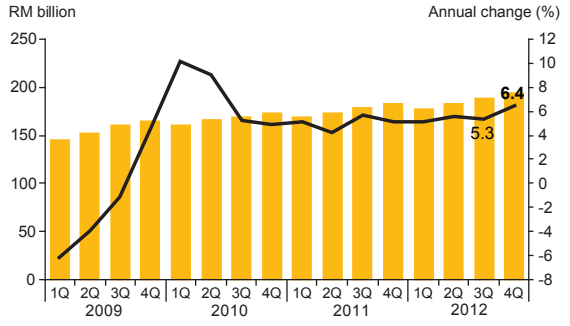
ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE FOURTH QUARTER OF 2012

OVERVIEW

Malaysian economy registered higher growth in the fourth quarter

Despite the challenging global economic environment, the Malaysian economy recorded a higher growth of 6.4% (3Q 12: 5.3%), supported by the continued strength in domestic demand. Total investment remained robust and was the main driver of growth during the quarter. The growth of private consumption continued to remain strong although the pace of increase moderated. The growth during the quarter also benefited from a significantly lower negative contribution from net exports. On the supply side, most economic sectors recorded improvements in growth during the quarter. For the year as a whole, the Malaysian economy expanded by 5.6%.

Higher growth in the fourth quarter
(at constant year 2005 prices)



Source: Department of Statistics, Malaysia

Domestic demand continued to expand at the pace of 7.5% (3Q 12: 11.4%) with gross fixed capital formation remaining strong, registering double-digit growth of 15% in the fourth quarter (3Q 12: 22.7%). Private sector investment advanced by 20.2% (3Q 12: 22.9%), supported by capital spending in the domestic-oriented manufacturing and consumer-related services sub-sectors, namely, telecommunications, real estate and aviation and the on-going implementation of projects in the oil and gas sector. Investment was also supported by capacity expansion in the primary-related manufacturing cluster and capital spending in new growth areas such as medical and communications equipment. Public investment expanded by 11.1% (3Q 12: 22.4%), driven by capital spending by public enterprises in the transportation, utilities, oil and gas and communications sectors.

Private consumption registered a growth of 6.1% in the fourth quarter (3Q 12: 8.5%), supported by stable labour market conditions and improved consumer sentiments. The stronger growth in the first half of the year reflected the effects of the various government transfers to households disbursed during the period. Public consumption grew by 1.1% (3Q 12: 2.3%), attributable to continued spending on emoluments amidst lower spending on supplies and services.

On the supply side, growth in most economic sectors improved in the fourth quarter. Growth was led by the manufacturing and services sectors, supported by domestic demand and a gradual improvement in the external environment. The agriculture sector expanded at a faster pace amidst higher crude palm oil output and production of poultry, while growth in the mining sector rebounded following a recovery in the production of natural gas. Meanwhile, growth in the construction sector continued to be robust, driven by the civil engineering and residential sub-sectors.

The headline inflation rate, as measured by the annual change in the Consumer Price Index (CPI), continued to moderate to 1.3% in the fourth quarter (3Q 12: 1.4%), reflecting lower inflation in the *food and non-alcoholic beverages* category.

In the external sector, the current account surplus increased in the fourth quarter to RM22.8 billion, equivalent to 6.6% of GNI, due to a larger goods surplus, a lower services deficit and net income payments. Meanwhile, the financial account sustained an outflow of RM9.0 billion, as net inflows of FDI and portfolio investments were offset by an increase in direct investment abroad. Consequently, the overall balance of payments turned around to record a surplus of RM5.9 billion (3Q 12: -RM7.5 billion).

The international reserves of Bank Negara Malaysia amounted to RM427.1 billion (equivalent to USD139.7 billion) as at 31 December 2012. This reserve level has taken into account the quarterly adjustment for foreign exchange revaluation changes. As at 31 January 2013, the reserves position amounted to RM428.6 billion (equivalent to USD140.2 billion), sufficient to finance 9.5 months of retained imports and is 4.6 times the short-term external debt.

Interest rates remained stable

The Overnight Policy Rate (OPR) was maintained at 3.00% during the fourth quarter of 2012. At this 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 unadjusted at 6.53%, while the weighted average lending rate (ALR) on loans outstanding moderated slightly to 5.52% as at end-December (end-September: 5.55%).

Total gross financing raised by the private sector through the banking system and the capital market was sustained at RM262.5 billion (3Q 12: RM272.9 billion). On a net basis, banking system loans and PDS outstanding expanded at an annual growth rate of 12.4% as at end-December (end-September: 12.8%).

Net funds raised in the capital market were higher at RM37.7 billion during the quarter (3Q 12: RM28.7 billion). The bulk of funds were raised by the private sector through new issuances of private debt securities. After adjusting for redemptions, net funds raised by the private sector amounted to RM20.1 billion (3Q 12: RM18.3 billion). Net funds raised by the public sector were RM17.6 billion in the fourth quarter (3Q 12: RM10.4 billion).

The monetary aggregates grew at a more moderate pace during the fourth quarter. M1, or narrow money, increased by RM15.4 billion during the period. On an annual basis, M1 expanded by 11.2% as at end-December (end-September 12: 12.3%). M3, or broad money, increased by RM15.2 billion on a quarterly basis to record an annual growth rate of 8.8% as at end-December (end-September 12: 12.5%). M3 continued to expand on account of the sustained credit extended to the private sector by the banking system. The placement of proceeds from the Government's fundraising activities and outflows of funds during the period, however, exerted a contractionary impact on broad money.

The ringgit appreciated against the US dollar supported by investor optimism over growth prospects for the region, including Malaysia. The uncertainty surrounding developments in the US economy, however, prompted some investors to unwind their holdings of emerging market assets, thus partially offsetting the ringgit appreciation during the quarter. Overall, the ringgit appreciated by 0.3% against the US dollar in the fourth quarter. The ringgit also appreciated against the Japanese yen (11.1%) and pound sterling (0.8%), but depreciated against the euro (-1.9%). The ringgit's performance against regional currencies was mixed.

Between 1 January and 18 February 2013, the ringgit appreciated against the Japanese yen (8.0%) and pound sterling (3.0%) but depreciated against the US dollar (-1.3%) and the euro (-2.2%). Against regional currencies, the ringgit strengthened against the Korean won and Singapore dollar by 0.2% and 0.1% respectively but depreciated against the Indonesian rupiah, Chinese renminbi, Philippine peso and Thai baht by between -0.9% and -3.6%.

Financial stability continued to be preserved

Financial stability was sustained throughout the quarter amidst continued challenges in the global environment. Stable financial conditions were underpinned by sound and well-capitalised financial institutions, orderly financial market conditions and sustained confidence in the financial system, which provided continued support for effective financial intermediation.

With strong level of capitalisation as core capital ratio and risk-weighted capital ratio improved to 13.4% (3Q 12: 13.2%) and 15.2% (3Q 12: 14.9%) respectively, the banking sector is well poised to withstand economic and financial shocks. The insurance sector also maintained a sound capital adequacy ratio of 222.3% (3Q 12: 218.6%) with excess capital buffer of RM22.5 billion.

Domestic economy to register growth, supported by firm domestic demand amidst gradual improvement in external environment

Going forward, there are emerging signs of improvements in the global economy. Latest economic indicators also suggest further stabilisation in the growth performance in Asia. Notwithstanding these improvements, considerable structural challenges remain in the advanced economies, which would constrain the prospect for a stronger economic recovery. In particular, several advanced economies will continue to address the issues relating to fiscal sustainability and persistently weak labour market conditions. In the emerging markets, the highly accommodative monetary policy sustained in the major advanced economies requires close surveillance given the potential impact of excessive global liquidity on asset price inflation.

For the Malaysian economy, the sustained expansion in domestic activity is expected to continue to drive growth, supported by the sustained private sector expansion. The stabilisation of external conditions is also expected to lend support to our economic growth prospects.

DEVELOPMENTS IN THE FOURTH QUARTER OF 2012

INTERNATIONAL ECONOMIC ENVIRONMENT

Global economic activity grew modestly

The world economic landscape in the fourth quarter of 2012 was characterised mainly by the uneven performance between the advanced and emerging regions. Growth in the major advanced economies weakened, while improvements were recorded in the emerging economies. Economic activity in several advanced economies was constrained by fiscal sustainability concerns, while the slowdown in Japan was partly attributable to weak export performance. In Asia, the growth momentum picked up at a modest pace amid the strengthening of production and regional demand, especially towards the end of the quarter. Several major central banks undertook easing measures to provide further support to economic activity and to boost sentiments.

While conditions in the international financial markets remained volatile during the quarter, the degree of volatility eased significantly from the highs recorded in the second quarter of the year. Financial markets were affected by the developments in Europe and the impending fiscal cliff in the US. At the beginning of the quarter, risk appetites were initially dampened by uncertainties surrounding the US presidential elections. Investors' attention was then refocused on the looming US fiscal cliff issue. Delays over the release of the next tranche of financial aid to Greece, together with weak economic data releases in the euro area, led to further risk aversion and higher volatility in the financial markets in mid-November. As the quarter advanced, market sentiments generally improved following the agreement on a package of measures for Greece and further progress in resolving the European debt crisis. Specifically, the approval of the framework for a single supervisory mechanism centred on the European Central Bank (ECB) in early December was a crucial move towards establishing a banking union in the euro area. Towards year-end, however, renewed uncertainties surrounding the outcome of the US fiscal cliff negotiations resulted in a brief period of heightened volatility. This subsequently receded as positive sentiments towards the achievement of a resolution of the fiscal issue overcame earlier concerns.

The US economic growth moderated in the fourth quarter (1.5%; 3Q 12: 2.6%). On a seasonally adjusted annualised basis, the economy contracted by 0.1% (3Q 12: 3.1%). Economic activity was dampened by the temporary disruption of economic activity during Hurricane Sandy in late October and uncertainties surrounding the fiscal issue in December. After the very rapid growth in 3Q 12 (11.1%), private domestic investment moderated to a more sustainable rate of growth of 3.1% due primarily to lower inventory and investment on structures. Government spending was a significant drag on growth (-1.7%; 3Q 12: -0.5%), following larger cuts in defense spending. Private consumption expanded at a modest pace, supported by an improvement in personal income growth and higher job creation of 603,000 jobs (3Q 12: 456,000). Residential investment continued to strengthen, supported by the recovery in prices and sales in the housing market. The overall assessment is that the US economy was adversely affected by temporary factors during the quarter, and that the modest recovery remained intact. Meanwhile, inflation edged higher to 1.9% (3Q 12: 1.7%), as increases in food and shelter prices outweighed the relatively flat growth in gasoline prices.

The euro area remained in recession as it registered its third consecutive negative quarter-on-quarter growth (-0.6%; 3Q 12: -0.1%). On an annual basis, real GDP declined by -0.9% (3Q 12: -0.6%). The contraction in economic activity was attributable to decline in domestic demand amid high uncertainties surrounding the sovereign debt crisis and weak global environment that affected export performance. Economic activity in the crisis-affected economies weakened further, weighed down by fiscal austerity measures, higher unemployment, negative sentiments and sluggish bank lending. Germany recorded its first contraction since the fourth quarter of 2011 as the weak exports and gross fixed capital formation affected growth. Inflation moderated slightly to 2.3% (3Q 12: 2.5%) amid lower energy prices.

Growth in the UK contracted on a quarter-on-quarter basis (-0.3%; 3Q 12: 0.9%), as the temporary boost to economic activity from the hosting of the Olympic Games receded. On an annual basis, economic performance was sluggish at 0.1% (3Q 12: 0.1%). The weak growth was attributable to the decline in the production sector and flat growth in services. In the production sector, the contraction in mining and quarrying was due in part to maintenance work at the UK's largest North Sea oil field, which reduced oil and gas extraction during the quarter. Manufacturing activity declined on account of weak domestic and external demand. In addition, domestic demand continued to be affected by the ongoing fiscal austerity measures, anaemic labour market conditions and low confidence. Inflation increased at a faster pace of 2.7% (3Q 12: 2.4%), following a broad-based increase in most components.

In Japan, growth remained weak at 0.3% (3Q 12: 0.4%) as the strength of domestic demand waned amid continued weakness in external demand. On a seasonally adjusted annualised basis, the economy contracted at a slower pace (-0.4%, 3Q 12: -3.8%). Exports recorded a further decline of -5.7% (3Q 12: -4.9%), as trade activity was affected by lower global demand for machinery equipment. On the domestic front, household spending moderated as average wage growth continued to decline, dampening consumer spending. This was further exacerbated by a sharp decline in automobile sales following the expiration of subsidies for energy-efficient cars in September. The economy remained in deflation as headline consumer prices (excluding fresh food) declined by -0.1% (3Q 12: -0.2%) following the decline in prices of durable goods amid slower increases in energy prices.

Advanced Economies: Real GDP Growth

	2011		2012		
	4Q	Year	3Q	4Q	Year
	Annual change (%)				
US[1]	4.1	1.8	3.1	-0.1[a]	2.2
Japan[1]	0.3	-0.6	-3.8[r]	-0.4[p]	1.9[p]
Euro area	0.6	1.5	-0.6	-0.9[p]	-0.5[p]
UK	0.6	0.9	0.1	0.1[p]	0.0[p]

[1] Annualised basis
[r] Revised
[a] Advance estimate
[p] Preliminary

Source: National authorities

Monetary policy in the advanced economies remained accommodative during the quarter. In the US, the Federal Open Market Committee (FOMC) maintained the federal funds rate at 0–0.25%. The Committee highlighted that a highly accommodative stance of monetary policy will remain appropriate as long as the unemployment rate is above 6.5% and inflation is below 2.5%. The FOMC also announced that it will continue to purchase agency mortgage-backed securities in the amount of USD40 billion a month and the maturity extension programme will be replaced with an outright purchase of long-term Treasuries at an initial USD45 billion a month. In the euro area, the European Central Bank (ECB) decided to leave the interest rate unchanged at 0.75%. Through the Outright Monetary Transactions programme, the Governing Council remained committed to preserving the monetary union and in ensuring the proper transmission of the policy stance to the real economy. The actions of the ECB, however, will be subjected to the affected governments' commitment to fiscal targets. The Bank of England maintained its key policy rate at 0.5% and the size of its asset purchase programme at £375 billion. Similarly, the Bank of Japan (BoJ) kept its overnight policy rate at a range of 0–0.1%. Nevertheless, its asset purchase programme was expanded by approximately ¥21 trillion to ¥101 trillion. The BoJ also announced that it will provide unlimited amounts of long-term funds to financial institutions at low interest rates in an effort to stimulate bank lending. In January 2013, the BOJ introduced a price stability target of 2% and the 'open-ended asset purchasing method' under the Asset Purchase Programme to overcome deflation and spur growth.

Regional Countries: Real GDP Growth

	2011		2012		
	4Q	Year	3Q	4Q	Year
	Annual change (%)				
PR China	8.9	9.3	7.4	7.9[p]	7.8[p]
Philippines	4.0	3.9	7.2[r]	6.8	6.6
Indonesia	6.5	6.5	6.2	6.1	6.2
Chinese Taipei	1.2	4.1	1.0	3.4[a]	1.3[a]
Korea	3.3	3.6	1.5	1.5[p]	2.0[p]
Singapore	3.6	5.0	0.0	1.1[a]	1.2[a]

[a] Advance estimate
[r] Revised
[p] Preliminary

Source: National authorities

In Asia, growth improved at a modest pace across most economies in the fourth quarter. Resilient domestic demand continued to be the primary driver of growth in the region, particularly in ASEAN, where it served to partially offset the weak external demand. The strength of domestic demand was underpinned by favourable labour market conditions, sustained income growth and continued access to credit. The improvements in growth performance in several economies were also attributable partly to the recovery in regional demand. PR China's economy expanded by 7.9% (3Q 12: 7.4%), underpinned in part by a rise in infrastructure spending. In the Philippines and Indonesia, economic activity remained resilient (6.8% and 6.1% respectively, 3Q 12: 7.2% and 6.2% respectively), with continued growth in consumption, investment and exports. Chinese Taipei expanded at a faster pace of 3.4% (3Q 12: 1.0%) mainly on account of a rebound in investment and an improvement in exports. Growth in the Korean economy remained steady at 1.5% (3Q 12: 1.5%), as the improvement in private consumption was offset by a larger decline in investment. In Singapore, growth improved to 1.1% (3Q 12: 0%), supported by an expansion in the services sector while the manufacturing sector remained in contraction.

With the exception of PR China, Korea and Thailand, headline inflation moderated across most economies, following stable commodity prices. Prices rose in PR China and Korea mainly on account of higher food prices, particularly vegetables due to the unusually cold winter. In Thailand, the rise in inflation reflected partly a faster pace of increase in energy prices. In most economies, core inflation remained stable. Amid a benign inflation environment, several regional central banks pursued further monetary policy easing to mitigate the weakness in the external sector. In October, the Bank of Thailand and Bangko Sentral ng Pilipinas lowered their key policy rates by 25 basis points (bps) each to 2.75% and 3.50% respectively to provide support to domestic economic activity. Similarly, the Bank of Korea reduced its benchmark interest rate by 25 bps to 2.75%. Other central banks in Asia kept their key policy rates unchanged during the quarter. In January 2013, the Reserve Bank of India reduced its policy repo rate by 25 bps to 7.75% to support growth amid lower inflationary pressures. The cash reserve ratio was also reduced by 25 bps to 4.00% to increase liquidity in the banking system. Several authorities highlighted signs of stabilisation in the global economic environment but remained vigilant to downside risks to the domestic economy.

Prices of crude oil[1] averaged at USD110.11 per barrel in the fourth quarter (3Q 12: USD109.42). Upward pressures on oil prices due to supply disruptions were partially mitigated by concerns arising from US fiscal policy. Heightened tensions in some Middle Eastern countries and the shutdown of the North Sea oilfields for maintenance resulted in higher oil prices at the beginning of the quarter. Subsequently, the easing of tensions in the Middle East and the return of the North Sea supply resulted in prices declining to a three-month low. In the latter half of the quarter, prices fluctuated within a tight range as markets responded to a confluence of factors. Favourable economic data releases from PR China provided upward support to oil prices, while uncertainties surrounding the US fiscal policy provided some offsetting effect. As at end-December 2012, crude oil prices closed at USD111.11 per barrel.

Major currencies ended the quarter broadly unchanged against the US dollar. Nevertheless, the movements of these currencies showed divergent trends in the middle of the quarter amid developments in the euro area. In the first half of the quarter, speculations of a full bailout in Spain and subsequently the delayed disbursement of a financial aid tranche for Greece led to heightened risk aversion and weighed on the euro's performance. Nevertheless, the trend reversed in end-November following the agreement to release the next tranche of Greek bailout funds amounting to €44 billion. Towards the end of the quarter, the agreement to install ECB as the direct supervisor for major European banks also led to an improvement in market sentiments. In

[1] Refers to Brent one-month futures on the Intercontinental Exchange (ICE).

contrast, the Japanese yen depreciated against the US dollar mainly on account of weaker economic activity. The yen weakened further following the newly-elected government's pledge to undertake more aggressive fiscal and monetary easing to provide support to growth. Asian currencies appreciated against the US dollar as risk appetites improved following favourable policy measures undertaken in the advanced economies. Of significance, the Fed's commitment to continued accommodative monetary easing, coupled with more progress towards the resolution of the European sovereign debt crisis, increased investors' appetite for higher yielding assets. The appreciation of the Philippine peso was also supported by the announcement that the country is on track to receive its first investment-grade rating. The Indonesian rupiah, however, depreciated amid concerns over the weakness in its external account position.

Going forward, there are emerging signs of improvements in the global economy. Latest economic indicators also suggest further stabilisation in the growth performance in Asia. Notwithstanding these improvements, considerable structural challenges remain in the advanced economies, which would constrain the prospect for a stronger economic recovery. In particular, several advanced economies will continue to address the issues relating to fiscal sustainability and persistently weak labour market conditions. In the emerging markets, the highly accommodative monetary policy sustained in the major advanced economies requires close surveillance given the potential impact of excessive global liquidity on asset price inflation.

DEVELOPMENTS IN THE MALAYSIAN ECONOMY

Higher growth in the fourth quarter

The Malaysian economy recorded a higher growth of 6.4% in the fourth quarter of 2012 (3Q 12: 5.3%), supported by the continued strength in domestic demand. Total investment remained robust and was the main driver of growth during the quarter. The growth of private consumption continued to remain strong although the pace of increase moderated. Net exports of goods and services continued to contract in the fourth quarter, but by a smaller magnitude. This reflected the contraction in imports following the decline in imports of intermediate goods and lower imports of consumption goods.

Given the smaller contraction in net exports and the sustained growth in domestic demand, overall GDP expanded at a higher rate during the quarter. On the supply side, most economic sectors recorded higher growth during the quarter.

Moderate expansion in domestic demand

Domestic demand continued to expand at the pace of 7.5% in the fourth quarter of 2012 (3Q 12: 11.4%). Gross fixed capital formation and total consumption remained strong, although the pace of increase moderated.

GDP by Expenditure Components
(at constant 2005 prices)

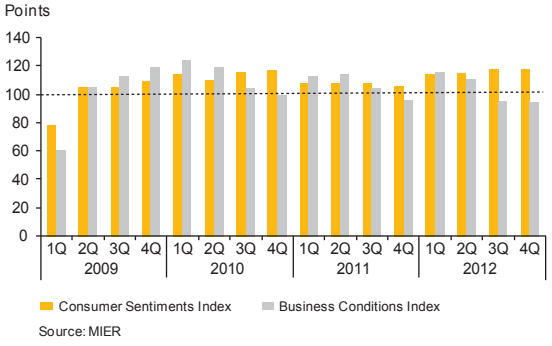
	2011		2012		
	4Q	Year	3Q	4Q	Year
	Annual change (%)				
Aggregate Domestic Demand (excluding stocks)	10.4	8.2	11.4	7.5	10.6
Consumption	11.1	8.9	7.3	4.8	7.1
Private sector	*7.3*	*7.1*	*8.5*	*6.1*	*7.7*
Public sector	*22.9*	*16.1*	*2.3*	*1.1*	*5.0*
Gross Fixed Capital Formation	8.4	6.5	22.7	15.0	19.9
Private sector	*18.8*	*12.2*	*22.9*	*20.2*	*22.0*
Public sector	*1.9*	*-0.3*	*22.4*	*11.1*	*17.1*
Net Exports	-10.5	-7.4	-50.3	-5.9	-29.4
Exports of Goods and Services	*5.5*	*4.2*	*-3.0*	*-1.5*	*0.1*
Imports of Goods and Services	*7.8*	*6.2*	*4.4*	*-0.9*	*4.5*
GDP	**5.2**	**5.1**	**5.3**	**6.4**	**5.6**

Source: Department of Statistics, Malaysia

Private consumption registered a growth of 6.1% in the fourth quarter (3Q 12: 8.5%), supported by stable labour market conditions and favourable consumer sentiments. The stronger growth in the first half of the year reflected the effects of the various Government transfers to households disbursed during the period. Public consumption grew by 1.1% (3Q 12: 2.3%), attributable to continued Government spending on emoluments amidst lower spending on supplies and services.

Gross fixed capital formation remained strong, registering double-digit growth of 15% in the fourth quarter (3Q 12: 22.7%). Private investment advanced by 20.2% (3Q 12: 22.9%), supported by capital spending in the domestic-oriented manufacturing and consumer-related services sub-sectors, namely, telecommunications, real estate and aviation. The on-going implementation of projects in the oil and gas sector also provided a considerable boost to investment activity. There was also investment in capacity expansion in the primary-related manufacturing cluster and in new growth areas such as medical and communications equipment. Public investment expanded by 11.1% (3Q 12: 22.4%), driven by capital spending by public enterprises in the transportation, utilities, oil and gas and communications sectors. Federal Government development expenditure was channeled mainly into the transportation, education and public utilities sector.

Continued improvement in consumer confidence



Source: MIER

Higher growth in most economic sectors

On the supply side, growth in most economic sectors improved in the fourth quarter. Growth was led by the manufacturing and services sectors, supported by domestic demand and a gradual improvement in the external environment. The agriculture sector expanded at a faster pace amidst higher crude palm oil output and production of poultry, while growth in the mining sector rebounded following a recovery in the production of natural gas. Meanwhile, growth in the construction sector continued to be robust, driven by the civil engineering and residential sub-sectors.

The services sector expanded by 6.3% in the fourth quarter of 2012 (3Q 12: 7%), with both consumption- and manufacturing-related activities contributing to growth. The wholesale and retail trade sub-sector expanded at a slower pace of 2.2% (3Q 12: 4.4%), attributable mainly to the moderation in wholesale segment, due to slower wholesale trade of commodity products, while retail segment continued to grow in tandem with positive growth in consumption. Growth in the trade- and manufacturing-related sub-sectors was higher, attributed to stronger domestic production and gradual improvement in external environment. The transport and storage sub-sector grew by 4.4% (3Q 12: 3.6%) while growth in the utilities sub-sector also increased (4.1%; 3Q 12: 3.8%). The finance and insurance sub-sector advanced by 10.9% (3Q 12: 11.8%), driven by bank lending activity and an increase in insurance premiums' growth.

GDP by Economic Activity (at constant 2005 prices)

	2011		2012		
	4Q	Year	3Q	4Q	Year
	Annual change (%)				
Agriculture	6.9	5.9	0.5	5.6	0.8
Mining	-3.8	-5.7	-1.2	4.3	1.4
Manufacturing	5.2	4.7	3.3	5.8	4.8
Construction	7.5	4.6	18.3	18.1	18.5
Services	6.6	7.0	7.0	6.3	6.4
Real GDP (Annual Change)	**5.2**	**5.1**	**5.3**	**6.4**	**5.6**
Real GDP (Preceding Change)	**1.8**	**5.1**	**3.3**	**2.9**	**5.6**

Source: Department of Statistics, Malaysia

Performance of the Services Sector (value added at constant 2005 prices)

	Share 2011 (%)	2011		2012		
		4Q	Year	3Q	4Q	Year
		Annual change (%)				
Intermediate Services	**40.6**	**6.5**	**6.2**	**8.9**	**8.3**	**7.4**
Finance & insurance	17.0	7.1	6.5	11.8	10.9	7.9
Real estate & business services	10.0	4.4	5.5	7.5	6.5	7.1
Transport & storage	6.8	6.0	5.4	3.6	4.4	4.9
Communication	6.8	8.8	7.6	9.1	8.5	9.1
Final Services	**59.4**	**6.7**	**7.5**	**5.7**	**5.0**	**5.7**
Wholesale & retail trade	26.6	6.8	7.1	4.4	2.2	4.6
Accommodation & restaurant	4.5	6.3	6.0	4.0	4.7	5.4
Utilities	4.7	3.6	3.1	3.8	4.1	4.3
Government services	14.3	10.4	12.4	11.0	11.4	9.6
Other services	9.4	2.5	4.7	3.8	3.3	3.9
Total Services	**100.0**	**6.6**	**7.0**	**7.0**	**6.3**	**6.4**

Source: Department of Statistics, Malaysia

Selected Quarterly Indicators in the Services Sector

	2011			2012		
	3Q	4Q	Year	3Q	4Q	Year
	Index					
MIER Consumer Sentiments Index	108.7	106.3	107.8	118.3	118.7	116.6
MIER Retail Trade Index	150.0	92.6	115.6	130.2	94.8	107.4
MIER Tourism Market Index	115.2	126.0	119.9	129.9	129.8	125.6
	Annual change (%)					
Tourist arrivals	4.7	5.4	0.6	-2.2	2.9	1.3
Total passenger traffic at all airports	10.8	7.0	10.6	2.9	8.6	4.9
Total consumption credit outstanding	8.5	9.5	9.5	7.6	7.1	7.1
Total loans outstanding	13.8	13.6	13.6	11.9	10.4	10.4
Loans outstanding to the wholesale & retail trade, hotels & restaurants	9.6	11.5	11.5	11.7	12.2	12.2
Imports of consumption goods	26.4	25.2	19.0	11.4	5.7	11.6
Total sales of motor vehicles	0.6	-1.5	-0.9	2.7	13.1	4.6
Container cargo handled (Port Klang and PTP)	9.8	11.5	11.3	1.7	0.4	3.4

Source: Various sources

Growth in the manufacturing sector was higher in the fourth quarter with the sector expanding by 5.8% (3Q 12: 3.3%). The expansion was broad-based, with all clusters registering better growth in line with the continued expansion in both domestic demand and the external demand for manufactured products. Growth in the export-oriented industry was led by the primary-related cluster, driven in particular by higher demand for chemicals and refined petroleum products. Growth in the E&E cluster also benefited from the low base in the fourth quarter of 2011 when the global E&E supply chain was disrupted by floods in Thailand. Performance of the domestic-oriented industries also strengthened further, driven primarily by the strong expansion in the construction-related cluster, which continued to benefit from robust domestic construction activity. Production in the consumer-related cluster also expanded favourably, especially in transport equipment due to higher production of motor vehicles and related parts.

Overall capacity utilisation rate in the manufacturing sector was sustained in the fourth quarter (80%; 3Q 12: 81%). Export- and domestic-oriented industries were operating at 81% and 79% of total capacity respectively (3Q 12: 80% and 82% respectively).

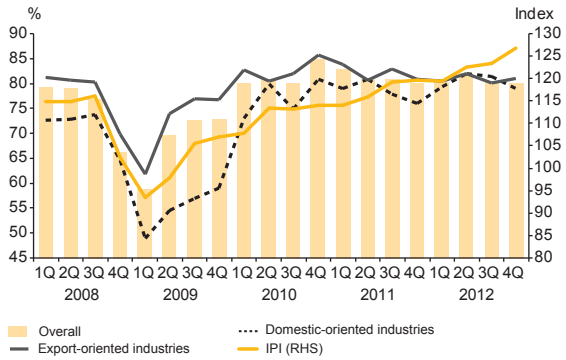
Performance of the Manufacturing Sector

	2011		2012		
	4Q	Year	3Q	4Q	Year
	Annual Change (%)				
Value Added (RM million at constant 2005 prices)	**5.2**	**4.7**	**3.3**	**5.8**	**4.8**
Overall Manufacturing Production[1]	**4.7**	**4.5**	**3.5**	**6.1**	**5.0**
Export-oriented industries	**2.9**	**3.4**	**2.5**	**5.2**	**3.9**
Electronics and electrical products cluster	**-3.0**	**-3.6**	**1.9**	**3.9**	**2.2**
Of which:					
Electronics	-10.3	-11.7	5.1	13.0	4.2
Electrical products	6.5	8.4	-1.9	-5.9	-0.2
Primary-related cluster	**6.1**	**7.4**	**2.7**	**5.9**	**4.8**
Of which:					
Chemicals and chemical products	14.1	8.8	5.9	7.1	8.2
Petroleum products	-1.1	6.2	-0.2	4.2	4.3
Rubber products	9.5	13.9	1.5	3.2	3.0
Off-estate processing	13.8	8.7	2.5	11.0	0.0
Domestic-oriented industries	**10.6**	**8.2**	**6.9**	**8.7**	**8.4**
Construction-related cluster	**12.3**	**17.6**	**10.5**	**11.3**	**8.7**
Of which:					
Construction-related products	8.3	13.0	1.6	-1.8	0.8
Fabricated metal products	17.5	23.8	21.6	27.1	18.5
Consumer-related cluster	**9.3**	**1.3**	**3.9**	**6.6**	**8.2**
Of which:					
Transport equipment	4.6	-4.3	11.9	19.9	14.1
Food, beverage & tobacco products	9.8	5.9	2.1	0.2	5.7

[1] Industrial Production Index (2005=100)

Source: Department of Statistics, Malaysia

Capacity utilisation rate in the manufacturing sector*



* Beginning 2012, the capacity utilisation rate in the manufacturing sector has been rebased from value-add in year 2006 to value-add in year 2009

Source: Bank Negara Malaysia & Department of Statistics, Malaysia

Value-added growth of the agriculture sector expanded strongly by 5.6% (3Q 12: 0.5%), driven largely by a sharply higher output of crude palm oil and supported by higher production of poultry in the livestock sub-sector. The mining sector turned around to record a growth of 4.3% (3Q 12: -1.2%), reflecting a recovery in natural gas production following a prolonged shutdown of several gas facilities for maintenance purposes in the previous quarter. Growth was further supported by higher production of crude oil in fields offshore Sabah.

Performance of the Agriculture Sector

	2011		2012		
	4Q	Year	3Q	4Q	Year
	Annual change (%)				
Value Added (at constant 2005 prices)	**6.9**	**5.9**	**0.5**	**5.6**	**0.8**
Industrial Crops	**7.8**	**5.8**	**-3.9**	**5.0**	**-2.6**
Of which:					
Oil palm	17.0	10.8	1.6	11.7	-0.3
Rubber	-6.9	6.1	-15.6	0.8	-7.0
Food Crops	**5.6**	**6.2**	**6.4**	**6.6**	**5.5**
Of which:					
Fishing	1.2	2.1	4.7	5.6	1.5
Livestock	10.3	10.4	7.1	11.7	9.3

Source: Department of Statistics, Malaysia

Performance of the Mining Sector

	2011		2012		
	4Q	Year	3Q	4Q	Year
	Annual change (%)				
Value Added (at constant 2005 prices)	**-3.8**	**-5.7**	**-1.2**	**4.3**	**1.4**
Production					
Of which:					
Crude oil and condensates	-6.6	-10.7	0.0	4.1	2.4
Natural gas	0.7	0.0	-3.3	6.0	-0.4

Source: PETRONAS
Department of Statistics, Malaysia

In the construction sector, growth was sustained at a double-digit rate in the fourth quarter (18.1%; 3Q 12: 18.3%), driven mainly by robust activity in the civil engineering and residential sub-sectors. The strong performance in the civil engineering sub-sector was mainly driven by the progress in the MRT project, in addition to other infrastructure and oil and gas projects such as the Second Penang Bridge, Janamanjung Power Plant and Kebabangan Gas Field. The residential sub-sector also registered firm growth, underpinned by the construction of high-end properties while the non-residential sub-sector continued to be supported by the construction of commercial buildings.

Indicators for the Construction Sector

	2011		2012		
	4Q	Year	3Q	4Q	Year
	Annual change (%)				
Housing approvals	29.8	32.2	3.2	12.3	47.4
New housing sales and advertising permits	22.4	16.1	25.6	-1.1	11.9
Production[1] of construction-related materials	12.3	17.6	10.5	11.3	8.7
Structural metal products	41.4	48.2	40.4	46.7	34.4
Iron and steel	1.0	1.4	-5.9	-2.8	-5.6
Structural non-refractory clay and ceramic products	2.5	-4.5	6.0	2.4	5.1
Ready-mix concrete	35.3	36.8	18.2	12.4	18.1
Loans for construction activity					
Approval	64.4	26.0	5.3	-60.1	-18.4
Disbursement	17.9	5.4	49.0	4.4	20.7

[1] Industrial Production Index (2005=100)

Source: Ministry of Housing and Local Government, Department of Statistics, Malaysia and Bank Negara Malaysia

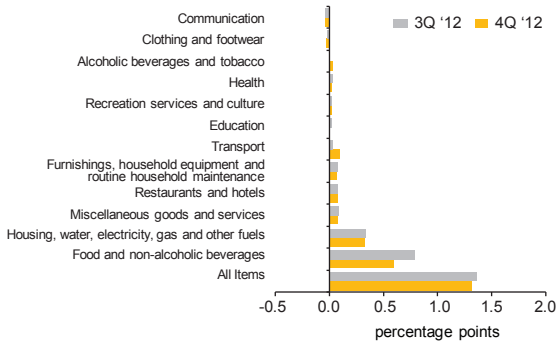
Inflation continued to moderate

The headline inflation rate, as measured by the annual change in the Consumer Price Index (CPI) continued to moderate to 1.3% in the fourth quarter (3Q 12: 1.4%), reflecting lower inflation in the *food and non-alcoholic beverages* category.

Inflation in the *food and non-alcoholic beverages* category was lower at 2.0% during the quarter (3Q 12: 2.6%). Prices in the *fish and seafood* sub-category increased at a slower pace of 3.7% (3Q 12: 7.3%) following cheaper imported fish from Indonesia. In addition, prices in the *food away from home* category also increased at a slower rate of 2.7% (3Q 12: 3.5%).

However, at 0.6%, inflation was higher in the *transport* category (3Q 12: 0.2%). Although the price of RON97 petrol was revised downwards in November and December 2012, the average price was higher in the fourth quarter of 2012 compared to the corresponding period in 2011 (average price of RON97 petrol in 4Q 12: RM 2.83 per litre; 4Q 11: RM 2.80 per litre). The upward revision in the price of cigarettes by 20 sen per pack of 20 in October 2012 led to higher inflation in the *alcoholic beverages and tobacco* category (4Q 12: 1.4%, 3Q 12: 0.2%).

Contribution to Consumer Price Inflation



Source: Bank Negara Malaysia

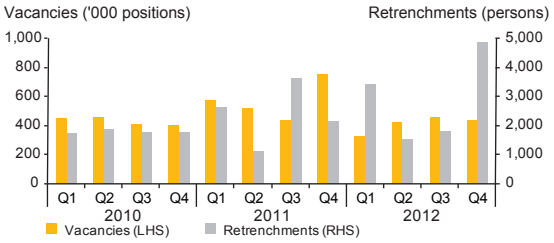
The Producer Price Index (PPI) continued to decline, contracting by 3.7% on an annual basis in the fourth quarter (3Q 12: -0.7%). In terms of composition, prices of commodity-related components declined by 10.3% (3Q 12: -2.7%) while prices of non-commodity-related components increased by 0.2% (3Q 12: 0.6%) during the quarter. Prices of local components declined by 5.2% (3Q 12: -1.1%) while those of imported components remained unchanged (3Q 12: 0.7%).

Softer labour market conditions in the fourth quarter

Overall employment conditions softened slightly during the quarter, with the unemployment rate increasing marginally to 3.1% in October-November (3Q 12: 3.0%). Total employment averaged 12.56 million persons during the first two months of the quarter, representing a year-on-year growth of 2.9% (3Q 12: 2.8%). However, total retrenchments reported to the Ministry of Human Resources during the quarter increased to 4,823 persons from 1,767 persons in the preceding quarter, with the manufacturing sector accounting for 70% of total layoffs.

Labour demand during the quarter declined as reflected in the lower number of job vacancies posted in the JobsMalaysia Portal (429,928 positions; 3Q 12: 453,893 positions). Meanwhile, aggregate real wages in the manufacturing sector recorded a higher growth of 6.4% as compared to the preceding quarter (3Q 12: 3.9%).

Labour Market Conditions



Note: Vacancies data from 2012 onwards is not comparable to previous years due to a reclassification exercise

Source: Ministry of Human Resources

External sector remained strong

The current account surplus increased in the fourth quarter to RM22.8 billion, equivalent to 6.6% of GNI, due to the larger goods surplus and lower services deficit and income outflows.

Balance of Payments

	2011		2012		
	4Q	Year	3Q	4Q	Year
	RM billion				
Current Account	**22.4**	**97.1**	**9.5**	**22.8**	**60.0**
(% of GNI)	*10.0*	*11.3*	*4.2*	*9.6*	*6.6*
Goods	36.8	148.1	25.5	34.5	125.2
Services	-3.8	-8.0	-3.4	-2.7	-13.4
Income	-5.3	-22.0	-7.9	-5.5	-33.7
Current transfers	-5.4	-21.0	-4.7	-3.5	-18.2
Financial Account	**-0.2**	**22.3**	**-8.7**	**-9.0**	**-22.5**
Direct investment abroad	-14.7	-46.7	-7.7	-23.8	-51.0
Foreign direct investment	6.5	36.6	9.6	5.9	29.1
Portfolio investment	-2.7	25.8	27.6	11.3	59.2
Financial derivatives	-0.3	-0.1	-0.1	0.1	0.9
Other investment	11.0	6.6	-38.1	-2.4	-60.7
- Official sector	*-0.1*	*-1.3*	*0.0*	*-0.7*	*-1.4*
- Private sector	*11.1*	*7.9*	*-38.0*	*-1.7*	*-59.3*
Errors & omissions	-15.9	-24.5	-8.3	-8.2	-33.6
Overall Balance	**6.2**	**94.7**	**-7.5**	**5.9**	**3.9**

Source: Department of Statistics Malaysia

The trade surplus widened to RM26.6 billion in the fourth quarter of 2012 as the moderation in gross imports more than offset the decline in gross exports.

Gross exports continued to decline (-2.3%) in the fourth quarter, weighed down by further contractions in both manufactured and commodity exports. The decline in manufactured exports was due mainly to weaker demand for electronics and electrical (E&E) products. Non-E&E exports contracted at a slower rate, reflecting sustained regional demand for both resource- and non-resource based products. Commodity exports were lower mainly on account of further declines in prices of all major commodities.

Trade Account

	2011		2012		
	4Q	Year	3Q	4Q	Year
	Annual change (%)				
Gross Exports	**9.8**	**9.2**	**-1.5**	**-2.3**	**0.6**
Manufactured	2.2	2.2	-1.3	-2.4	-0.1
E&E	*-5.0*	*-5.1*	*-1.7*	*-4.4*	*-2.5*
Non-E&E	*10.3*	*10.7*	*-0.8*	*-0.5*	*2.3*
Commodities	28.8	28.0	-3.0	-3.1	1.5
Agriculture	*18.9*	*32.7*	*-21.4*	*-16.8*	*-14.9*
Minerals	*36.6*	*24.7*	*11.8*	*6.2*	*13.6*
Gross Imports	**6.8**	**8.5**	**7.3**	**0.9**	**5.9**
Capital goods	2.8	8.7	22.6	14.5	20.5
Intermediate goods	2.4	5.5	-3.1	-8.8	-3.4
Consumption goods	25.2	19.0	11.4	5.7	11.6
Trade balance (RM billion)	**32.2**	**124.2**	**17.2**	**26.6**	**94.8**

Source: MATRADE and Department of Statistics, Malaysia

Gross imports moderated to 0.9% in the fourth quarter due to a broad-based moderation in all major import categories. Intermediate imports declined further in tandem with the further contraction in manufactured exports, while capital and consumption imports continued expanding, albeit at a slower pace. Growth of capital imports continued to be supported by imports of machinery and transport equipment, reflecting the continued expansion in investment activity. Imports of consumption goods were supported by imports of processed food and beverages and semi-durable consumer goods.

Deficit in the services account was significantly lower at RM2.7 billion in the fourth quarter. The lower deficit was mainly attributable to higher net travel receipts amidst sustained net payments for transportation services. The increase in travel receipts was driven by the higher number and stronger spending of foreign tourists in Malaysia, while the payments for transportation services were supported by higher spending on passenger travel, despite the moderation in imports during the quarter. The deficit in income account narrowed to RM5.5 billion, arising from higher investment

Malaysia: Direction of Exports

	2011		2012			2011		2012		
	4Q	Year	3Q	4Q	Year	4Q	Year	3Q	4Q	Year
	Annual change (%)					Share of total exports (%)				
United States	**-3.5**	**-5.4**	**8.3**	**4.1**	**5.4**	**8.0**	**8.3**	**9.2**	**8.6**	**8.7**
European Union (EU)	**3.9**	**4.9**	**-19.2**	**-15.7**	**-13.7**	**10.2**	**10.3**	**8.5**	**8.8**	**8.9**
Selected ASEAN countries[1]	**5.6**	**5.5**	**10.6**	**8.0**	**9.5**	**24.3**	**24.2**	**26.7**	**26.9**	**26.4**
North East Asia	**9.4**	**9.7**	**-7.6**	**-4.3**	**-3.7**	**24.2**	**24.7**	**23.8**	**23.7**	**23.6**
People's Republic of China	*15.4*	*14.3*	*-11.6*	*-4.9*	*-3.1*	*13.0*	*13.1*	*12.7*	*12.6*	*12.6*
Hong Kong SAR	*-7.3*	*-3.6*	*0.2*	*-4.2*	*-3.8*	*4.2*	*4.5*	*4.6*	*4.1*	*4.3*
Chinese Taipei	*13.1*	*14.9*	*-1.6*	*-8.8*	*-6.1*	*3.4*	*3.3*	*3.2*	*3.1*	*3.1*
Korea	*8.5*	*7.9*	*-6.7*	*2.1*	*-3.6*	*3.6*	*3.8*	*3.3*	*3.8*	*3.6*
West Asia	**6.5**	**12.1**	**2.5**	**-8.8**	**-3.1**	**3.5**	**3.6**	**3.6**	**3.3**	**3.4**
India	**33.7**	**34.5**	**0.7**	**12.9**	**4.2**	**4.0**	**4.0**	**4.3**	**4.6**	**4.2**
Total exports	**9.8**	**9.2**	**-1.5**	**-2.3**	**0.6**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

[1]Singapore, Thailand, Indonesia, Philippines, Brunei Darussalam and Vietnam

Source: Department of Statistics, Malaysia

income accrued to Malaysian companies investing abroad and lower investment income accrued to foreign direct investors in Malaysia. The higher income of Malaysian companies investing abroad was mainly attributable to companies in the oil and gas and services sectors.

The financial account sustained a net outflow of RM9.0 billion in 4Q 12 (3Q 12: -RM8.7 billion) as net inflows of portfolio investment and FDI were offset by an increase in direct investment abroad.

Portfolio investment recorded a smaller net inflow of RM11.3 billion during the quarter (3Q 12: RM 27.6 billion). While developments in the US, Japan and Europe caused significant deterioration of risk appetites in the markets; the expanded global liquidity conditions arising from the continued accommodative monetary policy stance in the advanced economies contributed to steady inflows of capital into the developing economies, including Malaysia. Moreover, the brighter growth prospects in the developing economies continued to attract portfolio investment inflows from non-residents, particularly into the purchases of Government debt securities.

FDI recorded a small net inflow of RM5.9 billion (3Q 12: +RM9.6 billion) due to slightly lower inflows of equity capital and retained earnings. FDI inflows continued to be broad-based during the quarter, mostly undertaken by companies in the *manufacturing, oil and gas*, and *services* sectors, particularly *within the wholesale and retail trade* and *finance and insurance* sub-sectors.

Direct investment abroad (DIA) by Malaysian companies, however, was significantly higher at RM23.8 billion in the last quarter of the year (3Q 12: -RM7.6 billion). Most of these outflows reflected strategic investments in the Liquefied Natural Gas (LNG) export market. Thus, the bulk of DIA were accounted by the *oil and gas* sector.

Other investment registered a small net outflow of RM2.4 billion in the fourth quarter (3Q 12: -RM38.1 billion), reflecting a turnaround in private sector flows, as large inflows from the banking sector were matched by outflows of trade credit extensions by Malaysian exporters. The official sector continues to register a small net outflow due to repayments of external loans.

The small net outflow position of the financial account, combined with the significant surplus in the current account resulted in a turnaround of the overall balance of payments to a surplus of RM5.9 billion in 4Q 12 (3Q 12: -RM7.5 billion). Taking into account a small revaluation gain in international reserves, the errors and omissions amounted to RM8.2 billion during the quarter.

Lower external debt

Malaysia's total external debt declined to RM252.8 billion at end-December 2012 (end-Sept: RM259.6 billion). This is equivalent to 28% of GNI and accounted for only 14.5% of total debt[2].

Medium- and long-term external debt edged higher to RM159.8 billion, as net drawdown of external borrowings by the private sector was partly offset by net repayment of the public sector. As at end-December 2012, the short-term external debt was lower at RM93 billion due mainly to net repayment of interbank borrowing.

External Debt Outstanding

	2011	2012	
	end-Dec	end-Sept	end-Dec[p]
	RM billion		
Medium- and long-term debt	153.5	159.1	159.8
Public sector	87.8	84.8	82.9
Private sector	65.8	74.3	76.9
Short-term debt[1]	103.9	100.5	93.0
Total external debt	**257.4**	**259.6**	**252.8**
USD billion equivalent	80.4	83.9	81.7
External debt/GNI (%)	30.0	28.7	28.0
Reserves/Short-term external debt (times)	4.1	4.2	4.6[2]

[1] Excludes currency and deposits held by non-residents with resident banking institutions
[2] Based on international reserves as at 31 January 2013
[p] Preliminary

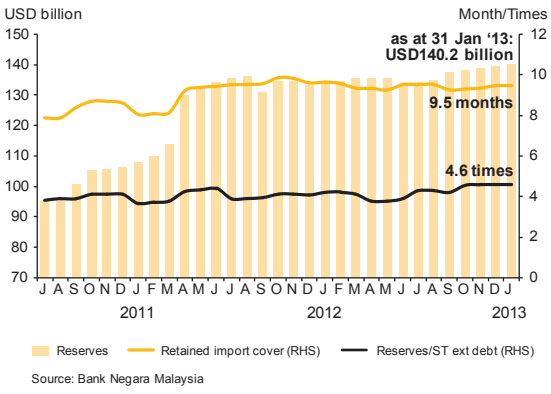
Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

[2] Total debt comprises domestic and external debt. Domestic debt comprises loans by banking system, private debt securities and Federal Government debt.

International reserves remained high

The international reserves of Bank Negara Malaysia amounted to RM427.1 billion (equivalent to USD139.7 billion) as at 31 December 2012. This reserve level has taken into account the quarterly adjustment for foreign exchange revaluation changes. As at 31 January 2013, the reserves position amounted to RM428.6 billion (equivalent to USD140.2 billion), sufficient to finance 9.5 months of retained imports and is 4.6 times the short-term external debt.

Net International Reserves (as at end period)



Source: Bank Negara Malaysia

Lower fiscal deficit of 4.5% in 2012 on higher revenue collection

The Federal Government's total revenue increased significantly in the fourth quarter, resulting in an improvement of fiscal deficit to 4.5% of GDP for the year as a whole (2011: 4.8% of GDP). The increase in revenue during the quarter was supported by the higher petroleum income tax. Expenditure was primarily channelled to the education and health sectors.

The fiscal deficit was fully financed from domestic borrowings. As at end-December 2012, total outstanding debt of the Federal Government stood at RM501.6 billion or 53.5% of GDP.

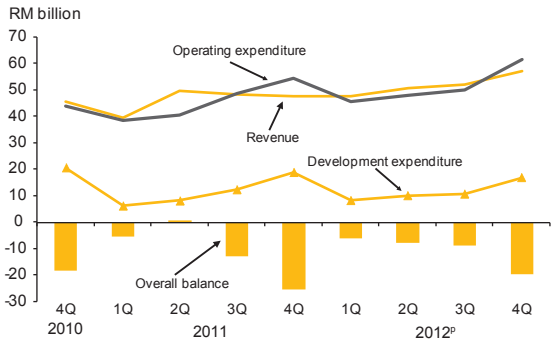
Federal Government Finance

	2011		2012[P]		
	4Q	Year	3Q	4Q	Year
	RM billion				
Revenue	47.7	185.4	52.1	57.2	207.9
% annual growth	*4.0*	*16.1*	*7.8*	*20.0*	*12.1*
Operating expenditure	54.5	182.6	50.1	61.6	205.5
% annual growth	*23.6*	*20.4*	*2.5*	*13.1*	*12.6*
Current account	**-6.9**	**2.8**	**2.0**	**-4.5**	**2.4**
% of GDP	***-3.0***	***0.3***	***0.9***	***-1.8***	***0.3***
Net development expenditure	18.5	45.3	10.8	16.6	44.3
% annual growth	*-7.1*	*-11.6*	*-11.8*	*-10.2*	*-2.2*
Overall balance	**-25.4**	**-42.5**	**-8.8**	**-21.1**	**-42.0**
% of GDP	***-11.1***	***-4.8***	***-3.7***	***-8.7***	***-4.5***
Memo item:					
Total net expenditure	73.0	227.9	60.9	78.3	249.9
% annual growth	*14.1*	*12.3*	*-0.4*	*7.2*	*9.6*
Total Federal Government debt (as at end-period)	456.1	456.1	484.6	501.6	501.6
% of GDP	*51.8*	*51.8*	*51.7*	*53.5*	*53.5*
Domestic debt	438.0	438.0	467.4	484.8	484.8
% of GDP	*49.7*	*49.7*	*49.9*	*51.7*	*51.7*
External debt	18.1	18.1	17.3	16.8	16.8
% of GDP	*2.1*	*2.1*	*1.8*	*1.8*	*1.8*

[P] Preliminary

Source: Ministry of Finance

Federal Government Finance



[P] Preliminary

Source: Ministry of Finance

MONETARY AND FINANCIAL DEVELOPMENTS

Interest rates remained stable

The Overnight Policy Rate (OPR) was maintained at 3.00% during the fourth quarter of 2012. At this level of the OPR, monetary conditions remain supportive of the economy.

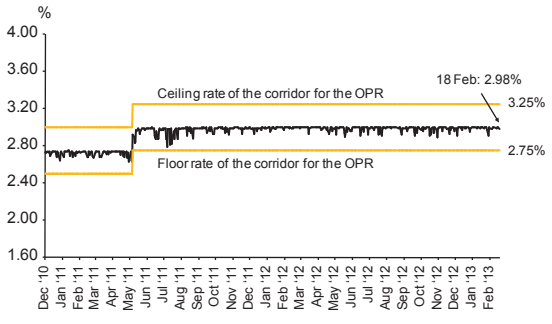
Reflecting the unchanged OPR, the average overnight interbank rate was stable during the quarter, moving within a range of 2.89% to 3.00%, between 1 October and 31 December 2012. Interbank rates of other short-term maturities were also relatively stable.

Rates on interest rate swaps and the 3-month Kuala Lumpur Interbank Offered Rate (KLIBOR) normalised during the period, as some market participants revised down their expectations for an OPR reduction given evidence of sustained domestic economic activity.

Retail deposit rates were stable during the quarter. The average quoted fixed deposit (FD) rates of commercial banks were relatively unchanged. As at end-December 2012, the average quoted FD rates of commercial banks for the tenures 1 to 12 months ranged between 2.90% to 3.15% respectively.

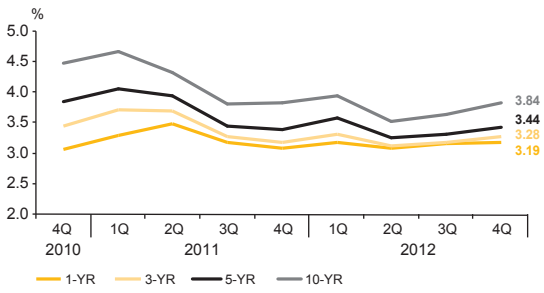
Borrowing costs to the economy were relatively stable during the period. The average base lending rate (BLR) of commercial banks remained unadjusted at 6.53%. The weighted average lending rate (ALR) on loans outstanding continued its gradual moderating trend (end-December 2012: 5.52%; end-September 2012: 5.55%), reflecting the maturity of loans that were contracted during the period of higher borrowing costs prior to the OPR reductions in 2008 and 2009, as well as the addition of new loans at relatively lower rates. Borrowing costs for businesses and households remained supportive of economic activity as lending rates continue to be below the levels prior to the global financial crisis.

Daily Weighted Average Overnight Interbank Rate



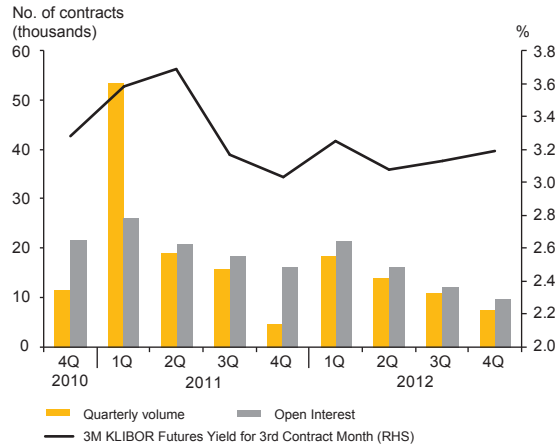
Source: Bank Negara Malaysia

Interest Rate Swap: Rates



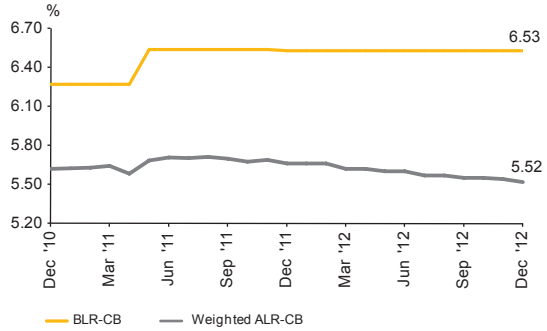
Source: Bloomberg

3-Month KLIBOR Futures



Source: Bursa Malaysia

Lending Rates of Commercial Banks (At end-period)



Source: Bank Negara Malaysia

Interest Rates

	2011	2012	
	4Q	3Q	4Q
	At end-period (%)		
Overnight Policy Rate (OPR)	3.00	3.00	3.00
Interbank rates			
Overnight	2.99	2.99	3.00
1-month	3.05	3.08	3.06
Base lending rate (BLR)			
Commercial banks	6.53	6.53	6.53
Weighted average lending rate (ALR)			
Commercial banks	5.66	5.55	5.52
Fixed deposit rates			
Commercial banks			
1-month	2.95	2.91	2.90
12-months	3.22	3.16	3.15

Source: Bank Negara Malaysia

Moderation in M3 growth

The monetary aggregates grew at a more moderate pace during the fourth quarter of 2012. M1, or narrow money, increased by RM15.4 billion during the period. On an annual basis, M1 expanded by 11.2% as at end-December (end-September 2012: 12.3%). M3, or broad money, increased by RM15.2 billion on a quarterly basis to record an annual growth rate of 8.8% as at end-December (end-September 2012: 12.5%).

M3 continued to expand during the quarter on account of the sustained credit extended to the private sector by the banking system. The placement of proceeds from the Government's fundraising activities, however, exerted a contractionary impact on broad money. The moderation in M3 was also due to the outflows of funds during the period, which was reflected in the moderation of *net foreign assets*.

In the banking system, ample liquidity conditions prevailed at both the institutional and system-wide levels. The level of surplus liquidity placed with BNM was relatively stable during the quarter.

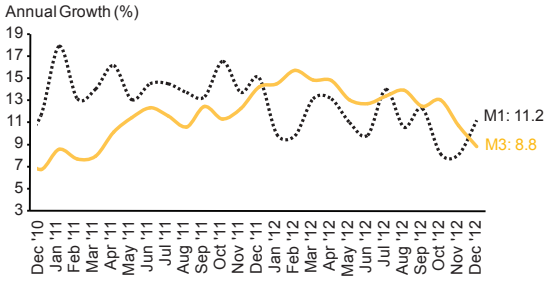
Determinants of Broad Money, M3

	Change during the period				
	2011		2012		
	4Q	Year	3Q	4Q	Year
	RM billion				
M3	**53.7**	**154.8**	**28.9**	**15.2**	**109.5**
Net claims on Govt	8.6	2.8	0.3	-4.9	-3.2
Claims on private sector	35.7	116.4	27.2	25.2	128.4
Loans	*33.4*	*111.8*	*19.5*	*19.2*	*105.5*
Securities	*2.2*	*4.6*	*7.7*	*6.0*	*22.9*
Net foreign assets[1]	7.5	95.8	22.1	-4.1	27.0
BNM	*11.2*	*87.0*	*0.6*	*5.8*	*11.7*
Banking System	*-3.8*	*8.8*	*21.5*	*-9.9*	*15.3*
Other influences	2.0	-60.2	-20.7	-1.0	-42.6

[1] Pre-evaluation

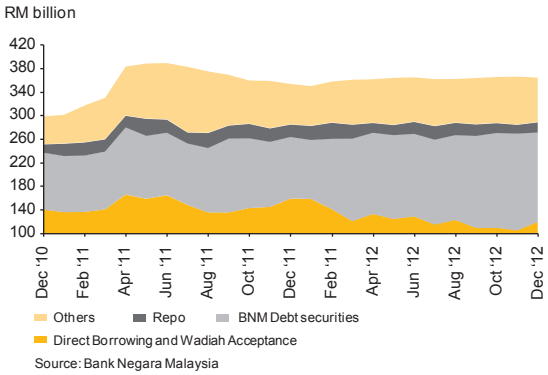
Source: Bank Negara Malaysia

Monetary Aggregates



Source: Bank Negara Malaysia

Outstanding Liquidity Placed with Bank Negara Malaysia (At end-period, RM billion)

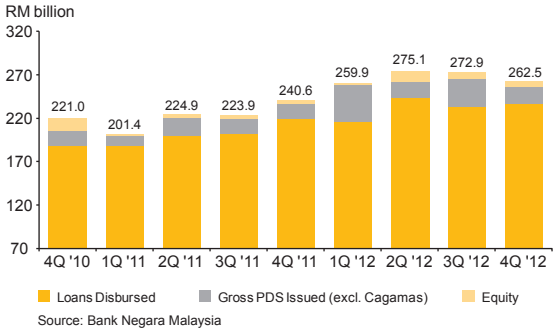


Source: Bank Negara Malaysia

Private sector financing activity was sustained

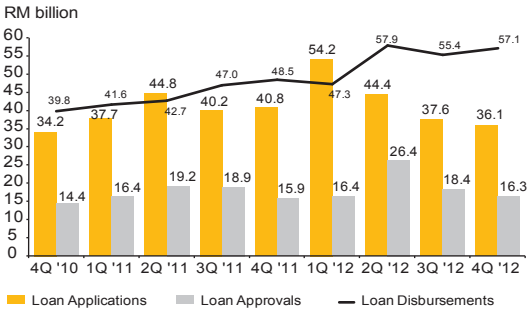
In the fourth quarter, financing conditions remained supportive of economic activity. Total gross financing raised by the private sector through the banking system and the capital market was sustained at RM262.5 billion in the fourth quarter (3Q 12: RM272.9 billion). On a net basis, banking system loans and PDS outstanding expanded at an annual growth rate of 12.4% as at end-December (end-September 2012: 12.8%).

Gross Private Sector Financing through Banking System and Capital Market



Source: Bank Negara Malaysia

Bank Lending to SMEs



Source: Bank Negara Malaysia

In the business sector, while loans outstanding from the banking system moderated due to large repayments during the quarter, loans disbursed to businesses remained strong. Most of the loans were disbursed mainly to the *wholesale and retail, restaurants and hotels; real estate; electricity, gas and water supply* and *agriculture* sectors. Demand for new financing by businesses, however, moderated due to the absence of the large loan applications that were seen earlier in the year. On an annual basis, business loans outstanding expanded at a growth rate of 10.9% as at end-December (end-September 2012: 13.6%).

Financing to the household sector continued to expand by RM17.9 billion during the quarter (3Q 12: RM17.2 billion). On an annual basis, however, household loans outstanding grew at a more gradual pace of 11.5% as at end-December (end-September 2012: 11.9%). Household demand for loans was sustained with loan applications mainly for the *purchase of residential property, passenger cars* and *securities*.

Financing of the Private Sector through Banking System and Capital Market

	During the period (RM billion)					Annual growth (%)				
	2011		2012			2011		2012		
	4Q	Year	3Q	4Q	Year	4Q	Year	3Q	4Q	Year
Gross total financing	**240.6**	**890.8**	**272.9**	**262.5**	**1,070.5**	**8.9**	**10.8**	**21.9**	**9.1**	**20.2**
Loans disbursed*	219.7	811.3	233.3	236.6	929.9	16.3	12.0	15.4	7.7	14.6
Gross PDS (excl. Cagamas)	17.1	66.9	31.8	19.8	113.1	-2.1	42.6	76.4	16.2	69.0
Equity	3.8	12.6	7.9	6.1	27.4	-73.9	-60.7	106.1	59.6	117.1
Net total financing (A)+(B)	**32.1**	**147.4**	**33.3**	**31.1**	**164.5**	**12.5**	**12.5**	**12.8**	**12.4**	**12.4**
Banking system	31.7	122.5	28.5	26.0	128.3	12.9	12.9	12.9	12.0	12.0
Loans outstanding (A)	*31.2*	*120.2*	*20.9*	*19.7*	*104.4*	*13.6*	*13.6*	*11.9*	*10.4*	*10.4*
Holding of PDS	*0.5*	*2.2*	*7.6*	*6.2*	*23.9*	*3.6*	*3.6*	*28.0*	*36.6*	*36.6*
PDS outstanding (B)	0.8	27.2	12.4	11.4	60.1	9.3	9.3	15.5	18.7	18.7
Memorandum item										
Gross PDS (incl. Cagamas)	17.4	69.6	32.6	23.1	121.1	-5.2	33.4	71.0	33.1	74.1

*Includes banking system loans sold to Cagamas

Source: Bank Negara Malaysia

Loan Indicators

	During the period (RM billion)					Annual growth (%)				
	2011		2012			2011		2012		
	4Q	Year	3Q	4Q	Year	4Q	Year	3Q	4Q	Year
Total										
Loan applications	192.3	745.4	180.0	170.4	766.0	10.9	16.2	-2.6	-11.4	2.8
Loan approvals	104.0	400.3	94.0	95.0	390.1	13.4	16.6	-4.6	-8.7	-2.5
Loan disbursements	219.7	811.3	233.3	236.6	929.9	16.3	12.0	15.4	7.7	14.6
Loan repayments	195.5	725.6	224.0	227.3	867.3	16.5	11.8	19.0	16.2	19.5
Change in loans outstanding*	31.2	120.2	20.9	19.7	104.4	13.6	13.6	11.9	10.4	10.4
Of which:										
Business enterprises**										
Loan applications	95.7	357.9	81.4	70.2	372.1	16.6	19.9	-5.3	-26.6	4.0
Loan approvals	52.5	193.3	41.4	41.7	186.3	20.8	21.3	-10.9	-20.5	-3.6
Loan disbursements	150.8	543.5	163.2	165.3	659.6	21.1	12.5	20.1	9.6	21.3
Loan repayments	137.8	494.7	161.9	164.4	625.0	21.9	11.6	24.4	19.3	26.4
Change in loans outstanding*	13.2	44.8	7.6	5.0	41.2	13.5	13.5	13.6	10.9	10.9
SMEs**										
Loan applications	40.8	163.4	37.6	36.1	172.3	19.3	27.3	-6.3	-11.3	5.5
Loan approvals	15.9	70.4	18.4	16.3	77.5	10.8	21.8	-2.6	2.3	10.0
Loan disbursements	48.5	179.9	55.4	57.1	217.7	21.9	22.3	17.8	17.7	21.0
Loan repayments	43.9	159.7	51.6	55.0	199.5	17.2	16.4	23.3	25.4	24.9
Change in loans outstanding*	8.2	24.8	4.7	2.5	23.8	19.3	19.3	20.3	15.5	15.5
Large corporations										
Loan applications	54.9	194.5	43.8	34.1	199.7	14.6	14.3	-4.4	-37.9	2.7
Loan approvals	36.6	122.9	23.0	25.4	108.8	25.8	21.1	-16.5	-30.5	-11.4
Loan disbursements	102.3	363.6	107.8	108.2	441.9	20.7	8.2	21.4	5.7	21.5
Loan repayments	94.0	335.0	110.3	109.3	425.6	24.3	9.5	24.9	16.4	27.0
Change in loans outstanding*	4.9	20.0	2.9	2.5	17.4	9.8	9.8	9.1	7.8	7.8
Households										
Loan applications	96.7	387.5	98.6	100.2	394.0	5.8	13.0	-0.2	3.7	1.7
Loan approvals	51.5	207.0	52.6	53.3	203.8	6.7	12.4	1.0	3.4	-1.5
Loan disbursements	68.9	267.7	70.0	71.3	270.4	7.1	10.9	5.8	3.6	1.0
Loan repayments	57.7	231.0	62.1	62.9	242.3	5.2	12.0	7.0	9.0	4.9
Change in loans outstanding*	17.8	63.1	17.2	17.9	63.7	12.9	12.9	11.9	11.5	11.5

* The annual growth is for end-period.
** Include loans to individual businesses.

Source: Bank Negara Malaysia

Fund raising activity in the capital market remained healthy

Net funds raised in the capital market were higher at RM37.7 billion during the fourth quarter (3Q 12: RM28.7 billion). The bulk of funds were raised by the private sector through new issuances of private debt securities, amounting to RM23.1 billion (3Q 12: RM32.6 billion). Funds raised were mainly used for new activities and for funding working capital, general corporate purposes and operating expenses. In the equity market, funds raised amounted to RM6.1 billion (3Q 12: RM7.9 billion), mainly via initial public offerings. After adjusting for redemptions, net funds raised by the private sector amounted to RM20.1 billion (3Q 12: RM18.3 billion).

Net funds raised by the public sector were RM17.6 billion in the fourth quarter (3Q 12: RM10.4 billion). Funds were raised through the new issuance of a 7.5-year Government Investment Issue (GII) and the re-opening of the 5-year, 7-year, 10-year and 20-year Malaysian Government Securities (MGS), as well as the issuance of a 5-year and 15-year GII. In addition, funds were also raised through the issuance of a RM1.9 billion Government Housing Sukuk. For the year as a whole, total net funds raised in the capital market amounted to RM137.4 billion (2011: RM82.7 billion).

Net Funds Raised in the Capital Market

	2011		2012		
	4Q	Year	3Q	4Q	Year
	RM billion				
By Public Sector	**15.9**	**45.6**	**10.4**	**17.6**	**46.7**
Government securities, *net*	15.9	47.1	7.8	15.7	48.7
Malaysian Government Securities	*12.9*	*58.8*	*14.2*	*11.6*	*54.7*
Government Investment Issues	*6.1*	*36.4*	*11.1*	*8.0*	*42.2*
Less: Redemptions	*3.1*	*48.1*	17.5	4.0	48.3
Khazanah Bonds, *net*	-	-	-	-	-
Savings Bonds, *net*	(0.0)	(1.6)	-	-	(6.5)
Government Housing Sukuk, net	-	-	2.6	1.9	*4.5*
By Private Sector	**3.5**	**37.1**	**18.3**	**20.1**	**90.7**
Shares	3.8	12.6	7.9	6.1	27.4
Debt securities, *net*	(0.3)	24.5	10.3	14.0	63.3
Private Debt Securities	*17.4*	*69.6*	*32.6*	*23.1*	*121.1*
Less: Redemptions	*17.7*	*45.1*	*22.3*	*9.1*	*57.8*
Total	**19.4**	**82.7**	**28.7**	**37.7**	**137.4**

Note: Numbers may not add up to total due to rounding

Source: Bank Negara Malaysia and Bursa Malaysia

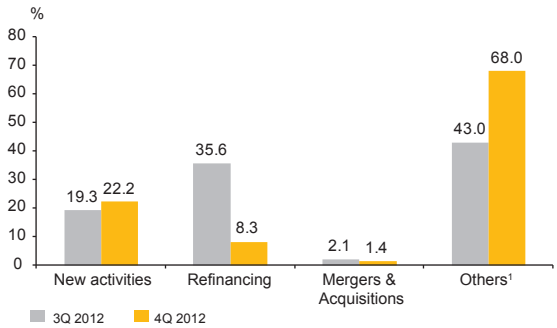
Loans by Sector

	Loans disbursed						Loans outstanding
	During the period					Share of total	Share of total
	4Q 11	2011	3Q 12	4Q 12	2012		
	(RM billion)					(%)	
Business enterprises	**150.8**	**543.5**	**163.2**	**165.3**	**659.6**	**70.9**	**44.4**
Large corporations	*102.3*	*363.6*	*107.8*	*108.2*	*441.9*	*47.5*	*28.4*
*SMEs**	*48.5*	*179.9*	*55.4*	*57.1*	*217.7*	*23.4*	*16.0*
Selected sectors							
Agriculture, hunting, forestry and fishing	6.1	22.9	7.1	8.0	28.8	3.1	2.6
Mining and quarrying	1.3	5.1	1.7	1.9	7.8	0.8	0.6
Manufacturing	47.4	175.6	53.1	51.5	206.2	22.2	8.6
Construction	14.0	45.1	16.1	14.6	54.5	5.9	4.0
Real estate	9.6	33.3	7.8	9.5	40.9	4.4	5.6
Electricity, gas and water supply	1.4	5.6	2.2	3.1	9.1	1.0	0.9
Wholesale, retail, restaurants and hotels	38.0	139.7	42.6	46.2	178.5	19.2	7.4
Transport, storage and communication	6.4	19.7	4.5	3.7	17.7	1.9	2.5
Finance, insurance and business services	16.4	63.0	20.7	18.3	85.0	9.1	6.8
Households	**68.9**	**267.7**	**70.0**	**71.3**	**270.4**	**29.1**	**55.6**
Purchase of residential properties	17.0	64.5	16.3	17.0	64.7	7.0	26.0
Consumption credit	41.6	162.9	42.7	43.4	163.3	17.6	19.2
Of which:							
Credit cards	*23.6*	*93.7*	*23.0*	*24.3*	*90.3*	9.7	3.0
Purchase of passenger cars	*9.3*	*35.7*	*10.8*	*10.6*	*40.2*	*4.3*	*11.3*
Others	10.3	40.3	11.0	11.0	42.4	*4.6*	*10.4*
Total	**219.7**	**811.3**	**233.3**	**236.6**	**929.9**	**100.0**	**100.0**

*Include loans to individual businesses.

Source: Bank Negara Malaysia

Private Debt Securities Issued by Purpose (% of total)



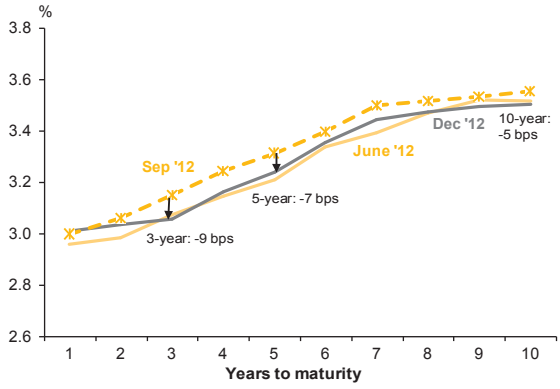
[1] Includes issuance by non-residents & Cagamas and for the purpose of working capital and general business activities

Source: Bank Negara Malaysia

Bond yields declined in the fourth quarter

In October, MGS yields were on a downward trend as a result of non-resident inflows, driven by investors' optimism over the growth prospects in the region including Malaysia, and the announcement of further monetary stimulus in the advanced economies. Towards the end of the year, however, yields increased slightly, as non-resident investors reduced their holdings of emerging market assets, including the MGS, due to increased uncertainty surrounding the US fiscal position. Overall, yields on the 3-year, 5-year and 10-year MGS declined marginally by 9, 7 and 5 basis points respectively in the fourth quarter.

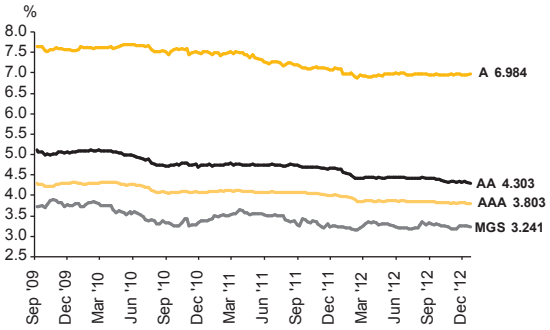
Trend in MGS Yields



Source: Bank Negara Malaysia

In general, corporate bond yields also recorded a decline in the fourth quarter, in line with MGS yields. The 5-year AAA, AA-rated yield recorded a decline of 3 and 9 basis points respectively, while the 5-year A-rated yield increased marginally by 2 basis points.

5-year MGS and 5-year Corporate Bond Yield

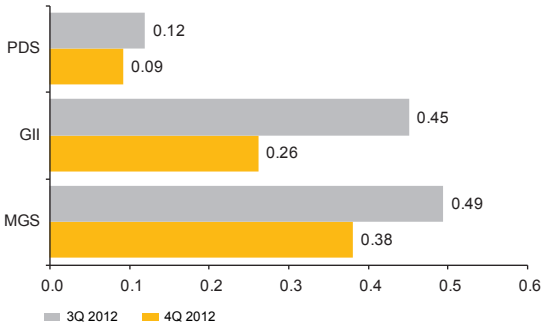


Source: Bank Negara Malaysia

Secondary trading in the bond market declined

Total trading in the secondary market declined to RM185 billion during the quarter (3Q 12: RM248 billion) due to the year-end holiday season. Correspondingly, all segments recorded lower liquidity ratios compared to the previous quarter. The MGS, GII and PDS segments registered liquidity ratios of 0.38, 0.26 and 0.09 respectively.

Liquidity Ratio: Turnover / Outstanding



Source: Bank Negara Malaysia

Positive performance of the KLCI

In the fourth quarter, the FBM (FTSE Bursa Malaysia) KLCI rose by 52.3 points to end the year at 1,689 (end-September 2012: 1,636.7). Earlier in the quarter, expectations of further monetary stimulus from the advanced economies and the release of better-than-expected third quarter domestic growth data kept the FBM KLCI on an upward trend. The trend however, reversed in November on profit-taking and rising uncertainty surrounding the US fiscal position. Nonetheless, the index subsequently recovered

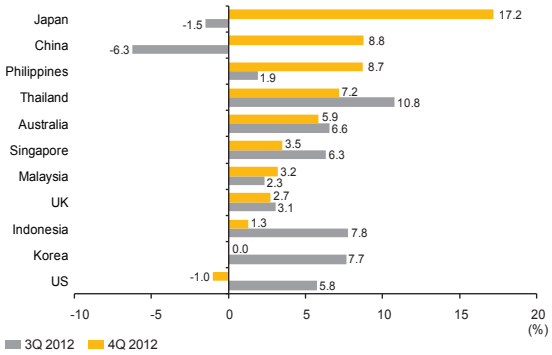
in December to end at an all-time high of 1,689, driven by higher demand by investors for blue-chips stocks. Overall, market capitalisation increased to RM1.47 trillion at end-December (end-September 2012: RM1.42 trillion) while the daily average turnover decreased to 1.05 billion units (3Q 12: 1.20 billion units) during the quarter. Open interest in the FBM KLCI futures increased to 30,550 contracts as at end-December (end-September 2012: 24,896).

On 18 February 2013, the KLCI ended slightly lower at 1,620.9 points (since end-December 2012: -4.0%), with market capitalisation of RM1.42 trillion (since end-December 2012: -3.4%).

Ringgit exhibited mixed performance against major and regional currencies

In the fourth quarter, the ringgit appreciated against the US dollar supported by investor optimism over growth prospects for the region, including Malaysia. The uncertainty surrounding developments in the US economy, however, including the presidential election and concerns over the US fiscal position prompted some investors to unwind their holdings of emerging market assets, thus partially offsetting the ringgit appreciation during the quarter. Overall, the ringgit appreciated by 0.3% against the US dollar in the fourth quarter. The ringgit also appreciated against the Japanese yen (11.1%) and pound sterling (0.8%), but depreciated against the euro (-1.9%). The ringgit's performance against regional currencies was mixed. The ringgit appreciated against the Indonesian rupiah (0.9%), but depreciated against the Thai baht, Chinese renminbi, Philippine peso and Korean won by between 0.4% and 3.9%. The ringgit was unchanged against the Singapore dollar.

Performance of Selected Global and Regional Markets in 2012 (% growth QoQ)



Source: Bloomberg and Bank Negara Malaysia calculations

Bursa Malaysia: Selected Market Indicators

	2011		2012		
	As at end				
	Dec	Year	Sep	Dec	Year
Price indices					
Composite	1,530.7	1,530.7	1,636.7	1,689.0	1,689.0
FBMEMAS[1]	10,489.1	10,489.1	11,106.6	11,438.1	11,438.1
ACE Market[2]	4,068.6	4,068.6	4,304.7	4,214.2	4,214.2
Market capitalisation (RM billion)	1,284.5	1,284.5	1,417.3	1,465.7	1,465.7
No. of companies listed	941	941	931	921	921
	During the quarter				
	4Q	Year	3Q	4Q	Year
Average daily turnover					
Volume (million units)	1,615.5	1,343.8	1,197.8	1,053.6	1,361.3
Value (RM million)	1,411.7	1,566.1	1,683.8	1,509.0	1,667.5

[1] FBMEMAS stands for FTSE Bursa Malaysia EMAS Index
[2] From 3 August 2009, Mesdaq market was replaced with ACE Market

Source: Bursa Malaysia

Bursa Malaysia: Market Turnover

	2011				2012					
	4Q		Year		3Q		4Q		Year	
	Billion units	RM billion	Billion units	RM billion	Billion units	RM billion	Billion units	RM billion	Billion units	RM billion
Turnover	98.5	86.1	329.2	438.2	73.1	102.7	65.3	93.6	333.5	408.3
Of which:										
Main Board	68.3	81.6	424.5	249.3	49.1	98.7	50.8	91.3	224.2	390.6
Of which										
Consumer Products	8.1	6.0	21.3	19.1	4.5	5.5	4.6	5.0	22.6	24.7
Industrial Products	14.6	10.7	60.5	51.8	10.0	8.9	10.6	8.5	44.6	44.3
Construction	2.7	4.1	25.1	13.5	1.9	3.4	2.1	3.1	8.3	14.3
Trading/Services	20.1	28.2	153.4	86.4	18.6	42.0	20.8	42.1	88.3	161.7
Finance	6.0	15.5	92.1	20.9	3.6	20.2	2.6	17.6	13.5	75.1
Properties	8.4	6.7	31.4	34.3	4.1	5.0	3.7	3.6	19.5	18.7
Plantations	2.0	4.9	23.9	7.4	1.8	7.8	1.1	4.7	5.9	25.4
Infrastructure	1.3	2.6	9.3	4.0	0.9	3.1	1.1	3.9	5.4	13.6
ACE Market[1]	18.7	2.7	7.5	47.7	18.5	3.3	10.0	1.8	76.1	12.6

[1] From 3 August 2009, Mesdaq market was replaced with ACE Market

Source: Bursa Malaysia

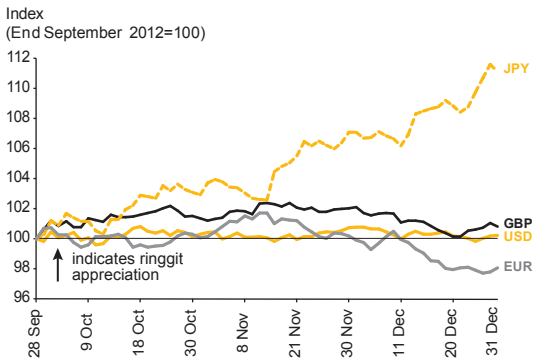
Between 1 January and 18 February 2013, the ringgit appreciated against the Japanese yen (8.0%) and pound sterling (3.0%) but depreciated against the US dollar (-1.3%) and the euro (-2.2%). Against regional currencies, the ringgit strengthened against the Korean won and Singapore dollar by 0.2% and 0.1% respectively but depreciated against the Indonesian rupiah, Chinese renminbi, Philippine peso and Thai baht by between -0.9% and -3.6%.

Activity in the foreign exchange derivatives market was subdued following lower volatility levels

The fourth quarter of 2012 saw the USD/RM pair trade within a stable range of 3.03 – 3.08, amidst a period of low exchange rate volatility. This development, coupled with an absence of market leads, led to reduced demand for hedging and consequently foreign exchange derivatives activity declined by 9.1% compared to the third quarter.

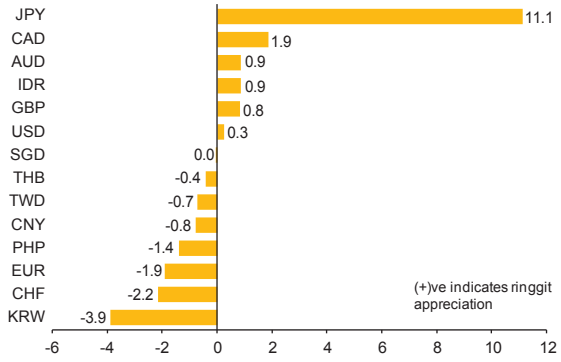
Meanwhile, the cost of borrowing US dollar through the cross-currency swap market increased slightly from 115bps to 124bps during the quarter, as the impact of the increase in the US dollar liquidity arising from monetary easing in developed markets gradually diminished.

Ringgit Performance Against Major Currencies



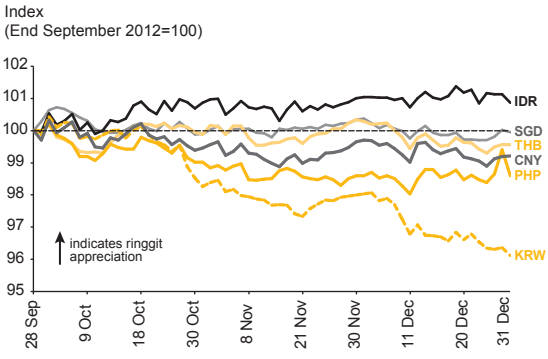
Source: Bank Negara Malaysia

Summary of Ringgit Performance Against Selected Currencies Percent Change (1 October - 31 December 2012)



Source: Bank Negara Malaysia

Ringgit Performance Against Regional Currencies



Source: Bank Negara Malaysia

Performance of Ringgit Against Selected Currencies

RM per foreign currency	As at end				% change since*		
	21 Jul 05	4Q 11	3Q 12	4Q 12	21 Jul 05	4Q 11	3Q 12
US dollar	3.8000	3.1770	3.0660	3.0583	24.3	3.9	0.3
Euro	4.6212	4.1118	3.9639	4.0412	14.4	1.7	-1.9
Pound sterling	6.6270	4.8962	4.9829	4.9420	34.1	-0.9	0.8
100 Japanese yen	3.3745	4.0975	3.9536	3.5576	-5.1	15.2	11.1
Singapore dollar	2.2570	2.4427	2.5018	2.5030	-9.8	-2.4	0.0
100 Thai baht	9.0681	10.009	9.9481	9.9910	-9.2	0.2	-0.4
100 Philippine peso	6.8131	7.2468	7.3402	7.4446	-8.5	-2.7	-1.4
100 Indonesian rupiah	0.0386	0.0347	0.0320	0.0317	21.8	9.2	0.9
100 Korean won	0.3665	0.2746	0.2754	0.2865	27.9	-4.2	-3.9
Chinese renminbi	0.4591	0.5034	0.4871	0.4909	-6.5	2.5	-0.8

* (+) indicates appreciation of ringgit against respective currency and (-) indicates depreciation.

Source: Bank Negara Malaysia

MANAGING RISKS TO FINANCIAL STABILITY

Financial stability continued to be preserved

Financial stability was sustained throughout the quarter amidst continued challenges in the global environment. Stable financial conditions were underpinned by sound and well-capitalised financial institutions, orderly financial market conditions and sustained confidence in the financial system, which provided continued support for effective financial intermediation.

A major milestone was accomplished with the passage of the Financial Services Bill 2012 and Islamic Financial Services Bill 2012 during the quarter. The new regulatory legislation significantly strengthens the foundations for the effective regulation and supervision of financial institutions under the Bank's purview. The bills combine six pre-existing statutes, namely the Banking and Financial Institutions Act 1989, Insurance Act 1996, Payment Systems Act 2003, Exchange Control Act 1953, Islamic Banking Act 1983 and the Takaful Act 1984, to provide a comprehensive and cohesive legal framework for the financial sector. Key enhancements in the legislation include increased transparency in regulatory matters, a more differentiated regime for different categories of financial intermediaries that reflects the risks posed by institutions to the stability of the overall financial system, strengthened provisions for business conduct and consumer protection, as well as broader powers and instruments for enforcement and supervisory interventions by the Bank.

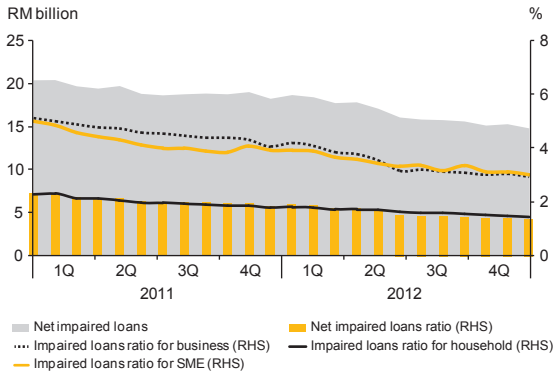
Overall risks to financial stability were contained during the quarter. Sustained economic growth and generally healthy financial positions of borrowers supported the stable credit risk of the banking system. The loan quality of banks remained intact, with the ratio of net impaired loans unchanged at 1.4% whilst loans-in-arrears improved marginally to 3.4% (3Q 12: 3.5%) of total loans. Credit risk exposures of the insurance industry, largely from holdings of private debt securities and reinsurance counterparties, were similarly stable at 3.4% of insurers' total capital.

Household debts rose at a moderate pace of 3.1% during the quarter (3Q 12: 3.4%). Financing for the purchase of residential properties grew at the same level as the previous quarter at 3%. However, outstanding credit card balances grew at a stronger pace at 3% (3Q 12: 0.2%) due mainly to year-end seasonal factors. At the aggregate level, debt accumulation by households was stronger than the increase in household financial assets which grew by 2.3% (3Q 12: 2.9%). Notwithstanding this, the financial buffers of households at the aggregate level remained comfortable. Total household financial assets remained above 2 times of household debts (3Q 12: 2.2 times) while the ratios for impaired loans and arrears of between one month and less than three months for household borrowings from banking institutions were stable at 1.5% and 2.8% of household loans (3Q 12: 1.6% and 2.7%) respectively, indicating households' continued ability to service debt.

Financing extended to businesses by the banking system moderated and grew by 1.2% during the quarter (3Q 12: 1.9%) due mainly to the slower activity in lending to the transportation (-6.2%; 3Q 12: -0.4%) and construction (-2.4%; 3Q 12: 9.3%) sectors which have raised funds mainly via the capital market for funding of long-term projects. Impairment improved further during the quarter driven mainly by the construction sector and the wholesale and retail trade segment which benefited from the implementation of mega projects by the Government and sustained domestic demand. As a result, gross impaired loans ratio remained low at 3% (3Q 12: 3.1%) of business loans while the leading indicator of loans-in-arrears of between one month and less than three months improved to 1.2% (3Q 12: 1.5%) of total business loans during the quarter. The debt servicing capacity of businesses remained intact, as evidenced by a comfortable interest coverage ratio of 6.3 times (2Q 12: 6 times).

The credit risk outlook for the banking system remained favourable against the backdrop of sustained economic growth and debt servicing capacity of borrowers. This is further supported by continued discipline observed in the credit risk management and underwriting practices of financial institutions. The level of household financial assets continues to provide adequate financial buffers for most households in mitigating any unexpected shocks to income. Similarly,

Banking System: Loan quality



Source: Bank Negara Malaysia

businesses are expected to sustain the ability to withstand challenges under an adverse operating environment, based on their strong financial positions as demonstrated by sustained profitability, low leverage and healthy liquidity positions. The expected default frequency for the business sector improved further to 0.5% as at the end of the quarter (3Q 12: 0.53%).

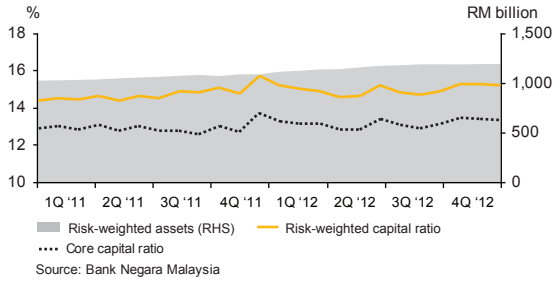
Volatile movements in short-term capital flows continued to be smoothly intermediated by the financial system without disruptive effects on the domestic financial markets. Volatility in the equity market eased further during the quarter to 6.7% (3Q 12: 7.2 %) while the benchmark index ended the quarter at an all-time high of 1,689 points. Trading liquidity in the debt and equity markets remained intact with relatively stable bid-ask spreads ranging between 0.05-0.14% and 0.31-0.79% of their respective price levels, amidst slightly lower turnover ratios. Interest rate and equity risk exposures of banks were unchanged at 4.8% and 0.6% (3Q 12: 4.8% and 0.6%) of capital base respectively. Similarly, the insurers' exposures to interest and equity risks were well-contained at 3.7% and 6.6% (3Q 12: 3.2% and 6.4%) of total capital available respectively.

Potential risks emanating from direct exposures of financial institutions to Europe and from deleveraging by European financial institutions remained limited. Direct credit exposures of the banking and insurance sectors to Europe accounted for less than 10% of banks' capital base and 0.3% of insurers' capital available respectively. Locally incorporated European banks continued to report healthy profits and showed no evidence of retrenchment from their operations in Malaysia, as demonstrated by the stable market share of assets, loans and deposits.

Financial sector continued to remain sound and resilient to weather potential adverse conditions

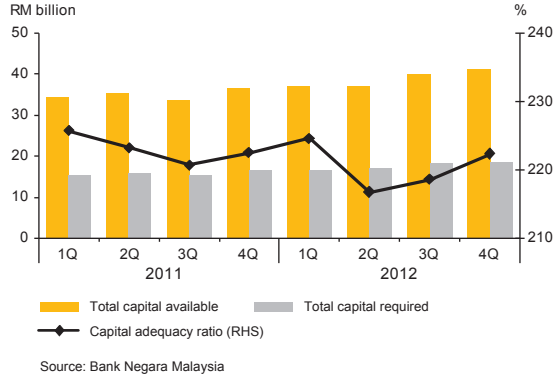
The banking sector is assessed to have the capacity to withstand shocks in the macroeconomy and financial markets, with a capital buffer in excess of RM80 billion at the end of 2012. Core capital ratio and risk-weighted capital ratio improved to 13.4% (3Q 12: 13.2%) and 15.2% (3Q 12: 14.9%) respectively. The banks are also well positioned to meet the Basel III requirements which will be phased in from January 2013. Banks also continued to maintain high quality capital, comprising paid-up capital, retained earnings, share premium and reserves, which accounted for 85% of total capital. Similarly, the insurance sector also maintained a sound capital adequacy ratio of 222.3% (3Q 12: 218.6%) with an excess capital buffer of RM22.5 billion.

Banking System: Capitalisation



Source: Bank Negara Malaysia

Insurance Sector: Capitalisation



Source: Bank Negara Malaysia

The profitability of the banking system improved to RM7.7 billion (3Q 12: RM7.4 billion) on account of higher trading and investment gains, as well as fee income. Net trading and investment income was 22% higher compared with the previous quarter following favourable developments in the financial markets. Returns on assets and equity were sustained at 1.6% (3Q 12: 1.6%) and 17.5% (3Q 12: 17.7%) respectively.

Banking System: Profitability

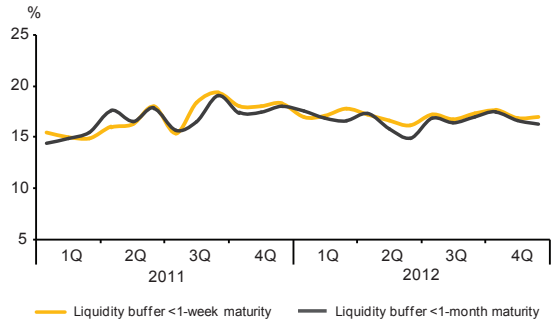


Source: Bank Negara Malaysia

The insurance and takaful industry recorded sustained profitability during the quarter. Excess of income over outgo in the life insurance and family takaful sector amounted to RM4.4 billion (3Q 12: RM5.2 billion) during the fourth quarter. The decline in profits was due to the one-off exceptional gains recorded in the third quarter which related to a divestment of investment assets by one of the insurers. Adjusting for the exceptional gains, the excess of income over outgo for the quarter would continue the upward trend observed throughout the year. General insurers and takaful operators registered a higher operating profit of RM882.6 million (3Q 12: RM688.4 million) following a more favourable underwriting performance resulting from a reduction in net claims incurred. Notably, the claim ratio for the 'motor act' cover (mandatory insurance cover required under the Road Transport Act 1987) improved to 237.1% (3Q 12: 242.2%).

The resilience of the banking system is also supported by ample liquidity in the system. Liquidity buffers to meet liquidity needs over a one-week and one-month horizon remained comfortable at 16.9% and 16.2% of total deposits (3Q 12: 17.3% and 17%) respectively. Net placements by banks with BNM which can be drawn on to meet additional liquidity needs stood at a further RM114 billion. The US dollar mismatch position in the less than one-month maturity bucket rebounded to a surplus of RM3.1 billion during the quarter from a shortfall of RM4.1 billion in the third quarter while the mismatch position in the less than one-week maturity bucket continued to record a surplus position.

Banking System: Liquidity Buffer to Total Deposit Ratio



Source: Bank Negara Malaysia

Insurance and Takaful Sectors: Indicators

	2011		2012				
	4Q	Year	3Q	4Q	Year	4Q	Year
	RM million		RM million			Annual Change (%)	
Life Insurance & Family Takaful							
Excess of Income Over Outgo	4,314.5	12,641.7	5,240.7[1]	4,365.8	17,635.1	1.2	39.5
General Insurance & General Takaful							
Operating profit	234.3	1,787.1	688.4	882.6	2,926.7	276.7	63.8
Claims ratio (%)	65.8	65.8	58.7	57.3	57.3	-1.4 (ppt)	-1.4 (ppt)

[1]Significant increase due to one-off exceptional gains in the life insurance segment.

Source: Bank Negara Malaysia

Governor's Keynote Address at the 19th ASEAN Banking Conference 2012 - "ASEAN: Towards a More Integrated Market" Kuala Lumpur, 7 November 2012

Keynote Address by

Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz
Governor, Bank Negara Malaysia

As we enter a new phase of globalisation, Asia's role in the world economy is being significantly transformed both in terms of its significance and influence. ASEAN economies are very much a part of this process. This trend has become more pronounced following the global financial crisis. Five years into the crisis, the world economy continues to be challenged to hold a sustained recovery. The financial sector restructuring and reforms, and the structural adjustments being undertaken by the crisis-affected economies will not only take time to produce results, but in the more immediate term, these efforts will involve costs to the economy.

While emerging markets such as those in the ASEAN region are not insulated from these developments, the region has displayed remarkable resilience during this period. The region has benefitted from the decade of restructuring and financial reforms following the Asian financial crisis. In addition, structural adjustments undertaken during this period and have resulted in more diversified economies, in which domestic sources have become increasingly important in sustaining growth performance. The region's more favourable growth prospects are also underpinned by the relatively sound fundamentals that include strong external and fiscal positions, stable macroeconomic conditions, low unemployment and resilient financial systems. This has also enabled the region to better manage the large and volatile capital flows that we are experiencing, thereby mitigating its destabilising effects on economic activity. These strong foundations have supported ASEAN economies through the challenging external developments that have taken place and have well positioned the region to realise its full potential as a dynamic growth centre.

It is my great pleasure to be here to speak at this 19th ASEAN Banking Conference, hosted this year by the Association of Banks in Malaysia (ABM) here in Kuala Lumpur. This Conference takes place at an important juncture for our region, as concrete plans are being advanced to achieve an ASEAN Economic Community (AEC) by 2015. The AEC Blueprint, adopted by ASEAN leaders in 2007, envisages ASEAN to become a single market and production base that is characterised by the free movement of goods, services, investment and skilled labour, and freer the flow of capital. Despite the recent global financial crisis, the drive for this vision to be realised remains resolute. This is well supported by the prevailing strong foundations and the tremendous growth prospects for ASEAN in the medium to longer term. My remarks today will focus on the elements of the prospects for the ASEAN economies, and the state of ASEAN financial integration and its importance in enhancing the regional growth potential. My remarks will conclude with some thoughts on imperatives for the banking sector going forward into the future.

Prospects for ASEAN Economies

ASEAN is currently one of the most dynamic and fastest-growing regions in the world economy. The region's GDP is expected to triple to USD3 trillion by 2017 relative to a decade ago. Economic expansion is expected to be sustained at a rate of 5.8% in the next five years, significantly outpacing global growth. In tandem with this, is the notable rise of the middle class population. The Asian Development Bank estimates that the share of ASEAN's middle class population is expected to increase to 65% by 2030, consequently contributing to altering the global consumer

landscape. With a sizeable population of 600 million people, this underscores the evolving role of ASEAN as a significant consumer market base with distinct needs and increasing purchasing power. Given that the share of the working population in ASEAN is estimated to reach 58% by 2050, ASEAN will benefit from its demographic dividend and abundant workforce.

An accompanying trend is the rise of entrepreneurship in the region. The emergence of home-grown businesses with prospects of becoming large national and multinational corporations has generated attention and priority to be accorded to supporting the development of small and medium scale enterprises (SMEs). Currently, SMEs account for 50% - 85% of domestic employment in ASEAN economies and 30-50% to GDP. Given the substantial contribution to income and employment generated by this sector, its development will be vital in creating employment and sustainable long-term growth in the ASEAN economies. On the corporate front, local corporations and businesses have fared well in establishing a stronger footprint in the region, as evidenced by their expanding regional presence and cross-border acquisition activity which has increased from USD10.9 billion during the first half of 2011 to USD26.2 billion for the same period in 2012. This vibrance of economic activity has been well supported by the continued access to financing by businesses in the region and resilient and strong ASEAN-based financial institutions.

Finally, ASEAN has also become an attractive foreign direct investment destination not only due to its stable macroeconomic environment but also due to its market size and the abundance of natural resources. ASEAN's proximity to major markets such as China and India reinforces its status as an important global value chain player and a preferred production base for many multinational corporations. In 2010, foreign direct investments into the region registered an impressive growth of more than 100% from the preceding year. The strong ties between the ASEAN economies are also underpinned by the continued growth of intra-regional trade, which now accounts for 25% of ASEAN's total trade. Going forward, this trend is set to continue. The growing consumer market and the expansion of production networks in Asia will continue to be a major driving force in promoting this increased intra-regional trade. In addition, the measures taken to boost investment, as well as infrastructure development will reinforce this trend.

Regional integration: the ASEAN model

We stand today on the brink of very exciting times for ASEAN as we draw closer to the vision of an ASEAN economic community in 2015. If the AEC vision was aspirational when it was first conceived, it is now clearly an imperative. This has prompted an increased momentum in efforts to realise an integrated ASEAN economic community, notably by achieving increased financial integration, higher levels of intra-regional trade and greater two-way cross-border investment flows. Like most regional blocs, the integration process for ASEAN seeks to promote greater regional connectivity which will in turn expand and reinforce the region's growth potential. The region's integration process however, has followed its own path. Given the diverse nature of our economies within ASEAN, the integration model adopted for ASEAN has been one that focuses on (i) strengthening preconditions through collective capacity building to promote more open market access among the economies in ASEAN; (ii) progressively reducing barriers to facilitate cross-border trade; (iii) developing the market infrastructure and enabling environment to promote efficient and effective intermediation of cross-border financial flows; and (iv) establishing the appropriate safeguards for financial system stability.

Progressive financial integration through this ASEAN model has been a strategy that has augured well for the region, allowing for the greater integration at a pace that is based on readiness and strength of the financial sector. Since 2007, ASEAN has achieved considerable progress in its efforts to deepen financial integration. ASEAN has undertaken gradual and sequenced liberalisation of identified financial services sub-sectors through the ASEAN Framework Agreement on Services (AFAS). Five rounds of negotiations have been concluded, with the sixth round of negotiations expected to be concluded by next year. In the area of financial markets, an Implementation Plan for an Integrated Capital Market has been

developed to enhance market access, linkages and liquidity. ASEAN has also made significant advancements in the areas of supporting financing for infrastructure development, as reflected by the establishment of the ASEAN Infrastructure Fund in 2011.

Notwithstanding these developments, a crucial driver for greater financial integration within the core of ASEAN financial systems is the banking sector. ASEAN banks have a significant role in supporting the financial integration process. Over the recent decade, we have witnessed the rising prominence of ASEAN financial institutions within the region, driven by the growing business fundamentals in the region and the strengthened capacity of the financial institutions. ASEAN commercial banks are predominant mobilisers of financial funds, as our experience shows, the banking sector is the most matured component in the financial sector of most jurisdictions. The banking sector therefore serves as an important conduit to increase connectivity among all ASEAN nations and in fostering financial integration.

Towards this end, the ASEAN central banks have endorsed the ASEAN Financial Integration Framework in 2011 and are in the final stages to launch the framework for banking sector integration. This will pave the way for a more meaningful presence of qualifying ASEAN banks within the region, while promoting regional financial stability. Recognising the diversity of ASEAN economies and the varying stages of financial sector development, the framework allows flexibility for ASEAN countries to participate in the integration process based on their readiness and willingness. Under the framework, qualifying ASEAN banks that have the capacity and that are well managed will serve as the regional standard bearers, and will be accorded more flexible access into regional markets. Greater flexibilities will also be given to facilitate the regional expansion plans of qualifying ASEAN banks to become important conduits of financial intermediation in the region. Tremendous opportunities can be harvested from this new framework. Hence, I welcome and look forward to the greater participation by financial institutions from all ASEAN countries in this process.

Imperatives for banking sector going forward

At this juncture, let me turn to imperatives for the banking sector going forward. There is a fundamental rethinking of banking by the international community in the aftermath of the recent global crisis. These are both driving and shaping the raft of reforms at the global level. I would like to touch briefly on four developments which could serve as a foundation for sustainable banking in the medium and longer-term. First, is for reduced complexity and increased transparency in the banking sector. Consistent with the more traditional banking models in this region, there are now increasing calls for a return to basic banking and its clear separation from higher risk-taking activities. This is part of the broader efforts to create a safer global financial system where markets and institutions are more transparent, less complex, and less leveraged than they are today.

While the banking sector in ASEAN has not reached the degree of complexity observed in the advanced economies, the region has to be mindful of the consequences as financial institutions evolve to become increasingly regional in orientation. Indeed, such growth must be commensurate with the capacity and capability of both the financial institutions and the regulators to manage and oversee the associated risks. Strengthened supervisory intensity and effectiveness, a core component of the financial sector reforms, is an essential pillar to check against unfettered innovation and risk-taking behaviours and promote strong incentives for prudent risk management. ASEAN will have to pursue an outcome that facilitates innovation and efficiency, without resulting in undue risks and unwanted costs on both the financial system and the overall economy.

Second, is the stronger focus on more responsible and sustainable financial business practices. Following the recent global financial crisis, there is a stronger international emphasis for appropriate risk-aligned mechanisms, particularly on compensation frameworks, which provide incentives for financial innovation and growth, while not compromising financial stability. This includes the increased pressure on financial institutions and regulators to have

incentive systems, governance, accountability and controls to address the issues of over-emphasis on short term performance, reckless risk-taking and the pervasive conflict of interests. In tandem with this, is the stronger focus to spur consumer activism as a means to encourage more responsible and sustainable business practices. It is in this area that financial institutions can have an important role in creating positive conduct and behaviours among financial participants in the industry, as well as contributing towards uplifting the state of financial education and consumer awareness.

Third, is the strengthening of boards' effectiveness and accountability, and sound governance of financial institutions. Following the crisis, i.e. the global financial crisis, corporate governance practices in the financial industry have come under significant scrutiny. There have been increased expectations on the management, boards of financial institutions and on regulators to significantly improve governance practices, particularly in the area of risk management policies and procedures. At the international level, substantial enhancements have been made to standards on corporate governance. The growing expansion of ASEAN banks in the region, must therefore be accompanied by an increased emphasis for the boards and senior management of financial institutions to provide the leadership and oversight of group-wide risks arising from cross-border operations. Greater diversity of boards to appreciate cultural nuances and competitive dynamics in different markets will hence be key to support sustainable cross-border operations of the institutions.

Fourthly, is reinforcing buffers to withstand future shocks. This is a key area of the international reform package that aims to significantly raise the resilience of the international financial system and to promote sound risk-taking activities. The standards will see financial institutions holding larger amounts of capital, including buffers which can be drawn down as losses occur. At the same time, the standards will also require banking institutions to significantly strengthen their liquidity and funding positions. Collectively, these standards aim to strengthen the banking institutions' ability to continue to support orderly credit intermediation, particularly during periods of instability. While carrying more equity entails greater costs of capital for banks especially in the short-term, this investment will support a more stable financial system and overall global economy as well as build the confidence of consumers and investors, particularly during periods of stress.

In view of these imperatives, this is a timely juncture for the industry to reflect and take charge of the efforts to rebuild and strengthen the foundations for more sustainable finance. Critical to this is the realisation that the creation of long-term shareholder value is consistent with, and not at odds with prudent risk taking and responsible business practices. Indeed, financial institutions with a regional footprint in ASEAN have the potential to contribute to the development of the financial systems in countries where they operate. There will be tremendous payoffs to be reaped from pursuing such sustainable strategies. Such long-term commitments to ASEAN will not only contribute to mutually reinforcing regional growth, but will become an important source of stability to the region.

Conclusion

Let me now conclude my remarks. There is less than three years to achieving the 2015 ASEAN aspirations. While many challenges remain, ASEAN is well positioned to collectively strive ahead towards the shared vision of a one ASEAN market. The financial industry has an important role in realising this vision, through its market conduct, business strategies and participation in domestic and regional collaborative initiatives. This conference provides an excellent strategic platform for the ASEAN industry to come together, share ideas and develop a greater understanding on the important issues towards building a stronger foundation for sustainable growth in ASEAN. On that note, I wish you an engaging and productive conference.

Governor's Speech at the Euromoney-Qatar Conference: "Global Financial Stability and the Internationalisation of Financial Systems in Emerging Economies" Qatar, 11 December 2012

Speech by

Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz
Governor, Bank Negara Malaysia

It is my honour to be here in Doha to speak at this Euromoney-Qatar Conference on "Global Finance Re-designed". I wish to thank the Qatar Central Bank for the invitation to speak at this event. In this current global environment, the unprecedented and wide ranging global policy responses have yet to produce financial stability and a sustainable recovery of the global economy.

The intensification of the globalization of finance in this decade has resulted in an even more connected and interdependent world. While the financial systems and economies in most parts of the world felt the effects of the recent global financial crisis, it has not discouraged the pace of internationalization of financial systems, in particular, in emerging economies. My address this morning will be on financial stability and the internationalization of financial systems in emerging economies. My remarks will cover the benefits and challenges of such internationalization, the lessons that can be drawn from the recent global financial crisis, the Malaysian experience on the internationalization of our financial system.

Benefits and Challenges of Internationalisation of Financial Systems

While there are significant benefits from internationalization of financial systems, the resulting increased international financial integration brings with it new risks and challenges. The case for increased financial liberalization and internationalization maintains that it would foster the development of a more efficient and robust financial system. While the resulting more competitive financial system will enhance the efficiency in the financial intermediation process and contribute towards reducing the cost of intermediation, the supervisory oversight needs to ensure over competition does not result in the mispricing of risk with adverse consequences on financial stability.

Other benefits are the increased opportunities for technology transfer, new expertise and greater innovation and new product offerings. Increased foreign participation in the domestic financial markets would also contribute to increased liquidity and more competitive pricing in the domestic financial markets and encourage a more efficient allocation of capital within the economy. It is also maintained that it will contribute to the expansion and development of the domestic financial markets in particular, the capital market, proving an important access for financing of investment activity. With the more efficient functioning of domestic financial markets, it would also improve the transmission mechanism of monetary policy.

Meanwhile, the increased capital inflows following the capital account liberalization represents another source of financing that would contribute towards increased investment and growth. It will allow jurisdictions with surplus funds to be channelled to those regions with productive investment opportunities and thus contribute towards a more efficient allocation of funds across international borders. The stronger cross border financial linkages has the potential to enhance international trade and investment opportunities. It allows countries to leverage on the respective comparative advantage and complementarities to reinforce mutual growth. This would be important in the current environment to facilitate cross border economic activity.

The liberalisation of the capital account in the form of removing restrictions to foreign exchange transactions would also increase the flexibility of managing such foreign exchange transactions. This would increase the potential to better manage its associated risks, while the increased efficiency gains would also reduce the cost of doing business. Finally, it is also argued that in a more liberalised environment, there would be greater market discipline which would in turn promote financial stability in the domestic financial system. This however, relies on a sufficient level of disclosure and transparency to allow the efficient functioning of the markets.

The internationalization of financial systems is however, not without risks and challenges. The risk of contagion following from the increased connectivity increases significantly, in terms of the extent and speed. The contagion can result from external events and developments that can range from failure of large and important international financial institution to the eruption of wars or political incidents that have regional or global repercussions. Meanwhile, global developments including from global policy spillovers have also resulted in more volatile capital flows. The increased openness of the financial system also increases the vulnerability to economic cycles in other parts of the world. The increased interdependence of financial systems and economies and the contagion effects can be expected to be among the significant outcomes of financial internationalization.

Financial liberalization could for example amplify further the implications of financial stress from other parts of the world on the domestic financial system. It could also accentuate and amplify asset bubbles and boom bust cycles. Other implications are that it could contribute to the widening of income disparities and also to the marginalization of domestic financial institutions if they are not able to perform in a more competitive environment. Finally, volatile capital flows may not only affect the efficient functioning of the financial markets but could result in misaligned exchange rates that do not reflect underlying fundamentals. These potential risks and vulnerabilities continue to be a challenge not only to emerging economies but also to the more developed financial systems and economies.

Lessons from the Financial Crisis

While there are benefits to be gained from the internationalization of financial systems, the risks to financial stability have also increased immensely. The risks generally emanate from the greater prospects for contagion following the greater degree of interdependence. These risks would be even more pronounced in emerging economies in which financial systems have yet to become more developed and matured. To be better positioned to reap the benefits from internationalization of financial systems in emerging economies, the crisis provides us with several lessons. Firstly, is to recognize that the different parts of the domestic financial system is highly interconnected. This also includes those parts that may not be under the regulatory capture. Financial stress in a specific segment may no longer be confined to that segment but may rapidly be transmitted to the rest of the financial system. Thus, a piecemeal policy response would not be sufficient. It would require a comprehensive response to ensure that such stressed conditions does not evolve into a major financial crisis.

Secondly, the buildup of risks to financial stability need to be identified early. Preemptive action would reduce the cost of the crisis on the financial system and the economy. Third, the regulatory authorities need to be accorded the necessary powers to manage the risks to financial stability. Fourth, the optimal policy mix may not only include policy actions to address immediate term issues but would also need to simultaneously address the underlying structural problems. Fifth, is to give recognition to the importance of enabling conditions that will render the implemented policies to yield the desired outcomes. Finally, to facilitate effective policy decision making there needs to be a platform and governance process for policy coordination across agencies within an economy and for this to be extended for regional and international collective action.

Following the recent global financial crisis, the policy response at the national level has been extensive and on an unprecedented scale. While there has been wide ranging financial reforms at the international level to strengthen the resilience of the financial sector,

the cross border dimension of policy-making has not been as extensive. This is despite the swift spread of financial and economic shocks throughout the global economy and international financial system following the eruption of the financial crisis in 2008.

Despite these increased challenges, the institutional arrangements for policy cooperation and coordination have yet to reach the levels that are commensurate with the degree of global economic and financial integration. While the individual efforts by any single economy is vital, it can no longer guarantee global financial stability. Emerging economies that are more open and integrated with the global economy and international financial system are the most affected by these developments. The crisis has forcefully demonstrated the importance of the international dimension of policy.

Finally, a consequence of financial crisis that deserves increased attention is the widening of income disparities within economies. The recent crisis has worsened this trend given the conditions of high unemployment in many parts of the world. At the national level, the development of inclusive financial systems and the development of social safety nets will contribute to containing this trend.

Financial Internationalisation and the Malaysian Experience

In pursuing financial sector liberalisation to transition to a more internationalised financial system, Malaysia adopted a gradual and sequenced approach. This was to ensure that the necessary preconditions were in place so that the benefits of increased financial internationalisation would be realised, while ensuring that the associated risks inherent to a more open economy and internationally integrated financial system could be effectively managed.

Seven preconditions were identified as being important to this process. The first was to accord priority to building the capacity of the intermediaries in the financial sector, and to strengthen their resilience and competitiveness. At the time of the Asian financial crisis, Malaysia had a highly fragmented banking sector with more than seventy banking institutions, many of which were small and highly vulnerable. During the financial crisis, a major restructuring exercise was undertaken. This was followed by an industry-wide merger exercise, prompted by an increase of the capitalisation requirements. The restructuring strengthened the balance sheets of the banking institutions, while the consolidation produced larger and stronger financial groups.

The second was to undertake financial reforms which focused on the transition to a more market-oriented financial system. This involved interest rate reforms that would support the more efficient pricing of financial products and services. The more competitive environment that was generated became an important driver of efficiency gains and innovation in the financial system.

Equal attention was also given to the development of the financial infrastructure, in particular, the payment and settlement system and the modernization of the legal framework to give greater clarity to the legislation governing the financial sector. This involved seven new legislation that have been enacted in the areas of central banking, the payments system, money services, deposit insurance, and the regulation of the banking, insurance, Islamic finance, development financial institutions and cooperatives. This has given greater certainty and predictability in the functioning of the financial system.

Importance was also given to strengthening the surveillance capabilities of the Central Bank and the effectiveness of the regulatory and supervisory regime. This involved the transition from a rule-based regulation to an enhanced principle-based regulation regime with focus on governance practices and risk management. This was reinforced by the shift to a risk-based supervision. The supervisory oversight has however continued to remain intrusive, with a pre-emptive intervention framework to ensure that the potential risks to financial stability would continue to be addressed including in a more regionally and internationally connected financial sector.

In parallel with these efforts was the development of the securities market. From a financial system in which there was an over-reliance on the banking system for financing, the financial system has now become more diversified with greater access to financing from the bond and sukuk market. The domestic securities market has now evolved to become a vibrant part of the Malaysian financing ecosystem, and has served to disperse the concentration of risk in the financial system thereby contributing towards preserving financial stability. The Malaysian securities market has expanded significantly to become the largest in the ASEAN region.

Malaysia also made significant investments in talent development for the financial services sector. Given its significance in defining performance and resilience of the financial sector, comprehensive institutional arrangements have been put in place for all levels of the industry; at the entry point, at the working and specialist levels, at the professional level and at the leadership levels including for the boards of financial institutions.

Finally, as the financial system became more regionally and internationally more integrated, regional financial stability arrangements have also been established. These included advancing collective initiatives in the areas of regional surveillance, the development of regional financial markets and payments infrastructure, and cross-border supervision. Forums for assessment of risks to regional financial stability have also been initiated, and work on establishing an integrated crisis management and resolution framework for the region is in progress. As part of these initiatives, a regional support mechanism has also been established.

With these pre-conditions in place, Malaysia commenced initiatives to internationalise our financial system beginning 2003. The internationalisation of the financial sector entailed the advancement in two main areas; financial sector liberalisation and capital account liberalisation. In pursuing greater regional and international financial integration, the aim was to enhance the diversity of the financial system in terms of its product offerings, to improve further the competitiveness of the financial system and to strengthen our economic linkages with the region and other parts of the world.

The financial sector liberalisation involved increased foreign entry and participation in our financial system. New licences were issued to foreign conventional and Islamic banking institutions, while the minimum foreign strategic stakes in the insurance and takaful industry were increased. Increased operational flexibilities were also accorded to the existing foreign banking institutions in the financial system which now account for about 30% of the banking system. At the same time, the foreign participation in our securities market was liberalised in 2007 to allow foreign corporations to raise financing either in domestic or foreign currency.

The capital account liberalisation throughout the first decade in the 2000s has involved the progressive removal of restrictions on foreign exchange administration rules. This liberalisation was intensified after 2005, taking into account the state of readiness of the financial system and the economy to manage the consequential increased cross border financial flows. In July 2005, Malaysia migrated from a fixed exchange rate regime to a flexible exchange rate regime to accord greater flexibility to adjust to changing structural conditions in the region and the global economy. With the progressive dismantling of restrictions, businesses now had the flexibility to manage their financial exchange exposures. This encouraged two way capital flows and contributed towards stabilising the volatile capital flows to our economy.

Finally, in addition to being accorded with the necessary powers in the new legislations, the policy toolkit of the Central Bank has also been expanded to address the potential build-up of financial imbalances and its risks to financial stability following increased internationalisation. This includes macro-prudential and supervisory measures to collectively address the underlying causes of financial stability. A platform has also been established for the greater coordination among policy makers within the country, among the regulators and the public sector.

Conclusion

Let me now conclude my remarks. While many lessons can be drawn from the various episodes of financial crisis experienced by the world economy, there is no one approach to the liberalization and internationalization of financial systems. Its success depends on the prevailing circumstances and the state of readiness of financial systems and the economy and its capacity to manage its associated risks. Premature internationalization can result in highly destabilizing conditions. The liberalization process also needs to be pragmatic, taking into consideration the different objectives that need to be achieved. With sufficient development of the financial infrastructure, the safeguards and the buffers, emerging economies have every potential to participate in a more internationally integrated financial system that will facilitate mutually reinforcing global growth and development.

Governor's Speech at the Islamic Development Bank (IDB) Regional Lecture Series on Islamic Economics, Finance and Banking: "Finance and the Real Economy: Fostering Sustainability" Jakarta 19 December 2012

Speech Adress by

Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz
Governor, Bank Negara Malaysia

I am most honoured to be invited to deliver this inaugural lecture of the Islamic Development Bank Regional Lecture Series. I am also most delighted to be back here in Jakarta. I would like to thank the Islamic Development Bank for the invitation, and Bank Indonesia for kindly hosting this event.

For more than three decades now, the Islamic Development Bank has had an important role in promoting economic growth and development in so many parts of the world, and associated with this, has been its role in fostering the development of Islamic finance. It has supported the building of key international financial infrastructure that has been important for the orderly global development of Islamic finance and for safeguarding financial stability. The Islamic Development Bank has also supported research and education efforts in this area, while its strategic interests in financial institutions in different jurisdictions have been an important catalyst for their establishment and expansion. In the current more uncertain environment, in the aftermath of the recent global financial crisis, the role of the Islamic Development Bank will continue to be important, given that the goal of sustainable growth and development in the world economy has now become even more challenging.

As the conventional financial system currently confronts what is perhaps its most defining period, several important lessons can be drawn for our collective efforts to build more resilient financial systems. Important considerations need to be accorded to the issues that have emerged, and on the policy directions affecting growth and stability. My address today will discuss several of these issues, and discuss how Islamic finance, given its nature and inherent features, can contribute to the process of enhancing the discipline that contributes to ensuring growth and financial stability.

At the core, the financial system needs to serve the real economy. The purpose of the financial system is intermediation - that is, to match savings and investments for the purpose of generating economic growth. Yet, in recent decades, a number of factors have contributed to the weakening of the link between financial intermediation and productive economic activity. Deregulation opened up new opportunities for financial institutions to enhance performance and expand the scope of their activities. Greater competition, reinforced by significant advances in technology, intensified the pace of innovation. And, the extended period of low inflation and low interest rates incentivised greater risk-taking. Cumulatively, these developments contributed to a dangerous build-up of financial imbalances.

This has prompted a rethinking of the issues related to the financial business and its models, and wide-ranging regulatory reforms by the international community. Related to these issues is the question on the "appropriate" size of the financial sector. As economies develop, the size of financial sector assets and, correspondingly, the value-added contribution of the financial sector, is expected to increase. However, while there is a fundamental relationship between the growth of the financial sector and the real economy, the relationship is not well-understood or captured in current macroeconomic models. This creates a potential challenge for policymakers to determine the point at which growth of the financial sector may be outstripping the demands and the potential of the real economy. This issue has become even more pronounced with greater

regional and global financial integration, and in countries that are also international financial centres. To the extent that corporate and personal income growth is driven by financial transactions rather than by an increase in production or employment growth, economies become potentially more vulnerable to the consequences of financial system stress.

The recent global financial crisis provides a distinct example of how excessive leverage and exponential growth in financial activities that are detached from the growth trajectory of the real economy can become a source of instability. Leverage increased sharply in the years leading to the crisis, buoyed by years of strong economic growth. In the advanced economies, bank balance sheets exploded, growing to multiples of annual GDP. For example, in the case of Iceland, the three largest banks that were nationalised in early October 2008 had seen their total assets expand from 100 percent of GDP in 2004, to more than 900 percent of GDP as at end-2007. Similarly in Ireland, assets in their financial institutions with substantial domestic businesses were more than 400 percent of GDP by 2008, while in the United Kingdom, bank assets were more than 500 percent of GDP prior to the global financial crisis. The sheer size, complexity and leverage in the banking system increased the fragility of financial institutions and limited their ability to absorb even small losses, thereby resulting in widespread and deep economic dislocations.

This expansion of financial activities was also in part due to the activities in the shadow banking system, which in the United States, grew to be even larger than the traditional banking sector in gross terms. At the height of the crisis, the size of gross amounts outstanding of over-the-counter (OTC) derivatives globally was estimated at over 614 trillion US dollars[1], more than ten times global GDP. Despite its size, the over-the-counter market was opaque and inadequately regulated, making it more difficult to quantify the risk that had been assumed by the financial institutions.

A further issue relates to financial innovation and for policy interventions not to stifle those innovations that are beneficial to society, while reining in those that are harmful. The current debate on the international financial reforms continues to reveal that this is a challenging task. While there is wide support for a return to basic banking, it is also acknowledged that financial innovations have been instrumental in improving financial access levels, by enabling financial institutions to manage risks in ways that have allowed for higher-risk economic activities to be undertaken. Contrary evidence, however, also exists. In the run-up to the crisis, derivatives were extensively used to arbitrage regulatory requirements and to extract excessive profits through opaque and complex transactions that resulted in the fundamental mispricing of risk. Current reform efforts are therefore confronted with the need to strike a balance between constraining harmful practices, without restricting innovation that is key to a progressive financial system.

Another issue relates to the prospect for aligning the expectations of capital providers with the imperatives of sustainable banking. In the years preceding the crisis, the growth of the financial system substantially exceeded that of the overall economy. Published data[2] indicates that the balance sheet of the world's largest 1000 banks increased by about 150 percent between 2001 and 2009. At its peak, the scale of the assets of the financial sector far exceeded those in other sectors, with record profits reported from year to year. In the current environment, banks continue to remain under considerable pressure to support activities that generate the kind of rates of return that capital providers have come to expect from the industry. This runs counter to expectations for banking to be returned to its fundamental role of supporting real economic activity. The extent to which these conflicting imperatives can be reconciled in a sustainable manner remains unclear.

A focal point of the reforms has been to protect retail banking from the vagaries of investment banking that often has involved higher risk-taking activities. In the United States, the Volcker Rule prohibits banks from carrying out certain types of investment banking activities if they wished to continue to rely on deposit funding. In a similar vein, in the United

[1] As at December 2009. BIS Quarterly Review Statistical Annex, June 2010, Table 19.
[2] The Banker publication

Kingdom, the adoption of the recommendations by the Independent Commission on Banking mandates banking groups to establish a separate subsidiary for their retail activities, and it prohibits the subsidiary from undertaking other businesses and risks. Solutions to these challenges are far from straightforward. While these and other reforms by the Basel Committee and the Financial Stability Board are expected to have far reaching implications for the landscape of the financial system as we know it today, they have yet to provide answers to many of the key questions that policymakers and the financial industry need to address in the pursuit of effective functioning and sound financial systems as we progress forward into the future.

Since the global financial crisis, significant attention has been directed at evolving an effective macro-prudential policy framework, which can serve to rein in excesses and strengthen the nexus between finance and the real economy. The concept of macro-prudential policies is hardly new and can be traced back to as early as the late 1970s, in reference to the macroeconomic and financial stability implications from the rapid pace of lending to developing economies[3]. Some emerging markets, including Asia, have, since the 1990s, deployed macro-prudential policy instruments to manage imbalances in the financial system and capital flows.

Following the recent global financial crisis, greater attention is now being focused on the role, scope, instruments and governance arrangements for macro-prudential policy to preserve financial stability. New or strengthened mandates for macro-prudential policies are being established in a growing number of jurisdictions, supported by wide-ranging changes to the legislative framework and institutional structures. Used effectively in combination with other policy tools, including micro-prudential measures and monetary and fiscal policy tools, macro-prudential policies have been demonstrated to significantly improve financial stability outcomes.

Effectively operationalising macro-prudential policy frameworks, however, remains a key challenge. By design, macro-prudential policies are intended to reduce the probability and severity of a future crisis. While further research will deepen our understanding of leading indicators and transmission channels, judgments will continue to have a key role. History has shown that political economic considerations have, at times, had an effect on the willingness of policymakers to act. Despite the high costs of crisis on the financial system on the economy and on the society, there is still an inherent bias towards inaction. This underscores the need for a stronger focus on creating an environment in which policymakers will have the confidence to act. This requires a strong mandate, sufficient policy instruments, and clear accountability structures.

While macro-prudential policy has a clear and important role in contributing towards financial stability moving forward, it does not however diminish the important role of micro-prudential supervision. Indeed, the notion that more developed macro-prudential policy frameworks can, over time, provide a credible alternative to the close supervision of systemic financial institutions - for example, through the development of better predictive macro indicators, or through reliance on recovery and resolution plans alone - is misplaced. There can be no substitute for the effective ongoing supervision of financial institutions, which relies on supervisory assessments and judgments, and enhances the understanding of firm behaviours in a manner that models and plans, no matter how sophisticated, will never be able to fully achieve. Efforts should therefore also be accorded towards further strengthening the conduct of micro-prudential supervision and promoting the complementarities between micro- and macro-prudential policies.

Let me now turn my remarks to the growing role and relevance of Islamic finance in contributing to the global agenda of fostering sustainable growth that is firmly anchored to the real economy.

[3] Based on the article entitled “The term ‘macro-prudential’: origins and evolution” published in the BIS Quarterly Review March 2010, which contains excerpt of the unpublished minutes of a meeting of the Cooke Committee (the precursor of the present Basel Committee on Banking Supervision)

The core proposition of Islamic finance draws from its inherent features and the values that it brings to the economy, and the tremendous potential that it offers in supporting sustainable economic growth and in safeguarding financial stability. These core propositions are derived from the Shariah, which dictates that Islamic financial transactions must be supported by underlying productive activities. This Shariah ruling ensures a close link between financial transactions and the real economy. Innovation and intermediation in Islamic finance are thus aligned to generating productive economic activities. There is also strong discouragement against excessive risk undertakings and a prohibition against speculative elements. These rulings also serve to insulate the Islamic financial system from excessive leverage, which in turn contributes towards promoting financial stability and its long-term sustainability. These fundamental elements resonate with the call for banking to focus on its core function of providing financial services that add value to the real economy.

This recent decade has also witnessed a dramatic transformation of the Islamic financial landscape. It has been marked by sustained rapid growth and the widening of its geographical reach, resulting in more diverse Islamic financial institutions and the generation of a wide spectrum of innovative products, particularly in the high-growth segment of the sukuk market. In this decade, Islamic finance has also evolved from being domestic-centric to become increasingly internationalised. In this dynamic environment, the scope of the Islamic finance business has expanded from simple retail and trade financing to include private equity, project finance, sukuk origination and issuance, as well as fund and wealth management products. Today, the total global size of the Islamic financial assets has surpassed more than 1 trillion US dollars. There are now more than 600 Islamic financial institutions operating in 75 countries.

The vision for the Islamic financial system in Malaysia was articulated in our first Financial Sector Masterplan that was launched in the year 2001, in which the plans for building the foundations for the Islamic financial system were outlined. This included strengthening and diversifying the financial intermediaries in the financial system, building and developing the financial markets, and enhancing the regulatory supervisory, Shariah and legal framework. Ten years later, in 2011, a new Financial Sector Blueprint was launched, charting the path for Islamic finance to transition to become increasingly internationalised, and thus to become more integrated into the mainstream of the global financial system.

Whilst Islamic finance has all the ingredients and the potential to meet the needs of the global economy, the channelling of funds to productive activities in Islamic finance today is still largely being carried out through non-participatory contracts, that includes the mark-up sale (Murabahah) and the lease-based (ijarah) structures, which continue to remain essential to cater for financing trade and the purchase of assets. Such contracts are similar to lending instruments which expose the Islamic financial institutions mostly to credit risk elements. Whilst non-risk-sharing contracts will continue to contribute to the future growth of Islamic finance, the wider use of risk-sharing transactions and undertakings under participatory finance models have significant scope in evolving a broader representation of Islamic financial products that will spur the next phase of industry growth and development. This includes participatory or equity-based contracts such as Mudarabah and Musharakah that support ventures involving entrepreneurship endeavours. Greater use of equity-based models in Islamic financial solutions has been observed in the more recent period. This has been most evident in the sukuk segment, with Shariah structures evolving from predominantly ijarah and murabahah structures to musharakah partnerships as well as convertible and exchangeable trusts.

The further development of participatory Islamic finance contracts on a broader scale offers particular potential in efforts to reinforce links between finance and the real economy. Several elements of risk- and profit-sharing participatory contracts support this. As profit-sharing and loss-bearing are clearly identified and agreed based on the contractual agreements between the financier and the entrepreneur, strong emphasis is placed on the value creation and

economic viability of productive efforts that create new wealth. In equity-based contracts, the financial intermediation is thus also directed towards promoting entrepreneurship, in that the clearly defined risk- and profit-sharing characteristics of the Islamic financial transaction provides strong incentives for both parties to contribute to the success of the investment. This also provides the foundation for a long-term trust-based relationship, and a clear interest for the financial institutions to undertake the appropriate due diligence to ensure that the returns are commensurate with the risks being assumed. Aspects of governance and risk management thus strongly underpin these contracts. In particular, such contracts demand higher standards of disclosure and transparency to be observed, which in turn act to strengthen market discipline.

The legal, regulatory and supervisory framework will need to be adjusted to accord greater clarity to the appropriate legal and regulatory treatment in order to foster the sound and orderly growth of risk-sharing structures and activities, both in terms of the funding and the assets-side of Islamic banks. In Malaysia, steps are currently being taken to provide a conducive enabling environment for this next phase of development that will spur more risk-sharing transactions though the formulation of new legislation for Islamic banking and takaful. This legislation is now at the final stages of the process of its enactment. This new law for the industry is aimed at promoting certainty to the legal and regulatory treatment of Islamic financial transactions by providing legal recognition to the contractual requirements in accordance with the Shariah. This provides a comprehensive legal environment under which effective risk and profit sharing activities can take place, encompassing all aspects of Islamic financial transactions, from its prudential and business conduct requirements to the legal treatment of Islamic banking assets upon its resolution, to be fully consistent with the distinctive elements of the respective Shariah contracts employed in these transactions.

This legal framework will also further enhance the capacity of the regulatory and supervisory framework for the Malaysian Islamic finance industry to evolve in greater alignment with the international regulatory and the supervisory standards and best practices issued by the Islamic Financial Services Board (IFSB) to govern the specificities of Islamic financial transactions. To complement the efforts to strengthen the regulatory law for Islamic finance, Malaysia has also established the Law Harmonisation Committee in 2010 to undertake objective reviews on other relevant laws and recommend legislative changes to ensure that the laws in the country would allow for Islamic financial transactions to take place effectively and efficiently.

Another important dimension in fostering the further development of risk and profit sharing instruments is the need to ensure the institutional soundness of the Islamic financial institutions and their enhanced ability to assess risks in the real sector. This underscores the imperative of robust risk management capabilities to manage new risks peculiar to risk and profit sharing contracts and the adoption of strong governance, transparency and disclosure practices within the Islamic financial institutions to meet the due diligence requirements for determining the viability of business and investment proposals.

Business risks of equity positions and ownership risks of underlying assets are, for example, embedded in these arrangements arising from the contractual relationships between the investors and entrepreneurs as well as the Islamic banking institutions as the intermediary of funds. Further in-depth applied research is also needed to develop more innovative financial products using risk and profit sharing structures with the corresponding development of risk management techniques. This also needs to be reinforced by enhanced consumer protection and education initiatives to deepen the understanding and awareness of consumers on the associated risks and rewards in the Islamic financial contracts, in particular for equity-based instruments.

Equally important in ensuring the institutional soundness of Islamic financial institutions is the need for robust liquidity management. Today, Islamic financial institutions operating in the different jurisdictions are still confronted with the challenge of managing their liquidity

positions effectively, given the limited supply of high quality Shariah-compliant liquid instruments being the reason most commonly cited. The lack of high quality liquidity instruments for Islamic finance is not only constraining effective liquidity management, but it is also affecting the efficient cross-border diversification of financial flows. It is therefore our hope that through the mandate of the International Islamic Liquidity Management Corporation (IILM) in issuing high-quality liquid sukuks, it will contribute to promoting more efficient cross-border liquidity management by Islamic financial institutions whilst facilitating Islamic financial institutions in meeting the international requirements on liquidity.

Let me conclude my remarks. Whilst the evolution of the global financial landscape is currently being shaped by the need to return finance to its basic functions of serving the real economy, several critical questions remain, the answers to which will continue to have an important bearing on the global agenda to build sound and resilient financial systems that promote sustainable growth. In particular, determining the appropriate size of a financial sector relative to its economy before it becomes a risk to overall financial system and economic stability; promoting conditions that ensure that financial innovation is beneficial to the economy; and enhancing prospects for aligning expectations of capital providers with more sustainable banking strategies present significant policy challenges that will continue to occupy the attention of policymakers going forward.

The global community has made some important strides, but more work remains to achieve an appropriate balance between preserving safety and soundness of the financial system and allowing financial institutions and markets to perform their intended functions. We are not without policy options. The role of macro-prudential policy and the developments in Islamic finance have gained greater prominence in terms of their potential to improve financial stability outcomes, and most notably by the vital contribution that they make towards restoring the foundations for finance that supports sustainable economic growth, and bringing with it immense benefits to the real economy and to the well-being of society.

CALENDAR OF EVENTS
October – December 2012

22 October 2012

The Bank announced the issuance of the Shariah Standard on Mudarabah to all Islamic financial institutions under its purview. The issuance of the Shariah Standard on Mudarabah marks an important milestone and is part of the Bank's continuous efforts to enhance the Shariah and regulatory framework in Malaysia. The standard would serve as guideline for the Islamic financial institutions in developing Islamic financial products and services based on Mudarabah. The Shariah Standard on Mudarabah is the second in the series of Shariah Standard (formerly known as Shariah Parameters), the first being the Shariah Standard on Murabahah.

30 October 2012

The Bank and the Securities Commission Malaysia (SC) signed a Memorandum of Understanding (MOU) to enhance joint regulatory oversight. This MOU builds on and further strengthens the MOUs signed by the Bank and the SC in 2002 and 2007 and it takes into account the changing financial landscape and the new international regulatory regime.

The MOU provides for an enhanced scope of collaboration and cooperation between the Bank and the SC, focusing on common areas of interest that are important to promote financial sector and capital market stability. These includes managing threats to financial stability and systemic risk, including supervision of financial groups, management of financial crisis, supervision of money markets and derivatives market, combating threats relating to money laundering and terrorism financing and supervision of auditors of financial institutions.

5 - 9 November 2012

The Bank and the International Finance Corporation (IFC) jointly organised the 4th Credit Reporting and Risk Management Training Workshop. More than 150 regulators, central bankers as well as credit reporting and finance professionals from around the world attended the workshop to promote best practices on credit reporting, scoring, modelling, risk management as well as reform of credit reporting systems.

The Bank shared its experience on the Central Credit Reference Information System (CCRIS) which has contributed towards greater responsible lending decisions, as reflected by Malaysia's number one ranking for five consecutive years in terms of Ease of Getting Credit, in the Doing Business Report, published jointly by the International Finance Corporation and the World Bank.

5 - 6 November 2012

The Bank and the Irving Fisher Committee on Central Bank Statistics jointly organised a two-day workshop on Financial Inclusion Indicators at Sasana Kijang, Bank Negara Malaysia. The workshop brought together financial inclusion policy makers and statisticians across the globe to attain greater convergence on issues related to measurements and indicators.

The workshop was also attended by representatives from International Monetary Fund, World Bank, Global Partnership for Financial Inclusion, Consultative Group to Assist the Poor, Alliance for Financial Inclusion and the International Finance Corporation where the role of financial institutions in overall economic development were deliberated.

This was followed by the National Statistics Conference (MyStats 2012) jointly organized by the Bank and the Department of Statistics Malaysia (DOSM). Entitled "Enhancing National Statistics to Meet Public and Private Sectors Needs during a Period of Transformation" it provided a platform for statisticians, analysts, economists, policy makers, academicians and the media to share, discuss and highlight statistical issues in analysis and policy formulation as well as challenges in the compilation and communication of statistics.

7 November 2012

In her keynote address at the 19th ASEAN Banking Conference 2012 at Kuala Lumpur, entitled "ASEAN: Towards a more integrated market", Governor Dr. Zeti highlighted the importance of the increased momentum to achieve an ASEAN Economic Community (AEC) by 2015, as we draw closer. This is notably by achieving increased financial integration, higher levels of intra-regional trade and greater two-way cross-border investment flows. She also emphasised on the role of banking sector as a crucial driver for greater financial integration within the core of ASEAN financial systems.

8 November 2012

At its final meeting for 2012, the Bank's Monetary Policy Committee (MPC) decided to maintain the Overnight Policy Rate (OPR) at 3.00 percent. In its assessment, the MPC stated that the global economy is expected to continue to experience slow growth with uncertainties surrounding the growth prospects of the advanced economies. However, despite the weaker external demand, growth in the regional economies remains supported by domestic demand.

On the Malaysian economy, the MPC added that domestic activity has offset the weakness in the external sector. While inflation may increase in 2013, it is expected to remain modest given the excess capacity in the economy with global energy and commodity prices also likely to be contained given the weak global conditions. Upside risks to inflation could, however, emerge in the event of supply disruptions that could result in higher global prices for commodities. The meeting also approved the schedule of MPC meetings for 2013.

12 November 2012

The Bank of Korea hosted the third meeting of the Financial Stability Board (FSB) Regional Consultative Group for Asia in Seoul, Korea, co-chaired by Governor Choongsoo Kim, Bank of Korea and Governor Zeti Akhtar Aziz, Bank Negara Malaysia.

The group deliberated on the short-term and long-term implications on financial stability and financial infrastructure in Asia following prolonged uncertainties in sovereign and financial sector issues in Europe and United States. The developments in macroprudential policy tools and potential challenges associated with their use in Asia were also discussed.

16 November 2012

During the press conference at the release of third quarter 2012 GDP, the Bank announced that the Malaysian economy grew by 5.2% in 3Q 2012 (2Q 2012: 5.6%), amid the challenging global economic conditions. Domestic demand continued to support growth, led by the favourable performance of private consumption and private and public investment. On the supply side, growth in services sector expanded further while manufacturing sector slowed and mining sector contracted. The headline inflation rate moderated to 1.4% in the third quarter (2Q 12:1.7%), reflecting lower inflation in the transport, recreation services and culture and miscellaneous goods and services categories.

11 December 2012

In her speech at the Euromoney-Qatar Conference, entitled “Global Financial Stability and the Internalisation of Financial Systems in Emerging Economies”, Governor Dr. Zeti highlighted the significant benefits from internationalization of financial systems while at the same time to be fully aware on the need to manage risks and challenges it entails.
In transition to a more internationalised financial system, she shared Malaysia’s gradual and sequenced approach. This was to ensure that the necessary preconditions were in place so that the benefits of increased financial internationalisation would be realised, while ensuring that the associated risks inherent to a more open economy and internationally integrated financial system could be effectively managed.

19 December 2012

In her speech at the Islamic Development Bank (IDB) Regional Lecture Series on Islamic Economies, Finance and Banking, entitled “Finance and the Real Economy: Fostering Sustainability” in Jakarta, Indonesia, Governor Dr. Zeti highlighted there has been weakening of the link between financial intermediation and productive economic activity in recent decades. Deregulation, innovation and extended period of low interest rates incentivized greater risk-taking, leading to dangerous build-up of financial imbalances.

She added this has prompted a rethinking of the issues related to the financial business and its models, and wide-ranging regulatory reforms by the international community. Significant attention has been directed at evolving an effective macro-prudential policy framework, which can serve to rein in excesses and strengthen the nexus between finance and the real economy. Finally, she emphasized on the growing role and relevance of Islamic finance in contributing to the global agenda of fostering sustainable growth that is firmly anchored to the real economy.

28 December 2012

The Bank announced, with effect from 1 January 2013, all commercial banking institutions are required to adopt standardised documentation for conventional housing loan and home financing agreements involving a principal sum of RM500,000 and below. The primary objective of this initiative is to enhance borrowers’ understanding and comparability of the key terms and conditions of the loan agreements, including the responsibilities and obligations of borrowers and financiers under such agreements.