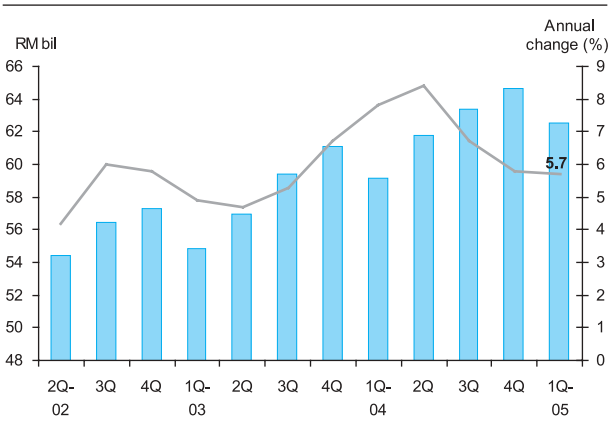
Economic and Financial Developments in the Malaysian Economy in the First Quarter of 2005

OVERVIEW

First quarter growth within expectations….

The Malaysian economy remained resilient despite a moderation in global economic activity amidst high oil prices and the continued downcycle of the global semiconductor industry. Real GDP growth of the Malaysian economy remained favourable and was within expectations, expanding by 5.7% in the first quarter of 2005. During the period under review, Malaysia continued to be one of the strong economic performers in the region.

1Q 2005 growth within expectations...



Source: Department of Statistics, Malaysia

Growth in the first quarter was broad based, with all major sectors of the economy, except construction, registering positive growth rates. The services sector continued to be the main contributor to growth, followed by the manufacturing and the primary commodity sectors. The overall services sector grew by 6%, supported by expansion in both the final and intermediate services groups. The final services benefited from robust consumer spending, high tourists arrivals and high usage of utilities amidst the favourable business environment. Meanwhile, increased banking, insurance and trade activities as well as robust growth in the telecommunication sector amidst the higher usage of voice and data services supported the intermediate services group.

Value added in the manufacturing sector expanded by 5.6%. Despite the slowdown in the electronics industry, the export-oriented industries continued to be resilient on the back of strong performance of resource-based industries such as chemicals, rubber products and off-estate processing industries. Growth in the domestic-oriented industries remained high, with higher output expansion in almost all the sub-sectors. The agriculture sector grew by 6% during the quarter, underpinned by strong performance in the palm oil sector following a substantial rise in productivity and an expansion in matured oil palm areas in East Malaysia. In the mining sector, although production of natural gas increased significantly, value added growth of the sector moderated to 3.3% due mainly to lower output of crude oil (including condensates). The construction sector

remained subdued in the quarter (-2.4%), due to lower civil engineering activity as well as delays in some projects due to the slow return of legal foreign workers following the Amnesty programme.

Domestic demand remained firm during the quarter under review, registering a growth of 5.9% . Private sector continued to be the key driver of economic growth in the first quarter, underpinned by robust consumer spending activities (10.1%), as a result of the cumulative effects of rising disposable income, high export earnings, favourable commodity prices and a stable employment market. Gross fixed capital formation rose by 2%, supported mainly by private investment activities which were spurred by improved business confidence and favourable financing conditions. Although the Federal Government's development expenditure declined, public investment for essential projects such as provisions for education, rural development, housing programme and health services continued during the quarter. The fiscal position saw an improvement to register a surplus of 2.3% of GDP in the first quarter of 2005, attributable to strong revenue collection and lower development expenditure.

Inflation increased moderately to 2.4% in the first quarter. This increase was driven mainly by higher prices of food and transport. The increase in prices of food was due to the higher demand for food given the festivals during the quarter coupled with tight supplies amid adverse weather conditions. The increase in prices of transport was caused mainly by the 10% increase in toll charges in January. Meanwhile, labour market conditions improved significantly underpinned by strong growth in productivity.

On the external front, the trade surplus increased to RM25.2 billion in the first quarter (4Q 2004: RM20.6 billion), due to a higher export growth relative to import growth. Gross exports increased by 13.5%, supported by strong growth in mineral exports that benefited from high prices for crude oil. Manufactured exports continued to post double-digit growth rate, underpinned by strong growth in exports of electronics and electrical (E&E), chemicals and petroleum products. Import growth increased at a more moderate pace of 9.8%. The growth in imports reflected the expansion in production and exports of manufactured goods as well as domestic consumption and private investment activity. Imports of capital goods (excluding lumpy items) remained strong, with a growth of 10.1% reflecting investment for capacity expansion and upgrading of technology. Meanwhile, imports of consumption goods grew by 10.4%, underscoring the sustained strength in private consumption. In line with the strong manufactured exports, imports of intermediate goods continued to post a double-digit growth rate. The market share of exports to the Asian (ex-Japan) region grew further to 45.8%, supported by increased outsourcing activities as well as the extensive production networks and linkages in the region following the relocation of companies to PR China and ASEAN countries. The market share of exports to India rose to 3%, while share of exports to US and EU remained significant at 17.6% and 11.9% respectively.

In the financial account, gross FDI inflows (excluding retained earnings) remained high at RM4.4 billion, mainly to the services, manufacturing and the oil and gas sectors. Malaysian companies' investments abroad increased further while portfolio investment moderated as fund managers reallocated their equity portfolio in the Asian region. Bank Negara Malaysia's net international reserves rose to RM275.2 billion or USD72.4 billion as at end-March 2005, supported by sustained repatriation of export proceeds and inflows of FDI and portfolio investment. International reserves strengthened further to RM284.4 billion or USD74.8 billion as at 14 May 2005, sufficient to finance 8.7 months of retained imports and is 7.2 times the short-term external debt.

Monetary policy continued to support growth

In the first quarter, monetary policy continued to support the expansion in private investment and consumption, with the Overnight Policy Rate (OPR) remaining unchanged at 2.70%. Low interest rates and ample liquidity in the banking system continued to support the financing of economic activities.

During the quarter, gross and net private sector financing through the banking system and the capital market grew at annual rates of 12.3% and 9.6% respectively. Total loans disbursed by the banking sector grew at a faster pace of 10.2% during the first quarter compared with 8.3% in the previous quarter. Similarly, total loans outstanding recorded a higher annual increase of 9.1% at end-March 2005 (end-2004: 8.5%). Of significance, the improvement in the demand for business loans since end-2004 continued into the first quarter of 2005. Loans outstanding of businesses grew at a positive rate for the second consecutive quarter, registering an annual growth of 2.8% at end-March 2005. Bank lending to small and medium enterprises (SMEs) rose further, with loans outstanding of SMEs increasing by 10.5%. Meanwhile, financing to the household sector was sustained at a high level, as reflected by the higher annual growth in the loans outstanding of households of 15.2% at end-March 2005.

In addition to bank financing, the capital market continued to be an important source of financing, especially for long-term business financing. In the first quarter of 2005, net funds amounting to RM10.5 billion were raised from the capital market. Gross funds raised from the private debt securities (PDS) market totalled RM5.5 billion, or 1.8 times the amount raised during the corresponding period of last year. Funds raised via the PDS market were mainly for restructuring and refinancing purposes as well as for new activities. During the quarter, funds amounting to RM2 billion were raised through the equity market.

In line with the expansion in domestic economic activity, narrow money or M1, expanded by 9.4% on an annual basis at end-March 2005. Meanwhile, broad money, M3, grew at an annual rate of 13.3%, driven mainly by higher claims on the private sector arising from increased lending by the banking

system as well as the continued inflow of external funds.

The banking system remained sound

The banking sector remained sound with a strong capitalisation level and improved profitability in the first quarter. The risk-weighted capital ratio of the banking system remained strong at 13.7%, while the pre-tax profits of the banking system improved by 12.2% to RM3 billion due mainly to lower loan loss provisions and operating expenses during the quarter. Banks' balance sheets were also healthier with the continued decline in non-performing loans (NPLs). The net NPL ratio based on 6-month classification continued to trend downwards to account for 5.4% of total net loans at end-March 2005. The 4.7% decline in net NPLs was due primarily to lower new loans classified as non-performing as well as higher restructuring and rescheduling of credit facilities during the quarter.

Sustained growth prospects

Going forward, the near-term outlook for Malaysia remains favourable despite some signs of moderating growth in the global economy and rising prices. Global growth is nevertheless still expected to be strong, supported by continued growth in consumer and investment demand. In the US, although the first quarter growth moderated, growth was supported by strong inventory-rebuilding and sustained consumption. In addition, current indicators point to continued strong growth in the Asian region. In particular, PR China continues to benefit from strong consumer spending, investment and high FDI inflows. Given the increased regional integration in trade and production with PR China, this trend will increasingly promote mutually reinforcing growth among regional economies including Malaysia. Meanwhile, the cyclical downturn in the global semiconductor industry is forecast to be modest and transitory in view of continued global demand, more rapid inventory adjustment and relatively low inventory levels.

On the domestic front, the prospects are for sustained growth in 2005. Although economic expansion may moderate due to the weaker external environment, economic activities would be sustained, driven by the private sector as suggested by the forward leading indicators. The Department of Statistics's Leading Index suggests continued economic expansion for the second and third quarters of 2005. This optimism is further corroborated by the MIER Consumer Sentiments Index which rose by more than 10 points to 120.9 points, reflecting rising consumer confidence. Given that households are not burdened by excessive debt, robust consumer spending is likely to be sustained. In addition, the MIER Business Conditions Index breached the 100-point threshold level to 104.1 points, indicating an upward trend in private investment activities.

More recently, there are emerging concerns over inflationary pressures. For Malaysia, price pressures have been contained to some extent by improvements in labour productivity and capacity expansion, while continued gains in external trade enable monetary policy to remain supportive of

growth. In addition, the recent liberalisation of the foreign exchange administration rules would further reduce the cost of doing business and encourage better risk management practices in the private sector. The banking system has also emerged stronger from the crisis, with NPLs trending downwards and profitability improving. The sound financial position of the banking institutions amidst favourable household and business sentiment would provide further support to the economy. Finally, the well-diversified economy increases resilience to weather developments in the external environment.

DEVELOPMENTS IN THE FIRST QUARTER OF 2005

International Economic Environment

Global economy expanded at a moderate pace

The global economy expanded at a more moderate pace in the first quarter amidst high oil prices. Growth continued to be led by the United States (US) and the People's Republic of China (PR China) while growth improved in Japan and remained subdued in the euro zone.

The **US** economy moderated to 3.1% in the first quarter, largely due to marked slowdown in business spending (4.7%, 4Q 2004: 14.5%) and a larger trade deficit. The household sector continued to hold up as evidenced from positive economic indicators such as new home sales, retail sales and unemployment rate. Trade deficit hit a new record due mainly to high oil prices. Against the backdrop of improving labour market conditions and gradually rising inflationary pressures, the Fed raised Federal funds rate further by 25 basis points each on 2 February and 22 March to 2.75% by the end of the quarter. Meanwhile, growth remained sluggish in the **euro area** as reflected in the weak indicators, notably the German IFO business climate index, which fell in April for the third consecutive month. Growth in the **United Kingdom** economy was sustained but showed signs of easing as industrial output contracted for the third consecutive quarter. In **Japan**, while deflationary pressures persist, recovery remains on track in 1Q, supported by household consumption amid improving labour market.

Global crude oil futures prices touched USD57.76 on 17 March, driven by continued strong demand and a lack of refining capacity. Although a new peak was reached on 4 April (USD58.28), prices have since eased in response to slowing economic growth in the US, rising US crude supplies and high OPEC production.

Industrial Countries: Real GDP growth

	2004			2005	Key contributing factors for 1Q growth
	1Q	4Q	Year	1Q	
	Annual change (%)				
US[1]	4.0	3.8	4.4	3.1[a]	Growth was supported mainly by strong inventory-rebuilding and sustained consumption. Slowdown in investment came mainly from slower growth in spending on equipment and software. Net exports exerted a larger drag on growth.
UK	3.0	2.9	3.1	2.8	Sustained growth, driven by the services sector as manufacturing output declined for the third consecutive quarter.
Euro zone	1.6	1.6	2.0	1.4[p]	A net export-driven rise led to an increase of 1.1% in GDP of Germany. Germany accounts for about one-third of the overall GDP for the euro zone. However, Italy and Netherlands recorded negative growth.
Japan[1]	6.0	0.1[r]	2.6	5.3[p]	Better-than-expected growth was driven by a turnaround in consumption and stronger capital spending.

[1] Annualised basis
[r] Revision
[a] Advance estimate
[p] Preliminary
Source: National authorities

In the **Asian** region, growth remained strong with broad-based expansion, led by PR China. Exports and industrial production remained favourable with several countries

maintaining strong growth despite the slowdown in the electronics cycle.

Regional Countries: Real GDP growth

	2004			2005	Key contributing factors for 1Q growth
	1Q	4Q	Year	1Q	
	Annual change (%)				
PR China	9.8	9.5	9.5	9.5	Supported by strong consumer spending and exports.
Indonesia	5.0	6.7	5.1	6.4	Supported by investments.
Korea	5.3	3.3	4.6	2.7	Moderation in exports and decline in construction investments.
Singapore	7.9	6.5	8.4	2.5	Slower expansion in the manufacturing sector notably in the biomedical cluster.
Chinese Taipei	6.7	3.3	5.7	2.5	Slower expansion due to sluggish exports and high oil prices.

Source: National authorities

In most regional countries, inflation edged upwards due to record high oil prices, rise in food prices as a result of the drought as well as the partial removal of fuel subsidies by several regional countries. In Indonesia, inflation reached a 27-month high of 8.8% in March following the rise in domestic fuel prices.

In the region, Thailand, Chinese Taipei, Indonesia, the Philippines and India raised interest rates during the first quarter to contain inflationary pressures arising mainly from higher oil prices. Meanwhile in Singapore, the authorities have maintained its policy of a modest and gradual appreciation of the Singapore dollar as inflationary pressures continue to be a concern over the medium term.

In the **foreign exchange market**, the depreciating trend of the US dollar stabilised during the first quarter in view of expectations for a faster pace of monetary tightening in the US coupled with the stronger economic performance in the US relative to other major industrialised countries. Meanwhile, most of the regional currencies appreciated initially before easing on concerns of more interest rate hikes in the US.

Going forward, the pace of expansion in the global economy is expected to be constrained by high oil prices, higher inflationary pressures and reduction in monetary accommodation. In the US, the Fed raised rates for the eighth consecutive time by another 25 basis points to 3% on 3 May. However, monetary policy is expected to remain accommodative with gradual interest rates hikes, mainly to contain inflationary expectations. Growth prospects for the Asian region remain favourable supported by the strong pace of growth in PR China and sustained domestic demand. While the global electronics industry is consolidating after reaching its peak in mid-2004, the downcycle is forecast to be modest in view of the continued global demand, speedier inventory adjustments and relatively low inventory levels.

Developments in the Malaysian Economy

Growth driven by the major economic sectors…

The Malaysian economy remained resilient in the first quarter of 2005, expanding by 5.7%. Growth was driven by the major sectors of the economy, namely services, manufacturing and the primary commodity sectors. The services sector growth remained firm supported by consumption, tourism and telecommunication activities, while the primary commodity sector grew further mainly on account of higher production of

crude palm oil and natural gas. Although the manufacturing sector was affected by the ongoing global semiconductor downcycle, the diversified industrial structure provided support to moderate the impact. Of significance, resource-based industries continued to perform strongly. Meanwhile, the construction sector remained weak due mainly to slower activity in the civil engineering segment.

Quarterly GDP by Kind of Economic Activity at 1987 Prices

	2004			2005
	1Q	4Q	Year	1Q
	Annual change (%)			
Agriculture	3.8	7.3	5.0	6.0
Mining	5.9	4.4	3.9	3.3
Manufacturing	12.5	5.5	9.8	5.6
Construction	0.9	-2.6	-1.5	-2.4
Services	6.4	6.5	6.8	6.0
Real GDP (Ann. Chg.)	**7.8**	**5.8**	**7.1**	**5.7**
Real GDP (Preceding Chg.)	**-3.2**	**1.9**	**7.1**	**-3.3**

Source: Department of Statistics, Malaysia

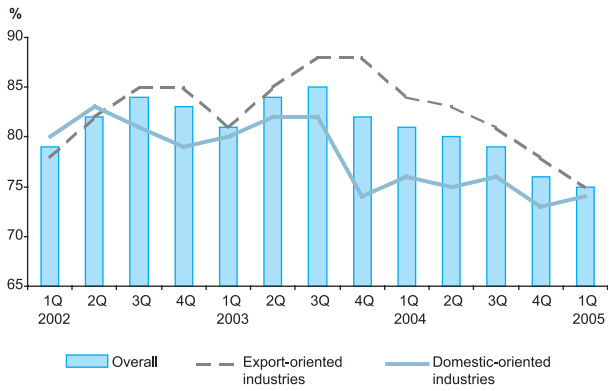
Continued growth in the manufacturing sector

Value added in the **manufacturing sector** expanded by 5.6% in the first quarter of 2005 (4Q 2004: 5.5%). In the **export-oriented industries**, output growth moderated slightly to 5.3% in the first quarter (4Q 2004: 7.8%), as the moderation in output of electronics was cushioned by higher output of the resource-based industries. Domestic manufacturers in the electronics and electrical (E&E) products segment continued with their inventory adjustment exercise and rationalised production during the quarter under review.

Nevertheless, resource-based industries such as chemicals, rubber products and off-estate processing industries, which account for about one-fourth of the manufacturing production index expanded at a rapid pace during the quarter. Output of chemical products expanded by 15.6% (4Q 2004: 13.3%), driven by robust expansion in the production of plastic products and industrial gases. The strong performance in the commodity sector also led to higher activity in the related downstream industries. The increase in output of industrial gases and off-estate processing (24.6%; 4Q 2004: 17.9%) reflected the strong natural gas and crude palm oil production during the quarter. The consolidation process undertaken by the rubber gloves companies has further enhanced their competitiveness in the global market, leading to higher output growth of the rubber products industry (11.4%; 4Q 2004: 9.1%).

Output of **domestic-oriented industries** expanded by 5.7% (4Q 2004: 6.3%) during the quarter. Growth in output was registered in almost all the sub-sectors, particularly in the transport equipment, fabricated metal, paper and petroleum products industries, which more than offset the contraction in the construction-related materials industries. The latter was affected by the weak performance of the construction industry. Meanwhile, output in the transport equipment industry continued to expand at a robust pace of 13.1% (4Q 2004: 17.8%), as evidenced by the higher passenger car sales during the quarter. The strong demand for passenger cars was supported by the favourable financial position of households and attractive financing packages and, to some

Capacity Utilisation in the Manufacturing Sector



Performance in the Manufacturing Sector

	2004			2005
	1Q	4Q	Year	1Q
	Annual change (%)			
Value Added (Constant Price)	**12.5**	**5.5**	**9.8**	**5.6**
Overall Production	**16.5**	**7.5**	**12.7**	**5.4**
Export-oriented industries	**19.3**	**7.8**	**14.2**	**5.3**
Of which :				
Electronics	34.1	9.6	25.0	-0.1
Electrical	-6.9	-13.8	-9.4	-6.5
Textiles & wearing apparel	-10.8	-14.5	-11.7	-4.1
Chemicals and chemical products	16.9	13.3	14.1	15.6
Off-estate processing	3.3	17.9	4.0	24.6
Rubber products	24.1	9.1	14.8	11.4
Wood and wood products[1]	13.9	5.1	12.7	-3.7
Domestic-oriented industries	**7.6**	**6.3**	**7.1**	**5.7**
Of which :				
Transport equipment	0.8	17.8	8.6	13.1
Fabricated metal products	35.4	21.4	29.2	16.1
Iron & steel and non-ferrous metal	6.2	4.7	4.4	-4.5
Non-metallic mineral products	-1.2	-4.8	-4.9	-3.7
Petroleum products	-1.9	5.4	1.3	10.4
Food	7.3	-0.5	3.0	-0.8
Total Manufactured Exports	**17.4**	**13.5**	**19.7**	**11.8**
Of which :				
Electronics and electrical products	15.1	7.5	15.3	9.7
Wood and wood products	28.3	12.4	29.5	16.8
Furniture & parts	15.1	16.2	17.8	10.3
Textiles, clothing & footwear	16.8	14.0	17.9	4.0
Rubber products	19.9	14.5	19.3	12.3
Optical & scientific equipment	11.1	19.6	26.3	22.9
Chemical and chemical products	26.0	26.9	31.0	20.2
Petroleum products	20.0	57.1	42.2	18.0
Transport equipment	47.0	108.7	65.0	51.0

[1] Output of furniture and parts are not captured in the wood production data.

Source: Department of Statistics, Malaysia

extent in anticipation of higher car prices upon the implementation of the new tariff structure in July 2005. Similarly, production of paper products industry expanded by double-digit growth of 15.7% (4Q 2004: 3.8%) due to increased demand for packaging activities.

Overall capacity utilisation for the manufacturing sector in the first quarter of 2005 was sustained (75%; 4Q 2004: 76%), with the export-oriented and domestic-oriented industries operating at 75% and 74% respectively (4Q 2004: 78% and 73%).

Sustained expansion in the services sector

Growth in the **services sector** was sustained at 6% (4Q 2004: 6.5%) as all sub-sectors continued to expand in line with higher consumption, tourism and telecommunication activities. Growth in the wholesale and retail trade, hotels and restaurants sub-sector strengthened to 7.7% (4Q 2004: 6.9%) underpinned by strong growth in domestic consumption as reflected by the high growth in sales of motor vehicles and credit card spending. Higher retail spending by

Performance of the Services Sector (Value Added)

	2004			2005
	1Q	4Q	Year	1Q
	Annual change (%)			
Intermediate Services	**7.4**	**6.9**	**7.1**	**6.6**
Transport, storage & communication	7.9	9.3	8.5	10.4
Finance, insurance, real estate & business services	7.1	5.6	6.3	4.4
Final Services	**5.7**	**6.3**	**6.6**	**5.6**
Electricity, gas & water	8.7	7.3	8.2	5.7
Wholesale & retail trade, hotels & restaurants	5.3	6.9	7.1	7.7
Government services	5.9	7.2	6.5	3.2
Other services	4.9	3.7	4.9	4.1
Total Services	**6.4**	**6.5**	**6.8**	**6.0**

Source: Department of Statistics, Malaysia

Selected Quarterly Indicators in the Services Sector

	2004			2005
	1Q	4Q	Year	1Q
	Annual change (%)			
Tourism-related indicators				
Hotel occupancy rate (%)	56.4	62.7	60.8	60.7
Tourist arrivals	38.4	15.4	48.5	4.6
Total passenger traffic at all airports	10.8	11.2	18.9	6.6
Consumption-driven indicators				
Total consumption credit	11.4	16.4	16.4	17.4
Imports of consumption goods	14.8	16.4	24.1	10.4
Total sales of passenger cars	-0.2	27.3	17.0	13.7
Cellular phone penetration rate (%)	46.2	55.9	55.9	60.9
Trade-related services indicators				
Cargo handled (All airports)	6.6	10.2	10.5	5.3
Container cargo handled (Port Klang and PTP)	15.8	3.6	11.2	4.7
Cargo revenue (Railway)	-1.2	12.2	7.6	7.7

Source: Various sources

consumers in aid of the Tsunami victims also contributed to the growth. The sub-sector was further supported by increased tourism and travel activities during the quarter with tourist arrivals exceeding 4.1 million.

The transport, storage and communication sub-sector recorded a double-digit growth, driven mainly by strong activity in the telecommunication services industry. This was evidenced by the high usage of the voice and data services in the mobile segment. Meanwhile, the transportation segment was supported by continued expansion in port, shipping and air cargo activities. The finance, insurance, real estate and business services sub-sector expanded by 4.4% (4Q 2004: 5.6%) supported by increased banking activities, including credit activity and fee-based services, as well as insurance activities. The utilities sub-sector grew by 5.7% (4Q 2004: 7.3%) due mainly to sustained demand for electricity by both the industrial and commercial sectors.

Favourable performance in the primary commodity sector

The **primary commodity sector** grew further during the quarter with both the agriculture and mining sectors expanding by 6% and 3.3% respectively (4Q 2004: 7.3% and 4.4% respectively). Growth in the agriculture sector was underpinned by strong performance in the palm oil sector for the second successive quarter, while the expansion in the mining sector was driven by higher natural gas production.

In the **agriculture sector**, production of crude palm oil grew strongly by 27.5% (4Q 2004: 16.5%), recording the highest level ever of 3.4 million tonnes in the first quarter, which is traditionally a low output period. Monthly production consistently breached the 1 million tonne threshold each month during the quarter, a historic occurrence in the Malaysian palm oil industry. The strong performance was due to the substantial rise in productivity, as well as further expansion in matured oil palm areas in Sabah and Sarawak. The positive developments in the palm oil industry also induced replanting activity in Peninsular Malaysia, to replace older, low-yielding oil palm trees. Yields, both in terms of fresh fruit bunches (FFB) and oil extraction rates (OER), were significantly higher during the quarter, at 4.35 tonnes per hectare and 20.19% respectively, compared to the corresponding period in 2004 (3.69 tonnes per hectare and 19.86% respectively). Meanwhile, rubber production declined by 9.4% as the onset of wintering caused latex output to decline. Similarly, growth in other agriculture activities was also subdued during the quarter. In

particular, output from fishery activities declined by 16.5%.

Performance of the Agriculture Sector

	2004			2005
	1Q	4Q	Year	1Q
	Annual change (%)			
Value Added (at 1987 prices)	**3.8**	**7.3**	**5.0**	**6.0**
Production[1]				
Of which:				
Crude palm oil	2.5	16.5	4.7	27.5
Crude palm kernel oil	3.8	11.8	-0.1	27.2
Rubber	19.3	7.2	19.7	-9.4
Saw logs	-15.2	3.8	0.2	-1.7
Cocoa	-33.5	17.9	-7.8	-5.2
Exports (RM million)	**13.8**	**1.2**	**7.4**	**5.7**
Of which:				
Palm oil				
('000 tonnes)	5.1	2.3	-5.6	14.3
(RM/tonne)	6.5	-6.1	5.5	-15.6
(RM million)	11.9	-3.9	-0.4	-3.6
Palm kernel oil				
('000 tonnes)	35.4	-24.7	-8.3	26.0
(RM/tonne)	27.8	38.9	46.9	10.9
(RM million)	73.1	4.5	34.7	39.8
Rubber				
('000 tonnes)	23.3	16.6	16.7	-0.9
(Sen/kilogramme)	36.6	2.6	24.3	-2.0
(RM million)	68.4	19.6	45.1	-2.9
Sawn timber				
('000 cu.metres)	5.9	16.3	13.5	16.4
(RM/cu.metre)	-12.2	-10.2	-10.4	6.0
(RM million)	-7.1	4.4	1.7	23.4
Saw logs				
('000 cu.metres)	-13.5	-17.9	-5.9	42.2
(RM/cu.metre)	1.0	6.2	8.9	4.4
(RM million)	-12.6	-12.8	2.5	48.4
Cocoa beans				
('000 tonnes)	-76.0	-15.6	-27.7	183.4
(RM/tonne)	-20.3	-5.9	-12.6	0.7
(RM million)	-80.9	-20.6	-36.8	185.3

[1] In '000 tonnes, except for saw logs in '000 cubic metres

Source: Malaysian Palm Oil Board (MPOB)
Malaysian Rubber Board (MRB)
Forestry Department (Peninsular Malaysia, Sabah and Sarawak)
Malaysian Cocoa Board (MCB)
Department of Statistics, Malaysia

In the **mining sector**, production of natural gas grew significantly by 19.8% to reach a new record of 6,352 million standard cubic feet per day. The strong production was driven mainly by higher capacity utilisation of the Malaysia Liquefied Natural Gas (MLNG) plants in Sarawak and Gas Processing Plants (GPPs) in Peninsular Malaysia. This was induced by higher demand for natural gas by both domestic (mainly power producers and industrial users) and external users.

Performance of the Mining Sector

	2004			2005
	1Q	4Q	Year	1Q
	Annual change (%)			
Value Added (at 1987 prices)	**5.9**	**4.4**	**3.9**	**3.3**
Production				
Of which:				
Crude oil and condensates				
('000 barrels)	8.0	1.4	3.6	-5.2
Natural gas (net)				
(million standard cubic feet)	2.3	10.3	4.0	19.8
Exports (RM million)	**15.5**	**44.7**	**38.2**	**36.3**
Of which:				
Crude oil & condensates				
('000 tonnes)	4.1	-11.0	1.0	0.5
(USD/barrel)	4.4	53.3	34.8	36.3
(RM million)	8.6	36.4	36.1	37.0
Liquefied natural gas				
('000 tonnes)	18.3	19.4	19.7	17.6
(RM/tonne)	-2.3	15.9	6.8	12.8
(RM million)	15.6	38.5	27.9	32.7

Source: PETRONAS
Department of Statistics, Malaysia

While output of crude oil (including condensates) declined by 5.2% during the quarter (1Q 2004: +8%), the quarterly output remained at a high level of 740,383 barrels per day. Crude oil prices registered record highs during the quarter supported mainly by fundamental factors. The strong global demand, particularly from the US and PR China, and minimal supply growth amidst production operating close to full capacity in the major oil producing countries resulted in the significant increase in prices. In line with developments in the global oil market, the Malaysian Tapis Blend crude oil prices

breached the USD50 mark in late February, sustained the rise and peaked at USD59.50 per barrel on 17 March. This higher level compared to benchmark oil grades such as West Texas Intermediate reflects its status as a premium oil grade in the international market. Prices closed the quarter at USD55.

Subdued construction activity

The **construction sector** contracted by 2.4% (4Q 2004: -2.6%) due mainly to lower civil engineering activity arising from fewer public sector projects. However, the residential and non-residential segments continued to be supported by demand for houses as well as office and retail space. Overall, the weaker performance of the construction sector during the quarter was also partly due to the slow return of legal foreign workers following the Amnesty programme, which had caused delays in some projects. Nevertheless, going forward, the industry is expected to benefit from the RM2.4 billion worth of Government projects that have been brought forward for immediate implementation from the Ninth Malaysia Plan.

Construction Indicators

	2004			2005
	1Q	4Q	Year	1Q
	Annual change (%)			
New sales and advertising permits	44.0	-19.4	-5.9	2.3
Housing approvals	48.9	-34.9	-14.1	11.2
Production of construction-related materials	2.2	-0.4	-0.6	-4.1
Loans approved for construction	-36.8	-14.8	2.3	47.6
Imports of construction materials & mineral products	19.0	15.8	42.1	15.5*

* Jan.-Feb.'05

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

Resilient domestic demand

Domestic demand remained resilient in the first quarter of 2005. Private sector continued to provide the main impetus to growth while the Government remained on track with its fiscal consolidation programme. Expansion in private sector expenditure was mainly supported by robust consumer spending activities.

GDP by Expenditure Components (at Constant 1987 prices)

	2004			2005
	1Q	4Q	Year	1Q
	Annual change (%)			
Aggregate Domestic Demand (excluding stocks)	7.6	6.7	7.5	5.9
Consumption	9.5	8.6	9.5	7.6
Private sector	*8.9*	*10.2*	*10.5*	*10.1*
Public sector	*11.8*	*4.2*	*6.0*	*-2.3*
Gross Fixed Capital Formation	3.5	2.2	3.1	2.0
Exports of Goods and Services	16.4	10.2	16.3	9.5
Imports of Goods and Services	21.0	12.9	20.7	7.6
GDP	**7.8**	**5.8**	**7.1**	**5.7**

Source: Department of Statistics, Malaysia

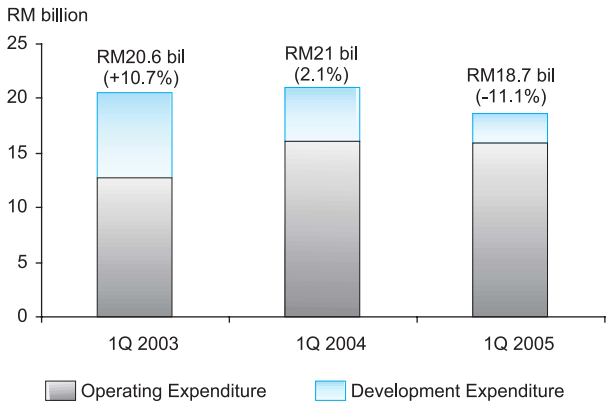
Private consumption remained strong in the first quarter, rising by 10.1% (4Q 2004: 10.2%). Consumers' willingness to spend was buoyed by rising disposable incomes and the stable employment market. Sustained high export earnings and favourable commodity prices ensured that wage growth remained positive. At the same time, employment prospects remained stable as job vacancies increased strongly while retrenchments remained low. Attractive sales promotions held for festive

celebrations and school holidays during the quarter provided further stimulus to consumption.

The findings of the Malaysian Institute of Economic Research (MIER)'s consumer sentiments survey indicate that consumers remained optimistic on job prospects and income expectations, given the strong economic fundamentals. As a result, MIER's Consumer Sentiments Index (CSI) rose by 11.6 points to 120.9 points (4Q 2004: 109.3 points). Other major consumption indicators such as the sales of passenger cars, imports of consumption goods, credit card transactions, and loans disbursed for consumption credit and consumer-oriented businesses, also supported the positive trend in private consumption.

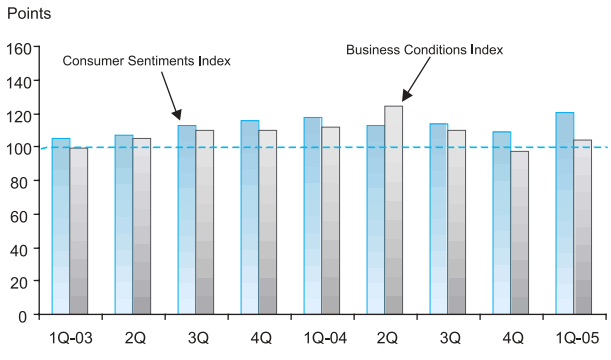
Meanwhile, **public consumption** declined by 2.3% during the quarter (4Q 2004: +4.2%) mainly on account of lower expenditure on supplies and services as well as defence.

Lower Federal Government Spending



Gross fixed capital formation recorded a growth of 2% in the first quarter (4Q 2004: 2.2%). Domestic investment was mainly supported by private sector capital spending as the Federal Government's development expenditure declined. Business confidence improved as indicated by MIER's Business Conditions Index, which breached the 100-point threshold level to 104.1 points (4Q 2004: 97.3 points), suggesting that manufacturers remained optimistic on sales and production expectations. The growth in investment activities was supported by the sustained growth in financing activities by the banking system. Besides investment in the manufacturing sector, sustained inflows of foreign direct investment into the oil and gas sector and increased imports of mining equipment suggests higher capital spending activities in the upstream segment of the sector, particularly in exploration and development activities.

Improved consumer and business confidence



The Federal Government continued to ensure that bulk of the development expenditure was channelled into essential projects such as provisions and maintenance

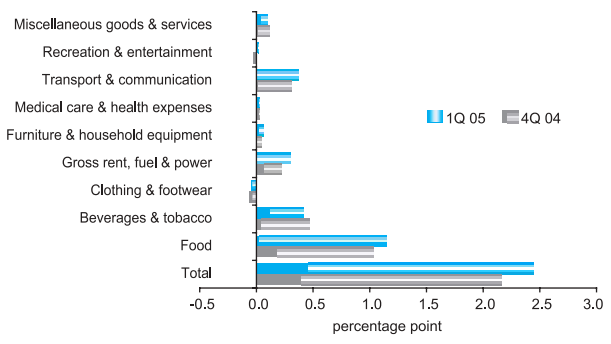
of transportation infrastructure, education and industrial training, agriculture and rural development, housing programme and health services.

Inflation increased moderately

The annual rate of inflation, as measured by the **Consumer Price Index** (CPI), increased to 2.4% (4Q 2004: 2.1%). The increase was driven mainly by the higher prices of food and transport. The increase in prices of food was due to the higher demand for food given the festivals during the quarter coupled with tight supplies amid adverse weather conditions. Meanwhile, the increase in prices of transport was caused mainly by the 10% increase in toll charges in January.

The **Producer Price Index** (PPI) increased at a slower rate of 5.1% (4Q 2004: 7.7%), due mainly to the decline in prices of crude palm oil and the slower rate of increase in crude oil prices. Excluding commodities, the PPI, however, was only slightly higher at 2.5% in the first quarter (4Q 2004: 2.2%).

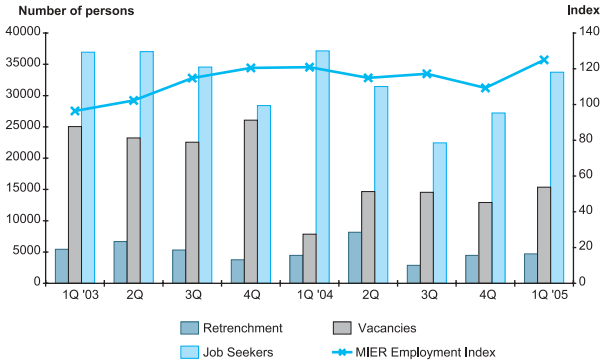
Contribution to Inflation



Labour market conditions improved significantly

Labour market conditions in the first quarter improved significantly, underpinned by strong growth in productivity. Vacancies reported to the authorities rose sharply (15,369 positions; 1Q 2004: 7,850 positions), while retrenchments remained low (4,709 persons; 1Q 2004: 4,463 persons). Registered unplaced jobseekers were also lower (33,740 persons; 1Q 2004: 37,143 persons). In the same period, growth in labour productivity, as measured by real sales value of products per employee in the manufacturing sector, rose by 14.7% exceeding the 1.6% growth in real wages per employee. The overall positive job sentiment was also reflected in the MIER Employment Index, which gained 15.7 points over the previous quarter to reach 125 points in the first quarter of 2005 (1Q 2004: 120.9 points).

Labour Market Conditions Improved Significantly

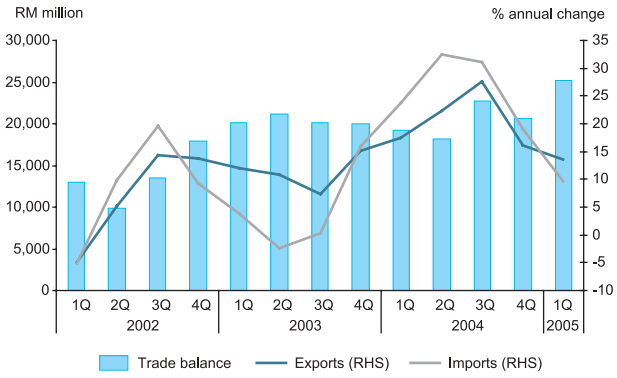


Trade account recorded a larger surplus

The **trade surplus** was larger at RM25.2 billion in the first quarter (4Q 2004:

RM20.6 billion), the largest quarterly surplus recorded. Gross exports and imports continued to expand by 13.5% and 9.8% respectively, in line with the growth in production and investment.

Trade balance



Gross exports grew by 13.5% in the first quarter of 2005 (4Q 2004: 16.1%). Exports of **manufactured goods** continued to increase at a double-digit rate of 11.8% in the first quarter of 2005 (4Q 2004: 13.5%). Despite the slower output expansion of E&E products, export growth of these products was higher at 9.7% (4Q 2004: 7.5%), reflecting the ongoing inventory adjustment by manufacturers. During the quarter, exports of resource-based products remained robust, led mainly by exports of chemical, petroleum, wood and rubber products. Exports of chemicals and petroleum products expanded by 20.2% and 18% respectively (4Q 2004: 26.9% and 57.1% respectively) due mainly to the higher prices arising from the increase in oil prices during the quarter. Meanwhile, exports of wood products increased further by 16.8% (4Q 2004: 12.4%) fuelled by strong demand from the North Asian region, particularly Japan, PR China and Korea. In line with the higher global demand for safety and high quality natural rubber gloves, growth in exports of rubber products was sustained. Overall, the increase in exports of manufactured goods during the quarter was due to increases in volume (5.9%) as well as unit value (5.6%).

Agriculture exports registered a moderate increase of 5.7% during the quarter supported mainly by exports of minor agriculture commodities such as saw logs, sawn timber, palm kernel oil and cocoa. Meanwhile, exports of major crops, namely palm oil and rubber declined. Despite the strong purchases by Pakistan and the European Union (EU), palm oil exports fell by 3.6% during the quarter. The decline was due to the lower prices (RM1,490 per tonne), from the exceptionally high levels seen in the corresponding period of 2004 (RM1,766 per tonne). Export receipts from rubber also declined by 2.9% due to both lower export volume (-0.9%) as well as lower prices (-2%).

Trade Account

	2004			2005
	1Q	4Q	Year	1Q
	Annual change (%)			
Gross Exports	**17.5**	**16.1**	**20.8**	**13.5**
Manufacturing	*17.4*	*13.5*	*19.7*	*11.8*
Agriculture	*13.8*	*1.2*	*7.4*	*5.7*
Minerals	*15.5*	*44.7*	*38.2*	*36.3*
Gross Imports	**23.7**	**19.1**	**26.4**	**9.8**
Capital goods	*30.9*	*37.2*	*36.0*	*-0.3*
Intermediate goods	*21.1*	*13.5*	*22.2*	*10.4*
Consumption goods	*14.8*	*16.4*	*24.1*	*10.4*
Trade balance (RM bil)	**19.2**	**20.6**	**80.7**	**25.2**

Source: Department of Statistics, Malaysia

Mineral exports continued to expand at a strong pace of 36.3% mainly benefiting from the high prevailing crude oil prices. Malaysian crude oil export prices strengthened significantly by 36.3% to an average of USD46.42 per barrel in line with developments in the international oil markets during the quarter. Major buyers, particularly Indonesia, India and Thailand, increased their purchases significantly by 92.8%, 48.9% and 8.1%, respectively. LNG exports also rose sharply by 32.7%, supported by both higher prices (12.8%) and higher volume (17.6%). The latter was due to higher demand for natural gas from Malaysia's largest LNG buyer, Japan (27.8%), as well as Korea (13%).

In the first quarter of 2005, Malaysia's trade with the regional countries (excluding Japan) continued to increase, with a higher share of 47.1%. The impetus to the growth stemmed mainly from stronger growth of exports to ASEAN, PR China and Hong Kong China, particularly in exports of E&E products, and chemicals. Export growth was supported by the extensive production networks and linkages in the region arising from relocation of companies into PR China and ASEAN countries as well as increased outsourcing activity. On the import side, Malaysia continued to source components from regional countries, particularly Singapore, Thailand, PR China and Chinese Taipei. The regional import share was sustained at 48.7% (4Q 2004: 48.1%), reflecting mainly imports of machinery, appliances and parts, chemicals and manufactures of metal.

Meanwhile, exports to both the US and Japan registered higher growth of 12.1% and 14.7% respectively (4Q 2004: 9.8% and 9.9% respectively), driven mainly by higher demand for E&E products, optical and scientific equipment and resource-based products, namely chemicals, wood and petroleum products. A significant development during the quarter was the

Malaysia: Direction of exports

	2004			2005	2004			2005	2004			2005
	1Q	4Q	Year	1Q	1Q	4Q	Year	1Q	1Q	4Q	Year	1Q
	RM billion				Share of total exports (%)				Annual change (%)			
United States	**19.3**	**23.2**	**90.2**	**21.6**	**17.9**	**18.3**	**18.8**	**17.6**	**12.0**	**9.8**	**15.8**	**12.1**
European Union (EU)[1]	**13.9**	**15.7**	**60.4**	**14.6**	**12.9**	**12.4**	**12.6**	**11.9**	**18.0**	**18.4**	**20.9**	**5.2**
Selected ASEAN countries[2]	**26.9**	**32.0**	**119.7**	**32.5**	**25.0**	**25.3**	**24.9**	**26.6**	**17.5**	**18.2**	**22.3**	**20.7**
North East Asia	**21.9**	**24.3**	**93.4**	**23.5**	**20.3**	**19.2**	**19.4**	**19.2**	**23.4**	**11.5**	**20.7**	**7.2**
People's Republic of China	*7.2*	*8.3*	*32.1*	*8.0*	*6.7*	*6.6*	*6.7*	*6.5*	*36.2*	*8.9*	*24.6*	*10.7*
Hong Kong China	*6.4*	*7.3*	*28.7*	*7.1*	*6.0*	*5.8*	*6.0*	*5.8*	*8.6*	*6.4*	*11.5*	*9.7*
Chinese Taipei	*3.6*	*4.1*	*15.8*	*3.1*	*3.3*	*3.2*	*3.3*	*2.5*	*6.5*	*7.4*	*10.0*	*-14.4*
Korea	*4.7*	*4.6*	*16.8*	*5.4*	*4.4*	*3.6*	*3.5*	*4.4*	*47.7*	*32.0*	*45.7*	*14.9*
India	**2.7**	**3.2**	**11.4**	**3.7**	**2.5**	**2.5**	**2.4**	**3.0**	**22.0**	**17.4**	**18.3**	**37.0**
Total exports	**107.8**	**126.7**	**480.7**	**122.4**	**100.0**	**100.0**	**100.0**	**100.0**	**17.5**	**16.1**	**20.8**	**13.5**

[1] Includes the 10 new member states
[2] Include Singapore, Thailand, Indonesia, Philippines, Brunei Darussalam and Viet Nam

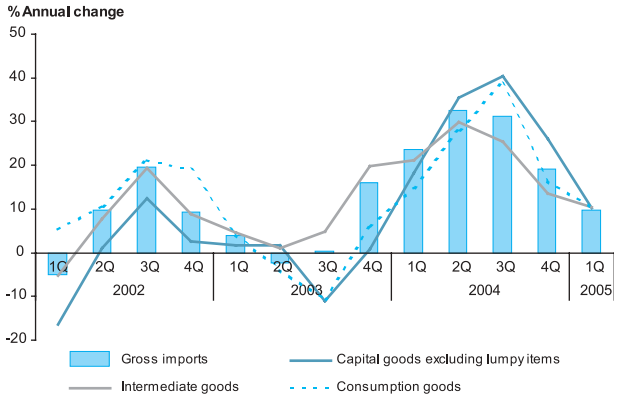
Source: Department of Statistics, Malaysia

stronger export growth to India of 37% to account for a higher export share of 3% (4Q 2004: 2.5%), reflecting mainly higher exports of chemicals, metal products, optical and scientific equipment and petroleum-related products.

Gross imports increased at a more moderate pace of 9.8%. Import growth reflected expansion in production and exports of manufactured goods as well as domestic consumption and private investment activity. Imports of **intermediate goods** expanded by 10.4%, supported by imports of industrial supplies such as metal products, iron and steel products and resource-based inputs, namely chemicals, rubber products and wood pulp. The continued growth in demand for passenger cars led to higher imports of parts and accessories of transport equipment. Stronger growth in imports of fuel and lubricants reflected mainly the high oil prices.

Imports of **capital goods** remained high at RM12.2 billion during the quarter. The growth of capital imports excluding lumpy items remained strong at 10.1%, reflecting capacity expansion and upgrading of technology in manufacturing, services and mining sectors. Imports of machinery and office equipment registered strong growth. The extension of network infrastructure and introduction of new technologies, in particular, the third-generation (3G) technology by telecommunication companies caused imports of telecommunication equipment to record robust growth. Increased exploration and downstream activities in the oil and gas industry in the wake of high prices of

Import growth



Malaysia: Imports by Economic Function And Broad Economic Categories (BEC) Classification

	2004			2005
	1Q	4Q	Year	1Q
	Annual change (%)			
CAPITAL GOODS	**30.9**	**37.2**	**36.0**	**-0.3**
Capital goods (except transport equipment)	20.0	30.4	28.3	8.1
Transport equipment	221.4	90.8	151.0	-55.7
INTERMEDIATE GOODS	**21.1**	**13.5**	**22.2**	**10.4**
Food and beverages, mainly for industry	32.9	25.1	52.9	-7.9
Industrial supplies, n.e.s.	25.6	29.2	38.9	16.0
Fuel and lubricants	-2.2	68.4	41.8	95.7
Parts and accessories of capital goods (except transport equipment)	20.8	-0.3	10.9	-0.3
Parts and accessories of transport equipment	17.8	38.9	35.0	41.2
CONSUMPTION GOODS	**14.8**	**16.4**	**24.1**	**10.4**
Food and beverages, mainly for household consumption	19.3	18.9	31.3	9.6
Transport equipment, non-industrial	-31.1	-34.4	-6.7	-16.2
Consumer goods, n.e.s.	13.6	16.7	20.8	11.7
Durables	*11.9*	*18.5*	*21.1*	*9.1*
Semi-durables	*15.8*	*8.2*	*17.7*	*5.2*
Non-durables	*12.9*	*22.4*	*23.0*	*17.8*
DUAL USE GOODS	**28.0**	**43.5**	**39.8**	**17.0**
OTHERS	**7.5**	**4.7**	**10.8**	**-6.0**
RETAINED IMPORTS	**21.9**	**17.3**	**24.3**	**8.7**
RE-EXPORTS	**89.6**	**77.6**	**102.9**	**35.3**
GROSS IMPORTS	**23.7**	**19.1**	**26.4**	**9.8**

Source: Department of Statistics, Malaysia

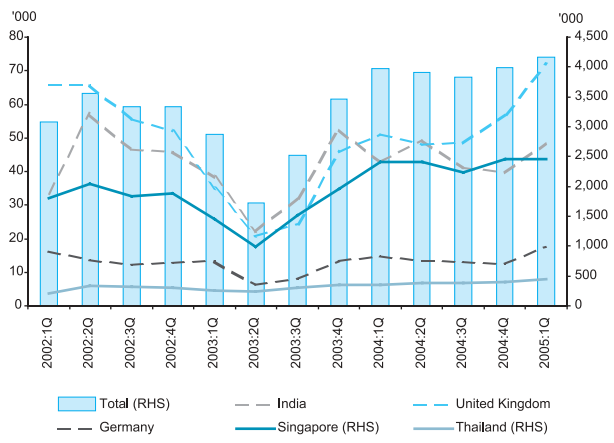
petroleum led to higher imports of construction and mining equipment.

Consonant with sustained private consumer spending and higher demand during the festivities, imports of **consumption goods** increased by 10.4%. Growth in consumption imports was mainly supported by higher demand for food and beverages and consumer goods. Reflecting continued demand for assembling and packing activities in free commercial zones, imports for re-exports grew by 35.3% during the quarter.

Higher tourist arrivals

Tourist arrivals increased by 4.6% to 4.2 million in the first quarter of 2005, despite the Tsunami, which hit the region on 26 December 2004. The increase in tourist arrivals was attributed mainly to visitors from Singapore and Thailand, which together accounted for 69.5% of total arrivals. International events, such as Formula One Petronas Malaysia Grand Prix has also contributed to the improvement in tourist arrivals. Visitors from India increased by 22.3% from the preceding quarter, supported by improved economic performance and greater connectivity with the increase in gateway points to India. Promotional campaigns and attractive travel packages also caused a 29.6% increase in long-haul tourists from Europe.

Quarterly Tourist Arrivals



While inflows of FDI were sustained, portfolio investment moderated

On a cash basis, gross inflows of **foreign direct investment (FDI)** were sustained at RM4.4 billion in the first quarter of 2005 (4Q 2004: RM4.7 billion). The inflows were channelled mainly into the services sector, particularly in the business and support services as well as the wholesale and retail trade sub-sectors. FDI inflows into the manufacturing sector were mainly for the E&E, petroleum-related activities as well as cable and wires industries. The oil and gas sector continued to receive new FDI flows particularly from foreign production sharing partners in Canada and the US. After adjustments for outflows due to repayment of loans to related companies and liquidation of foreign-owned businesses in Malaysia, net FDI registered an outflow of RM0.8 billion (4Q 2004: +RM1.7 billion).

Gross outflows for **overseas investment** increased to RM28 billion (4Q 2004: -RM18.1 billion) due to higher short-term loan extension by non-resident controlled companies in Malaysia to their related companies abroad arising from their centralised treasury operations. Nevertheless, these outflows were largely

offset by inflows arising from repayment of short-term inter-company loans during the quarter. After adjusting for inflows due mainly to repayment of inter-company loans from abroad, overseas investment recorded a net outflow of RM3.2 billion in the first quarter of 2005 (4Q 2004: -RM3.6 billion). Overseas investments were effected mainly by companies in the services sector, particularly the transport and communications sub-sector, reflecting the acquisition of a mobile operator in Indonesia. In the manufacturing sector, overseas investments were mainly directed into the petroleum-related activities and semiconductors and other electronic component industries. Meanwhile, companies in the oil and gas sector continued to invest abroad, with overseas investment channelled mainly to the Asian and African regions.

Meanwhile, net inflows of **portfolio investment** moderated to RM3 billion (4Q 2004: RM10.4 billion), as fund managers reallocated their equity portfolio in the Asian region.

External debt declined

Malaysia's total external debt declined to RM195 billion or USD51.3 billion as at end-March 2005 (4Q 2004: RM200.5 billion or USD52.8 billion), equivalent to 43.9% of GNP. **Medium- and long-term external debt** was lower at RM154.3 billion or USD40.6 billion (4Q 2004: RM156.6 billion or USD41.2 billion), due largely to net repayment of external loans by both the Federal Government and the non-financial public enterprises (NFPEs). The NFPEs registered a net repayment of RM2.5 billion, reflecting significantly lower drawdown while repayment was larger. The repayments, including the maturity of a US dollar-denominated bond, were effected mainly by the NFPEs in the manufacturing sector. Meanwhile, the private sector recorded a net drawdown, mainly by the companies in the agriculture and oil and gas sectors.

External Debt Outstanding

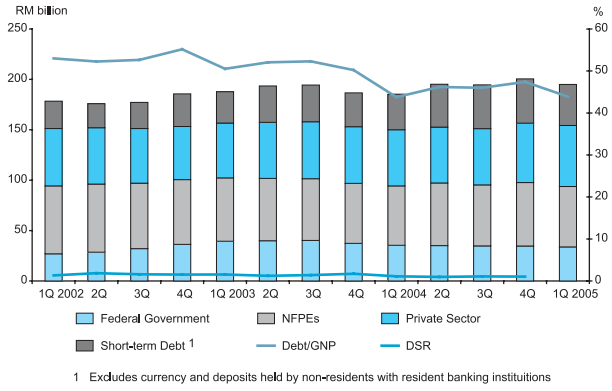
	2004		2005
	1Q	4Q	1Q [p]
	RM billion		
Medium- and Long-term debt	150.0	156.6	154.3
Public sector	94.3	97.7	93.7
Private sector	55.7	58.9	60.6
Short-term debt [1]	35.3	44.0	40.7
Total external debt	185.3	200.5	195.0
- USD billion equivalent	48.8	52.8	51.3

[1] Excludes currency and deposits held by non-residents with resident banking institutions

[p] Preliminary

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

External Debt Outstanding



1 Excludes currency and deposits held by non-residents with resident banking instituitions

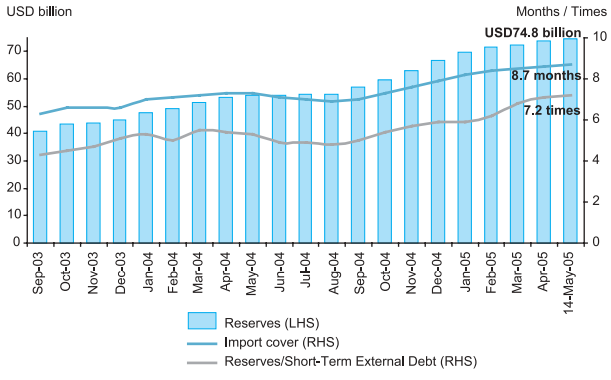
The total **short-term external debt** was lower at RM40.7 billion or USD10.7 billion (4Q 2004: RM44 billion), reflecting lower

short-term borrowings by both the banking and non-bank private sectors. As at end-March, the short-term debt remained low, accounting for 20.9% of total external debt and is about 14.8% of the net international reserves.

International reserves continued to increase

The international reserves of Bank Negara Malaysia increased further in the first quarter of 2005. As at 31 March 2005, the net international reserves stood at RM275.2 billion or USD72.4 billion, an increase of RM21.6 billion or USD5.7 billion since end-2004. The increase in reserves during the quarter was supported mainly by sustained repatriation of export earnings, inflows of FDI and portfolio funds. Meanwhile, outflows reflected mainly payments for imports of goods and services, repatriation of profits and dividends, and repayments of external loans. The reserves level has also taken into account the quarterly adjustment of the foreign exchange revaluation loss amounting to USD1.2 billion.

Net International Reserves (as at end-period)



The reserves increased further to RM284.4 billion or USD74.8 billion as at 14 May 2005, reflecting continued repatriation of export earnings and inflows of FDI and portfolio investment. The reserves position is adequate to finance 8.7 months of retained imports and is 7.2 times the short-term external debt.

Improved Fiscal Position

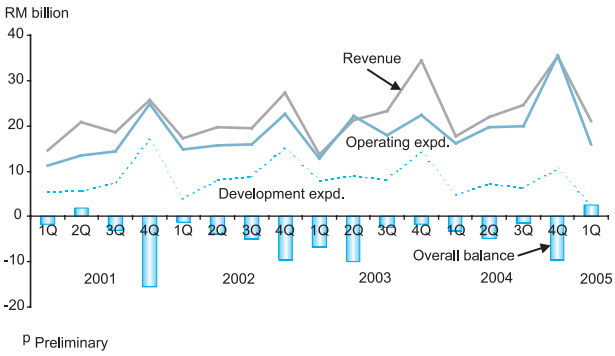
The Federal Government recorded a small fiscal surplus of RM2.6 billion or 2.3% of GDP in the first quarter due to strong revenue collection and lower development expenditure. Strong revenue performance was recorded in the first quarter, mainly from higher petroleum-based revenue. Most

Federal Government Finance

	2004			2005
	1Q	4Q	Year	1Q[p]
	RM billion			
Revenue	17.7	35.3	99.4	21.1
% growth	*29.3*	*2.5*	*7.3*	*19.2*
Operating expenditure	16.2	35.5	91.3	15.9
% growth	*26.7*	*58.3*	*21.4*	*-1.5*
Current account	**1.6**	**-0.2**	**8.1**	**5.2**
% of GDP	***1.5***	***-0.2***	***1.8***	***4.5***
Gross development expenditure	4.9	10.5	28.9	2.8
% growth	*-38.0*	*-26.8*	*-26.7*	*-42.9*
Loan recoveries	0.1	1.0	1.3	0.2
Overall balance	**-3.2**	**-9.8**	**-19.4**	**2.6**
% of GDP	***-3.1***	***-8.3***	***-4.3***	***2.3***
Memo item:				
Total gross expenditure	21.0	46.0	120.2	18.7
% growth	*2.1*	*25.1*	*4.9*	*-11.1*
Total Federal Government debt (as at end period)	194.3	216.6	216.6	223.1
% of GDP	*43.2*	*48.2*	*48.2*	*47.4*
Domestic debt	157.0	182.0	182.0	189.3
% of GDP	*34.9*	*40.5*	*40.5*	*40.2*
External debt	37.3	34.7	34.7	33.8
% of GDP	*8.3*	*7.7*	*7.7*	*7.2*

[p] Preliminary

Federal Government Finance[p]



[p] Preliminary

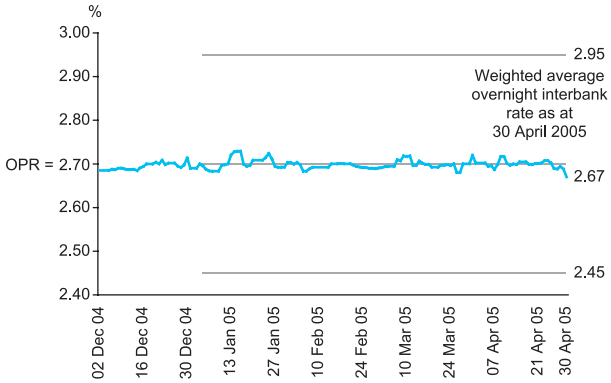
major sources of indirect taxes registered better growth reflecting the higher domestic aggregate demand. Given the ample liquidity in the domestic market, funds were raised entirely from domestic sources. As at end-March 2005, total outstanding debt of the Federal Government amounted to RM223.1 billion or 47.4% of GDP. The external debt of the Federal Government continues to remain low at 7.2% of GDP.

MONETARY AND FINANCIAL DEVELOPMENTS

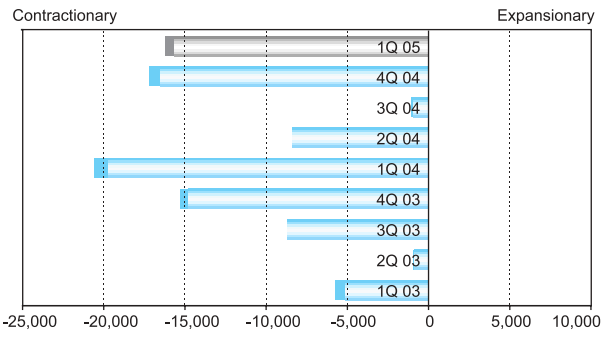
Monetary policy continued to support growth

In the first quarter, monetary and financial indicators continued to reflect a sustained expansion in underlying economic activity with monetary policy continuing its growth supportive stance. The Overnight Policy Rate (OPR) was maintained at 2.70%. The daily weighted average of the overnight interbank rate moved within a narrow range of 2.67% - 2.73%, averaging 2.70% in the period 1 January - 30 April 2005. Low interest rates and ample liquidity in the banking system continued to support the financing of economic activity through the banking system and the capital market.

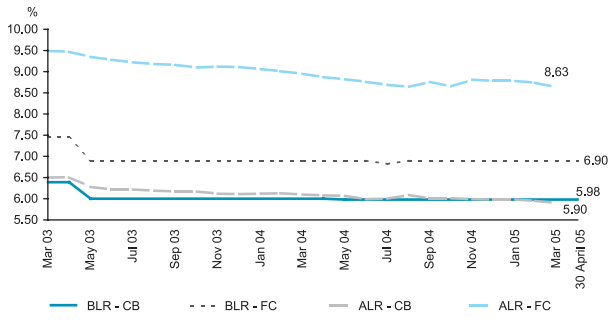
Daily Weighted Average Overnight Interbank Rate



BNM Liquidity Operations
(During the quarter, RM m)



Lending Rates of Commercial Banks & Finance Companies
(average for the month)



Interest Rates

	1Q 04	4Q 04	1Q 05
	At end-period (%)		
3-month intervention rate*	4.50		
Overnight Policy Rate (OPR)*		2.70	2.70
Interbank rates			
Overnight	2.71	2.69	2.70
1-month	2.98	2.77	2.76
Base lending rates (BLR)			
Commercial banks	6.00	5.98	5.98
Finance companies	6.90	6.90	6.90
Average lending rates			
Commercial banks	6.10	5.98	5.90
Finance companies	8.95	8.78	8.63
Fixed deposit rates			
Commercial banks			
3-month	3.00	3.00	3.00
12-month	3.70	3.70	3.70
Finance companies			
3-month	3.00	3.00	3.00
12-month	3.70	3.70	3.70

* Effective 26 April 2004, the Overnight Policy Rate (OPR) replaced the 3-month intervention rate as the indicator of the monetary policy stance.

As at end-March 2005, the average BLR of commercial banks (CBs) and finance companies (FCs) remained unchanged at 5.98% and 6.90% respectively, while the ALR of CBs and FCs declined to 5.90% and 8.63%.

Financing of the private sector sustained at a high level

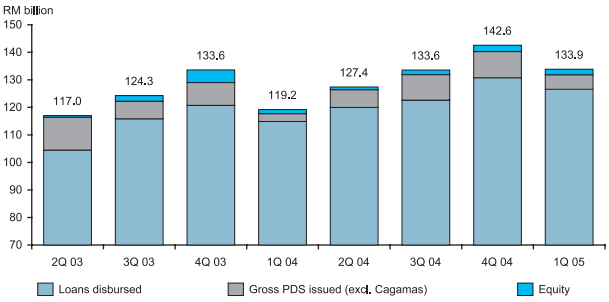
In the first quarter of 2005, gross private sector financing raised through the banking system and the capital market stood at RM133.9 billion (4Q 2004: RM142.6 billion), with an annual growth rate of 12.3% (4Q 2004: 6.7%). The amount of financing was slightly lower than the previous quarter, however, in part due to the fewer number of working days in the first quarter. Meanwhile, on a net basis, banking system loans and PDS outstanding increased further at an annual rate of 9.6% at end-March 2005 (end-2004: 9%), driven mainly by loans outstanding, which grew by 9.1% on an annual basis at end-March 2005 (end-2004: 8.5%).

Financing of the Private Sector through Banking System and Capital Market

	During the period (RM billion)				Annual change (%)			
	1Q 04	4Q 04	2004	1Q 05	1Q 04	4Q 04	2004	1Q 05
Gross total financing	119.2	142.6	522.8	133.9	1.7	6.7	6.2	12.3
Loans disbursed	114.9	130.8	488.2	126.6	14.4	8.3	10.6	10.2
Gross PDS (excl. Cagamas)	2.8	9.5	28.1	5.3	-82.5	14.7	-34.4	86.4
Equity	1.5	2.3	6.5	2.0	160.1	-49.3	-16.7	31.6
Outstanding total financing (A)+(B)	6.9	18.2	55.6	11.2	8.2	9.0	9.0	9.6
Banking system	3.3	10.7	39.0	8.2	5.3	7.7	7.7	8.6
Loans outstanding (A)[1]	*5.3*	*11.9*	*40.1*	*8.7*	*5.7*	*8.5*	*8.5*	*9.1*
Holding of PDS	*-2.0*	*-1.2*	*-1.1*	*-0.6*	*0.1*	*-3.1*	*-3.1*	*1.3*
PDS outstanding (B)	1.6	6.3	15.5	2.5	17.5	10.7	10.7	11.2
Memorandum item								
Gross PDS (incl Cagamas)	6.0	10.1	36.3	5.5	-65.3	-3.9	-28.7	-9.2

[1] Including loans sold to Cagamas

Gross Private Sector Financing through Banking System and Capital Market



The major loan indicators registered positive growth rates in the first quarter. Loan disbursements to businesses rose at an annual rate of 11.1% during the quarter (4Q 2004: 7.8%) and continued to be channeled mainly to the manufacturing sector (35.6% of total disbursements to businesses); wholesale, retail, restaurants and hotels sector

Loans by Sector

	Loans disbursed					Loans out-standing
	During the period				Share of total	Share of total
	2004	1Q 04	4Q 04	1Q 05		
	RM billion				%	
Business enterprises	335.3	78.2	90.8	86.9	68.7	41.9
Large corporations	*234.9*	*54.6*	*63.7*	*61.0*	*48.2*	*24.8*
SMEs	*100.4*	*23.7*	*27.2*	*25.9*	*20.5*	*17.1*
Households	130.3	30.8	34.0	33.9	26.8	52.3
By sector						
Agriculture, hunting, forestry and fishing	13.7	3.1	3.4	3.1	2.5	2.1
Mining and quarrying	2.0	0.5	0.7	0.5	0.4	0.2
Manufacturing	121.5	27.2	32.5	30.9	24.4	12.0
Broad property sector	88.8	21.0	23.2	22.0	17.4	40.8
Construction	*30.3*	*7.0*	*8.5*	*7.4*	*5.8*	*5.8*
Purchase of residential property	*38.8*	*9.5*	*9.3*	*9.2*	*7.3*	*26.3*
Purchase of non-residential property	*12.1*	*2.7*	*3.3*	*3.5*	*2.8*	*6.1*
Real estates	*7.5*	*1.8*	*2.1*	*1.9*	*1.5*	*2.7*
Electricity, gas and water supply	6.4	1.5	2.2	1.4	1.1	1.0
Wholesale, retail, restaurants and hotels	83.7	18.3	24.0	22.3	17.6	8.4
Transport, storage and communication	9.5	2.5	2.6	1.9	1.5	1.8
Finance, insurance and business services	36.5	10.6	8.6	11.1	8.7	6.1
Total	**488.2**	**114.9**	**130.8**	**126.6**	**100.0**	**100.0**

Source: Bank Negara Malaysia

Loan Indicators

	During the period (RM billion)				Annual change (%)			
	1Q 04	4Q 04	2004	1Q 05	1Q 04	4Q 04	2004	1Q 05
Total								
Loan applications	58.6	67.8	273.3	68.4	4.4	21.6	20.1	16.9
Loan approvals	37.2	43.2	173.6	42.6	5.2	10.9	13.6	14.6
Loan disbursements	114.9	130.8	488.2	126.6	14.4	8.3	10.6	10.2
Loan repayments	112.5	120.7	461.6	117.9	11.5	-1.8	7.3	4.8
Change in loan outstanding*	5.3	11.9	40.1	8.7	5.7	8.5	8.5	9.1
Of which:								
Business enterprises								
Loan applications	30.5	37.4	149.9	36.3	-9.9	31.0	20.0	19.0
Loan approvals	17.2	21.7	84.9	20.0	-5.1	14.8	9.8	16.3
Loan disbursements	78.2	90.8	335.3	86.9	14.9	7.8	10.5	11.1
Loan repayments	75.6	84.5	319.8	82.6	8.9	-2.7	6.8	9.3
Change in loan outstanding*	-0.4	1.0	5.5	...	-0.6	2.6	2.6	2.8
SMEs								
Loan applications	10.5	13.9	54.2	13.1	-17.8	41.4	21.7	24.4
Loan approvals	5.7	8.7	31.6	8.1	-15.9	30.5	22.0	40.8
Loan disbursements	23.7	27.2	100.4	25.9	12.3	9.1	15.3	9.6
Change in loan outstanding*	-1.1	2.2	6.3	1.2	5.3	7.7	7.7	10.5
Large corporations								
Loan applications	20.0	23.5	95.7	23.2	-5.0	25.5	19.1	16.2
Loan approvals	11.5	12.9	53.3	12.0	1.4	6.2	3.7	4.1
Loan disbursements	54.6	63.7	234.9	61.0	16.0	7.2	8.6	11.7
Change in loan outstanding*	0.6	-1.2	-0.8	-1.2	-3.9	-0.6	-0.6	-2.0
Households								
Loan applications	27.2	29.3	120.2	31.0	29.9	15.0	22.1	14.0
Loan approvals	19.3	21.3	86.8	21.9	20.8	14.1	20.5	13.3
Loan disbursements	30.8	34.0	130.3	33.9	17.5	12.0	13.9	10.0
Loan repayments	26.8	27.9	107.0	28.1	19.2	6.2	13.7	4.6
Change in loan outstanding*	6.0	8.9	33.3	8.7	12.9	14.4	14.4	15.2

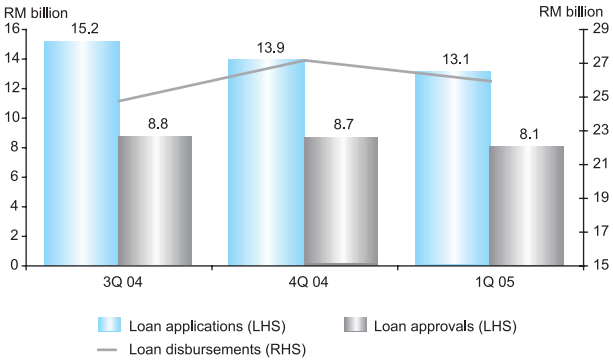
... negligible
* The annual growth is for end-period.
Source: Bank Negara Malaysia

(25.6%); and the finance, insurance and business services sector (12.7%). Higher demand for financing by businesses was also reflected in loan applications and approvals, which continued to record sustained growth rates of 19% and 16.3% respectively in the first quarter (4Q 2004: 31% and 14.8% respectively). Of significance, loans outstanding of businesses registered positive annual growth rates for two consecutive quarters, sustaining at an annual growth rate of 2.8% at end-March 2005 (end-2004: 2.6%) amid a declining trend in the gross non-performing loans (NPLs) ratio of businesses to 12.7% at end-March 2005 (end-2004: 13.7%).

Within the business sector, bank lending to the small and medium enterprises (SMEs) continued to increase. Loans outstanding of the SMEs grew significantly by 10.5% on an annual basis at end-March

2005 (end-2004: 7.7%). Meanwhile, loans disbursed to the SMEs were higher by 9.6% on an annual basis in the first quarter of 2005 (4Q 2004: 9.1%), with a total of RM8.1 billion approved to 19,711 SME accounts during the quarter (4Q 2004: RM8.7 billion approved to 25,924 SME accounts).

Bank Lending to SMEs

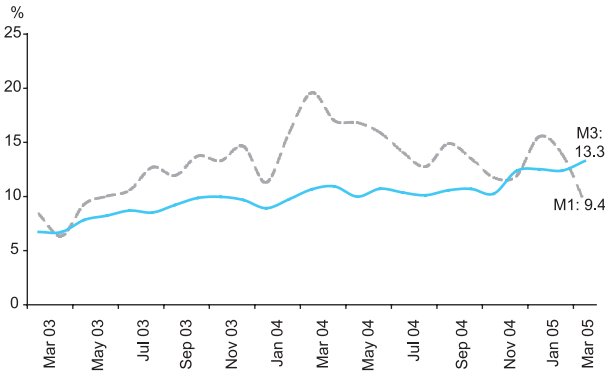


Financing to the household sector was sustained at a high level. Reflecting the sustained demand for bank financing by households, loan disbursements to households rose at an annual rate of 10% during the quarter (4Q 2004: 12%), and continued to be channelled towards credit card spending (29.4% of total disbursements to households), the purchase of residential properties (27.3%) and the purchase of passenger cars (25.3%). Similarly, loan applications and approvals expanded at annual rates of 14% and 13.3% respectively (4Q 2004: 15% and 14.1% respectively). Meanwhile, the growth in loans outstanding of households was higher at 15.2% at end-March 2005 (end-2004: 14.4%). Similar to business loans, gross NPL ratio of household loans was slightly lower at 7.4% at end-March 2005 (end-2004: 7.5%).

Continued growth in money supply in tandem with economic expansion

Monetary aggregates grew during the quarter in line with the expansion in domestic economic activity. Narrow money, M1, expanded by 9.4% on an annual basis at end-March 2005 (end-2004: 11.9%). Meanwhile, broad money, M3, grew at an annual rate of 13.3% at end-March 2005 (end-2004: 12.4%), driven mainly by higher claims on the private sector arising from increased lending by the banking system, as well as the continued inflow of external funds.

Monetary Aggregates: Annual Change



M3 Determinants

	Change during the year			
	Quarterly		Yearly	Quarterly
	1Q 04	4Q 04	2004	1Q 05
	RM billion			
M3	18.9	25.7	68.0	26.4
Net claims on Government	-6.0	-5.3	-15.9	-9.1
Claims on private sector	3.7	3.8	30.0	9.1
Net external operations*	33.3	30.6	81.9	29.0
Other influences	-12.2	-3.4	-28.1	-2.7

* Pre-revaluation

The capital market remained a major source of financing

In the first quarter of 2005, the capital market continued to be a major source of financing, especially for long-term business financing, with net funds raised amounting to RM10.5 billion. In the private debt securities (PDS) market, gross funds raised amounted to RM5.5 billion or 1.8 times the amount raised during the corresponding period of last year. These funds were raised by 25 corporations, of which 66.4% of the funds raised were channeled to the finance and business services sectors, followed by the manufacturing sector. The private sector continued to take advantage of the low interest rate environment as funds raised were mainly for restructuring and refinancing purposes (37% and 28.1% of total PDS issued, respectively). Funds raised for new activities accounted for 22% of total PDS issued. During the quarter, a new asset class was introduced with the inaugural issuance of an RM80 million Islamic principal municipal bond backed by assessment tax collections of a local authority. After adjusting for redemptions, net funds raised from the PDS market totaled RM1.3 billion.

The public sector bond issuances remained significant and accounted for 68.7% of total net funds raised. The Government issued two Malaysian Government Securities (MGS) with maturity of 5.5-year and 10.5-year. For the first time, a 10-year Government Investment Issues (GII) was issued, as part of the Government's efforts to lengthen the Islamic benchmark yield curve.

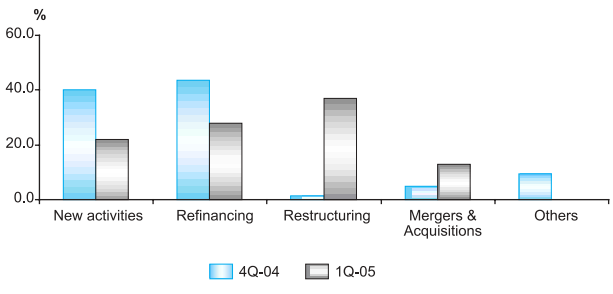
Funds raised through the equity market remained high at RM2 billion. Bulk of the funds were raised through 22 initial public offerings (IPOs) totaling RM1.8 billion. During the quarter, there were 23 new listings on Bursa Malaysia, with six listings on the Main Board, eight on the Second Board and nine on the MESDAQ Market.

Funds Raised in the Capital Market

	2004		2004	2005
	1Q	4Q		1Q
	RM million			
By Public Sector				
Government Securities, *gross*	11,000	7,021	43,173	4,000
Less Redemptions	5,500	1,000	18,200	-
Less Government holdings	-	-	-	-
Equals Net Federal receipts	5,500	6,021	24,973	4,000
Khazanah Bonds, *net*	-	-	(1,198)	833
Govt. Investment Issues, *net*	-	1,243	1,423	2,000
Malaysia Savings Bond, *net*	45	436	1,474	357
Net Funds Raised	5,545	7,700	26,671	7,190
By Private Sector				
Shares	1,527	2,316	6,475	2,009
Debt securities	6,041	10,083	36,340	5,486
Private Debt Securities (PDS)	2,836	9,483	28,050	5,286
Cagamas	3,205	600	8,290	200
Less Redemptions	6,928	4,463	26,814	4,212
Net Issues	(887)	5,620	9,526	1,274
Net issues (excluding Cagamas)	(2,092)	5,494	8,402	2,634
Net Funds Raised	640	7,936	16,001	3,282
Total Net Funds Raised	6,185	15,636	42,672	10,473
Short-term Papers and Notes, *net*[1]	(269)	(1,103)	(3,208)	587
Total	5,916	14,533	39,465	11,059

[1] Refers to Commercial Papers and Cagamas Notes only.

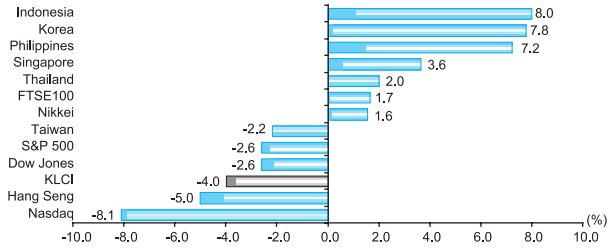
Private Debt Securities Issued by Purpose
(% of total)



KLCI performance consolidated due to concerns over escalating oil prices

Concerns over the strength of corporate earnings and the adverse implications of rising oil prices continued to plague the performance of the equity market. In the first quarter, the KLCI declined by 36.08 points, ending the quarter lower at 871.35 (-4% since end-2004). As a result, market capitalisation during the quarter was lower at RM694.9 billion (end-2004: RM722 billion). Nevertheless, trading activity improved with slightly higher average daily turnover recorded in terms of volume and value.

Performance of Selected Global and Regional Markets in the First Quarter of 2005



Bursa Malaysia: Selected Market Indicators

	As at end		
	2004		2005
	1Q	4Q	1Q
Price Indices			
- Composite	901.85	907.43	871.35
- EMAS	219.76	214.26	204.98
- Second Board	135.33	110.87	101.76
Average daily turnover			
- Volume (million units)	650.65	441.36	517.97
- Value (RM million)	1,328.20	835.02	965.78
Market Capitalisation (RM b)	724.15	722.04	694.89
No. of Companies Listed	923	962	982

Source: Bursa Malaysia

Bursa Malaysia: Turnover of Corporate Securities

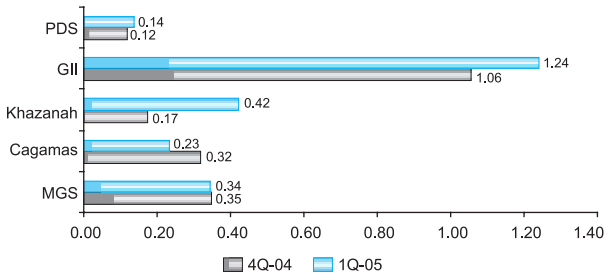
	2004				2004		2005	
	1Q		4Q				1Q	
	million units	RM million	million units	RM million	million units	RM million	million units	RM million
Turnover	37,737	77,036	27,364	51,771	107,610	215,623	30,042	56,261
of which:								
Main Board	27,626	61,454	20,186	45,129	78,132	180,408	21,236	48,384
of which								
- Consumer Products	1,173	3,905	899	2,924	4,008	12,583	1,018	3,117
- Industrial Products	4,087	6,067	4,036	4,978	12,365	17,427	4,829	5,767
- Construction	1,693	4,044	1,070	1,922	4,721	9,582	1,579	3,114
- Trading/Services	5,632	19,975	5,500	16,991	18,937	63,418	4,320	15,710
- Finance	4,536	14,521	1,958	8,090	10,843	38,176	3,059	10,495
- Properties	4,159	5,145	3,205	5,468	11,749	17,151	3,367	5,602
- Plantations	762	3,106	771	2,171	2,455	10,184	604	2,168
- Mining	43	140	-	1	48	175	0	1
Second Board	6,258	11,249	4,227	4,102	18,516	24,948	5,537	5,586

Source: Bursa Malaysia

Higher secondary trading in the bond market

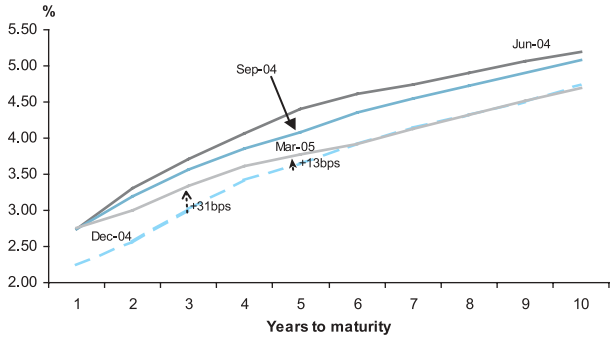
In the secondary market, total turnover increased to RM98.8 million in the first quarter (4Q 2004: RM91.7 million), with the highest turnover being recorded in March. Government securities accounted for 66.7% of the total trade, while Cagamas bonds and Khazanah bonds contributed 10.9% of the total trade. In terms of liquidity, the GII and Khazanah bonds were the most liquid papers, registering liquidity ratios of 1.24 and 0.42 respectively.

Liquidity Ratio: Turnover / Outstanding



Throughout the first quarter of 2005, sentiments in the bond market were positive until the last week of March. The MGS benchmark yields rose marginally before trending downwards in late January, following concerns over the impact of higher crude oil prices on global economic growth as well as the higher demand for Ringgit fixed income securities from non-residents. Subsequently, the shorter-end of the MGS yields shifted upwards in late-March, mirroring the increase in the US Treasury yields following the Federal Fund rates hike and concerns over the inflationary pressures in the US economy. As a result, the 3- and 5-year MGS benchmark yields increased by 31 basis points and 13 basis points respectively during the quarter.

Trend in MGS Yield



Performance of the ringgit

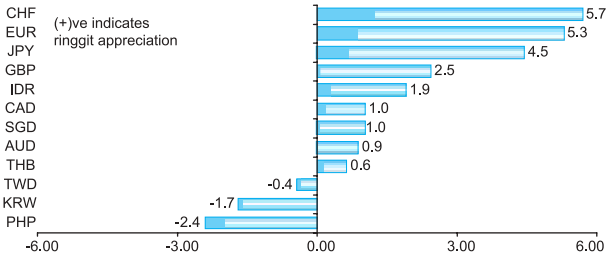
Reflecting movements in the US dollar, the ringgit appreciated against the major currencies over the quarter. The US dollar appreciated against these currencies, despite the yen reaching a 5-year high of 102.095 on 17 January, on expectations of, and the eventual increase in US interest rates by 0.25% at each of the two Federal Open Market Committee meetings. Anticipation of accelerated interest rate increases to contain inflationary pressures also contributed to the US dollar rally. Concurrently, forecasts and economic data indicated that positive economic growth in the US would continue to outpace that in the euro area and Japan in 2005.

The dollar, and hence the ringgit, appreciated against most regional currencies. Concerns of rising oil prices affecting regional

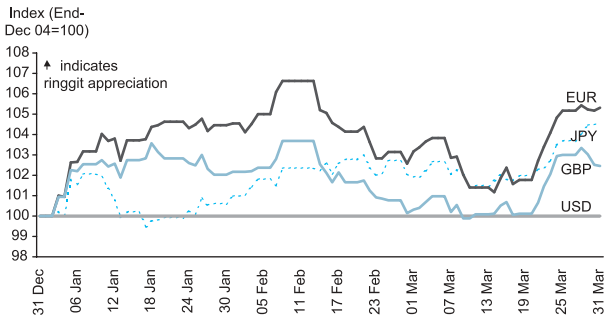
growth prospects contributed to some easing of regional currencies. The ringgit, however, depreciated against the Korean won as Korean exporters continued to repatriate earnings from abroad. The ringgit also depreciated against the Philippine peso over investor optimism that proposed tax increases would be approved in Congress.

Summary of Ringgit Performance Against Selected Currencies

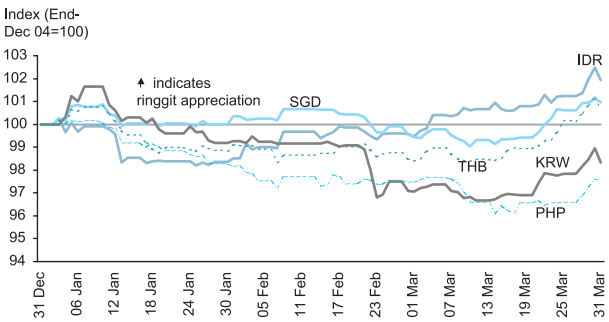
Percent Change (1 January - 31 March 2005)



Ringgit Performance Against Major Currencies



Ringgit Performance Against Regional Currencies



Performance of Ringgit Against Selected Currencies

RM per foreign currency	As at end					% change since*			
	30 Jun 97	02 Sep 98	1Q 04	4Q 04	1Q 05	30 Jun 97	02 Sep 98	1Q 04	4Q 04
US dollar	2.5235	3.8000	3.8000	3.8000	3.8000	-33.6	0.0	0.0	0.0
Euro	-	-	4.6522	5.1729	4.9125	-	-	-5.3	5.3
Pound sterling	4.1989	6.3708	6.9667	7.3169	7.1415	-41.2	-10.8	-2.4	2.5
100 Japanese yen	2.2088	2.7742	3.6334	3.7026	3.5446	-37.7	-21.7	2.5	4.5
Singapore dollar	1.7647	2.1998	2.2633	2.3258	2.3034	-23.4	-4.5	-1.7	1.0
100 Thai baht	9.7470	9.3713	9.6239	9.7636	9.7013	0.5	-3.4	-0.8	0.6
100 Philippine peso	9.5878	8.8302	6.7580	6.7706	6.9381	38.2	27.3	-2.6	-2.4
100 Indonesian rupiah	0.1038	0.0354	0.0442	0.0408	0.0401	159.0	-11.7	10.4	1.9
100 Korean won	0.2842	0.2827	0.3308	0.3671	0.3734	-23.9	-24.3	-11.4	-1.7

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

DEVELOPMENTS IN THE BANKING SYSTEM

The banking system remained sound with a strong capitalisation level and improved profitability in the first quarter of 2005. Non-performing loans (NPLs) of the banking system declined further during the quarter, resulting in strengthened balance sheets.

Capitalisation remained strong

The risk-weighted capital ratio (RWCR) and core capital ratio (CCR) of the banking system remained strong at 13.7% and 10.8% respectively, although both ratios were marginally lower. The decline in the RWCR was largely due to the twin effects of lower capital base (-RM1.1 billion or -1.4%) and higher risk-weighted assets (+RM13.5 billion or +2.4%). The lower capital base resulted from higher investment in subsidiaries and redistribution of profits to shareholders by some banking institutions during the quarter, whilst higher lending activities led to the expansion in risk-weighted assets.

Banking System: Capital Position

	2003	2004				2005
	4Q	1Q	2Q	3Q	4Q	1Q
Capital						
CCR (%)	11.1	11.0	11.7	11.4	11.2	10.8
RWCR (%)	13.8	13.7	14.3	13.9	14.2	13.7

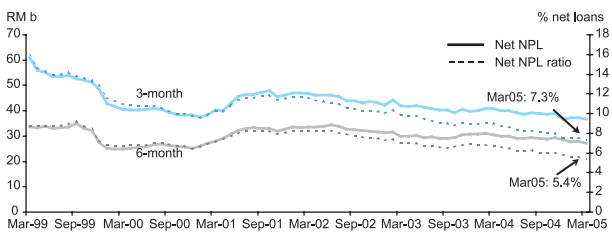
Profitability improved on account of lower expenses

Pre-tax profits of the banking system increased by RM0.3 billion (+12.2%) to RM3 billion during the first quarter of 2005. The stronger performance was achieved on account of significantly lower loan loss provisions (-50%) and operating expenses (-5.5%), which more than offset the marginal declines in net interest (-2.7%) and fee-based income (-1.9%). This resulted in a substantial increase in gross operating profits net of loan loss provisions to RM2.2 billion (+71.7%) for the quarter. The annualised return on average assets and equity both improved to 1.4% and 16.8% respectively (4Q 2004: 1.3% and 14.9%).

Continued downtrend in NPLs

Net NPLs based on the 6-month classification declined by 4.7% during the quarter to RM27.3 billion with NPL ratio dropping to 5.4% of total net loans (4Q 2004: 5.8%). The improvement was due primarily to lower new loans classified as non-performing as well as higher restructuring and rescheduling of credit facilities during the quarter. Net NPLs based on the 3-month classification recorded a marginal increase of 0.1% to RM36.8 billion or 7.3% of total net loans (4Q 2004: 7.5%).

Banking System: Non-performing Loans



Dialogue Session with Banking Institutions
17-18 February 2005, Kuala Lumpur

"Strengthening the Banking Sector for Further Competition"

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

Economic transformation, a more competitive environment, advances in technology, strengthening international linkages and more discerning customers will be the important forces that will drive changes in the domestic financial landscape in the years ahead. Economic transformation can be expected to be more pronounced as efforts intensify to shift resources to new areas of growth. A more competitive environment will emerge from increased deregulation and further liberalisation. Advances in technology will continue to increase the potential for creating new instruments, new business processes and enhance the ability to measure and manage risks. Strengthening international linkages will come as foreign presence and participation in the domestic financial system increases and as initiatives are taken by domestic groups to operate beyond domestic borders. Against this background, more demanding customers with higher expectations will see greater consumer activism exerting their influence on the financial landscape. These developments will indeed present a dynamic environment with new challenges for the banking industry.

It is my pleasure to welcome you to the dialogue session between Bank Negara Malaysia and the banking industry. This dialogue will provide an opportunity for the industry to discuss with the Central Bank these developments and their implications, important issues that have emerged and the Central Bank's policy initiatives.

As the year 2005 unfolds, it is important for us to reflect on our progress achieved, the new challenges that have emerged and the actions that need to be taken to drive performance in the period ahead. The banking system in Malaysia today is vibrant, strong and profitable. In fact, the banking system is at its strongest position since the financial crisis. The high level of capital, improving asset quality and strong profitability have also been reinforced by substantial enhancements in the areas of corporate governance and risk management standards. Large investment has also been made to strengthen internal systems and processes, to improve delivery channels and to acquire talent. Cumulatively, these enhancements have enabled the banking institutions, particularly the domestic banking institutions, to remain competitive and to offer differentiated products and value-added services. Undoubtedly, the competitive environment has also driven domestic banking

institutions to strive for greater efficiency as well as to venture into new areas of businesses, tapping new sources of income and entering into alliances with regional banking institutions. Most of all, these advancements have enabled the banking institutions to assume an important role in facilitating the increased role of the private sector in the economic growth process.

The foundations for strong performance have now been well established for the domestic banks. As we advance into the second phase of our Financial Sector Masterplan, the policy of gradually deregulating and liberalising the banking system will be complemented with the objectives of bringing increased benefits to the overall economy. While foreign banks will benefit from this process, it becomes equally important that there is reciprocity in the relationship. It is acknowledged that foreign banks have contributed to the development and vibrancy of our financial sector. They have made large capital investments and facilitated transfer of skills and technology to Malaysia. But the foreign banks have in turn benefited and flourished in the stable economic environment and significant economic growth Malaysia has achieved. Therefore, while greater operational flexibility will be accorded to the existing foreign banks so that they can better serve the needs of the growing economy, foreign banks will also need to become more integrated into the domestic economy. This includes ensuring affordable access to banking products and services by all segments of the society and not to focus only on specific locations. Therefore, the potential to establish additional branches will be balanced with the requirement to distribute the branch network to include non-urban areas. While the focus of foreign banks have been for the most part in urban areas, it should be noted that the record has shown that domestic banking institutions with large presence in the non-urban areas have been among those institutions that have sustained strong performance.

The economic prospects for 2005 will continue to be favourable. Despite some signs of slower global growth, this has not become a cause for concern as the underlying conditions in the global environment continue to remain supportive of growth. Positive developments are that income growth and job creation in the world's largest economy, the United States, has improved while growth in the Asian region also continues to be strong and mutually reinforcing. Despite higher commodity prices, inflationary pressures in the major economies remain moderate. While some countries have begun to raise interest rates, the environment has allowed the upward adjustments to be gradual and supportive of growth. Therefore, although the pace of world growth may moderate, global growth in 2005 will remain strong.

The current global environment is however, affected by uncertainty arising from the global imbalances. The United States continues to record large deficits in the current and fiscal accounts. There has been extensive discussion by the global community on the nature of the adjustment that should take place. Currently, the discussion on the measures to address the existing imbalances appears to be skewed toward pressures for a realignment of exchange rates. Ultimately,

these structural imbalances would have to be addressed by the countries where these imbalances exist. Exchange rates may be part of the solution but even so, they are only a small part of the solution. The issue of competitiveness however, requires more than just adjustments in exchange rates. It requires fundamental structural changes in the countries concerned. The appreciation of regional currencies is not likely to eliminate these imbalances. In fact, excessive focus on the exchange rates as corrective mechanisms for these imbalances has led to speculative capital inflows into Asian economies. This has required policy makers to intervene to avoid a sharp appreciation of their currencies, thus accumulating large reserve holdings. Clearly, at best, exchange rates offer only a partial solution and excessive focus on this area could in fact be counter productive. It risks sharp movements in exchange rates which at the extreme would be highly destabilising to the global currency, capital and commodity markets.

The long-term solution would be for the US to increase its savings and moderate its import demand and for the rest of the world to increase its demand and imports. Such a transformation will eventually occur but it is unlikely to occur overnight. In the transition there could be some economic dislocation. However, with its young workforce and with the growing productivity, competitive and dynamic economies, there is great potential for the Asian economies to become the growth dynamo for the region and the world. With rising income levels in regional economies, particularly among the growing middle income group in the People's Republic of China, India and the ASEAN economies, there is potential for an intrinsic source of demand within the region. This rebalancing of demand across the world will eventually reduce the prevailing imbalances.

In 2004, the Malaysian economy experienced strong growth. Going forward, the economy will continue to be well supported by both domestic and external demand. The strength of domestic demand, in particular, private expenditure, together with sustained exports, is expected to continue to support growth in 2005. This will be reinforced by sound domestic economic fundamentals as well as strong corporate and financial sectors. Private investment is likely to remain on an upward trend as companies upgrade facilities and install new capacity in response to strong domestic and external demand. The strength of the economy, the highly diversified economic structure and the strong fundamentals increase Malaysia's potential to absorb and respond to the challenging external environment.

Bank Negara Malaysia's monetary policy has played a supportive role to the economy throughout 2004. Going forward, this stance will be maintained. Inflation has risen from the earlier low levels but it is expected to remain relatively low in 2005 despite the US dollar depreciation and the higher international price of oil. Temporary increases in the inflation rate caused by one-off supply shocks or price adjustments do not warrant a monetary policy response. The focus of monetary policy is to continue to support further expansion in business investment activity to enhance the long-

term growth potential of the Malaysian economy.

During 2004, Bank Negara Malaysia also implemented a number of measures to enhance the operational efficiency and transparency of its monetary policy. In particular, almost one year after its introduction, the new interest rate framework is operating well, with the Overnight Policy Rate providing the signal to the market on the stance of monetary policy. Combined with the quarterly Monetary Policy Statement issued by the Central Bank, the market is provided with regular information on current and expected monetary conditions. The deregulation of pricing under the new interest rate framework has also acted as a catalyst for more efficient pricing in the financial system.

Against volatile world currency markets, the pegged exchange rate regime continues to accord significant benefits to the Malaysian economy by providing greater predictability and stability for international trade and investment. From time to time, isolated developments or rumours have prompted market speculation on the need to review the pegged exchange rate. Bank Negara Malaysia has consistently maintained that the exchange rate regime would not be reviewed unless the Ringgit is expected to be fundamentally misaligned or if the regime is no longer consistent with economic fundamentals arising from major structural changes within the international and regional financial systems. It should be noted that while the Ringgit has declined with the US dollar, its depreciation against Malaysia's trading partners' currencies as a group has been relatively small. Given the small degree of undervaluation, the inflation pass-through arising from the weakness in the US dollar is also likely to be small, and consequently, the potential for misalignment is correspondingly small. Therefore, the pegged exchange rate regime remains fundamentally sound and we expect that it would continue to serve the economy well. Any change in the exchange rate regime would be on the basis of longer-term structural considerations and not on account of short-term movements in capital flows and transient shifts in exchange rate expectations.

In spearheading the development of the financial sector, Bank Negara Malaysia's objective is to develop a dynamic, competitive and resilient financial sector. In the year 2005, focus will be accorded to strengthen the effectiveness of the banking sector in meeting the new requirements of the economy, enhance competition and hence efficiency and to strengthen the infrastructure for consumer protection. These initiatives would be taken in the context of preserving the soundness and stability of the financial system.

An important component of a strong financial sector is the institution of a robust regulatory and supervisory framework. Two main principles will be taken into consideration in the formulation and implementation of prudential policies. First, is the creation of a regulatory environment that fosters innovation and competition, while promoting best practices to preserve financial stability. Policies will therefore balance the need to attain efficiency whilst preserving stability. Second, regulations will increasingly be

"principle-based". Regulations will focus on identifying parameters within which banking institutions must operate, whilst retaining sufficient flexibility to allow institutions to determine their own individual strategies and approaches within these parameters. This is in the light of the improved corporate governance and risk management practices within banking institutions. The Board and management will be accountable for strengthening individual institutions.

The success of the principle-based approach to regulation will depend on the ability of banking institutions, individually and collectively as an industry, to make use of the flexibilities given without giving rise to excessive risk taking, overpricing, credit rationing and other actions that could threaten stability in the financial system and overall economic well-being of the nation. The key is for banking institutions to act responsibly, as the actions of banking institutions would have implications on all segments of the economy. Due attention must be given to ensure that all segments of the society have access to banking services at reasonable cost and no groups should be marginalised in this process. In this respect, while we advocate a principle-based regulatory framework, Bank Negara Malaysia will closely monitor the performance and actions of banking institutions, and would intervene and prescribe specific regulations in the event that actions by banking institutions could jeopardise financial stability and public confidence in the financial system.

As a custodian of public funds, and as a service-oriented industry, the banking sector must continuously strive to maintain public confidence in the system and deliver high standards of services. Maintaining public confidence entails efforts beyond maintaining strong financial results and having a wide range of products and services for customers. As customers become more financially savvy and better informed of their rights, the conduct and practices of banking institutions will increasingly be scrutinised by the public. Fraud, unethical practices, and monopolistic and unfair practices would, if left unchecked, adversely affect public opinion and confidence in the banking system, with consequences on the financial performance of individual institutions. Indeed, in order to preserve corporate reputation and sustain public confidence, banking institutions must be sensitive to the impact of their policies and practices on their customers and other stakeholders. It is, therefore, in the interest of the industry to collectively ensure that public confidence in the system is maintained at all times.

The recent issue on the fees and charges imposed by the banking institutions received significant attention by the public. Bank Negara Malaysia's policy has been to gradually deregulate the rules on fees and charges, as a way to drive improvement in the performance of banking institutions and promote innovation. Nevertheless, the flexibility given needs to be judiciously enforced so as not to result in any erosion of public confidence in the banking sector. To protect consumer interest, Bank Negara Malaysia will balance the competing expectations of banking institutions and consumers. While it is recognised that enhancements to products and delivery

channels involve substantial investments, any realignment to the pricing structures on products and services need to be supported by the adequate costing and justification that also takes into account cost savings. More importantly, it must be accompanied by improvements in service quality.

While Bank Negara Malaysia will continue to strengthen the consumer protection framework through enhanced disclosure standards, effective dispute resolution mechanisms, and promotion of fair practices, banking institutions must also play their role. An important aspect is to ensure that consumers are adequately equipped with the relevant information to minimise the risks of poor financial decisions and their consequences. Market practices and disclosure standards must be fair and comprehensive so as to ensure that consumers are treated equitably and have access to adequate and timely information to facilitate effective decision-making.

In this recent year, Bank Negara Malaysia has put in place two important infrastructures within the banking sector, the first being the framework for the establishment of Islamic subsidiaries, and secondly, the merger of commercial banks and finance companies within the same banking groups. These frameworks have paved the way for banking institutions to further rationalise their operations and improve efficiency. Both allow for the operations to be now undertaken within a new structure where the operations will be able to leverage on the group infrastructure, including the branch network and the support functions, to maximise cost efficiency and reap the benefits of group synergies. A number of banking institutions have already capitalised on the opportunities provided by these frameworks.

Going forward in 2005, Bank Negara Malaysia will finalise a number of key regulations for the banking system. These regulations will focus on enhancing Bank Negara Malaysia's overall oversight on banking institutions, whilst according greater flexibility for the Boards and management of the banking institutions to chart business strategies within the parameters set by the regulations.

In an environment where group structures are becoming more complex, prudential regulation and surveillance over diversified financial conglomerates will be further strengthened. In this regard, Bank Negara Malaysia will finalise the Framework for Consolidated Supervision of Financial Conglomerates in 2005. The first Concept Paper that was issued in December 2003 has received positive feedback from the industry. On the group structure, there has been wide acceptance of the proposal for all financial groups to be headed by financial holding companies. The essence of having the financial holding company is to allow banking institutions within the financial group to rely on the holding company as a source of financial strength. Flexibility will, however, be given for commercial banks to remain at the apex of the financial groups. Nevertheless, safeguards will be introduced to ensure that the commercial banks exhibit higher standards of risk

management practices and oversight to manage the higher risks arising from such structures.

A further issue is the scope and nature of activities that would be permissible within the financial holding company structure. The principle for defining financial activities or activities that are incidental to financial activities will be clearly outlined to facilitate any likely restructuring that will be required as a result of the new policy. Work is also ongoing to define the appropriate corporate governance and prudential standards to be applied at the financial holding company level. With regard to capital requirements, whether there should be a standard capital rule for all financial holding companies is currently being reviewed. The more important consideration is to minimise excessive leveraging and ensure that the financial holding company has the necessary infrastructure to have an overall view of the risk taking activities within the group.

It is envisaged that in a more liberalised financial system, market discipline will play a greater role in driving performance in banking institutions. In this regard, shareholders are expected to be more involved in overseeing the performance of banking institutions and the effectiveness of the board of directors and management. The policy on shareholding will therefore be enhanced to promote greater shareholder activism within banking institutions. Shareholders need to be concerned with the practices of banking institutions, particularly those which can have adverse implications on depositors' interests and on financial stability.

Similarly, given the increasingly competitive environment, advancement in risk management practices and the strengthened corporate governance framework, a more flexible policy framework on lending to connected parties will be put in place. However, to prevent abuses of such flexibilities, there will be safeguards and conditions that need to be observed by banking institutions.

The adoption of a principle-based regulatory approach will provide banking institutions with greater flexibility in deciding on strategic options in a more competitive environment. As the banking industry grows at an accelerating pace, there are common areas where collective efforts by the industry will not only bring benefits to the financial sector but also to the overall economy. In this regard, there is an increasing trend among developed countries such as the United Kingdom, Canada, and Australia, where the bankers associations have an important role in spearheading initiatives to promote high standards of ethical code of market conduct to meet consumers' rising expectations and demands. The bankers associations have increasingly assumed the role as a focal point for consultation with not only the regulatory authorities, but also with the other stakeholders on policies affecting the financial sector. In this respect, such associations have played an important complementary role to the regulatory authorities' efforts in promoting a more progressive, dynamic and resilient banking system. In addition, banking associations in these countries have also acted as the voice for the industry in articulating the position of their members

to promote the interests of the industry. In Malaysia, there are several areas of common interest to the industry which the associations can spearhead. It is, therefore, to the benefit of the industry to reassess the role of the associations with respect to taking forward common initiatives and interests of the industry.

Moving forward, consumer and SME financing will continue to be two important areas of growth. The overall macroeconomic and interest rate environment would continue to be supportive of growth in these two sectors. The challenge for banking institutions is to ensure that consumers and the businesses have access to a wide range of products, while at the same time ensuring that the necessary infrastructure is in place to manage risks arising from these businesses. This is to ensure that lending to these sectors would be sustainable and avoid the risks that have recently been experienced in a number of other countries in this region.

While focusing on consumer and SME financing, banking institutions should also recognise the emergence of a number of new growth sectors in the economy, including activities in the services sector, and the agriculture and agro-based industries. These areas represent opportunities that can be capitalised upon by the banking institutions. While these may be viewed as non-traditional areas, banking institutions that introduce new lending models and products to cater to the financial requirements of these areas would have the early advantage in capitalising the potential of these new markets.

In this regard, the main theme of this year's dialogue, is "Tapping Opportunities in the New Growth Areas - Fostering Best Lending Practices", for discussion by the banking community. We are very pleased to have four distinguished speakers to share with us their expertise and experiences in building successful and sustainable portfolios in consumer lending, SME financing, microcredit and agriculture financing. Following their presentations, there will be break-up sessions in these four areas where bankers are encouraged to actively discuss the issues relating to these respective areas. Each group will be invited to present the results of their deliberations tomorrow morning. It is hoped that this will be a constructive process that will contribute towards elevating the level of performance and value added in these areas.

Launch of Bank Negara Malaysia LINK

Bank Negara Malaysia
25 February 2005, Kuala Lumpur

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

The Central Bank engaging with the public is what Bank Negara Malaysia LINK is about. It is my great pleasure and honour to welcome you to the official launch of the Bank Negara Malaysia *Laman Informasi Nasihat dan Khidmat* or the Bank Negara Malaysia LINK.

The Bank Negara Malaysia LINK aims to enhance the effectiveness of Bank Negara Malaysia's interface with the public. Bank Negara Malaysia LINK is established as a centralised point of contact with the public on issues that relate to our operations, our policies, the financial sector and consumer education in the area of finance. We believe this continuous engagement with the public will not only enhance awareness, understanding and appreciation of the issues at hand but also contribute to facilitating the efficient functioning of the financial system and ensure the effectiveness of policy. Bank Negara Malaysia LINK will also centralise all interface with the SMEs on issues that relate to matters on access to financing and thereby contribute towards enhancing their value added to the economy.

We are most honoured today by the presence of Yang Amat Berhormat Dato' Seri Abdullah Ahmad Badawi to launch the Bank Negara Malaysia LINK. We took the opportunity from Yang Amat Berhormat's attendance at the economic briefing at Bank Negara Malaysia this morning, to officiate the launching of Bank Negara Malaysia LINK. The setting up of the Bank Negara Malaysia LINK represents the Central Bank's commitment in further enhancing the services to the general public and to facilitate access to financing by the SMEs. The official launch today is of particular significance to us as the Prime Minister has been the champion for further improvement in the public sector delivery system. Yang Amat Berhormat Dato' Seri has also played a prominent role in enhancing the potential of SMEs as an engine of economic growth.

Bank Negara Malaysia has always been in direct contact with the public. The Central Bank receives walk-in members of the public seeking information in relation to our operations, policies and regulations as well as those who seek redress on financial issues. The SME Unit in Bank Negara Malaysia also has direct contact with the SMEs relating to issues of access to financing. The establishment of Bank Negara Malaysia LINK is to allow the interface with members of the

public as well as the SMEs to be centralised and conducted in a more efficient and effective manner.

The premises of the Bank Negara Malaysia LINK was previously the Kuala Lumpur branch of Bank Negara Malaysia. The Kuala Lumpur branch used to provide retail banking services to the Government as part of our role as banker to the Government. This role has now been transferred to banking institutions. It was also where currency was processed. This has also now been outsourced to MEPS Currency Management Sdn. Bhd. The branch premises is therefore now being transformed to a centralised service centre.

Bank Negara Malaysia LINK will also provide support to the Bank's SME Special Unit in a number of areas associated with access to financing. The SME Special Unit was established within Bank Negara Malaysia almost two years ago. Initially, the functions of the SME Special Unit was to provide information on the various sources of financing available to the SMEs; facilitate the loan application process; and to provide advisory services relating to the financial requirements of SMEs. The role has subsequently been enhanced to monitor, coordinate and evaluate SME financing across all sectors, to review policies to enhance access to financing and coordinate the implementation of all SME financing policies. In addition, the SME Special Unit also acts as the Secretariat to the Small Debt Resolution Committee, which facilitates the restructuring of non-performing loans (NPLs) of SMEs with on-going businesses. The SME facilities available at Bank Negara Malaysia LINK will greatly increase the outreach capabilities of the SME Special Unit.

As the financial system becomes more developed and sophisticated, there needs to be increased financial literacy. As part of our Financial Sector Master Plan, we have implemented a 10-year programme to increase consumers' financial literacy. We are now in the third year of the programme. The effective participation by the public in the financial system needs to be an informed participation. There needs to be better understanding of the consumer's financial rights and responsibilities, the opportunities and the associated risks and costs.

Bank Negara Malaysia LINK through its exhibitions, interactive information kiosks and booklets, will serve as a channel to provide consumer financial education to the public. In this connection, Bank Negara Malaysia LINK will provide information relating to conventional and Islamic banking, insurance and takaful, SMEs, foreign exchange administration, Central Credit Reference Information System (CCRIS), *Biro Maklumat Cek*, development financial institutions, and other financing related matters. Bank Negara Malaysia LINK would also attend to public complaints on the above matters. As part of efforts to preserve the history on Bank Negara Malaysia's role in nation building, Bank Negara Malaysia LINK also includes a section on the Bank's contribution in shaping the country's economy and financial sector since the 1950s.

The establishment of Bank Negara Malaysia LINK takes the Central Bank's public

outreach programme to a higher level. By providing a centralised platform for the public to seek information and address financial issues, it is our hope that Bank Negara Malaysia LINK will be instrumental in building bridges between consumers, including SMEs, the financial business community, consumer associations and policymakers. We believe in the importance of this outreach effort not only because the public has a right to an informed participation in their financial dealings, but also because it is an important part of our collective and combined efforts that will determine the success of our endeavours.