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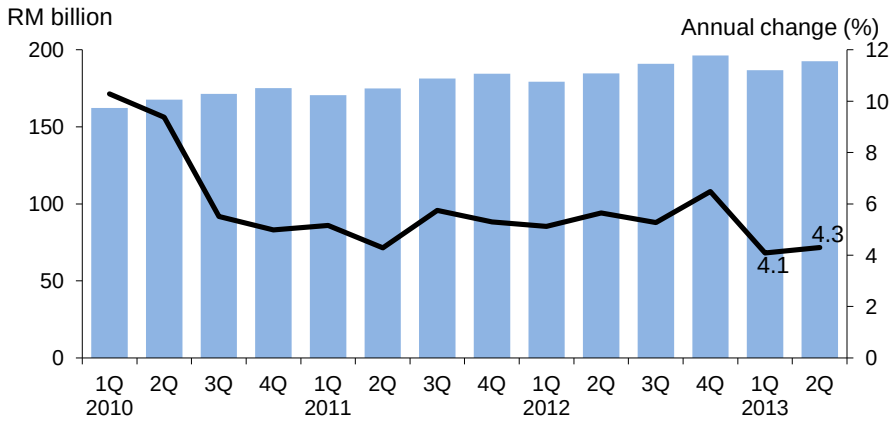
ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE SECOND QUARTER OF 2013

Firm domestic demand continued to support growth amid weaker external demand

The global economy continued to experience modest growth in the second quarter of 2013. The US economy expanded at a moderate pace, while economic activity in the euro area remained weak amid austerity measures and ongoing sovereign debt concerns. In Asia, growth of several economies moderated in the second quarter, as the prolonged weakness in the external environment had begun to affect domestic economic activity, particularly in the more open economies. While domestic demand in the Malaysian economy has remained strong, the overall growth performance was affected by the weak external sector. In the second quarter, the Malaysian economy expanded by 4.3% (1Q 2013: 4.1%). While domestic demand remained firm, growing by 7.3% (1Q 2013: 8.2%), exports registered a larger decline, amid weakness across most export products. On the supply side, the major economic sectors expanded further in the second quarter, supported by the continued strength in domestic demand.

On a quarter-on-quarter seasonally adjusted basis, the economy recorded a growth of 1.4% (1Q 2013: -0.4%).

The economy expanded in the second quarter
(at constant 2005 prices)



Source: Department of Statistics, Malaysia

Private consumption expanded by 7.2%, supported by stable employment conditions and sustained wage growth in the domestic-oriented sectors. Public consumption growth improved to 11.1% (1Q 2013: 0.1%), reflecting mainly higher Government spending on supplies and services, and sustained spending on emoluments.

Gross fixed capital formation continued to expand (6%; 1Q 2013: 13.1%), reinforced by private sector capital spending. Private investment grew by 12.7%, supported by capital spending in the consumer-related services sub-sectors, the ongoing implementation of infrastructure projects and capacity expansion in the oil and gas sector. Meanwhile, public investment declined by 6.4% (1Q 2013: 17.3%). Continued expansion in capital spending by public enterprises, particularly in the oil and gas, telecommunications and utilities sectors, was outweighed by lower Federal Government development expenditure.

On the supply side, the services and manufacturing sectors continued to expand, driven largely by sub-sectors catering to the domestic market. Growth of the mining sector rebounded following higher production of both natural gas and crude oil. However, the agriculture sector moderated, weighed down by a sharp reduction in natural rubber output and slower growth in crude palm oil production. In the construction sector, growth remained firm, led by the civil engineering and residential sub-sectors.

The headline inflation rate, as measured by the annual change in the Consumer Price Index (CPI), was higher at 1.8% in the second quarter (1Q 2013: 1.5%), attributable mainly to price increases in the *food and non-alcoholic beverages* and *housing, water, electricity, gas, and other fuels* categories.

In the external sector, the current account surplus amounted to RM2.6 billion in the second quarter, equivalent to 1.1% of GNI, due to a lower goods surplus, as well as sustained services deficit and outflows in the income accounts. The financial account recorded a net inflow of RM5.2 billion (1Q 2013: RM1 billion), largely reflecting banking inflows amid sustained direct investment by foreign multinational corporations. During the quarter, Malaysian residents continued to build direct investment and portfolio assets abroad. The overall balance of payments registered a surplus of RM1.5 billion (1Q 2013: RM4 billion).

The international reserves of Bank Negara Malaysia amounted to RM432.8 billion (equivalent to USD136.1 billion) as at 28 June 2013. This reserves level has taken into account the quarterly adjustment for foreign exchange revaluation changes. As at 31 July 2013, the reserves position amounted to RM438.3 billion (equivalent to USD137.8 billion), sufficient to finance 9.7 months of retained imports and is 3.8 times the short-term external debt.

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Interest rates remained stable

The Overnight Policy Rate (OPR) was maintained at 3.00% during the second quarter. At the prevailing level of the OPR, monetary conditions remain supportive of economic activity.

Reflecting the unchanged OPR, the average interbank rate of all maturities was relatively stable. In terms of retail interest rates, the average quoted fixed deposit (FD) rates of commercial banks were relatively unchanged. The average base lending rate (BLR) of commercial banks remained unchanged at 6.53%, while the weighted average lending rate (ALR) on loans outstanding continued its gradual moderating trend (end-June 2013: 5.42%; end-March 2013: 5.50%).

Total gross financing raised by the private sector through the banking system and the capital market amounted to RM250.6 billion in the second quarter (1Q 2013: RM244.8 billion). Banking system loans outstanding expanded at an annual growth rate of 9.1% as at end-June (end-March 2013: 10.6%), while net funds raised in the capital market had moderated to RM13.9 billion in the second quarter (1Q 2013: RM16.7 billion).

The monetary aggregates continued to experience positive growth during the second quarter. M1, or narrow money, increased by RM4.9 billion. On an annual basis, M1 expanded by 12.5% as at end-June (end-March: 12.7%). M3, or broad money, increased by RM23.3 billion on a quarter-on-quarter basis to record an annual growth rate of 8.5% as at end-June (end-March: 9.1%). The expansion of M3 was mainly on account of net disbursements of loans by the banking system to the private sector.

The ringgit strengthened against most regional and major currencies earlier in the quarter as the announcement of further monetary easing in Japan led to increased investor interest towards regional financial assets and contributed to the strengthening of regional currencies. The ringgit also strengthened following the conclusion of the General Elections in Malaysia. Nevertheless, the discussions on the possible scale back of the quantitative easing (QE) in the US and the concerns over PR China's growth trajectory in the latter part of the quarter led to a reversal in the flow of funds in the regional financial markets. During the quarter, the ringgit depreciated by 2.8% against the US dollar. The ringgit also depreciated against the euro (-4.6%) and pound sterling (-3.2%), but appreciated against the Japanese yen (2.0%). The ringgit had a mixed performance against regional currencies.

Between 1 July and 20 August 2013, the ringgit further depreciated against the US dollar by 3.7%. The ringgit also depreciated against the pound sterling (-6.0%), euro (-5.7%) and Japanese yen (-4.9%). Against regional currencies, the ringgit strengthened against the Indonesian rupiah (1.9%), but depreciated against other currencies by between -2.1% and -5.5%.

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Financial stability continued to be preserved

The domestic financial system remained resilient throughout the second quarter amid episodes of higher volatility in the global and domestic financial markets. Domestic financial intermediation continued to be well-supported by sound financial institutions, orderly financial market conditions and sustained confidence in the financial system.

The banking system remained well-capitalised, with the common equity tier 1 (CET1) capital ratio, tier 1 capital ratio and total capital ratio remaining well above the Basel III requirements at 11.7%, 12.6% and 13.8%, respectively. Similarly, the capital adequacy ratio of the insurance sector remained strong at 220.8% (1Q 2013: 221.6%), with an excess capital buffer of more than RM20 billion.

Domestic demand will continue to be supportive of growth

Going forward, the global economy continues to face downside risks, emanating from developments in several major economies. Policy uncertainty surrounding the QE programme in the US and European sovereign debt concerns are expected to weigh on market sentiment and growth prospects. While overall growth performance in most emerging economies, including in Asia, will be affected by these developments, domestic demand will continue to support the overall growth performance. The growth prospects are also being augmented by targeted policy measures.

For the Malaysian economy, the prolonged weakness in the external environment has affected the overall growth performance of the economy going forward. While domestic demand is expected to remain firm, supported by sustained private consumption, capital spending in the domestic-oriented industries and the ongoing implementation of infrastructure projects, the weak external sector in the first half of this year will affect our overall growth performance for the year. The overall growth of the economy for this year has now been revised to 4.5 - 5.0%. Going forward, domestic demand is expected to remain on its steady growth trajectory and will continue to be supported by an accommodative monetary policy.

Bank Negara Malaysia
21 August 2013

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GDP by Expenditure Components
(at constant 2005 prices)

	2012		2013		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
Aggregate Domestic Demand (excluding stocks)	14.0	11.8	8.2	7.3	7.7
Consumption	9.1	8.4	6.1	8.0	7.1
Private sector	*8.6*	*8.0*	*7.5*	*7.2*	*7.4*
Public sector	*11.0*	*10.1*	*0.1*	*11.1*	*5.8*
Gross Fixed Capital Formation	26.2	20.7	13.1	6.0	9.3
Private sector	*25.6*	*22.4*	*10.8*	*12.7*	*11.8*
Public sector	*27.2*	*17.9*	*17.3*	*-6.4*	*4.7*
Net Exports	-40.4	-33.1	-36.4	-41.6	-38.7
Exports of Goods and Services	*1.6*	*1.9*	*-0.6*	*-5.2*	*-2.9*
Imports of Goods and Services	*8.3*	*7.7*	*3.6*	*-2.0*	*0.8*
GDP	**5.6**	**5.4**	**4.1**	**4.3**	**4.2**
GDP (q-o-q growth, seasonally adjusted)	**1.3**	**-**	**-0.4**	**1.4**	**-**

Source: Department of Statistics, Malaysia

GDP by Economic Activity
(at constant 2005 prices)

	Share 2012 (%)	2012		2013		
		2Q	1H	1Q	2Q	1H
		Annual change (%)				
Agriculture	7.3	-4.6	-1.3	6.0	0.4	3.1
Mining	8.4	2.2	1.2	-1.9	4.1	1.0
Manufacturing	24.9	5.7	5.1	0.3	3.3	1.9
Construction	3.5	21.5	18.5	14.2	9.9	12.0
Services	54.6	6.6	6.2	5.9	4.8	5.4
Real GDP	**100.0**[1]	**5.6**	**5.4**	**4.1**	**4.3**	**4.2**
Real GDP (q-o-q seasonally adjusted)	**-**	**1.3**	**-**	**-0.4**	**1.4**	**-**

[1] Numbers do not add up due to rounding and exclusion of import duties component

Source: Department of Statistics, Malaysia