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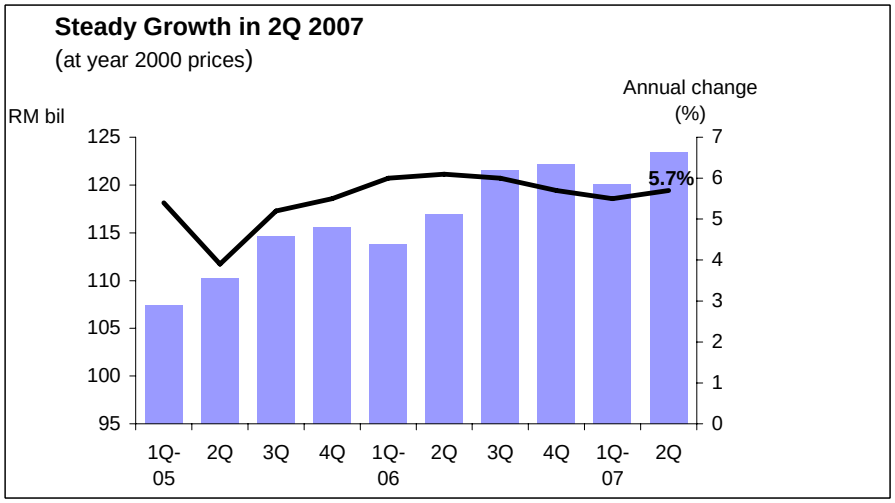
PRESS RELEASE

ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE SECOND QUARTER OF 2007

OVERVIEW

Economy on a steady growth path

The Malaysian economy continued to be on a steady growth path, with real GDP expanding by 5.7% in the second quarter of 2007 (1Q: 5.5%). Private sector activity remained resilient in the second quarter. The increased public sector spending provided added support to the growth. Sustained strong performance in the services sector and higher activities in the mining and construction sectors supported the growth in the second quarter.



The services sector, which grew by 9.2% in the second quarter (1Q: 9.7%), continued to benefit from increased finance and business activity as well as favourable stock market performance and increased demand for computer and professional services. Meanwhile, the wholesale and retail trade, accommodation and restaurant sub-sector recorded a higher growth during the quarter due to strong spending by domestic consumers as well as robust tourism activities. Growth in the transport, storage and communication sub-sector was also higher during the quarter led by strong growth in both the transportation and telecommunications segments. The construction sector expanded further during the quarter (4.8%; 1Q: 4%), underpinned by the commencement of new projects under the Ninth Malaysia Plan and further supported by activities in the non-residential sector. In the mining sector, growth of 7.7% (1Q: -0.6%) was supported by higher output of both crude oil and natural gas. Output of natural gas increased strongly during the quarter, supported by rising demand from domestic electricity producers as well as external demand for liquefied natural gas, particularly from Japan and Korea.

Although output of export-oriented industries declined during the quarter, weighed down mainly by the weakness in the electronics and electrical industry, the manufacturing sector continued to record a positive growth of 1.5% in the second quarter (1Q: 2%). Growth reflected the increase in production by domestic-oriented industries mainly led by strong demand for construction-related materials following the improvement in domestic construction activities. Meanwhile, the agriculture sector contracted by 0.9% in the second quarter (1Q: 2.2%), following the lower production of crude palm oil due to lower yields, as harvest activity was affected by unfavourable weather conditions.

Domestic demand expanded strongly in the second quarter (10.8%; 1Q: 8.7%), supported by private sector activity and continued increase in public investment spending. Private consumption expenditure was stronger, (13.1%; 1Q: 8.6%), supported by the steady increase in disposable income and stable employment market conditions as well as stronger commodity prices. In addition, the favourable performance of the stock market reinforced consumer sentiments during the quarter. Meanwhile, gross fixed capital formation expanded by 6.6% in the second quarter (1Q: 9.9%), on continued capital spending activities by both the private and public sectors. The government development spending initiatives during the quarter were focussed on high-multiplier impact projects, mainly for agriculture and rural development, upgrading and construction of transportation related infrastructure and public utilities. Private sector capital spending activities expanded steadily, particularly in the manufacturing, construction and upstream oil and gas sectors, supported by improved business conditions.

The headline inflation rate, as measured by the change in the Consumer Price Index (CPI), moderated further to average 1.5% in the second quarter of 2007 (1Q: 2.6%), which is the lowest rate observed since the third quarter of 2004.

On the external front, the trade account recorded a higher surplus of RM22.5 billion (1Q: RM21.1 billion). While gross exports rose by 1.2% in the second quarter (1Q: 1%), reflecting higher exports of primary commodities amidst the strong prices, gross imports moderated to 1.7% (1Q: 5.5%). Agriculture exports, in particular, performed exceptionally well during the quarter, driven by the strong growth in palm oil exports following the double-digit increases in export prices. The factors that contributed to the surge in palm oil prices include the continued high global demand for palm oil, amidst the declining domestic production and stocks during the quarter, the rise in soybean oil prices as well as the decision by India to reduce its tariff on palm oil imports to be nearly on par with the tariff on soybean imports. Mineral exports also rose during the quarter, driven entirely by the rise in LNG exports, due to higher offtake by the major buyers as well as higher prices. Growth of manufacturing exports was subdued during the second quarter as a result of lower electronics and electrical (E&E) exports. Exports of resource-based products however, remained strong, mainly supported by chemicals, petroleum and food products as well as furniture and parts.

The moderation in gross imports was attributable mainly to lower growth in intermediate imports (6.3%; 1Q: 9%). This reflected mainly the slower growth in imported inputs for manufactured exports, in tandem with the lower external demand for E&E products. Following continued growth in private consumption expenditure, import of consumption goods increased by 1.3% (1Q: 8.9%). Imports of capital goods amounted to RM16.6 billion in the second quarter. Excluding one-off large items, imports of capital goods expanded by 3.8% (1Q: -1.3%). This reflected higher imports of construction and mining equipments for continued exploration and downstream activities in the oil and gas sector, as well as imports of machinery and equipments for increased development activity and capacity expansion in the services and agriculture sectors.

In the financial account, net inflow of foreign direct investment (as captured by Bank Negara Malaysia's Cash BOP System which does not include retained earnings and investment in the form of imported machinery and equipment) increased to RM13.6 billion in the second quarter (1Q: RM0.8 billion). This reflected the larger inflows of equity into the services, agriculture and manufacturing sectors. Portfolio investment recorded a net inflow of RM14.5 billion in the second quarter (1Q: RM27.4 billion), while overseas investment recorded a larger net outflow of RM7.8 billion (1Q: -RM3.8 billion).

The international reserves of Bank Negara Malaysia amounted to RM339.8 billion or equivalent to USD98.4 billion as at end-June 2007. As at 15 August 2007, the reserves amounted to RM339.7 billion or equivalent to USD98.4 billion, sufficient to finance 8.9 months of retained imports and is 8.7 times the short-term external debt.

Monetary policy remained supportive of economic activity

The overnight policy rate (OPR) was unchanged at 3.50% throughout the second quarter of 2007 as the prevailing level of the policy rate remains

consistent with the medium term outlook of low inflation and sustained economic growth.

Reflecting the unchanged OPR, interbank rates of all maturities remained stable during the quarter. Retail lending and deposit rates also remained relatively unchanged.

Financing to the private sector was higher in the second quarter, with banking system loans and private debt securities (PDS) outstanding expanding at a combined annual rate of 6.8% at the end of the second quarter. Banking system loans outstanding increased at an annual rate of 6%, with loans outstanding to businesses and households expanding by 6% and 7.2% respectively. The major loan indicators were higher on an annual basis. Loan applications and approvals were notably higher, driven mainly by the business sector.

M3, or broad money, increased at an annual rate of 12.6% as at end-June (1Q: 14.2%). There was a strong increase in net foreign assets during the second quarter following higher inflows in the form of export proceeds, net foreign investments and portfolio investments. Bank Negara Malaysia, through its sterilisation operations, limited the impact of the inflows on broad money expansion, maintaining a steady pace of M3 growth.

Net funds raised in the capital market by the public and private sectors were significantly higher, amounting to RM22 billion in the second quarter. The bulk of the funds were raised by the private sector in the private debt securities market for merger and acquisition activity, new activity and refinancing. On a net basis, the funds raised through the PDS market, excluding Cagamas, amounted to RM12.4 billion. Meanwhile, funds raised in the equity market were slightly lower at RM512 million during the second quarter.

Amidst two-way trade and investment flows, the ringgit continued to strengthen against the US dollar going into the second quarter of 2007, appreciating by about 2% until end-May. The turbulence in global financial markets triggered by developments in the subprime market in the United States in July however culminated in the weakening of regional currencies, including the ringgit against the US dollar. Thus, following an extended period of appreciation since the beginning of the year, the ringgit depreciated with other regional currencies against the US dollar. Nevertheless, for the second quarter as a whole, the ringgit was relatively unchanged against the US dollar.

For the period 1 July – 28 August, the ringgit depreciated against the major and regional currencies in the range of 0.2% - 7.5%, the exception being an appreciation against the Indonesian rupiah (2.7%) and Korean won (0.4%).

Continued high resilience in the banking sector

The banking system continued to exhibit high resilience in the second quarter of 2007, supported by strong capitalisation and improved profitability. The risk-weighted capital ratio (RWCR) remained strong at 13.1%, while the pre-tax profit of the banking sector registered a strong growth of 17.6% to RM4.5 billion (1Q: RM3.8 billion) due mainly to higher income derived from both interest related activities and fee-based activities. The level of non-performing loans (NPLs) continued to improve with the total net NPLs based on the 3-month classification declining further to RM24.1 billion as at end of the second quarter (1Q: RM25.6 billion). Given the continuous improvement in loan quality, the net NPL ratio declined further to 4.1% of net total loans (1Q: 4.4%).

Growth is expected to improve in the second half-year

Going forward, the global economic expansion is expected to be sustained at above 4% in 2007. Despite the moderation in the US economy and ongoing uncertainties such as high oil prices and unstable conditions in the financial markets, favourable growth momentum in the European and Asian regions would sustain global growth over the near term. The recent turmoil in the US subprime mortgage and credit markets have so far been confined to the financial markets. While the financial markets can be expected to experience continued volatility, the strong fundamentals prevailing in Malaysia would continue to support the steady growth momentum of the Malaysian economy.

Forward looking indicators for Malaysia continued to point towards improved growth performance in the second half-year. The six-month smoothed growth of the index for leading indicators accelerated from 6.7% in April to 9.2% in May 2007. Factors that continue to support domestic demand include strong private consumption and investment spending as well as the pick up in Government development spending following implementation of projects under the Ninth Malaysia Plan. The MIER Consumer Sentiments Index for the second quarter has remained above the 100-point threshold for the fifth consecutive quarter. Private consumption is expected to be supported by positive labour market conditions, the continued growth in disposable incomes as well as firm commodity prices. Meanwhile, private investment is expected to expand at a steady pace. The MIER Business Conditions Index also rose significantly to 122.1 points in the second quarter (1Q: 105.5 points), indicating improved business sentiment. On the sectoral performance, growth is expected to be supported by further expansion in the services, mining as well as construction sectors, while the manufacturing sector is expected to benefit from the gradual recovery in the electronics industry.

29 August 2007
Bank Negara Malaysia