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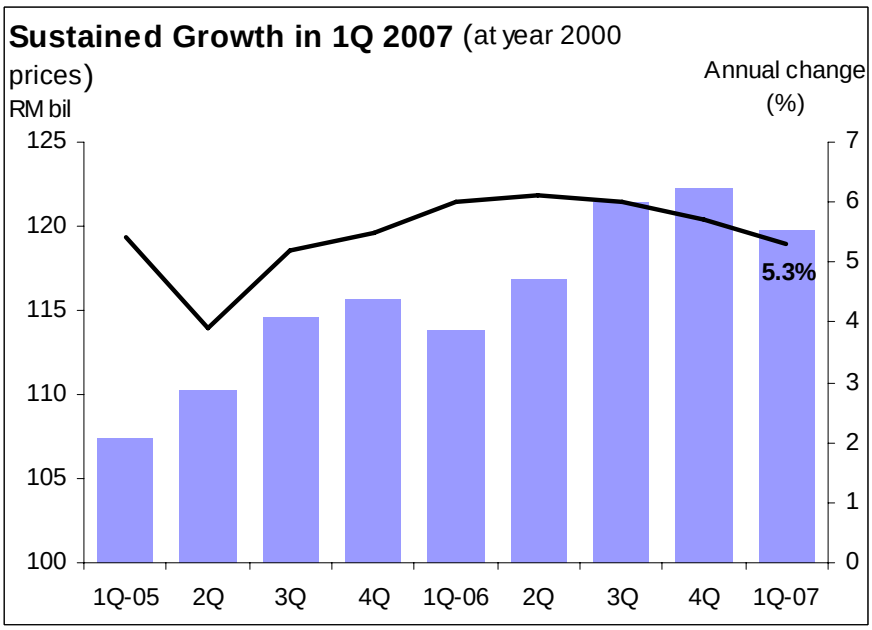
PRESS RELEASE

Economic and Financial Developments in Malaysia in the First Quarter of 2007

Growth supported by resilient domestic demand

The Malaysian economy continued to expand by 5.3% in the first quarter of 2007 (4Q 2006: 5.7%). Domestic demand, driven by the private sector consumption and investment activities, was reinforced by increased public investment spending. On the supply side, growth was supported by strong expansion in the services sector and higher construction activity.



The services sector strengthened significantly to expand at an accelerated pace of 9.6% (4Q 2006: 8%), driven by an increase in consumption-related activities, finance and business services. This was reflected in the strong growth in the wholesale and retail trade, accommodation and restaurant as well as in the finance, insurance, real estate and business services sub-sectors. The services sector remained the key driver of growth, contributing five percentage points to overall GDP growth. The construction sector gained further momentum in the first quarter of 2007, supported by the better performance in the civil-engineering sub-sector following the launch of projects under the Ninth Malaysia Plan. The sector was also underpinned by increased activity in the non-residential sector.

Despite the moderation in growth in the electronics and electrical (E&E) sector, the manufacturing sector recorded a positive growth of 1.7%. Growth was supported by the more diversified base of the manufacturing sector, with growth in resource-based industries and selected domestic-oriented industries offsetting the effects of the weakness in the E&E sector. Output of export-oriented industries increased by 0.1% during the quarter (4Q 2006: 4.3%) due mainly to the expansion in the resource-based industries such as chemicals and rubber products, and to a lesser extent wood and petroleum products. Meanwhile, the strong domestic demand, particularly for construction-related materials, fabricated metal, and food industries provided support to the domestic-oriented industries.

The agriculture sector continued to expand by 2% in the first quarter, supported mainly by growth in other minor agricultural activities such as fish, livestock, forestry, cocoa and fruits and vegetables. Meanwhile, the mining sector contracted by 1.1% (4Q 2006: 2.1%) due to lower production of crude oil.

Domestic demand strengthened further in the first quarter to record an annual growth of 7.6% (4Q 2006: 7.1%), underpinned by strong private consumption and increased public investment spending. The steady increase in disposable income in an environment of stable labour market conditions and firm commodity prices contributed to the continued strong growth in private consumption of 8.6%. Gross fixed capital formation recorded a growth of 5.4% (4Q 2006: 9.8%) reflecting the positive growth in investment expenditure by both the private and public sectors. The bulk of the public sector spending was channelled towards improving essential services including transportation, agriculture, rural development and public utilities.

The headline inflation rate, as measured by the change in the Consumer Price Index (CPI), continued to moderate, averaging 2.6% in the first quarter of 2007 (4Q 2006: 3%). The slower increase in prices mainly reflected the lower contribution of the transport category to the headline inflation rate, following the lapse of the effects of the March 2006 increase in the prices of retail petroleum products.

On the external front, the surplus on trade account narrowed to RM21.3 billion (4Q 2006: RM30.2 billion) as growth in imports of 5.4% (4Q 2006: 6.8%) outpaced growth in exports of 1.1% (4Q 2006: 6.6%). Despite the moderation in demand for computers and parts, manufactured exports grew by 1.5%. Growth was supported by the continued growth in exports of semiconductor chips to the non-US market, expansion in resource-based products such as chemical and rubber products, as well as the sustained growth in exports of consumer products. Meanwhile, agriculture exports rose by 7.7% during the quarter, supported mainly by the substantial rise in palm oil exports attributable to the strong increase in export prices. This is largely due to the continued high global demand for palm oil, particularly from the People's Republic of China (PR China), European Union (EU) and the US, amidst declining production and stocks, as well as the rise in soybean oil prices due to switching of the crops to corn planting in the US to fulfil domestic demand for biofuel. Receipts from mineral exports declined during the quarter due to lower exports of crude oil arising from the decline in prices, while export volume continued to increase.

Gross imports increased further in the first quarter reflecting higher imported inputs for manufactured exports and sustained increased in consumption products. Imports of intermediate goods increased by 8.8%, while imports of consumption goods grew by 8.9%. Imports of capital goods remained high at RM15 billion due mainly to higher imports of machinery and equipments in the agriculture, services as well as oil and gas sectors.

In the financial account, foreign direct investment (FDI), as captured by Bank Negara Malaysia's Cash BOP System (does not include retained earnings and investment in the form of imported machinery and equipment), recorded a net inflow of RM0.9 billion in the first quarter, reflecting inflows of equity capital mainly into the manufacturing, services and oil and gas sectors. The strong foreign participation in the domestic equity market during the first quarter is reflected in the significant net inflow in portfolio investment of RM26.9 billion. Meanwhile, overseas investment recorded a larger net outflow of RM3.8 billion (4Q 2006: -RM1.6 billion).

The international reserves of Bank Negara Malaysia amounted to RM305.9 billion or equivalent to USD88.6 billion as at 30 March 2007. As at 15 May 2007, the reserves amounted to RM326.5 billion or equivalent to USD94.5 billion, sufficient to finance 8.6 months of imports and is 9.6 times the short-term external debt.

Monetary policy remained supportive of economic activity

The overnight policy rate (OPR) was left unchanged at 3.50% throughout the first quarter of 2007 as the prevailing level of the policy rate is consistent with the medium term outlook of relatively low and stable inflation and steady pace of economic growth.

Reflecting the unchanged OPR, interbank rates of all maturities remained stable during the quarter. Retail lending and deposit rates also remained relatively unchanged. The real fixed deposit rates, however, rose significantly in March following the decline in inflation.

Financing to the private sector remained firm, with banking system loans and private debt securities (PDS) outstanding expanding at a combined annual rate of 6.1% at the end of the first quarter. Banking system loans outstanding increased at an annual rate of 6.2%, with loans outstanding to businesses and households expanding by 6.3% and 7.8% respectively. The major loan indicators were higher on an annual basis. Loan applications and approvals were notably higher, driven by increased demand by businesses.

Net funds raised in the capital market by the public and private sectors increased to RM9.4 billion during the quarter. Although gross funds raised in the PDS market were lower than in the previous quarter, net funds raised were significantly higher at RM1.2 billion, due to the lower redemptions during the quarter. Funds raised in the equity market were also higher, amounting to RM795 million.

M1, or narrow money, increased at a stronger annual rate of 17.9% as at the end of the first quarter of 2007, reflecting mainly the increase in demand deposits placed by business enterprises and, to a lesser extent, the higher amount of currency held by the private sector. The growth in M3 was sustained at 12.8%. The expansion in M3 during the quarter was driven mainly by the increase in net foreign assets following higher inflows in the form of export proceeds, net foreign direct investment and portfolio investments.

The ringgit appreciated against the major currencies in the first quarter of 2007. The ringgit appreciation was generally in line with the major regional trading partners. The ringgit appreciated against all regional currencies, except the Thai baht, in the first quarter.

For the period 1 April – 28 May 2007, the ringgit appreciated against the major currencies. The ringgit recorded a mixed performance against regional currencies. The ringgit appreciated against the Singapore dollar (2.7%), Korean won (0.9%), Chinese renminbi (0.9%) and Thai baht (0.9%), but depreciated against the Philippine peso (2.9%) and Indonesian rupiah (2.7%).

High resilience in the banking sector

The banking system continued to demonstrate strong resilience, as supported by high level of capitalization and improved profitability. The risk-weighted capital ratio (RWCR) stood at 13.1% as at end-March 2007, while the pre-tax profit registered an increase of 17.8% compared with the corresponding period of 2006 to amount to RM3.7 billion. Asset quality of the banking system continued to improve during the quarter as reflected in the further decline in the total net non-performing loans (NPLs) based on the 3-month classification. Consequently, the net NPL ratio declined further to 4.6% of net loans (4Q 2006: 4.8%).

Stronger growth in the second half of 2007

Going forward, the Malaysian economy is expected to record stronger growth in the second half-year. On the external front, indicators point to favourable growth performance for Europe, Japan and Asia, PR China and India. In addition, the current moderation in the E&E sector is expected to be temporary as forward-looking indicators such as the book-to-bill ratio and the US tech pulse index point towards an improvement in the electronics industry in the second half of the year. On the domestic front, forward-looking indicators show that private consumption and investment will continue to support domestic demand. The MIER Consumer Sentiments Index for the first quarter 2007 increased to 124.1 points, the highest level recorded since 3Q 2000, indicating that overall consumer confidence remained on the prospects for the economy. The sustained income growth due to firm commodity prices and stable employment conditions are expected to continue to support household consumption. Meanwhile, the MIER Business Confidence Index has remained above the 100-point threshold, suggesting a steady expansion in investment activities. On the production front, the more rapid implementation of projects under the Ninth Malaysia Plan, the commencement of production of Kikeh Oil Field and full commencement of MLNG-2 plant after an upgrade and the expected significant increase in tourist arrivals during the peak summer travel season are expected to contribute to the growth in the second half of 2007.

Bank Negara Malaysia
30 Mei 2007