*-7.3*	*-3.6*	*-8.1*	*4.6*	*4.2*	*4.5*	*4.0*
Chinese Taipei	*16.9*	*14.5*	*12.4*	*-2.0*	*3.2*	*3.4*	*3.3*	*3.0*
Korea	*-8.3*	*9.0*	*6.1*	*9.4*	*3.8*	*3.6*	*3.7*	*4.0*
West Asia	**17.6**	**6.5**	**12.1**	**-4.8**	**3.7**	**3.5**	**3.6**	**3.4**
India	**24.2**	**33.7**	**34.6**	**-5.1**	**3.9**	**4.0**	**4.1**	**3.6**
Total exports	**4.9**	**9.8**	**8.7**	**4.4**	**100.0**	**100.0**	**100.0**	**100.0**

[1]Singapore, Thailand, Indonesia, Philippines, Brunei Darussalam and Vietnam

Source: Department of Statistics, Malaysia

imports of lumpy items and machineries, in line with the improvement in domestic activities. Growth in consumption imports was sustained, supported by imports of food and beverages and non-durable consumer goods.

The deficit in the **services account** was sustained at RM3.8 billion as the smaller outflows in other services was offset by lower receipts for transportation services and travel. The lower net outflows in other services was due mainly to higher receipts of professional business services. Meanwhile, the lower receipts for transportation services mainly reflected the moderation in trade activities. The **income account** registered a larger deficit of RM8.6 billion as lower investment income were accrued to Malaysian companies investing abroad.

The **financial account** recorded a larger net outflow of RM10.3 billion during the quarter (4Q 11: -RM0.2 billion), due mainly to net outflows in other investments which more than offset the large inflows of foreign portfolio funds.

Portfolio investment turned around from a small net outflow position to record a large net inflow of RM25.3 billion (4Q 11: -RM2.7 billion). The resumption of inflows largely reflected foreign purchases of both debt and equity securities following improvements of market sentiments in the global financial markets, particularly in the early part of the quarter. Similar developments were also observed in the regional economies.

FDI increased further to RM7.5 billion, or 3.5% of GNI (4Q 11: +RM6.5 billion, or 2.9% of GNI), supported by larger inflows of equity capital as well as higher earnings retained by the existing multinational companies (MNCs) operating in Malaysia. FDI inflows continued to be broad-based during the quarter, the bulk of which were undertaken by companies in the *mining* and *manufacturing* sectors, particularly the *E&E* and *petrochemical* sub-sectors. The *finance and insurance* and *information and communication* sub-sectors also received sizeable investments during the quarter.

Direct investment abroad (DIA) by Malaysian companies was also higher, amounting to a net outflow of RM16.9 billion in the first quarter (4Q 11: -RM14.7 billion). The larger net DIA reflected substantially higher extensions of inter-company loans to subsidiaries abroad and higher outflows of equity capital. These investments were mainly channelled into the *services* sector, particularly, the *finance and insurance*, *wholesale and retail trade*, and *healthcare* sub-sectors. There were also sizeable investments abroad by Malaysian companies in the *oil and gas* sector. The bulk of the investments abroad was mainly channelled to regional countries.

Other investments reversed to register a net outflow of RM26.1 billion (4Q 11: +RM11 billion) in the first quarter, following the turnaround in the private sector flows. The outflows in the private sector largely reflected the placement of assets abroad by the banking sector as well as higher net extension of trade credits.

Overall balance of payments turned around to record a deficit of RM7.2 billion in the first quarter (4Q 11: +RM6.2 billion), following a lower current account surplus and a higher net outflow from the financial account. Errors and omissions (E&O) including quarterly reserves adjustment for foreign exchange revaluation loss were smaller during the quarter, amounting to an outflow of RM14.9 billion (4Q 11: -RM15.9 billion). Excluding this revaluation loss, the net E&O is significantly smaller and reflects the errors and omission of data compilation.

Lower external debt

Malaysia's **total external debt** declined to RM249.5 billion or USD80.5 billion as at end-March 2012 (end-December 11: RM257.4 billion or USD80.4 billion). This is equivalent to 27.8% of GNI, and remains small as a share to total debt[1] (12%).

The **medium- and long-term external debt** decreased to RM148.6 billion (end-December 11: RM153.5 billion), reflecting the strengthening of ringgit against major and regional currencies during the quarter. This more than offset a small net drawdown of external borrowing by both the public and private sectors.

As at end-March 2012, the **short-term external debt** was lower at RM100.9 billion (USD32.6 billion) and accounted for 40.4% of total external debt. The international reserves were able to cover 4.1 times the short-term external debt.

[1] Total debt comprises domestic and external debt. Domestic debt comprises loans by banking system, private debt securities and federal government debt.

External Debt Outstanding

	2011		2012
	end-Mar	end-Dec	end-Mar[p]
	RM billion		
Medium- and long-term debt	142.3	153.5	148.6
Public sector	77.4	83.1	80.0
Private sector	64.9	70.4	68.6
Short-term debt[1]	91.1	103.9	100.9
Total external debt	**233.5**	**257.4**	**249.5**
USD billion equivalent	76.4	80.4	80.5
External debt/GNI (%)	27.2	30.0	27.8
Reserves/Short-term external debt (times)	3.8	4.1	4.1[2]

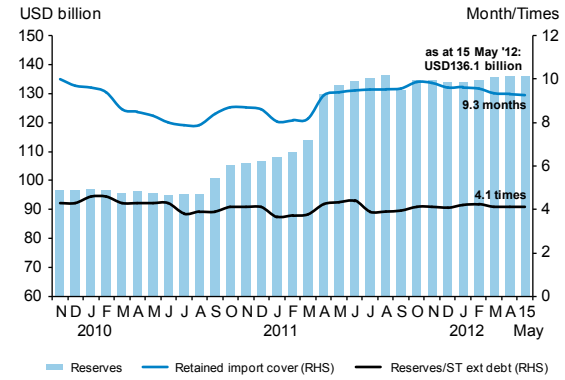
[1] Excludes currency and deposits held by non-residents with resident banking institutions
[2] Based on international reserves as at 15 May 2012
[p] Preliminary

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

International reserves remained high

The international reserves of Bank Negara Malaysia amounted to RM416.1 billion (equivalent to USD135.7 billion) as at 30 March 2012. The reserves level has taken into account the quarterly adjustment for foreign exchange revaluation loss, following the strengthening of ringgit against major and regional currencies during the quarter. As at 15 May 2012, the reserves position amounted to RM417.5 billion (equivalent to USD136.1 billion), sufficient to finance 9.3 months of retained imports and is 4.1 times the short-term external debt.

Net International Reserves (as at end period)



Source: Bank Negara Malaysia

Sustained growth in revenue supported Government spending

In the first quarter, the Federal Government revenue increased by 20.4% on an annual basis due to sustained income tax collections and higher non-tax revenue. The increase in revenue supported the corresponding increase in operating expenditure which was driven by higher subsidy payments and the transfer of funds to statutory bodies. Development expenditure also increased and was channelled mainly to the trade and industry, and public utilities sectors. As a result, the Federal Government recorded a fiscal deficit of RM5.8 billion or 2.6% of GDP during the quarter (1Q 11: -2.5% of GDP). The deficit was financed from domestic borrowing. As at end-March 2012, total outstanding debt of the Federal Government amounted to RM470.8 billion or 51.3% of the estimated 2012 GDP.

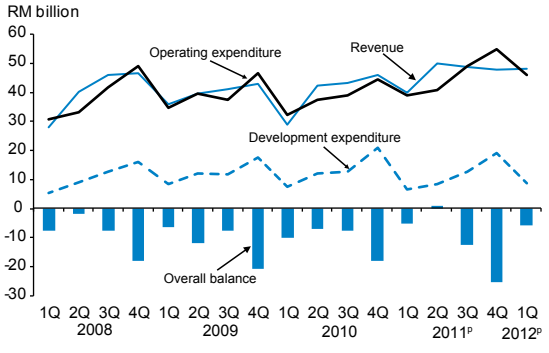
Federal Government Finance[p]

	2011			2012
	1Q	4Q	Year	1Q
	RM billion			
Revenue	39.8	47.7	185.4	47.9
% growth	*38.4*	*4.0*	*16.1*	*20.4*
Operating expenditure	38.7	54.5	182.6	45.6
% growth	*21.2*	*23.6*	*20.4*	*18.0*
Current account	**1.1**	**-6.9**	**2.8**	**2.3**
% of GDP	***0.5***	***-3.0***	***0.3***	***1.0***
Gross development expenditure	6.4	19.1	46.4	8.5
% growth	*-12.0*	*-8.4*	*-12.1*	*32.3*
Overall balance	**-5.2**	**-25.4**	**-42.5**	**-5.8**
% of GDP	***-2.5***	***-11.1***	***-4.8***	***-2.6***
Memo item:				
Total gross expenditure	45.1	73.6	229.0	54.1
% growth	*15.0*	*13.4*	*12.0*	*20.0*
Total Federal Government debt (as at end-period)	430.2	456.1	456.1	470.8
% of GDP	*48.8*	*51.8*	*51.8*	*51.3*
Domestic debt	414.2	438.0	438.0	453.9
% of GDP	*47.0*	*49.7*	*49.7*	*49.4*
External debt	15.9	18.1	18.1	16.9
% of GDP	*1.8*	*2.1*	*2.1*	*1.8*

[p] Preliminary

Source: Ministry of Finance

Federal Government Finance



[p] Preliminary

Source: Ministry of Finance

MONETARY AND FINANCIAL DEVELOPMENTS

Interest rates remained stable

The Overnight Policy Rate (OPR) was left unchanged at 3.00% in the first quarter of 2012. At the prevailing level of the OPR, monetary conditions remain supportive of economic activity.

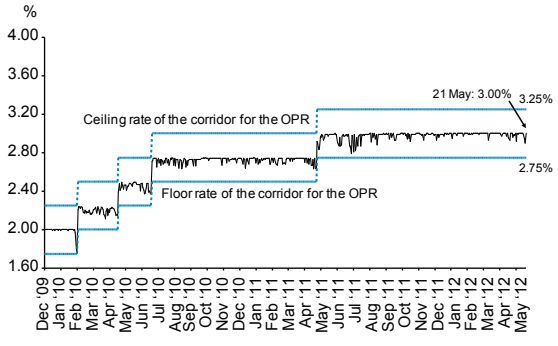
Reflecting the unchanged OPR, the average overnight interbank rate was stable during the quarter, moving within a narrow range of 2.95% to 3.00% during the period 3 January - 30 March 2012. Interbank rates of other short-term maturities were also relatively stable.

Rates on interest rate swaps and the 3-month KLIBOR futures, however, increased in the first quarter as markets revised their earlier expectations for an OPR reduction when confronted with the stronger-than-expected GDP growth in the fourth quarter of 2011, as well as improvements in the global economic and financial conditions.

Retail deposit rates remained stable during the quarter. The average quoted fixed deposit (FD) rates of commercial banks were relatively unchanged. As at end-March 2012, the average quoted FD rates for the 1 to 12 months tenures ranged between 2.93% and 3.21% respectively.

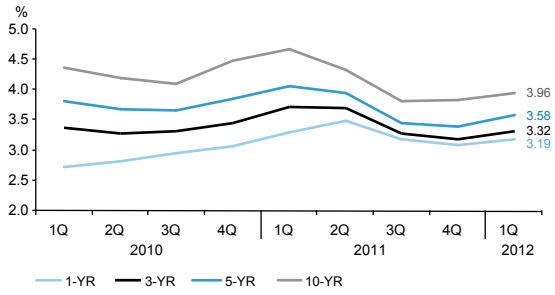
Borrowing costs were also stable in the first quarter. The average base lending rate (BLR) of commercial banks was unchanged at 6.53% throughout the period. The weighted average lending rate (ALR) on loans outstanding remained stable, standing at 5.62% as at end-March 2012 (end-December 2011: 5.65%). The cost of borrowing for businesses and households remained below pre-crisis levels.

Daily Weighted Average Overnight Interbank Rate



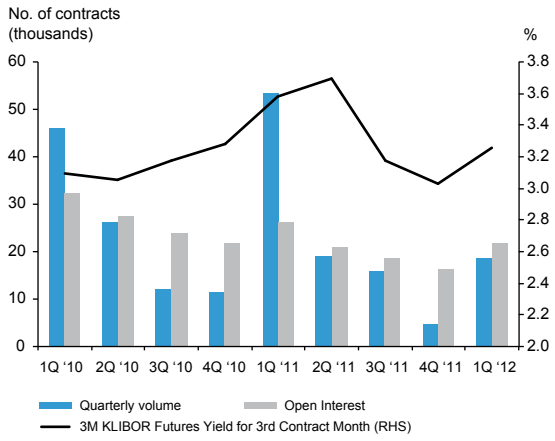
Source: Bank Negara Malaysia

Interest Rate Swap: Rates



Source: Bloomberg

3 Month KLIBOR Futures



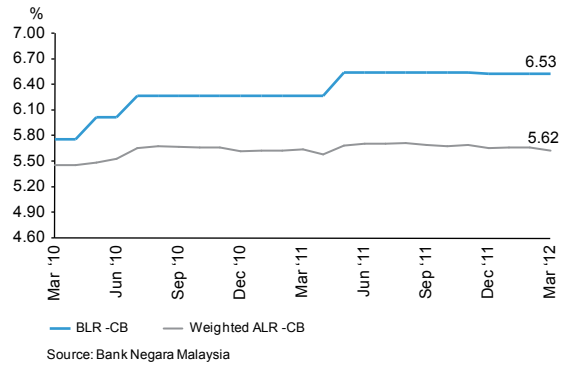
Source: Bursa Malaysia

Interest Rates

	2011		2012
	1Q	4Q	1Q
	At end-period (%)		
Overnight Policy Rate (OPR)	2.75	3.00	3.00
Interbank rates			
Overnight	2.74	2.99	3.00
1-month	2.79	3.05	3.06
Base lending rate (BLR)			
Commercial banks	6.27	6.53	6.53
Weighted average lending rate			
Commercial banks	5.64	5.65	5.62
Fixed deposit rates			
Commercial banks			
1-month	2.71	2.95	2.93
12-month	2.98	3.22	3.21

Source: Bank Negara Malaysia

Lending Rates of Commercial Banks (At end-period)



Source: Bank Negara Malaysia

M3 continued to expand

The monetary aggregates continued to grow in the first quarter of 2012. M1, or narrow money, increased by RM13.3 billion. On an annual basis, M1 expanded by 13.2% as at end-March (end-December 11: 15.1%). M3, or broad money, increased by RM38.8 billion on a quarter-on-quarter basis to record an annual growth rate of 15% as at end-March 2012 (end-December 11: 14.4%).

The increase in M3 reflected the continued extension of credit to the private sector, in line with the sustained pace of economic activity. The increase in net capital inflows, which had an expansionary impact on M3, was reflected in the rise in net foreign assets of the banking system. Nevertheless, the expansion in M3 was partially offset by a drawdown of deposits by the private sector for the purchase of securities issued by the Government.

During the quarter, the higher banking system liquidity from capital inflows was sterilised by Bank Negara Malaysia through the use of various instruments.

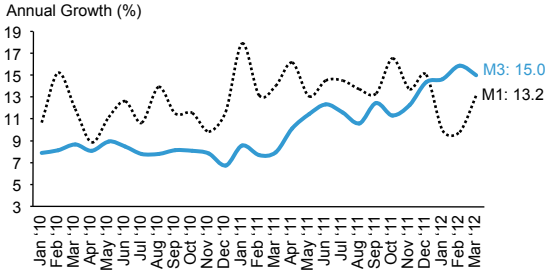
Determinants of Broad Money, M3

	Change during the period			
	2011			2012
	1Q	4Q	Year	1Q
	RM billion			
M3	**28.0**	**55.2**	**156.3**	**38.8**
Net claims on Govt	-3.7	-7.3	-12.0	-4.9
Claims on private sector	22.8	35.7	116.4	23.1
Loans	*26.5*	*33.4*	*111.8*	*18.4*
Securities	*-3.7*	*2.2*	*4.6*	*4.7*
Net foreign assets[1]	25.2	7.5	95.8	17.2
BNM	*15.7*	*11.2*	*87.0*	*0.4*
Banking System	*9.5*	*-3.8*	*8.8*	*16.8*
Other influences	-16.3	19.3	-43.9	3.3

[1] Pre-revaluation

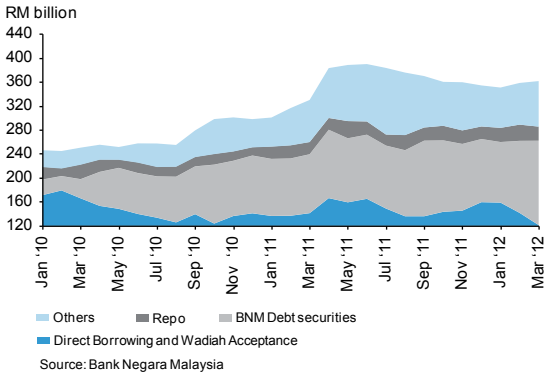
Source: Bank Negara Malaysia

Monetary Aggregates



Source: Bank Negara Malaysia

Outstanding Liquidity Placed with Bank Negara Malaysia (At end-period, RM billion)



Source: Bank Negara Malaysia

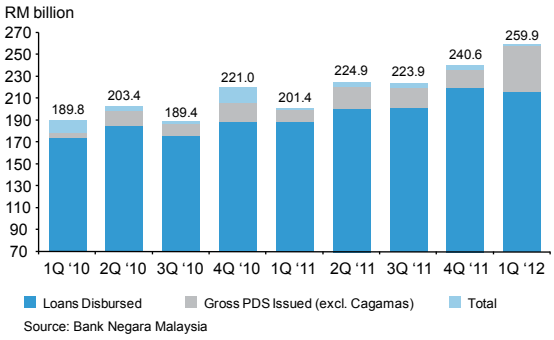
Private sector financing activity strengthened

In the first quarter, financing conditions remained supportive of economic activity. Total gross financing raised by the private sector through the banking system and the capital market increased to RM259.9 billion (4Q 11: RM240.6 billion). The higher financing was attributable mainly to the increase in net private debt securities (PDS) issuances. On a net basis, banking system loans and PDS outstanding expanded at an annual growth rate of 13.3% as at end-March 2012 (4Q 11: 12.5%).

In the business sector, while loans outstanding from the banking system moderated slightly due to large repayments during the quarter, loans disbursed to businesses remained high. The bulk of the loans were disbursed to finance working capital in the *wholesale and retail, restaurants and hotels; finance, insurance and business services* and *electricity, gas and water supply* sectors. Demand for new financing by businesses increased with higher loan applications mainly from the *transport, storage and communication; real estate; finance, insurance and business services* and *wholesale and retail, restaurants and hotels* sectors. On an annual basis, business loans outstanding expanded at a growth rate of 10.8% at end-March (end-December 11: 13.5%).

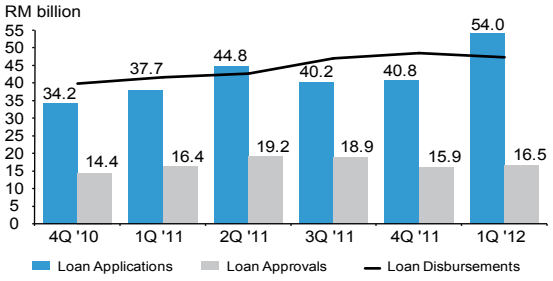
Financing to the household sector expanded more moderately by RM11.9 billion to increase at an annual growth rate of 11.9% at end-March (4Q 11: by RM17.7 billion or 12.9%).

Gross Private Sector Financing through Banking System and Capital Market



Source: Bank Negara Malaysia

Bank Lending to SMEs



Source: Bank Negara Malaysia

Financing of the Private Sector through Banking System and Capital Market

	During the period (RM billion)				Annual growth (%)			
	2011			2012	2011			2012
	1Q	4Q	2011	1Q	1Q	4Q	2011	1Q
Gross total financing	**201.4**	**240.6**	**890.8**	**259.9**	**6.1**	**8.9**	**10.8**	**29.1**
Loans disbursed*	188.6	219.7	811.3	216.7	8.2	16.3	12.0	14.9
Gross PDS (excl. Cagamas)	11.6	17.1	66.9	41.9	161.3	-2.1	42.6	260.6
Equity	1.1	3.8	12.6	1.3	-89.9	-73.9	-60.7	20.7
Net total financing (A)+(B)	**32.8**	**32.1**	**147.4**	**45.8**	**12.1**	**12.5**	**12.5**	**13.3**
Banking system	25.9	31.7	122.5	25.0	12.4	12.9	12.9	12.5
Loans outstanding (A)	*28.8*	*31.2*	*120.2*	*19.7*	*13.2*	*13.6*	*13.6*	*12.2*
Holding of PDS	*-2.8*	*0.5*	*2.2*	*5.3*	*2.1*	*3.6*	*3.6*	*17.3*
PDS outstanding (B)	4.0	0.8	27.2	26.1	8.7	9.3	9.3	16.5
Memorandum item								
Gross PDS (incl. Cagamas)	12.2	18.3	69.6	44.8	161.3	-5.2	33.4	266.5

*Banking systems loans include loans sold to Cagamas

Source: Bank Negara Malaysia

Loan Indicators

	During the period (RM billion)				Annual growth (%)			
	2011			2012	2011			2012
	1Q	4Q	2011	1Q	1Q	4Q	2011	1Q
Total								
Loan applications	168.5	192.3	745.4	195.4	26.8	10.9	16.2	16.0
Loan approvals	87.6	104.0	400.3	89.8	25.0	13.4	16.6	2.4
Loan disbursements	188.6	219.7	811.3	216.7	8.2	16.3	12.0	14.9
Loan repayments	168.1	195.5	725.6	205.5	8.8	16.5	11.8	22.2
Change in loans outstanding*	28.8	31.2	120.2	19.7	13.2	13.6	13.6	12.2
Of which:								
Business enterprises**								
Loan applications	79.6	95.7	357.9	105.3	32.6	16.6	19.9	32.3
Loan approvals	38.9	52.5	193.3	45.3	32.8	20.8	21.3	16.5
Loan disbursements	122.1	150.8	543.5	152.5	4.2	21.1	12.5	24.9
Loan repayments	109.8	137.8	494.7	146.0	4.3	21.9	11.6	32.9
Change in loans outstanding*	11.3	13.2	44.8	3.6	10.9	13.5	13.5	10.8
SMEs**								
Loan applications	37.7	40.8	163.4	54.3	35.0	19.3	27.3	44.0
Loan approvals	16.4	15.9	70.4	16.5	27.3	10.8	21.8	0.4
Loan disbursements	41.6	48.5	179.9	47.3	17.3	21.9	22.3	13.7
Loan repayments	37.2	43.9	159.7	46.1	11.4	17.2	16.4	23.7
Change in loans outstanding*	3.4	8.2	24.8	4.8	2.4	19.3	19.3	19.9
Large corporations								
Loan applications	41.9	54.9	194.5	51.0	30.5	14.6	14.3	21.7
Loan approvals	22.4	36.6	122.9	28.8	37.1	25.8	21.1	28.3
Loan disbursements	80.4	102.3	363.6	105.1	-1.5	20.7	8.2	30.7
Loan repayments	72.6	94.0	335.0	99.9	1.1	24.3	9.5	37.6
Change in loans outstanding*	7.9	5.0	20.0	-1.2	17.0	9.8	9.8	5.1
Households								
Loan applications	88.9	96.7	387.5	90.2	22.0	5.8	13.0	1.4
Loan approvals	48.8	51.5	207.0	44.5	19.4	6.7	12.4	-8.8
Loan disbursements	66.6	68.9	267.7	64.2	16.4	7.1	10.9	-3.5
Loan repayments	58.3	57.7	231.0	59.5	18.4	5.2	12.0	2.1
Change in loans outstanding*	14.8	17.7	63.1	11.9	13.2	12.9	12.9	11.9

* The annual growth is for end-period.
** Include loans to individual businesses.

Source: Bank Negara Malaysia

Fund raising activity in the capital market rose significantly

Net funds raised in the capital market increased to RM43.5 billion during the quarter (4Q 11: RM19.4 billion). The bulk of funds were raised by the private sector, particularly through the issuance of private debt securities (PDS). New PDS issuances increased significantly to RM44.8 billion (4Q 11: RM17.4 billion), due mainly to a single large debt issuance to finance a merger and acquisition. Funds raised from the equity market, however, declined to RM1.3 billion. Funds were mainly raised through rights issues (RM0.8 billion), while the rest was raised via initial public offerings and private placements or restricted offers-for-sale. After adjusting for redemptions, net funds raised by the private sector in the capital market amounted to RM29.8 billion (4Q 11: 3.5 billion).

In the public sector, net funds raised amounted to RM13.7 billion (4Q 11: RM15.9 billion).

Funds were raised through the new issuance of 10.5-year and 15-year Malaysian Government Securities (MGS), 3.5-year, 5.5-year and 7.5-year Government Investment Issue (GII), and the re-opening of the 7-year MGS.

Net Funds Raised in the Capital Market

	2011			2012
	1Q	4Q	Year	1Q
	RM billion			
By Public Sector	**24.6**	**15.9**	**45.6**	**13.7**
Government securities, *net*	24.6	15.9	47.1	15.6
Malaysian Government Securities	*15.1*	*12.9*	*58.8*	*12.8*
Government Investment Issues	*9.5*	*6.1*	*36.4*	*12.0*
Less: Redemptions	-	*3.1*	*48.1*	9.2
Khazanah Bonds, *net*	-	-	-	-
Savings Bonds, *net*	(0.1)	(0.0)	(1.6)	(1.9)
By Private Sector	**5.1**	**3.5**	**37.1**	**29.8**
Shares	1.1	3.8	12.6	1.3
Debt securities, *net*	4.0	(0.3)	24.5	28.5
Private Debt Securities	*12.2*	*17.4*	*69.6*	*44.8*
Less: Redemptions	*8.2*	*17.7*	*45.1*	*16.3*
Total	**29.7**	**19.4**	**82.7**	**43.5**

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

Source: Bank Negara Malaysia and Bursa Malaysia

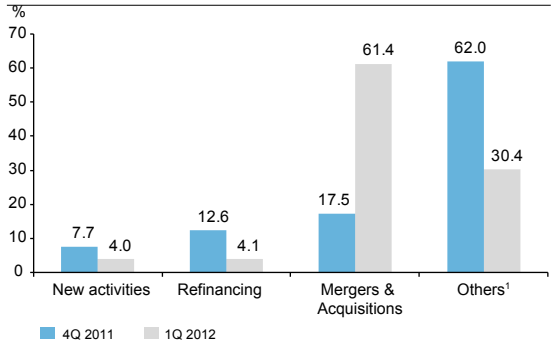
Loans by Sector

	Loans disbursed					Loans out-standing
	During the period				Share of total	Share of total
	1Q 11	4Q 11	2011	1Q 12		
	(RM billion)				(%)	
Business enterprises	**122.1**	**150.8**	**543.5**	**152.5**	**70.4**	**44.8**
Large corporations	*80.4*	*102.3*	*363.6*	*105.1*	*48.5*	*29.4*
*SMEs**	*41.6*	*48.5*	*179.9*	*47.3*	*21.8*	*15.4*
Selected sectors						
Agriculture, hunting, forestry and fishing	5.6	6.1	22.9	5.7	2.6	2.2
Mining and quarrying	1.1	1.3	5.1	1.4	0.6	0.5
Manufacturing	41.2	47.4	175.6	46.3	21.3	9.0
Construction	10.3	14.0	45.1	11.9	5.5	3.9
Real estate	6.4	9.6	33.3	8.0	3.7	5.3
Electricity, gas and water supply	1.5	1.4	5.6	1.7	0.8	1.0
Wholesale, retail, restaurants and hotels	30.8	38.0	139.7	44.1	20.3	7.3
Transport, storage and communication	4.4	6.4	19.7	4.6	2.1	2.8
Finance, insurance and business services	14.9	16.4	63.0	21.5	9.9	7.3
Households	**66.6**	**68.9**	**267.7**	**64.2**	**29.6**	**55.2**
Purchase of residential properties	15.0	17.0	64.5	16.4	7.6	25.8
Consumption credit	40.1	41.6	162.9	37.1	17.1	19.5
Of which:						
Credit cards	*23.3*	*23.6*	*93.7*	*21.4*	9.9	3.1
Purchase of passenger cars	*8.9*	*9.3*	*35.7*	*8.6*	*4.0*	*11.4*
Others	11.4	10.3	40.3	10.7	*4.9*	*9.8*
Total	**188.6**	**219.7**	**811.3**	**216.7**	**100.0**	**100.0**

*Include loans to individual businesses.

Source: Bank Negara Malaysia

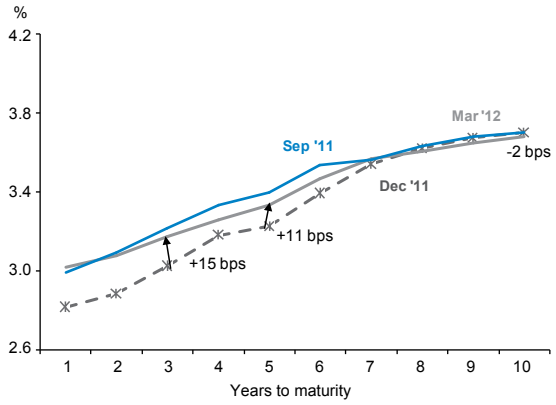
Private Debt Securities Issued by Purpose (% of total)



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

Source: Bank Negara Malaysia

Trend in MGS Yields



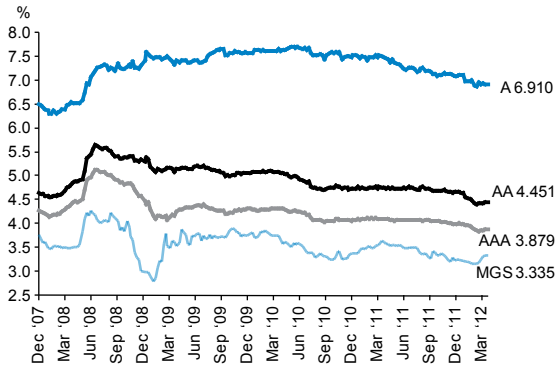
Source: Bank Negara Malaysia

The benchmark yield curve flattened

In the first quarter, MGS yields were influenced by market expectations of an adjustment in the policy rate amid an uncertain global growth environment. In the first six weeks of the year, MGS yields declined as investors priced in a reduction in the policy rate due to a possible softening of the global economic recovery. From mid-February to end-March, yields increased on account of reduced expectations of a cut in the policy rate due to tentative signs of improvement in global growth prospects. Overall, the benchmark 3-year and 5-year MGS recorded an increase of 15 and 11 basis points respectively, while the 10-year MGS recorded a decline of 2 basis points.

Corporate bond yields recorded a decline at the beginning of the first quarter, in line with MGS yields but stabilised between mid-February to March. The 5-year AAA, AA and A-rated papers declined by 11, 20 and 20 basis points respectively.

5-year MGS and 5-year Corporate Bond Yield

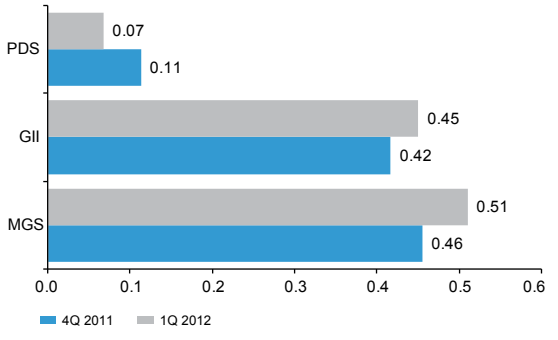


Source: Bank Negara Malaysia

Secondary trading in the bond market increased

Total trading in the secondary market increased to RM220 billion during the quarter (4Q 11: RM209 billion). The improved liquidity conditions were evident in both the MGS and GII segments, which registered higher liquidity ratios of 0.51 and 0.45 respectively. The PDS segment, however, registered a marginally lower liquidity ratio of 0.07.

Liquidity Ratio: Turnover / Outstanding



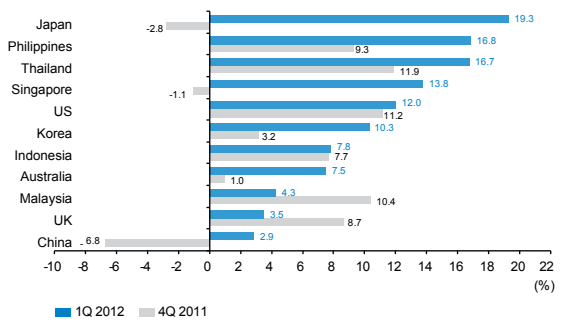
Source: Bank Negara Malaysia

KLCI continued its upward trend

The FBM (FTSE Bursa Malaysia) KLCI rose by 65.6 points, ending the first quarter at 1596.3 (end-December 11: 1530.7), in line with the trends in global and regional markets. The index increased by 4.3% (4Q 2011: 10.4%), reflecting the positive developments made in addressing the European sovereign debt crisis and encouraging economic data releases from the US, which contributed to improving investor confidence. As a result, market capitalisation increased to RM1.36 trillion at end-March 2012 (end-December 2011: RM1.28 trillion), while the daily average turnover increased to 2.02 billion units (4Q 11: 1.62 billion units) during the quarter. Open interest in the FBM KLCI futures increased to 29,962 contracts as at end-1Q 2012 (4Q 2011: 23,505).

On 21 May 2012, the KLCI ended lower at 1538.9 points (since end-March 2012: -3.60%), with market capitalisation of RM1.29 trillion (since end-March 2012: -5.10%).

Performance of Selected Global and Regional Markets in 2012 (% growth QoQ)



Source: Bloomberg and Bank Negara Malaysia calculations

Ringgit strengthened against regional and most major currencies

The appreciating trend of the ringgit against the US dollar in the final quarter of 2011 continued into the first two months of 2012, following better-than-expected economic data from Asia and the US, and progress in tackling the European sovereign debt crisis, resulting in increased investors' optimism and interest for financial assets in the region. This upward trend, however, was partially mitigated by some withdrawal of funds from the region by international investors in March in reaction to weak data releases in Asia. For the quarter as a

Bursa Malaysia: Selected Market Indicators

	2011			2012
	As at end			
	Mar	Dec	Year	Mar
Price Indices				
Composite	1,545.1	1,530.7	1,530.7	1,596.3
FBMEMAS[1]	10,612.5	10,489.1	10,489.1	10,939.6
ACE Market[2]	4,333.5	4,068.6	4,068.6	4,583.8
Market capitalisation (RM billion)	1,311.0	1,284.5	1,284.5	1,355.4
No. of companies listed	954	941	941	939
	During the quarter			
	1Q	4Q	Year	1Q
Average daily turnover				
Volume (million units)	1,730.1	1,615.5	1,343.8	2,019.9
Value (RM million)	2,233.9	1,411.7	1,566.1	1,977.8

[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

	2011						2012	
	1Q		4Q		Year		1Q	
	Billion units	RM billion	Billion units	RM billion	Billion units	RM billion	Billion units	RM billion
Turnover	102.1	131.8	98.5	86.1	329.2	438.2	119.2	116.4
Of which:								
Main Board	84.1	128.4	68.3	81.6	249.3	424.5	75.6	109.5
Of which								
Consumer Products	4.0	5.4	8.1	6.0	19.1	21.3	9.4	7.8
Industrial Products	18.8	21.2	14.6	10.7	51.8	60.5	13.3	16.7
Construction	4.6	9.0	2.7	4.1	13.5	25.1	2.8	4.9
Trading/Services	33.5	46.2	20.1	28.2	86.4	153.4	29.4	39.9
Finance	4.4	24.6	6.0	15.5	20.9	92.1	4.0	19.8
Properties	12.8	9.6	8.4	6.7	34.3	31.4	7.8	6.5
Plantations	2.4	8.2	2.0	4.9	7.4	23.9	1.7	5.8
Infrastructure	1.1	2.4	1.3	2.6	4.0	9.3	2.0	3.4
ACE Market[1]	8.3	1.2	18.7	2.7	47.7	7.5	27.7	4.3

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

Source: Bursa Malaysia

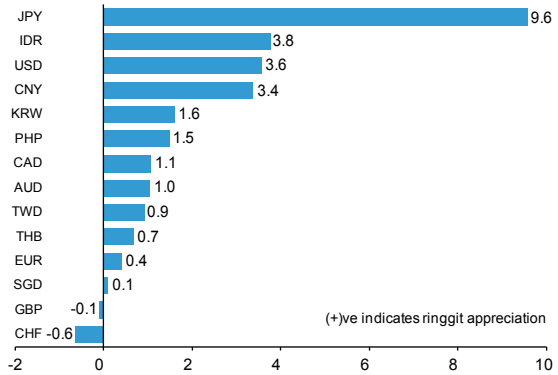
whole, the ringgit appreciated by 3.6% against the US dollar. Against other major currencies, the ringgit appreciated against the Japanese yen (9.6%) and the euro (0.4%), but depreciated marginally against the pound sterling (-0.1%). Against regional currencies, the ringgit strengthened in the range of 0.1% and 3.8%.

During the period of 1 April to 21 May 2012, the ringgit appreciated against the euro (2.3%), but depreciated against the Japanese yen (-5.4%), the US dollar (-2.0%) and the pound sterling (-1.1%). Against regional currencies, the ringgit appreciated against the Korean won (0.7%), but depreciated against the Thai baht, Singapore dollar, Indonesian rupiah, Philippine peso and Chinese renminbi by between -0.6% and -1.6%.

Volume of foreign exchange swaps and forwards continued to rise

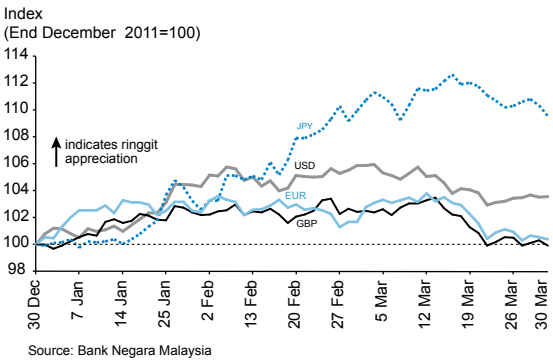
Volume of foreign exchange swaps and forwards rose by 1.9% during the quarter. The rise was mainly driven by hedging activities by local exporters, proactively managing their foreign currency exposure through forward selling of the US dollar, given the anticipation of a stronger ringgit. The growing optimism in the financial market also led to lower costs in the regional and domestic dollar funding markets. Against this backdrop, the 5-year USD/RM cross-currency swap points narrowed by half, from 240bps in Q4 2011 to 125bps in March.

Summary of Ringgit Performance Against Selected Currencies Percent Change (1 January- 31 March 2012)



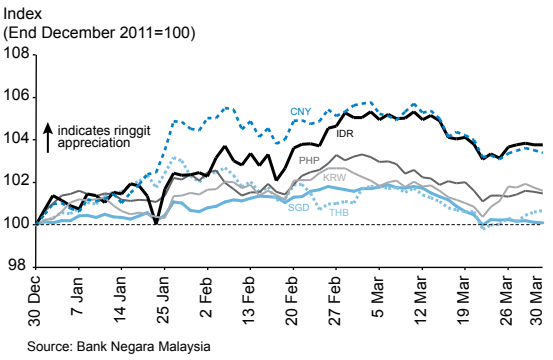
Source: Bank Negara Malaysia

Ringgit Performance Against Major Currencies



Source: Bank Negara Malaysia

Ringgit Performance Against Regional Currencies



Source: Bank Negara Malaysia

Performance of Ringgit Against Selected Currencies

RM per foreign currency	As at end				% change since*		
	21 Jul 05	1Q 11	4Q 11	1Q 12	21 Jul 05	1Q 11	4Q 11
US dollar	3.8000	3.0259	3.1770	3.0680	23.9	-1.4	3.6
Euro	4.6212	4.2762	4.1118	4.0955	12.8	4.4	0.4
Pound sterling	6.6270	4.8687	4.8962	4.9008	35.2	-0.7	-0.1
100 Japanese yen	3.3745	3.6602	4.0975	3.7396	-9.8	-2.1	9.6
Singapore dollar	2.2570	2.3994	2.4427	2.4405	-7.5	-1.7	0.1
100 Thai baht	9.0681	9.9947	10.009	9.9433	-8.8	0.5	0.7
100 Philippine peso	6.8131	6.9637	7.2468	7.1407	-4.6	-2.5	1.5
100 Indonesian rupiah	0.0386	0.0347	0.0347	0.0334	15.7	4.0	3.8
100 Korean won	0.3665	0.2747	0.2746	0.2702	35.6	1.7	1.6
Chinese renminbi	0.4591	0.4617	0.5034	0.4870	-5.7	-5.2	3.4

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

Source: Bank Negara Malaysia

MANAGING RISKS TO FINANCIAL STABILITY

Financial stability continued to be preserved

Financial stability was maintained throughout the first quarter of the year. This was underpinned by sound financial institutions and orderly financial market conditions. The continued effective functioning of financial intermediation has provided a supportive environment for economic activity. Confidence in the financial system was also preserved.

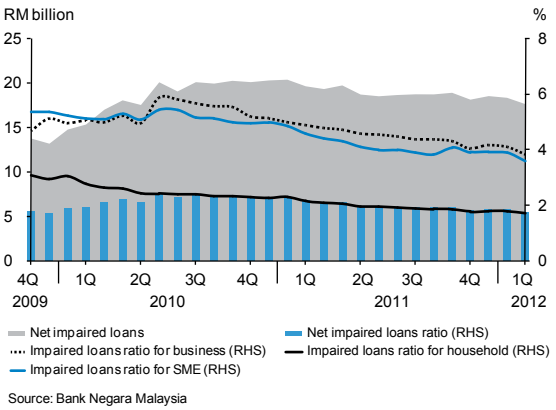
The overall quality of credit exposures of the financial sector remained manageable, further supported by the sound economic fundamentals. Both impaired loans and loans-in-arrears (for duration of one to less than three months) improved in terms of value and ratio. As at end-March 2012, loan impairment and loans-in-arrears ratios were at 1.7% of net loans (4Q 11: 1.8%), or 3.5% of gross loans (4Q 11: 3.6%) respectively. Credit risk exposures of the insurance industry, emanating mainly from holdings of private debt securities, were similarly maintained at a manageable level with exposures at 3.4% of insurers' total capital (4Q 11: 3.2% of total capital).

Growth in household indebtedness continued to moderate to 0.4% during the quarter (4Q 11: 3.2%). Financing for the purchase of residential properties grew by 3.4% (4Q 11: 3.2%), whilst outstanding credit card balances declined during the quarter. The household sector continued to exhibit the ability to meet its debt obligations, with the overall impaired loans ratio for the household sector improving marginally to 1.7% during the quarter (4Q 11: 1.8%).

Credit extended to businesses expanded by 0.9% during the quarter, with broad-based expansion in financing across business sectors. Credit risk for this portfolio remained manageable with the risk of delinquency, as measured by the expected default frequency, improving further to 0.53% (4Q 11: 0.68%), supported by the sustained debt servicing capacity of businesses. During the quarter, the level of loan impairment for the business segment improved to 3.8% of gross business loans (4Q 11: 4.1%).

The overall level of global financial market volatility improved during the first quarter as significant actions taken by the European policymakers led to some improvement in global market sentiments. On the domestic front, the financial markets remained orderly and exhibited ample capacity to intermediate the portfolio flows. Trading liquidity in the debt and equity markets remained intact, as reflected in higher turnover ratios and relatively stable bid-ask spreads. Interest rate risk exposures remained stable at 4.9% of capital base for the banking system while that of the insurance sector accounted for 3.1% of capital base (4Q 11: 3.8%). The banking system exposures to equity risk remained well-contained at 0.9% of capital base (4Q 11: 0.9%), while exposures of insurers increased slightly to 7.0% (4Q 11: 6.8%) of capital base following higher investments in equity amounting to RM31.3 billion (4Q 11: RM29 billion).

Banking System: Asset quality

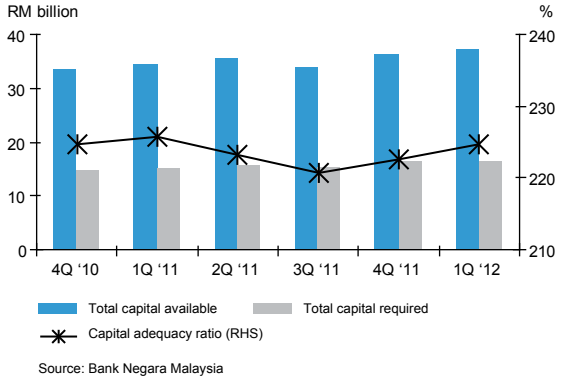


Source: Bank Negara Malaysia

The financial sector remained resilient

The financial sector continued to be well-capitalised with strong financial buffers to withstand potential losses from possible adverse financial and economic conditions. Core capital ratio and risk-weighted capital ratio of the banking system remained firm at 13.0% (4Q 11: 13.6%) and 14.7% (4Q 11: 15.6%) respectively. Approximately 88.7% of total capital is made up of high quality Tier-1 capital, comprising paid-up capital and reserves. Capital in excess of the minimum 8% regulatory requirement remained high at RM71.6 billion. Similarly, the insurance sector also maintained a sound capital adequacy ratio of 224.8% (4Q 11: 222.5%) and excess capital buffer of RM20.8 billion.

Insurance Sector: Capitalisation

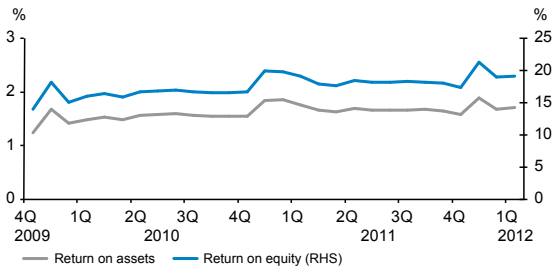


Source: Bank Negara Malaysia

The banking system recorded pre-tax profit totalling RM7.7 billion for the quarter (4Q 11: RM5.9 billion), attributable mainly to the higher income from financing activities and fee-based income, which partly offset the increase in overhead costs. Returns on assets and equity were 1.7% (4Q 11: 1.6%) and 19.1% (4Q 11: 17.4%) respectively.

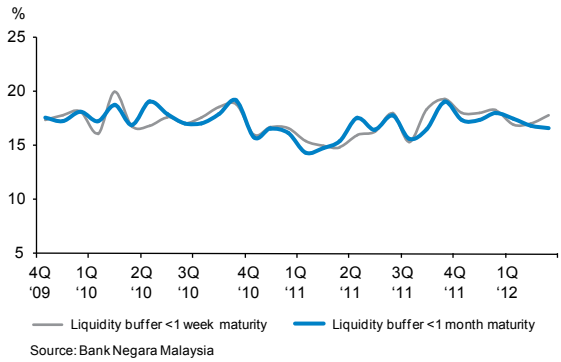
The life insurance and family takaful businesses recorded an excess of income over outgo of RM4 billion (4Q 11: RM4.3 billion). The lower amount of net premiums for ordinary life and investment-linked products was partly offset by higher capital gains arising from improved financial market conditions. The general insurers and general takaful operators registered a higher level of underwriting and operating profit totalling RM317.9 million and RM653 million respectively (4Q 11: underwriting loss of RM242 million and operating profit of RM143.2 million, respectively) following moderation in claims. The claims ratio for the Motor 'Act' cover (mandatory insurance cover required under the Road Transport Act 1987) improved to 182.7% (4Q 11: 321.4%).

Banking System: Profitability



Source: Bank Negara Malaysia

Banking System: Liquidity Buffer to Total Deposit Ratio



Source: Bank Negara Malaysia

Banking sector resilience was further reinforced by the sustained availability of ample liquidity to meet demands for deposit withdrawals and other liquidity obligations. Liquidity buffer accounted for 18% of total deposits for liquidity needs maturing within one month. The foreign currency liquidity mismatch of banks remained manageable, recording a small negative position in the less than one month bucket of RM11.5 billion, in tandem with some easing in on-shore USD liquidity.

Insurance and Takaful Sectors: Indicators

	2011			2012	2011			2012
	1Q	4Q	Year	1Q	1Q	4Q	Year	1Q
	RM million				Annual Change (%)			
Life insurance & family takaful								
Excess of income over outgo	3,238.5	4,342.9	12,662.2	3,964.2	11.4	37.8	-9.4	22.4
General insurance & general takaful								
Operating profit	553.9	143.2	1,776.9	653.0	5.6	-74.6	-20.9	17.9
Claims ratio (%)	61.5	66.7	66.7	60.5	-1.3	4.6	4.6	-1.0

Source: Bank Negara Malaysia

13th Annual Conference of Fixed Income, Money Market and Derivatives Association of India (FIMMDA) and Primary Dealers Association of India (PDAI) Kuala Lumpur, 27 January 2012

Keynote Adress by

Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz
Governor, Bank Negara Malaysia

It has been more than half a decade since the beginning of the global financial crisis, and its ramifications continue to reverberate across the world. Currently, the global financial and economic landscape continues to be confronted with stress and uncertainty, stemming from the prevailing structural weaknesses, deleveraging of the private financial and non-financial sectors, and the escalating strains in public finances in the advanced economies. Despite these significant near-term challenges, the fundamental global economic and financial transformation that commenced prior to the crisis has continued unabated. A new global economy is emerging. The rise in significance of the emerging economies is resulting in a fundamental realignment in the global landscape as the balance of global economic strength shifts to the emerging economies, with its consequent implications on long-term global economic and financial flows. With the rapid growth in domestic demand, reinforced by the vast productive investment opportunities within and across the emerging economies, it is projected that the emerging world will account for 60 percent of total world output by 2030, higher by 20 percent from its current level.

It is my pleasure to welcome you to Malaysia for this 13th Annual Conference that is being organised by the Fixed Income, Money Market and Derivatives Association of India and the Primary Dealers Association of India. We are most pleased to host this conference here in Kuala Lumpur. The theme of this conference, "Asian Money, Bonds and Derivatives in the New Global Economy", is a relevant topic to be discussed in this period of transition to an increasingly multipolar world, in which Asia together with other emerging regions will have an increasingly more important role.

Asia's Potential and Regional Integration

While this recent global financial crisis has provided us with challenges, it has also seen the resilience of Asia in weathering a number of major shocks in the international financial markets. Asian financial systems have demonstrated the capacity to continue to function and to meet the demands of its significant investment requirements. Moreover, the trend towards greater regional financial integration will provide for a more effective and efficient channeling of the sizeable surplus funds to such activities within the region. This increased intra-regional economic and financial activities is already taking place. The economic integration is supported by the strong demand from the growing middle class Asian population, which is projected to reach 3.3 billion by 2030. The intra-regional trade in Asia now represents more than 50 percent of total trade in the region, increasing from 32 percent in 1995. Intra-regional investment activities have also been on a rising trend.

With the strong economic fundamentals and the positive growth prospects of Asia, international and regional financial institutions are also now shifting their focus into the region. With the high savings rate in Asia, and of its massive requirement for infrastructure development, the region would benefit significantly from more effective and efficient intermediation of Asia's surplus funds. Indeed, intra-regional cross-border portfolio investments have already increased to 28 percent of total assets holdings in 2011 compared with 21 percent in 2001. The gains from greater regional financial integration will be far-reaching as it will not only bring about a more efficient allocation of resources in the

region but it will act as a catalyst for greater regional economic growth. Over the coming years, as growth experienced in the developed economies is expected to remain slow in the aftermath of the financial and debt crisis, the growth performance of Asia is expected to continue resulting in the region becoming a more important component of the global economy.

Asian funding markets have also remained highly accessible during this period with Asian names enjoying strong demand and attractive funding costs at a time when the developed countries funding markets have tightened. During this more challenging time, Asian sovereigns such as Indonesia, Philippines, Thailand, Sri Lanka, Vietnam and Malaysia continue to successfully tap the market and to issue bonds with tenure up to 30-years. In addition, as financial markets in Asia become more developed, the markets now have the capacity to transact large quantities with cost effective pricing. In 2011, Malaysia issued the first 10 year global sovereign USD Sukuk, with the issuance size of 2 billion, under an innovative Shariah principle of Wakala which recorded the lowest absolute yields achieved by an Asian sovereign for a new USD issuance. Another recent landmark issuance on the domestic front is by PLUS Berhad, the largest toll operator in Malaysia, with the issuance of a record size of RM30.6 billion programme, equivalent to USD9.7 billion, with maturities ranging from 5 years to 27 years.

The depth and breadth of Asian capital markets have drawn investors to expand their investment activities to this region. Even central banks, as traditionally conservative investors, are also venturing into investing part of their reserves, in each other's markets. Bank Negara Malaysia, has since 2003, gradually embarked on investments in regional markets. This includes investments in the Indian rupee market. As an approved Foreign Institutional Investor, we have also been able to actively participate in the Indian rupee market.

Progression in the Malaysian Financial Markets

Progressive efforts have been made to transform Malaysia's financial sector with a major dimension of the transformation involving achieving greater regional integration. Following a decade, institutional and financial infrastructure development that focused on enhancing domestic capacity of the financial sector while evolving a more competitive environment. We have the foundations to take our financial sector to a new level of development that will focus on new areas that will further strengthen the competitiveness and efficiency of the financial sector and its potential role in facilitating Malaysia's ongoing economic transformation and in strengthening our linkages in the region.

As Malaysia evolves and the new financial landscape emerges, one prominent area of focus is the development of deep, liquid and efficient financial markets in particular, the development of our domestic bond market. Malaysia's bond market has already grown to MYR867 billion or 105 percent of GDP in 2011, and has become one of the largest debt securities market in South East Asia which has now been liberalized to allow issuance by foreign corporation and in multiple currency. Our Islamic capital markets have also thrived, with a growing presence of international issuers and investors operating in both the ringgit and foreign currency sukuk markets in Malaysia. We have seen new innovative structures for sukuk issuances including a world's first issuance in Renminbi from Malaysia's own sovereign wealth fund, Khazanah Holdings. The money and foreign exchange markets also continue to grow in depth and liquidity. The volumes transacted in the domestic money market and the foreign exchange market have now reached RM23.5 trillion and RM9.21 trillion trades respectively. Participation in these markets have also broadened significantly with the growing presence of new issuers, banks, institutions and investors in general, including a growing presence of regional players.

In moving forward, measures will continue to be introduced to broaden further the participation of regional players in the domestic market through progressive liberalization of the foreign exchange administration rules and also the development of cross-border settlement infrastructures to enable more efficient and cost effective foreign currency trading and settlements.

Arrangements Supporting the Regional Integration Process

The region has more recently worked collectively towards establishing arrangements to support the economic and financial integration process. In particular, the ASEAN region has already benefited from the implementation of the ASEAN Free Trade Area (FTA), which was established to increase ASEAN's competitive edge as a production base in the world market through the elimination of trade barriers within ASEAN. This is now further strengthened with the implementation of the ASEAN Investment Area which was adopted to promote greater flows of capital, skilled labour and technology within the region. In the area of financial markets, the ASEAN Capital Markets Forum Blueprint is also working towards achieving significant progress in building a regionally integrated market. This vision encapsulates free movements of capital, freedom for issuers to raise capital anywhere and for investors to have access to investment avenues anywhere within the region. In such a market, investors would be able to trade in ASEAN capital market products freely in any ASEAN market at a competitive fee from a single access point, with capital market intermediaries being able to provide services throughout ASEAN. The strong cross-border linkages of an integrated ASEAN capital market provide vast business opportunities for countries to capitalize on the diverse comparative advantages in this region.

As an access point, Malaysia is well positioned to be one of the gateways for non-ASEAN countries, institutions and investors to participate in these markets. Malaysia has a facilitative environment with a strong regulatory and supervision to support business activities while safeguarding financial stability. In addition, there has also been the strengthening of bilateral economic and financial ties, which has become a prevalent theme across Asia. Supplementary to these affiliations, is also a strong trend to increase participation in Asia's enormous growth potential through affiliations in regional bodies. Within the ASEAN grouping, among the areas of priority is the deepening of cooperation to accelerate the role of the financial sector in supporting the realization of the ASEAN Economic Community by 2015.

Risk Mitigation as Asia Strives for Regional Integration

The events surrounding the recent European sovereign debt crisis provide us with many important lessons. While exposures to numerous financial markets bring about tremendous economical and financial benefits, it is not without risks. Financial integration between markets, if not well designed, can lead to costly financial implications. Hence, the path to integration can expect its associated challenges that will need to be addressed. In implementing institutional arrangements across the region, it can be expected that individual countries will have to balance national priorities while seeking to strengthen their place in the global market.

Asia has therefore adopted a different approach to regional integration. The effort towards integration is from the perspective of strengthening economic and business ties, complemented by strengthening the resilience and stability of the financial sector. Towards this, regional surveillance mechanisms are being put in place reinforced by financial support facilities and an integrated framework for crisis resolution. Various forums among regulators and central banks are already in place across most of Asia to collectively enhance crisis management. Such fora also serves as financial safety nets across the region to ensure that the financial institutions operating in this region will be able to withstand the destabilizing spill-over effects of a global financial crisis in an orderly manner. Malaysia is already implementing such arrangements, with swap agreements and cross border collateral arrangements that will serve as an alternative avenue for banks operating in Malaysia and the region to obtain liquidity for their efficient functioning including during challenging times. Bilateral arrangements that are now being entered into will allow for the acceptance of each others' currency and securities as collateral.

Strengthening economic and financial ties with India

The potential for collaboration between India and Malaysia is tremendous. Historic and cultural ties originate many years back and

form a strong foundation for the relations to be strengthened going forward. Currently, Malaysia's exports to India has amounted close to USD9 billion in 2011, equivalent to 4.1 percent of Malaysia's total exports, while the outstanding direct investments from India is now close to half a billion USD. The financial sector has an important role to be a catalyst to facilitate growth in such trade and investment activities between India and Malaysia. The establishment of our relationship has already begun with the issuance of a full commercial banking license to an Indian bank to operate here in Malaysia in 2010. A licence has also been granted to an Indian fund manager.

Rise of Islamic Finance in the New Global Economy

Another development in several emerging economies in Asia and the Middle East is the rapid growth of Islamic finance. An important development in this decade has been the growing significance of the international dimension of Islamic finance and its increased role in mobilising and channeling funds to productive investment activities across borders. Expanding steadily at a double digit pace of growth, total Islamic financial assets currently is estimated to be more than US$1 trillion. With more than 600 Islamic financial institutions now operating in more than 75 countries, countries from Asia, Middle East and Africa are increasingly participating in cross-border financial markets. In financing trade and investment activities, Islamic finance has influenced a new global pattern of trade and financial flows.

Islamic finance serves as an important channel for more efficient allocation of funds across borders and diversification of risks. It has facilitated stronger financial and economic ties between Asia and Middle East. The sukuk market in particular, has become an important avenue for international fund raising and investment activities that generate significant cross-border flows. The sukuk market has experienced tremendous growth in the recent few years from an outstanding amount of USD33 billion in 2006 to USD180 billion as at end 2011. Malaysia is now evolving to become a major multi-currency bond and sukuk market.

Important in this development are the initiatives that have been taken to strengthen the institutional and international infrastructure of Islamic finance. Most important is the emphasis being given to the development of the international financial infrastructure relating to financial stability. The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) was established in 1990 and in 2002, the Islamic Financial Services Board (IFSB) was established as the international prudential standard setting body for the Islamic finance industry in the areas of risk management, capital adequacy, governance, conduct of business and supervisory process. From ten members at its inception, the IFSB is now a 189 strong member institution comprising mainly regulatory and supervisory authorities.

A more recent initiative is the establishment of the Islamic Financial Stability Forum (IFSF) as a platform for greater engagement between the regulatory authorities in the Islamic financial system and promoting more effective cross-border cooperation.

Efforts now is focused on putting in place arrangements for enhancing liquidity management in the Islamic financial system. The International Islamic Liquidity Management Corporation (IILM) was therefore established in 2010 as a collaborative effort between 12 central banks and two multilateral organizations to facilitate effective liquidity management solutions through the periodic issuance of short-term Shariah-compliant financial instruments.

Let me now conclude my remarks. This decade has been a defining moment for Asia, characterized by rapid global expansion and increased internationalisation. Among the important trends are the significant actions taken by many emerging economies in Asia towards increased liberalisation as well initiatives toward strengthening of cross-border linkages. Moving forward, it is essential for us to continue to establish strong collaboration given the dynamic nature of the economies and financial markets today. As the new decade beckons the prospects for new opportunities, our ability to capitalize on these opportunities and realize its potential will be increasingly determined by our capability and capacity in building such strong and lasting regional and global linkages.

International Conference on "Asian Market Integration and Financial Innovation" Tokyo, 10 February 2012

Keynote Address by

Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz
Governor, Bank Negara Malaysia

The world economy and international financial system is entering into a new phase of globalisation. Far from having an effect of slowing the pace of globalisation, the recent global financial crisis has intensified the process, resulting in a more connected and interdependent world. While - previously - globalisation manifested itself in the form of trade and investment between the emerging and developed world, emerging economies are now becoming more connected with each other within and across regions. This trend is being reinforced by similar changes in the pattern of financial flows. While previously, financial flows were predominantly between the developed and emerging world, greater financial integration among the emerging economies is facilitating the intensification of this connectivity.

While unable to be in Tokyo, it is my pleasure to speak at this international conference on the topic of Asian Financial Integration. My remarks will touch on the main motivation for pursuing financial integration in Asia, despite the fact that its absence has not previously hindered economic integration in the region. Whilst Asia may draw lessons from the European experience, I will discuss the different approach that is being pursued in Asia. The growing internationalisation of Islamic finance is also contributing to strengthened economic and financial ties among emerging economies including in Asia and the Middle East. Finally, I will discuss the current global regulatory reform and its possible implications for regional financial integration in Asia.

The aspiration for greater economic and financial integration in Asia is to achieve greater shared prosperity that is mutually reinforcing for the economies in the region. Regional financial integration will achieve more efficient and effective intermediation of funds to enable at least some part of the surplus savings of the region to be channeled to productive investments in the region, and at lower costs with improved risk diversification. Improved access to financing would also support intra-regional trade while a more cohesive region will facilitate greater collaborative efforts on safeguarding financial stability. Collective actions would also enhance the ability to better manage and respond to risks to the region. And finally, as a cohesive group, our perspectives and position would be better represented in the governance structure and processes in the international financial system.

Approach of Financial Integration in Asia

Asia comprises a highly heterogeneous group of countries that are different in terms of economic structure, natural resources, degree of market orientation, stage of development, size and degree of openness. Asian economies have however, recognised the respective individual comparative advantages and have leveraged on the prevailing complementarities. Given the diverse nature of the region, it would be highly ambitious and challenging to achieve the necessary preconditions for achieving an integration that is similar to that in Europe.

The integration process in Europe was taken forward with the establishment of supranational institutions with mandates to promote common approaches and frameworks across the member states in the union. In contrast, Asia is adopting a more flexible approach. Regional financial integration in Asia has manifested itself mainly in the form of greater regional presence and participation in domestic financial systems. This is taking place with the gradual and sequenced liberalisation of the financial sector and the capital account.

Capital account liberalisation in particular is prompting increased intra-regional investment and portfolio flows which in turn contributes to the deepening of the financial markets.

By itself, the liberalisation of the financial sector and the capital account will however, not be sufficient to achieve regional financial integration. Most important, is the development of regional financial markets, the financial infrastructure including the regional payments and settlement systems, harmonising the financial standards and practices including the regulatory and supervisory regime and building the institutional capacity of the domestic financial intermediaries. For the ASEAN region, an agreement has already been reached to allow for different speeds of integration depending on the state of readiness of the respective member countries. This is being reinforced by arrangements for surveillance for assessments of risks to the region and regional frameworks for crisis management and resolution, including arrangements for mutual assistance. Equally important in this process is the cooperation and collaboration among regulatory authorities for sustaining regional financial stability. Much of this work has focused on putting in place strong and effective institutional arrangements to preserve regional financial stability.

In the decade following the Asian Financial Crisis, most of Asia has accelerated the pace of financial sector development and reforms. Several of the Asian economies have made significant strides in improving the soundness and efficiency of financial institutions and in developing domestic financial markets. At the regional level, key initiatives have included the development of the regional bond markets through the creation of various Asian Bond Funds and the ASEAN+3 Bond Market Initiatives, the regional arrangements for crisis management that includes liquidity support, and the collaborative efforts advanced under EMEAP to facilitate liquidity management for financial institutions operating in the region through Cross-Border Collateral Arrangements. Currently, while intra-regional cross-border portfolio investments within Asia is relatively small, it has already increased to 28 percent of total assets holdings in 2011 compared with 21 percent in 2001.

Another important development that has contributed to greater regional financial integration is the increasing role of Islamic finance in the international financial system. In its early stages of development, Islamic finance was highly domestic-centric in its orientation. This recent decade has seen the rapid internationalisation of Islamic finance resulting in significant growth in cross border financial flows. The development of Islamic financial markets, in particular, the sukuk market, the progressive financial sector liberalisation, and the establishment of international arrangements and institutions to safeguard financial stability, cumulatively have contributed to enhance the international dimension of the industry. There are now more than 600 Islamic financial institutions operating in more than 75 countries.

Given that Islamic financial transactions require an underlying economic transaction, it is a form of financial intermediation that is well anchored to serve the real economy. With its internationalisation, it has become an increasingly more important channel for the efficient allocation of financial resources across borders and for the diversification of risks. This new international dimension of Islamic finance has facilitated stronger financial ties between Asia and the Middle East. The sukuk market in particular has become an important avenue for international fund raising and investment activities that generate significant cross border flows.

While the efforts to put in place these pre-conditions will continue, equally important is the role of the private sector in driving the Asian regional financial integration agenda, particularly in building the institutional capability to effectively intermediate funds in the region. While foreign presence throughout our region facilitates this process, it needs to be complemented by strong domestic regional intermediaries whose operations would be more inclusive and thus increase the potential for balanced growth in our region.

Asia has demonstrated its resilience to the many shocks from the international financial markets and the global economy during this recent global financial crisis. As highly open economies, most economies

in Asia have been highly affected by these developments. Stronger domestic demand, greater intra-regional trade and investment, reinforced by resilient financial systems and strong macroeconomic fundamentals, have supported the economic performance of our region. There have been tremendous payoffs for the region from the decade long of financial reforms, institutional building and development of financial infrastructure. Despite the highly challenging environment of slower trade and volatile financial markets, financial intermediation in Asia has continued uninterrupted and financial markets, while more volatile, have remained orderly. It is thus on these strong foundations that the regional financial integration in Asia is not being set back. On the contrary, despite these global developments, the integration process has continued and regional financial cooperation and collaboration has strengthened, reinforced by the increased regional participation and presence of the private sector.

Global regulatory reforms

Let me now turn to the global regulatory reforms and its implications for Asia. The global regulatory response to the financial crisis is now moving into the implementation phase. At its core are the reforms to build a stronger global regulatory framework to significantly raise the level of resilience of the banking system. While that work has now been largely finalised, the complex task of implementing the new global capital and liquidity standards is just beginning. Indeed, this implementation is proceeding at a time of a difficult global financial and economic environment. Several countries have however, announced their timelines, with some that are moving faster and further than the Basel III standards.

Asia is in a relatively stronger position to transition to the new standards. We are, however, vigilant over the global economic and financial consequences of its implementation in other parts of the world. As open economies, we are not insulated from these consequences. While the work of the Basel Committee suggests that the effect of tightening conditions on economic growth will be modest, the highly dynamic global financial conditions imply that regulators will have to continue to proceed cautiously, and on a fully informed basis, in implementing the new standards. Of importance is the need to recognise the point beyond which the costs to the real economy exceed the desired benefits of greater systemic resilience.

The reform agenda has also focused on the fundamental and no less significant changes to institutional arrangements and market structures. Some of these, such as reforms involving the OTC derivatives markets and policy frameworks for systemically important financial institutions (SIFIs), are being advanced through global platforms, notably the Financial Stability Board (FSB). Other reforms, such as the structural changes to banking models that are being contemplated in the UK and the implementation of wide-ranging reforms under the Dodd-Frank Act in the US, although not being imposed outside these countries, are nevertheless charting a path forward that is likely to have wider ramifications, given the significant cross-border operations of affected institutions, including in Asia.

Like most jurisdictions, the options for central clearing for domestic OTC derivatives are also being examined. These reforms are already under way in the world's larger financial markets to meet the G20 mandate for standardised OTC derivatives transactions to be centrally cleared by the end of 2012. For smaller OTC derivatives markets in Asia, the effects on domestic market efficiency and stability are key considerations in contemplating a move towards central clearing arrangements. A key concern is the potential for the offshore central clearing of transactions in key domestic markets to increase the stability risks to the domestic financial system. There will also be limited scope for domestic regulatory authorities to have oversight on such offshore central counterparties (CCP) and to respond during periods of financial stress. Domestic central clearing arrangements, however, could have negative effects on efficiency and the functioning of the market, in particular for cross border transactions. In addition, fragmented clearing arrangements could reduce netting opportunities and collateral efficiencies, in turn raising costs to participants. There is also a need to close important information gaps on

the rules that will govern global CCPs, including the criteria for mutual recognition of CCPs and membership conditions, as well as details on the arrangements to mitigate the concentration of risk to the CCP itself or its members. These gaps are currently limiting a more complete assessment of domestic and regional options for central clearing.

The global reforms for the most part would contribute to the promotion of more consistent approaches to regulation which is an important precondition for greater financial integration in Asia. In a number of countries, the global reforms have had a role in accelerating further domestic priorities to strengthen financial resilience. Initiatives that are being advanced at the global level also work to strengthen regional financial stability arrangements. This includes putting in place more robust frameworks for the oversight of systemically important financial institutions at a regional level. Within Asia, a clear evolution of such frameworks can already be seen in the operationalisation of cross-border supervisory colleges for financial institutions with a significant regional presence. The reforms have further encouraged closer coordination and communication on financial stability developments between countries in the region. This has been borne out of common perspectives and challenges shared among countries in the region on the direction and impact of the reforms, and the need to bring forward the collective views of the region. These implications will further strengthen the foundations for regional financial integration in Asia.

Policy shifts and the proliferation of binding "one-size-fits-all" regulatory prescriptions however, goes against the grain of regulation that is proportionate to risk which has been a well established principle of sound regulation. There is therefore considerable risk to simply following new `trends' which may lead us down yet another potentially misguided path. In particular, the significant efforts made in the region over the recent decade to bolster financial sector efficiency and innovation, which in turn promotes financial integration, could be disproportionately curtailed.

In addition, it has only been recently that the global attention has also turned to enhancing supervisory intensity and effectiveness as an essential component of the financial reform effort. This is a welcome move and will add a critical dimension to the consideration of future reforms by national authorities. In Asia, financial reforms were already accompanied by a significantly strengthened supervisory approach and safety net arrangements, which served to check unfettered innovation and reckless risk-taking behaviours and promote strong incentives for prudent risk management. For these reasons, our banking systems have been resilient through the global financial crisis and have continued to remain strong since, despite continued risks in the global economy. As we contemplate the raft of reforms that will continue to occupy the global agenda in the next few years, our considerations should be to pursue domestic and regional solutions that will deliver a more resilient financial system without impairing the continuous provision of efficient financial services that are vital for our economies.

Let me conclude my remarks. While many challenges remain, Asia is at the cusp of experiencing significant collective economic growth and development. Asia should however significantly draw important lessons from the global financial crisis and recognise the implications of greater interdependence. In addition, the sovereign debt crisis in Europe relates not only to fiscal matters but to debt management which has significant implications for financial markets. While fiscal issues may remain a national matter, its financing and its broader consequences needs to be addressed. Given the positive environment in Asia, the opportunity needs to be taken to put in place the necessary arrangements to best address these challenges. The world is increasingly now looking towards Asia. With these enabling conditions, Asian economies would be better positioned to collectively strive and work towards achieving the shared vision of financial and economic integration that will not only unlock our potential but also enhance the prospects to contribute towards a more balanced and sustainable global economy.

EU-Malaysia Chambers of Commerce and Industry's (EUMCCI) Quarterly Financial Panel Discussion 2012 - "Islamic Finance: New Frontiers in Financing the Economy" Kuala Lumpur, 8 March 2012

Keynote Address by

Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz
Governor, Bank Negara Malaysia

In this new phase of globalisation in which economies and financial systems are increasingly becoming more interconnected, we are seeing the emergence of several new trends in trade and investment flows. While there has been a slower expansion in world trade and investment flows in the aftermath of the global financial crisis, cross-border trade and investment activities among emerging economies have been increasing significantly. Asia is very much part of this changing pattern in world trade and investment activity. In Asia, strong domestic demand, supported by resilient financial systems and well developed financial markets have well intermediated these international flows.

The most pressing challenge confronting the current global economy is to generate growth and employment. It is particularly important for the crisis-affected economies that growth resumes and is sustained, while addressing fiscal imbalances, public and private sector over-indebtedness and the financial sector impairment, the solutions to which will most likely result in slower growth. While supportive domestic policies will thus be necessary to support the growth, also important is the potential growth that can be gained from trade and investment with other parts of the world.

For the countries in the ASEAN region, the partnership with the EU region has expanded steadily over time, and has continued to evolve and strengthen. There is significant potential to expand such trade and investment links between both the EU and ASEAN regions. Global corporations, including the EU and ASEAN multinational corporations (MNCs), have contributed to maximising the mutual benefits from such relationships. In Malaysia there are currently more than a thousand multinational corporations from more than 30 countries. Many are from the EU region. Initiatives that continue to lower the barriers between our respective regions are also set to strengthen the growth of such strategic partnerships.

It is my pleasure to be here at this Quarterly Financial Panel Discussion, organised by the EU-Malaysia Chamber of Commerce and Industry, to speak on the role that Islamic finance might have on facilitating greater trade and investment between our regions. Islamic finance, which was previously domestic-centric, is now increasingly providing financial solutions for cross-border trade and investment. Progressive liberalisation has facilitated the internationalisation of Islamic finance. This has been reinforced by the dynamic pace of innovation in Islamic finance that has widened the range of financial products and services. Islamic finance has thus become an increasingly important channel for the efficient allocation of funds across borders and the diversification of risks.

Islamic Finance: Financial Solutions for International Business

Despite an increasingly more challenging environment, Islamic finance has continued to expand its potential as a sustainable and stable form of financial intermediation. Its emphasis on the close link between financial transactions and economic activity has positioned Islamic finance to be well-anchored to serve the real economy. The adoption of profit- and risk-sharing, transparency and disclosure, and the universal ethical values of fairness which is implicitly embedded in the Islamic financial system provides the internal checks and balances. Embraced in its entirety, it enhances the prospects for sustainable economic growth and financial stability.
The resilience of the Islamic financial system is

also further strengthened by the international prudential standards and best practices that have now been introduced. These include the standards issued by the Islamic Financial Services Board since 2002 in the areas of capital adequacy, risk management, governance, and the conduct of business and supervisory process. The industry is also guided by international accounting standards that have been developed by the Accounting and Auditing Organisation for Islamic Financial Institutions since its establishment in 1990. In enhancing liquidity management in the Islamic financial system, the International Islamic Liquidity Management Corporation (IILM), which was established in 2010, is putting in place the mechanism that will facilitate effective liquidity management solutions through the periodic issuance of short-term Shariah-compliant financial instruments.

As the Islamic financial system transitions to becoming more diversified and comprehensive, it provides the spectrum of financial solutions that meet the different needs of the economy. Such financing products offered in Islamic finance also include syndicated financing, equity financing and venture capital. There are also a wide range of investment and treasury instruments, as well as fund and wealth management products for the management of portfolios of businesses. In terms of takaful, there is also a broad range of products, including takaful coverage for physical properties and assets of businesses, as well as protection for employees.

The growing significance of the international dimension of Islamic finance in this recent decade has witnessed its increasing role in bridging economies through the mobilisation and channelling of funds to productive investment activities across borders. Despite the challenging global environment and the increased uncertainties, the Islamic finance industry has continued to experience the double digit growth of 21 percent, and total Shariah-compliant assets have surpassed the USD1 trillion mark. There are now more than 600 Islamic financial institutions operating in more than 75 countries in both Muslim and non-Muslim jurisdictions. The emergence of new financial centres in Asia and the Middle East and their increased connectivity has strengthened the foundations for intra- and inter-regional linkages in trade and investments.

More recently, Islamic finance is also being introduced in the EU region. The establishment of Islamic finance in key financial centres, namely London and Luxembourg, presents opportunities for businesses in the EU to raise funds using Islamic financial instruments such as the sukuk, and to diversify investment portfolios with Islamic fund and wealth management products. The development of Islamic finance has also been initiated in several other European economies. Malaysia has entered into a number of collaborative arrangements in the areas of talent development and expertise, business linkages, and infrastructure development. To date, Malaysia has signed Memorandums of Understanding in the area of Islamic finance with the UK, France and Luxembourg.

The now well-developed existing Islamic financial markets, including the sukuk and Islamic money markets, have been particularly instrumental in intermediating funds in the Islamic financial system. It is fast becoming an important platform for international fund raising and investment activities that are generating increased cross-border flows. From an outstanding amount of USD33 billion in 2006, the sukuk market has expanded to USD180 billion as at end-2011.

The sukuk market brings with it many attractive value propositions for both issuers and investors. A central merit of the sukuk structure is that it is based on underlying assets that have an income stream. This therefore discourages over-exposure of the financing facility beyond the value of the underlying asset, given that the issuer cannot leverage in excess of the asset value. In addition, with the requirement that the financing must be channelled towards productive purposes, the risk exposure in sukuk is therefore to the project and not to the uncertainties or activities that have no economic benefits. This element not only contributes towards financial stability, but also offers investors another asset class for investment.
The demand for sukuk currently exceeds the supply, as the high level of surplus savings in Asia and the Gulf region spurs the strong demand. Although the size of the market

may seem modest by global standards, the sukuk market has been registering an average annual growth of 40 percent. The growth of the Islamic bond market in particular, in the current environment also reflects its cost effectiveness. An increasing number of multilateral agencies, Government agencies and the corporate sector including multinational corporations have relied on the sukuk market as a source for raising financing. In Malaysia, Shell MDS Sdn. Bhd. issued the world's first ringgit-denominated corporate sukuk in 1990, amounting to RM125 million. The issuance of a RM3.5 billion programme sukuk by TESCO Stores in 2007 witnessed the first sukuk issuance by a British owned MNC, while Toyota Capital Services, a Japanese MNC, issued a RM1 billion programme in 2008. There has also been a growing trend for multi-currency sukuk issuances in Asia, with the latest landmark issuance of the world's first renminbi sukuk issuance in 2011 being issued in the Malaysian market. These multi-currency issuances have attracted international investors to participate in this market.

As an asset class, there are now a wide range of structures, size and different maturities. Recent examples in Malaysia include the PLUS Berhad's issuance of a record size of RM30.6 billion or equivalent to USD9.7 billion programme, with maturities ranging from 5 to 27 years. This also facilitates the potential for diversification of portfolios. The Islamic capital market has also been an avenue for businesses to raise equity financing globally. Shariah-compliant corporations that are listed in major global Islamic stock market indices, such as the Dow Jones Islamic Market Indices and the FTSE Global Islamic Index, are able to enhance their profiles among the prospective investors, including those with inclination towards socially responsible investment. In Malaysia, similar listing opportunities are available through the FTSE Hijrah Shariah index and the FTSE Bursa Malaysia EMAS Shariah index for Shariah-compliant investment, that has been designed to provide a broad benchmark for investors that wished to invest in Shariah-compliant stocks. Malaysia operates a dual financial system that comprises the conventional and the Islamic financial system. Businesses are able to select the financial offerings that best serve their requirements. While Malaysia has progressively liberalised our financial system, the liberalisation of the Islamic financial system has been at a more rapid pace. The motivation for this is to forge greater international economic and financial linkages. Liberalisation of the conventional sector has been more gradual and sequenced to ensure that the financial system promotes balanced growth while remaining stable and sustainable. The robust legal and regulatory framework, together with the availability of a large and diverse pool of talent and expertise in Islamic finance, forms the solid components in the system to meet the requirements of businesses.

There is also Shariah certainty in Islamic finance through a robust Shariah governance framework, which comprises Shariah committees at the industry level and the Shariah Advisory Council at the regulatory level. Malaysia's supportive framework and process for sukuk origination and sukuk listing also facilitates the issuance process of ringgit or non-ringgit denominated sukuk in our market. Efforts to deepen the sukuk market have provided significant opportunities for participation in this market, with the size of the Malaysian sovereign and corporate sukuk outstanding growing threefold from a total of RM120 billion in 2005 to RM353 billion as at end-2011. The market has also drawn the interest of foreign participation for their financing and investment activities. Key in the development of Islamic finance in Malaysia has been its progressive internationalisation and the introduction of more innovative Shariah-compliant financial solutions that meet the increasingly more complex and diverse international business requirements.
Let me conclude my remarks. In serving the needs of the real economy, Islamic finance offers a comprehensive and competitive solution in meeting funding and investment requirements of businesses. Given its international outreach and dimension, and ability to provide a total financial solution, Islamic finance is now at the frontier in which it presents new opportunities to support the economy and overall financial stability. Today's dialogue session would serve to provide a greater understanding and appreciation on Islamic finance and its potential for the intermediation of finances for international businesses.

CALENDAR OF EVENTS
January – March 2012

6 January 2012

The Bank updated the public on the progress of the implementation of the New Motor Cover Framework (the Framework). Since March 2011, several enhancement measures have been introduced to improve the efficiency of the claim settlement process. In addition, effective 16 January 2012 the Motor Tariff premium rates will be gradually revised to reflect the significant rise of medical expenses, costs of vehicle repairs, accident rate and claims. It will be the first to be undertaken after non-revision for more than 30 years. The premium adjustment is small in quantum and to be implemented gradually over a period of four years. The adjustment will be reviewed periodically to ensure that the adjusted premium rates continue to be reflective of the claims experience. The Framework will pave the way for detariffing of the motor insurance premiums in 2016, in which premium rates will be further differentiated in accordance to the risk profile of individual vehicles and fairer to vehicle owners as those with good claims experience would enjoy much better premium rates than those with higher risk profile.

10 January 2012

The Bank announced that the new coins series will be issued into circulation in phases from 16 January 2012 onwards. The new coins will co-circulate with the existing series until the existing series is phased out. To encourage a smooth transition to the new coins series, machine vendors had been given advance notice to calibrate their machines to accept the new coins.

27 January 2012

In her keynote address at the 13th Annual Conference of Fixed Income, Money Market and Derivatives Association of India and Primary Dealers Association of India in Kuala Lumpur, Governor Dr. Zeti highlighted that the Bank will continue to introduce measures to broaden the participation of regional players in the domestic market through progressive liberalisation of the foreign exchange administration rules and the development of cross-border settlement infrastructure. She said that the measures would enable more efficient and cost effective foreign currency trading and settlements. In addition, the Malaysian financial sector will be further developed to strengthen its competitiveness and efficiency while enhancing its role in facilitating Malaysia's ongoing economic transformation and strengthening linkages in the region. She also noted that the Islamic capital market has thrived with a growing presence of international issuers and investors, operating in both the ringgit and foreign currency sukuk markets in Malaysia.

30 January 2012

The Bank announced liberalisation measures as part of its continuous efforts to enhance competitiveness in the economy and to develop the domestic financial markets. The liberalisation measures which will be effective 31 January 2012 are namely; onshore banks are permitted to trade foreign currency against another foreign currency with a resident; a licensed onshore bank is allowed to offer ringgit-denominated interest rate derivatives to a non-bank non-resident; and flexibility is permitted for a resident to convert their existing ringgit or foreign currency debt obligation into a debt obligation of another foreign currency. These measures are expected to contribute towards increasing the liquidity, depth and participation of wider range of players in the domestic financial markets, in line with the broad thrust of the Financial Sector Blueprint.

31 January 2012

At its first meeting for 2012, the Bank's Monetary Policy Committee (MPC) decided to maintain the Overnight Policy Rate (OPR) at 3.00%. The MPC stated that in recent months the global economic and financial conditions have deteriorated. These conditions pose downside risks to global growth. In Asia, the growth momentum has moderated amid the weaker external environment. In the domestic economy, latest indicators point towards continued expansion in the fourth quarter of 2011 and the economy is expected to continue to expand. In the MPC's assessment, the global environment will become more challenging, going forward. As Malaysia's economic growth and inflation prospects will be affected by these external developments, the MPC will continue to assess carefully the risks to domestic growth and inflation. At its subsequent meeting on 9 March, the MPC decided to maintain the OPR at the same level as downside risks to the global economy remain despite some improvements in global financial conditions.

2 February 2012

The Bank and the Bank of Thailand signed a Memorandum of Understanding to enter into a cross-border collateral arrangement to facilitate a reciprocal operational arrangement aimed at enhancing liquidity facilities to financial institutions in both countries. The signing underlines the recognition by both central banks of the growing presence of cross-border banking and the importance of trade-linkages between the two nations. This collaboration will further support both central banks in preserving monetary and financial stability, as well as strengthen the cooperation of both countries in the area of domestic liquidity management.

8 February 2012

The Bank and the People's Bank of China renewed its currency swap agreement for another three years and increased the size to RM90 billion. The original agreement was established on 8 February 2009 with an initial total size of RM40 billion. This renewed currency swap agreement will further reinforce the financial cooperation between both economies and facilitate greater bilateral trade and investment.

10 February 2012

In her keynote address at the International Conference on "Asian Market Integration and Financial Innovation" in Tokyo, Governor Dr. Zeti said that Asia is on the verge of experiencing significant collective economic growth and development. She noted that the region should draw important lessons from the global financial crisis and recognise the implications of greater interdependence. She added that Asian economies would be better positioned to collectively strive and work towards achieving the shared vision of financial and economic integration. This will not only unlock the region's potential but also enhance the prospects to contribute towards a more balanced and sustainable global economy.

15 February 2012

The Bank announced that the growth of the Malaysian economy remained favourable in the fourth quarter of 2011 despite the challenging external environment. The economy expanded by 5.2% in the fourth quarter with growth being underpinned by domestic demand that was supported by both private and public sector spending. On the supply side, the services sector recorded slower growth, while the manufacturing sector grew at a similar pace to the previous quarter. This trend reflected the weaker external environment amid strong growth in domestic activity. For the whole year, the Malaysian economy expanded by 5.1%.

24 February 2012

The Bank held an engagement session with representatives from the automotive industry to discuss issues relating to the automotive industry arising from the implementation of the Guidelines on Responsible Financing (Guidelines) which took effect on 1 January 2012. The Bank reiterated that the main intent of the Guidelines is to promote prudent, responsible and transparent retail financing practices and to ensure that the household sector and credit market remains resilient. In addition, the Bank also emphasised that individuals and households must borrow within their means and that the Guidelines did not hamper access to financing by borrowers who could afford to repay their loans. The meeting also discussed various implementation issues which will be resolved with financial institutions, that would contribute towards more efficient procedures and processes for vehicle financing.

6 March 2012

Governor Dr. Zeti was declared as the winner of the Islamic Development Bank (IDB) Prize in Islamic Banking and Finance for the year 2012 in recognition of her substantial and outstanding contributions in promoting Islamic banking and finance. The IDB has established this Prize since 1988 with the aim to recognize, reward and encourage the activity of outstanding merit in promoting Islamic Economics, Banking and Finance. Over the past 24 years, 33 (researchers, bankers, economists, shariah scholars and institutions) have been awarded the IDB Prize annually alternating between Islamic Economics and Islamic Banking & Finance.

8 March 2012

In her keynote address at the EU-Malaysia Chambers of Commerce and Industry's Quarterly Financial Panel Discussion 2012 themed "Islamic Finance: New Frontiers in Financing the Economy", Governor said that Islamic finance offers a comprehensive and competitive solution in meeting funding and investment requirements of businesses. She noted that well-developed Islamic financial markets, including the sukuk and Islamic money markets, have been particularly instrumental in intermediating funds in the Islamic financial system. It is fast becoming an important platform for international fund raising and investment activities that are generating increased cross-border flows. She also said that given its international outreach and dimension, and the ability to provide a total financial solution, Islamic finance is now at the frontier in which it presents new opportunities to support the economy and overall financial stability.

13 March 2012

The Bank, the Hong Kong Monetary Authority and Euroclear Bank jointly announced the launch of a pilot platform for cross-border investment and settlement of debt securities (Pilot Platform). The Pilot Platform, operational on 30 March 2012, will enhance cross-border debt securities settlement efficiency and strengthen the capacity for debt securities issuance activities in the Asian region, particularly in Malaysia and Hong Kong. Through the Pilot Platform, investors in the two countries can buy and hold foreign debt securities and settle cross-border transactions on a Delivery-versus-Payment basis whilst local and international bond issuers can issue a wide range of debt securities.

14 March 2012

The Bank provided an update on the status of Skim Rumah Pertamaku (Scheme) which was announced by the Malaysian Government in March 2011. The Scheme aims to allow young working adults to obtain 100% financing from banking institutions to purchase their first home. As at end January 2012, a total of 1,062 actual applications received of which 389 applications have been approved, 168 applications were still being processed by banking institutions with 505 applicants not meeting the eligibility criteria.

21 March 2012

The Bank released its Annual Report and the Financial Stability and Payment Systems Report for 2011. At the press conference, Governor Dr. Zeti announced that the Malaysian economy recorded a steady growth of 5.1% in 2011 despite the challenging international economic environment. Growth was driven mainly by strong domestic demand, supported by both household and business spending, and higher public sector consumption. On the supply side, the overall growth for the year was sustained by firm activity in the domestic-oriented sectors. Headline inflation averaged 3.2% during the year. On the outlook for 2012, Malaysian economy is projected to grow by 4 – 5% while inflation is expected to moderate, averaging between 2.5 – 3.0%.

On the financial system, Governor Dr. Zeti highlighted that the stability of the financial system was sustained throughout 2011, enabling financial intermediation to continue functioning effectively in supporting economic activity. The payment and settlement systems remained resilient and supportive of financial system and economic growth. On financial sector development, Governor Dr. Zeti indicated that policy measures in 2011 were focused on reinforcing Malaysia's long-term growth potential by strengthening the financial sector's capacity and enhancing Malaysia's regional and international financial linkages. With regard to regulatory and supervisory framework, the Bank continued to reinforce and advance further the core tenets of regulation and supervision to strengthen the legislative framework and improve risk management, governance and business conduct practices.

On the same day, the Bank announced that the settlement services of its Real-time Electronic Transfer of Funds and Settlement System will now include the Renminbi. Besides providing greater efficiency and competitiveness in trade settlements, the Renminbi Settlement Services (RSS) complements various regional initiatives already in place that foster greater financial integration. The RSS will not only further facilitate bilateral trade between Malaysia and People's Republic of China, but also provide a natural hedge against the fluctuations and volatility of other currencies while eliminating settlement risk for Renminbi transactions.