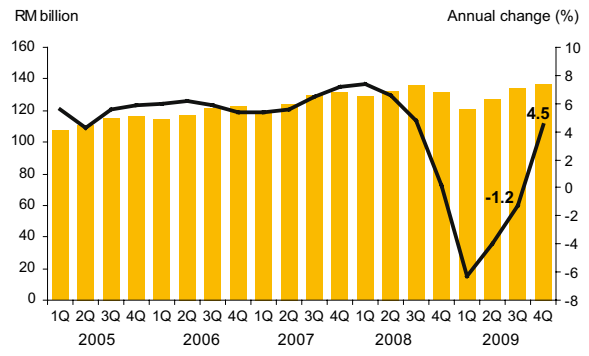
# ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE FOURTH QUARTER OF 2009

## OVERVIEW

### The Malaysian economy registered positive growth in the fourth quarter

The Malaysian economy registered a positive growth of 4.5% in the fourth quarter (3Q 09: -1.2%), amid strengthened domestic and external demand. Sustained growth in private consumption and increased public sector spending contributed to higher domestic demand. The implementation of the fiscal stimulus measures had gained further momentum during the quarter, providing an additional impetus to growth. Meanwhile, Malaysia's export performance benefited from improvements in external demand, particularly from the regional economies, and from stronger commodity prices. On the supply side, all economic sectors recorded positive growth, with the exception of the mining sector. For the year as a whole, the Malaysian economy contracted by 1.7% (2008: +4.6%).

**Positive growth in the fourth quarter**
(at year 2000 prices)




Source: Department of Statistics, Malaysia

During the quarter, domestic demand increased by 3% (3Q 09: 0.4%) following sustained growth in private consumption and higher public sector spending. Private consumption spending, which expanded by 1.7% (3Q 09: 1.5%), was supported by better conditions in the labour market, a low level of inflation and higher spending for the year-end festive season amid improved consumer sentiments. The public sector continued to provide impetus to growth, with public consumption expanding by 1.3% supported by the expenditure on emoluments and supplies and services. Following accelerated implementation of the stimulus measures during the quarter, public sector capital expenditure also increased further. The bulk of the development expenditure was channelled into the trade and industry, public utilities, education and transportation sectors. Although private capital spending remained weak, there were signs of stabilisation as business sentiment continued to improve. As a result, gross fixed capital formation turned around to register a positive growth of 8.2% during the quarter (3Q 09: -7.9%).

On the supply side, all economic sectors registered improved performance during the quarter. In the services sector, growth was higher at 5.1% (3Q 09: 3.4%), driven primarily by strong performance in the finance and insurance, wholesale and retail trade, and real estate and business services sub-sectors. The manufacturing sector recovered to record a positive growth of 5.3% during the quarter (3Q 09: -8.6%), reflecting improvements in both external and domestic demand. Meanwhile, the construction sector expanded further by 9.2% (3Q 09: 7.9%), supported mainly by the continued progress in the implementation of projects under the stimulus packages. Growth in the agriculture sector was driven mainly by higher production of industrial crops, while the mining sector contracted at a slower pace due to lower production of crude oil.

The headline inflation rate, as measured by the change in the Consumer Price Index (CPI), declined at a more moderate annual rate of 0.2% in the fourth quarter (3Q 09: -2.3%). The decline in consumer prices was largely attributed to the continuing but waning effect of the cumulative downward adjustments in retail fuel prices in the second half of 2008.

In the external sector, the trade surplus remained large at RM32.4 billion as both gross exports and imports recovered to record positive growth rates. Gross exports turned around to register a positive growth of 5.1% in the fourth quarter, supported by higher external demand, especially from the region, and stronger commodity prices. Gross imports increased by 6.7% due to higher manufacturing production and an improvement in domestic demand activity.

On a cash basis, gross inflows of foreign direct investment (FDI)[1] increased to RM7.2 billion in the fourth quarter of 2009 (3Q 09: RM6.7 billion). After adjusting for gross outflows due mainly to the repayment of inter-company loans, net FDI was sustained at RM2.5 billion (3Q 09: RM2.6 billion). The bulk of the FDI was channelled mainly into the manufacturing and services sectors. Net direct investment abroad by Malaysian companies amounted to RM4.8 billion (3Q 09: -RM4.9 billion), mostly for investment in the services sector. Meanwhile, portfolio investment registered a net outflow of RM2.6 billion during the quarter (3Q 09: +RM9.3 billion) as net purchases of foreign assets by residents more than offset net inflows by non-residents. Foreign investors had continued to increase their holdings of Malaysian debt instruments amid further signs of global and regional economic recovery. Portfolio flows remained volatile in the first two months of 2010, reflecting changing sentiments among international investors.

The international reserves of Bank Negara Malaysia amounted to RM331.3 billion (equivalent to USD96.7 billion) as at 31 December 2009, and increased marginally to RM332.1 billion (equivalent to USD96.9 billion) as at 12 February 2010. The reserves position is sufficient to finance 9 months of retained imports and is 4.1 times the short-term external debt.

## Monetary policy continues to support economic activity

The OPR was left unchanged at 2.00% in the fourth quarter. Interbank rates for all maturities were relatively stable during the quarter. In terms of lending rates, the average base lending rate (BLR) remained unchanged from the previous quarter, while the average lending rate (ALR) continued decreasing to a historic low of 4.83% in December 2009.

Financing extended to the business and household sectors expanded significantly in the fourth quarter following the improvement in the economy, coupled with the prevailing low interest rate environment. Total gross financing raised by the private sector through the banking system and the capital market increased to RM216 billion during the quarter (3Q 09: RM180.9 billion). On a net basis, banking system loans and PDS outstanding rose by 8.5% as at end-December 2009 (end-September 2009: 7.2%).

During the fourth quarter, net funds raised in the capital market by both the public and private sectors amounted to RM29.6 billion (3Q 09: RM23.4 billion), driven mainly by the private sector, which accounted for 81% of the total net funds raised. Gross funds raised in the PDS market totalled RM16.4 billion (3Q 09: RM13.5 billion), while funds raised in the equity market during the quarter amounted to RM13.2 billion (3Q 09: RM1.2 billion) following a large initial public offering by a major telecommunications company in November 2009. Meanwhile, net funds raised by the public sector amounted to RM5.6 billion.

Monetary aggregates registered a faster annual increase in the final quarter of 2009, consistent with the pick up in economic activity. M3, or broad money, expanded at a faster annual growth rate of 9.1% at end-December 2009 (end-September 2009: 6.8%).

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

During the quarter, the ringgit appreciated by 1.5% against the US dollar as further signs of global and regional economic recovery contributed to favourable investor sentiment towards the regional financial markets. The ringgit also appreciated against the Japanese yen (4.4%), euro (3.3%) and pound sterling (1.2%). The Japanese yen depreciated against most currencies due to the market expectation for a weaker yen to support economic recovery, while the euro depreciated due to concerns over sovereign-credit issues in several EU countries. Against regional currencies, the ringgit appreciated against the Chinese renminbi (1.4%), Thai baht (0.9%), Singapore dollar (0.7%) and Korean won (0.3%), but depreciated against the Indonesian rupiah (-1.5%) and Philippine peso (-1.2%). Between 1 January and 22 February 2010, the ringgit appreciated against the US dollar (0.8%), euro (6.1%) and pound sterling (4.5%), but remained stable against the Japanese yen. Against regional currencies, the ringgit appreciated against the Singapore dollar (1.1%), Chinese renminbi (0.8%), Philippine peso (0.7%) and Thai baht (0.2%), but depreciated against the Korean won (-0.8%) and Indonesian rupiah (-0.3%).

## Continued resilience of the financial sector

The financial sector remained resilient with strong capitalisation, improving non-performing loan (NPL) ratio and ample liquidity. The banking, insurance and takaful sectors recorded improved profitability in the fourth quarter of 2009. This enabled the financial sector to continue to support financing activity and to provide the necessary financial services to the economy.

As at end-December 2009, the risk-weighted capital ratio of the banking system was 14.7%, whilst core capital ratio stood at 13.1%. Capital in excess of the minimum regulatory requirement was maintained at more than RM50 billion. Loan quality remained favourable with the continued downtrend in NPLs. The net NPL ratio improved to 1.8% as at the end of the quarter, with a loan loss coverage of 95.2%. The banking system recorded a pre-tax profit that totalled RM5.2 billion during the quarter, supported by an increase in fee-based income and higher investment gains.

Meanwhile, the Capital Adequacy Ratio of the insurance industry remained strong at 230.3% (3Q 09: 214.7%). Overall profitability of the insurance and takaful sector increased to RM3.7 billion (4Q 08: RM1.7 billion), driven primarily by improvements in the performance of the equity market and in business conditions.

## Recovery in domestic economy set to gather momentum going forward

The recovery in the global economy had improved further in the fourth quarter of 2009. The advanced economies experienced a gradual pick-up in growth benefiting from the policy support, while the regional economies recorded a stronger recovery supported by favourable domestic demand and an increase in intra-regional trade. This positive trend is expected to continue in 2010, although the pace of the global recovery is expected to be gradual and uneven. The prospect for sustained global growth will depend importantly on the recovery in private sector demand, particularly when the effects of policy measures begin to diminish.

The Malaysian economy has recovered from the global crisis and turned around to record a positive growth in the fourth quarter. Going forward, the improvement experienced in the second half of 2009 is expected to strengthen in 2010. Higher domestic demand, particularly private consumption spending, is expected given the stable labour market conditions, improved consumer and business confidence, and continued access to financing. Further improvements in external demand, following the gradual recovery in the global economy, is also expected to provide further impetus to the domestic economy.