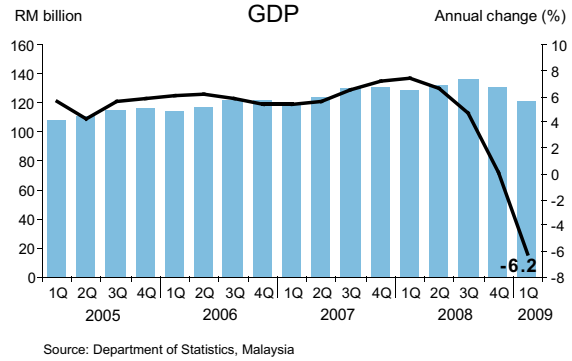
ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE FIRST QUARTER OF 2009

OVERVIEW

Growth contracted in the first quarter of 2009

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

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



Source: Department of Statistics, Malaysia

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

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

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

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

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

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

Interest rates lowered in line with OPR reductions

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

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

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

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

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

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

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

Banking and insurance sectors remained resilient

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

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

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

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

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

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

Domestic demand remains important in supporting growth

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

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

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

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

DEVELOPMENTS IN THE FIRST QUARTER OF 2009

INTERNATIONAL ECONOMIC ENVIRONMENT

Further deterioration in global economic conditions

The global economy deteriorated further in the first quarter of 2009, while conditions in the international financial system began to stabilise towards the latter part of the quarter. Major advanced economies are still facing a deepening economic contraction following compression in private sector demand. Regional economies experienced a sharp economic slowdown in the first quarter following further deterioration in both exports and production. Amidst worsening economic growth and diminishing inflationary pressures, authorities in the advanced economies continued to adopt aggressive monetary and financial measures to stabilise the financial system.

In the **US**, real GDP contracted at an annualised rate of 6.1% in the first quarter (4Q 08: -6.3%), its third consecutive quarter of decline, marking the longest contraction since 1975. While there was a quarter-on-quarter increase in consumer spending, the decline in overall GDP was due to larger declines in private fixed investment and government spending as well as significant inventory drawdown. Private fixed investment activities registered a larger contraction of 37.9% (4Q 08: -21.7%), reflecting a broad-based decline in residential and non-residential sectors. Private inventory drawdown accounted for nearly half of the GDP decline in the first quarter, as businesses continued to reduce inventories amidst weak demand prospects. Meanwhile, headline inflation declined by 0.2% in the quarter (4Q 08: 1.5%) due mainly to lower energy prices and transportation cost.

In **Japan**, real GDP contracted by an annualised rate of -15.2% (4Q 08: -14.4%), its worst decline in the postwar period, driven mainly by the sharp fall of 46.9% in exports during the quarter (4Q 08: -23.2%). The broad-based decline in exports, especially in automobiles to the US and Europe and electronics to the Asian region, had been accompanied by a sharp contraction of 34.5% in industrial production (4Q 08: -14.6%). Meanwhile, private consumption remained under stress as unemployment reached a 5-year high of 4.8% in March. On the inflation front, prices as measured by core consumer prices (excluding fresh food) recorded flat growth in the quarter (4Q 08: 1%), reflecting lower commodity prices and sluggish demand conditions.

The **euro area** experienced a decline in real GDP of 4.6% in the first quarter (4Q 08: -1.5%), recording the largest contraction since its formation in 1999. Germany, the largest member country, contracted by 6.9% (4Q 08: -1.6%), its steepest decline in 30 years driven by deterioration in net exports and investment. Domestic demand in several economies such as Ireland and Spain were affected by the ongoing correction in the housing market. The financial turmoil has also resulted in tighter credit conditions for households and businesses in the euro area, with the economic sentiment indicator reaching a record low of 64.6 points in March. Meanwhile, in the **UK**, real GDP declined by 4.1% in the first quarter (4Q 08: -2.0%), its largest contraction since 1980. This was attributed to larger contractions in both the manufacturing and services sectors. On the inflation front, consumer prices continued to trend downwards to 3.0% in the first quarter (4Q 08: 3.9%).

Industrial countries: Real GDP Growth

	2008			2009	Key contributing factors for 1Q growth
	1Q	4Q	Year	1Q	
	Annual change (%)				
U.S[1]	0.9	-6.3	1.1	-6.1[a]	Large declines in private investment and government spending as well as inventory drawdown.
UK	2.6	-2.0	0.7	-4.1	Bigger contraction in both the manufacturing and services sectors.
Euro area	2.1	-1.5	0.8	-4.6[p]	A combination of external-driven slowdown in Germany and weak domestic conditions in other euro economies.
Japan[1]	3.4	-14.4[r]	-0.7[r]	-15.2[p]	Deterioration in exports and production

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

Source: National authorities

While the global financial system has showed some tentative signs of stabilisation, central banks in the advanced economies continued to adopt quantitative easing measures and introduced further measures to strengthen the fragile financial institutions and markets. In the **US**, as the federal funds rate was already at near zero, the **Federal Reserve** (Fed) decided to inject liquidity into the financial system and support the housing market by purchasing long-term US Treasury securities of as much as USD300 billion and mortgage-backed securities of up to USD750 billion on 18 March. The Fed also utilised the *Term Asset-Backed Securities Loan Facility* (TALF) to support business and consumer lending through the secondary markets. Of significance, the US authorities unveiled a new plan called the *Public-Private Investment Program for Legacy Assets* to remove toxic assets up to USD1 trillion from the balance sheets of banking institutions. As part of its recapitalisation plan, the US authorities conducted stress tests on the 19 largest US banks to determine whether further capital injections were needed before the banks could normalise their lending activities. The stress tests revealed that 10 out of 19 banks have to increase their capital by a total of USD75 billion. Meanwhile, the **European Central Bank** (ECB) reduced its overnight rate by 50 basis points to 1.5% in March, and by another 25 basis points to 1.25% in April. In May, the ECB announced that it will purchase €60 billion euro-denominated covered bonds to improve bank lending and market liquidity. The **Bank of England** (BoE) also cut its base lending rate by 50 basis points to a record low of 0.5% in March and announced a £75 billion asset purchase programme to increase the money supply over a 3-month horizon. Similarly, the **Bank of Japan** also announced a plan to increase by nearly 30 percent its monthly purchases of government bonds from the banking institutions as part of its strategy to inject liquidity into the system.

In the first quarter, global **crude oil prices**[1] initially declined to a two-month low of USD33.98 per barrel in mid-February due to a combination of weak global demand conditions as well as a build-up in inventories. However, oil prices strengthened to close at USD49.66 per barrel at the end of the quarter on investor optimism that the global economy may have bottomed out.

In the **Asian region**, the more open economies including Singapore, Chinese Taipei, Korea and Hong Kong SAR experienced deeper recessions following the broad weakness in external demand while growth of other regional economies decelerated sharply during the first quarter. Growth in some economies was further affected by inventory drawdown as companies continued to cut production by a larger magnitude relative to exports. Following a weaker export performance, growth in PR China moderated to 6.1% in the first quarter (4Q 08: 6.8%). However, economic indicators in March showed that there were some signs of a pick-up in economic activity in PR China arising from the implementation of the fiscal stimulus. In response to the worsening global economic prospects amidst subsiding inflationary pressures, central banks across Asia have reduced interest rates by between 75 and 175 basis points.

[1] Refers to WTI one-month futures on NYMEX

Regional Countries: Real GDP Growth

	2008			2009	Key contributing factors for 1Q growth
	1Q	4Q	Year	1Q	
	Annual change (%)				
PR China	10.6	6.8	9.0	6.1	Growth moderated due to weakening external demand but remain supported by resilient domestic demand
Indonesia	6.3	5.2	6.1	4.4	Supported by strong domestic demand
Korea	5.5	-3.4	2.2	-4.3[a]	Downturn in private consumption, investment and exports.
Thailand	6.0	-4.2	2.6	-7.1	Contraction led by manufacturing sector
Hong Kong SAR	7.3	-2.6	2.4	-7.8	Contraction in growth due to weaker external and domestic demand
Singapore	6.7	-4.2	1.1	-10.1	Declines in both manufacturing and services sectors
Chinese Taipei	6.3	-8.6	0.1	-10.2[p]	Contraction due to sharp falls in exports and private investments

[a] Advance estimate
[p] Preliminary

Source: National authorities

In the foreign exchange market, most major currencies depreciated against the US dollar during the period January-February as there was increased risk aversion among investors amidst increasing signs of deterioration in the growth prospects of the advanced economies. To some extent, the euro was also affected by concerns of the impact of emerging Eastern European financial crisis on the European financial sector. However, most major currencies began to stabilise or have strengthened against the US dollar since March as there was improved risk appetite among investors amidst the rally in the global equities markets. Similarly, regional currencies also initially depreciated against the US dollar, as there was growing concern over the impact of sharp declines in exports and industrial production on the growth prospects in the region. Of significance, the Korean won reached an 11-year low in early March due to concerns on the ability of Korean private sector to service its external debt. However, as global equities strengthened from March onwards, the regional currencies strengthened risk appetite among investors improved.

Going forward, while some segments of the financial markets have showed improvement, global growth prospects are expected to remain weak despite some tentative signs of stabilisation in a number of economic indicators in several economies. Nonetheless, the implementation of large stimulus measures, as well as the ongoing measures to restore the health of the financial sector have increased the prospects for global economic conditions to stabilise in the second half of the year.

DEVELOPMENTS IN THE MALAYSIAN ECONOMY

Growth contracted in the first quarter

The Malaysian economy contracted by 6.2% in the first quarter of 2009 (4Q 08: 0.1%), the first contraction since the third quarter of 2001, due mainly to a significant deterioration in external demand and the decline in domestic demand. External demand deteriorated significantly following the deepening recession in several advanced economies as well as slower growth in the regional economies. Domestic demand contracted, due mainly to weaker investment and private consumption activities. Higher public spending provided some support to the domestic economy. The large inventory drawdown, particularly in the manufacturing and commodity sectors, also contributed to the decline of growth in the first quarter. On the supply side, all sectors of the economy, except the construction sector, recorded contractions.

Domestic demand contracted

Domestic demand contracted in the first quarter, registering a decline of 2.9% (4Q 08: 2.8%). Households and businesses remained cautious as labour market conditions weakened and export demand contracted further in the first quarter. Nevertheless, higher public sector spending provided some support to domestic demand.

GDP by Expenditure Components (at constant 2000 prices)

	2008			2009
	1Q	4Q	Year	1Q
	Annual change (%)			
Aggregate Domestic Demand (excluding stocks)	9.8	2.8	6.8	-2.9
Consumption	11.8	7.1	9.0	-0.2
Private sector	*11.3*	*5.3*	*8.5*	*-0.7*
Public sector	*14.1*	*12.7*	*10.9*	*2.1*
Gross Fixed Capital Formation	4.6	-10.2	0.8	-10.8
Net Exports	28.1	-39.5	-3.5	39.1
Exports of Goods and Services	*5.9*	*-13.3*	*1.3*	*-15.2*
Imports of Goods and Services	*3.2*	*-10.2*	*1.9*	*-23.5*
GDP	**7.4**	**0.1**	**4.6**	**-6.2**

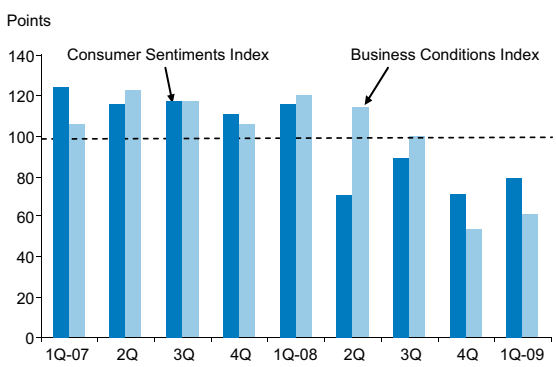
Source: Department of Statistics, Malaysia

Private consumption declined marginally by 0.7% in the first quarter, as household spending was affected by weak sentiments and higher retrenchments, especially in the manufacturing sector. The weak private consumption spending was reflected in most of the major consumption indicators, namely sales of food and beverages, imports of consumption goods and sales of new passenger cars. Nevertheless, the effects of monetary easing, moderating prices of goods and services as well as festive spending, particularly during the early part of the quarter, had lent some support to private consumption. In addition, the MIER Consumer Sentiments Index increased to 78.9 points in March (4Q 08: 71.4 points), indicating that while consumers generally remained cautious, their sentiments have improved.

Meanwhile, **public consumption** continued to expand, recording a growth of 2.1% in the first quarter, underpinned by higher expenditure on emoluments as well as supplies and services.

Gross fixed capital formation declined by 10.8% in the first quarter, reflecting mainly the sharper contraction in private investment activity which more than offset the higher public development spending. Private investment activity was affected by the significant decline in external demand which led to deterioration in business confidence. Major investment indicators such as imports of capital goods, loans disbursed to businesses and number of new companies registered recorded negative growth in the first quarter, pointing to continued weakness in private sector capital spending activity. Similarly, the weaker business conditions were also reflected in the MIER Business Conditions Index, which had remained below the 100-point threshold since the second half of 2008. Meanwhile, public sector capital spending was higher in the first quarter, reflecting the Government's commitment to mitigate the impact of the externally induced slowdown on the domestic economy. The higher spending was mainly focused on education, agriculture and rural development.

Weak business and consumer sentiment



Source: MIER

Contractions in all economic sectors, except the construction sector

On a sectoral basis, weaknesses were seen across all economic sectors, with the exception of the construction sector. The manufacturing sector recorded a sharp decline amidst significant deterioration in external demand as well as weaker domestic conditions. The services sector registered only a marginal decline, due to weaker growth in sub-sectors closely linked to the manufacturing sector and trade-related activities. The performance of the agriculture sector was affected by weaker production of palm oil and rubber, while growth in the mining sector continued to be sluggish on lower output of both crude oil and natural gas. Meanwhile, the construction sector turned around to register a small positive growth, supported by the activities in the commercial and residential sub-sectors.

Quarterly GDP by Economic Activity (at constant 2000 Prices)

	2008			2009
	1Q	4Q	Year	1Q
	Annual change (%)			
Agriculture	6.5	0.5	4.0	-4.3
Mining	3.6	-5.7	-0.8	-5.2
Manufacturing	7.0	-8.8	1.3	-17.6
Construction	5.3	-1.6	2.1	0.6
Services	8.4	5.7	7.2	-0.1
Real GDP (Annual Change)	**7.4**	**0.1**	**4.6**	**-6.2**
Real GDP (Preceding Change)	**-1.5**	**-3.4**	**4.6**	**-7.7**

Source: Department of Statistics, Malaysia

Marginal decline in the services sector

The **services sector** registered a marginal decline of 0.1% (4Q 08: 5.6%) during the quarter, affected by the challenging economic environment. In particular, services sub-sectors which are closely linked to the manufacturing sector and trade-related services activities declined.

The **transport and storage** sub-sector registered its first contraction (-3.9%; 4Q 08: 1.0%) since the third quarter of 2003, with weaker demand in both the cargo and passenger segments in line with slower trade and tourism-related activity. The **utilities** sub-sector registered a sharper contraction of 8.2% (4Q 08: -2.6%) due to the lower demand for electricity from the manufacturing sector. For the third consecutive quarter, the **real estate and business services** sub-sector declined, in line with slower capital market and general business activity during the quarter.

The **wholesale & retail trade** sub-sector declined by 1.7% (4Q 08: 5.9%), mainly due to slower wholesale activity as well as the decline in motor vehicle sales, reflecting cautious consumer spending for durable goods. Continued consumer retail spending on essential items, provided some cushion to the overall impact on growth.

Meanwhile, the **finance and insurance** sub-sector recorded a positive growth of 1.2% in the first quarter (4Q 08: 3.5%), as continued bank lending to both households and businesses supported growth. However, fee-based income of the banking system was affected by lower capital market activity. In the insurance segment, growth was sustained, due to the continued increase in insurance premiums collectable during the quarter.

The **communication** sub-sector expanded at 4.9% (4Q 08: 6.3%) as demand for both data and voice services particularly broadband services, remained favourable following aggressive promotions and coverage expansion by internet service providers. The **accommodation and restaurant** sub-sector expanded at a slower rate of 2.1% (4Q 08: 7.4%) while growth in the **other services** sub-sector was sustained at 5.2% (4Q 08: 5.3%) benefiting from the strong demand for private education and health services.

Performance of the Services Sector (value added at year 2000 prices)

	Share 2008 (%)	2008			2009
		1Q	4Q	Year	1Q
		Annual change (%)			
Intermediate Services	**43.3**	**8.4**	**2.6**	**6.0**	**-0.7**
Finance & insurance	20.0	9.9	3.5	7.7	1.2
Real estate & business services	9.4	4.8	-0.6	1.5	-6.7
Transport & storage	7.0	9.9	1.0	6.1	-3.9
Communication	7.0	7.5	6.3	7.3	4.9
Final Services	**56.7**	**8.5**	**7.9**	**8.3**	**0.3**
Utilties	5.3	4.7	-2.6	2.1	-8.2
Wholesale & retail trade	23.2	11.8	5.9	9.8	-1.7
Accommodation & restaurant	4.4	10.0	7.4	7.3	2.1
Government services	13.4	7.0	18.2	11.1	2.8
Other services	10.4	5.0	5.3	5.2	5.2
Total Services	**100.0**	**8.4**	**5.7**	**7.2**	**-0.1**

Source: Department of Statistics, Malaysia

Selected Quarterly Indicators in the Services Sector

	2008				2009
	1Q	2Q	3Q	4Q	1Q
	Index				
MIER Consumer Sentiment Index	115.5	70.6	88.9	71.4	78.9
MIER Retail Trade Index	106.1	94.5	116.5	52.7	52.3
MIER Tourism Market Index	120.3	107.5	109.2	94.0	78.1
	Annual change (%)				
Tourist arrivals	1.2	3.9	8.2	7.5	2.2
Total passenger traffic at all airports	13.1	6.8	2.7	2.1	-4.5
Total consumption credit outstanding	7.6	9.6	9.7	8.9	8.5
Loans outstanding to the wholesale & retail trade, hotels & restaurants	10.1	15.4	14.0	9.0	3.5
Imports of consumption goods	5.6	21.3	16.2	4.5	-3.9
Total sales of motor vehicles	24.6	27.1	10.5	-8.3	-9.2
Container cargo handled (Port Klang and PTP)	9.7	9.4	16.4	-3.9	-10.6

Source: Various sources

Sharper contraction in the manufacturing sector

Value added in the **manufacturing sector** registered a sharp decline (-17.6%; 4Q 08: -8.8%) in the first quarter, reflecting significant deterioration in external demand and weaker domestic conditions.

Production in export-oriented industries contracted further in the first quarter, led by steeper decline in the **E&E industry** (-41.4%; 4Q 08: -22.5%), especially in the first two months of the quarter. In particular, manufacturers reduced production as well as drew down inventories in response to the sharp contraction in demand, which led to a further reduction in output across all segments in the E&E industry. However, the pace of decline in production moderated in March, in tandem with tentative signs of stabilisation in external demand conditions.

Primary-related industries also weakened further during the quarter, with contraction in production for all major segments. In particular, continued sluggish external demand and slowdown in E&E and transport equipment segments contributed to the decline in output of chemical and plastic products segments as well as rubber products industry. Similar weakness was also seen in the petroleum products and off-estate processing segments.

Performance in the Manufacturing Sector

	2008			2009
	1Q	4Q	Year	1Q
	Annual Change (%)			
Value Added (at constant 2000 prices)	**7.0**	**-8.8**	**1.3**	**-17.6**
Overall Production[1]	**8.7**	**-11.1**	**0.6**	**-21.6**
Export-oriented industries	**7.4**	**-13.4**	**-1.2**	**-23.1**
Electronics and electrical cluster	**6.9**	**-22.5**	**-3.6**	**-41.4**
Of which:				
Electronics	9.8	-27.8	-5.4	-44.0
Electrical	0.1	-8.2	0.9	-34.9
Primary-related industry cluster	**7.7**	**-6.8**	**0.4**	**-11.4**
Of which:				
Chemicals and chemical products	3.9	-15.0	-3.5	-18.6
Petroleum products	17.2	2.0	5.9	2.9
Rubber products	6.8	2.1	4.7	-22.8
Off-estate processing	22.1	-0.2	9.4	-7.9
Domestic-oriented industries	**14.0**	**-2.0**	**8.0**	**-15.9**
Construction-related cluster	**11.6**	**-8.3**	**4.3**	**-21.5**
Of which:				
Construction-related materials	15.8	-10.7	3.2	-29.5
Fabricated metal products	5.3	-4.4	6.1	-8.1
Consumer-related cluster	**15.9**	**3.1**	**11.0**	**-11.4**
Of which:				
Transport equipment	22.9	18.4	23.4	-15.9
Food, beverage & tobacco products	13.1	-2.3	7.4	-12.6

[1] Industrial Production Index (2005=100)

Source: Department of Statistics, Malaysia

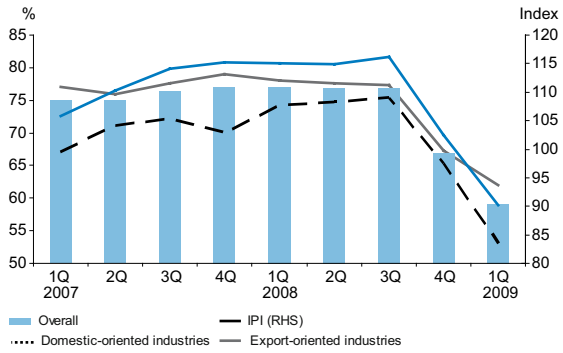
Domestic-oriented industries declined, with weakness coming from both consumer-related products and construction-related materials. In consumer-related industries, decline in growth was recorded in both the transport equipment and food products segments, corresponding with weaker domestic demand conditions. Meanwhile, the subdued performance of construction-related materials was in tandem with slower activities in the civil engineering sub-sector.

Against the backdrop of weak demand, overall capacity utilisation rate in the manufacturing sector declined to 59% in the first quarter (4Q 08: 66%), with the export- and domestic-oriented industries operating at 62% and 53% of total capacity respectively (4Q 08: 67% and 64% respectively).

Decline in commodities

Value-added of the **agriculture sector** declined by 4.3% in the first quarter (4Q 08: 0.5%) due to lower output of both palm oil and rubber. Palm oil production declined by 3.9%, driven mainly by a lower fresh fruit bunch (FFB) yield of 7.8%, while rubber production fell sharply by 39.2%, as lower prices reduced smallholders' incentive to increase tapping activity. This was mitigated somewhat by the 13.2% increase in output of fish, amidst strong external demand for aquaculture by-products. Meanwhile, the mining sector contracted further by 5.2% during the quarter (4Q 08: -5.7%), due to lower output of both crude oil (-5.7%) and natural gas (-4.7%).

Capacity utilisation rate in the manufacturing sector



* Beginning 2009, the capacity utilisation rate in the manufacturing sector has been rebased from value-add in year 2004 to value-add in year 2006

Source: Department of Statistcs, Malaysia and Bank Negara Malaysia

Performance in the Agriculture Sector

	2008			2009
	1Q	4Q	Year	1Q
	Annual change (%)			
Value Added (at year 2000 prices)	**6.5**	**0.5**	**4.0**	**-4.3**
Industrial Crops	8.8	-3.1	2.9	-13.9
Food Crops	3.4	5.8	5.6	9.2
Production				
Of which:				
Crude palm oil	23.9	3.6	12.1	-3.9
Rubber	-2.2	-29.7	-10.6	-39.2
Fish	0.4	7.1	5.2	13.2
Livestock	0.9	3.0	4.3	-4.6

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

Performance in the Mining Sector

	2008			2009
	1Q	4Q	Year	1Q
	Annual change (%)			
Value Added (at year 2000 prices)	**3.6**	**-5.7**	**-0.8**	**-5.2**
Production				
Of which:				
Crude oil and condensates	7.0	-5.6	2.0	-5.7
Natural gas (net)	-1.2	-5.5	-4.9	-4.7

Source: PETRONAS
Department of Statistics, Malaysia

Positive growth in the construction sector

The value added of the **construction sector** turned around to register a positive growth of 0.6% (4Q 08: -1.6%). This was due mainly to higher construction of office space especially in the Klang Valley as well as, supported by increased activity in the high-end segment of the residential sub-sector, particularly luxury condominiums in Klang Valley and Penang. Meanwhile, the civil engineering sub-sector was lower due to a slower-than-expected take-off of some key infrastructure projects.

Construction Indicators

	2008			2009
	1Q	4Q	Year	1Q
	Annual change (%)			
New sales and advertising permits	-6.4	-47.8	-18.9	-25.5
Housing approvals	10.4	-53.8	-18.8	-30.2
Production[1] of construction-related materials	11.6	-8.3	4.3	-21.5
Loans approved for construction	74.4	-25.2	-1.7	-48.2
Imports of construction materials and mineral products	8.3	-10.0	2.8	-25.8[2]

[1] Industrial Production Index (2005=100)
[2] Jan-Feb 2009

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

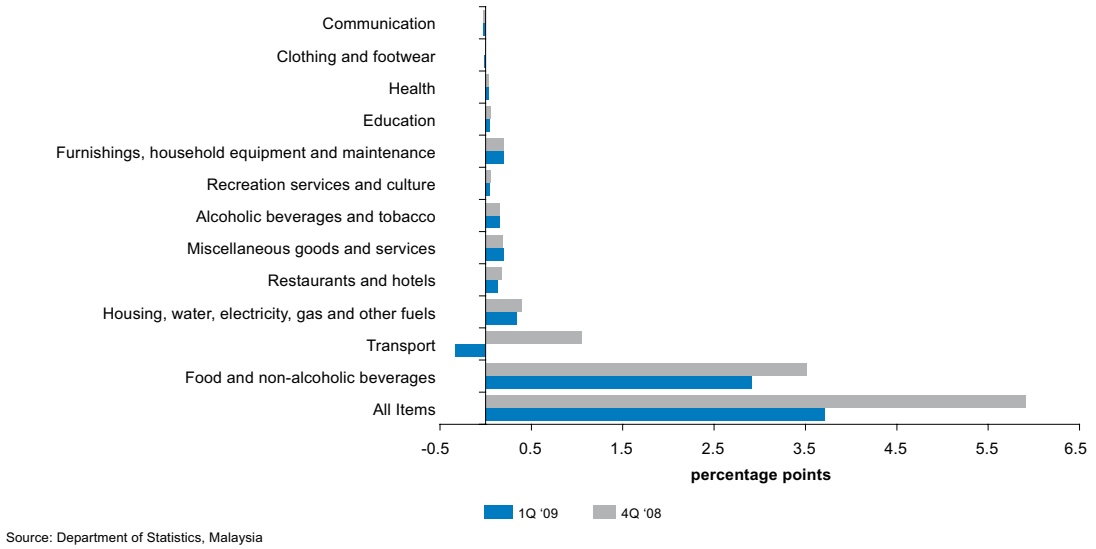
Continued moderation in price pressures

The headline inflation rate, as measured by the change in the Consumer Price Index (CPI), moderated to 3.7% in the first quarter of 2009 (4Q 08: 5.9%). The moderation in inflation was due mainly to lower inflation in the food and non-alcoholic beverages and transport categories. Inflation in the food and non-alcoholic beverages category moderated to 9.2% (4Q 08: 11.2%), with 10 out of the 11 sub-components recording lower inflation rates during the quarter. Prices in the transport category declined by 2.1% compared to its level a year ago (4Q 08: 6.6%). This reflects the fact that retail fuel prices are lower than their levels a year ago. Inflation in the housing, water, electricity, gas and other fuels category also moderated to 1.6% (4Q 08: 1.8%), reflecting the 2.54% reduction in electricity tariffs for households which came into effect on 1 March. Headline inflation continued to moderate to 3.0% in April.

Producer prices, as measured by the Producer Price Index (PPI) declined by 6.6% in the first quarter of 2009 (4Q 08: -0.1%). The decline in producer prices was due mainly to the sharp correction in commodity prices since mid-2008. All commodity-related components of the PPI recorded double-digit declines in prices. As a result, the commodity-related component of the PPI fell significantly by 19.4% (4Q 08: -1.7%). Meanwhile, prices in the non-commodity-related component of the PPI declined by 0.7% (4Q 08: 0.6%).

In terms of composition, both the local and imported components of the PPI recorded declining prices. Prices in the local components of the PPI declined by 8.5% (4Q 08: 0%), while prices in the imported components of the PPI were lower by 2.5% (4Q 08: -0.2%).

Contribution to Consumer Price Inflation

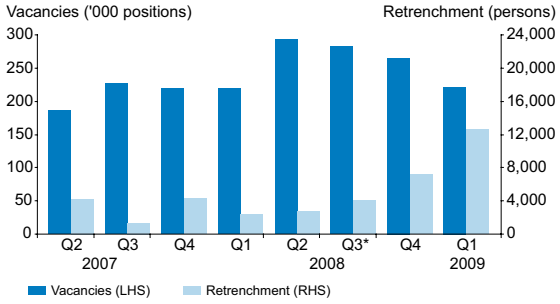


Source: Department of Statistics, Malaysia

Weaker labour market conditions

Labour market conditions weakened in the first quarter on higher retrenchments and lower job vacancies. Total retrenchments increased to 12,590 persons (4Q 08: 7,254 persons), with almost 80% of retrenched workers being from the manufacturing sector, in particular, from the E&E industry (45% of total retrenchments). Meanwhile, total vacancies posted in the Electronic Labour Exchange declined by about 43,000 positions (221,876 positions; 4Q 08: 264,674 positions), reflecting lower job openings especially in the manufacturing sector (-20,717 positions). With the exception of the agriculture sector, all other sectors had fewer vacancies during the quarter. Meanwhile, wages in the manufacturing sector declined further, reflecting the reduction in workforce, as well as the effect of temporary layoffs, pay cuts and lower bonus payments. During the quarter, nominal wage per worker contracted by -1.6% (4Q 08: -3.0%)

Labour Market Conditions



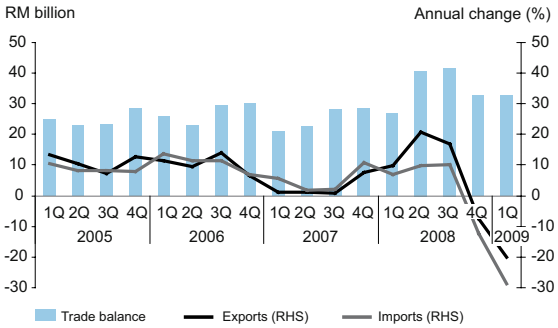
* Reflects adjusted retrenchments for Q3 2008
Source: Ministry of Human Resources

Further contraction in exports and imports

Gross exports contracted by 20% in the first quarter of 2009, the sharpest contraction ever recorded due to the significant decline in demand from the major trading partners as well as lower commodity prices. Further declines in manufactured exports and the ensuing inventory adjustments as well as weaker domestic demand conditions led to a sharper import contraction of 28.9%. The trade balance continued to record a large surplus of RM32.7 billion.

Growth in **commodity exports** turned negative in the quarter reflecting the impact of lower prices and weaker demand for major commodities except

Trade Balance



Source: Department of Statistics, Malaysia

LNG. **Manufactured exports** contracted further as external demand for both E&E and non-E&E manufactured products continued to decline. Lower demand for electrical products from the US, EU, Japan and ASEAN countries led to a further contraction in electrical exports. Meanwhile, electronic exports contracted at a slower pace due mainly to the improvement in semiconductor demand, particularly from PR China, Hong Kong SAR, Chinese Taipei and Korea. Better global semiconductor prices during the quarter also provided support to the growth of semiconductor exports. The continued contraction in non-E&E manufactured exports was generally broad-based, reflecting the impact of sharply lower commodity prices and slower external demand, particularly from Singapore, Hong Kong SAR, Korea and Chinese Taipei. Lower exports of chemicals and chemical products, petroleum products and wood products contributed largely to the decline in resource-based products.

Trade Account

	2008[1]			2009[1]
	1Q	4Q	Year	1Q
	Annual change (%)			
Gross Exports	**9.9**	**-7.5**	**9.6**	**-20.0**
Manufactured	-1.9	-11.2	1.8	-18.0
E&E	*-12.2*	*-16.2*	*-3.4*	*-16.5*
Non-E&E	*12.1*	*-4.3*	*8.9*	*-19.5*
Commodites	55.4	6.1	38.4	-23.8
Agriculture	*61.2*	*-10.6*	*32.2*	*-28.1*
Minerals	*52.1*	*16.9*	*42.4*	*-21.1*
Gross Imports	**6.8**	**-12.2**	**3.3**	**-28.9**
Capital goods	7.8	-13.4	0.0	-6.9
Intermediate goods	9.0	-12.2	5.7	-34.9
Consumption goods	5.6	4.5	11.8	-3.9
Trade balance (RM billion)	**26.8**	**32.7**	**141.9**	**32.7**

[1] Malaysia's trade classification has been revised in April 2008 to reflect the revisions of the international trade codes i.e. Harmonised System (HS), ASEAN Harmonised Tariff Nomenclature (AHTN) and Standard International Trade Classification (SITC)

Source: MATRADE and Department of Statistics, Malaysia

Malaysia: Direction of Exports

	2008			2009	2008			2009
	1Q	4Q	Year	1Q	1Q	4Q	Year	1Q
	Annual change (%)				Share of total exports (%)			
United States	**-17.5**	**-23.1**	**-12.7**	**-31.0**	**12.9**	**11.9**	**12.4**	**11.1**
European Union (EU)[1]	**2.3**	**-14.2**	**-3.8**	**-28.0**	**11.9**	**11.6**	**11.3**	**10.7**
Selected ASEAN countries[2]	**13.9**	**-15.0**	**9.9**	**-26.8**	**26.7**	**24.2**	**25.6**	**24.4**
North East Asia	**3.5**	**-18.3**	**10.9**	**-5.9**	**18.9**	**18.1**	**20.1**	**22.3**
People's Republic of China	*12.5*	*-18.4*	*19.2*	*-1.8*	*8.3*	*8.4*	*9.5*	*10.2*
Hong Kong SAR	*-13.7*	*-22.7*	*1.2*	*3.5*	*3.6*	*4.0*	*4.3*	*4.7*
Chinese Taipei	*-4.5*	*-22.1*	*-1.4*	*-18.1*	*2.4*	*2.2*	*2.4*	*2.4*
Korea	*9.5*	*-9.9*	*12.4*	*-14.3*	*4.7*	*3.6*	*3.9*	*5.0*
West Asia	**25.5**	**29.3**	**38.0**	**-12.7**	**3.4**	**4.0**	**3.9**	**3.7**
India	**24.1**	**9.8**	**22.4**	**-14.9**	**3.5**	**4.0**	**3.7**	**3.7**
Total exports	**9.9**	**-7.5**	**9.6**	**-20.0**	**100.0**	**100.0**	**100.0**	**100.0**

[1]Refers to European Union (EU) 27 from 2007 onwards
[2]Singapore, Thailand, Indonesia, Philippines, Brunei Darussalam and Vietnam

Source: Department of Statistics, Malaysia

Gross imports declined sharply in the first quarter, with all major categories of imports registering negative growth. **Intermediate imports** registered the sharpest decline in tandem with a large contraction in manufactured exports and the corresponding inventory adjustment. Growth in **consumption imports** turned negative as consumers became more cautious and prudent in their spending. Nevertheless, consumption imports turned positive in March, due mainly to imports of food and beverages and non-durable goods. Imports of **capital goods** contracted at a slower pace of 6.9% during the quarter. However, excluding lumpy imports, capital imports recorded a larger contraction of 16%, reflecting weaker private investment activity.

Lower inflows of FDI while outflows of portfolio funds moderated further

On a cash basis, gross inflows of **foreign direct investment (FDI)**[2] amounted to RM6.4 billion in the first quarter of 2009 (4Q 08: RM9 billion), reflecting inflows of equity capital and the drawdown of inter-company loans. After adjusting for gross outflows due mainly to the repayment of inter-company loans, net FDI amounted to RM2.1 billion (4Q 08: RM3.4 billion). During the quarter, net FDI was directed mainly into the manufacturing sector, followed by services and oil and gas sectors. FDI in the manufacturing sector was mainly for investment in the E&E, solar cells and basic metal industries. Meanwhile, FDI in the services sector was channelled mainly into the real estate and business services, wholesale and retail trade as well as transport sub-sectors

Overseas investment by Malaysian companies was also lower, recording a net outflow of RM3 billion in the first quarter of 2009 (4Q 08: -RM8.1 billion), attributed mainly to lower outflows of equity capital. The bulk of overseas investments was in the services sector, particularly for acquisition of strategic stakes in a bank and a power plant in the region. There were also continued investments in real estate and business services, and wholesale and retail trade sub-sectors. Meanwhile, overseas investments in the manufacturing sector were channelled mainly into the E&E and petroleum-related industries.

Net outflows of **portfolio investment** moderated to RM9.5 billion (4Q 08: -RM24.8 billion), reflecting mainly lower net liquidation of both equities and debt securities by foreign investors. Investors sentiment, while remaining cautious for the most of the quarter, improved in the second half of March. The improvement was supported mainly by expectations that global financial market conditions would stabilise and thus facilitate global economic recovery. This led to improved risk appetite towards financial assets in the emerging markets, including Malaysia. Meanwhile, on the domestic front, the announcement of the Second Stimulus Package by the Government had also supported investor sentiments. Net outflows of portfolio investment had moderated further and registered net inflows in May.

[2] The statistics for FDI on a cash basis does not include retained earnings and investment in the form of imported machinery and equipment.

External debt remained manageable

As at end-March 2009, Malaysia's total **external debt** amounted to RM243.8 billion or USD66.1 billion (end-2008: RM236.2 billion or USD67.4 billion), equivalent to 35.1% of GNI. The medium- and long-term external debt increased to RM159.5 billion, reflecting mainly the depreciation of the ringgit against the USD during the quarter (+RM5.7 billion) which more than offset net repayments by both the public and private sectors. Within the public sector, the Federal Government and the NFPEs recorded net repayments of RM0.6 billion and RM1.7 billion respectively. Meanwhile, the private sector recorded a net repayment (-RM1.2 billion) due mainly to repayment of inter-company loans.

The total short-term external debt amounted to RM84.3 billion or USD22.9 billion due mainly to inter-bank borrowing activities. As at end-March 2009, the short-term debt accounted for 34.6% of total external debt and was 26.3% of the net international reserves

External Debt Outstanding

	2008		2009
	1Q	4Q	1Q[p]
	RM billion		
Medium- and long-term debt	131.9	156.5	159.5
Public sector	74.2	83.4	85.1
Private sector	57.7	73.1	74.4
Short-term debt[1]	84.5	79.6	84.3
Total external debt	216.3	236.2	243.8
- USD billion equivalent	67.0	67.4	66.1

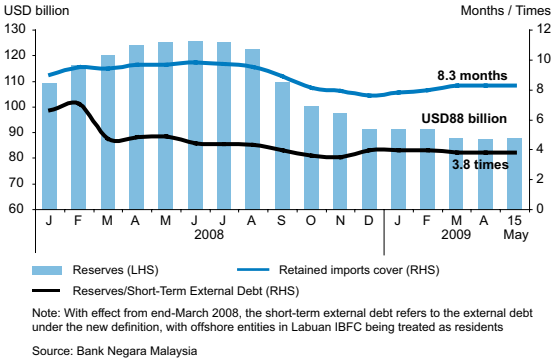
[1] Excludes currency and deposits held by non-residents with resident banking institutions
[p] Preliminary

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

International reserves

The international reserves of Bank Negara Malaysia amounted to RM320.7 billion (equivalent to USD87.8 billion) as at 31 March 2009. The level of reserves had taken into account the quarterly adjustment for the foreign exchange revaluation gain, following the strengthening of some of the major currencies against the ringgit during the quarter. The reserves amounted to RM321.5 billion (equivalent to USD88 billion) as at 15 May 2009 and is sufficient to finance 8.3 months of retained imports and is 3.8 times the short-term external debt.

Net International Reserves (as at end period)



Note: With effect from end-March 2008, the short-term external debt refers to the external debt under the new definition, with offshore entities in Labuan IBFC being treated as residents

Source: Bank Negara Malaysia

Fiscal policy remained expansionary

Fiscal expenditure of the Federal Government continued to be expansionary in the first quarter, recording a deficit of RM6.7 billion or 4.3% of GDP. Development expenditure was higher during the quarter, recording a year-on-year increase of 55.4% (1Q 08: -0.3%). Development spending was mainly for agriculture and rural development and education. During the period, the higher operating expenditure was mainly due to the payments for supplies and services, and grants and transfers to statutory bodies. Meanwhile, total revenue remained favourable on account of higher investment income and collections from sales tax. The fiscal deficit was financed from domestic borrowings. As at end-March 2009, total outstanding debt of the Federal Government amounted to RM317.1 billion or 45.9% of GDP.

Federal Government Finance[p]

	2008			2009
	1Q	4Q	Year	1Q
	RM billion			
Revenue	28.0	46.3	159.8	35.9
% growth	15.4	-3.9	14.2	28.3
Operating expenditure	30.4	48.9	153.5	34.4
% growth	40.3	13.8	24.7	12.9
Current account	**-2.5**	**-2.6**	**6.3**	**1.5**
% of GDP	***-1.4***	***-1.4***	***0.9***	***1.0***
Gross development expenditure	5.3	16.0	42.8	8.2
% growth	-0.3	-12.0	5.6	55.4
Overall balance	**-7.7**	**-18.2**	**-35.6**	**-6.7**
% of GDP	***-4.4***	***-10.3***	***-4.8***	***-4.3***
Memo item:				
Total gross expenditure	35.7	64.9	196.3	42.6
% growth	32.3	6.2	20.0	19.2
Total Federal Government debt				
(as at end-period)	275.1	306.4	306.4	317.1
% of GDP	37.2	41.5	41.5	45.9
Domestic debt	256.8	286.1	286.1	297.0
% of GDP	34.8	38.7	38.7	43.0
External debt	18.2	20.3	20.3	20.2
% of GDP	2.5	2.8	2.8	2.9

[p] Preliminary

Source: Ministry of Finance

MONETARY AND FINANCIAL DEVELOPMENTS

Interest rates lowered in line with OPR reductions

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

Interbank rates traded in three distinct ranges during the quarter, reflecting the prevailing rate of the OPR. During the period 1 – 21 January, the daily weighted average overnight interbank rate traded at 3.25%. Following the reduction in the OPR on 21 January to 2.50%, the daily weighted average overnight interbank rate decreased and stabilised at a lower range of 2.49% - 2.51% during the period 22 January – 24 February. With the further reduction in the OPR to 2.00% on 24 February, the daily weighted average overnight interbank rate decreased and stabilised at the lower range of 1.99% - 2.01%. Interbank rates of other maturities also declined in line with the reductions in the OPR.

The accumulated reductions in the OPR were transmitted quickly and substantially to retail lending rates. The average base lending rate (BLR) of commercial banks (CBs) was reduced by a total of 119bps and ended the first quarter at a historically low level of 5.53% (end-December 2008: 6.48%). Accordingly, existing loans with variable rates were re-priced lower. New loans were also contracted at lower rates after the reduction in the OPR. As a result, the average lending rate (ALR) on loans outstanding softened to a historic low of 5.16% in March 2009, compared to 5.86% as at end-December 2008.

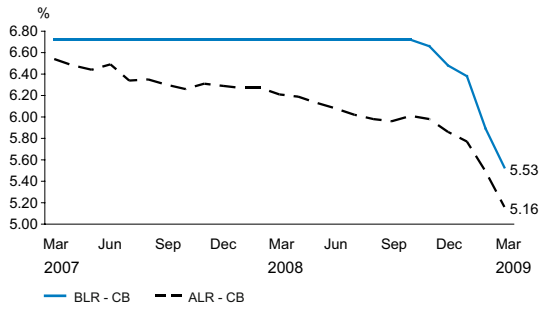
Similarly, the average quoted fixed deposit (FD) rates of CBs decreased in the first quarter. As at end-March, the average quoted FD rates for tenures between 1 to 12 months ranged between 2.02% and 2.52% respectively.

Interest Rates

	2008		2009
	1Q	4Q	1Q
	At end-period (%)		
Overnight Policy Rate (OPR)	3.50	3.25	2.00
Interbank rates			
Overnight	3.50	3.25	2.00
1-month	3.55	3.30	2.06
Base lending rates (BLR)			
Commercial banks	6.72	6.48	5.53
Average lending rates (ALR)			
Commercial banks	6.21	5.86	5.16
Fixed deposit rates			
Commercial banks			
3-month	3.14	3.04	2.04
12-month	3.70	3.50	2.52

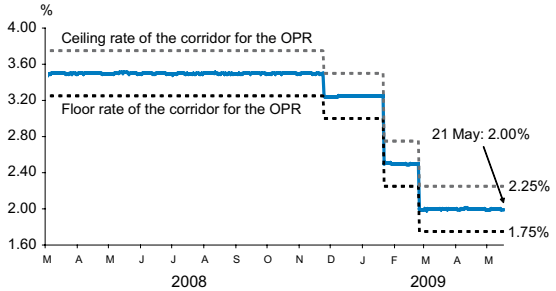
Source: Bank Negara Malaysia

Lending Rates of Commercial Banks (Average for the period)



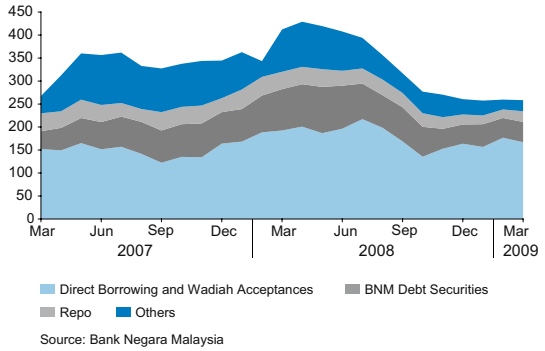
Source: Bank Negara Malaysia

Daily Weighted Average Overnight Interbank Rate



Source: Bank Negara Malaysia

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



Source: Bank Negara Malaysia

Determinants of Broad Money, M3

	Change during the period			
	2008			2009
	1Q	4Q	Year	1Q
	RM billion			
M3	51.6	18.9	98.9	17.6
Net claims on Govt	0.9	23.1	33.4	5.9
Claims on private sector	17.2	18.3	94.2	5.0
Loans	*16.7*	*11.2*	*76.9*	*4.5*
Securities	*0.5*	*7.1*	*17.3*	*0.5*
Net foreign assets[1]	45.8	-37.6	-46.1	3.8
BNM	*52.5*	*-48.6*	*-12.4*	*-4.3*
Banking System	*-6.7*	*11.0*	*-33.7*	*8.1*
Other influences	-12.2	15.1	17.4	3.0

[1] Pre-revaluation

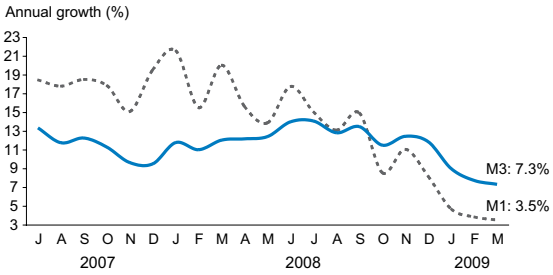
Source: Bank Negara Malaysia

M3 rose at a more moderate pace

Monetary aggregates registered a slower annual increase in the first quarter, a trend that has continued from end-2008. The slower growth is consistent with the more moderate growth of economic activity. M1, or narrow money, decreased by RM3.2 billion during the quarter. On an annual basis, M1 expanded at a modest annual growth rate of 3.5% (end-December 2008: 8.2%). Similarly, M3, or broad money, expanded at a slower annual growth rate of 7.3% at end-March 2009 (end-December 2008: 11.9%). On a quarter-on-quarter basis, M3 increased by RM17.7 billion.

In contrast to the same period last year, the growth in M3 was driven mainly by domestic factors. The main impetus for monetary growth came from strong Government spending, financed mainly by the subscription of Government bonds by the banking institutions. Net foreign assets also increased relative to the preceding quarter, after declining consecutively for two quarters, reflecting the net foreign inflows arising from export proceeds. This had an expansionary impact on broad money.

Monetary Aggregates

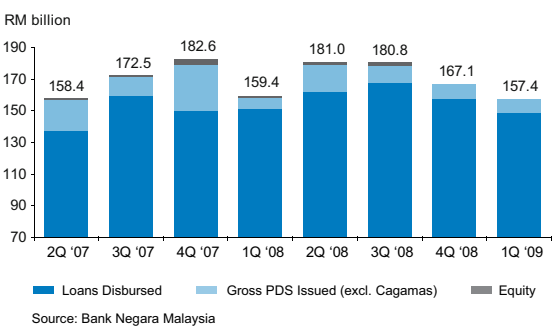


Source: Bank Negara Malaysia

Private sector financing was sustained in the first quarter

Financing for the economy remained adequate and was accessible across all segments of the economy. Liquidity in the financial system remained sufficient to support the demand for financing from both the public and private sectors. Gross financing raised by the private sector through the banking system and the capital market was sustained at RM157.3 billion in the first quarter (quarterly average of RM157.5 billion during the period 2006 - 2008). On a net basis, banking system loans and PDS outstanding rose by 10.7% as at end-March (end-2008: 12.7%).

Gross Private Sector Financing through Banking System and Capital Market



Source: Bank Negara Malaysia

Financing of the Private Sector through Banking System and Capital Market

	During the period (RM billion)				Annual growth (%)		
	2008	1Q 08	4Q 08	1Q 09	2008	4Q 08	1Q 09
Gross total financing	**688.3**	**159.4**	**167.1**	**157.4**	**6.1**	**-8.5**	**-1.3**
Loans disbursed *	639.9	151.5	157.9	148.2	11.2	5.3	-2.2
Gross PDS (excl. Cagamas)	42.9	6.5	9.0	9.0	-35.5	-68.9	39.1
Equity	5.5	1.4	0.2	0.1	-23.1	-94.2	-89.3
Net total financing (A)+(B)	**110.1**	**22.8**	**16.1**	**7.8**	**12.7**	**12.7**	**10.7**
Banking system	87.2	17.2	15.0	8.6	12.4	12.4	10.9
Loans outstanding (A)	*82.3*	*17.4*	*13.8*	*7.3*	*12.8*	*12.8*	*10.9*
Holding of PDS	*4.9*	*-0.1*	*1.1*	*1.3*	*8.6*	*8.6*	*11.1*
PDS outstanding (B)	27.8	5.5	2.3	0.5	12.4	12.4	9.9
Memorandum item							
Gross PDS (incl. Cagamas)	49.7	10.0	9.0	9.3	-28.4	-68.9	-7.4

* Banking system loans include loans sold to Cagamas

Source: Bank Negara Malaysia

Loan Indicators

	During the period (RM billion)				Annual growth (%)			
	2008	1Q 08	4Q 08	1Q 09	2008	1Q 08	4Q 08	1Q 09
Total								
Loan applications	475.5	111.0	102.5	108.1	3.9	32.9	-21.9	-2.6
Loan approvals	291.8	71.7	61.6	58.9	-2.3	35.0	-30.0	-17.8
Loan disbursements	639.9	151.5	157.9	148.2	11.2	17.2	5.3	-2.2
Loan repayments	567.7	138.9	143.4	138.0	9.4	17.7	-6.8	-0.7
Change in loan outstanding*	82.3	17.4	13.8	7.3	12.8	10.0	12.8	10.9
Of which:								
Business enterprises**								
Loan applications	244.3	55.4	51.3	52.0	-7.0	23.4	-33.6	-6.1
Loan approvals	147.9	38.1	29.5	26.1	-18.5	27.6	-48.0	-31.5
Loan disbursements	455.3	106.4	112.6	100.8	12.2	17.8	7.1	-5.2
Loan repayments	402.8	97.5	101.9	93.5	8.8	19.4	-11.4	-4.1
Change in loan outstanding*	34.4	7.7	-1.4	-1.2	13.2	11.2	13.2	9.5
SMEs**								
Loan applications	100.3	24.1	19.9	20.2	1.2	18.1	-23.5	-16.1
Loan approvals	54.0	12.8	11.5	8.9	-2.0	19.4	-17.0	-30.6
Loan disbursements	164.3	39.9	39.6	34.7	16.0	20.8	5.2	-13.1
Loan repayments	146.6	36.0	36.1	32.3	15.6	22.8	4.5	-10.4
Change in loan outstanding*	10.6	4.3	0.0	-6.8	9.3	9.7	9.3	-0.4
Large corporations								
Loan applications	144.0	31.3	31.4	31.8	-11.9	27.7	-38.7	1.6
Loan approvals	93.9	25.3	18.0	17.2	-25.7	32.2	-58.0	-32.0
Loan disbursements	291.0	66.5	73.0	66.2	10.2	16.0	8.2	-0.5
Loan repayments	256.2	61.4	65.8	61.2	5.2	17.5	-18.2	-0.3
Change in loan outstanding*	23.8	3.3	-1.5	5.6	16.2	12.5	16.2	17.3
Households								
Loan applications	231.2	55.6	51.2	56.1	18.6	43.9	-5.1	0.9
Loan approvals	143.9	33.6	32.1	32.8	22.9	44.4	2.8	-2.2
Loan disbursements	184.6	45.1	45.4	47.3	8.9	16.0	1.0	4.9
Loan repayments	164.9	41.5	41.5	44.4	11.1	13.9	7.0	7.2
Change in loan outstanding*	32.5	6.2	7.9	5.4	9.1	8.2	9.1	8.8

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

Source: Bank Negara Malaysia

As economic activity slowed down further in the first quarter, loan disbursements to the business sector declined, mainly reflecting lower working capital requirements in the manufacturing as well as wholesale and retail, restaurants and hotels sectors. On an annual basis, business loans outstanding expanded at an annual growth rate of 9.5% as at end-March (end-2008: 13.2%). Demand for new financing, however, was sustained as loan applications by businesses were slightly higher compared to the previous quarter.

Financing to the household sector, on the other hand, remained favourable. All loan indicators increased compared to the previous quarter. Loan applications were higher, reflecting the higher demand for the purchase of residential properties and the usage of credit cards. Loan disbursements also increased during the quarter, and were primarily channelled to finance the purchase of residential properties and to support credit card spending. Accordingly, household loans outstanding expanded by RM5.4 billion to increase at a sustained annual growth rate of 8.8% as at end-March (end-2008: 9.1%).

Sustained fund raising activity in the capital market

During the first quarter, net funds raised in the capital market amounted to RM11.6 billion (4Q 08: RM14.3 billion). Most of the funds were raised by the public sector, reflecting the Government's expansionary fiscal policy. Funds were raised through issuances of the 3.5-year Malaysian Government Securities (MGS) and 10.5-year Government Investment Issues (GII), as well as the re-opening of the 5-year MGS. After adjusting for large redemptions, net funds raised by the public sector amounted to RM10.8 billion.

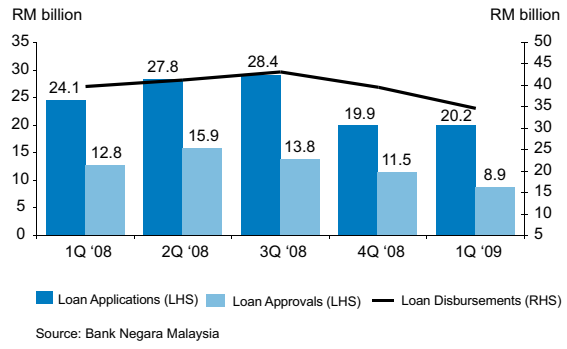
Loans by Sector

	Loans disbursed					Loans out-standing
	During the period				Share of total	Share of total
	2008	1Q 08	4Q 08	1Q 09		
	(RM billion)				(%)	
Business enterprises	**455.3**	**106.4**	**112.6**	**100.8**	**68.0**	**40.1**
Large corporations	*291.0*	*66.5*	*73.0*	*66.2*	*44.6*	*24.1*
*SMEs **	*164.3*	*39.9*	*39.6*	*34.7*	*23.4*	16.1
Households	**184.6**	**45.1**	**45.4**	**47.3**	**32.0**	**53.6**
Selected sectors						
Agriculture, hunting, forestry and fishing	16.1	3.7	3.9	4.2	2.8	2.3
Mining and quarrying	2.3	0.5	0.5	0.7	0.5	0.3
Manufacturing	151.5	36.2	34.9	30.2	20.4	10.4
Construction	34.7	9.3	8.0	8.7	5.8	4.8
Real estate	16.5	4.1	4.7	5.2	3.5	3.7
Electricity, gas and water supply	2.6	0.8	1.0	1.0	0.7	0.6
Wholesale, retail, restaurants and hotels	113.9	25.2	27.5	24.5	16.5	8.1
Transport, storage and communication	17.8	2.7	3.3	5.6	3.8	3.4
Finance, insurance and business services	57.6	14.3	15.0	11.4	7.7	6.7
Consumption credit	121.8	30.1	29.0	31.2	21.0	22.5
Of which:						
Credit cards	*61.0*	*15.5*	*15.3*	*16.7*	*11.3*	*3.3*
Purchase of passenger cars	*37.4*	*9.0*	*8.0*	*8.5*	*5.8*	*14.8*
Total	**639.9**	**151.5**	**157.9**	**148.2**	**100.0**	**100.0**

* Include loans to individual businesses.

Source: Bank Negara Malaysia

Bank Lending to SMEs



Source: Bank Negara Malaysia

Gross funds raised from PDS issuances during the quarter were slightly higher at RM9.3 billion (4Q 08: RM9 billion). In January, issuers delayed their bond issuances in anticipation of a reduction in the OPR by Bank Negara Malaysia. Issuance activity, however, picked up in the subsequent months of the quarter after the reduction in OPR, and as PDS yields stabilised. Fund raising activity in the PDS market was also supported by several large issuances by Government-linked entities. During the period, most of the funds were raised by companies involved in the construction as well as the finance, insurance, real estate and business sectors. The PDS were

issued mainly for working capital purposes and general business activities (48.5%), as well as for refinancing purposes (37.5%).

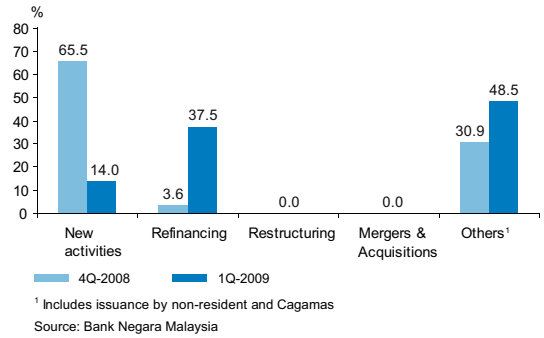
Funds raised in the equity market remained low, amounting to RM144 million (4Q 08: RM222 million) amidst weak market sentiments. Funds were raised through restricted offers for sale (ROFS).

Funds Raised in the Capital Market

	2008			2009
	1Q	4Q	Year	1Q
	RM million			
By Public Sector	**10,633**	**13,859**	**36,188**	**10,806**
Government securities, net	10,633	14,865	37,720	8,811
Malaysian Government Securities	*14,283*	*11,965*	*44,618*	*20,477*
Government Investment Issues	*2,000*	*7,500*	*16,500*	*6,000*
Less: Redemptions	*5,650*	*4,600*	*23,399*	*17,666*
Khazanah Bonds, net	-	(1,000)	(3,000)	-
Merdeka Savings Bonds, net	-	(6)	1,468	1,995
By Private Sector	**2,082**	**451**	**21,114**	**842**
Shares	1,356	222	5,477	144
Debt securities, net	726	229	15,637	698
Private Debt Securities	*9,996*	*8,953*	*49,658*	*9,257*
Cagamas	-	-	-	-
Less: Redemptions	*9,270*	*8,724*	*34,021*	*8,559*
Total	**12,715**	**14,310**	**57,302**	**11,649**

Source: Bank Negara Malaysia

Private Debt Securities Issued by Purpose (% of total)



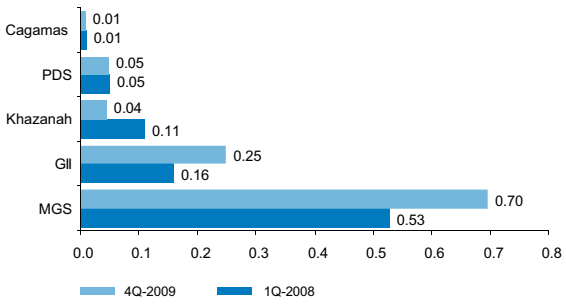
[1] Includes issuance by non-resident and Cagamas

Source: Bank Negara Malaysia

Lower secondary trading in the bond market

Total trading in the secondary market declined to RM131.2 billion during the first quarter (4Q 08: RM165.8 billion). Government securities (MGS and GII) accounted for 91% of the total trade. In terms of liquidity, the MGS was the most

Liquidity Ratio: Turnover / Outstanding

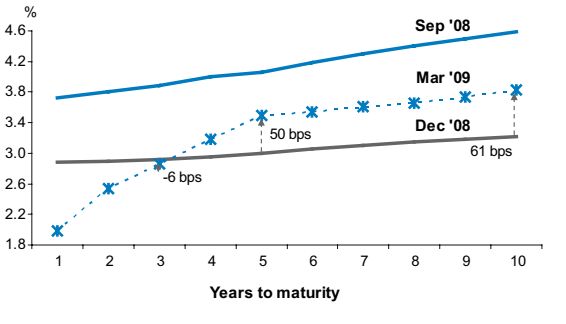


Source: Bank Negara Malaysia

liquid paper, registering a liquidity ratio of 0.53, followed by the GII with a liquidity ratio of 0.16.

At the beginning of the quarter, MGS yields were on a downward trend on expectations of a reduction in the OPR. Following the decision to lower the OPR on 21 January, yields continued on a declining trend. Yields, however, began rising in February, as investors expected a larger supply of MGS for the year, given news of Government plans for additional fiscal stimulus. Yields subsequently declined slightly when the OPR was lowered further on 24 February. Following the announcement of the Second Stimulus Package and the auction calendar of Government securities, yields stabilised as investors gained greater clarity with regard to Government issuances. By end-March, the 5-year and 10-year MGS yield had risen by 50 and 61 basis points respectively. The 3-year MGS yield, however, had fallen by 6 basis points, reflecting increased interest in the shorter-tenure MGS, which is more liquid. This resulted in the steepening of the slope of the yield curve.

Trend in MGS Yields



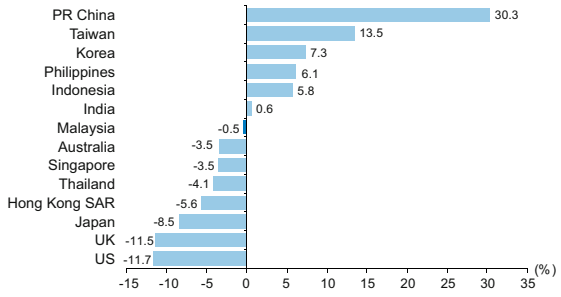
Source: Bank Negara Malaysia

KLCI declined marginally in the first quarter

The KLCI ended the first quarter lower at 872.6 (4Q 08: 876.8), in line with the performance of some major markets. Concerns over the health of the global economy, as well as weaker regional and domestic economic indicators affected the performance of KLCI. Domestic market sentiments, however, improved towards the end of the quarter following the announcement of the Second Stimulus Package and positive developments in the global markets. Market capitalisation declined to RM662.1 billion (4Q 08: RM663.8 billion) and trading activity moderated to a daily average turnover of 454.5 million units (4Q 08: 610.1 million units).

On 26 May 2009, the KLCI closed higher at 1,051.6 (since end-2008: +19.9%), with market capitalisation increasing to RM805.6 billion (since end-2008: +21.4%).

Performance of Selected Global and Regional Markets (31 December 2008 - 31 March 2009)



Source: Bloomberg

Bursa Malaysia: Selected Market Indicators

	As at end			
	2008			2009
	1Q	4Q	Year	1Q
Price Indices				
Composite	1,247.5	876.8	876.8	872.6
FBM30[1]	8,232.9	5,637.7	5,637.7	5,598.5
FBMEMAS[2]	8,423.7	5,726.5	5,726.5	5,701.1
FTSE Second Board	5,884.6	4,007.3	4,007.3	3,872.4
FTSE Mesdaq	4,923.2	3,333.6	3,333.6	2,942.7
Average daily turnover				
Volume (million units)	930.4	610.1	630.4	454.5
Value (RM million)	2,035.2	907.3	1,277.9	688.4
Market capitalisation (RM billion)	952.3	663.8	663.8	662.1
No. of companies listed	989	977	977	969

[1] FBM30 stands for FTSE Bursa Malaysia 30 Index
[2] FBMEMAS stands for FTSE Bursa Malaysia EMAS Index

Source: Bursa Malaysia

The ringgit depreciated against the US dollar

The ringgit depreciated against the US dollar by 5.0% in the first quarter. Against other major currencies, the ringgit was stronger against the Japanese yen (3.3%) and the euro (0.9%), but weaker against the pound sterling (-4.2%). The ringgit recorded a mixed performance against regional currencies. In terms of its trend path, the ringgit continued to depreciate against the US dollar coming into 2009 as the protracted uncertainty in the international financial markets and global economic slowdown dampened sentiments and sustained investors' risk aversion. The ringgit, however, stabilised in March amidst improved investor risk appetite towards financial assets in emerging markets following the additional and more concerted policy measures to address

Bursa Malaysia: Turnover of Corporate Securities

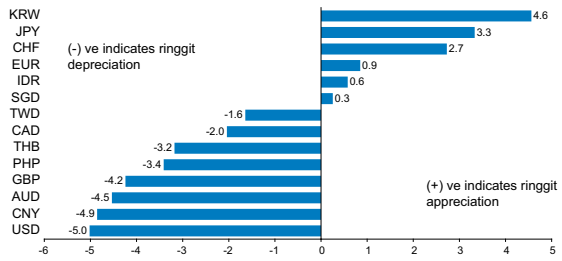
	2008						2009	
	1Q		4Q		Year		1Q	
	million units	RM million	million units	RM million	million units	RM million	million units	RM million
Turnover	53,962	118,044	36,605	54,438	154,459	313,083	26,360	39,927
Of which:								
Main Board	36,488	111,552	31,273	53,316	119,303	301,289	22,657	39,075
Of which								
Consumer Products	931	3,622	946	2,478	3,671	11,973	675	2,096
Industrial Products	3,409	7,002	7,609	5,450	17,865	23,704	3,798	2,401
Construction	4,722	13,820	3,076	3,967	14,119	30,070	2,508	2,936
Trading/Services	10,383	38,521	9,327	20,377	35,826	106,698	8,261	14,423
Finance	3,391	21,975	2,652	10,190	10,846	59,459	1,903	8,095
Properties	4,234	5,027	3,044	1,805	12,832	12,076	2,984	1,895
Plantations	2,262	13,866	2,011	6,284	7,524	39,238	1,085	4,332
Infrastructure	1,148	3,671	787	2,170	3,398	10,713	629	2,405
Second Board	4,098	3,038	2,276	739	10,761	6,521	1,647	498
Mesdaq	5,621	2,438	1,686	294	11,239	3,921	798	193

Source: Bursa Malaysia

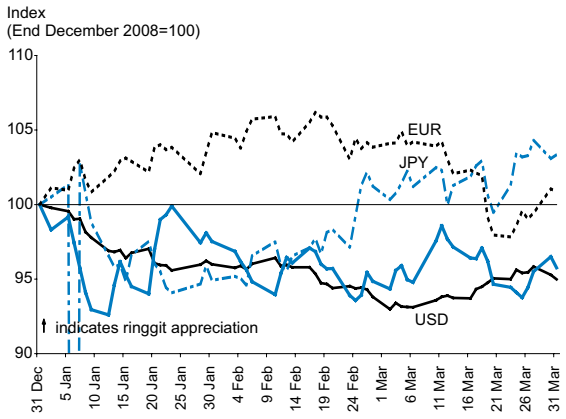
the economic and financial crisis in the developed economies. Sentiments were also supported by the tentative signs of stabilisation in some US economic indicators. Domestically, the ringgit also benefited from positive market reaction to the Second Stimulus Package announced on 10 March. During the period of 1 – 26 May 2009, the ringgit appreciated against the U.S. dollar (4.5%) and the Japanese yen (0.5%). The ringgit however depreciated against the pound sterling (-5.8%) and the euro (-0.9%).

The ringgit recorded a mixed performance against regional currencies. The ringgit appreciated against the Chinese renminbi, the Philippine peso and the Thai baht in the range of 1.2% to 4.4%, but depreciated against the Indonesian rupiah, the Korean won, and the Singapore dollar in the range of 0.4% to 6.9%.

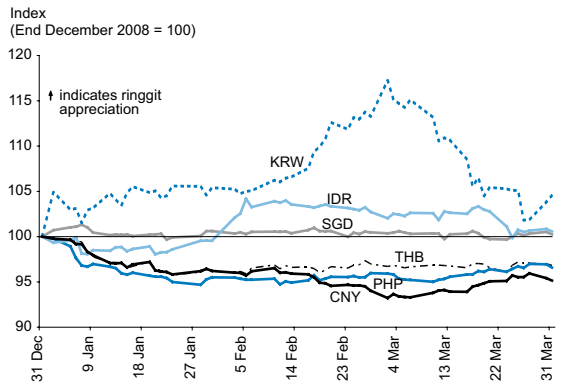
Summary of Ringgit Performance Against Selected Currencies Percent Change (1 January - 31 March 2009)



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*		
	21 Jul 05	1Q 08	4Q 08	1Q 09	21 Jul 05	1Q 08	4Q 08
US dollar	3.8000	3.1875	3.4640	3.6470	4.2	-12.6	-5.0
Euro	4.6212	5.0369	4.8759	4.8348	-4.4	4.2	0.9
Pound sterling	6.6270	6.3586	4.9989	5.2203	26.9	21.8	-4.2
100 Japanese yen	3.3745	3.1912	3.8327	3.7091	-9.0	-14.0	3.3
Singapore dollar	2.2570	2.3102	2.4070	2.4008	-6.0	-3.8	0.3
100 Thai baht	9.0681	10.108	9.9398	10.266	-11.7	-1.5	-3.2
100 Philippine peso	6.8131	7.6421	7.2774	7.5343	-9.6	1.4	-3.4
100 Indonesian rupiah	0.0386	0.0346	0.0316	0.0315	22.7	9.9	0.6
100 Korean won	0.3665	0.3211	0.2750	0.2630	39.3	22.1	4.6
Chinese renminbi	0.4591	0.4545	0.5076	0.5335	-13.9	-14.8	-4.9

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

Source: Bank Negara Malaysia

DEVELOPMENTS IN THE BANKING SECTOR

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

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

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

Banking System

	1Q 08	4Q 08	1Q 09
Capital position			
Risk-weighted assets (RM bilion)	833.8	909.6	884.9
Capital base (RM billion)	111.3	115.2	118.9
RWCR (%)	13.3	12.7	13.4
CCR (%)	10.4	10.6	11.5
Profit before tax	5,658.1	5,039.0	4,784.3
Annualised ROE	23.4	18.5	19.9
Annualised ROA	1.8	1.5	1.7

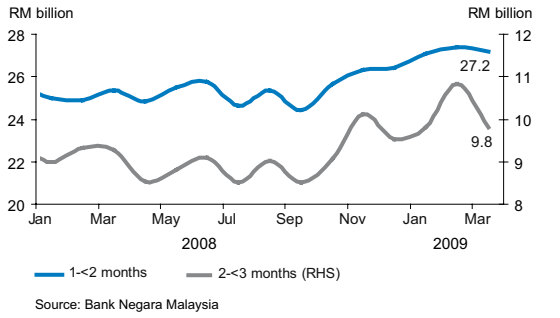
The quality of loan portfolio was preserved despite the challenging environment. The level of gross NPLs registered a small decline of 4% primarily on account of a drop in the business NPLs level, whilst the net NPL ratio stabilised at 2.2% in the first quarter of 2009. The outlook for credit risk, nonetheless, remains challenging particularly in the second half given the lagging behaviour of NPLs.

The potential increase in delinquencies is expected to be manageable, given the comprehensive and pre-emptive measures that have already been put in place to facilitate restructuring and to ensure continued access to financing. These include the establishment of Danajamin Nasional Berhad, SME special funds, Industry Restructuring Loan Guarantee Scheme, Small Debt Resolution Scheme, the re-activation of Corporate Debt Restructuring Committee as well as the Credit Counselling and Debt Management Agency. This is further supported by pro-active efforts undertaken by banking institutions in engaging and assisting borrowers with potential increased financial strains through restructuring and rescheduling of loans.

Banking System: NPL

	%		
	1Q 08	4Q 08	1Q 09
Net NPL (RM million)	19,042.9	15,897.3	16,029.1
Net NPL ratio	3.0	2.2	2.2
Gross NPL ratio	6.1	4.8	4.6
Business (excl. SMEs)	7.9	6.3	5.9
SMEs	8.4	6.8	6.8
Household	5.0	4.2	4.1

Banking System: Loan-in-arrears



Source: Bank Negara Malaysia

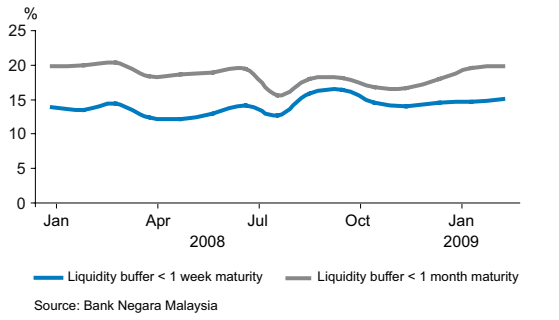
The banking institutions' exposure to interest rate risk, which forms the main component of market risk, increased in 1Q 09 due to higher exposure in interest rate swaps. Interest rate risk, as indicated by the duration weighted position, was manageable, accounting for 6.2% of capital base. Exposure to foreign exchange risk, largely denominated in US dollar, remained minimal at 4.7% of capital base. The level of market risk is expected to remain low supported by hedging and financial institutions pro-active management of interest rate exposures.

Banking System: Market Risk

	1Q 08	4Q 08	1Q 09
Duration weighted position (RM million)	4,967	4,371	6,373
As % of capital base	5.0	4.4	6.2
Net open position (RM million)	4,720	6,219	5,607
As % of capital base	4.3	5.2	4.7

The liquidity buffer of the banking system as at March 2009 for the maturity bucket of up to one month remained ample at 19.9% of the total deposit (4Q 08: 16.6%). Meanwhile, the projected surplus of the banking sector increased to RM128.5 billion (4Q 08: RM116.8 billion) for the maturity bucket of up to one week and RM168.7 billion (4Q 08: RM138.5 billion) for the maturity bucket of up to one month. These were sufficient to meet demand for deposit withdrawals and other liquidity obligations. Loan-to-deposit ratio remained stable at 73.7% as at March 2009.

Banking System: Liquidity Mismatch to Total Deposit Ratio



Source: Bank Negara Malaysia

Developments in the insurance and takaful sector

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

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

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

Operating profit for the general business moderated improved slightly on account for higher earned premium income from the motor and fire business.

Exposure to market movements remained manageable given the improvement in insurers' investment in fixed income securities, which more than offset the decline in value of investments in equity. The ratio of market value to cost for the investment in fixed income securities improved, as a result of the declining yields of AAA and AA rated PDS held by insurance companies. The ratio of liquid assets to benefits/claims was 1.9 times (1Q 08: 2.2 times).

Insurance and Takaful Sector: Profitability

	RM million		
	1Q 08	4Q 08	1Q 09
Life/family business			
Excess of income over outgo	2,696,3	1,369.9	2,029.0
General business			
Operating profit	267.2	327.3	204.6

44th SEACEN Governors' Conference
Kuala Lumpur, 6 February 2009

Welcoming Remarks by

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

Bank Negara Malaysia is very honoured to host the SEACEN Governor's Conference for this year. We are particularly privileged to be able to welcome Governors from the SEACEN membership to be with us, at this time, on the occasion of the 50 th Anniversary of our Central Bank. On 26 January 1959, 50 years ago, Bank Negara Malaysia opened its doors as the Central Bank for the nation. The SEACEN group is among the most inclusive grouping in the region, with highly diverse economies, in terms of size and stages of development. This has, however, not been a restraint in the progress and advancement of SEACEN as a cohesive grouping in achieving greater cooperation, particularly in the area of strengthening the capacity and effectiveness of Central Banks in the region.

This year's Governors' meeting, however, takes place at a time of great turmoil in the global financial and economic environment. Indeed, it will be a time for us to reflect on the extent to which our efforts have rendered us better able to respond and to cope with this highly challenging environment.

My dear fellow Governors, today, we are honoured with the presence of The Honourable Dato' Sri Mohd Najib Tun Abdul Razak, the Deputy Prime Minister and Minister of Finance of Malaysia, who has kindly accepted to officiate the commencement of our Conference. We are also very appreciative to Mr. Dominique Strauss-Kahn, the Managing Director of the International Monetary Fund who will be joining our meeting despite the great demands on his time during this most turbulent of times. We will most certainly benefit from the International Monetary Fund's perspective on the unfolding developments and the assessment on the respective responses and interventions that are being made.

Today, we will also have the honour of listening to Mr. Nout Wellink, President of De Nederlandsche Bank who will be sharing with us on the institutional arrangements for prudential supervision, market conduct and consumer protection, issues that are highly relevant in the current environment given the on-going search for the most effective institutional arrangements for achieving financial stability. This is also not only relevant to developed financial systems but also to Central Banks in the SEACEN membership as we continue to develop and evolve our financial systems.

Since the Asian Financial crisis more than ten years ago, the region has benefited from the reforms and restructuring of our respective financial systems and economies. While our strengthened position has not insulated us from destabilising external shocks, it has however strengthened our capacity to cope with such developments. The region has also benefited from the greater pace of regional financial and economic integration. Our increased propensity to trade and invest with one another contributes towards building the foundations for stronger regional stability and resilience. This has also been reinforced by greater regional collaboration and cooperation.

Despite the diverse financial and economic structures, we have all shared the same conviction in that financial progress has to be accompanied with the appropriate degree of regulation and supervision to preserve financial stability but without stifling the incentives for financial innovation and the adoption of prudent risk-taking. Our theme for today on preserving monetary and financial stability in the current global environment continues to resonate as the international dimensions of financial instabilities impinge on our national frontiers and on the policy options available to us. The current

experience demonstrates the fragilities in the financial systems even among the developed economies. Critical issues are emerging particularly on financial intermediation, financial innovation, and the corresponding regulatory regime and surveillance mechanisms that need to be in place to provide the necessary oversight over such activities. These experiences have underscored the critical importance of good governance, sound risk management, rigorous supervision and a strengthened crisis management framework that are sufficiently robust to withstand extreme market conditions.

Globalisation and financial integration have brought a new and salient dimension to the attainment of financial stability, namely, the consideration that needs to be given to the regional and global implications. Greater international collaboration is needed. Moreover, the re-alignment of the international financial architecture has become even more urgent, otherwise, gains achieved at the national level, will continue to be undermined. With each missed opportunity to embark on necessary reforms to the international financial architecture, the financial, economic and social costs have and will continue to become increasingly higher.

The SEACEN grouping has a long history of serving as a platform for high-level policy discussions. Although the SEACEN Centre was established in 1972, the Governors of SEACEN central banks have been meeting annually since 1967. The SEACEN Governors' Conference has always provided a valuable forum for exchanging candid views and sharing policy experiences. Regional surveillance has also been enhanced with the establishment of regional support mechanisms and the strengthening of capacities in the management of risks to our financial system and environment. SEACEN's cooperation has been able to respond to the changing regional and global environment. This has included the SEACEN Experts' Group which was established to exchange information, in particular on the financial flows in the region. In the more recent period, we have also come together to ensure that our circumstances and views be taken into account by international organisations in decisions that would affect the interests of the region.

The SEACEN Centre has also been an effective regional collaborative effort in the capacity building of Central Banks in the region. There has been continuous knowledge building and human capital development across all levels of our institutions. The SEACEN Centre has been providing support for the entire career-cycle of a central banker thus strengthening our talent development. The SEACEN Centre is the most visible outcome of our collaboration which has evolved significantly over the years.

The SEACEN Centre's steadfast efforts have trained more than 10,000 participants from our member Central Banks. With the increased demands on Central Banks, members will continue to place even greater reliance on the SEACEN Centre. I am very pleased to mention here that the SEACEN Centre will be moving to new premises in the next few weeks that will have the state-of-the-art learning facilities. It will also include a new modern residential hostel. As the host country to the SEACEN Centre, Bank Negara Malaysia is very much committed to supporting the Centre in becoming a premier learning centre that leads in the development of central bankers.

Let me conclude my remarks. I look forward to stimulating and productive deliberations at our Conference. Despite the intensive schedule that has been planned, we also hope that some time will be taken to experience Kuala Lumpur during your visit here.

Ceremony for the 50th Anniversary of Bank Negara Malaysia: "50 Years of Central Banking - Stability and Sustainability" Kuala Lumpur, 8 February 2009

Keynote Address by

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

Bank Negara Malaysia opened its doors as a Central Bank on January 26, 1959, just over a year after Malaysia gained independence in August 1957, reflecting the importance that was being accorded by our founding fathers to the institution of Central Banking. At the very outset, the Central Bank was entrusted to provide leadership in performing the traditional Central Bank mandate of promoting monetary and financial stability. Equally important was the mandate to develop the domestic financial system - a financial system that would facilitate economic growth and development.

It is my very great honour to welcome distinguished guests that have come from different parts of the world to join us on this special occasion to commemorate the fiftieth anniversary of Bank Negara Malaysia. We also wish to express our appreciation to the Prime Minister of Malaysia for his presence as the guest of honour at this occasion.

Introduction

Allow me to share our experience during these 50 years and our aspirations moving forward. These five decades have been highly challenging but rewarding with many fulfilling outcomes. And there were also lessons learned. While the country has experienced great prosperity during most of the period, our economic and financial progress has also been punctuated by episodes that have tested our resolve. Rising to manage and address these challenges, the growth and economic transformation experienced in these 50 years have been achieved in an environment of macroeconomic and financial stability.

During the five decades, Malaysia has experienced an average annual growth that has exceeded 6 per cent and an annual inflation that has been less than 3 per cent. The continued increase in incomes and the low and stable inflation have not only promoted a high rate of savings that has exceeded 30 per cent of GDP but it has also resulted in the financialisation of savings. This has allowed Malaysia to rely on domestic sources of funding to finance our growth and development, thereby minimising our levels of external indebtedness.

Monetary Stability

Being a highly open economy, the sources of monetary instability have generally emanated from external price shocks, which have occurred during periods of high commodity and energy prices, and to a lesser extent, from periods of excess demand and overheating conditions. There has essentially been only two episodes in our history in which overheating conditions have generated inflationary pressures; the major one being the period prior to the Asian financial crisis.

Since the 1990s, monetary policy has been further complicated by volatile capital flows. This was evident in several periods, the early nineties, the mid-nineties, and in the late nineties, when outflows occurred during 1997 - 1998 and in the current period following the deleveraging by financial institutions in the advanced economies.

In the early days of the Bank, policy actions were focused on the management of liquidity in the financial system through the imposition of statutory and liquidity reserve requirements, and through prescription of interest rates and portfolio restrictions that included ceilings on lending. Further progress and sophistication in the financial sector, the deepening of the financial markets and the growing influence of capital flows, resulted in the reliance on interest rates and other market-based instruments for monetary policy. Further, with the increased significance of expectations, greater clarity in policy signals became desirable.

Thus in 2004, the New Interest Rate Framework was implemented, in which the Overnight Policy Rate became the new policy rate, thereby enhancing the efficiency of the monetary transmission mechanism. The new framework has also served as a catalyst for efficient pricing of financial products and services by banking institutions.

A key issue for monetary policy in an open economy like Malaysia has been in maintaining a flexible exchange rate and monetary independence in the face of increasingly large capital flows. To better manage the surges in capital flows which have become more prevalent, the range of market-based instruments for monetary policy operations has been widened. Given the rise in intra-regional trade and investment flows, greater importance is being accorded to stability of the exchange rate against regional currencies.

The monetary policy decision-making process at the Bank has also been redefined in which the governance for monetary policy is based on the Monetary Policy Committee to achieve a more optimal process for policy making. Monetary policy communication and increased transparency have also become highly important in this framework.

Thus, while the Central Bank's responsibility towards promoting monetary stability conducive to sustainable growth has remained unchanged since the inception of the Central Bank in 1959, the strategies, framework and instruments have evolved substantially to ensure its effectiveness in delivering this desired objective.

Financial Sector Development

A key focus of the Central Bank during these five decades has been institutional building, financial market development and putting in place the appropriate financial infrastructure. The evolution of the financial system has seen its transformation, from a rudimentary financial system that was dominated by the banking sector to a highly diversified financial system, from a highly controlled financial system to a financial system that functions with greater market orientation, from a highly fragmented system to one that is more consolidated and rationalised. It has also become a financial system that is supported by an extensive legal regime and regulatory and supervisory framework, and a financial system that is more liberalised with stronger international linkages.

Part of the institutional building was the establishment of regulatory institutions that have clearly defined mandates. These institutions that include the Securities Commision, the Cooperative Commission, the Labuan Offshore Financial Services Authority (LOFSA), join us today in celebrating the long tradition of cooperation to meet the common purpose. Specialised development financial institutions were also established to promote access to financial services to sectors that are not being serviced by existing financial institutions. Financial inclusion, to ensure that all economic activities and all segments of society have access to financial services, has always been a key priority of the Central Bank. Currently, about 80% of our population have some forms of banking account as the access to the financial system becomes more extensive and widespread.

An important financial infrastructure established by the Bank to support the intermediation process includes the comprehensive centrally coordinated credit information system at the national level which allows for better-informed credit decisions by financial institutions. In addition, the Credit Guarantee Corporation was established to provide support for small businesses. Cagamas, the national mortgage corporation, was established by the Central Bank to ensure a steady flow of funds to the housing industry and to develop a secondary mortgage market.

At the centre of the financial infrastructure is the payments infrastructure which has been enhanced and modernised over the years to achieve greater efficiency and reliability of the payments system. The payments landscape has evolved from a mainly paper-based to one that includes a range of new electronic forms of payment. Internet banking which was not available in Malaysia as recent as 10 years ago is now widely used by the entire population of internet subscribers in the country. The acceleration of the nation's migration to the more efficient electronic payments continues to be an important agenda of the Central Bank.

Complementing institution building has also included the support given by the Central Bank to the development of talent in the financial services industry. The growth of the financial sector cannot

be achieved without adequate attention to the development of the professional requirements of the financial services industry.

In the recent two decades, a comprehensive Islamic financial system has also evolved in Malaysia, that includes the institutions, markets and supporting legal, regulatory and supervisory framework. The Islamic financial system now offers the full breadth and depth of Islamic financial services. Malaysia is the host to the secretariat for the Islamic Financial Services Board in Kuala Lumpur that sets the international regulatory and supervisory standards in Islamic finance.

Financial market development has also been central to building a robust financial system. The Central Bank's efforts in this direction have included establishing the institutions and the infrastructure to improve market efficiency of money, capital and foreign exchange markets. The Securities Commission, the domestic rating agencies and Cagamas, the mortgage corporation, are among the initiatives initiated by the Bank as part of the development of the domestic bond market. In addition, the Bank has also put in place a comprehensive and modern depository, delivery and settlement system that facilitates the issuance, trading and settlement of debt securities in the market, as well as mechanisms to increase liquidity in the market to enhance the overall price discovery process. This has contributed towards the proliferation of new instruments with extended maturity profiles, leading to the enhanced depth and breadth of the debt securities market.

The development of a robust and vibrant foreign exchange market still remains an outstanding area of development. As a highly open economy, this market is a vital part of our financial system. The country exit from the Currency Board system in 1967 and introduced the ringgit (known as the Malaysian dollar then). The changeover was successful. It was a time when there was an absence of speculators. It was only in 1997-98 when the ringgit and other regional currencies came under speculative attack. The volume of foreign exchange transactions had become massive, far exceeding volume of trade and the normal financial flows. This resulted in exchange rate volatility during the Asian crisis that occurred in wave after wave during this period. As a consequence, regional currencies plummeted to historical lows.

After more than a year of this turmoil and the uncertainty generated in the foreign exchange market, Malaysia implemented selective capital controls and deinternationalised the ringgit. This was instrumental in restoring stability in the market. It acted very much like a circuit breaker. Offshore trading of the ringgit, the major source for financing the speculative attacks, was effectively eliminated. Within a year, all the controls that was imposed were removed. More than 10 years later, the ringgit, however, still remains non-internationalised. An important precondition for the internationalisation of the currency is the development of a robust foreign exchange market in our financial system.

Financial Stability

The events surrounding the current financial crisis has brought into sharp focus the role of central banks in financial stability. As these events continue to unfold with great uncertainty on the financial markets and broader economy, allow me to reflect on Bank Negara Malaysia's own role in financial stability.

In addition to its functions as the lender of last resort, Bank Negara Malaysia also has the responsibility for the regulation of banking institutions. Since 1988, the Bank also assumed responsibility for the insurance industry and in 2002, the development financial institutions. The prudential regulatory and supervisory framework during these 50 years have also undergone significant evolution. The prudential framework and the supervisory approaches adopted by the Bank have provided the flexibility to respond to the new developments and challenges that have confronted the financial sector. Several factors have guided the approach adopted by the Bank. The first is to recognise the limitations of the regulatory tools and instruments. Second, is the acceptance that change is required in an environment that is constantly changing, and to carefully assess the trade-offs that arise given the different stages of development within the financial sector. And finally, to take into account the interlinkages within the financial system, and between the financial systems across borders.

Guided by these parameters, the Bank has evolved a prudential framework which at the start, comprised simple prudential rules that addressed capital, gearing, liquidity and portfolio restrictions,

to the now more differentiated and principle-based regulations that reflect the levels of risk taken by an institution. As a result, significantly greater flexibility is now accorded to institutions that demonstrate sound governance practices and robust risk management capabilities. This flexibility has been accompanied by fundamental changes in the approach to supervision that has now shifted from a predominantly compliance-based approach, to one that focuses on the assessment of the risk-taking activities of an institution and the control functions to manage the risks. The supervisory tools have also been expanded to include more forward-looking assessments of the risks to financial stability, supported by more dynamic stress testing approaches and enhanced surveillance systems.

To a large extent, the preconditions for the shift to the principle-based approach to regulation have been strengthened through capacity building measures that have been pursued in the period immediately following the Asian financial crisis. The development of the Financial Sector Masterplan which was released in 2001 is a blueprint not only for comprehensive financial sector reforms, but also it provided the framework and strategies for the modernisation of our financial system.

The financial safety net was also strengthened with the introduction of a comprehensive deposit insurance system and the establishment of institutions to assist consumers in managing their debt and resolving disputes with financial institutions. These measures have also contributed towards maintaining confidence in the financial system.

The Crisis: A Defining Moment for the Bank

In the 1990s, it became evident for emerging economies that new challenges to stability arising from the international dimensions of financial activity had emerged. In particular, highly volatile and potentially destabilising capital flows had become a dominant feature of the international financial environment. Strong economic fundamentals alone proved to be insufficient in containing instability in the domestic economy and financial system.

Many of us still vividly recall the Asian financial crisis of 1997-98 that significantly affected several of the countries in the region. What started as a currency crisis turned into a financial and economic crisis. During this period, the ringgit exchange rate depreciated by about 40% at the peak of the crisis; the stock market declined by almost 80%. While the Malaysian economy continued to expand in 1997 by 7.3%, conditions deteriorated significantly in 1998 and the economy contracted by 7.4%.

An extensive set of measures were implemented. This included a comprehensive restructuring programme for the financial and corporate sectors. While still at the early stage of the crisis, an asset management company was established to acquire and manage the non-performing loans of banking institutions. A special purpose vehicle to recapitalise the banking institutions and a Corporate Debt Restructuring Committee were also established to provide avenues for voluntary debt restructuring for businesses. Within six months of the implementation of these measures, the problems in the financial sector were addressed and lending activities resumed. This contributed to the rebound of the economy which expanded by 6.1% in 1999. Notably, the stakes taken in the financial institutions were disposed back to the private sector with the cost of the exercise being more than covered.

The Bank's efforts to sustain stability did not end when the Asian financial crisis abated and economic recovery was firmly in place. The lesson that the foundations for resilience are built during good times was earnestly embraced. Therefore, once stability was restored, the Bank embarked on a comprehensive restructuring and reform of the financial sector. This included the consolidation of domestic financial institutions; the strengthening of the corporate governance, risk management and the institutional capacity of the domestic financial institutions; as well as the deepening of the bond market. These efforts have put the Malaysian financial system in a much stronger position to weather the current global financial crisis.

Regional Cooperation

From the beginning, the Bank has always had an active engagement in the region and was from the very beginning part of the SEACEN grouping

which is the oldest and most inclusive regional grouping. Starting in 1967, SEACEN has been a valuable regional forum. While it is a group of highly diverse economies, this did not prevent it from being a cohesive grouping. The permanent secretariat of SEACEN which resides in Kuala Lumpur was established in 1979. The Bank is also part of other regional groupings including EMEAP and the Asian Consultative Council (ACC) of the BIS. Collaborative efforts among the Asian Central Banks in surveillance, regional financial market development and the sharing of information have been extensive. In Islamic finance, the Bank is a founding member of the Islamic Financial Services Board to promote and enhance the soundness and stability of the Islamic financial services industry.

Modernisation of the Central Bank

In the 50 years, the Central Bank has also been fundamentally transformed. At its inception, the Bank started with 57 people with four departments. The Bank has now grown in strength to more than 2,600 staff to accommodate our expanded roles. The modernisation of the Bank has involved change to our legal framework, our organisational and governance structure, and the nature of our human capital, so as to enable the Bank to become more effective in the changed environment.

As we advance forward into the future, the Bank will be confronted with increased challenges, and with many of the building blocks now in place, the next phase of development of the Malaysia's financial sector will involve greater market liberalisation and internationalisation. These developments will intensify the demand for greater readiness, capacity and capability from the Bank to best serve the nation moving forward.

This year, the Bank is in the process of submitting to Parliament a new Central Banking Act. As the economic and financial landscape, both domestic and international, is now significantly different from 50 years ago, the proposed Act involves a holistic review of the present legislative framework to give greater clarity to the Bank's mandate, governance, and accountability to ensure that the Bank remains effective in performing its functions. The proposed Act will provide the Bank with the necessary powers and instruments to perform the Bank's roles and functions effectively. The proposed Act will also not only institutionalise many of the practices that have been introduced in this recent decade but also to have the necessary powers which is deemed as critical in ensuring that the Central Bank is in a state of readiness to face future challenges.

In concert with these, the new Act will essentially reinforce the existing governance framework with adequate mechanisms to ensure sufficient checks and balances are in place. The governance framework will further facilitate and enhance high quality decision-making in the Bank, institutionalising both existing and new procedures and processes to enhance accountability, professionalism and transparency. The strengthening of governance and accountability will form the prerequisite for the Bank to maintain our public legitimacy and autonomy, as well as to ensure the integrity of the Bank as a public institution serving the nation's interests.

Conclusion

Bank Negara Malaysia's experience during these fifty years in preserving monetary and financial stability and in supporting the sustainability of economic development has seen many challenges. Throughout this journey, we have remained focused on what needs to be achieved and the vision of where we want to be. Key to our effectiveness is the internal capacity of the Bank. At the heart of this is the people in the Bank. While the operating environment has changed significantly and our policy focus has evolved, the values that the Bank represents, of integrity, of respect for diversity, professionalism and drive for the highest standards of excellence, have been enduring and reinforced over time.

Finally, the Central Bank could not have been successful in achieving our objectives and our policies if we did not have the support in our country - from the Government, from the financial and business communities and from the people of the country - for their confidence and trust in us during these 50 years. The Bank, going forward, through our policy actions and in discharging our responsibilities, will continue to uphold this trust that has been placed upon us.

Bank Negara Malaysia's High Level Conference
Kuala Lumpur, 10 February 2009

Opening Remarks by

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

It is my pleasure to welcome you to the Bank Negara Malaysia Conference on "Central Banking in the 21st Century: Implications of Economic and Financial Globalisation" that is being held in conjunction with the 50 th Anniversary of Bank Negara Malaysia. Indeed, the conference takes place at a time when we need to reflect on the many issues that are emerging from the current global financial and economic crisis and the new challenges and lessons that it brings to central banks.

We are most honoured by the presence of central banks from more than 50 countries who have come to be with us on the occasion of our 50 th Anniversary. This gathering has also brought together distinguished speakers not only from the central banking community but also outstanding scholars and senior practitioners from the financial services industry. It is hoped that this conference will contribute to a greater understanding of the issues confronting central banks in the 21 st century.

Indeed, we are now in a world that is fundamentally different, a world that calls for a greater appreciation of the changes that need to be made to the systems and structures, to the institutional arrangements and mechanisms, and to the manner in which we operate in this new environment. The international dimension of these changes calls for an outcome in which the international financial system is less prone to disruptions and failures and in which economic progress is a shared prosperity amongst nations.

Globalisation had a deep impact on the way modern economies function. The benefits of globalisation have accrued to diverse communities and regions but it has also brought with it significant risks. While the Asian Crisis showed the effects of globalisation, it also showed that Asia was able to rapidly rebound and continue to benefit from increased international trade and financial flows. The rapid restoration of stability and resumption of growth had confined the crisis to Asia.

As the current financial crisis is translated into an economic crisis, its repercussions are now being felt on a global scale. While the turmoil had its origins in a number of the developed economies, its continued escalation has extended the effects of the crisis to the rest of the world.

Economic and financial globalaisation thus not not only calls for policy responses at the national level but also at the international level. It also calls for the consideration that such policy responses may have implications that extend beyond domestic borders. Benefits may also be derived from cross border coordination of policy responses to increase the prospects of achieving the desired outcomes.

Our conference today focuses on the impact of economic and financial globalisation on the role of central banks, as well as to assess how central banks can effectively contribute to promote stability in this environment. In particular, this conference will be looking at the implications and challenges that globalisation brings to the mandate of the central banks in preserving monetary and financial stability. The pace and nature of globalisation has also brought significant stress to the international financial architecture. The current financial crisis has highlighted the vulnerabilities in the international financial architecture, leading to renewed thinking about the reform of the global financial system. Tonight, Professor Joseph Stiglitz will be speaking on "Strong Institutions for Growth and Crisis Management".

Tomorrow, we will address some of the specific management challenges central banks face in a globalised environment. We will also discuss some recent developments in central banks' cooperation and the areas for reform of the international financial architecture.

The crisis presents an opportunity for us to re-evaluate, promote and embrace sustainable long terms solutions. Our focus is for the discussions to contribute to the means through which central banks can contribute more effectively in promoting stability and economic growth. This conference, we hope, will provide an opportunity to reassess our traditional views on many of the issues before us. On that note, I wish you a very engaging and substantive conference.

Euromoney 8th Annual Islamic Finance Summit: "Islamic Finance and Global Financial Stability" London, 24 February 2009

Keynote Address by

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

It is my honour to be invited to speak at this 8th Annual Islamic Finance Summit organised by Euromoney. This summit, which takes place at a time of an unprecedented global financial crisis, provides us with an opportunity to reflect on the challenges confronting us and to consider the issues that have emerged in the context of the Islamic financial system.

My address will in particular focus on Islamic finance as a form of financial intermediation and financial stability. I will also touch on the steps that have been taken both at the national and international level to strengthen the resilience and robustness of Islamic finance, taking into account the lessons drawn from financial crisis that have been experienced including from the current crisis.

As we weather the current environment and prepare for the next wave of the growth cycle, it is also timely to explore the potential synergy that can be optimised between London, an international financial centre and Malaysia, an international Islamic financial hub. And in so doing, capitalise on the respective comparative advantage, thereby strengthening the linkages between Islamic financial markets, in particular, between the East and West.

It was exactly five years ago that I spoke at this forum. At that time, the world's GDP was expanding by close to 5%, with emerging economies growing by 7.5%[1]. Islamic finance during this period expanded rapidly not only in the Muslim world but across the Western world. With total global Islamic financial assets now estimated at USD700 billion in 2007, the Islamic financial industry offers a wide range of complex and sophisticated Islamic financial products and services. Of significance, is its greater integration into the international financial system.

As it becomes part of the financial globalisation process, Islamic finance has however become increasingly exposed to the systemic implications of external developments. Two issues are of interest. Firstly, as Islamic finance expands, its potential for sustaining financial stability and secondly, how robust is the industry to external shocks.

Foundations of Islamic Finance

Guided by Shariah principles in the development of the Islamic financial system, it forms the very foundation that contributes towards its overall stability and resilience. These foundations are further reinforced by the values that are extolled in Islamic finance that are similar to those found in ethical finance and socially responsible investment.

The Shariah injunctions require that Islamic financial transactions are supported by an underlying economic activity. In essence, Islamic financial transactions need to be accompanied by business and trade activities that generate legitimate profits. This ensures that the funds are channelled into productive economic activity. This results in a close link between financial and productive flows, which in turn, shields the Islamic financial system from excessive leveraging, imprudent risk taking and speculative activities.

Aligned to the primary objective of Islam (maqasid al Shariah) of promoting justice and fairness is the prohibition of interest. That is, the gaining of reward without accepting equivalent counter values ('iwad) of risk, effort and liability in the transaction is prohibited. Based on the arrangement, the real activity is therefore expected to generate sufficient wealth to compensate for the risks.

[1] IMF (28 January 2009), "Global economic slump challenges policies", World Economic Outlook Update

The risk sharing requirement thus necessitates Islamic financial institutions to institute strong risk management practices that involve the appropriate due diligence on the economic viability of the business activity or of the underlying asset. This is reinforced by the explicit requirements of transparency and disclosure. The intrinsic principle of profit and risk sharing and the upholding of the universal values of justice and fairness thus provides implicit in-built checks and balances in the system. Embedded in this arrangement is also ethics and good governance.

When embraced in its entirety, these essential features as required by the principles of Shariah, reduces the prospect of precipitating financial instability. Potential risks may nevertheless arise when the economic environment and conditions in the financial markets turn adverse or when the Shariah principles are violated. The risk of the former will be greater for those Islamic financial institutions that have pursued aggressive investment strategies during periods of strong growth.

In the current global financial crisis, the initial tightening of liquidity and the subsequent breakdown of the functioning of the financial markets precipitated stress and insolvency in the financial sector. The credit crunch that followed, has resulted in catastrophic damage to the global economy. Second round effects will be felt as the economic contraction produces further strain on the financial sector. The Islamic financial system will not be immune to these developments.

Strengthening the Resilience of the Islamic Financial System

With increased globalisation and greater integration of Islamic finance with the international financial system, the higher will be the risk of the contagion effects arising from financial and economic disruptions from other jurisdictions. Several initiatives have therefore been taken to enhance the ability of the Islamic financial system to manage such testing and challenging conditions.

Essential to this process is a well functioning liquidity management framework. An absence of a well developed money market would inhibit the capability of Islamic financial institutions to effectively manage funding of Islamic financial transactions. Facilities for adjusting portfolio balances in a Shariah compliant manner are crucial in ensuring liquidity risks are effectively managed.

Malaysia has, for more than a decade now, an efficient functioning Islamic money market that has evolved from liquidity instruments structured on profit sharing (mudharabah) basis to instruments structured on custody with guarantee (wadiah yad dhamanah), leasing (ijarah) and on a cost plus (murabahah) basis. This has accorded greater monetary flexibility in the Islamic financial system. The next step is to allow this platform to take on an international dimension and to allow for greater participation from a wider international financial community in this market. This can be achieved by expanding the number of players to include those from other jurisdictions, offering product suites that are denominated in other currencies and structured in a manner that would meet a wider range of applications and purposes.

A further strategy to strengthen the soundness and stability of the Islamic financial system is to have in place a comprehensive prudential regulatory regime. The Islamic Financial Services Board (IFSB) was established in 2002 to set prudential standards for Islamic finance. It has now issued 7 guidelines and standards that cover capital adequacy, risk management, corporate governance, Shariah governance as well as standards of transparency and disclosure. The most recent issuance was on the governance of collective investment schemes and capital adequacy for sukuk, securitisation and real estate investment activities. The adoption of the IFSB standards across jurisdictions will be key in promoting and enhancing the soundness and stability of Islamic financial services industry.

In addition to the implementation of these prudential standards, there is also a need to ensure the supervisory and legal infrastructure remain relevant to the rapidly changing Islamic financial landscape. In Malaysia these efforts are also supported by a comprehensive financial safety net that includes a deposit

insurance scheme and a resolution mechanism, so that not only are depositors protected, but it also allows for prompt, effective and least cost resolution of the financial system.

Indeed, the current crisis has highlighted the importance of having in place an integrated crisis management framework. Such measures include the mechanism and vehicle to provide short-term liquidity; arrangements to remove troubled assets from the balance sheets of financial institutions and the mechanism for recapitalization of Islamic financial institutions. Finally, initiatives to promote greater intra-regional cooperation has fostered closer linkages amongst regulators across jurisdictions and the convergence of standards in the supervisory and regulatory approaches. Sharing of information, findings and experience has also been a key area of cooperation.

One of the inherent risks facing the Islamic finance sector is operating in a more entrenched conventional financial system. The absence of an Islamic benchmark has exposed Islamic finance to "displacement risk" due to changing monetary conditions in which it co-exists with the conventional system. This fundamental issue has to be addressed to reduce the vulnerabilities of the Islamic financial sector to changing economic environment. In addition, the absence of strong corporate governance would expose the Islamic banks to similar risks as in the conventional system. In fact, it is more crucial for the board of management of Islamic financial institutions to institute higher standard of leadership and comprehensive governance culture and framework.

Internationalisation of Islamic Financial System

Let me now turn to the internationalisation of the Islamic financial system and the synergies that London and Malaysia could benefit from the collaboration.

The development of the Islamic financial system in Malaysia has progressively evolved towards becoming an increasingly more liberalised and internationalised environment. The transformation from a rudimentary Islamic financial system that was dominated by the banking sector has now transformed to a comprehensive Islamic financial system with an extensive spectrum of financial products and services, and having an extended reach that is beyond serving the domestic economy.

Since 2003, measures were introduced to create a more competitive environment in Islamic finance. Flexibilities were accorded to foreign players and dedicated Islamic licences to conduct business in international currencies were introduced. Permitting the issuance of ringgit and foreign currency denominated sukuk in Malaysia by foreign entities has also increased the diversity of players and promoted innovation in the financial system.

Our Islamic banking sector registered double-digit growth over the recent eight years with an average annual growth rate of 20% in terms of assets. As at the end of 2008, the share of Islamic banking assets in the total banking sector has expanded to reach 16.7% as compared to 6.9% in the year 2000. Our takaful industry registered a growth rate averaging 23% per annum in the recent five years with family and general takaful accounting for 11% and 7%, respectively of the overall insurance sector. Malaysia also remains the world's largest sukuk market, accounting for more than 37% of global sukuk issuances in 2008[2].

The participation of established international financial centres such as London in Islamic finance will reinforce the trend of greater internationalisation of Islamic finance, contribute towards strengthening inter-linkages in the international Islamic financial system and the optimisation of the allocation of financial resources across borders but also through the greater diversification of risk contribute towards enhancing global financial stability.

Linkages between Malaysia and London

In this regard, there are several areas of potential collaboration. In the area of liquidity management, Malaysia has an established and vibrant Islamic money market. The range of Islamic money market instruments can be

[2] Standard & Poor's (14 January 2009), RatingsDirect

a viable platform towards the development of a bilateral currency market. London has the international base for foreign currency supply and demand. With Islamic infrastructure in Malaysia and London's global reach, a mutually enriching international currency Islamic money market could potentially be developed in which other financial centres can participate and leverage on the enhanced interconnectivity. In the immediate term, it could accord advantages to Islamic financial institutions in the United Kingdom and Malaysia to manage their liquidity management requirements.

In the area of sukuk, Malaysia has the largest sukuk market whilst London has one of the most established exchanges. An area for potential cooperation could be in the area of the cross-listing of sukuks. Putting in place a mechanism for sukuks issued in one jurisdiction to be recognised by the other would have a considerable impact on market accessibility, thereby allowing for greater issuer and investor reach. In addition, mutual recognition can additionally be for all Islamic financial products already approved in the respective jurisdictions so as to facilitate greater cross border transactions.

Finally, in the area of talent development, Malaysia has a number of learning establishments that provide Islamic finance training and education. The UK in turn has long been associated with quality education. Partnerships in this area have already been entered into. The University of Reading and International Centre for Education in Islamic Finance (INCEIF) in Malaysia have already entered into a joint programme. The availability of a pool of skilled talent in Islamic finance is a core element to support the continued innovation and maintain the vibrancy of the Islamic financial system.

Concluding Remarks

The global financial crisis has highlighted several structural weaknesses and imbalances in the international financial system. Whilst Islamic finance is not insulated from the effects of the current environment, the Shariah principles and values that underlies Islamic finance provides an important underlying foundation. This has been further reinforced by the strengthening of the financial infrastructure, the regulatory regime, the supervisory and legal framework, and the crisis management capabilities. At the same time, building and strengthening linkages between nations can contribute to this process. Indeed, both Malaysia and London can pave the way towards bridging Islamic financial markets between the East and the West, while we prepare ourselves for the next phase of development of the global economic and financial system.

CALENDAR OF EVENTS
January – March 2009

21 January 2009

At its first meeting for 2009, the Bank's Monetary Policy Committee (MPC) decided to reduce the Overnight Policy Rate (OPR) by 75 basis points to 2.50% while the Statutory Reserve Requirement (SRR) was also cut from 3.5% to 2% effective 1st February. With the heightened downside risks to growth, the magnitude of the reductions in the OPR and the SRR were aimed to be pre-emptive in providing a more supportive monetary environment for the domestic economy. At its subsequent meeting on 24 February, the MPC reduced the OPR further by 50 basis points to 2% while the SRR was adjusted downwards from 2% to 1% effective 1st March to reduce further the cost of intermediation.

23 January 2009

The Bank announced the establishment of a RM2 billion SME Assistance Guarantee Scheme to ensure that viable Small and Medium Enterprises (SMEs) adversely impacted by the current economic slowdown will continue to have access to adequate financing. Eligible SMEs can obtain financing of up to RM500,000 each with tenures of up to 5 years. The Credit Guarantee Corporation Berhad (CGC) will provide an 80% guarantee cover for financing approved under this Scheme. SMEs can apply for this Scheme at any commercial and Islamic banks as well as participating development financial institutions.

28 January 2009

The Bank announced the issuance of Bon Simpanan Merdeka 01/2009 amounting to RM1 billion. The bond, which is scripless and based on Shariah principles, is an additional savings instrument for Malaysian senior citizens aged 56 years old and above, as well as those who retired on medical grounds. The bond, which went on sale from 18 February, has a 3-year tenure and offers a tax-free return of 5% per annum with the flexibility for early redemption. On 11 March, the Bank announced that the bond was fully subscribed.

6 – 7 February 2009

The Bank hosted the 44th South East Asian Central Banks (SEACEN) Governors' Conference and the 28th Meeting of the SEACEN Board of Governors at its headquarters. Governors and representatives of the sixteen SEACEN members and two other central banks which joined as observers participated in the Conference which was officiated by Dato' Sri Mohd Najib Tun Razak, the then Deputy Prime Minister of Malaysia. Chaired by Governor Dr. Zeti, the theme for the Conference was "Preserving Monetary and Financial Stability in the New Global Financial Environment". In his opening address, Dato' Sri Najib said that policymakers and authorities, need to identify and adequately manage new sources of systemic risks to preserve the stability of the financial system. He added that further reforms of the Asia's financial system are needed to ensure its resilience towards the volatility of the global economic and financial environment. In her welcoming remarks, Governor noted that the Asian region has benefited from the reforms and restructuring of its respective financial systems and economies following the Asian Financial crisis. Greater financial and economic integration in the region, reinforced by greater regional collaboration and cooperation, contribute towards building a stronger regional stability and resilience. She highlighted that recent global economic and financial instability have underscored the critical importance of good governance, sound risk management, rigorous supervision and strengthened crisis management framework to withstand extreme market conditions. Governor also added that greater international collaboration and re-alignment of international financial architecture is urgently needed to reduce the regional financial, economic and social costs.

8 February 2009

The Bank and the People's Bank of China established a RM40 billion (80 billion yuan) bilateral currency swap arrangement to promote bilateral trade and investment for economic development of the two countries. The effective period of the arrangement will be 3 years, and could be extended by agreement between the two nations.

8 – 11 February 2009

The Bank held a series of meetings and events in conjunction with its 50th anniversary. The series of events and meetings started off with Islamic Financial Services Board (IFSB) Public Lecture on Financial Policy and Stability, followed by Bank of International Settlements (BIS) Asian Consultative Council Meeting as well as BIS Special Governor's Meeting and Central Bank Governor's Forum. More than 40 central bank governors attended these meetings. In her keynote address at the Bank's 50th Anniversary special ceremony, Dr. Zeti shared the Bank's experience during the past fifty years in preserving monetary and financial stability as well as in supporting the sustainability of economic development in Malaysia. From 10 to 11 February, the Bank also organised a High Level Conference with the theme 'Central Banking in the 21st Century: Implications of Economic and Financial Globalisation'. The conference covered economic and financial market developments and their implications for monetary and financial stability. The unique challenges posed to central banks and the prospects of central bank cooperation and the role of central banks in the global financial architecture were the subjects of in-depth discussions. Central bank governors, leading academicians and eminent members of the financial community were invited as speakers for the conference.

12 February 2009

The Bank was awarded the "Best Central Bank in Promoting Islamic Finance" at the Islamic Finance news Awards 2008 Ceremony held at Mandarin Oriental Hotel, Kuala Lumpur. This is the fourth consecutive year that the Bank had won the award. In the second and third place were the State Bank of Pakistan and the Central Bank of Bahrain, respectively.

24 February 2009

At the Euromoney 8th Annual Islamic Finance Summit in London, Dr. Zeti in her keynote address, highlighted the potential for Britain and Malaysia to collaborate and pave the way towards bridging the Islamic financial markets between the East and the West. Governor added that participation of international financial centres such as London would reinforce the trend of greater internationalisation of Islamic finance. This, in turn, will help to strengthen inter-linkages in the international Islamic finance system and optimisation of the allocation of financial resources across borders. On the same day Dr. Zeti was presented with an award by the London based Euromoney Magazine in recognition for her Outstanding Contribution to Islamic Finance. The magazine gave due recognition to Dr. Zeti as one of Islamic finance's most prominent advocates and her significant role in promoting Malaysia as a hub for Islamic finance.

25 February 2009

The Bank signed a Memorandum of Understanding (MoU) with the UK Trade and Investment (UKTI) in London to establish a collaborative framework to promote mutual co-operation in the area of Islamic finance. Under the MoU, Malaysia and UK will cooperate in the development of talent and expertise, business linkages and infrastructure support in Islamic finance.

6 March 2009

The Bank announced the appointment of Encik Bakarudin Bin Ishak and Dr. Sukhdave Singh as Assistant Governors effective 5 March. This brings the number of Assistant Governors in the Bank to eight.

25 March 2009

The Bank released its Annual Report and the Financial Stability and Payment Systems Report for 2008. At the press conference, Governor announced that the Malaysian economy registered a growth of 4.6% in 2008. Growth was supported by robust domestic demand, particularly sustained private consumption and strong public spending during the year. On the supply side, the services sector maintained its robust performance in the first half of the year, driven by strong demand and the expansion in trade and tourism activities. However, in the second half-year, all economic sectors were affected by the global downturn and the sharp correction in commodity prices. Headline inflation was higher at 5.4% in 2008, due mainly to the sharp increase in global food and fuel prices. As for the outlook for the Malaysian economy in 2009, Governor highlighted that the real GDP performance is projected to be between -1% to 1% while inflation is expected to average between 1.5 – 2%.

On the financial system, Governor added that the Malaysian financial sector remained stable and resilient against the backdrop of global economic and financial market turmoil. Pre-emptive measures taken by the Bank and the Government during the year preserved confidence and stability in the financial sector. Capitalisation and solvency positions were sustained at strong levels with sufficiently high level of financial buffers, supported by strengthened institutional structures and enhanced governance and risk management practices.