BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

SIARAN AKHBAR

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PRESS RELEASE

The Malaysian Economy in 2009

Despite a severe contraction in the first half of the year, the Malaysian economy contracted by only 1.7% as recovery strengthened in the second half of the year. Given the high degree of openness of the Malaysian economy, the deterioration in external demand had a significant impact on employment, income and overall business and consumer sentiments. Growth for the Malaysian economy turned negative in the first three quarters, with the economy contracting markedly by 6.2% in the first quarter. The swift implementation of the fiscal stimulus measures and the monetary policy easing that was reinforced by measures to ensure continued access to financing, contributed to the stabilisation of the domestic economy in the second quarter, and the subsequent recovery in the second half of the year. As a result, the Malaysian economy regained its growth momentum in the fourth quarter, to grow by 4.5%, with strengthened domestic and external demand contributing to growth.

In the first quarter of 2009, **aggregate domestic demand** contracted by 2.9% as households and businesses became cautious following a significant deterioration in external demand, weaker labour market conditions and an overall decline in private sector sentiments. Conditions, however, began to stabilise in the second quarter. Private consumption improved gradually and was supported by a rebound in consumer sentiments, stable employment prospects, low inflation and favourable financing conditions. The significant easing of monetary policy and the implementation of fiscal stimulus measures began to have a positive effect on growth in the second-half of the year. As a result, domestic demand grew 1.7% in the second half of 2009, bringing the overall aggregate domestic demand for the year to be approximately flat at -0.4% (2008: +6.8%).

Real GDP by Expenditure Components (% change)

	2008	2009*p*
Domestic Demand[1]	**6.8**	**-0.4**
Private sector expenditure	7.0	-3.4
Consumption	*8.5*	*0.8*
Investment	*0.8*	*-21.8*
Public sector expenditure	6.3	7.7
Consumption	*10.9*	*3.7*
Investment	*0.7*	*12.9*
Net exports of goods and services	**-3.5**	**8.4**
Exports	1.3	-10.1
Imports	1.9	-12.5
Real GDP	**4.6**	**-1.7**

[1] Excluding stocks

p Preliminary

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On the **supply side**, growth in the first quarter was particularly affected by a sharp decline in the manufacturing sector following the significant deterioration in external demand. Other sectors, with the exception of construction, also contracted. The services sector recorded a marginal decline in the first quarter due mainly to contractions in the sub-sectors related to manufacturing and trade. From the second quarter, however, the services sector gradually improved, with growth emerging from the services sub-sectors that are dependent on domestic economic activity, as well as finance and capital market-related activities. The manufacturing sector recorded positive growth in the fourth quarter following the recovery in external demand. Growth of the construction sector had remained positive throughout the period due primarily to the implementation of construction-related projects under the Ninth Malaysia Plan (9MP) and the fiscal stimulus measures.

Real GDP by Sector (2000=100)

	2008	**2009*p***
	Annual change (%)	
Agriculture	4.0	0.4
Mining & quarrying	-0.8	-3.8
Manufacturing	1.3	-9.3
Construction	2.1	5.7
Services	7.2	2.6
Real Gross Domestic Product (GDP)	**4.6**	**-1.7**

P Preliminary
Source: Department of Statistics, Malaysia

Conditions in the **labour market** weakened in the first quarter as firms in the manufacturing sector that were affected by the crisis, scaled back some of their operations. Labour market conditions, however, stabilised in the second quarter and improved thereafter as retrenchments declined and firms started to hire workers again. For the year, the unemployment rate stood at 3.7%, lower than the initial forecast of 4.5%.

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Headline inflation averaged 0.6% in 2009 as inflationary pressures in Malaysia moderated substantially, in line with global developments. The marked decline in headline inflation was driven by supply-related factors and the subdued demand conditions.

Inflation and Unemployment

	2008	2009
Inflation (% change)		
CPI (2005=1000)	5.4	0.6
Core CPI	4.0	2.7
Unemployment (% of labour force)	3.7	3.7

Malaysia's **external position** remained strong in 2009 despite the extremely weak external environment. During the year, the current account remained in surplus, supported by a sizeable trade surplus and improvements in the services account. Despite the significant deterioration in gross exports, particularly in the first half of the year, the trade surplus remained large as lower demand for exports was also accompanied by a decline in imports. In the financial account, lower net outflows were recorded, reflecting the significant moderation in portfolio outflows in the first half of the year and the net inflows in the second half of the year. As the current account surplus more than offset the net outflows on the financial account, the overall balance of payment recorded a surplus in 2009.

In 2009, **net international reserves** of Bank Negara Malaysia increased by RM13.8 billion to RM331.3 billion (equivalent to USD96.7 billion) as at 31 December 2009. The increase in reserves was mainly supported by the continued surplus in the current account. Net foreign portfolio inflows in the second half of the year also contributed to the increase in net international reserves. As at 15 March 2010, reserves amounted to RM331.7 billion (equivalent to USD96.8 billion). This level of reserves is adequate to finance 9.2 months of retained imports and is 4.3 times the short-term external debt.

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Monetary and Financial Conditions in 2009

In the first three months of 2009, **international financial markets** went through a period of turbulence amidst a severe global recession. Financial market conditions subsequently stabilised in the second and third quarters. By the fourth quarter, global economic and financial conditions recovered as the expansionary impact of the large fiscal and monetary stimulus led to a revival of growth. Domestic monetary and financial conditions, continued to remain favourable and supportive of economic activity despite being subjected to adverse global economic and financial shocks arising from the financial crisis. Prompt policy responses and the resilience of the banking sector and capital market ensured that the financial intermediation process continued to function effectively and smoothly.

In 2009, **monetary policy** was confronted with the heightened risk to growth arising from the global economic and financial crisis. In early 2009, the economy was severely affected by the steep decline in exports and private investment activity, following the contraction in global demand. With inflation decelerating, Bank Negara Malaysia frontloaded its monetary policy stimulus by reducing its Overnight Policy Rate (OPR) by a total of 150 basis points between November 2008 and February 2009 to 2.00 percent to cushion the economy from a rapidly weakening global economy. Additionally, to ensure greater transmission from the policy rate to retail lending rates, the statutory reserve requirement (SRR) was also concurrently reduced by 300 basis points.

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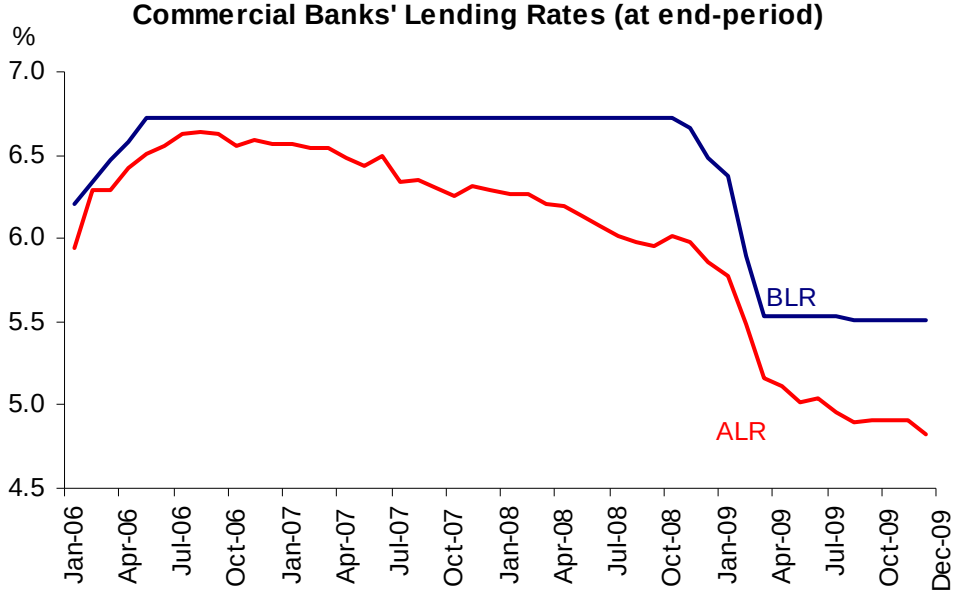
For the rest of the year, Bank Negara Malaysia left the policy rate unchanged with the view that the cumulative monetary policy measures were sufficient to provide support to domestic demand. The strong financial system and well-functioning monetary transmission process delivered the impact of the monetary policy stimulus to the economy effectively. Reflecting the high pass-through of the OPR reduction to money market interest rates, banks responded by lowering retail lending rates to households and businesses. With the re-pricing of new and existing loans, the average lending rates on loans outstanding declined to a historic low of 4.83% as at end-2009.

The easing of monetary policy was complemented by other measures designed to reach specific sectors of the economy. Ensuring continued access to financing was a key policy priority. During the year, Bank Negara Malaysia and the Government implemented several measures to ensure the continued flow of financing to the various segments of the economy. These measures included the setting up of several special funds for the small and medium enterprises (SMEs) and the establishment of Danajamin Nasional Berhad to provide financial guarantees for the issuances of PDS and Sukuk by financially viable companies. Avenues for individuals and businesses for debt restructuring were also established.

Commercial Banks' Lending Rates (at end-period)



Source: Bank Negara Malaysia

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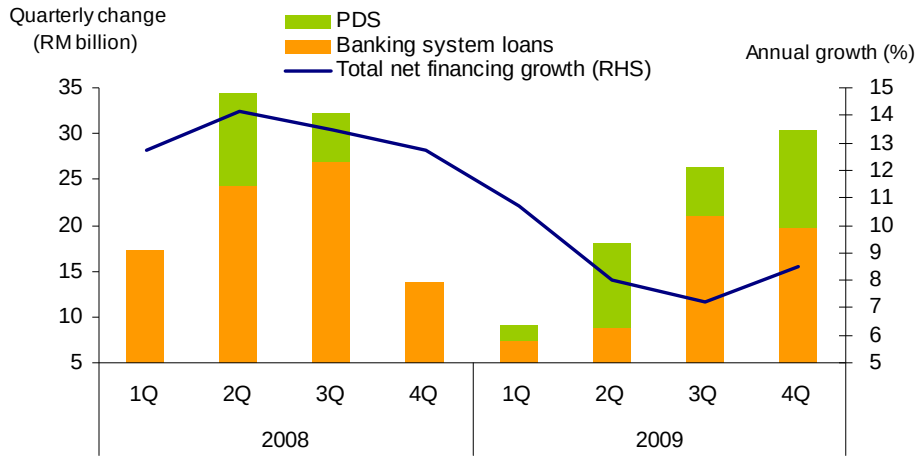
As a result of the policy measures, overall financing conditions in 2009 remained conducive and supportive of economic activity. Private sector financing grew at a slower pace in the early part of the year, in line with the general weakness in the economy. In the second half of the year, financing began to gain momentum underpinned by lower lending rates and the extensive measures put in place to ensure continued access to funds for all sectors of the economy. For the year as a whole, **net financing** to the private sector raised through banking system loans and private debt securities (PDS) rose by 8.6% (2008: 12.7%).

Total net financing to the private sector through Banking System Loans and PDS



Loans extended to households were higher, largely driven by the lower cost of borrowings and the availability of financing in a competitive environment. Household financing were further supported by improvements in consumer sentiments and labour market conditions towards the second half of the year.

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Financing to the business sector grew at a more moderate pace during the year. Demand for financing from businesses was lower as businesses scaled back their operations and postponed their expansion plans. Nevertheless, demand for financing by businesses improved from the second quarter. For the year as a whole, net financing extended to the business sector through the banking system and the PDS market increased by 6.3% (2008: 12.8%). Meanwhile, loans to the SMEs extended by the banking system and DFIs, excluding companies that have graduated from the definition of SME, increased by 5.1% in 2009. At the end of the year, SME loans outstanding accounted for 40% of total business loans of the banking system and development finance institutions (DFIs).

The performance of the **ringgit** during the year was influenced by developments in the international financial markets. Early in the year, the ringgit weakened as foreign investors sold off domestic assets to deleverage. The depreciation, however, was partly mitigated by proceeds from Malaysia's trade surplus. In March 2009, the trend reversed due to both external and domestic factors. Expansionary measures to offset the economic downturn globally helped to improve investor sentiments and risk appetite and shifted their focus to the more positive growth prospects of the regional economies. Large portfolio inflows were channeled into the emerging markets including Malaysia. The ringgit also benefited from positive market reaction to the second stimulus package announced by the Government on March 10. Between mid-October to December 2009, the ringgit exhibited greater fluctuations as investors remained cautious. The fluctuations were also driven by investor reaction to various external developments, such as the imposition of capital controls in Brazil and Taiwan as well as potential systemic impact of the debt crisis in Dubai and the sovereign debt issue of Greece. To date in 2010, the ringgit has appreciated in the range of 0.1% to 10.8% against the regional and major currencies.

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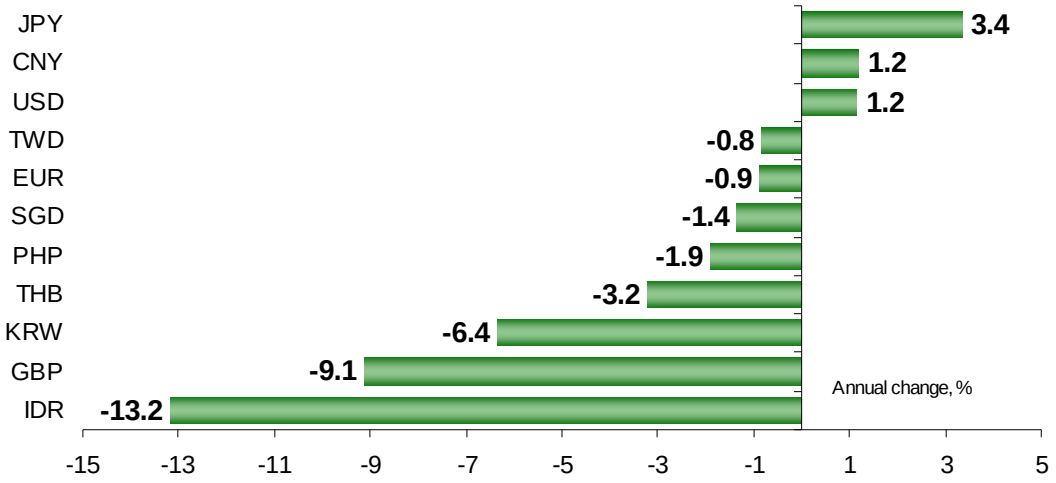
Summary of Malaysian Ringgit Performance against Major and Regional Currencies in 2009



Note: (+) indicates an appreciation of the ringgit against foreign currency
Source: Bank Negara Malaysia

Sovereign **bond yields** were relatively stable for the most part of 2009. Malaysian Government Securities (MGS) yields initially rose following concerns over the large increase in the issuances of Government bonds. Yields, however, remained generally stable for most of the year as economic conditions improved amid a benign inflation outlook. Private debt securities (PDS) yields were affected by investors' increased risk aversion. Concerns over credit conditions in particular influenced the yields of lower-rated PDS. Sentiments in the PDS market began to improve in the second half of the year, partly due to the establishment of Danajamin Nasional Berhad, a financial guarantee institution that provides credit guarantees to financially viable issuers. The domestic **equity market** experienced significant volatility in the early part of the year amid heightened uncertainties in global financial markets. Despite the initial decline, the market rebounded from the second quarter onwards, as investors risk appetite improved. For the year as a whole, the FBM KLCI rose by 45.2% (2008: -39.3%).

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Outlook for the Malaysian Economy in 2010

The Malaysian economy is projected to grow by 4.5% - 5.5% in 2010, underpinned by strengthening domestic demand and an improving external environment. Growth is expected to be driven by greater private sector activity and robust external demand from the regional countries. The underlying strong fundamentals, the healthy private sector financial position and a strong financial system, will provide support for a private sector-led recovery. Additionally, the supportive monetary environment, including continued access to financing will foster recovery in private sector activity.

Domestic demand, led by the private sector is expected to be the key contributor to growth in 2010. Further expansion in private consumption will be supported by favourable domestic conditions, including the improvements in the labour market, rising disposable incomes and sustained consumer confidence. Private investment is also expected to gradually recover in 2010. In addition, the recovery in the global economy, in particular the more robust expansion in the regional countries, will provide an important impetus to growth in 2010. The strengthening of **external demand** will have positive spill-over effects on the broader economy in terms of employment, production activity and overall business and consumer sentiments, thus supporting greater private consumption and investment.

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Real GDP by Expenditure Components (2000=100)

	2010*f*	
	Annual change (%)	Contribution to real GDP growth (percentage point)
Domestic Demand[1]	**3.2**	**2.8**
Private sector expenditure	3.3	2.1
Consumption	*3.8*	*2.0*
Investment	*0.7*	*0.1*
Public sector expenditure	2.7	0.7
Consumption	*-2.7*	*-0.4*
Investment	*9.3*	*1.1*
Change in stocks		**4.5**
Net exports of goods and services	**-18.6**	**-2.7**
Exports	7.7	8.3
Imports	11.7	11.0
Real Gross Domestic Product	**4.5 ~ 5.5**	**4.5 ~ 5.5**

[1] Excluding stocks

f Forecast

On the **supply side**, most economic sectors are expected to record a better performance in 2010 as domestic demand strengthens and external demand improves. The manufacturing and mining sectors are expected to record positive growth as external demand for major products such as electronics, crude oil and natural gas recovers. The services sector will remain a key contributor to overall GDP growth, with growth expected to be broad-based.

The agriculture sector is also projected to register higher growth as demand from the major export markets for industrial crops improves with better economic prospects in 2010. Meanwhile, the construction sector is expected to sustain its growth, as it benefits from the continued implementation of the remaining projects under the second stimulus package and the Ninth Malaysia Plan.

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Real GDP by Sector (2000=100)

	2009*p*	**2010*f***
	Annual change (%)	
Agriculture	0.4	3.1
Mining & quarrying	-3.8	2.5
Manufacturing	-9.3	6.5
Construction	5.7	3.7
Services	2.6	4.9
Real Gross Domestic Product (GDP)	**-1.7**	**4.5 ~ 5.5**

p Preliminary
f Forecast

Source: Department of Statistics, Malaysia
Bank Negara Malaysia

Labour market conditions are expected to improve further in 2010, with the unemployment rate projected to decline to 3.6% of the labour force. Based on Bank Negara Malaysia's survey, most firms in the manufacturing, services and construction sectors plan to increase employment and provide a higher salary increment in 2010, in line with the expected recovery in global and domestic economic activity.

On the **external front**, the current account surplus is projected to remain sizeable, albeit lower at 14.3% of GNI in 2010, reflecting the lower trade surplus, higher income account deficit, sustained current transfer outflows, as well as a small services account deficit. The trade surplus is expected to be lower as further expansion in exports will be partly offset by the increase in gross imports in tandem with the recovery in the manufacturing sector and the strengthening of domestic demand. On the financial account, foreign direct investment inflows and direct investment abroad by Malaysian companies are likely to increase given the improving global and domestic economic conditions.

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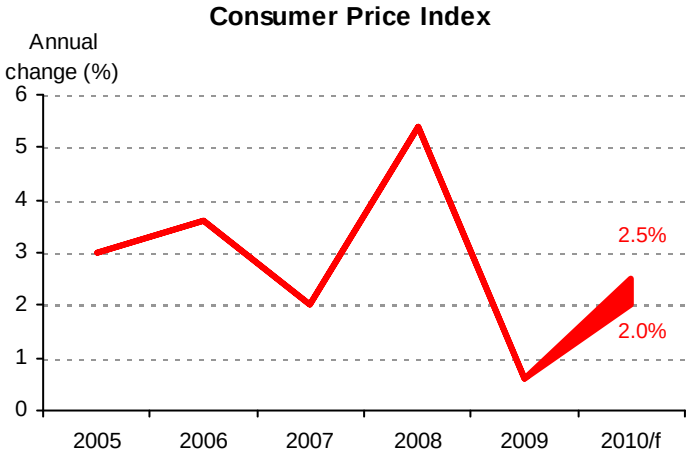
Headline inflation is expected to remain modest with average inflation of 2% to 2.5% in 2010. This reflects the improving economic conditions and the possible adjustments to the administered prices by the Government.



The projected growth of the Malaysian economy of between 4.5% and 5.5% in 2010 is based on the expectation of a gradual and uneven global economic recovery. The global economy is still facing several downside risks, including the weaknesses in the financial systems of advanced economies, the continued de-leveraging in the private sector and the fiscal stress in a number of large economies. Under these circumstances, domestic demand will be a key factor in driving growth in 2010. In this environment, policies will remain supportive of growth, in particular to ensure that private sector activity strengthens further and that the recovery is firmly established.

Economic and Monetary Management in 2010

As the Malaysian economy continues to recover in 2010, fiscal policy will remain geared towards preparing the foundation for a stronger recovery of private sector consumption and investment. Efforts by the Government to strengthen private investment and increase the participation of the private sector in the economy were reflected in the measures announced in the 2010 Budget. These include liberalisation of the economy, privatisation of Government-owned corporations, providing incentives to several high growth sectors and instituting improvements in the Government delivery system.

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To further support growth of private consumption, the Government has reduced the personal income tax and raised individual tax relief to increase the disposable income of households.

With a view towards a gradual consolidation of the fiscal position, the 2010 Budget placed emphasis on measures to improve the effectiveness and efficiency of the Government's revenues and expenditures. These measures include the restructuring of the fuel subsidy system and the intensification of the public-private partnership programme for several high impact projects. The Federal Government fiscal deficit is expected to commence narrowing in 2010. Given the ample liquidity in the domestic market, the Government will finance its fiscal deficit mainly from the domestic bond market. Apart from raising funds through the issuance of government securities, the Government will also issue an RM3 billion retail bond known as Sukuk 1Malaysia. The issuance will serve as an alternative investment avenue for Malaysians to receive a better return in an environment of low domestic interest rates.

Given that the threat of a fundamental recession has diminished, the Monetary Policy Committee (MPC) raised the OPR by 25 basis points in March 2010 as it moves toward normalising monetary conditions. Maintaining interest rates at too low a level over an extended period could encourage disintermediation, financial imbalances and excessive risk taking. Such developments can undermine the sustainability of the recovery process and reduce the longer term growth potential of the economy.

With price pressures expected to be modest going forward, monetary policy in 2010 will focus on promoting the sustainability of economic recovery and ensuring access to financing continues to be available to the private sector. Given the lingering uncertainties surrounding the future growth path of the global economy, an accommodative monetary policy stance will be maintained to support and strengthen private investment and consumption demand and thus overall economic growth.

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With the economy no longer being confronted by the threat of a fundamental recession, monetary and fiscal policies would continue to be supportive of the economy, while at the same time ensuring that financial imbalances do not develop in the economy. Altogether, the policy measures, the strong economic and financial fundamentals, augur for a stronger recovery of the Malaysian economy in 2010.

Bank Negara Malaysia's Audited Financial Statements for 2009

Bank Negara Malaysia's financial position and its operations in 2009 have been examined and certified by the Auditor General. Total assets of Bank Negara Malaysia stood at RM363 billion as at end-2009 (end-2008: RM344.5 billion). Bank Negara Malaysia registered a net profit of RM7.7 billion for the financial year ended 31 December 2009 and declared a dividend of RM2 billion to the Government.

Bank Negara Malaysia
24 March 2010

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