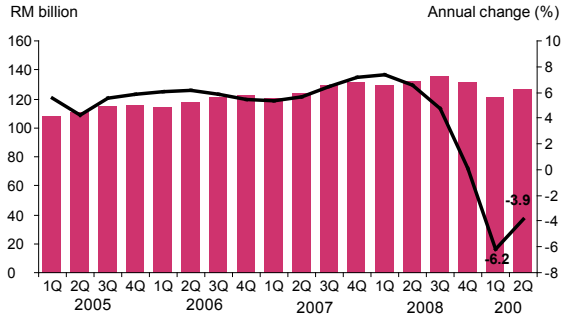
ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE SECOND QUARTER OF 2009

OVERVIEW

Growth declined at a slower pace in the second quarter

The Malaysian economy contracted at a slower rate of 3.9% in the second quarter of 2009 (1Q 09: -6.2%), due mainly to higher public spending and positive growth in private consumption. Nonetheless, growth continued to be affected by weak external demand and private investment activity. Reflecting continued sluggish global economy, real net exports of goods and services declined by 0.7%. On the supply side, all economic sectors registered improved performance.

Slower pace of contraction in the second quarter
(at constant 2000 prices)



Source: Department of Statistics, Malaysia

During the quarter, domestic demand registered a slower decline of 2.3% (1Q 09: -2.9%) following expansion in public sector spending and private consumption. Private consumption recorded a positive growth of 0.5% (1Q 09: -0.7%), as stabilisation in labour market conditions and lower price levels provided further support to consumer spending. Consumer sentiments improved in the second quarter as reflected by MIER Consumer Sentiments Index, which increased to 105.8 points from 78.9 points in the previous quarter. Meanwhile, public consumption expanded by 1% due to higher expenditure on supplies and services and emoluments. Gross fixed capital formation contracted by 9.8% (1Q 09: -10.8%) following continued decline in private investment activity, particularly in the manufacturing sector due to prevailing excess capacity amidst weak external demand. Nevertheless, higher public sector spending on development projects in the education, trade and industry as well as agriculture and rural development sectors provided some support to the overall investment activity.

All key sectors of the economy recorded better performance during the quarter. The services sector registered a positive growth of 1.6% (1Q 09: -0.2%) due mainly to better performance of the finance and insurance sub-sector. The manufacturing sector declined at a slower pace of 14.5% (1Q 09: -17.9%) following improvements in the export-oriented industries, particularly the E&E industry, as a result of increasing inventory replenishment activity after the massive cut in production and large inventory drawdown undertaken during the first quarter. Growth in the construction sector strengthened to 2.8% (1Q 09: 1.1%) as the industry benefitted from the increased implementation of the stimulus package. Meanwhile, the agriculture sector turned around to grow by 0.3% (1Q 09: -4.3%) supported by continued strong production of food crops and a smaller decline in industrial crops, while growth in the mining sector declined at a moderate pace of 2.6% (1Q 09: -5.2%) due to a smaller contraction in the output of natural gas and crude oil.

Headline inflation rate, as measured by the change in the Consumer Price Index (CPI), was 1.3% in the second quarter of 2009 (1Q 09: 3.7%). As with the previous quarter, the moderation in inflation was largely explained by lower inflation in the *food and non-alcoholic beverages* and *transport* categories. Inflation in the *food and non-alcoholic beverages* category moderated to 5.3% (1Q 09: 9.2%). Meanwhile, prices in the *transport* category fell by 8.2% compared to their levels a year ago (1Q 09: -2.1%), reflecting mainly the high base effect of the sharp rise in the price level in June 2008 arising from fuel price adjustments.

In the external sector, the trade surplus narrowed but remained large at RM26.5 billion, as gross imports contracted at a slower pace compared to gross exports. Gross exports registered a sharper contraction of 26.3% (1Q 09: -20.0%) as demand for manufactured products from major trading partners remained weak, while commodity exports contracted significantly by 40.6% (1Q 09: -23.8%) due primarily to lower prices compared with the same period of 2008. Meanwhile, improved manufacturing output and the restocking of inputs for production led to a smaller contraction in imports of intermediate goods, and thus a lower decline of imports of 23.7% (1Q 09: -29.0%).

On a cash basis, gross inflows of foreign direct investment (FDI)[1] was higher at RM10.4 billion in the second quarter (1Q 09: RM6.8 billion), reflecting mainly higher inflows of equity capital. Net FDI amounted to RM6.7 billion (1Q 09: RM2.1 billion), directed mainly into the oil and gas and manufacturing sectors. Overseas investment by Malaysian companies registered a net outflow of RM0.9 billion (1Q 09: -RM2.8 billion). Investments were concentrated in the services sector, mainly in finance, insurance, real estate and business services and communications. Meanwhile, net outflows of portfolio investment amounted to RM15 billion (1Q 09: -RM9.6 billion), due largely to the maturity of the Federal Government USD1.5 billion Global Bond (1999). Excluding this, net outflows in equity and debt securities were largely unchanged.

The international reserves of Bank Negara Malaysia amounted to RM322.9 billion (equivalent to USD91.5 billion) as at 30 June 2009, and RM322.2 billion (equivalent to USD91.4 billion) as at 14 August 2009. The reserves are sufficient to finance 9 months of retained imports and are 3.8 times the short-term external debt.

Monetary policy remains supportive of economic activity

The OPR was left unchanged at 2.00% in the second quarter, in line with the assessment that the accumulated monetary policy easing would provide sufficient support to economic activity over the medium term.

Concurrently, interbank rates for all maturities were relatively stable during the quarter. In terms of lending rates, the average base lending rate (BLR) remained unchanged during the quarter, while the average lending rate (ALR) continued to decrease in the second quarter to a low of 5.02% in May, before stabilising at 5.04% in June. Meanwhile, deposit rates were relatively unchanged.

Total gross financing raised by the private sector through the banking system and the capital market was higher at RM183.4 billion during the quarter (1Q 09: RM157.4 billion), supported by more accommodative monetary conditions since end-2008 and extensive measures targeted at improving access to financing for all segments of the economy. In terms of annual growth, net banking system loans and PDS outstanding increased by 8% per annum as at end-June (end-March 2009: 10.7%). Overall loan applications, approvals and disbursements were also higher compared to the previous quarter.

During the second quarter, net funds raised in the capital market by both the public and private sectors amounted to RM45.7 billion (1Q 09: RM11.6 billion). After adjusting for redemptions, net funds raised by the public sector totalled RM24.7 billion (1Q 09: RM10.8 billion), reflecting the Government's expansionary fiscal policy. For the private sector, net funds raised through the PDS market amounted to RM19.3 billion, while funds raised through the equity market amounted to RM11.5 billion.

Monetary aggregates continued to register a modest annual increase in the second quarter, consistent with the moderation in economic activity. M3, or broad money, expanded at a slower annual growth rate of 5.8% at end-June 2009 (end-March 2009: 7.3%). On a quarter-on-quarter basis, M3 increased by RM1.6 billion. The main impetus for M3 growth came from credit expansion.

The ringgit appreciated by 3.5% against the US dollar during the quarter, reflecting the broad

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

trend of regional currencies. Movements in the ringgit were reflective of developments in both the domestic and international economic and financial conditions. The ringgit was supported by the improved sentiments towards emerging markets following incipient signs of greater stabilisation in the global and regional economic conditions. The ringgit also appreciated against the yen (1.0%), but depreciated against the pound sterling (-10.9%) and euro (-2.7%). Amidst signs of improvements in the UK economy, the pound sterling recovered significantly against most currencies including the ringgit, reversing some of the marked depreciation experienced in 2008. Against regional currencies, the ringgit appreciated against the Chinese renminbi (3.5%) and Philippine peso (3.1%), but depreciated against other regional currencies between 0.9% and 8.7%. The ringgit depreciated significantly against the Indonesian rupiah and Korean won as these currencies recovered from significant weakness earlier during the year. The rupiah had appreciated against all regional currencies following positive sentiments arising from favourable economic conditions as well as the recent electoral outcome in Indonesia. The Korean won also strengthened as better economic conditions were supported by stronger exports and domestic demand. Between 1 July and 25 August, 2009, the ringgit appreciated against the US dollar by 0.3%. The ringgit also appreciated against the pound sterling by 1.7%, but depreciated against the Japanese yen (-1.7%) and the euro (-1.1%). Against regional currencies, the ringgit appreciated against the Philiipine peso (1.1%), Thai baht (0.3%) and the Chinese renminbi (0.3%), but depreciated between 0.2% and 2.2% against other regional currencies.

Financial sector remained resilient

The financial sector remained resilient supported by strong capitalisation and strengthened risk management capability. Profitability was sustained despite the difficult economic environment. Given the strong financial buffer, reinforced by robust funding and liquidity positions, the financial sector remained well-positioned in meeting the financing and financial services needs of the economy throughout the quarter.

As at end-June 2009, the risk weighted capital ratio (RWCR) and core capital ratio (CCR) strengthened to 14% and 12.3% respectively. The strong capitalisation was attributed to retained earnings and pro-active capital management initiatives by several banking institutions. Loan quality remained favourable. The net non-performing loans ratio has been sustained at 2.2% since December 2008. Pre-tax profit was sustained at RM4.8 billion, driven by improved revenue from financing and fee related businesses.

The Capital Adequacy Ratio (CAR) of the insurance industry improved to 214.8% (1Q 09: 210.2%). Profitability of the sector improved to RM3.6 billion driven largely by increased premiums and contributions across all business segments. Lacklustre capital market activity, nonetheless, continued to exert some downward pressure on profitability, albeit at a more moderate pace.

Growth outlook to improve in the second half of 2009

There are increasing signs that conditions in the global economy are stabilising. In the major advanced economies, the pace of the decline in economic activity is moderating, while conditions in the international financial markets have broadly improved. These improvements were the result of the cumulative effects of extensive policy measures undertaken to stabilise the financial markets and to support the economy. There is also evidence that economic activity in the regional economies is picking up. Economic recovery, however, is likely to be slow as most advanced economies are still undergoing adjustments amidst on-going deleveraging activity in the private sector.

The domestic economy continued to be affected by the weak global economic activity in the second quarter as reflected in the continued sharp decline in exports. However, recent indicators, including industrial production, export growth and conditions in the labour market, point towards stabilisation of the domestic economy. Going forward, the expectation remains that the domestic economy will improve in the second half of the year, to be supported by a recovery in domestic demand following

improvements in labour market conditions, as well as business and consumer sentiments. The accelerated implementation of the fiscal measures, lower inflation, continued access to financing, and the accomodative monetary environment will provide further support to domestic demand. The stabilisation of the global economy is also expected to contribute to the improvement in the domestic economy in the second half of the year.