DEVELOPMENTS IN THE THIRD QUARTER OF 2004

International Economic Environment

Sustained growth in major countries and regional economies, despite rising oil prices

Global economic activity remained firm in the third quarter, underpinned by strong growth in the United States (US), continued economic revival in Japan and Europe, while growth in the Asian region remained strong.

The **US** GDP growth strengthened to 3.7% in the third quarter, driven by investment and a stronger-than-expected growth in consumption (4.6%). Despite some easing in US consumer confidence due to high oil prices, major indicators such as home sales, retail sales and personal income remained strong. As inflation remained low, the Fed continued on its measured tightening of monetary policy, raising interest rates for the third time this year on 21 September by 25 basis points to 1.75%. In the **euro zone**, the 1.9% GDP growth (2Q 2004: 2%) continued to be sustained by the external sector as domestic demand remained weak. The **United Kingdom** economy remained strong, but growth has moderated following a slowdown in the industrial sector and the impact of the recent monetary tightening. Meanwhile, in **Japan**, economic growth slowed to 0.3%, supported by private consumption while exports and capital expenditure weakened.

During the quarter, global crude oil futures prices rose by about 28.1% to $49.63 by the end of September 2004. It rose further to breach the level of $50 per barrel in October 2004 (record high of $55.67 on 25 October 2004) before easing to an intra-day low of US$45.25 per barrel on 15 November. The strong oil price has been supported by geopolitical uncertainties, concerns on possible supply disruptions in both OPEC (Iraq, Nigeria) and non-OPEC (Russia) countries, and strong global demand.

Industrial Countries: Real GDP growth

	2003		2004			Key contributing factors for 3Q growth
	3Q	4Q	1Q	2Q	3Q	
	Annual change (%)					
US[1]	7.4	4.2	4.5	3.3r/	3.7	Stronger-than-expected growth in consumer spending supported growth in the 3Q.
UK	2.2	2.9	3.4	3.6r/	3.1	Growth was affected mainly by a slowdown in the industrial sector.
Germany	-0.3	0.2	1.5	1.9r/	1.3	Moderate growth, led by increase in investment spending, but weighed down by declining exports.
Japan[1]	2.3	7.6	6.3	1.1r/	0.3	Growth was driven by private consumption, while exports and capital expenditure weakened.

[1] annualised basis
r revision
Source: National authorities

In the **Asian** region, growth remained on track albeit at a slightly more moderate pace. Growth was broad based, supported by continued expansion in export and domestic demand. Nevertheless, export growth started to show signs of easing during the 3Q, reflecting largely the gradual slowdown in the global electronics cycle. Growth was led by

Regional Countries: Real GDP growth

	2003		2004			Key contributing factors for 3Q growth
	3Q	4Q	1Q	2Q	3Q	
	Annual change(%)					
P.R. China	9.6	9.9	9.8	9.6	9.1	-Continued broad-based growth with expansions in export and retail sales. -Slight moderation in 3Q growth due to administrative measures.
Singapore	1.7	4.9	7.5	12.5	7.5	-Driven by robust double-digit export growth. -Slower expansion in the manufacturing sector notably in the biomedical cluster.
Korea	2.4	3.9	5.3	5.5	4.6	-Supported by strong exports and expansion in investment.
Chinese Taipei	4.0	5.7	6.7	7.9	5.3	-Broad-based expansion led by robust export growth.
Indonesia	3.7	4.1	5.0	4.5	5.0	-Continued expansion in domestic consumption.

Source: National authorities

P.R. China, although its momentum has moderated somewhat as a result of the Government's tightening measures.

Inflation continued to trend upwards during the quarter, attributed to surging oil prices on the back of continued rising food prices which have been aggravated by the Asian bird flu epidemic, and surging oil prices. Of significance, in Hong Kong China, deflationary pressures turned around, with consumer prices recording a 0.8% increase following stronger domestic demand and higher food and petroleum prices, the first positive gain since 3Q 1998. With the exception of Singapore, where inflation fell slightly due to falling housing costs amidst weak property market conditions, inflation rose for all the other regional countries.

To contain rising inflationary pressures, Taiwan and Thailand raised interest rates during the third quarter, followed by P.R. China and India in October. The rate hike in China was also aimed at addressing the concern on overheating. However, Korea lowered interest rates in an attempt to boost sluggish domestic demand.

Going forward, global growth is expected to remain resilient despite a slight moderation amidst relatively high oil prices. Against the backdrop of improving labour market conditions, low inflation and strong growth, the Fed continued to raise interest rates at a measured pace, with another interest rate hike by 25 basis points to 2% on 10 November. In Japan, the inflation data released in September was seen to herald an end to deflation, fuelling expectations of the economy moving into inflation next year. Meanwhile, the growth prospect in the Asian region remains favourable, supported by stable employment conditions and positive consumer spending. Regional growth, however, is expected to gradually consolidate amid slower global electronics demand, strong oil prices and an upward trend in global interest rates.

Developments in the Malaysian Economy

Broad based growth across sectors

In the third quarter of 2004, growth continued to be driven by the key economic sectors, namely manufacturing, services and the primary commodity sectors. The manufacturing sector continued to register a strong growth, supported by both domestic and external demand. The activity in the services sector remained firm supported by consumption, trade and tourism-related activities, while the performance of the primary commodity sector improved during the quarter.

Quarterly GDP by Kind of Economic Activity at 1987 Prices

	2003		2004		
	3Q	4Q	1Q	2Q	3Q
	Annual change in %				
Agriculture	5.9	1.9	3.2	3.6	6.1
Mining	1.2	5.3	5.8	1.2	4.2
Manufacturing	8.3	12.2	12.7	11.9	9.9
Construction	2.4	2.7	0.6	-1.7	-3.0
Services	4.9	4.7	6.6	7.8	6.1
Real GDP (Ann. Chg.)	**5.3**	**6.6**	**7.8**	**8.2**	**6.8**
Real GDP (Preceding Chg.)	**4.3**	**2.7**	**-3.5**	**4.7**	**2.9**

Source: Department of Statistics, Malaysia

Capacity Utilisation in the Manufacturing Sector



The weaker performance of the construction sector was due mainly to slower activity in the civil engineering sub-sector.

Strong manufacturing activity

Manufacturing production continued to record a double-digit growth of 11.5% in the third quarter of 2004 (2Q 2004: 15.7%). The **manufacturing sector** continued to be the main driver of growth with value added expanding by 9.9%. Activity in the export-oriented industries was largely influenced by the global electronics trends as well as the knock-on effects on the chemical industry while growth in the domestic-oriented industries was slightly higher during the quarter, supported by strong domestic demand and higher exports. The overall capacity utilisation rate for the sector continued to remain high at 80%, with the export- and domestic-oriented industries operating at 83% and 75% respectively (2Q 2004: 85% and 74% respectively).

Production of the export-oriented industries grew by 12.3% (2Q 2004: 18.2%), influenced by the global electronics cycle,

Performance of the Manufacturing Sector

	2003		2004		
	3Q	4Q	1Q	2Q	3Q
	Annual Change in %				
Value Added (Constant Price)	**8.3**	**12.2**	**12.7**	**11.9**	**9.9**
Overall Production	**10.1**	**15.7**	**16.5**	**15.7**	**11.5**
Export-oriented industries	**11.5**	**17.7**	**19.3**	**18.2**	**12.3**
of which :					
- Electronics	14.0	30.4	34.1	33.0	26.3
- Electrical	-11.9	-3.5	-6.9	-7.7	-8.8
- Textiles & wearing apparel	0.4	-11.1	-10.8	-7.8	-13.6
- Chemicals and chemical products	20.2	22.7	16.9	18.2	7.6
- Off-estate processing	17.1	0.0	3.3	-5.9	1.5
- Rubber products	26.2	23.9	24.1	21.2	7.8
- Wood and wood products [1]	1.1	-0.9	13.9	20.9	11.4
Domestic-oriented industries	**6.0**	**8.8**	**7.6**	**7.5**	**8.8**
of which :					
- Transport equipment	-3.8	3.4	0.8	10.0	6.3
- Fabricated metal products	0.5	17.5	35.4	23.9	46.2
- Iron & steel and non-ferrous metal	13.7	13.3	6.2	9.0	-3.9
- Non-metallic mineral products	9.2	8.3	-1.2	-8.6	-4.5
- Petroleum products	-6.5	-1.2	-1.9	-5.1	11.6
- Food	15.5	7.2	7.3	7.6	-1.6
Total Manufactured Exports	**4.9**	**14.1**	**17.3**	**20.6**	**26.5**
- Electronics and electrical products	3.2	13.2	14.9	17.8	20.5
- Wood and wood products	-2.3	9.7	28.2	32.2	47.1
- Furniture & parts	3.3	18.2	14.5	14.8	24.0
- Textiles, clothing & footwear	-1.2	0.3	16.6	21.1	19.3
- Optical & scientific equipment	6.2	12.5	11.4	33.2	37.0
- Chemical and chemical products	13.9	24.4	25.2	28.0	43.5
- Petroleum products	5.2	10.5	20.0	26.0	68.1

[1] *Output of furniture and parts are not captured in the wood production data.*

which showed signs of having peaked in the second quarter of 2004, as well as the spill-over effects on related industries in the chemical cluster. Besides plastics and resins, which are related to the electronics industry, production of industrial gases in the chemical industry was in line with the performance in the production of

natural gas. Meanwhile, the resource-based industries continued to perform favourably, particularly the wood and wood products industry, supported by demand from the regional countries.

Production growth for the domestic-oriented industries was slightly higher at 8.8%, supported by strong growth in the fabricated metal products industry (46.2%), a turnaround in the beverage industry (9.5%) as well as continued expansion in the transport equipment industry (6.3%). Manufacturers in the fabricated metal products industry, particularly those producing bolts and nuts, gas and water pipes as well as steel structures for buildings and containers increased their production, responding to the strong external demand from the regional countries as well as the higher prices. Meanwhile, the transport equipment industry was supported by sustained consumer demand for passenger cars as evidenced by higher car sales and higher exports of motorcycles and scooters to the regional countries.

Underlying strength in the services sector

The **services sector** grew by 6.1% reflecting an underlying strength across the sub-sectors supported by strong consumption, tourism and trade-related activities. Higher passenger travel arising from the strong tourism activities as well as sustained growth in cargo volume contributed favourably to the transport, storage and communication sub-sector. The

Performance of the Services Sector (Value Added)

	2003		2004		
	3Q	4Q	1Q	2Q	3Q
	Annual change in %				
Intermediate Services	**6.5**	**5.8**	**7.4**	**7.8**	**6.2**
Transport, storage & communication	5.7	8.0	7.8	9.0	7.4
Finance, insurance, real estate & business services	6.9	4.6	7.2	7.1	5.5
Final Services	**3.8**	**3.9**	**6.0**	**7.8**	**6.0**
Electricity, gas & water	4.7	5.5	8.8	8.7	7.6
Wholesale & retail trade, hotel & restaurants	1.8	3.1	5.8	10.1	5.9
Government services	7.3	5.1	5.7	4.3	6.9
Other services	3.8	3.4	5.1	6.7	4.5
Total Services	**4.9**	**4.7**	**6.6**	**7.8**	**6.1**

Source: Department of Statistics, Malaysia

sub-sector was also driven by strong growth in the telecommunications industry, particularly the cellular segment, which benefited from product innovations and increased popularity in the usage of mobile data. During the quarter, cellular phone subscribers rose further to surpass 13 million, resulting in a penetration rate of 50.7% (2Q 2004: 48.5%).

Meanwhile, the wholesale and retail trade, restaurants and hotels sub-sector continued to expand by 5.9%. On a preceding basis, growth was higher at 4.5% (2Q 2004: 0.4%). Activitiy was supported by strong consumer sentiment and further reinforced by the robust increase in tourist arrivals (51.5%), particularly by big spenders from the West Asian market during their summer vacation. The finance, insurance, real estate and business services sub-sector grew by 5.5% underpinned by increased bank lending and strong insurance activities. The electricity, gas and water sub-sector expanded further to meet increased demand from all users.

Selected Quarterly Indicators in the Services Sector

	2003		2004		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Tourism-related indicators					
Hotel occupancy rate (%)	57.1	59.3	56.4	58.4	65.6
Tourist arrivals	-24.2	3.8	38.4	127.4	51.5
Total passenger traffic at all airports	3.4	10.7	10.8	44.6	15.2
Consumption-driven indicators					
Total consumption credit	11.6	11.1	11.4	13.3	14.7
Imports of consumption goods	-9.8	6.5	14.3	26.4	37.8
Total sales of passenger cars	-9.5	-11.7	-3.3	18.8	19.6
Cellular phone penetration rate (%)	41.1	43.9	46.2	48.5	50.7
Trade-related indicators					
Cargo handled (all airports)	3.7	2.9	6.6	11.3	13.7
Container cargo handled (Port Klang and PTP)	14.5	11.2	15.8	17.8	8.3
Cargo revenue (railway)	0.0	10.3	-1.2	-0.4	19.9

Source: Various sources

Higher growth in the primary commodity sector

The primary commodity sector performed favourably during the quarter, with stronger growth in both the agriculture sector (6.1%; 2Q 2004: 3.6%) and the mining sector by 4.2%; (2Q 2004: 1.2%). Growth in the agriculture sector was broad based, with all major sub-sectors, particularly palm oil, rubber, forestry, cocoa, fisheries and miscellaneous agriculture (including fruits and vegetables) recording higher production. In the mining sector, growth was due entirely to higher production of crude oil, while natural gas output declined.

In the **agriculture sector**, crude palm oil output recorded a sharp turnaround, expanding by 5.2% during the quarter (2Q 2004: -3.6%), due particularly to stronger production in Sabah and Sarawak (12.2%). Growth in the East Malaysian states was driven mainly by expansion in mature areas as well as improved yields from replanted areas. Yields, both in terms of fresh fruit bunches and oil extraction rates (OER) in these states were higher than the national average, at 5.22 tonnes per hectare and 21.17% respectively vis-à-vis the national average of 5.15 tonnes per hectare and 20.11%. The Malaysian palm oil industry achieved two historical milestones during the quarter: highest production ever recorded (September 2004: 1.49 million

Performance of the Agriculture Sector

	2003		2004		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Value Added (at 1987 prices)	**5.9**	**1.9**	**3.2**	**3.6**	**6.1**
Production[1]					
Of which:					
Crude palm oil	15.2	5.4	2.5	-3.6	5.2
Crude palm kernel oil	20.6	3.4	3.7	-10.9	-3.5
Rubber	6.1	12.4	23.4	32.9	23.1
Cocoa beans	-56.8	-42.0	-33.5	-8.5	17.7
Exports (RM million)	**28.1**	**14.8**	**13.8**	**11.4**	**4.2**
Of which:					
Palm oil					
('000 tonnes)	36.1	0.7	5.1	-12.7	-14.0
(RM/tonne)	7.3	10.6	6.5	16.9	5.9
(RM million)	46.0	11.4	11.9	2.1	-8.9
Palm kernel oil					
('000 tonnes)	80.9	42.4	35.4	20.4	-39.9
(RM/tonne)	-1.9	10.3	27.8	61.6	55.9
(RM million)	77.4	57.0	73.1	94.5	-6.4
Rubber					
('000 tonnes)	-6.7	9.7	23.4	12.1	15.7
(Sen/kilogramme)	26.8	36.1	36.5	35.9	28.5
(RM million)	18.3	49.4	68.4	52.3	48.7
Sawn timber					
('000 cu.metres)	98.4	261.2	2.8	-28.0	-42.1
(RM/cu.metre)	-49.8	-70.8	-9.6	31.9	95.2
(RM million)	-0.4	5.6	-7.1	-5.0	13.0
Saw logs					
('000 cu.metres)	-11.3	9.9	-13.5	-11.0	22.8
(RM/cu.metre)	-7.3	-5.7	1.0	19.6	7.3
(RM million)	-17.8	3.7	-12.6	6.4	31.8
Cocoa beans					
('000 tonnes)	-74.3	-53.6	-76.0	-8.3	53.8
(RM/tonne)	11.9	-11.0	-20.3	-12.9	-5.8
(RM million)	-71.3	-58.7	-80.9	-20.1	44.8

[1] In '000 tonnes, except for saw logs in '000 cubic metres

tonnes) and highest OER (August 2004: 20.48%). During the quarter, rubber production continued with its strong double-digit growth trend of 23.1%. Smallholders, accounting for 95% of the total output, increased their tapping activity in response to sustained high prices (435 sen per kilogram; 2Q 2004: 476 sen per kilogram). Growth in output was also due to increased productivity through applications of new tapping technologies, such as the low intensity tapping scheme (LITS), which induced higher yields.

Similarly, the forestry sub-sector performed favourably during the quarter, in response to increased demand from the wood-based industries. Fisheries recorded a higher growth of 2.6%, due entirely to higher marine landings (3.3%). Following five successive quarters of declining production, cocoa registered its first quarterly growth for the year, rising sharply by 17.7% (2Q 2004: -8.5%). The growth was due to lower incidence of black pod infections which had affected production in the earlier quarters as well as utilisation of better agriculture inputs in response to remunerative cocoa prices (RM5,081 per tonne; 2Q 2004: RM4,617 per tonne). Miscellaneous agriculture, including fruits and vegetables, recorded higher production during the quarter.

The **mining sector** grew by 4.2% (2Q 2004: 1.2%), driven entirely by increased output of crude oil. Production of crude oil (including condensates) rose by 4.9%, to average 760,560 barrels per day during the quarter (2Q 2004: 738,435 bpd) amidst the strong external demand and high prices. Malaysian Tapis Blend crude oil prices strengthened significantly by about 20% compared with the previous quarter to average US$45.10 (annual growth: 54%) and breached the US$50 per barrel level at end-September. Demand for the Malaysian crude, which is of the "light and sweet" variety, has been strong due to the shortage of this variety in the global market. Meanwhile, natural gas production declined marginally during the quarter by 1.4% to 8,061 million tonnes (2Q 2004: 8,689 million tonnes) due to shutdowns in the MLNG plants in Sarawak for maintenance purposes.

Performance of the Mining Sector

	2003		2004		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Value Added (at 1987 prices)	**1.2**	**5.3**	**5.8**	**1.2**	**4.2**
Production					
Of which:					
Crude oil and condensates ('000 barrels)	2.4	6.4	8.0	-0.2	4.9
Natural gas (net) (million standard cubic feet)	-1.0	5.2	2.3	4.0	-1.4
Exports (RM million)	**21.3**	**26.1**	**15.4**	**43.9**	**50.0**
Of which:					
Crude oil					
('000 tonnes)	15.6	19.3	4.1	4.5	7.8
(US$/barrel)	7.0	12.6	4.4	33.6	50.6
(RM million)	23.6	34.3	8.6	39.6	62.3
Liquefied natural gas					
('000 tonnes)	9.3	16.7	18.3	34.1	8.4
(RM/tonne)	11.8	-0.1	-2.3	1.5	12.0
(RM million)	22.1	16.6	15.6	36.0	21.4

Weak construction activity

The **construction sector** contracted further by 3% (2Q 2004: -1.7%) due mainly to

lower civil engineering activity. However, activity in the residential and non-residential segments continued to be sustained. Demand for residential property was supported by higher disposable incomes and low mortgage rates. In particular, demand was strong for landed properties. Construction activity in the non-residential sub-sector also expanded due to sustained demand for office and retail space, particularly for projects located in prime locations. The recent upliftment of restrictions on the provision of bridging finance for property development is expected to have some positive impact on the construction sector going forward.

Construction Indicators

	2003		2004		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
New sales and advertising permits	14.9	21.5	42.0	0.7	-31.9
Housing approvals	19.3	26.7	48.5	-15.2	-30.8
Production of construction-related materials	11.2	10.6	2.2	-0.8	-4.2
Loans approved for construction	17.9	16.1	-36.8	31.7	39.0
Imports of construction materials & mineral products	-23.7	17.8	14.5	51.4	-61.9

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

Domestic demand remained strong, led by the private sector

Continuing the trend of the first two quarters, the private sector remained the dominant source of **domestic demand** growth in the third quarter as the public sector remained on track with its plans for further consolidation. Expansion in domestic demand was supported mainly by robust household consumption and private investment activities, and to a small extent, by the moderate expansion in public consumption.

Private consumption expanded strongly by 10.8% in the third quarter (2Q 2004: 11.4%). Consumer spending strengthened further with the sustained increase in disposable incomes due to high export earnings and favourable commodity prices. Low inflation and interest rates as well as stable employment conditions provided further support to household consumption.

GDP by Expenditure Components (at Constant 1987 prices)

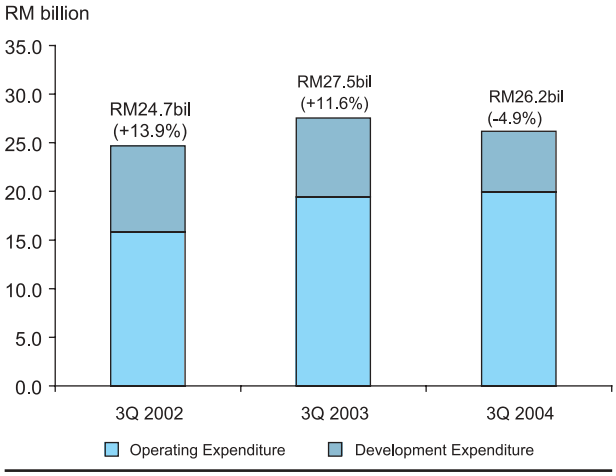
	2003		2004		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Aggregate Domestic Demand (excluding stocks)	4.9	7.7	7.3	8.4	7.1
Consumption	5.6	9.5	9.0	10.8	8.9
Private sector	*7.0*	*8.6*	*8.4*	*11.4*	*10.8*
Public sector	*1.8*	*12.2*	*11.4*	*8.7*	*3.3*
Gross Fixed Capital Formation	3.2	3.6	3.5	3.5	3.2
Exports of Goods and Services	4.4	10.9	15.6	19.3	18.5
Imports of Goods and Services	1.5	15.9	19.4	25.3	23.2
GDP	**5.3**	**6.6**	**7.8**	**8.2**	**6.8**

Source: Department of Statistics, Malaysia

The improved consumer confidence was reflected in the higher Malaysian Institute of Economic Research (MIER) Consumer Sentiments Index of 113.9 points in the third quarter (2Q 2004: 112.4 points). Major indicators for consumption such as imports of consumption goods, sales of passenger cars, loans approved as well as disbursed to households, the wholesale, retail, restaurants and hotels and for consumption credit, recorded strong expansion. Household consumption also benefited from the nationwide retail sales promotions in conjunction with the August school holidays. Meanwhile, **public consumption** increased

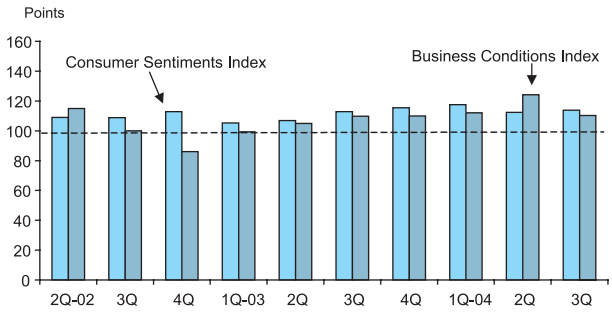
moderately with sustained expenditure on supplies and services as well as emoluments.

Lower Federal Government Spending



Gross fixed capital formation was sustained at 3.2% in the third quarter (2Q 2004: 3.5%). The growth was supported mainly by sustained private investment activities as development expenditure of the Federal Government continued to decline. The growth in private investment was in response to higher capacity utilisation. Given the strong output growth since the third quarter of 2003, companies took advantage of improving corporate profitability and favourable financing conditions to upgrade capacity. Investment activity was reflected mainly by the continued investment in machinery and equipment, higher investment in transport equipment as well as capacity expansion. Although the MIER Business Confidence Index moderated to 110.2 points in the third quarter (2Q 2004: 124.1 points), the Index remained above the 100-point threshold level, reflecting continued expansion in the manufacturing sector. Other major private investment indicators, including loans approved and disbursed for businesses and construction sectors, imports of capital goods and sales of commercial vehicles, also pointed towards sustained investment growth. In addition, domestic investment was also supported by the higher inflows of foreign direct investment, particularly in the manufacturing, services and oil and gas sectors.

Consumer confidence strengthened further while business confidence sustained



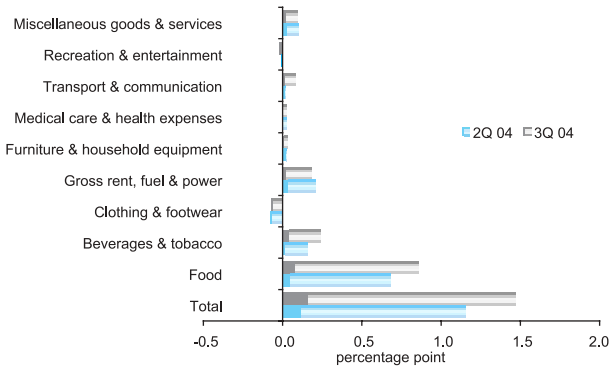
Reflecting the Federal Government's intention to continue with the process of gradual fiscal consolidation, the development expenditure of the Federal Government declined further. The bulk of the spending continued to be disbursed for development of the transportation infrastructure, education, housing, agriculture and rural development.

Inflation edged up slightly

The annual rate of inflation, as measured by the **Consumer Price Index** (CPI), edged up slightly to 1.5% (2Q 2004: 1.2%). Food prices were higher compared with the second quarter due mainly to increase

in the prices of food taken away from home. Price increases for beverages and tobacco were also higher due to the increase in excise duties of the 2005 Budget. Higher prices for these products were offset to some extent by declines or lower price increases for other consumer products and services.

Contribution to Inflation

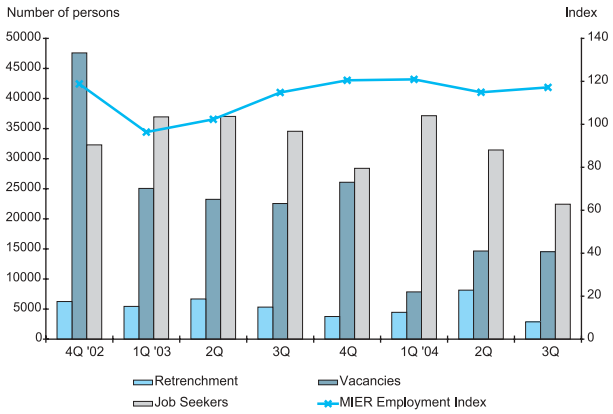


The increase in the **Producer Price Index** (PPI) was 11.9% (2Q 2004: 11.2%), due mainly to higher crude oil prices. PPI excluding commodities, slowed to 1.8% in the third quarter (2Q 2004: 2.6%).

Labour market conditions remained stable

Labour market conditions in the third quarter remained stable, supported by stronger growth in productivity. Vacancies reported to the authorities (14,544 positions) significantly exceeded retrenchments (2,879 persons) and unplaced jobseekers reached a seven-year low of 22,442 persons. Growth in labour productivity during the quarter, as measured by real sales value of products per employee in the manufacturing sector, rose by 18.3% exceeding the 2% increase in real wage per employee.

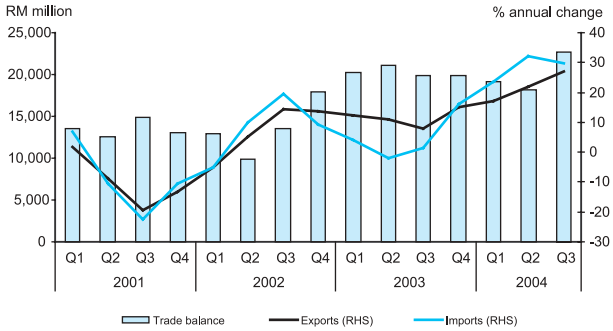
Stable Labour Market Conditions



Both exports and imports recorded strong growth

Consistent with strong expansion in manufactured and mineral exports, the **trade account** remained strong and recorded a larger surplus of RM22.7 billion in the third quarter (2Q 2004: RM18.1 billion). While exports expanded by 26.9%, gross imports increased at a stronger pace of 29.9%.

Trade balance



Gross exports recorded a higher growth of 26.9% in the third quarter of 2004 (2Q 2004: 22%) due mainly to strong growth in manufactured and mineral exports, and

continued expansion in agriculture exports. Growth was supported by both higher export volume (21.1%) and prices (6.5%). Export prices of commodities, such as crude oil, sawn timber, LNG and rubber were significantly higher during the quarter.

Manufacturing exports expanded further by 26.5% (2Q 2004: 20.6%), supported by stronger demand for resource-based products, particularly for metal, wood, chemical and petroleum-related products as well as continued expansion in exports of electronics and electrical products. The growth in exports of resource-based products was due to higher prices of commodities as well as strong demand from the regional countries, especially China. While production of electronics has already begun to taper in line with the softening of the global electronics cycle, exports of electronics continued to remain high in response to earlier orders. In addition, there has been a notable increase in the exports of transport equipment during the quarter, particularly floating and submersible-drilling platforms for oil and gas exploration activity.

During the quarter, export unit value of manufactured goods increased by 2.5% (2Q 2004: 0.8%), as the decline in prices of electronics and electrical products was more than offset by the higher prices of resource-based products. Meanwhile, growth in export volume of manufactured products remained high, expanding by 25% (2Q 2004: 20.4%).

Exports of **agriculture commodities** increased only marginally by 4.2% during the quarter (2Q 2004: 11.4%), due mainly to higher receipts from all sub-sectors, except palm oil. Palm oil exports declined by 8.9% during the quarter (2Q 2004: +2.1%), arising from lower offtake from major buyers, namely, India, China, Pakistan and the Middle East, following the build up in stocks of edible oil in these countries, ahead of the year-end festivities. The impact from softer demand was somewhat cushioned by continued high palm oil prices (3Q 2004 average: RM1,660 per tonne). Meanwhile, in recent months, the US has been increasing its palm oil purchases, with exports expanding by 61.1% during the quarter to 81,530 tonnes. The US currently accounts for 2.7% of total Malaysian palm oil exports, compared with an average of 1.5% during the 2000-2003 period. The increased offtake may have been in response to the recent US Food and Drug Administration (FDA) ruling which requires food manufacturers to label their products that contain Transfatty Acids (TFAs) effective 2006. While palm oil is TFA-free, it is a component in soybean oil, palm oil's closest competitor in the global edible oil market.

In contrast, rubber exports continued to register a strong growth of 48.7% (2Q 2004: 52.3%), supported by marked expansions in both prices (28.5%) and volume (15.7%). The rise in crude oil prices has directly led to an increase in the price of synthetic rubber (which is a petrochemical-based product), resulting in natural rubber prices being traded at a discount. As a result, demand for natural rubber has remained strong, particularly from nations that have a large automotive sector such as China, Germany, the United States and France, which have registered growth of between 25-33% during the quarter.

Trade Account

	2003		2004		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Gross Exports	**7.9**	**15.2**	**17.3**	**22.0**	**26.9**
Manufacturing	4.9	14.1	17.3	20.6	26.5
Agriculture	28.1	14.8	13.8	11.4	4.2
Minerals	21.3	26.1	15.4	43.9	50.0
Gross Imports	**1.3**	**16.1**	**23.5**	**32.1**	**29.9**
Capital goods	-1.7	14.7	23.2	26.8	30.4
Intermediate goods	4.4	18.4	22.5	31.8	25.9
Consumption goods	-9.8	6.5	14.3	26.4	37.8
Trade balance (RM bil)	**19.9**	**19.9**	**19.2**	**18.1**	**22.7**

Source: Department of Statistics, Malaysia

Mineral exports continued to expand at a rapid pace of 50%, due mainly to the strong increase in crude oil prices during the quarter. Export prices of crude oil strengthened by 50.6% to an average of US$43 per barrel as Malaysian crude is favoured due to its "light and sweet" variety. Currently, there is a mismatch in the global oil supply with an oversupply of the “heavy, sour” oil and shortage of the “light, sweet” crude. The major buyers, including Australia, India, Thailand, Singapore and Korea, increased their purchases by between 50 and 79% during the quarter. Meanwhile, LNG exports increased by 21.4%, supported by higher prices (12%) as well as stronger global demand for natural gas. Malaysia's traditional buyers of LNG, namely Korea and Chinese Taipei, increased their imports by between 175% and 21% respectively.

The market share of exports to the regional countries remained strong at 43.6%. Export growth to the regional countries continued to outpace that of major industrial countries, with exports to ASEAN countries increasing by 31.4%. Consequently, Malaysia's export share to ASEAN remained high at 24.8%. Exports to the East Asian region continued to remain strong, increasing by 22.3%, reflecting higher exports to Korea and Chinese Taipei (65.4% and 14.2% respectively), while exports to P.R. China was sustained at 27.7%. Higher exports to the regional countries were underpinned mainly by the expansion in exports of electrical and electronic (E & E) products and resource-based products namely, crude and refined petroleum, chemicals, wood and liquefied natural gas (LNG). Supported by high export growth in E & E products as well as petroleum products and crude petroleum,

Malaysia: Direction of exports

	2003		2004			2003		2004			2003		2004		
	3Q	4Q	1Q	2Q	3Q	3Q	4Q	1Q	2Q	3Q	3Q	4Q	1Q	2Q	3Q
	RM billion					% share of total exports					Annual change (%)				
United States	**20.0**	**21.1**	**19.3**	**22.8**	**25.0**	**19.7**	**19.4**	**17.9**	**19.3**	**19.5**	**-1.8**	**15.6**	**12.0**	**15.6**	**25.1**
European Union	**12.1**	**12.7**	**13.3**	**13.7**	**15.0**	**12.0**	**11.7**	**12.3**	**11.7**	**11.7**	**8.6**	**8.5**	**16.0**	**14.8**	**23.5**
Selected ASEAN countries[1]	**24.2**	**27.1**	**26.9**	**28.9**	**31.9**	**24.0**	**24.8**	**25.0**	**24.5**	**24.8**	**1.1**	**17.1**	**17.3**	**20.8**	**31.4**
North East Asia	**19.7**	**21.8**	**21.9**	**23.1**	**24.1**	**19.5**	**20.0**	**20.3**	**19.6**	**18.8**	**15.1**	**15.9**	**23.0**	**26.8**	**22.3**
People's Republic of China	*6.7*	*7.6*	*7.2*	*8.1*	*8.6*	*6.7*	*7.0*	*6.7*	*6.8*	*6.7*	*22.2*	*35.0*	*34.9*	*30.2*	*27.7*
Hong Kong China	*6.9*	*6.9*	*6.4*	*7.5*	*7.4*	*6.8*	*6.4*	*6.0*	*6.4*	*5.8*	*27.2*	*10.5*	*8.6*	*25.3*	*6.8*
Chinese Taipei	*3.7*	*3.8*	*3.6*	*3.8*	*4.2*	*3.7*	*3.5*	*3.3*	*3.3*	*3.3*	*11.5*	*14.6*	*6.4*	*11.2*	*14.2*
Korea	*2.3*	*3.4*	*4.7*	*3.7*	*3.9*	*2.3*	*3.1*	*4.4*	*3.1*	*3.0*	*-17.2*	*-3.5*	*47.5*	*43.1*	*65.4*
India	**2.3**	**2.7**	**2.7**	**2.7**	**2.8**	**2.2**	**2.5**	**2.5**	**2.3**	**2.2**	**33.0**	**30.1**	**21.7**	**10.5**	**25.3**
Total exports	**101.1**	**109.1**	**107.8**	**118.0**	**128.2**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**7.9**	**15.2**	**17.3**	**22.0**	**26.9**

1/ Include Singapore, Thailand, Indonesia, Philippines, Brunei Darussalam and Viet Nam

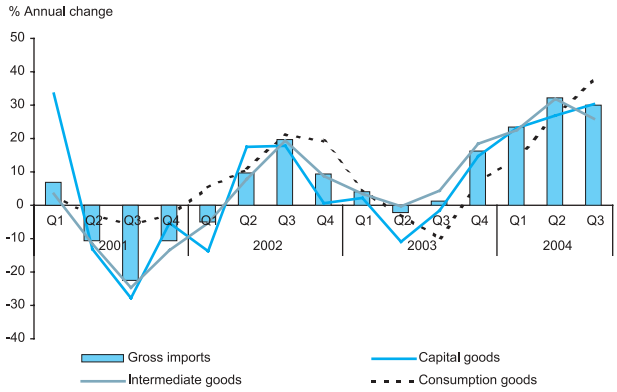
Source: Department of Statistics, Malaysia

exports to the United States increased by 25.1% to account for a higher export share of 19.5%. In line with improvements in economic activity, exports to the EU countries recorded higher growth of 23.5%. Another notable development during the quarter is the sustained high export growth to Australia (55.7%) supported mainly by higher exports of resource-based products.

Gross imports continued to expand strongly by 29.9% to RM105.5 billion, reflecting growth in the production and exports of E & E products, strong domestic demand and investment activities. Imports of **intermediate goods**, which were the main driver of import growth, continued to grow by 25.9%. Intermediate imports are inputs for the production of manufactured exports, particularly E & E products. Inputs which recorded significant increases included industrial supplies such as metals and metal products, chemicals, parts for electrical apparatus, and construction materials. Growth of the motor assembly industry stemming from the robust demand for passenger cars also caused imports of parts and accessories of transport equipment to expand. Imports of primary and processed materials used by the food and beverages industry increased, reflecting the strong growth in private consumption.

A notable feature was the significant growth of 30.4% in **capital imports** indicating that growth in private investment is more entrenched. Capital imports excluding lumpy items, grew by 26.1%. The increase in imports for capacity expansion occurred in the manufacturing and services industries as evidenced by higher imports of machinery, office equipment, generators, turbines and electric motors and telecommunication equipment. Consonant with higher private consumer spending and demand owing to festivities, imports of **consumption goods**

Import growth



Malaysia: Imports by Economic Function And Broad Economic Categories (BEC) Classification

	2003		2004		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
CAPITAL GOODS	**-1.7**	**14.7**	**23.2**	**26.8**	**30.4**
Capital goods (except transport equipment)	3.8	6.7	12.9	24.7	20.1
Transport equipment	-56.9	203.7	205.1	78.3	279.1
INTERMEDIATE GOODS	**4.4**	**18.4**	**22.5**	**31.8**	**25.9**
Food and beverages, mainly for industry	-3.1	9.9	31.8	109.5	56.9
Industrial supplies, n.e.s.	-8.1	17.5	25.1	47.7	52.3
Fuel and lubricants	4.7	18.7	-2.1	23.1	76.4
Parts and accessories of capital goods (except transport equipment)	12.8	19.3	23.2	20.7	9.0
Parts and accessories of transport equipment	-26.5	16.8	24.6	75.0	45.1
CONSUMPTION GOODS	**-9.8**	**6.5**	**14.3**	**26.4**	**37.8**
Food and beverages, mainly for household consumption	-15.9	9.8	19.8	37.8	56.0
Transport equipment, non-industrial	34.7	125.9	-8.5	15.2	45.5
Consumer goods,n.e.s.	-7.2	2.6	11.5	20.5	28.3
Durables	-10.9	-22.2	8.1	14.1	35.3
Semi-durables	-4.7	9.4	15.8	22.0	23.1
Non-durables	-7.3	16.7	10.2	22.7	29.2
DUAL USE GOODS	**-4.4**	**23.2**	**22.6**	**27.9**	**45.3**
OTHERS	**-13.2**	**-5.0**	**7.5**	**5.2**	**17.5**
RETAINED IMPORTS	**2.0**	**16.6**	**21.7**	**30.0**	**27.4**
RE-EXPORTS	**-19.7**	**3.1**	**89.6**	**107.7**	**125.6**
GROSS IMPORTS	**1.3**	**16.1**	**23.5**	**32.1**	**29.9**

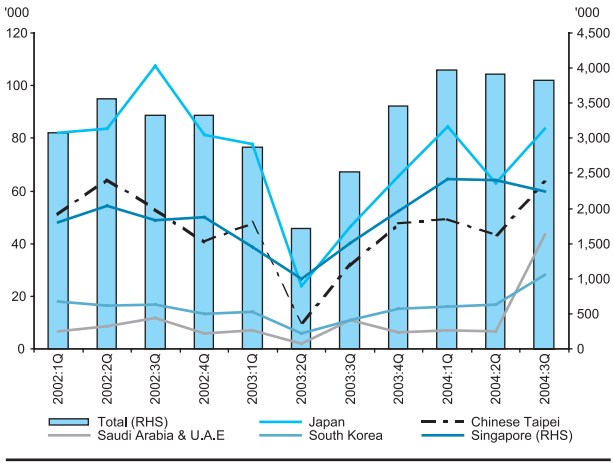
Source: Department of Statistics, Malaysia

increased by 37.8%. Imports of food and beverages for household consumption registered significant growth of 56% during the quarter. Similarly, imports of consumer goods were also robust, increasing by 28.3%. Imports for re-exports continued to grow strongly, reflecting strong growth in packing and assembling activities at distribution parks located in the free commercial zones at the major ports.

Tourist arrivals remained high

Tourist arrivals were sustained at 3.8 million in the third quarter (2Q 2004: 3.9 million). Tourists from Singapore, Thailand and Indonesia, continued to account for a significant share of arrivals (74.4%). Visitors from Japan, Chinese Taipei and South Korea recorded strong increases, in line with improved economic performance and greater connectivity with increases in flights. Aggressive marketing campaigns targeted at summer vacation travel led to a four-fold increase in tourist arrivals from West Asia during the quarter. Tourist arrivals from the Oceania and European countries were also higher supported by the attractive promotional packages and marketing campaigns.

Quarterly Tourist Arrivals



FDI, overseas investment and portfolio investment recorded higher flows

On a cash basis, gross inflows of **foreign direct investment (FDI)** were higher in the third quarter (RM4.1 billion; 2Q 2004: RM3.2 billion). The FDI inflows continued to be broad based and channelled mainly into the services and manufacturing as well as the oil and gas sectors. In the services sector, the investments in the business and support services and wholesale and retail trade sub-sectors remained large. Meanwhile, investments in the manufacturing sector were concentrated in the electrical and electronics, metal and chemical products, and petroleum related activities. After adjustments for outflows due mainly to loan repayment to related companies, FDI recorded a higher net inflow of RM2.0 billion (2Q 2004: RM0.5 billion).

Gross outflows for **overseas investment** increased to RM5.3 billion (2Q 2004: RM2.6 billion) due mainly to higher loans extended by non-resident controlled companies in Malaysia to their related companies abroad. The investments were effected mainly by companies in the services sector, particularly financial institutions and investment holding companies as well as companies in the construction and wholesale and retail trade sub-sectors. Investments by companies in the oil and gas and manufacturing sectors, particularly the

petroleum related activities and electrical and electronics industries were larger. The outflows were channelled mainly into Chad, Thailand, Sudan, Vietnam and Singapore. Overseas investment, after adjusting for inflows from repayment of inter-company loans from abroad, recorded a net outflow of RM1.8 billion (2Q 2004: RM0.2 billion).

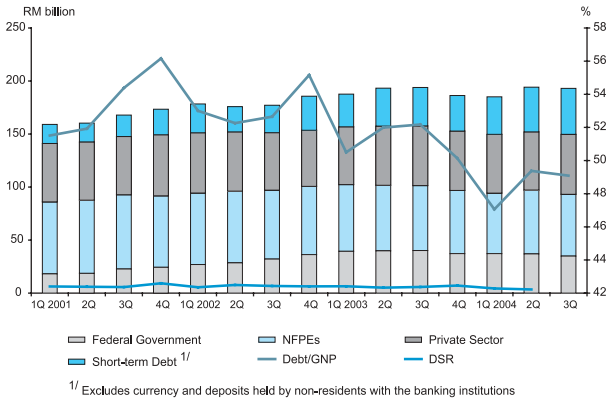
Portfolio investment recorded a net inflow of RM6.1 billion (2Q 2004: RM2.3 billion; 1Q 2004: RM16.3 billion), in line with improved sentiment in the stock market as well as sustained foreign interest in Malaysian debt securities.

External debt declined

Malaysia's total external debt declined to RM193.1 billion or US$50.8 billion as at end-September 2004 (2Q 2004: RM194.2 billion), equivalent to 49.1% of GNP. The lower **medium and long-term external debt** at RM149.7 billion or US$39.4 billion (2Q 2004: RM152.1 billion), was attributable to net repayments of external loans by both the Federal Government and non-financial public enterprises (NFPEs). The NFPEs registered a net repayment of RM3.4 billion, reflecting lower gross drawdown while repayment was significantly larger. Meanwhile, the private sector registered a net drawdown of external loans, particularly by the agriculture and oil and gas sectors.

The total **short-term external debt** stood at RM43.3 billion or US$11.4 billion (2Q 2004: RM42.1 billion) reflecting a moderate increase in short-term debt of

External Debt Outstanding



External Debt Outstanding

	2003		2004		
	End-Sept.	End-Dec.	End-March	End-June	End-Sept.[p]
	RM billion				
Medium & Long-term debt	157.7	152.8	149.7	152.1	149.7
Public sector	101.5	96.8	94.3	97.2	93.2
Private sector	56.2	56.0	55.5	54.9	56.5
Short-term debt [1]	36.3	33.5	35.3	42.1	43.3
Total external debt	193.9	186.3	185.1	194.2	193.1
- US$ billion equivalent	51.0	49.0	48.7	51.1	50.8

[1] Excludes currency and deposits held by non-residents with banking institutions.
[p] Preliminary
Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

the banking sector. The increase was due mainly to banks' hedging activities in relation to trade-related transactions and money market operations involving regional treasury activities. As at end-September, the short-term debt remained low, accounting for 22.4% of total external debt, and is about 20.1% of the net international reserves.

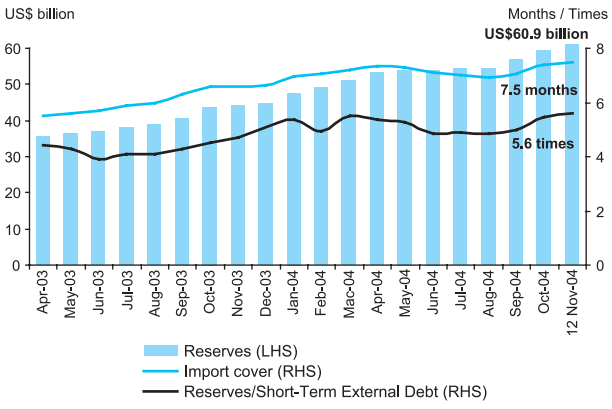
International reserves continued to increase

The rising trend in the **international reserves** of Bank Negara Malaysia

continued into the third quarter of 2004. As at 30 September 2004, the net international reserves stood at RM216.1 billion (US$56.9 billion), representing an increase of RM11.3 billion (US$3 billion) since end-June. The increase in reserves during the quarter was driven mainly by the higher repatriation of export earnings and inflows of funds for portfolio and foreign direct investment. The reserves level has also taken into account the quarterly adjustment of the foreign exchange revaluation gain amounting to US$392 million. Meanwhile, outflows reflected mainly payment for imports of goods and services, repayment of external loans and the repatriation of dividends.

The reserves increased further to RM231.4 billion (US$60.9 billion) as at 12 November 2004, underpinned by continued repatriation of export receipts and inflows of portfolio funds. The reserves level is sufficient to finance 7.5 months of retained imports and is 5.6 times the short-term external debt.

Net International Reserves (as at end period)



Lower fiscal deficit

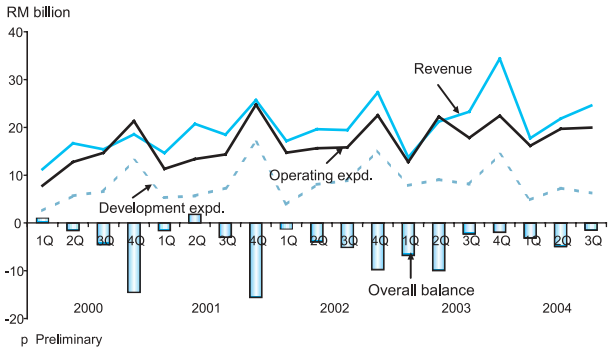
The Federal Government recorded a lower fiscal deficit of RM1.5 billion or 1.3% of GDP in the third quarter due to stronger revenue collection and lower development expenditure. Revenue receipts increased by 5.5%, reflecting higher collection from income taxes and most major categories of indirect taxes. Receipts for sales tax was lower due to the higher duty exemption on petroleum products to stabilise retail prices following higher global oil prices. Total expenditure rose at an annual rate of 1% due to higher operating expenditure. Given adequate liquidity conditions in the domestic banking system, the fiscal deficit was

Federal Government Finance p

	2003		2004		
	3Q	Jan-Sept	2Q	3Q	Jan-Sept
	RM billion				
Revenue	23.3	58.2	21.8	24.6	64.1
% growth	*19.9*	*3.6*	*2.9*	*5.5*	*10.2*
Operating expenditure	17.8	52.8	19.7	19.9	55.8
% growth	*12.6*	*14.4*	*-11.4*	*11.9*	*5.7*
Current account	**5.5**	**5.4**	**2.1**	**4.6**	**8.3**
% of GDP	***5.5***	***5.4***	***1.9***	***4.1***	***2.5***
Gross development expenditure	8.1	25.0	7.3	6.2	18.4
% growth	*-8.5*	*20.2*	*-19.9*	*-23.0*	*-26.6*
Loan recoveries	0.3	0.5	0.2	0.1	0.4
Overall balance	**-2.4**	**-19.1**	**-4.9**	**-1.5**	**-9.7**
% of GDP	***-2.4***	***-19.1***	***-4.5***	***-1.3***	***-2.9***
Memo item:					
Total gross expenditure	**25.9**	**77.8**	**27.0**	**26.2**	**74.2**
% growth	*5.0*	*16.2*	*-13.8*	*1.0*	*-4.7*
Total Federal Government debt (as at end period)	188.6	188.6	197.8	204.4	204.4
% of GDP	*47.8*	*47.8*	*45.1*	*46.6*	*46.6*
Domestic debt	148.4	148.4	160.8	169.5	169.5
% of GDP	*37.7*	*37.7*	*36.7*	*38.7*	*38.7*
External debt	40.2	40.2	37.0	34.9	34.9
% of GDP	*10.2*	*10.2*	*8.4*	*8.0*	*8.0*

p Preliminary

Federal Government Finance [p]



funded entirely from domestic sources. As at end-September 2004, total outstanding debt of the Federal Government amounted to RM204.4 billion or 46.6% of GDP. The external debt of the Federal Government continues to remain low, at 18.1% of the nation's outstanding external debt or 8% of GDP.