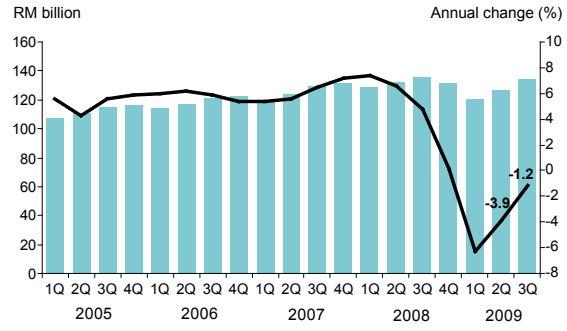
ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE THIRD QUARTER OF 2009

OVERVIEW

Pace of recovery gathering momentum in the third quarter

The Malaysian economy registered an improvement in the third quarter with a reduced contraction of 1.2% (2Q 09: -3.9%) amidst positive growth in domestic demand and stabilisation of external demand. The growth impetus emanated mainly from domestic demand, as a result of stronger private consumption and higher public sector spending. Improvements in the global economy, particularly the regional economies, helped to stabilise the external sector. On the supply side, all economic sectors, except agriculture, recorded improved performance.

Further improvement in the third quarter
(at constant 2000 prices)



Source: Department of Statistics, Malaysia

During the quarter, domestic demand turned around to expand by 0.4% (2Q 09: -2.2%), led by stronger growth in private consumption and public sector spending. Private consumption, which grew by 1.5% (2Q 09: 0.5%), was supported by improved labour market conditions, lower price levels and higher spending for the festive season. Consumer sentiments remained positive in the third quarter as reflected by the MIER Consumer Sentiments Index which was above the 100-point threshold. The public sector continued to provide support to the economy, where public consumption expanded by 10.9% (2Q 09: 1%), following higher expenditure on emoluments while public development expenditure remained strong and was channelled mainly into rural development, education and the transportation sector. The strong public investment provided support to gross fixed capital formation, which contracted at a more moderate pace of 7.9% (2Q 09: -9.6%) as private investment remained subdued.

On the supply side, all economic sectors, except agriculture, recorded a better performance during the quarter. The services sector expanded further by 3.4% (2Q 09: 1.6%), supported mainly by improvements in the wholesale and retail trade, finance and insurance, and real estate and business services sub-sectors. In the construction sector, growth was higher at 7.9% (2Q 09: 4.5%) as implementation of construction projects under the stimulus packages picked up pace. The manufacturing sector declined at a slower pace of 8.6% (2Q 09: -14.5%) as the contraction in export-oriented industries moderated further due to the stabilisation of external demand while the improvement in domestic-oriented industries was driven by higher activity in the construction-related and consumer-related clusters. The contraction in the mining sector also eased slightly to 3.5% (2Q 09: -3.6%). Meanwhile, the agriculture sector registered a 0.5% decline in value-added (2Q 09: 0.3%) due mainly to lower production of industrial crops.

Headline inflation rate, as measured by the change in the Consumer Price Index (CPI), declined by 2.3% on an annual basis in the third quarter (2Q 09: 1.3%). The decline in consumer prices was largely due to the effect of the cumulative downward adjustment to retail fuel prices since the June 2008 price increase.

In the external sector, the trade surplus remained large at RM26.7 billion in the third quarter as both gross exports and imports contracted at a smaller pace. Gross exports declined by 22.3% (2Q 09: -26.3%). A gradual recovery in demand for manufactured products and increased exports of LNG contributed to a smaller decline in commodity exports. A smaller decline in gross imports of 18.3% (2Q 09:

-23.8%) was contributed by slower contraction in imports of intermediate and consumer goods which were in line with the improved manufactured exports and higher private consumption spending.

On a cash basis, gross inflows of foreign direct investment (FDI)[1] moderated to RM6.2 billion in the third quarter (2Q 09: RM9.1 billion). After adjusting for gross outflows due mainly to loan repayment to parent companies, net FDI amounted to RM2.1 billion (2Q 09: RM6.5 billion). The bulk of the FDIs was directed mainly into the manufacturing and services sectors. Overseas investment by Malaysian companies recorded a larger net outflow of RM3.4 billion (2Q 09: -RM2.1 billion), mostly for investments in the services sector. Meanwhile, portfolio investment registered a net inflow of RM8.8 billion (2Q 09: -RM13.6 billion), due largely to the proceeds of bonds issued abroad by a Non-Financial Public Enterprise in the oil and gas sector during the quarter to finance its future capital expenditure.

The international reserves of Bank Negara Malaysia amounted to RM334.3 billion (equivalent to USD96 billion) as at 30 September 2009, and remained largely unchanged at RM334.8 billion (equivalent to USD96.1 billion) as at 13 November 2009. The reserves are sufficient to finance 9.9 months of retained imports and are 4.1 times the short-term external debt.

Monetary policy continued to support economic activity

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

Interbank interest rates for all maturities were relatively stable during the quarter. In terms of lending rates, the average base lending rate (BLR) was unchanged during the quarter, while the average lending rate (ALR) continued to decrease in the third quarter to a historic low of 4.91% in September 2009. Meanwhile, with the inflation rate being negative since June 2009, real fixed deposit (FD) rates have remained positive across all tenures.

Total gross financing raised by the private sector through the banking system and the capital market remained high at RM180.5 billion during the third quarter (2Q 09: RM183.3 billion). Financing activity was supported by the low interest rate environment, the ample liquidity in the banking system, and the targeted measures to improve access to financing. Net banking system loans outstanding expanded by RM21 billion, reflecting higher loans extended to the business and household sectors. In terms of annual growth, net banking system loans and private debt securities (PDS) outstanding expanded by 7.2% as at end-September (end-June: 8%).

During the third quarter, net funds raised in the capital market by both the public and private sectors amounted to RM23.4 billion (2Q 09: RM45.7 billion), reflecting mainly funds raised by the Government through the issuances of Malaysian Government Securities (MGS) and Government Investment Issues (GII). During the quarter, gross funds raised in the PDS market totalled RM13.5 billion (2Q 09: RM19.3 billion), while funds raised in the equity market amounted to RM1.2 billion (2Q 09: RM11.5 billion).

The ringgit appreciated by 1.4% against the US dollar during the quarter, and was generally stable against other regional currencies. The ringgit was supported by favourable investor sentiments and improved risk appetites towards the region following the stronger recovery in the Asian economies. The ringgit also appreciated against the pound sterling (5.2%), but depreciated against the Japanese yen (-5.1%) and euro (-2.2%). Against regional currencies, the ringgit appreciated against the Chinese renminbi (1.3%), but depreciated against other regional currencies by between 0.1% and 6.4%. For regional currencies, the Indonesian rupiah and the Korean won sustained their strong performance against other regional currencies. From 1 October to 19 November, the ringgit appreciated against the US dollar by 2.8%, Japanese yen (2%) and euro (0.7%), but depreciated against the pound sterling (-1.3%). Against regional currencies, the ringgit appreciated between 0.8% and 2.8%.

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

The financial sector exhibited continued resilience

The financial sector remained resilient with strong capitalisation, high asset quality, ample liquidity and continued profitability in the third quarter. This enabled the financial sector to remain supportive of the financing and financial services needs of the economy.

As at end-September, the risk weighted capital ratio and core capital ratio of the banking system strengthened to 14.5% and 12.9% respectively, with a capital buffer of more than RM50 billion. The net non-performing loans ratio improved to 2.1% whilst the delinquency level, as reflected by loan-in-arrears between 1 to 2 months, declined to account for 3.4% of total loans. Pre-tax profit from all major revenue sources improved to RM5.1 billion during the quarter, resulting in a return on equity of 13%.

Meanwhile, the Capital Adequacy Ratio of the insurance industry remained strong at 214.7% (2Q 09: 208%). Profitability of the insurance and takaful sector strengthened to RM4.6 billion, driven largely by increased premium income in almost all business segments as well as favourable results from investment activities in line with the improved capital market conditions.

Domestic economy set to register positive growth going forward

There have been increasing signs of improvements in international economic and financial conditions in the third quarter. Economic activity in the advanced economies continued to stabilise while several regional economies have recorded positive growth in the third quarter. This positive trend is expected to continue going into 2010. While these improvements are positive, the pace of recovery in the global economy is likely to be gradual and uneven, and the outlook remains uncertain, in particular once the effects of the significant policy support begins to diminish.

The Malaysian economy has exhibited stronger signs of improvement in the third quarter and evidence suggests that domestic economic activity is gaining strength. Domestic demand, particularly private consumption and public sector spending, has been the main impetus of growth. Going forward, the pace of economic recovery is expected to gain momentum, as business and consumer sentiment improve further in an environment of continued implementation of fiscal measures, accommodative monetary policy and continued access to financing. In addition, the gradual improvement in the global economy will continue to contribute positively to the recovery of the domestic economy.