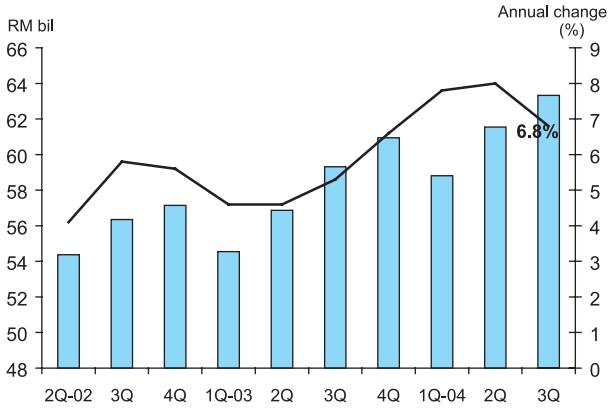
Economic and Financial Developments in the Malaysian Economy in the Third Quarter of 2004

OVERVIEW

Growth remained favourable

Following two consecutive quarters of strong growth averaging 8%, real GDP growth for Malaysia continued to remain favourable at 6.8% in the third quarter of 2004. Growth was driven mainly by the private sector as the public sector remained committed to fiscal consolidation. The expansion in domestic demand was due largely to stronger household consumption and sustained private investment activities. Nonetheless, the modest expansion in public consumption during the quarter contributed marginally to overall growth.

Real GDP remained favourable in 3Q 2004



Source: Department of Statistics Malaysia

The key economic sectors, namely, manufacturing, services and the primary commodity sectors, continued to drive growth. The manufacturing sector continued to record a strong growth supported by both domestic and external demand. Meanwhile, growth in the services sector was sustained by strong consumption and tourism- and trade-related activities, while the primary commodity sector posted stronger growth on account of higher production, especially for major commodities. The weaker performance in the construction sector was mainly on account of slower activity in the civil-engineering sub-sector.

Production in the manufacturing sector expanded further by 11.5% in the third quarter. Growth in the export-oriented industries, of which electronics and electrical products (E & E) account for 33% share, still remained high at 12.3% (2Q 2004: 18.2%), with growth in electronic products increasing by 26.3% (2Q 2004: 33%). The chemical products cluster, especially plastic and resins, continued to perform in tandem with the electronics industry. Meanwhile, growth in the domestic-oriented industries strengthened to 8.8% (2Q 2004: 7.5%), supported mainly by increased output of industries producing fabricated metal products, beverages and transport equipment.

Reflecting strong consumption and increased tourism- and trade-related activities, the services sector expanded by 6.1% during the quarter (2Q 2004: 7.8%). The final services sub-sector increased by 6%, while growth in the intermediate services was at 6.2%. Growth in final services emanated

mainly from the wholesale and retail trade, restaurants and hotels sub-sector on improved consumer sentiments and high tourist arrivals. The Malaysian Institute of Economic Research (MIER) survey for the third quarter showed that the Consumer Sentiments Index gained 1.5 points quarter on quarter to 113.9 points, while other indicators such as imports of consumption goods, sales of passenger cars, consumption credit and loans approved and disbursed to households and the wholesale, retail, restaurants and hotels segment remained strong and continued to record significant growth. Expansion of the intermediate services segment was attributable mainly to growth in trade related activities and sectoral development, as reflected in the sustained expansion of the transport, storage and communication (transport) and the finance, insurance, real estate and business services (finance) sub-sectors. While the transport sub-sector benefited from increased trading activities and a large number of tourist arrivals during the quarter, growth in the finance sub-sector was underpinned by high bank lending and strong insurance activities in tandem with the expansion in domestic economic activities.

Growth in the agriculture and mining sectors strengthened to 6.1% and 4.2% respectively during the third quarter (2Q 2004: 3.6% and 1.2%). Growth in the agriculture sector was broad based, driven mainly by higher production of palm oil, rubber and forestry as well as other miscellaneous agriculture, including fisheries, vegetables and fruits. The expansion in the mining sector was driven wholly by increased crude oil production, as natural gas production declined. Meanwhile, the construction sector declined by 3% (2Q 2004: -1.7%), due mainly to slower activity in the civil engineering sub-sector. It was, however, partially mitigated by sustained growth in the residential and non-residential segments.

During the third quarter, the private sector continued to take the lead in stimulating domestic demand amidst ongoing consolidation by the public sector. The expansion in domestic demand was underpinned mainly by stronger household consumption and sustained private investment activities. Private consumption increased strongly by 10.8% supported by a sustained increase in disposable incomes following higher export earnings and favourable commodity prices, stable employment conditions, low inflation and the low interest rate environment.

Gross fixed capital formation increased further by 3.2% (2Q 2004: 3.5%), supported mainly by sustained private investment activities as the Federal Government further reduced its development expenditure, lowering the fiscal deficit to 1.3% of GDP during the third quarter. Growth in private investment, which had turned around since the third quarter of 2003, was stronger due primarily to higher capacity utilisation, with some industries operating at near full capacity. This high level of capacity utilisation, together with improving corporate profitability and favourable financing conditions, have encouraged investment in new projects as well as increased investment in machinery and equipment for capacity expansion. Key private investment indicators, namely, loan approvals

and disbursements to businesses and the construction sector, imports of capital goods and sales of commercial vehicles, suggest continued sustainability of private investment activities. This is corroborated by MIER Business Confidence survey for the third quarter, which showed the Business Confidence Index at 110.2 points, above the 100-point threshold level. This essentially reflects ongoing expansion in the manufacturing sector. Domestic investment was also supported by higher inflows of FDI, particularly to the manufacturing, services and oil and gas sectors, during the quarter.

Growth in the Malaysian economy was achieved amid low inflation, with consumer prices edging up slightly to 1.5% during the quarter (2Q 2004: 1.2%). On the other hand, the Producer Price Index trended upwards during the quarter, largely reflecting firmer commodity prices. Meanwhile, labour market conditions remained stable, supported by sustained productivity, as reflected in the manufacturing sector's real sales per employee growth of 18.3%, far exceeding the 2% increase in real wage per employee.

During the quarter, Malaysia's balance of payments position remained strong, with the trade surplus increasing to RM22.7 billion (2Q: RM18.1 billion), with strong gross exports and gross imports growth of 26.9% and 29.9% respectively (2Q: 22% and 32.1% respectively). Growth in exports was attributable to stronger growth from manufactured goods and minerals, while the increase in agriculture revenue moderated. Overall, export volume increased by 21.1% and prices by 6.5%. However, export prices of a number of major primary commodities, including crude oil, LNG and rubber, were significantly higher during the quarter. The market share of exports to the region remained strong at 43.6%, while the share to the US was 19.5% and to the EU, 11.7%.

The strong increase in gross imports was broad based. Imports of intermediate goods, which accounted for the bulk of total imports, rose by 25.9% in tandem with continued domestic economic activities, particularly in the manufacturing sector. Among imported inputs that registered marked increases were industrial supplies, parts for electrical apparatus and construction materials. Imports of capital goods were also stronger, rising by 30.4%, while capital imports excluding lumpy items rose by 26.1%. Consonant with higher private consumption and demand owing to festivities, imports of consumption goods surged by 37.8% during the quarter.

In the financial account, FDI and both overseas and portfolio investments rose during the quarter. Gross inflows of FDI were higher at RM4.1 billion and were channelled mainly into the services, manufacturing and oil and gas sectors. Gross outflows of overseas investment doubled during the third quarter and were mainly by companies in the services, oil and gas and manufacturing sectors. Portfolio investment also recorded a net inflow during the quarter in line with improvement in stock market sentiment and sustained foreign interest in Malaysian debt securities. Given the inflows of FDI and portfolio funds as well as continued repatriation of export proceeds, the

international reserves position increased to RM231.4 billion (US$60.9 billion) as at 12 November 2004. The reserves level is sufficient to finance 7.5 months of retained imports and is 5.6 times the short-term external debt. Owing to concerns on the rising trend in oil prices and its impact on the global economy, especially the US economy, sentiment on the US dollar weakened. Thus, the ringgit depreciated against the euro but recorded a mixed performance against the regional currencies.

Monetary policy continued to support growth

During the third quarter, the financial sector continued to support growth. In response to strong demand from both the business and household segments, gross private sector financing through the banking system and the capital market increased at an annual rate of 7.5% to RM133.6 billion. This amount was higher than levels recorded in the first two quarters of this year, and reflected the higher bank loan disbursements and the larger issuance of PDS. On a net basis, banking system loans and PDS outstanding grew at an annual rate of 8% at end-September (8.2% at end-June). Compared with the second quarter, the growth rates of most loan indicators moderated in the third quarter partly due to the high base effect.

Total loan disbursements to businesses rose at an annual rate of 5% and by 11.3% to households during the quarter. Loans disbursed to businesses were channelled mainly to the manufacturing sector (37.4% to total disbursements of businesses), and the wholesale, retail, restaurants and hotels sector (25.8%). Within the business sector, loan disbursements to SMEs grew at an annual rate of 12.8%. A total of RM8.7 billion was approved to 25,379 SME accounts during the quarter, up from RM8.4 billion to 22,161 SME accounts in the second quarter. An important development during the quarter was the establishment of the National SME Development Council in August to coordinate policy initiatives and to ensure the effective implementation of policy measures to develop this sector.

As part of the ongoing financial structural reform efforts, three mergers between commercial banks and their finance companies were effected, resulting in some technical adjustments to their base lending rates (BLRs) and average lending rates (ALRs). Notwithstanding these adjustments, the average BLR of all the commercial banks and finance companies remained stable at 5.98% and 6.90% respectively as at end-September 2004.

During the quarter, the expansion in broad money, M3, of 10.6%, was broadly in line with the growth rates registered at the end of the last quarter (10.7%). In absolute terms, M3 recorded a larger quarterly expansion attributable to higher external inflows from repatriation of export proceeds as well as inflows of FDI and portfolio funds. The increase was also driven by the sustained increase in the claims on the private sector. Meanwhile, M1 achieved a double-digit annual growth rate largely in line with the expansion in private consumption activity.

The banking system remains sound

The performance of the banking system remained strong in the third quarter with asset quality improving further amidst an expansion in lending activities. In addition, the level of capitalisation remained strong despite a marginal decline, following the completion of the Bafin merger exercise between three commercial banks and three finance companies. The risk-weighted capital ratio (RWCR) and core capital ratio (CCR) of the banking system stood at 13.8% and 11.3% respectively during the quarter. The level of capitalisation of the banking system is expected to improve upon the inclusion of the audited profits. The profitability of the banking system remained favourable with RM2.8 billion pre-tax profits recorded during the third quarter, compared to RM2.4 billion in the corresponding quarter of last year.

The net NPLs based on the 6-month classification continued to trend downwards to account for 6.1% of total net loans, the lowest level since the Asian crisis (2Q 2004: 6.2%). The improvement was mainly on account of lower incidences of new NPLs and higher write-offs.

The near term outlook for Malaysia to remain favourable despite signs of moderating global growth trends…

Prospects are for global growth to trend to more sustainable levels in an environment of high oil prices and rising interest rates. In the US, although the third quarter growth picked up further on account of increased investment and stronger-than-expected consumption, the economy is expected to moderate to a more sustainable pace of expansion as the monetary stimulus is gradually removed. While the growth momentum in Europe and Japan has been supported by strong external demand, nevertheless, signs of slower export-led growth are emerging. In the Japanese economy however, this would likely be offset by stronger domestic demand amidst stable labour market conditions. Meanwhile, export demand in the Asian region still remains strong despite some modest easing, notably for electronics, towards the end of the quarter. The growth prospect for the Asian region is assessed to remain strong, supported mainly by strong underlying domestic demand in most regional economies amidst stable labour market conditions.

Despite some moderation in global growth trend, the Malaysian economy is expected to sustain growth, driven largely by the private sector as the public sector consolidates its fiscal position. Several leading indicators point to continued favourable growth. The improvement in the growth rate of the Leading Index for August suggests continuing favourable growth into early 2005, while the Consumer Sentiment Index is higher in the third quarter, reflecting continued consumer optimism.

Sustained high global oil prices can be expected to have implications on the Malaysian economy. As an open economy and as a small net exporter of oil, Malaysia however, has stronger resilience to such developments. The direct impact of high oil prices had and would in fact benefit Malaysia

in terms of a higher trade surplus and higher gross government revenue. Inflationary pressures are expected to be minimal as oil accounts for only a minor share of the consumption basket for the average consumer while the pass-through effect would also be minimal with improved efficiency in the use of oil. The indirect risk, emanates from its implications on external demand from Malaysia's trading partners should the high oil prices persist into 2005. The trade data for the first nine months has nonetheless remained in Malaysia's favour, with mineral exports, including oil, generating significantly higher export receipts. It is thus expected that on balance, Malaysia would likely continue to be affected positively as a result of the high oil prices in the near term.

Amidst the Government's ongoing fiscal consolidation process, the economy would continue to be private sector-driven, largely through expansion in domestic demand from higher consumption and investment. Despite expectations of some easing in global demand, positive business and consumer sentiments suggest that private consumption would remain favourable, supported by rising incomes amid stable labour market conditions, while inflationary pressures are expected to remain subdued and monetary policy continues to be supportive of economic growth. Similarly, private investment, which has increased since 2003, would continue to be supported by inflows of new FDI and reinvestments. Forward-looking investment indicators signal a continued upward trend in investment activities, as reflected in the higher loan approvals and disbursements including that to the SME sector; imports of capital goods; sales of commercial vehicles; as well as increased investment for capacity expansion. At the same time, measures currently implemented to improve the government delivery system and corporate governance would further enhance the investment environment. In addition, increased investments are also expected in new growth areas such as the ICT and shared services sub-sectors, agriculture and higher value-added technology activities. These new potential sources of growth would also benefit from the various incentives introduced in the 2005 Budget. Overall, the banking sector is in a strong position to support and finance economic growth given its sound position as reflected in the capital adequacy of the banking system while the ratio of NPLs has been trending downwards. Going forward, these supportive investment factors augur well for stronger private investment activity.

Against a potentially less buoyant global environment, Malaysia will continue to have in place policies that are supportive of the growth process while addressing the nation's vulnerability to external developments.

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)

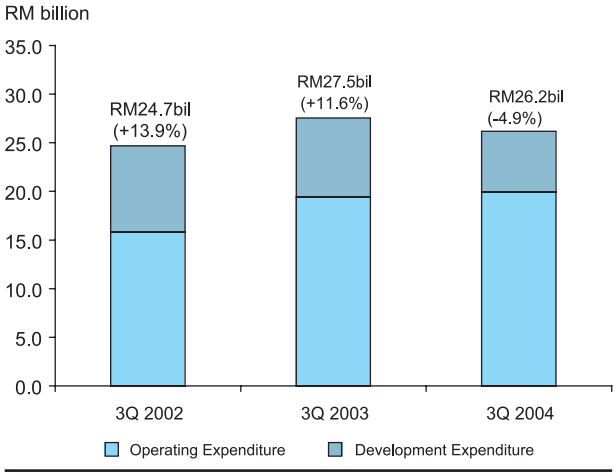
	2003		2004		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Aggregate Domestic Demand (excluding stocks)	4.9	7.7	7.3	8.4	7.1
Consumption	5.6	9.5	9.0	10.8	8.9
Private sector	*7.0*	*8.6*	*8.4*	*11.4*	*10.8*
Public sector	*1.8*	*12.2*	*11.4*	*8.7*	*3.3*
Gross Fixed Capital Formation	3.2	3.6	3.5	3.5	3.2
Exports 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

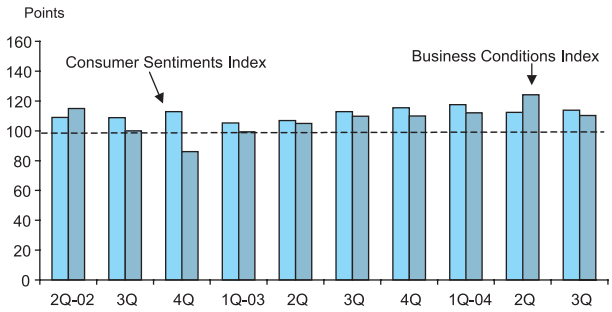
moderately with sustained expenditure on supplies and services as well as emoluments.

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



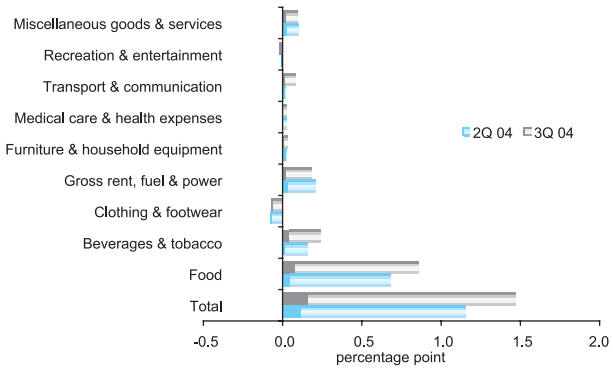
Reflecting the Federal Government's intention to continue with the process of gradual fiscal consolidation, the development expenditure of the Federal Government declined further. The bulk of the spending continued to be disbursed for development of the transportation infrastructure, education, housing,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

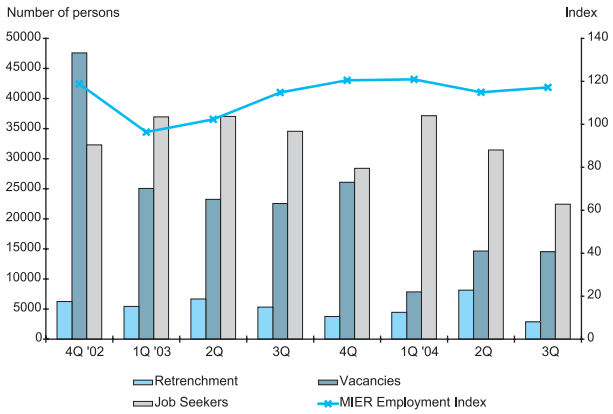


The increase in the **Producer Price Index** (PPI) was 11.9% (2Q 2004: 11.2%), due mainly to higher crude oil prices. PPI excluding commodities, slowed to 1.8% in the third quarter (2Q 2004: 2.6%).

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.

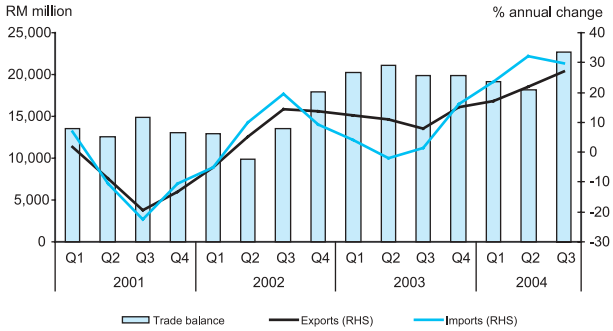
Stable Labour Market Conditions



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

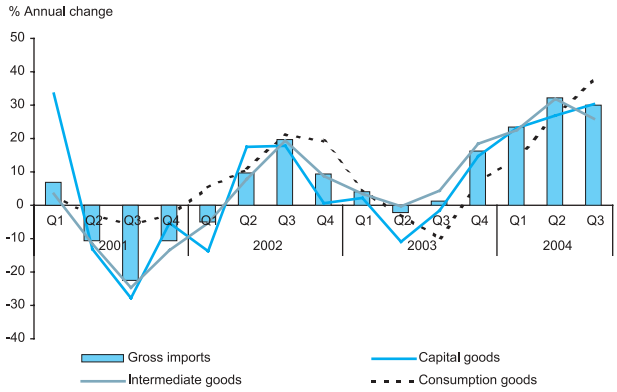
Source: Department of Statistics, Malaysia

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**

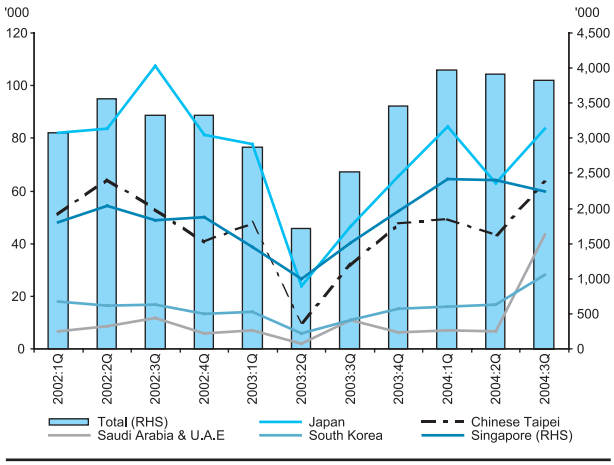
Source: Department of Statistics, Malaysia

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).

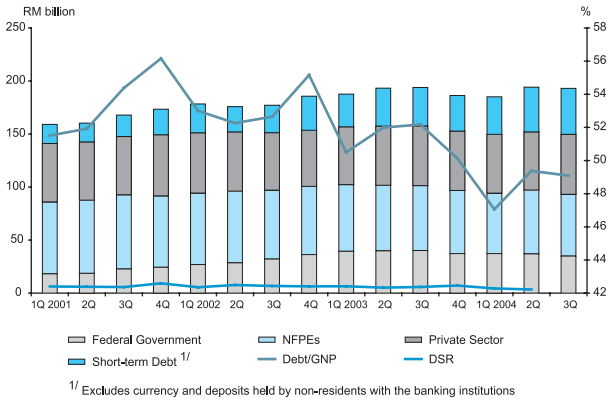
Portfolio investment recorded a net inflow of RM6.1 billion (2Q 2004: RM2.3 billion; 1Q 2004: RM16.3 billion), in line with improved sentiment in the stock market as well as sustained foreign interest in Malaysian debt securities.

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.

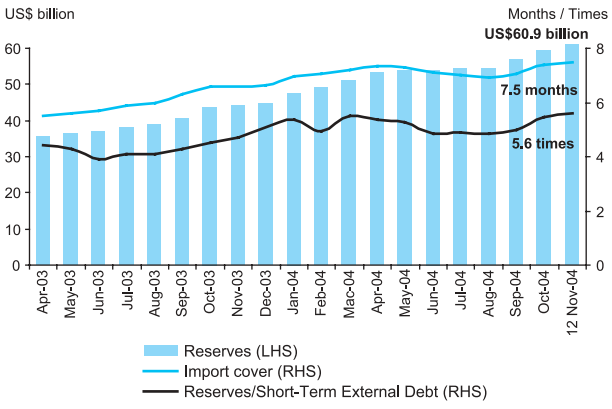
International reserves continued to increase

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

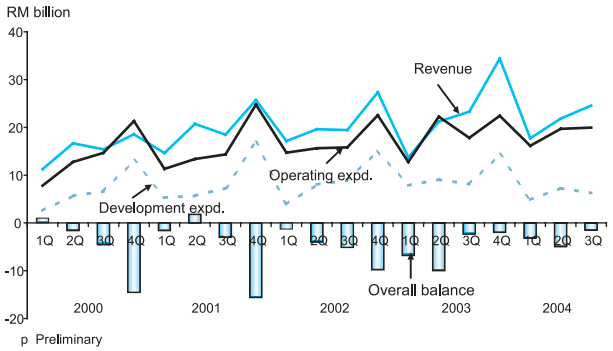
The Federal Government recorded a lower fiscal deficit of RM1.5 billion or 1.3% of GDP in the third quarter due to stronger revenue collection and lower development expenditure. Revenue receipts increased by 5.5%, reflecting higher collection from income taxes and most major categories of indirect taxes. 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]



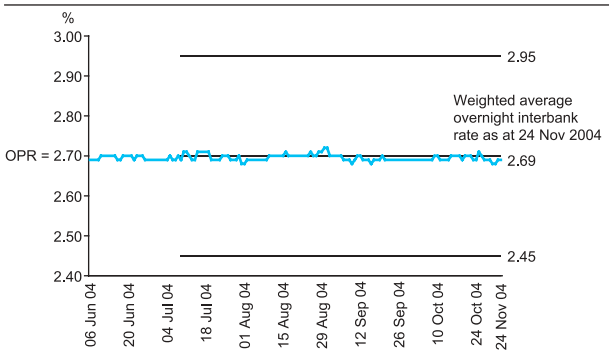
funded entirely from domestic sources. As at end-September 2004, total outstanding debt of the Federal Government amounted to RM204.4 billion or 46.6% of GDP. The external debt of the Federal Government continues to remain low, at 18.1% of the nation's outstanding external debt or 8% of GDP.

MONETARY AND FINANCIAL DEVELOPMENTS

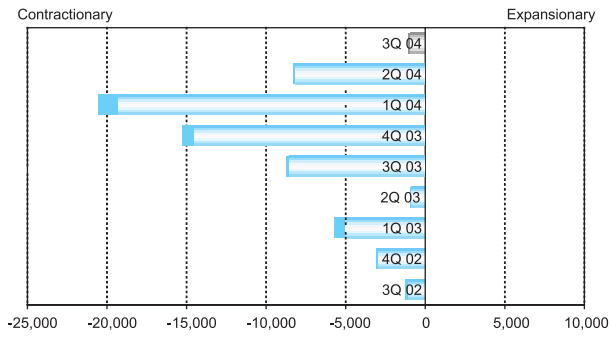
Monetary policy continued to support growth

Monetary and financial indicators during the third quarter reflected sustained expansion in underlying economic activity. In an environment of low inflation, the Overnight Policy Rate (OPR) was maintained at 2.70%. The daily weighted average of the overnight interbank rate moved within a narrow range of 2.68% - 2.72%, averaging 2.69% in the period 1 July - 24 November.

Daily Weighted Average Overnight Interbank Rate

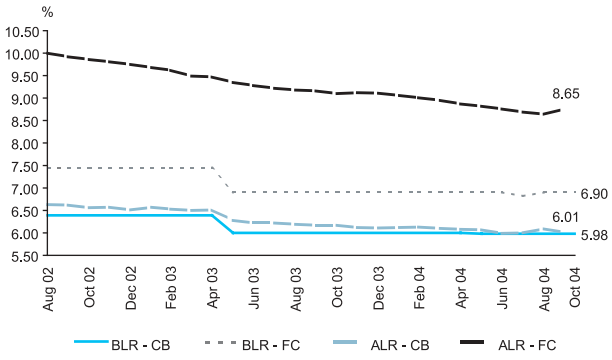


BNM Liquidity Operations
(During the quarter, RM m)



The three mergers between three commercial banks and their finance companies, which occurred during the quarter, led to some technical adjustments of the banks' base lending rates (BLRs) and average lending rates (ALRs). Notwithstanding these adjustments, the average BLR of commercial

Lending Rates of Commercial Banks & Finance Companies
(average for the month)



Interest Rates

	3Q 03	2Q 04	3Q 04
	At end-period (%)		
3-month intervention rate *	4.50		
Overnight Policy Rate (OPR)*		2.70	2.70
Interbank rates			
Overnight	2.71	2.70	2.69
1-month	2.99	2.81	2.79
Base lending rates (BLR)			
Commercial banks	6.00	5.98	5.98
Finance companies	6.90	6.90	6.90
Average lending rates			
Commercial banks	6.17	5.99	6.01
Finance companies	9.16	8.76	8.76
Fixed deposit rates			
Commercial banks			
3-month	3.00	3.00	3.00
12-month	3.70	3.70	3.70
Finance companies			
3-month	3.00	3.00	3.00
12-month	3.68	3.70	3.70

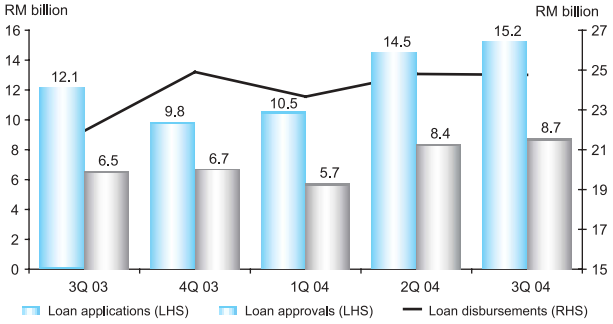
* Effective 26 April 2004, the Overnight Policy Rate (OPR) replaced the 3-month intervention rate as the indicator of the monetary policy stance.

banks (CBs) and finance companies (FCs) remained stable at 5.98% and 6.90% respectively at end-September 2004. The technical adjustments, however, caused the average lending rate (ALR) of CBs to increase slightly to 6.01% while the ALR of FCs remained unchanged at 8.76% at end-September.

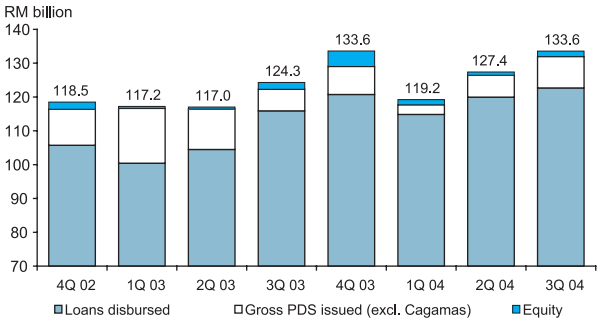
Financing of the private sector was sustained

Gross private sector financing through the banking system and the capital market increased at an annual rate of 7.5% in the third quarter to RM133.6 billion. This amount was higher than levels recorded in the first two quarters of this year, and reflected the higher bank loan disbursements and the larger issuance of PDS. On a net basis, banking system loans and PDS outstanding grew at an annual rate of 8% at end-September (8.2% at end-June).

Bank Lending to SMEs



Gross Private Sector Financing through Banking System and Capital Market



Financing of the Private Sector through Banking System and Capital Market

	During the period (RM billion)				Annual growth (%)		
	2003	3Q 03	2Q 04	3Q 04	2003	2Q 04	3Q 04
Gross total financing	492.1	124.3	127.4	133.6	9.0	8.9	7.5
Loans disbursed *	441.6	115.9	120.0	122.7	7.3	14.8	5.8
Gross PDS (excl. Cagamas)	42.8	6.4	6.5	9.3	60.5	-46.0	45.5
Equity	7.8	2.0	1.0	1.6	-41.5	66.0	-20.0
Outstanding total financing (A)+(B)	57.8	14.8	15.9	14.5	10.3	8.2	8.0
Banking system	28.1	9.6	14.1	10.9	5.9	6.4	6.5
Loans outstanding (A)	21.6	8.6	13.6	9.3	4.8	6.2	6.2
Holding of PDS	6.6	0.9	0.5	1.7	23.8	8.8	10.9
PDS outstanding (B)	36.2	6.1	2.3	5.2	33.4	15.4	14.0
Memorandum item							
Gross PDS (incl. Cagamas)	51.0	10.2	7.5	12.7	40.8	-41.9	25.1

* Banking system loans include loans sold to Cagamas.

Compared with the second quarter, the growth rates of most loan indicators moderated in the third quarter partly due to the high base effect. Loan disbursements to businesses grew by 5% on an annual basis (15.8% in the second quarter), with funds channelled mainly to the manufacturing sector (37.4% of total disbursements of businesses) and the wholesale, retail, restaurants and hotels sector (25.8%). The two forward looking indicators, applications and approvals of business loans, continued to register double digit growth rates, 29.4% and 10.1% respectively during the third quarter.

Loan disbursements to the small and medium enterprises (SMEs) grew at an annual rate of 12.8% in the third quarter (2Q 2004: 29.5%), contributing to an 8.1% growth of total loans outstanding to the SMEs at end-September (7.4% at end-June). A total of

Loan Indicators

	During the period (RM billion)				Annual Growth (%)			
	2003	3Q 03	2Q 04	3Q 04	2003	3Q 03	2Q 04	3Q 04
Total								
Loan applications	227.6	62.8	70.4	76.5	4.8	7.8	32.9	21.9
Loan approvals	152.8	40.2	46.6	46.7	11.1	7.3	21.4	16.2
Loan disbursements	441.6	115.9	120.0	122.7	7.3	14.6	14.8	5.8
Loan repayments	430.4	109.9	110.3	118.3	6.9	8.7	14.0	7.6
Change in loan outstanding *	21.6	8.6	13.6	9.3	4.8	5.1	6.2	6.2
Of which:								
Business enterprises								
Loan applications	124.9	34.0	37.9	44.0	-7.7	-4.2	33.4	29.4
Loan approvals	77.3	20.4	23.6	22.4	12.8	7.3	18.4	10.1
Loan disbursements	303.4	79.5	82.8	83.4	7.6	17.0	15.8	5.0
Loan repayments	299.5	77.0	76.0	83.9	8.6	10.4	14.6	8.9
Change in loan outstanding *	-5.2	0.4	5.4	-0.4	-2.4	-1.0	0.2	-0.2
SMEs								
Loan applications	44.5	12.1	14.5	15.2	-8.6	n.a.	49.0	25.3
Loan approvals	25.9	6.5	8.4	8.7	-15.6	n.a.	42.1	33.7
Loan disbursements	87.1	21.9	24.8	24.8	76.0	n.a.	29.5	12.8
Change in loan outstanding *	7.4	1.5	2.9	2.2	10.0	7.3	7.3	8.1
Large corporations								
Loan applications	80.4	21.9	23.4	28.8	n.a.	n.a.	25.3	31.6
Loan approvals	51.4	13.8	15.2	13.7	n.a.	n.a.	8.5	-1.0
Loan disbursements	216.3	57.5	58.0	58.6	-7.0	n.a.	10.7	2.0
Change in loan outstanding *	-12.7	-1.1	2.5	-2.6	-8.8	-5.2	-3.8	-4.9
Households								
Loan applications	98.4	28.1	32.3	31.5	20.2	25.2	34.5	12.3
Loan approvals	72.0	19.2	22.8	23.4	7.6	8.3	25.5	22.0
Loan disbursements	114.4	30.6	31.5	34.1	8.9	14.1	15.4	11.3
Loan repayments	94.1	23.8	25.6	26.8	12.4	13.5	18.4	12.9
Change in loan outstanding *	26.2	7.9	8.0	10.4	12.8	12.3	13.5	14.2

*The annual growth is for end-period.
Source: Bank Negara Malaysia

Loans by Sector

	Loans disbursed					Loans out-standing
	During the period				Share of total	Share of total
	2003	3Q 03	2Q 04	3Q 04		
	RM billion				%	
Business enterprises	303.4	79.5	82.8	83.4	68.0	*43.4*
Large corporations	*216.3*	*57.5*	*58.0*	*58.6*	*47.8*	*26.3*
SMEs	*87.1*	*21.9*	*24.8*	*24.8*	*20.2*	*17.1*
Households	114.4	30.6	31.5	34.1	27.8	50.9
By sector						
Agriculture, hunting, forestry and fishing	11.1	3.1	3.7	3.5	2.8	2.2
Mining and quarrying	1.7	0.7	0.4	0.4	0.4	0.2
Manufacturing	110.3	27.9	30.7	31.2	25.4	12.7
Broad property sector	78.9	21.1	21.7	22.9	18.6	40.4
Construction	*27.5*	*7.3*	*7.3*	*7.6*	*6.2*	*6.0*
Purchase of residential property	*35.6*	*9.7*	*9.7*	*10.4*	*8.4*	*25.7*
Purchase of non-residential property	*9.7*	*2.6*	*2.9*	*3.2*	*2.6*	*6.0*
Real estates	*6.1*	*1.4*	*1.9*	*1.8*	*1.4*	*2.7*
Electricity, gas and water supply	6.0	2.0	1.5	1.2	0.9	1.1
Wholesale, retail, restaurants and hotels	70.1	17.1	20.0	21.5	17.5	8.3
Transport, storage and communication	12.0	4.3	2.8	1.7	1.4	1.8
Finance, insurance and business services	36.7	9.7	8.8	8.5	7.0	5.9
Consumption credit	72.4	18.9	20.4	22.1	18.0	19.8
Of which:						
Credit cards	*30.5*	*7.9*	*8.6*	*9.3*	*7.6*	*2.7*
Purchase of passenger cars	*24.5*	*6.7*	*7.1*	*7.9*	*6.4*	*13.8*
Purchase of securities	12.9	4.0	2.8	3.2	2.6	4.0
Purchase of transport vehicles excluding passenger cars	1.2	0.2	0.2	0.1	0.1	0.5
Others	28.3	7.0	7.1	6.4	5.2	2.9
Total	**441.6**	**115.9**	**120.0**	**122.7**	**100.0**	**100.0**

Source: Bank Negara Malaysia

RM8.7 billion was approved to 25,379 SME accounts during the quarter up from RM8.4 billion to 22,161 SME accounts in the second quarter. An important development during the quarter was the establishment of the National SME Development Council in August to coordinate policy initiatives and to ensure the effective implementation of policy measures to develop this sector.

Financing to the household sector continued to support the growth of private consumption during the quarter. Total loan disbursements to households rose at an annual rate of 11.3% (2Q 2004: 15.4%). The bulk of the loans disbursed were for the purchase of residential property (30.4% of total disbursements to households), credit card

spending (27.2%) and the purchase of passenger cars (23.1%). While the disbursements of loans for credit card spending continued to grow at a strong annual rate of 18%, these were matched to a large extent by high repayments (annual growth rate of 14.8%). Overall, outstanding balances on credit cards represented 2.6% of total loans outstanding and 5.2% of total loans outstanding of the household sector at end-September (2.6% and 5.1% respectively at end-June). Meanwhile, both forward-looking loan indicators of loan applications and loan approvals moderated from the high levels registered in the previous quarter to register sustainable annual growth rates of 12.3% and 22% respectively in the third quarter (34.5% and 25.5% respectively in the second quarter).

Sustained expansion in broad money

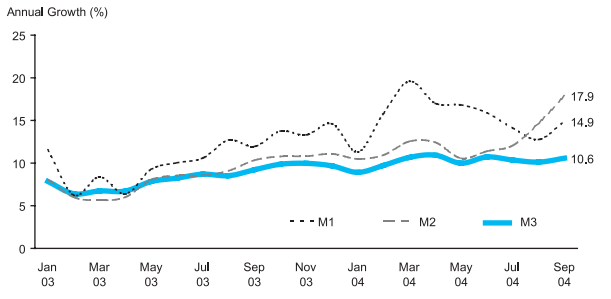
The annual growth rate of broad money, M3, was 10.6% at end-September 2004. The quarterly expansion in M3 by RM13.6 billion in the third quarter (+RM9.9 billion in 2Q 2004) was attributed to higher external inflows in the form of repatriation of export proceeds, some portfolio and FDI inflows (3Q 2004: +RM12 billion; 2Q 2004: +RM6 billion) and the sustained increase in the claims on the private sector (3Q 2004: +RM10.7 billion; 2Q 2004: +RM12.2 billion). M1 continued to increase at a double-digit annual growth rate, reflecting resilient consumer and business spending during the quarter[1].

M3 Determinants

	Change during the period				
	Yearly	Quarterly			Jan-Sep
	2003	1Q 04	2Q 04	3Q 04	2004
	RM billion				
M3	48.5	18.9	9.9	13.6	42.3
Net claims on Government	12.9	-6.0	-2.0	-2.5	-10.5
Claims on private sector	31.3	3.8	12.2	10.3	26.2
Net external operations*	20.8	33.3	6.0	12.0	51.3
Other influences	-16.5	31.7	-6.4	-6.2	19.2

* Pre-revaluation

Monetary Aggregates



Higher new funds raised in the capital market

In the third quarter, total net funds raised from the capital market were significantly higher, amounting to RM16.9 billion (2Q 2004: RM3.9 billion). Improved market sentiment and the increased importance of the capital market as a source of financing for the private sector were reflected in higher funds raised from both the private debt securities (PDS) and equity markets.

As in the last quarter, the new issuances of private debt securities (PDS) were mainly to finance new activity (49% of total issuance). Corporations that utilised the PDS market were mainly from the electricity, gas and water supply, and the manufacturing sectors. Of significance, Islamic debt securities formed 59.2% of the total new PDS issues during the quarter. On a net basis,

[1] The stronger growth of M2 was attributed to the three mergers of finance companies with commercial banks, which led to the reclassification of the deposits held by the finance companies. M2 includes M1 and the sum of deposits/interest bearing instruments placed by the non-bank private sector with the commercial banks and Islamic banks.

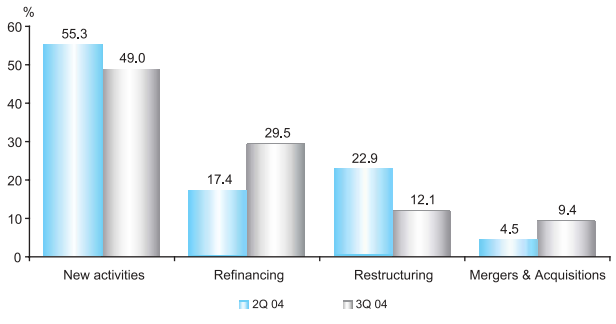
funds raised through the PDS market were higher at RM5.9 billion, compared with a net redemption of RM1 billion in the previous quarter.

Funds Raised in the Capital Market

	2Q 03	3Q 03	2Q 04	3Q 04
	RM million			
By Public Sector				
Malaysian Government Securities (MGS), *gross*	8,132	12,632	14,763	10,389
Less Redemptions	1,500	6,800	9,700	2,000
Less Government holdings	0	0	0	0
Equals Net Federal receipts	6,632	5,832	5,063	8,389
Khazanah Bonds, *net*	-138	-183	-1,000	-198
Government Investment Issues (GII), *net*	0	0	-560	740
Malaysia Savings Bond, *net*	-2	-2	0	0
Merdeka Savings Bond, *net*	0	0	497	495
Net Funds Raised	6,491	5,647	4,001	9,426
By Private Sector				
Shares	584	2,028	969	1,663
Debt securities	12,911	10,165	7,498	12,718
Private Debt Securities (excluding Cagamas)	*11,966*	*6,370*	*6,463*	*9,268*
Cagamas	*945*	*3,795*	*1,035*	*3,450*
Less Redemptions	9,602	4,472	8,558	6,865
Net Issues	3,310	5,694	-1,060	5,853
Net issues (excluding Cagamas)	*4,135*	*3,754*	*75*	*4,925*
Net Funds Raised	3,894	7,722	-91	7,516
Total Net Funds Raised	10,385	13,368	3,910	16,942
Short-term papers and notes, *net**	-1,437	-85	-1,213	-623
TOTAL	8,949	13,283	2,697	16,319

*Refers to Commercial Papers and Cagamas Notes only.

Private Debt Securities Issued by Purpose
(% of total)



In the equity market, improved market sentiment during the quarter resulted in higher funds raised, totalling RM1.6 billion, of which RM1.2 billion were raised from 16 initial public offerings. There were 15 new listings on Bursa Malaysia, with one listing on the Main Board, six on the Second Board and eight on MESDAQ.

Meanwhile, funds raised by the public sector were lower at RM12.6 billion (2Q 2004: RM16.7 billion). The bulk of the funds were raised through the issuances of four Malaysian Government Securities (MGS). Of significance, a long tenured 15-year MGS of RM2 billion was successfully issued in July. After adjusting for redemptions, net funds raised in the public sector amounted to RM9.4 billion (2Q 2004: RM4 billion).

KLSE CI strengthened on positive sentiment

In the third quarter, the KLSE CI ended on a stronger note as market sentiment improved following the release of better quarterly corporate earnings and the announcement of the 2005 Budget, which contained proposed measures to liberalise Malaysia's capital market. Overall, the KLSE CI increased by 3.7% to 849.96 at end-September (end-June 2004: 819.9). Market capitalisation at the end of the quarter was higher by 2.9% at RM672.64 billion (end 2Q

Bursa Malaysia: Selected Market Indicators

	As at end				
	2Q 03	3Q 03	1Q 04	2Q 04	3Q 04
Price Indices					
Composite	691.96	733.45	901.85	819.86	849.96
EMAS	170.23	182.03	219.76	197.34	202.35
Second Board	108.96	122.03	135.33	117.17	108.95
Average daily turnover					
Volume (million units)	286.7	644.3	650.6	332.7	338.9
Value (RM million)	457.2	958.1	1,328.2	714.6	659.3
Market Capitalisation (RM b)	532.5	572.3	724.2	653.9	672.6
No. of Companies Listed	877	889	923	934	945

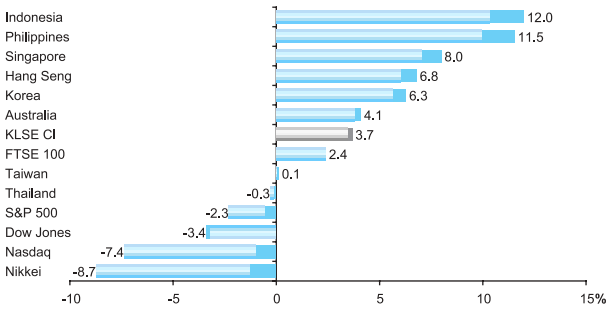
Source: Bursa Malaysia

Bursa Malaysia: Turnover of Corporate Securities

	During the period									
	2Q 03		3Q 03		1Q 04		2Q 04		3Q 04	
	million units	RM million	million units	RM million	million units	RM million	million units	RM million	million units	RM million
Turnover	17,776	28,349	41,877	62,274	37,737	77,036	20,478	43,964	22,031	42,852
of which:										
Main Board	14,421	24,648	27,849	46,225	27,626	61,454	14,826	37,062	15,494	36,763
of which:										
Consumer Products	509	1,959	857	2,768	1,173	3,905	782	2,605	1,154	3,149
Industrial Products	1,429	2,105	3,911	5,406	4,087	6,067	2,211	3,663	2,031	2,719
Construction	1,181	1,796	2,088	3,967	1,693	4,044	862	1,911	1,096	1,706
Trading / Services	3,329	9,009	5,993	14,829	5,632	19,975	3,509	12,723	4,296	13,729
Finance	1,908	4,422	3,497	8,471	4,536	14,521	2,342	7,728	2,008	7,838
Properties	2,942	2,210	5,215	4,567	4,159	5,145	2,155	2,978	2,230	3,560
Plantations	307	1,129	675	1,815	762	3,106	539	2,779	383	2,127
Mining	53	92	42	67	43	140	5	30	0	4
Second Board	2,685	3,377	8,069	12,103	6,258	11,249	4,018	5,468	4,014	4,130

Source: Bursa Malaysia

Performance of Selected Global and Regional Markets in the Third Quarter of 2004

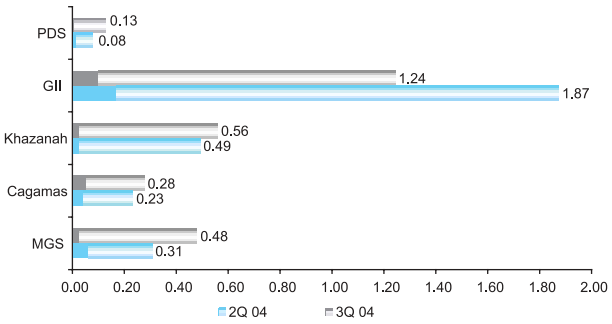


2004: RM653.94 billion) while the average daily turnover for the quarter was higher at 333.8 million units.

Higher secondary trading in the bond market

Total turnover in the secondary bond market increased to RM69.8 billion in the third quarter (2Q 2004: RM43.1 billion), due mainly to greater interest in the bond market, following concerns over the impact of rising oil prices on world growth. During the quarter, trading activities were concentrated on 3- and 5-year MGS papers. In terms of liquidity, the GII and Khazanah bonds were the most liquid papers, with liquidity ratios of 1.24 and 0.56 respectively.

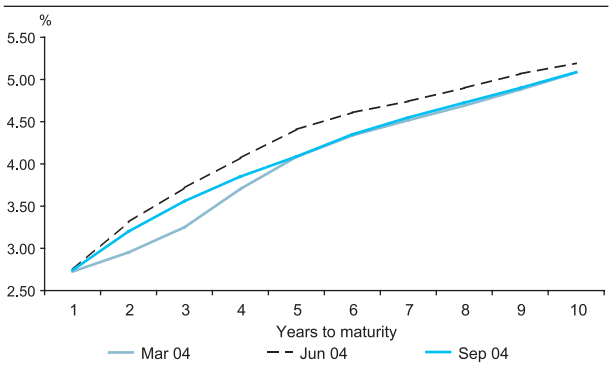
Liquidity Ratio: Turnover/Outstanding



MGS benchmark yields trended lower in the third quarter. The 3- and 5-year MGS benchmark yields declined by 16 and 32 basis points respectively towards the end of the third quarter, reflecting mainly the increased demand for fixed income securities, following concerns over the impact of higher oil prices

on global economic performance. Market participants responded positively to the revision of the regulatory treatment for new Cagamas bonds and the withholding tax exemption for non-residents on income earned from investment in Islamic securities and debentures announced in September.

Trend in MGS Yield

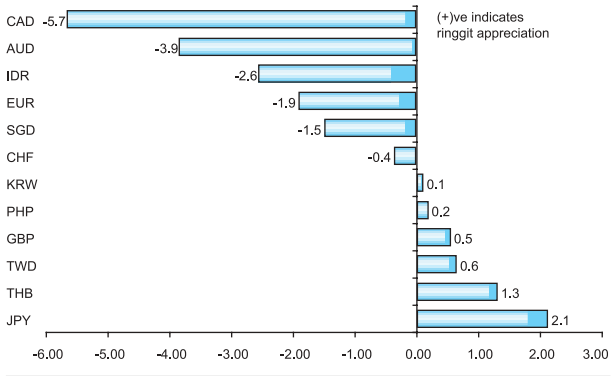


Performance of the ringgit

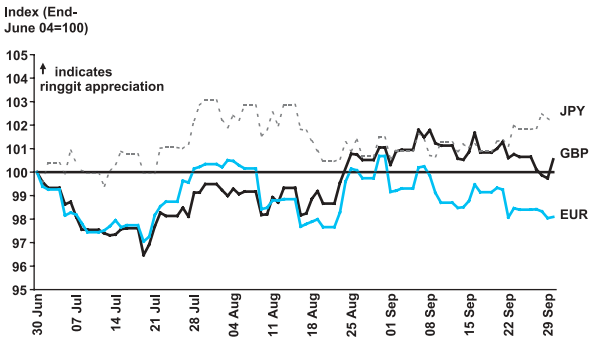
In the third quarter of 2004, the ringgit recorded a mixed performance against the major currencies. The ringgit depreciated against the euro as the US dollar was affected by market concerns over the impact of rising oil prices on US growth. In contrast, the ringgit appreciated against the Japanese yen. Concerns over the impact of rising oil prices on the Japanese economy were also evident given Japan's high dependency on oil imports. The yen depreciated against the dollar as a result of an increase in the demand for the dollar to finance the higher cost of oil imports. Against the regional currencies, the ringgit also recorded a mixed performance.

Notwithstanding the volatility of the exchange rates of major and regional currencies, the ringgit's trade-weighted value continued to remain consistent with the underlying fundamentals of the economy.

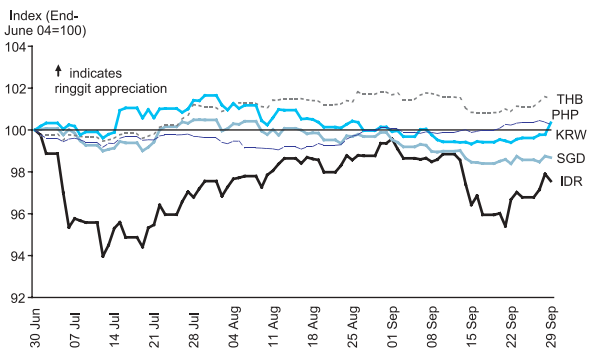
Summary of Ringgit Performance Against Selected Currencies
Percent Change (1 July - 30 September 2004)



Ringgit Performance Against Major Currencies



Ringgit Performance Against Regional Currencies



Performance of Ringgit Against Selected Currencies

RM per foreign currency	As at end				% change since *		
	30 Jun 97	02 Sep 98	2Q 04	3Q 04	30 Jun 97	02 Sep 98	2Q 04
US dollar	2.5235	3.8000	3.8000	3.8000	-33.6	0.0	0.0
Euro	-	-	4.5933	4.6826	-	-	-1.9
Pound sterling	4.1989	6.3708	6.8719	6.8347	-38.6	-6.8	0.5
100 Japanese yen	2.2088	2.7742	3.4991	3.4264	-35.5	-19.0	2.1
Singapore dollar	1.7647	2.1998	2.2139	2.2475	-21.5	-2.1	-1.5
100 Thai baht	9.7470	9.3713	9.2841	9.1644	6.4	2.3	1.3
100 Philippine peso	9.5878	8.8302	6.7640	6.7517	42.0	30.8	0.2
100 Indonesian rupiah	0.1038	0.0354	0.0404	0.0414	150.5	-14.6	-2.6
100 Korean won	0.2842	0.2827	0.3298	0.3295	-13.7	-14.2	0.1

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

DEVELOPMENTS IN THE BANKING SYSTEM

The financial position of the banking system remained strong in the third quarter. Asset quality improved further amidst an expansion in lending activities by the banking system, which continued to support economic growth. The level of capitalisation and profitability remained strong, despite a marginal decline in the level of capitalisation, following the completion of the mergers between commercial banks and finance companies (Bafin mergers). The level of capitalisation is however, expected to strengthen upon the inclusion of audited profits.

Capitalisation remains high amidst mergers

The risk-weighted capital ratio (RWCR) and core capital ratio (CCR) of the banking system declined to 13.8% (-0.5 ppts) and 11.3% (-0.4 ppts) respectively. This was attributed to lower capital base (-RM1.7 billion) as a result of the Bafin mergers and higher total risk weighted assets (+RM5.8 billion) following higher lending activities.

Capital Position Remained Strong

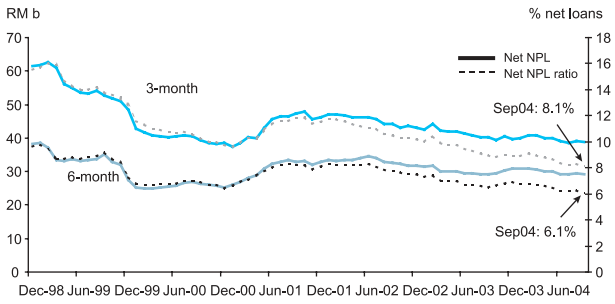
	2003		2004		
	3Q	4Q	1Q	2Q	3Q
Capital					
CCR (%)	10.9	11.1	11.0	11.7	11.3
RWCR (%)	13.4	13.8	13.7	14.3	13.8

Profitability remains favourable

The profitability of the banking system remained favourable with RM2.8 billion pre-tax profit recorded during the third quarter, compared to RM2.4 billion in the corresponding quarter of last year. Consequently, the annualised return on average assets and equity of the banking system improved to 1.3% and 15.4% respectively (3Q 2003: 1.2% and 14.3%).

Further decline in NPLs

Banking system: Non-performing loans



Net non-performing loans (NPLs) based on the 6-month classification continued the downward trend to RM29.1 billion to account for 6.1% of total net loans, the lowest level post-Asian crisis (2Q 2004: 6.2%). The improvement was largely due to lower incidences of new NPLs and higher write-offs. Similarly, the net NPLs based on 3-month classification improved to RM38.8 billion or 8.1% of total net loans (2Q 2004: 8.4%).

ASLI's Conference on Developing Islamic Banking & Capital Market
25 August 2004, Kuala Lumpur

"New Opportunities, New Market and New Frontier in Islamic Banking & Finance"

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

I. Introduction

Islamic banking and finance has emerged as a financial intermediation process that is competitive and resilient and that contributes to the overall wealth creation, growth and development of our nation. Amidst an increasingly challenging and competitive financial environment, the evolution of a comprehensive Islamic financial system seeks to meet the range of requirements of a rapidly changing economic environment, with its soundness and stability secured through the robustness of its regulatory framework supported by the strength of its financial infrastructure and the sophistication of its products and services. Indeed, the strength of the respective components of the system and the interconnections of its markets will open new frontiers in Islamic banking and finance and will maximize the potential and opportunities that it accords.

The Islamic financial system in Malaysia has evolved as a viable and competitive component of the overall financial system, complementing the conventional financial system as a driver of economic growth and development. The rapid progress of the domestic Islamic financial system, reinforced by significant developments in the Islamic financial infrastructure, including the legal and Shariah infrastructure and the regulatory and supervisory framework, has strengthened the position of the Islamic financial system as an increasingly important component in meeting the changing requirements of the new economy. The Financial Sector Masterplan launched three years ago provides the strategic direction envisioned for the development of the Islamic financial sector looking beyond the near term and taking a longer-term perspective into the needs and requirements of the future. The strategies outlined in the Plan have emphasized the development of the respective building blocks of the various parts of the financial sector that need to be put in place to form the solid foundation on which sustainable future progress can be achieved. The expansion of the Islamic financial system in Malaysia has therefore taken place with attention given for the development of a comprehensive system.

II. Towards A More Diversified Islamic Financial System

At the onset of our journey in the development of a comprehensive Islamic financial system that is progressive, efficient, dynamic and sustainable, due attention was thus given to the development of the key structural components of the Islamic financial system, comprising the Islamic banking industry, the takaful industry and the Islamic money and capital markets. The intra-dependency of these key components creates the enabling environment for the Islamic financial system to effectively perform its role as an efficient conduit for mobilizing resources and channeling the funds to finance productive economic activity. The absence of any particular component could reduce the effectiveness and efficiency and thus affect the viability and sustainability of the system. While the Islamic banking system has an important role in mobilizing deposits and providing financing, the Islamic capital market has an equally important role in providing a stable source of long-term funds for financing large investments and development projects as well as for capital and business expansion. The development of the Islamic capital market not only allows for a more balanced allocation of financial and economic resources within an economy but more importantly, ensures greater diversification of risks within the Islamic financial system. This enhances the resilience and robustness of the Islamic financial system to withstand financial shocks and contributes to the overall stability of the Islamic financial system.

In terms of the development of our Islamic financial system, as at June 2004, the assets mobilized by the Islamic banking sector have increased to RM89.1 billion, accounting for a market share of about 10% of the banking system. At the same time, deposits have also increased to RM64 billion, constituting a market share of 10.4% while financing mobilized amounted to RM54 billion to garner 11% of the market share. Product offerings have also increased in sophistication from the deposit products to hybrid products that are able to enhance returns to depositors. A further advancement was made with the introduction of the Islamic variable rate financing mechanism that provides an alternative to the fixed-rate financing. This will assist the Islamic banking institutions in mitigating part of the risks emanating from asset and liability mismatches.

The Islamic capital market, in particular, the Islamic debt market, has also experienced rapid growth since its emergence in the 1990s. The issuance of Islamic bonds has expanded steadily at an average growth rate of 33.7% since 1995. In 2003, the total funds raised via the issuance of Islamic bonds amounted to RM8.1 billion, constituting 19% of the total funds raised in the bond market. New innovative Islamic financial instruments such as Islamic asset-backed securities have also emerged and the financial structures underlying Islamic securities have become more diversified. The number of Shariah-based unit trust funds has also grown consistently over the years to reach 55 in 2003 with a net asset value of RM4.75 billion, constituting a market share of

6.8%. The rapid growth of Islamic unit trusts comprising a variety of bond funds, equity funds and balanced funds increases the efficiency and potential of the Islamic financial system as an intermediation channel by providing investors access to professional asset management that is based on their distinct risk tolerance levels.

The development of a vibrant, efficient and effective Islamic capital market requires the creation of a broad spectrum of innovative Islamic financial instruments and the infrastructure to promote active trading so as to enhance the breadth and depth of the market. In the development of Islamic financial instruments, the challenge is to develop innovative and more diverse Islamic financial structures that are not only able to accord flexibility to issuers in managing their distinct financing requirements but also able to meet investor's demand in accordance with their risk and return preferences.

At the international level, the successful issuance of the first sovereign global Islamic sukuk by the Government of Malaysia which attracted significant interest from a wide international investor base, acted as a catalyst for other countries and corporations to tap the international Islamic financial market and provided the impetus to the development of the International Islamic Financial Market (IIFM). The IIFM is entrusted with the task of creating an enabling environment that will encourage active participation by both Islamic and non-Islamic financial institutions in the secondary market for Islamic financial instruments. Strategic alliances such as those forged between IIFM, the Labuan International Financial Exchange and the Bahrain Stock Exchange will further pave the way for cross-border listing and trading of Islamic financial products. This will increase international investors' access to Islamic financial instruments, enhance liquidity and spur the development of an Islamic capital market with greater global reach.

III. Strengthening the Foundations for the Development of a Sound, Progressive and Sustainable Islamic Financial System

The strengthening of the financial infrastructure is a key pre-requisite for the development of a dynamic and progressive Islamic financial system. An important feature of a comprehensive and well-developed financial infrastructure is the diversity of the players and institutions in the system that have been developed based on their distinctive capabilities and competitive advantage thus raising their performance level, valued added and contribution to overall growth and development. In addition, as part of the strategy to enhance our integration with the international financial system and to strengthen our inter-linkages with other economies, the liberalization of the Islamic banking industry has been brought forward to take place in 2004. The issuance of new Islamic banking licences to qualified foreign financial institutions will allow for the presence of foreign Islamic banking players to act as a bridge between Malaysia and other global Islamic financial markets and increase the potential to tap new markets and growth opportunities. It will also contribute to spur

financial innovation as well as facilitate international trade and investment flows between Malaysia and the rest of the world.

An important dimension of the financial infrastructure is a comprehensive and effective legal infrastructure for legal redress arising from Islamic financial transactions. The legal infrastructure needs to comprise both effective regulatory and substantive laws as well as appropriate adjudicative fora for parties to resolve disputes relating to Islamic financial transactions. This will instill confidence and promote the sound expansion of the Islamic financial industry. Towards meeting this objective, the High Court of Malaysia has assigned a dedicated High Court to preside over litigated cases on matters relating to Islamic banking and finance. To complement the court system, disputes may also be referred to the arbitration centre for resolution. In this regard, the Kuala Lumpur Regional Centre for Arbitration will be enhanced to serve as a platform to deal with dispute cases on Islamic banking and finance, and to extend these services beyond our borders. In addition to the dispute resolution mechanisms, the Central Bank has formed the Law Review Committee to review the common law-based domestic legislations to assimilate Shariah principles with the aim of removing any impediments to ensure the unhindered and efficient functioning of the Islamic banking and financial system. This review covers tax and stamp duty laws, company laws, land laws and procedural laws.

An important consideration in the development of an effective legal framework for Islamic banking and finance is the need to ensure enforceability of Islamic financial contracts in accordance with Shariah principles. In this regard, the Central Bank of Malaysia Act 1958 was amended to position the Shariah Advisory Council of Bank Negara Malaysia as the sole authority on Shariah matters pertaining to Islamic banking and finance that fall under the purview of the Central Bank. With this stature, the Shariah Advisory Council will therefore serve as the reference point for the court or arbitrator in dispute resolution that involves Shariah issues in Islamic banking and finance cases.

To further strengthen the Shariah infrastructure, guidelines will be issued to define the new structure, roles and functions of the Shariah Committees of the Islamic banks, the Islamic Banking Scheme banks and the takaful operators. The guidelines would specify among others, the requirements for the appointment of the Shariah Committee members and the duties and responsibilities of Islamic financial institutions to facilitate the effective functioning of the Shariah Committee. In the Islamic capital market, the establishment of a strong Shariah infrastructure is equally pertinent to ensure that the structuring of Islamic capital market instruments, the construction of Islamic investment funds and the execution of Islamic investment fund strategies are Shariah-compliant. This is important to preserve the integrity of the Islamic financial system and promote confidence that Islamic banking and financial operations do not deviate from the dictates of the Shariah.

The hallmark of a well-developed financial infrastructure is an effective

regulatory and supervisory framework which underpins the stability of the financial system. The regulatory and supervisory function is an indispensable and vital component of the financial infrastructure. In a dual financial environment, the prudential regulatory design needs to take into account the unique characteristics peculiar to Islamic banking and finance as well as provide a level playing field in relation to conventional banking and finance so as to ensure that Islamic financial institutions and transactions are not at a comparative disadvantage. It also needs to assess and mitigate any potential regulatory arbitrage practices between the conventional and Islamic financial system that could undermine the stability of the overall financial system. While conventional banking is primarily premised on an interest-based debtor-creditor relationship, Islamic banking transactions are relatively more complex arising from the diverse contractual relationships between the Islamic financial institutions and their customers, ranging from the low risk sales and lease-based modes of finance to the higher risk equity-based modes. Each of these modes of finance has a distinct intrinsic characteristic dictated by its underlying Shariah principles and thus, entails different risk profiles. Therefore, the risk management infrastructure in Islamic financial institutions must be in place to identify, unbundle, measure, monitor and manage all the specific risks in Islamic financial transactions and instruments to provide for their effective quantification and management. The establishment of the Islamic Financial Services Board (IFSB) in 2002 marks an important milestone in the development of internationally accepted prudential regulatory standards and best practices for the Islamic financial services industry. Since its establishment, the IFSB has attracted wide participation. To date, there are 13 full members, 4 associate members and 35 observer members in the IFSB. The technical committee of the IFSB is now in the final stages of the formulation of the prudential standards on capital adequacy and risk management. The IFSB has also commenced work on standards for corporate governance.

Whilst appropriate regulations and standards are vital to mitigate the risks involved, of equal importance is the oversight and monitoring of the Islamic financial institutions through effective supervision by the regulatory authority to ensure that the prudential requirements are observed. Lack of oversight, inadequate check and balances, and over exposure to risks are amongst the factors that may result in vulnerabilities to the system. The best of regulations and financial safety nets would not be able to avoid vulnerabilities if early warning systems are not in place. To effectively perform the supervisory function it is important to not only identify the risks involved in the various Islamic financial transactions but also to be able to detect any contravention of Shariah principles in financial transactions and operations.

A central feature of the regulatory framework for Islamic financial institutions is financial transparency and disclosure. This is particularly pertinent for Islamic financial transactions. For example, investment depositors in the Islamic banking institutions have the role of quasi shareholders that are not only entitled to share the profits of the

Islamic banking business but are also exposed to the risks of losing their capital in the event of losses. In this connection, the issuance of a standard framework for the derivation of the rate of return in Islamic banking business has an important role in addressing the information asymmetry between the Islamic banking institutions and the depositors so as to ensure depositors receive their appropriate share of returns on the investment. In addition, the issuance of the guidelines on the model financial statement for Islamic banks will provide for greater disclosure on the risk and return profiles of the different categories of deposits. This will enable depositors to obtain the true and fair assessment of the Islamic banks' financial performance and hence, promote confidence and strengthen the competitiveness of the Islamic financial industry.

Enhanced financial disclosure needs to be complemented by customer education and awareness programmes to elevate the level of financial literacy of consumers and businesses to be able to make informed financial decisions and instill market discipline amongst financial players. The launching of the Consumer Education Programme and the organization of the Islamic Banking and Takaful Week are aimed at achieving these objectives. These programmes have contributed to enhance the understanding and appreciation of the unique characteristics of Islamic banking and finance, Islamic financial products and services and their underlying Shariah principles and concepts. Enhanced awareness on the manner in which Islamic financial transactions are being conducted and Islamic financial contracts are being executed will not only strengthen the role of market discipline in driving Islamic financial institutions towards ensuring Shariah compliance in the operations, but also contribute towards improving operational efficiency, strengthening risk management infrastructures and instituting sound and dynamic risk management practices.

IV. Conclusion

To harness the full potential of the Islamic financial system, genuine endeavours to strengthen further the Islamic financial infrastructure, to develop the Islamic financial markets and to innovate Islamic financial instruments and activities that are able to meet the changing requirements of the new economy and the contemporary global marketplace need to be continuously pursued. With the acceleration of the global integration of Islamic finance, it will provide the synergies and opportunities for the Islamic financial industry to evolve into an important component of the international financial system that can contribute to enhance the prospects for a more balanced global growth and global financial stability.

Asian Islamic Banking & Finance Summit
21 September 2004, Kuala Lumpur

"Towards Creating an Islamic Financial System as an Integral Part of the International Financial System - Strategies and Challenges"

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

I. Introduction

The integration of Islamic finance with international financial markets and institutions has demonstrated its viability, competitiveness, resilience and sustainability as a form of financial intermediation. This trend has contributed towards facilitating greater cross border flows in terms of increased trade and investment transactions thereby strengthening the global economic and financial linkages. As this international integration process intensifies, it not only raises the prospects for more balanced global growth but also allows for greater diversification of risks thus contributing towards greater global stability. At the core of this financial globalisation process is the robustness and resilience of the domestic Islamic financial system. The development of a sustainable Islamic financial system that is able to withstand the challenges of the uncertainties and instabilities inherent in the global financial system, thus not only requires an effective global financial architecture but a system that is also supported by an appropriate, comprehensive and sound domestic financial infrastructure. These mutually reinforcing structures would not only accentuate wealth creation and foster greater potential for trade but would also promote global financial stability and breakthroughs in new business relationships.

While the overall development of Islamic banking and finance for more than three decades has been evolutionary, the pace has intensified in recent years. Islamic financial concepts have been incorporated into many financial products to meet the changing needs of consumers, businesses and investors. New Islamic financial institutions are being established ranging from the traditional banking institutions to more specialised financial institutions. This Islamic financial landscape has been supported by a well-developed regulatory, prudential, legal, accounting, framework and reinforced by the necessary research and development. Initiatives to promote greater awareness and education amongst Muslims and non-Muslims have also been intensified.

In this recent decade, we have seen the financial globalisation of Islamic finance

with the participation of both the authorities and the private sector. In the case of the former, attention has been given to developing the financial infrastructure, including the financial markets, institutions and agencies as well as establishing the necessary prudential and accounting standards. While the latter has included the borrowers, investors and institutions that participate in the process. Sovereigns, corporations and multinational and multilateral entities have accessed the international markets while the institutions and investors have been a source of financing. Indeed, these funds are either raised directly from international banking institutions or through bonds and equity issues in international markets. It has not only expanded the investor base, but reduced the cost of capital and enhanced its liquidity. By operating beyond their domestic borders, financial institutions also provide their services from different geographical locations. There has also been greater use of international financial institutions by corporations, households and funds to increase their ability to diversify their risks. Investments in the domestic economies have also been financed by foreign capital. International firms have also participated in local markets through Islamic based financial structures. With increased liberalization, there is also increased foreign presence in terms of foreign entry into the domestic financial system. This is an area where Malaysia is taking a step forward during the course of this year. The globalisation process has also taken place in terms of participation by firms in international capital markets through cross listings. My remarks today will focus on the strategies on the approach to accelerate the transition of Islamic finance towards being an integral part of the international financial system in terms of both the international financial architecture of the Islamic financial system and the development of a comprehensive domestic financial infrastructure.

The establishment of the Islamic Financial Services Board (IFSB) has been an important initiative in the development of the international Islamic financial architecture. It has been established to promulgate the international regulatory and supervisory standards for Islamic financial institutions aimed at achieving best practices and to secure soundness and financial stability in Islamic finance. In this regard, the IFSB has already made progress in developing the prudential standards on the capital adequacy and risk management framework, and has commenced work on developing standards on corporate governance.

Appropriate accounting standards have also been put in place to reflect the true and fair value of banking operations that would lead to greater accountability and responsibility on the part of financial institutions. While the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) has made a significant contribution in formulating and issuing accounting and auditing standards for Islamic financial institutions, efforts need to be intensified to promote of the adoption of these standards.

The International Islamic Financial Market (IIFM) further provides the environment that will encourage active participation by both

Islamic and non-Islamic financial institutions in the secondary market for Islamic financial instruments. Several global sovereign sukuks have been issued in the international market that has attracted wide interest, both by Muslim and non-Muslim investors. The next phase in this development is the raising of funds from this market by multinational corporations and multilateral institutions. As the volume increases, it would strengthen the inter-linkages and integration amongst the Islamic financial centres. In addition to structuring a variety of attractive off-the-shelf instruments, efforts need to be intensified to create a benchmark curve for future issues. With a well-developed system, the trading of instruments would encourage the free flow of capital movements and would in turn facilitate greater Islamic fund management activities.

As a platform to promote greater cooperation among Muslim countries and further promote IIFM, a proposal that can be explored is the creation of an Islamic universal bond, structured similar to the universally-accepted asset-backed Ijarah sukuk. Under this proposal, interested countries and selected organisations could be invited, where each country sells its assets to an SPV, which in turn would lease back the assets to the country. Proceeds could then be transferred to the participating country for the general purpose of socio-economic development. This could be an avenue for countries that have not secured stronger ratings to get more competitive funding. Indeed regional and multilateral entities would be well positioned to explore the viability of this proposal.

The role of Shariah is one of the key elements that can spur the innovation process and enhance the global integration of the Islamic financial system. To effectively enhance Shariah governance, the understanding of the mechanics of finance by the Shariah experts is imperative to assist in the deliberation process in deriving a sound Shariah decision. The Shariah decision should then be made transparent. With such disclosure, the ability for others to appreciate the juristic reasoning based on contemporary analysis and logical inference of process could lead to wider acceptance of a Shariah decision, especially if it has implications on cross-border transactions.

With better understanding, the likelihood of a Shariah convergence is higher and this will enable the creation and trading of Islamic financial instruments at the international arena to be more universally accepted, as interpretations will be uniform and consistent. Harmonisation of the differing views among the scholars from different schools of thought is necessary to enhance the global development of Islamic banking and finance. I believe, at this juncture, the right approach is to advocate mutual respect in any Shariah discourse where there are differences in opinions, interpretations and practices.

To complement the efforts to create a sustainable and comprehensive Islamic financial system, consumer education and awareness on Islamic banking and finance should be extensively undertaken. Concerted efforts between the governments and Islamic financial fraternities should be engaged to develop such a consumer education

programme. Such programmes would increase transparency on the virtues and availability of Islamic financial instruments offered by the Islamic financial institutions. How consumers can expect to benefit will depend on how well informed they are about the financial services being provided. Barriers across geographical boundaries can be removed by leveraging upon the advances on Information Communication Technology to create an integrated internet platform as means for the knowledge sharing on research findings, conference discussions, Shariah rulings and other vital information on Islamic banking and finance. Improvements can be made to the existing internet portals to be more comprehensive with linkages to other useful information providers. Equally important is the consumer protection infrastructure. An international financial information dissemination body should be set up to disseminate the development of Islamic banking and finance worldwide. In addition, with greater disclosure and transparency on the manner in which Islamic financial transactions are being conducted and the risk and return profiles of the products, the role of market discipline in driving Islamic financial institutions towards ensuring Shariah compliance will be strengthened. This will ensure operational efficiency, strengthen risk management infrastructures and institute sound and dynamic risk management practices.

As part of the process of enhancing inter-linkages with the rest of the world in the area of Islamic finance, Malaysia is also encouraging the domestic Islamic financial institutions to be more global by expanding beyond the domestic shores. With the experience that has been acquired in Islamic banking and finance that has been accumulated over more than three decades now, it is timely and desirable to extend this experience beyond our own borders. The domestic Islamic financial institutions would need to undertake feasibility studies and in-depth groundwork to identify new markets to expand their business operations, in particular with economies in which there is potential for greater economic linkages and integration.

As the pace of globalisation and liberalisation accelerates, securing financial stability and confidence has increased demands for more robust and resilient financial systems. While affected by some market instability and uncertainties, it has not, however, undermined the development of the global Islamic financial system that has now become an increasingly integral component of the international financial system.

The approach to building a sustainable and progressive domestic Islamic financial system involves the creation of the key components comprising the **Islamic banking industry, Islamic financial markets, the Islamic insurance or takaful market**, and fund management industry given the strong linkages, inter-dependence and synergies among these components in the system. In addition, to the financial intermediaries and fund managers, other institutional players such as brokers, specialists and corporate treasurers also have important roles to play.

Another area of focus is the growth of non-bank Islamic Financial institutions. In

Malaysia, the first included Tabung Haji, the Pilgrim Fund Board. Other components include institutions such as waqaf, corporate zakat, investment trusts, mutual funds and inheritance management. This is part of wealth management that will become more significant as the domestic economy enters into its next level of development and as savings across borders becomes more institutionalized. This will become an important source of funding for productive investment, in particular for large-scale investments. New forms of financial structures may be developed for this purpose.

In promoting Islamic finance in the Labuan offshore financial center, emphasis is being given to several of these areas, in particular, to promote the fund management industry including via the Labuan International Financial Exchange (LFX). Labuan will also be promoted as a center for waqaf administration. It will also promote the development and market acceptance of IIFM. In the LFX, dual listing and trading of capital market instruments are being undertaken, for both Islamic and conventional papers. This includes equities, debt instruments, bonds (sukuks), asset back securities and mutual funds. In addition, the Islamic capital market will be expanded through IIFM and strategic alliances with other stock exchanges. These offshore activities will thus complement the onshore activities. Not only has attention to be given to the financial infrastructure, the financial markets and to institutional development, but also to the regulatory, Shariah and legal dimension. The hallmark of a well-developed financial infrastructure is an effective legal, regulatory and supervisory framework which underpins the stability of the financial system. For the Islamic financial system, this framework also needs to be consistent with the requirements of the Shariah.

It is also recognised that good corporate governance reinforces sound regulation and supervision. This contributes towards maintaining market confidence, and strengthening transparency and accountability that is implicit in Islamic finance. Its emphasis is value-oriented and to promote fairness and justice with respect to all stakeholders of the financial institution. Transparency and disclosure is essential to this process. While the comprehensive and timely availability of financial information will increase market discipline, it also needs to be complemented with the ability of the market players to analyse, and appropriately interpret the information. Closely related to this issue is the need to strengthen the framework for consumer protection to provide an avenue for redress in the event of disputes.

Emphasis on improved corporate governance goes hand in hand with the need for improvements in risk management standards. Sound risk management practices will minimise adverse consequences faced by financial institutions during periods of uncertainty. Robust internal controls to provide qualitative standards are also necessary to complement the quantitative analysis of risk to provide the necessary checks and balances. In the area of Islamic banking, the requirement to manage the risks becomes more important because of the unique peculiarities in the contracts. Basel II has, to a certain extent,

incorporated some aspects in the identification of risks, in particular the credit, market and operational risks that can be assimilated by the Islamic banks in terms of its product offering.

Another important pre-condition to sustain the continued growth of Islamic banking and finance is a comprehensive legal infrastructure for legal redress arising from disputes in Islamic financial transactions. The legal infrastructure needs to comprise both effective regulatory and substantive laws as well as appropriate adjudicative fora to resolve disputes relating to Islamic financial transactions. To address this, efforts are needed to develop a sufficient number of competent lawyers and judges that are equipped with sound knowledge and expertise in both Shariah and civil laws to deal with such matters. This would need to be supported by an efficient court system that can effectively deal with all Islamic banking and finance cases, whose decisions are enforceable over the range of financial issues. Above all, these pre-conditions have to be in conformity with the Shariah framework.

Whilst it is necessary to have in place the market infrastructure, institutional players and the regulatory, Shariah and legal framework, it is still not sufficient in sustaining the robustness and dynamism of an Islamic financial system. To achieve this, the strong linkages and synergies especially among the components in the financial markets, namely, the money market, foreign exchange market and the capital market, have to be extensively capitalised. The Islamic money and foreign exchange markets are integral to the functioning of the Islamic banking system, firstly, in providing the Islamic financial institutions with the facility for funding and adjusting portfolios over the short-term and thus the necessary liquidity mechanism to promote stability, and secondly, serving as a channel for the transmission of monetary policy.

The inter-linkages in the functioning of the Islamic financial markets have brought about a natural environment for innovation of Islamic financial instruments. A broad spectrum of instruments, such as Government papers including bonds and treasury bills, Central Bank notes and Islamic accepted bills, can be structured on a Shariah-compliant basis to meet the needs of these markets. In addition, instruments for a risk mitigating mechanism for hedging or value protection need to be developed. While risk mitigation is desirable in Islamic finance, innovations need to be made for this purpose.

To aid the process of developing the financial markets, Bank Negara Malaysia has recently developed a website on the Islamic money market as a source of information on domestic Islamic financial instruments and to facilitate investment decisions and secure public confidence in their investment. The website aims to effectively meet the needs of bankers, financiers, statisticians, economists and prospective investors as well as increase awareness of the users - domestic and foreign. Moving forward, the website will be linked with other markets to serve as a

platform for exchanging information and knowledge beyond our borders.

The existence of a well-developed capital market is also important to provide users of capital with an alternative and cost efficient source of medium and long-term financing. It would also provide investors and savers with a wider range of financial instruments to suit their individual return and risk profiles as well as allow for better diversification of risks in the financial system. One of the linkages in this market is asset securitisation. Mortgage financing is an example of where the asset liability mismatch can be addressed. This would substantially improve the liquidity and quality of assets of the banking institutions, while at the same time contribute towards promoting the development of the capital market and secondary trading of instruments through the issuance mortgage-backed private debt securities. Over the years, the scope of securitisation activities can evolve and expand with the introduction of securitisation of Islamic hire and purchase or leased assets ending with ownership, and other types of leased financing.

At the core of a financial system of any country must lie an efficient and effective payment system as a means for clearing and settling payments. In modern economies, this function is already highly mechanised to support a sound and stable financial sector. It is vital that a real time settlement system for inter-bank funds transfer be implemented to reduce the credit and settlement risk in the financial system. It must be able to handle scripless debt securities trading, processing and settlement on a model that reduces counterparty risk.

II. Conclusion

As Islamic finance advances forward to become an important integral component of the international financial system, efforts need to continue to strengthen further both the international architecture and to enhance international cooperation and collaboration as well as to develop the domestic financial system to meet the changing requirements of a highly dynamic and rapidly evolving environment. Malaysia will continue to play an active role in this process. In our quest to build a viable and sustainable Islamic financial system, the aim is to contribute to the channeling of capital flows to productive investments, create wealth and promote trading activities, with the activities undertaken not just among Muslims but with the rest of humanity.

Citigroup-INSEAD Women's Financial Education Summit
2 November 2004, Hong Kong

"The Importance of Financial Literacy Among Women in Asia"

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

I. Introduction

Asia represents the fastest growing region in the global economy. Of significance, is that more than half the population in Asia are women. The participation of women in the economy would therefore not only enhance their own economic well being but would also contribute towards raising further the economic potential of Asia. Women are already engaged in both the informal and formal sectors and are increasingly emerging as a more important force in the economy. The effective participation, however, needs to be an informed participation. Financial literacy among women becomes an important part of this process, regardless of the income constituency to which they belong. There needs to be a better understanding of their financial rights and responsibilities, and their opportunities for income generation and the associated risks and costs involved. This is particularly important for Asia, where rapid economic and financial transformation is occurring. Financial literacy among women is thus a vital part of this process, not only to promote greater engagement of women in the current economic environment, but also to prepare them for the future.

My remarks today will first discuss some of the major structural and cultural transformations in Asia that are changing and impacting the economic environment faced by women in Asia, and their rapidly changing role in the economy. I will also touch on aspects of the challenges faced by women in Asia in their endeavour for greater economic engagement. This will be followed by a discussion on the important enablers for enhanced financial literacy and to share with you Malaysia's experience in driving a more financially literate society in particular, that enhances the inclusion of women in the economic mainstream.

Asia is being transformed. For more than two decades now we have seen unprecedented structural and cultural changes in Asia that have resulted in the transformation of the environment faced by women. Asia has emerged as the fastest growing region in the world with GDP in Asia now accounting for 23% of the world economy, compared to 17% in 1980. Per capita income during this period has more than quadrupled. If these trends continue, by the year 2020 Asia will account for about 27% of the world economy while the income per capita would have further tripled.

These dynamic changes have made financial literacy among women even more vital.

Indeed, against these favourable trends, there has been a growing participation of women in the growth and development process in Asia. In particular, there has been a strong migration from the informal to the formal sector, following the modernisation and industrialisation process. The increase in the relative significance of the financial sector in most Asian economies can be seen in terms of the momentum in the financialisation of savings and the increase in the volume of financial transactions being conducted through the formal financial sector. These trends are being reinforced by the shift of activities that is taking place from the traditional sectors to the industrial and services sectors. On average, the industrial and services sector now accounts for 74% of the economy in Asia, compared to 60% in 1980. In contrast, agriculture now accounts for 12%, compared to 26% in 1980. Involved in this transformation, women have demonstrated a high degree of mobility, participating in all segments of economic activity. Most discernable is the increasing participation of women in the services sector. Here in Hong Kong, the percentage of women in the services sector relative to the total population increased from 43% in 1980 to 87% in 1999. Similarly in Indonesia, the rise was from 32% to 42%, and in Malaysia, it was from 33% to 57% and in Thailand, from 18% to 34%.

In Asia, the demographic structure also reinforces the economic potential of Asia. The population in Asia continues to grow at a relatively high and stable rate to account for more than half the world's population. Of significance is the relatively young demographic structure in Asia. More than 50% of women fall in the age group 15 to 49 years, similar to that for men. This demographic structure thus not only contributes to enhance the potential of the economy but combined with rising incomes and improved standards of living, has resulted in increases in consumption spending. This resultant increase in purchasing power has strengthened domestic demand, making it an important driver of growth in the Asian economies. Indeed, these trends have strengthened the sustainability of consumption-based growth. As part of this process, women have become an important consumer target group with enhanced purchasing power. In fact, in several of the Asian economies, women are emerging as a key target market. This greater capacity for earning, spending, saving and investing requires ability for financial management, and hence the urgency for greater financial literacy.

While financial literacy is important, regardless of economic status, it becomes even more important for those that are less privileged. For those that have less to manage, it becomes more vital to manage the finances even more effectively. It is also those that have been under-served by the financial system that need to be more aware of the financial services that they should be able to access, and the benefits that can be drawn from the various options available. They too have the same need for maximising the benefits from their limited resources, and to achieving financial and economic security. Strengthening their financial position becomes even more

important for this target group. There needs to be awareness of the alternative assets that can be accumulated not only to generate an income stream but also towards building wealth. Of equal importance is to draw those operating in the informal sector into the formal sector, where their financial requirements, whether households or businesses can be better served.

A further phenomenon taking place in Asia is the increased regional economic and financial integration that is taking place. This has manifested itself in increased intra-regional trade, investment flows and the increased intra-regional presence of corporations and financial institutions. A more recent phenomenon is the increased mobility of labour in the region. Of significance is the number of women who have ventured beyond their own borders in search of new employment opportunities. While data on this is not available, the statistics on remittances of income show this is a growing trend. Overseas employment is particularly evident in the manufacturing and services sectors. Financial literacy under these circumstances becomes even more vital. In venturing to new areas where different systems, languages and cultures prevail, it becomes important to have knowledge of the basic financial matters so as to maximise the benefits the new employment is expected to yield.

As the formal economies of Asia prosper and grow, there is a greater need to integrate the informal sectors of the economy with the formal sector. There are millions of women in Asia involved in a wide range of economic activities from the home, making handicraft, assembling parts for international brand names and working in the fields. They work for a small income, and generally in difficult circumstances. Deliberate actions to integrate the informal economy into the formal economy will give this segment of society increased opportunities. In many countries, the success of various national and international socio-economic reform programs have resulted in women becoming an increasing part of the formal economy. Through the concerted efforts of women's rights movements, economic policy intervention and gradual shifts in cultural norms, women today have more opportunities for education, careers and political representation. However, in many instances the increase in participation in the formal economy has not come with a commensurate level of sophistication in financial literacy. As a result, women continue to face special challenges in their endeavour to be active participants in the economic system.

II. Challenges women in Asia face in financial literacy

Let me now turn to discuss some of the challenges faced by women in Asia in their endeavour to become more financially literate and financially independent. Firstly, with the socio-economic environment in Asia changing rapidly, there is greater uncertainty and volatility which represents a challenge even for financial experts. The financial system has also become more complex, with new risks emerging. This increased sophistication thus makes it increasingly difficult for those who are less financially literate to make sound decisions.

Secondly, the advances in technology has led to a proliferation of financial products and services. There needs to be a greater understanding of the basic concepts and practices of banking, insurance and equity so as to know how to make choices from the wide range of financial products available, and to assess the respective risks, costs and returns. Also important is the basic principles of debt management, wealth management and personal budgeting to be able to understand the importance of long-term savings in funding future requirements.

Financial literacy involves being able to identify and understand the opportunities for income generation, access to funding, and learning how to make the most of the range of financial products available. It also involves learning how to manage financial risks in an environment where the financial infrastructure may be under developed. This may relate to the laws and procedures in the country. Also important is the need to be able to recognize illegal schemes and other exploitative practices such as predatory lending.

Thirdly, while women in Asia are being less stereotyped and given greater opportunities for entering into the economic mainstream, nonetheless the working conditions for women in many countries have tended to be less favourable. The exploitation of labour in the informal sector in some instances are particularly bad, not only for women, but also for children and minority groups. Women who are disadvantaged in this manner have found it difficult to escape from the trap of indebtedness.

Frequently, the disadvantaged and those who are not able to access the formal financial system have resorted to the informal financial systems. Recourse to these financial sources have also been due to the lack of awareness. These may be in the form of deposit schemes that entail high risk, access to financing from sources that are highly costly, and almost inevitably against high collateral. Very often, the practices are unfair and deceptive. Examples in predatory lending are found to be unscrupulous and highly disadvantageous to the borrower.

Fourthly, in some Asian societies, traditions continue to create cultural pressures that restrict a woman's choices and liberties. Though there is increased freedom for women to pursue education and careers, in some societies, cultural pressures still make it more difficult for a woman to get the exposure on financial matters. In addition, the increased incidence of divorces and single parenthood mean that more women are left to fend for themselves and their children. In certain Asian societies, single women may face unusual difficulties in arranging their finances. In some cases, a woman may even have difficulty claiming her legal rights in a contract, even though the law does not dispute such a right. Deeply entrenched human behaviour is not able to change as rapidly as the financial system is evolving.

Fifthly, statistics on life expectancy confirm that women tend to live longer. In segments of society where women earn less than men, combined with the fact that they may live longer, it is crucial to have financial acumen in order to increase the financial

independence of women. This trend also magnifies the need to plan for retirement especially in an era of rising medical costs.

III. Enabling Environment for Financial Literacy

The promotion of greater awareness and understanding in financial issues in a dynamic and constantly changing environment has to be a continuous process. The effort needs to focus not only on providing education programmes but also on putting in place the supporting infrastructure to enhance the access to financial services, to ensure an environment of financial transparency and disclosure as well as adequate consumer protection. Enhanced financial literacy is about bringing people into the financial mainstream so that they are able to make well informed decisions regarding their earnings, spending, savings and investments. The effort thus has to encompass a comprehensive set of strategies including the education process reinforced by the supporting infrastructure.

The goal of any financial education programme is to increase awareness of the value of effective financial management, to show how it can contribute to financial security and improvement in the economic well-being. The most effective of programmes have been those that are targeted to specific groups. Fundamental education for greater financial literacy that will have most sustainable impact are those through the school system. Such educational programmes would provide the education to women from an early age. Essentially, it would not result in the marginalisation of anyone target group, in particular women. Such programmes would therefore best serve its purpose as part of the core curriculum. Indeed, the national education system can play a pivotal role in financial literacy within a country.

The responsibility of promoting economic and financial literacy needs to be a collaborative effort amongst the authorities, the financial service providers and the community to connect to the different target groups including all social groups. These would include the lower income groups, workers and businesses. Important are programmes directed to families where women have an important role and to engage those we have not been able to participate fully to benefit from the favourable economic environment prevailing in the region.

Among the successful financial education programmes are those with specific objectives that are tailored to meet particular needs. This includes programmes to promote savings for specific objectives; for education; or for retirement. The education programmes can also be linked to other objectives such as good health, house ownership and so on. Financial products can be tailored for such purposes to not only to promote interest but to also meet these objectives.

All distribution channels need to be relied on to maximise the effectiveness of financial education programmes. Formal training programmes can be reinforced by web based content via the Internet. The World Wide Web offers dramatic economies of scale in terms of distribution of content at low cost. Connectivity to the Internet can serve to bring

information from all over the world to the local education system. Iterative programmes can be useful to encourage participation. Web based programmes while requiring computer literacy, has a wider outreach and allows for flexibility of time that is of particular importance to women.

A further means by which financial advise is provided is through financial advisors. Financial advisors are able to address the issues for the more sophisticated investors. Similarly, infrastructure for advisory services for small businesses is key. This can in particular be provided by financial institutions. Systems need to be in place where consumers and businesses are explained their rights and responsibilities. Micro credit institutions have also been highly successful in many countries in providing access to financial services to microenterprises. This will contribute towards greater reliance on the formal financial infrastructure and less on the informal structures.

Higher level of consumer education and financial literacy must be complemented with effective disclosure regime, fair and transparent market practices, simplification of financial products and enhanced communications in the marketplace to minimise information asymmetry.

While efforts may be taken to enhance transparency and disclosure by service providers, and while programmes for enhanced literacy can produce positive results, consumer protection is still needed. Given the asymmetry of information, consumers often do not have enough information to be completely protected. Building the confidence of consumers also requires that there be adequate avenues for consumers to seek redress to enable consumers to resolve conflicts through an equitable process. Also important are the requirements for complaints to be handled promptly by financial institutions.

IV. The Malaysian Experience

For several decades, Malaysia has made significant economic progress. The economy grew by an average of 7% per year, while the per capita income has increased from USD300 in 1970 to USD4,236 in 2004. From a commodity-based economy, Malaysia now has a highly diversified economy, with significant contribution from the manufacturing and services sectors. Women account for about half of Malaysian population, and have played an important role in this economic transformation process. Women account for about 45% of the labour force, with increasing representation at the professional, managerial and technical levels. Such progress is achieved following increased educational opportunities that have been made available to women. Female primary and secondary students account for half of total enrolment, while at public universities, female students account for 55% of total enrolment. While women continue to play a major role in household financial planning, a new generation of women who are financially independent and sophisticated is emerging.

The financial sector in Malaysia has also experienced significant progress, with greater diversity of players, products as well as delivery channels with extensive distribution nationwide. The widespread distribution of financial institutions has been a conscious and deliberate policy to ensure the widest reach of financial services to both the urban and rural areas. With the improved access of consumers and businesses to financial products and services, consumer education on financial matters is an important priority for the Central Bank.

Consistent with the belief of the importance of instilling financial awareness at an early age, Bank Negara Malaysia introduced a pocket money book to inculcate smart financial management habits among students in 1996. The programme also included Household Account Books to assist families in the management of household income, savings and investments. This was distributed to cover a wider group, including women, teachers and workers.

Following this, in 1997 together with the Education Ministry, the Central Bank embarked on a School Adoption Programme. Through this programme, more than 7000 schools have been adopted by banking institutions to play a leading role in educating school children on basic financial knowledge. In October this year, an online interactive version of the Pocket Money Book to be used in the School Adoption Programme was launched.

The Central Bank of Malaysia has also laid out a blueprint known as the Financial Sector Master Plan that charts the development of the Malaysian financial system over a ten year period commencing in 2001. A key component of that plan is the 10-year Consumer Education Programme for the banking and insurance sectors. This programme is known as BankingInfo and InsuranceInfo, and was launched in 2003. To reach a wide spectrum of the population, various channels are being employed to disseminate information, including through media, road shows, information brochures and a dedicated web site. There is also a dedicated outreach programme aimed at specific target groups, which includes women in rural areas, low income earners and disadvantaged women such as single mothers. To date, the BankingInfo website has received an overwhelming response - about 14 million hits and more than 2.5 million booklets were taken up by the public. In the insurance sector, over 1.4 million hits have been received on the InsuranceInfo website, and more than 1.3 million insurance info-booklets have been disseminated by the insurers to the public.

Similar to many other Asian economies, microenterprises in Malaysia are a substantial contributor to employment. Women are extensively involved in microenterprises, often operated as family run businesses. To support the growth of microenterprises, dedicated agencies and funding mechanisms have been established. In order to equip the microenterprises with proper knowledge, education materials were developed on the fundamentals of starting a business, specifically addressing issues of getting access to appropriate financing

within the constraints faced by microenterprises. Dedicated agencies, including specialist development financial institutions, were identified to provide training and advisory services to complement these initiatives.

In addition to the consumer education programmes, the Central Bank has put in place a consumer protection framework. In collaboration with the financial industry the Central Bank has established a Financial Mediation Bureau. The Financial Mediation Bureau aims to serve as a one-stop center for the resolution of retail consumer complaints against financial institutions regulated by the Central Bank. The Central Bank is also establishing a one-stop service centre in the Bank that will function as a Public Information Centre for the promotion of financial literacy among the Malaysian public. The service centre will provide advisory services on financial matters to small and medium enterprises.

V. Conclusion

Financial literacy among women is all about having sufficient awareness of financial matters to enable women to protect and prosper for themselves and their families in a world that is becoming increasingly more complex and uncertain. To be an effective participant in this modern economy, we cannot take financial literacy for granted. It is a knowledge and skill that must be deliberately pursued. From a national and institutional perspective, promoting financial literacy must be an integral part of the overall agenda for financial and economic reform and development.

Let me conclude with the words of Jawaharlal Nehru, "We talk of revolutions, political and economic. And yet the greatest revolution in a country is the one that affects the status and living conditions of its women. It is in so far as our revolution has affected our women that it is basic."

Calendar of Events
July - September 2004

13 July 2004
The inaugural meeting of the Takaful and Insurance Regulatory and Supervisory Authorities of the D-8 (Developing Eight) Countries was held in Kuala Lumpur. The Bank organised the meeting to discuss developments in the takaful and insurance industries in the eight nations, as well as to establish a mechanism for cooperation among the countries' takaful and insurance regulatory and supervisory authorities.

3 August 2004
The Governor delivered the opening address at the Euromoney Conference on "Remaking Malaysia: Investing in the New Malaysia" in which she said that the strategy to ensure the sustainability of the country's strong growth performance, is to focus on the economy's distinct capabilities, and to leverage on the areas of strengths to secure competitive advantage. Going forward, the process of rebalancing the economy to enhance its competitiveness could be expected to intensify and widen.

4 August 2004
The Bank signed a Memorandum of Understanding (MOU) with the Philippines Anti-Money Laundering Council. The MOU is to facilitate the exchange of information and sharing of financial intelligence between the two organisations to combat money laundering.

13 August 2004
The First Meeting of the National Small and Medium Enterprise (SME) Development Council was held in Putrajaya, and was chaired by the Prime Minister. The Council represents the highest-level policy-making body to chart future direction and strategies for SME development. Its establishment was a result of the Bank's recommendation to streamline and coordinate the efforts of the various ministries and Government agencies involved in the development of SMEs, and to accelerate the process of strengthening the supporting infrastructure.

20 August 2004
The Bank announced the fourth issuance of Bon Simpanan Merdeka amounting to RM500 million which was issued on 1 October 2004. The bond provides an additional savings instrument to senior citizens, retired Malaysian Armed Forces personnel, as well as Malaysian citizens who have retired on medical grounds.

25 August 2004

The Bank announced that the Malaysian economy grew by 8.0% in the second quarter of 2004, the highest quarterly growth since the third quarter of 2000. The growth continued to be broad based, led by the manufacturing and services sectors. For the first half-year, the combination of stronger private sector expenditure and sustained high growth in external demand resulted in a GDP growth of 7.8%.

The Monetary Policy Statement stated that with the low domestic inflation environment, the current stance of the monetary policy will be maintained to support growth.

The Governor delivered a keynote address at the ASLI (Asian Strategy and Leadership Institute) Conference on Developing Islamic Banking & Capital Market, in which she emphasised that the strengthening of the financial infrastructure is a key pre-requisite for the development of a dynamic and progressive Islamic financial system. She also highlighted the developments that have taken place in Islamic banking and finance in the country.

3 September 2004

The Bank announced the revision of the regulatory treatment accorded to new Cagamas debt securities issued after 4 September 2004, to further enhance the efficient functioning of the domestic bond market. The measure will promote a more market-based pricing as well as heighten investors' interest in the new debt securities, which augurs well for the development of a vibrant bond market.

21 September 2004

The Governor delivered a keynote address at the Asian Islamic Banking & Finance Summit in Kuala Lumpur, in which she highlighted the strategies and challenges of integrating the Islamic financial system with the international financial system.