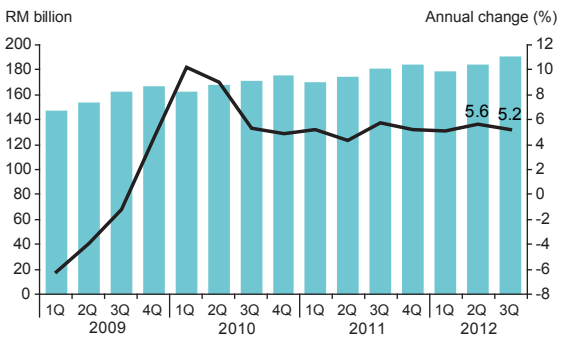
ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE THIRD QUARTER OF 2012

OVERVIEW

Malaysian economy expanded by 5.2% in the third quarter

The world economic environment remained challenging in the third quarter of 2012. Growth in the advanced economies was uneven with the US economy experiencing an improvement while several other major advanced economies continued to experience weak growth, constrained by fiscal adjustments, sluggish labour markets and impaired financial intermediation. In Asia, economic activity moderated due mainly to further weakness in external demand arising from the uncertain global environment. Amid the challenging global economic conditions, the Malaysian economy recorded a growth of 5.2% (2Q 12: 5.6%) during the quarter. Growth was affected by slower external demand, which resulted in a further decline in net real exports of goods and services. Domestic demand however, continued to sustain growth, supported by the favourable performance of private consumption and investment activity by both the private and public sectors.

Malaysian economy expanded by 5.2% in the third quarter (at constant year 2005 prices)



Source: Department of Statistics, Malaysia

During the quarter, domestic demand expanded by 11.4% (2Q 12: 14.0%). Gross fixed capital formation registered a robust performance (22.7%, 2Q 12: 26.1%), underpinned by capital spending by both the private and public sectors. Private sector investment was driven by capital spending in the services sector, particularly the transportation, real estate and utilities sub-sectors and the on-going implementation of projects in the oil and gas sector. For public investment, the capital spending by public enterprises was mainly channelled into the transportation, oil and gas and utilities sectors while Federal Government's development expenditure was mainly channelled into the transportation, education and public utilities sectors. Domestic demand was also supported by the continued expansion in private consumption which grew by 8.5% (2Q 12: 8.8%), supported by favourable labour market conditions and sustained income growth. In addition, the bonus payment to civil servants, and the second (of three) payout of RM5,000 to FELDA settlers provided further impetus to consumer spending. Public consumption moderated to 2.3% (2Q 12: 10.9%), attributable to lower spending in and supplies and services.

On the supply side, activity in most economic sectors moderated in the third quarter. Growth in the manufacturing sector slowed, weighed down by the weaker external environment while the mining sector contracted due to a sharp decline in natural gas production following a prolonged planned shutdown of several gas facilities for maintenance purposes. In the agriculture sector, growth turned positive in line with the recovery in crude palm oil production. The construction sector continued to record robust growth, while growth in the services sector expanded further, driven by firm domestic demand.

The headline inflation rate, as measured by the annual change in the Consumer Price Index (CPI), moderated to 1.4% in the third quarter (2Q 12: 1.7%), reflecting lower inflation in the *transport, recreation services and culture* and *miscellaneous goods and services* categories.

In the external sector, the current account surplus narrowed slightly in the third quarter to RM9.5 billion, equivalent to 4.2% of GNI, as the

goods surplus was partially offset by net income payment and services deficit. The financial account turned around to record a net outflow of RM8.7 billion in 3Q 12 (2Q 12: +RM5.4 billion) as net inflows in FDI and portfolio investment were outweighed by net outflows of direct investment abroad and other investment. Consequently, the overall balance of payments turned around to record a deficit of RM7.5 billion in 3Q 12 (2Q 12: +RM12.7 billion).

The international reserves of Bank Negara Malaysia amounted to RM421.3 billion (equivalent to USD137.5 billion) as at 28 September 2012. This reserves level has taken into account the quarterly adjustment for foreign exchange revaluation loss, following the strengthening of ringgit against major and regional currencies during the third quarter. As at 31 October 2012, the reserves position amounted to RM423.9 billion (equivalent to USD138.3 billion), sufficient to finance 9.3 months of retained imports and is 4.2 times the short-term external debt.

Interest rates remained stable

The Overnight Policy Rate (OPR) was left unchanged at 3.00% during the third quarter of 2012. At the prevailing level of the OPR, monetary conditions remain supportive of economic activity.

Reflecting the unchanged OPR, the average overnight interbank rates of all maturities were relatively stable. In terms of retail interest rates, the average quoted fixed deposit (FD) rates of commercial banks were relatively unchanged during the quarter. The average base lending rate (BLR) of commercial banks remained unadjusted at 6.53%, while the weighted average lending rate (ALR) on loans outstanding remained stable at 5.55% as at end-September 2012 (end-June 2012: 5.60%).

In the third quarter, total gross financing raised by the private sector through the banking system and the capital market was RM272.9 billion (2Q 12: RM275.0 billion). On a net basis, banking system loans and PDS outstanding expanded at an annual growth rate of 12.8% as at end-September (2Q 12: 13.0%).

Net funds raised in the capital market increased to RM28.7 billion during the quarter (2Q 12: RM27.6 billion). As in the previous quarter, the bulk of funds were raised by the private sector, in particular from the issuance of private debt securities (PDS). After adjusting for redemptions, net funds raised by the private sector amounted to RM18.3 billion (2Q 12: RM22.5 billion). In the public sector, net funds raised also increased to RM10.4 billion (2Q 12: RM5.0 billion).

The monetary aggregates continued to grow during the third quarter. M1, or narrow money, increased by RM8.6 billion. On an annual basis, M1 expanded by 12.3% as at end-September (end-June 2012: 9.9%). M3, or broad money, increased by RM27.5 billion on a quarter-on-quarter basis to record an annual growth rate of 12.5% as at end-September (end-June 2012: 12.8%). The increase in M3 reflected continued credit extension to the private sector and an increase in net capital inflows.

During the quarter, the ringgit appreciated by 4.0% against the US dollar as further monetary easing in the advanced economies and expectations for progress in resolving the European sovereign debt crisis contributed to favourable investor sentiments towards Malaysia and regional economies. The ringgit also appreciated against the Japanese yen (1.7%) and euro (1.2%), but remained unchanged against the pound sterling. Against regional currencies, the ringgit strengthened in the range of 0.1% and 5.1%.

Between 1 October and 12 November 2012, the ringgit remained relatively unchanged against the US dollar (0.1%), but strengthened against the Japanese yen (2.6%), pound sterling (2.3%) and euro (1.7%). Within the

region, the ringgit strengthened against the Indonesian rupiah (0.7%), but weakened against the Korean won (-2.2%), Philippine peso (-1.5%), Chinese renminbi (-0.9%) and Thai baht (-0.5%). The ringgit remained relatively unchanged against the Singapore dollar (-0.1%).

Financial stability remained intact

Overall domestic financial stability had been preserved throughout the third quarter, supported by strong financial buffers both at the system and at the institutional levels. Financial market conditions continued to remain orderly as volatile portfolio flows were well intermediated by the markets.

The banking sector remained resilient during the quarter, with strong capital buffers, sustained profitability and ample liquidity. Capitalisation of the banking sector remained stable, with the core capital ratio and risk-weighted capital ratio at 13% (2Q 12: 13.4%) and 14.8% (2Q 12: 15.1%) respectively. Similarly, the insurance sector recorded a strong capital adequacy ratio of 218.6% (2Q 12: 216.7%) and a capital buffer in excess of RM20 billion.

Domestic demand to provide support to growth amidst continued weakness in external environment

Recent economic indicators suggest some stabilisation in global growth going forward. Nevertheless, risks remain arising from continued policy uncertainties in several key economies. In particular, policymakers in these economies face a challenging task of weighing crucial decisions on issues related to fiscal consolidation and key reforms to address the underlying structural weaknesses that impedes economic recovery.

For the Malaysian economy, while the weakness in global economic conditions has affected growth in the third quarter, domestic demand continued to provide support to growth. Going forward, the more challenging international environment would present risks to Malaysia's growth prospects. Nevertheless, domestic demand is expected to continue to be the anchor of growth, supported by the expansion in private consumption and investment. Public spending and investment activity are also expected to lend support to growth.

DEVELOPMENTS IN THE THIRD QUARTER OF 2012

INTERNATIONAL ECONOMIC ENVIRONMENT

Global growth moderated further amid improvement in financial market conditions

The world economic environment remained challenging in the third quarter of 2012. Growth in the advanced economies was uneven with the US economy experiencing an improvement while several other major advanced economies continued to experience weak growth, constrained by fiscal adjustments, sluggish labour markets and impaired financial intermediation. In Asia, economic activity moderated as spillover effects of the external uncertainties on domestic demand became more apparent. A number of countries implemented policy measures to support economic growth.

Conditions in the international financial markets improved following policy actions in the crisis-affected economies to ease uncertainties in the market. At the beginning of the third quarter, volatility in the financial markets receded from its peak as the outcome of the European Summit in June provided clearer policy directions on the future of the currency union. In addition, central banks in the euro area, US and Japan undertook further unconventional monetary easing, relieving some pressures in financial markets. Nevertheless, there were periods of heightened volatility in the financial markets as developments in the euro area led to a temporary rise in risk aversion. These events include the USD125 billion funding request by the Spanish government to recapitalise the banking sector, causing yields on the Spanish 10-year sovereign bond to increase to a record high of around 7.5%. Market sentiments deteriorated further following the downgrades of sovereigns and banks by several credit ratings agencies such as the Spanish sovereign rating downgrade by Fitch and the downgrade of banks in Germany and Austria by Moody's. In November, volatility in the financial markets rose as delays over the release of the next tranche of financial aid to Greece led to renewed uncertainty. In the US, investors refocused their attention to the impending fiscal cliff issue after the presidential election.

The US economy grew at an annual rate of 2.3% in the third quarter (2Q 12: 2.1%). On a seasonally adjusted annualised basis, the economy grew at 2.0% (2Q 12: 1.3%). Private consumption improved, particularly in demand for automobiles and non-durable goods. Household spending was sustained by the increase in credit and withdrawal in personal savings amid higher consumer confidence. Job creation remained positive, registering a stronger gain of 521,000 during the quarter (2Q 12: 200,000). Private fixed investments grew by 6.4% (2Q 12: 9.9%), as the tentative improvement in housing market led to higher residential investment. Federal government expenditures rose due to the larger-than-expected increase in defence spending. The annual rate of inflation was lower at 1.7% (2Q 12: 1.9%).

Growth in the euro area remained weak amid continued recession in several crisis-affected economies. Domestic demand was affected by negative sentiments in the private sector arising from austerity measures and the ongoing sovereign debt crisis. Consumption, particularly in the crisis-affected economies, fell due to weak labour markets and tight financing conditions. The eurozone unemployment rate rose to 11.5%, with youth unemployment exceeding 50% in Greece and Spain. Headline inflation remained steady at 2.6% (2Q 12: 2.5%).

The UK economy recorded flat growth in the third quarter (2Q 12: -0.5%). On a quarter on quarter basis, real GDP expanded by 1.0% (2Q 12: -0.4%), reversing three quarters of consecutive contraction. The services sector was a key contributor to growth, supported by the hosting of the Olympic Games. Nevertheless, overall economic performance remained weak, attributable mainly to a decline in the construction sector. The protracted weakness reflected the negative impact of ongoing fiscal consolidation and declining exports to the euro area. Inflation maintained a steady downward trend due to smaller increases in energy prices (2.4%, 2Q 12: 2.8%).

In Japan, the pace of economic recovery has slowed to 0.1% (2Q 12: 3.3%), reflecting the fading effect of reconstruction-related demand amid continued weakness in the external environment. On a seasonally adjusted annualised basis, the economy contracted by 3.5% (2Q 12: 0.3%). Export growth declined significantly during the quarter (-4.9%, 2Q 12: 9.2%). On the domestic front, household spending remained resilient amid last minute purchases of energy-efficient cars as the subsidies programme came to an end. Deflationary pressures continued to persist as core consumer prices (excluding fresh food) declined in the third quarter (-0.2%, 2Q 12: 0.0%) following broad-based weakness in prices across all categories and slower increases in energy prices.

Advanced Economies: Real GDP Growth

	2011		2012		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
US[1]	1.3	4.1	2.0	1.3	2.0[a]
UK	0.7	0.7	-0.1	-0.5	0.0
Japan[1]	9.5[r]	-1.2[r]	5.2[r]	0.3[r]	-3.5[p]

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

Source: National authorities

Monetary policy remained accommodative in the advanced economies, with more unconventional measures undertaken amid increasing signs of weakening growth prospects. In the US, the Federal Open Market Committee (FOMC) maintained the federal funds rate at a historic low of 0-0.25%. In addition, the FOMC expanded its quantitative easing measures by increasing its purchase of agency mortgage-backed securities at a pace of USD40 billion per month. The European Central Bank (ECB) decreased its policy rate by 25 basis points to 0.75% and cut the overnight deposit rate to 0%. The ECB also expanded the range of eligible assets to be used as collateral from euro area banks to support bank lending activity in the region. In view of the weak economic recovery, the Bank of England (BoE) expanded its quantitative easing measures by increasing the size of its asset purchase programme in July by a total of £50 billion to £375 billion while keeping its policy rate at 0.5%. In addition, the BoE and the British government jointly unveiled a £100 billion lending plan for households and businesses. The Bank of Japan (BoJ) decided to enhance an existing loan scheme by ¥2 trillion through the Growth-Supporting Funding Facility. The funding facility was introduced early this year in an effort to support funding to prospective growth industries. The BoJ also expanded the total size of the Asset Purchase Programme by ¥10 trillion to ¥80 trillion for the purchase of Japanese government bonds and treasury discount bills.

Regional Countries: Real GDP Growth

	2011		2012		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
PR China	9.1	8.9	8.1	7.6	7.4[p]
Singapore	6.0	3.6	1.6[r]	2.5[r]	0.3[p]
Korea	3.6	3.3	2.8	2.3	1.6[a]
Chinese Taipei	3.5	1.9	0.4	-0.2	1.0[a]
Indonesia	6.5	6.5	6.3	6.4	6.2

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

Source: National authorities

Most economies in Asia continued to expand at a slower pace due mainly to further weakness in external demand. In several economies, there were also increasing signs that the adverse spillover effects from the external sector had begun to affect domestic demand. Nevertheless, many ASEAN economies continued to register relatively robust growth rates, partly supported by higher government spending (Thailand, Malaysia and the Philippines) and resilient domestic demand (Malaysia and Indonesia). Growth in PR China's economy moderated to 7.4% (2Q 12: 7.6%), on account of slower activity in the primary and secondary sectors. In Singapore, growth slowed to 0.3% (2Q 12: 2.5%) due to a deceleration in manufacturing and construction activities. The Korean economy also expanded at a slower rate of 1.6% (2Q 12: 2.3%) due mainly to weaker investment and export activity. The Chinese Taipei economy improved to 1.0% (2Q 12: -0.2%) following a rebound in investment growth. Economic activity in Indonesia grew by 6.2% (2Q 2012: 6.4%), on account of sustained consumption and investment.

In line with the weaker economic activity and slower increases in global commodity prices, headline inflation moderated in several economies during the quarter with the exception of the Philippines and Chinese Taipei, where prices rose on account of higher cost of food. India's headline inflation accelerated towards the end of the quarter as the government hiked subsidised fuel prices to rein in the budget deficit. With inflation becoming less of a policy concern in the region, several monetary authorities eased monetary policies to support growth amid heightened risks from the external environment. In July, the Bank of Korea (BoK) and Bangko Sentral ng Pilipinas (BSP) lowered their key policy rates by 25 bps each to 3.00% and 3.75% respectively. Similarly, the People's Bank of China reduced its benchmark one-year lending rate by 31 bps to 6.00% after lowering the rate by 25 bps in June. In October, BoK and BSP further reduced their key policy rates by 25 bps each to 2.75% and 3.50%, while the Bank of Thailand also lowered its benchmark policy rate by a similar magnitude to 2.75%. On the fiscal front, several economies, including PR China, Korea, Thailand and Chinese Taipei, have undertaken fiscal measures to boost domestic demand. These policies include the acceleration of approvals and implementation of infrastructure projects in PR China, and lower consumption taxes and an expansion of social-welfare programmes in Korea. In Thailand, in addition to the ongoing spending on flood-prevention measures, the government has announced plans to speed up investments in railway infrastructure and water management projects. Chinese Taipei's government has also unveiled stimulus to support the economy, which includes regulatory easing of foreign investments and implementing infrastructure projects to boost private investment.

Since reaching a trough of USD90.9 per barrel in late June, the price of crude oil[1] has been rising steadily during the third quarter, averaging USD109.5 per barrel (2Q 12: USD108.8 per barrel). The ascent was due mainly to a series of supply-side events, arising from a strike by workers in major Norwegian oil companies, lower production in the North Sea, and ongoing geopolitical tensions in the Middle East. The upward trend briefly reversed in late September following weaker Chinese economic data and Saudi Arabia's pledge to moderate prices. As at 28 September 2012, crude oil price closed at USD112.2 per barrel.

Foreign exchange markets were buoyed by market optimism emanating from further monetary easing by the monetary authorities. As a result, most major and Asian currencies appreciated against the dollar. Early in the quarter, the euro and Asian currencies depreciated against the US dollar, following Spanish regions' requests for financial aid from the federal government, which led to a re-intensification of the European sovereign debt crisis and subsequently heightened risk aversion. Weaker prospects for global growth also weighed down on investor confidence. In September, however, unconventional monetary easing measures undertaken by the US Federal Reserve, the BOJ and the ECB lifted sentiments in the market. Consequently, most currencies appreciated during the quarter as an expansion in liquidity spurred investors to seek higher yielding assets. Movements in the Japanese yen largely reflected safe-haven demand, with the appreciation during periods of risk aversion offsetting a marginal decline in August caused by weak domestic economic data.

Recent economic indicators suggest some stabilisation in growth performance going forward. Nevertheless, risks remain arising from continued policy uncertainties in several major economies. In particular, policymakers in those economies face a challenging task of weighing crucial decisions on issues related to fiscal consolidation and key reforms to address the underlying structural weaknesses that impedes economic recovery.

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

DEVELOPMENTS IN THE MALAYSIAN ECONOMY

Malaysian economy expanded by 5.2% in the third quarter

The Malaysian economy recorded a growth of 5.2% in the third quarter of 2012 (2Q 12: 5.6%). Growth was driven by a continued robust expansion in domestic demand amid weaker external demand. Net exports contracted further, with exports declining due to the deterioration in exports of manufactured goods and commodities. The last time exports showed a decline was in 3Q 2009. On the supply side, activity in most economic sectors moderated in the third quarter.

Domestic demand remained supportive

Domestic demand expanded by 11.4% in the third quarter of 2012 (2Q 12: 14.0%) supported by the favourable performance of private consumption and investment activity by both the private and public sectors.

GDP by Expenditure Components
(at constant 2005 prices)

	2011		2012		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Aggregate Domestic Demand (excluding stocks)	8.7	10.4	10.0	14.0	11.4
Consumption	10.0	11.1	7.7	9.2	7.3
Private sector	*7.6*	*7.3*	*7.4*	*8.8*	*8.5*
Public sector	*21.1*	*22.9*	*9.1*	*10.9*	*2.3*
Gross Fixed Capital Formation	5.4	8.4	16.1	26.1	22.7
Private sector	*2.9*	*18.8*	*19.8*	*24.6*	*22.9*
Public sector	*9.4*	*1.9*	*10.3*	*28.9*	*22.4*
Net Exports	10.5	-10.5	-20.9	-36.2	-50.5
Exports of Goods and Services	*4.8*	*5.5*	*2.8*	*2.1*	*-3.0*
Imports of Goods and Services	*3.9*	*7.8*	*6.8*	*8.1*	*4.4*
GDP	**5.7**	**5.2**	**5.1**	**5.6**	**5.2**

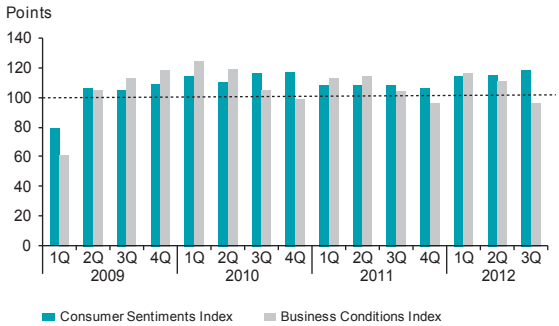
Source: Department of Statistics, Malaysia

Gross fixed capital formation registered a robust growth of 22.7% in the third quarter (2Q 12: 26.1%), underpinned by capital spending by both the private and public sectors. Private investment grew by 22.9% (2Q 12: 24.6%), supported by capital spending in the services sector, such as the transportation, real estate and utilities sub-sectors and the on-going implementation of projects in the oil and gas sector. Public investment expanded by 22.4% (2Q 12: 28.9%), driven by capital spending by the public enterprises (mostly, the non-financial public enterprises in the transportation, oil and gas, and utilities sectors). Federal Government development expenditure was channeled mainly into the transportation, education and public utilities sectors. The continued expansion in investment activity was also reflected in key indicators such as sales of commercial vehicles and imports of capital goods.

Private consumption grew at a continued strong pace of 8.5% in the third quarter (2Q 12: 8.8%). Household spending was supported by favourable labour market conditions and sustained income growth. Consumption also benefited from the bonus paid to civil servants and the second (of three) payout of RM5,000 to 112,635 FELDA settlers. The continued expansion in consumer spending amidst improved sentiments was reflected in the growth of imports of consumption goods, services tax collections and credit card spending.

Public consumption, moderated to 2.3% (2Q 12: 10.9%), attributable to lower spending in supplies and services.

Consumer confidence improved further



Source: MIER

Growth across most economic sectors moderated

On the supply side, activity in most economic sectors moderated in the third quarter. Growth in the manufacturing sector slowed, weighed down by the weaker external environment while the mining sector contracted due to a sharp decline in natural gas production following a prolonged planned shutdown of several gas facilities for maintenance purposes. In the agriculture sector, growth turned positive in line with the recovery in crude palm oil production and strong output of food crops. The construction sector continued to record robust growth, while growth in the services sector expanded further, driven by firm domestic demand.

The services sector expanded further in the third quarter of 2012 (7.0%; 2Q 12: 6.6%), as growth continued to be driven by firm domestic demand. The wholesale and retail trade sub-sector moderated to 4.4% (2Q 12: 5.9%), weighed down by the wholesale segment amidst slower trade activity. Nonetheless, growth in the retail segment was sustained, supported by firm household spending. In the communication sub-sector, growth remained robust (9.1%; 2Q 12: 9.5%), supported by continued demand for data communication services. The finance and insurance sub-sector expanded strongly by 11.8% (2Q 12: 6.6%), reflecting continued growth in net interest and fee-based income. In the utilities sub-sector, growth was lower (3.8%; 2Q 12: 4.3%), as slower manufacturing activity resulted in lower electricity demand by industrial users. Growth in the transport and storage sub-sector was also lower (3.6%; 2Q 12: 5.8%), amidst slower trade activity due to the weaker external environment.

GDP by Economic Activity (at constant 2005 prices)

	2011		2012		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Agriculture	8.8	6.9	2.1	-4.7	0.5
Mining	-5.9	-3.8	0.3	2.3	-1.2
Manufacturing	5.4	5.2	4.4	5.6	3.3
Construction	4.0	7.5	15.5	22.2	18.3
Services	7.1	6.6	5.7	6.6	7.0
Real GDP (Annual Change)	**5.7**	**5.2**	**5.1**	**5.6**	**5.2**
Real GDP (Preceding Change)	**3.7**	**1.8**	**-2.8**	**3.0**	**3.3**

Source: Department of Statistics, Malaysia

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

	Share 2011 (%)	2011		2012		
		3Q	4Q	1Q	2Q	3Q
		Annual change (%)				
Intermediate Services	**40.6**	**5.9**	**6.5**	**5.1**	**7.2**	**8.8**
Finance & insurance	17.0	5.3	7.1	2.0	6.6	11.8
Real estate & business services	10.0	4.6	4.4	6.9	7.6	7.2
Transport & storage	6.8	6.1	6.0	5.9	5.8	3.6
Communication	6.8	8.9	8.8	9.4	9.5	9.1
Final Services	**59.4**	**8.0**	**6.7**	**6.1**	**6.2**	**5.7**
Wholesale & retail trade	26.6	8.4	6.8	6.4	5.9	4.4
Accommodation & restaurant	4.5	6.3	6.3	6.1	6.8	4.0
Utilities	4.7	4.5	3.6	5.0	4.3	3.8
Government services	14.3	11.5	10.4	7.1	8.4	11.0
Other services	9.4	4.3	2.5	4.3	4.3	3.8
Total Services	**100.0**	**7.1**	**6.6**	**5.7**	**6.6**	**7.0**

Source: Department of Statistics, Malaysia

Selected Quarterly Indicators in the Services Sector

	2011			2012		
	2Q	3Q	4Q	1Q	2Q	3Q
	Index					
MIER Consumer Sentiments Index	107.9	108.7	106.3	114.3	114.9	118.3
MIER Retail Trade Index	120.8	150.0	92.6	85.3	119.4	130.2
MIER Tourism Market Index	125.4	115.2	126.0	125.2	117.3	129.9
	Annual change (%)					
Tourist arrivals	-4.8	4.7	5.4	0.4	4.3	n.a.
Total passenger traffic at all airports	13.4	10.8	7.0	6.4	1.9	2.9
Total consumption credit outstanding	8.7	8.5	9.5	7.8	7.5	7.6
Loans outstanding to the wholesale & retail trade, hotels & restaurants	6.8	9.6	11.5	11.1	11.1	11.7
Imports of consumption goods	17.8	26.4	25.2	20.4	10.7	11.4
Total sales of motor vehicles	-9.7	0.6	-1.5	-12.6	17.3	2.7
Container cargo handled (Port Klang and PTP)	9.6	9.8	11.5	7.4	4.2	1.7

Source: Various sources

Value-added growth in the manufacturing sector slowed to 3.3% (2Q 12: 5.6%), as production of both the export-oriented and domestic-oriented industries moderated in the third quarter. In the export-oriented industries, output of the E&E cluster registered a modest growth of 1.2% (2Q: 2.9%), weighed down by weaker output of electrical products. In addition, there was a moderation in the production of chemicals and chemical products due to the weak external demand conditions. On the other hand, expansion in domestic-oriented industries was supported by the performance of the construction-related cluster, which continued to benefit from robust domestic construction activity.

Overall, the capacity utilisation rate in the manufacturing sector moderated marginally (81%; 2Q 12: 82%), reflecting the softer production growth in the sector. Export- and domestic-oriented industries operated at 80% and 82% of total capacity respectively during the quarter (2Q 12: 82% and 82% respectively).

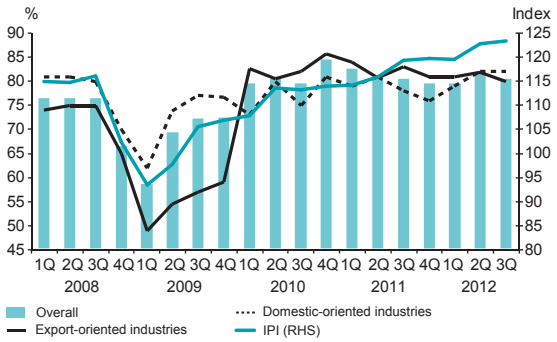
Performance of the Manufacturing Sector

	2011		2012		
	3Q	4Q	1Q	2Q	3Q
	Annual Change (%)				
Value Added (RM million at constant 2005 prices)	**5.4**	**5.2**	**4.4**	**5.6**	**3.3**
Overall Manufacturing Production[1]	**5.4**	**4.9**	**4.6**	**5.8**	**3.5**
Export-oriented industries	**4.0**	**2.9**	**3.0**	**5.1**	**2.3**
Electronics and electrical products cluster	**-0.5**	**-3.0**	**0.0**	**2.9**	**1.2**
Of which:					
Electronics	-3.9	-10.3	-3.6	3.0	5.1
Electrical products	4.0	6.5	4.6	2.8	-3.6
Primary-related cluster	**6.5**	**6.1**	**4.5**	**6.2**	**2.9**
Of which:					
Chemicals and chemical products	9.7	14.1	9.1	10.8	6.2
Petroleum products	1.7	-1.1	3.8	9.5	-0.2
Rubber products	15.5	9.5	3.4	4.1	2.2
Off-estate processing	9.9	13.8	2.2	-15.4	2.5
Domestic-oriented industries	**10.0**	**11.4**	**10.0**	**8.2**	**7.0**
Construction-related cluster	**19.1**	**12.3**	**8.3**	**4.8**	**10.5**
Of which:					
Construction-related products	13.1	8.3	0.9	2.6	1.6
Fabricated metal products	27.5	17.5	17.4	7.6	21.5
Consumer-related cluster	**3.5**	**10.7**	**11.4**	**11.3**	**4.1**
Of which:					
Transport equipment	-0.1	8.5	9.9	14.6	12.7
Food, beverage & tobacco products	4.9	9.8	11.5	10.2	1.9

[1] Industrial Production Index (2005=100)

Source: Department of Statistics, Malaysia

Capacity utilisation rate in the manufacturing sector*



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

Source: Bank Negara Malaysia & Department of Statistics, Malaysia

In the construction sector, growth remained robust in the third quarter (18.3%; 2Q 12: 22.2%), driven by the civil engineering sub-sector. The pickup in progress of newer projects namely the MRT and Tanjung Bin power plant supported the growth of the sub-sector, as did other ongoing major infrastructure and oil and gas projects such as the Second Penang Bridge, Janamanjung power plant, offshore pipelines for Gumusut-Kakap project and Sabah-Sarawak Gas Pipeline. Growth in the residential and non-residential sub-sectors also remained firm. While the growth of the residential sub-sector was underpinned by the construction of high-end residential properties, the non-residential sub-sector was supported by construction of industrial and commercial buildings.

Indicators for the Construction Sector

	2011		2012		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Housing approvals	54.1	29.8	75.6	126.9	3.2
New housing sales and advertising permits	6.0	22.4	12.5	13.9	25.6
Production[1] of construction-related materials	19.1	12.3	8.3	4.8	10.5
Structural metal products	65.5	41.4	49.2	3.1	40.1
Iron and steel	2.1	1.0	-11.7	-2.0	-5.3
Structural non-refractory clay and ceramic products	-2.4	2.5	3.3	8.9	4.3
Ready-mix concrete	38.7	35.3	18.2	23.8	18.2
Loans for construction activity					
Approval	-19.9	64.4	38.2	-9.0	5.3
Disbursement	-4.7	17.9	16.0	17.9	49.0

[1] Industrial Production Index (2005=100)

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

Value-added growth of the agriculture sector turned around to expand by 0.5% (2Q 12: -4.7%), due mainly to a recovery in the production of crude palm oil and strong production of food crops. The mining sector however, contracted by 1.2% (2Q 12: 2.3%), reflecting a sharp drop in natural gas production following a prolonged planned shutdown of several gas facilities for maintenance purposes.

Performance of the Agriculture Sector

	2011		2012		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Value Added (at constant 2005 prices)	**8.8**	**6.9**	**2.1**	**-4.7**	**0.5**
Industrial Crops	**10.7**	**7.8**	**1.4**	**-12.3**	**-3.9**
Of which:					
Oil palm	12.5	16.9	3.5	-17.5	1.6
Rubber	15.1	-6.9	-9.4	-2.1	-15.6
Food Crops	**6.2**	**5.6**	**2.8**	**5.8**	**6.4**
Of which:					
Fishing	3.6	1.2	-4.4	-0.2	4.7
Livestock	11.9	10.3	11.0	7.7	7.1

Source: Department of Statistics, Malaysia

Performance of the Mining Sector

	2011		2012		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Value Added (at constant 2005 prices)	**-5.9**	**-3.8**	**0.3**	**2.3**	**-1.2**
Production					
Of which:					
Crude oil and condensates	-9.8	-6.6	0.1	5.7	0.0
Natural gas	-2.0	0.7	-0.2	-4.4	-3.3

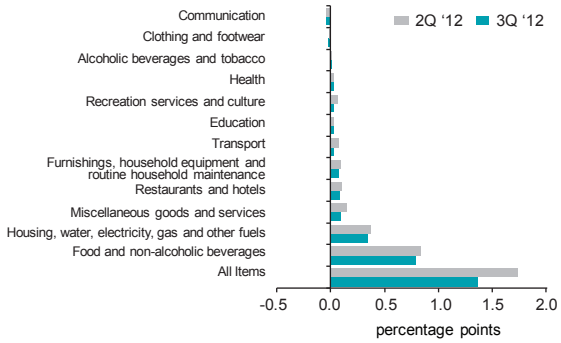
Source: PETRONAS
Department of Statistics, Malaysia

Inflation continued to moderate

The headline inflation rate, as measured by the annual change in the Consumer Price Index (CPI), moderated to 1.4% in the third quarter (2Q 12: 1.7%), reflecting lower inflation in the *transport, recreation services and culture* and *miscellaneous goods and services* categories.

Inflation in the *transport category* moderated to 0.2% (2Q 12: 0.5%) as the impact from the downward adjustment to the price of RON97 petrol in July more than offset the impact from the subsequent upward adjustments in August and September. Inflation in the *recreation*

Contribution to Consumer Price Inflation



Source: Bank Negara Malaysia

services and culture category was lower as the impact from the increase in satellite television services charges in mid-July 2011 dissipated (3Q 12: 0.5%, 2Q 12: 1.3%). Inflation in the *miscellaneous goods and services* category declined to 1.4% during the quarter (2Q 12: 2.3%) reflecting mainly slower increase in the prices of jewellery.

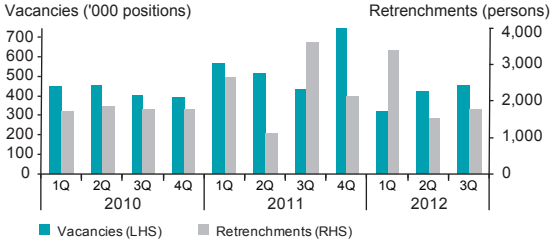
Food inflation remained relatively stable during the quarter at 2.6% (2Q 12: 2.7%). The slight moderation in inflation reflected the decline in prices in the *meat* category (3Q 12: -3.1%; 2Q 12: -1.9%) and slower price increases in the *fish and seafood* category (3Q 12: 7.3%; 2Q 7.6%) due partly to the implementation of the Government's festive season price control scheme in July and August.

The Producer Price Index (PPI) declined by 0.7% on an annual basis in the third quarter (2Q 12: 0.8%). In terms of composition, prices of commodity-related components declined by 2.7% (2Q 12: 1.7%) while prices of non-commodity-related components increased by 0.6% (2Q 12: 0.2%) during the quarter. Prices of local components declined by 1.1% (2Q 12: 0.8%) while prices of imported components increased at a slower rate of 0.7% (2Q 12: 0.8%).

Labour market conditions remained favourable

Overall labour market conditions remained positive during the quarter. Total employment in July and August averaged 12.67 million persons, representing a net job creation of 169,450 jobs from the second quarter. Unemployment rate improved to 2.9% for the first two months of the quarter (2Q 12: 3.0%).

Labour Market Conditions



Note: : Beginning 2012, vacancies data reflected a technical review
Source: Ministry of Human Resources

However, retrenchment increased marginally to 1,767 persons from 1,516 persons recorded in the preceding quarter, with the manufacturing sector accounting for 78% of total layoffs, mostly in the export-oriented industries.

Labour demand during the quarter was also sustained, as reflected in the higher number of job vacancies posted in the JobsMalaysia Portal (453,893 positions; 2Q 12: 419,636 positions). The construction sector accounted for the bulk of the increase in job openings, in line with the sector's robust growth. Real wages in the manufacturing sector recorded a lower growth of 3.8% as compared to the preceding quarter (2Q 12: 5.2%).

Sustained current account surplus

The current account surplus narrowed slightly in the third quarter to RM9.5 billion, equivalent to 4.2% of GNI, as the goods surplus was partially offset by net income payment and services deficit.

Balance of Payments

	2011		2012		
	3Q	4Q	1Q	2Q	3Q
	RM billion				
Current Account	**27.4**	**22.4**	**18.1**	**9.6**	**9.5**
(% of GNI)	*12.5*	*10.0*	*8.3*	*4.4*	*4.2*
Goods	37.7	36.8	35.8	29.4	25.5
Services	-1.1	-3.8	-3.8	-3.6	-3.4
Income	-3.9	-5.3	-8.6	-11.7	-7.9
Current transfers	-5.3	-5.4	-5.3	-4.6	-4.7
Financial Account	**-22.5**	**-0.2**	**-10.3**	**5.4**	**-8.7**
Direct investment abroad	-13.0	-14.7	-16.9	-2.5	-7.7
Foreign direct investment	9.1	6.5	7.5	6.1	9.6
Portfolio investment	-28.0	-2.7	25.3	-5.0	27.6
Financial derivatives	-0.3	-0.3	0.0	1.0	-0.1
Other investment	9.7	11.0	-26.1	5.9	-38.1
- Official sector	*-0.5*	*-0.1*	*-0.5*	*-0.3*	*0.0*
- Private sector	*10.2*	*11.1*	*-25.6*	*6.1*	*-38.0*
Errors & omissions	6.0	-15.9	-14.9	-2.2	-8.3
Overall Balance	**10.9**	**6.2**	**-7.2**	**12.7**	**-7.5**

Source: Department of Statistics Malaysia

Gross exports growth turned negative (-1.5%) in the third quarter on account of the decline in the exports of manufactured goods and commodities. The contraction in manufactured exports was due mainly to weaker external demand for E&E products from both the advanced and regional economies. Exports of resource-based manufactured products and commodities also declined, reflecting lower commodity prices and softer demand from regional economies. Nonetheless, exports of minerals continued to expand, supported by sustained demand for and high prices of natural gas.

Gross imports continued to expand (+7.3%), albeit at a slower pace, due mainly to sustained high imports of capital and consumption goods. Growth of capital imports was supported by imports of machineries and aircrafts, reflecting continued investment activity in the domestic economy. Imports of consumption goods were sustained due mainly to higher imports of processed food and beverages and non-durable consumer goods. However, intermediate imports contracted further in tandem with the decline in manufactured exports.

Deficit in the services account was slightly lower at RM3.4 billion in the third quarter. The lower deficit was mainly attributable to lower net payments for transportation services amidst higher net travel receipts. The deficit in income account narrowed to RM7.9 billion, arising from higher investment income accrued to Malaysian companies investing abroad and lower investment income accrued to foreign direct investors in Malaysia. During the quarter, higher profits were mainly reflected by high profits of Malaysian companies investing in the financial and oil and gas sectors abroad.

The financial account turned around to record a net outflow of RM8.7 billion in 3Q 12 (2Q 12: +RM5.4 billion) as net inflows in FDI and portfolio investment were outweighed by net outflows of direct investment abroad and other investment.

Portfolio investment turned around from a small net outflow position to record a net inflow of RM27.6 billion during the quarter (2Q 12: -RM5 billion). Given Malaysia's favourable growth prospects and sound economic fundamentals, the resumption of inflows is attributable to investors' continued search for higher returns in

Trade Account

	2011		2012		
	3Q	4Q	1Q	2Q	3Q
	Annual change (%)				
Gross Exports	**11.7**	**9.8**	**3.9**	**2.8**	**-1.5**
Manufactured	4.9	2.2	1.2	2.1	-1.3
E&E	*-4.0*	*-5.0*	*-1.7*	*-2.4*	*-1.7*
Non-E&E	*15.9*	*10.3*	*4.2*	*6.7*	*-0.8*
Commodities	29.6	28.8	9.1	3.7	-3.0
Agriculture	*45.0*	*18.9*	*-8.0*	*-12.5*	*-21.4*
Minerals	*19.4*	*36.6*	*20.9*	*16.3*	*11.8*
Gross Imports	**7.3**	**6.8**	**6.8**	**8.7**	**7.3**
Capital goods	5.4	2.8	18.3	27.1	22.6
Intermediate goods	3.7	2.4	-1.4	-0.2	-3.1
Consumption goods	26.4	25.2	20.4	10.7	11.4
Trade balance (RM billion)	**30.6**	**32.2**	**29.8**	**21.3**	**17.2**

Source: MATRADE and Department of Statistics, Malaysia

Malaysia: Direction of Exports

	2011		2012			2011		2012		
	3Q	4Q	1Q	2Q	3Q	3Q	4Q	1Q	2Q	3Q
	Annual change (%)					Share of total exports (%)				
United States	**-3.6**	**-3.5**	**5.5**	**3.8**	**8.3**	**8.3**	**8.0**	**8.3**	**8.6**	**9.2**
European Union (EU)	**6.3**	**3.9**	**-10.4**	**-8.9**	**-19.2**	**10.3**	**10.2**	**9.1**	**9.0**	**8.5**
Selected ASEAN countries[1]	**10.1**	**5.6**	**9.3**	**10.3**	**10.6**	**23.8**	**24.3**	**25.8**	**26.2**	**26.7**
North East Asia	**15.1**	**9.4**	**-3.1**	**0.5**	**-7.6**	**25.4**	**24.2**	**22.9**	**24.1**	**23.8**
People's Republic of China	*27.4*	*15.4*	*-3.4*	*9.2*	*-11.6*	*14.2*	*13.0*	*11.9*	*13.2*	*12.7*
Hong Kong SAR	*-2.2*	*-7.3*	*-8.1*	*-3.2*	*0.2*	*4.5*	*4.2*	*4.0*	*4.4*	*4.6*
Chinese Taipei	*5.6*	*13.1*	*-6.0*	*-7.5*	*-1.6*	*3.2*	*3.4*	*3.0*	*3.1*	*3.2*
Korea	*6.2*	*8.5*	*5.8*	*-15.2*	*-6.7*	*3.5*	*3.6*	*4.0*	*3.4*	*3.3*
West Asia	**11.9**	**6.5**	**-4.8**	**-0.9**	**2.5**	**3.4**	**3.5**	**3.4**	**3.6**	**3.6**
India	**36.0**	**33.7**	**-5.1**	**7.6**	**0.7**	**4.3**	**4.0**	**3.6**	**4.2**	**4.3**
Total exports	**11.7**	**9.8**	**3.9**	**2.8**	**-1.5**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

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

Source: Department of Statistics, Malaysia

the region. In addition, the higher inflows also reflected the market's reaction to the additional monetary policy easing by the advanced economies. Other regional economies also experienced portfolio inflows during the quarter.

FDI recorded a larger net inflow of RM9.6 billion (2Q 12: +RM6.1 billion) following higher earnings retained by the multinational companies (MNCs) in Malaysia as well as larger inflows of equity capital. FDI inflows continued to be broad-based during the quarter, the bulk of which were undertaken by companies in the *manufacturing* and *oil and gas* sectors.

Direct investment abroad (DIA) by Malaysian companies was also higher at RM7.7 billion in the third quarter (2Q 12: -RM2.5 billion). The higher net DIA outflow reflected larger outflows of equity capital amidst sizeable earnings retained by Malaysian companies operating abroad. DIA were mainly channelled into the services sector, particularly the *finance and insurance*, *wholesale and retail trade* and *real estate activities* sub-sectors. There were also sizeable investments abroad by domestic companies in the *oil and gas* sector.

Other investment registered a net outflow of RM38.1 billion in the third quarter (2Q 12: +RM5.9 billion). The outflows were accounted mainly by interbank placements by domestic banking institutions with foreign counterparts amidst an environment of ample global liquidity. There were also sizeable outflows arising from continued extension of trade credits. The official sector registered a small net outflow, due to continued repayment of external loans.

Given the net outflow position in the financial account amidst lower current account surplus, the overall balance of payments turned around to record a deficit of RM7.5 billion in 3Q 2012 (2Q 12: +RM12.7 billion). The errors and omissions amounted to -RM8.3 billion and largely reflected the foreign exchange revaluation loss on external reserves during the quarter, following the appreciation of the ringgit against major currencies.

Lower external debt

Malaysia's total external debt decreased to RM257.8 billion at end-September 2012 (end-June 2012: RM269.3 billion). This is equivalent to 28.4% of GNI and accounted for only 11.8% of total debt[2].

Medium- and long-term external debt was lower at RM156.9 billion (end-June 2012: RM159.2 billion), as the strengthening of ringgit against major and regional currencies during the quarter more than offset net drawdown of external borrowings, particularly by the private sector. As at end-September 2012, the short-term external debt was also lower at RM100.9 billion due mainly to net repayment of interbank borrowing.

External Debt Outstanding

	2011	2012	
	end-Sept	end-June	end-Sept[P]
	RM billion		
Medium- and long-term debt	157.8	159.2	156.9
Public sector	88.5	87.3	84.8
Private sector	69.3	71.9	72.1
Short-term debt[1]	105.5	110.1	100.9
Total external debt	**263.3**	**269.3**	**257.8**
USD billion equivalent	81.8	83.5	83.3
External debt/GNI (%)	30.6	29.7	28.4
Reserves/Short-term external debt (times)	4.0	3.9	4.2[2]

[1] Excludes currency and deposits held by non-residents with resident banking institutions
[2] Based on international reserves as at 31 October 2012
[P] Preliminary

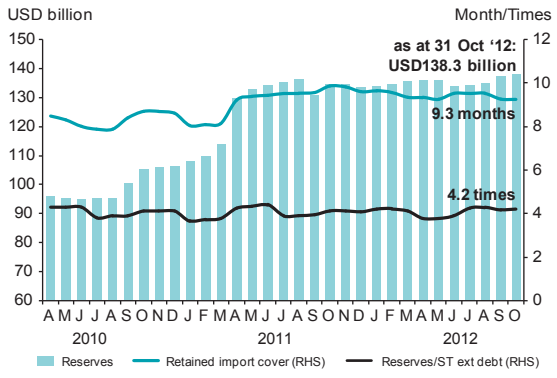
Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

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

International reserves remained high

The international reserves of Bank Negara Malaysia amounted to RM421.3 billion (equivalent to USD137.5 billion) as at 28 September 2012. This reserves level has taken into account the quarterly adjustment for foreign exchange revaluation loss, following the strengthening of ringgit against major and regional currencies during the third quarter. As at 31 October 2012, the reserves position amounted to RM423.9 billion (equivalent to USD138.3 billion), sufficient to finance 9.3 months of retained imports and is 4.2 times the short-term external debt.

Net International Reserves (as at end period)



Source: Bank Negara Malaysia

Steady revenue growth supported Government expenditure

In the third quarter, the Federal Government revenue increased to RM52.1 billion (2Q 12: RM50.7 billion), supported by income tax collection. The higher revenue was adequate to sustain the moderate increase in operating expenditure, which was driven by higher emolument payments. Development expenditure amounting to RM10.9 billion (2Q 12: RM10.3 billion) were disbursed primarily to the transportation and public utilities sectors. Overall Government expenditure stood at RM60.9 billion (2Q 12: RM58.5 billion), resulting in a deficit of RM8.8 billion (-3.7% of GDP) during the quarter (2Q 12: RM7.8 billion, -3.3% of GDP). The deficit was financed by domestic borrowings. As at end-September 2012, total outstanding debt of the Federal Government stood at RM484.6 billion or 51.8% of the estimated 2012 GDP.

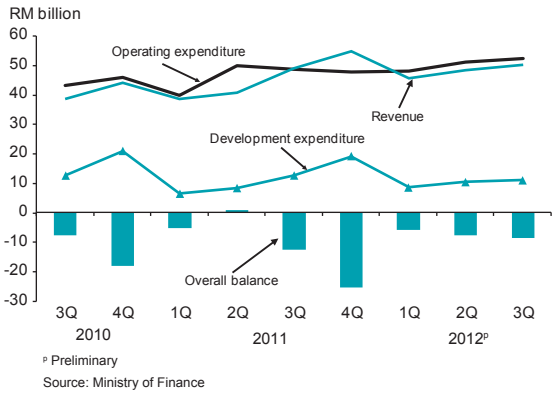
Federal Government Finance

	2011		2012[p]		
	3Q	4Q	1Q	2Q	3Q
	RM billion				
Revenue	48.3	47.7	47.9	50.7	52.1
% annual growth	*12.1*	*4.0*	*20.4*	*2.2*	*7.8*
Operating expenditure	48.8	54.5	45.6	48.2	50.1
% annual growth	*26.6*	*23.6*	*18.0*	*18.8*	*2.5*
Current account	**-0.5**	**-6.9**	**2.3**	**2.5**	**2.0**
% of GDP	***-0.2***	***-3.0***	***1.0***	***1.1***	***0.9***
Gross development expenditure	12.6	19.1	8.5	10.3	10.9
% annual growth	*0.3*	*-8.4*	*32.3*	*24.0*	*-13.0*
Overall balance	**-12.8**	**-25.4**	**-5.8**	**-7.8**	**-8.8**
% of GDP	***-5.7***	***-11.1***	***-2.6***	***-3.3***	***-3.7***
Memo item:					
Total net expenditure	61.1	73.0	53.7	58.5	60.9
% annual growth	*20.0*	*14.1*	*19.4*	*19.9*	*-0.4*
Total Federal Government debt (as at end-period)	440.8	456.1	470.8	476.7	484.6
% of GDP	*50.0*	*51.8*	*50.3*	*50.9*	*51.8*
Domestic debt	422.8	438.0	453.9	458.8	467.4
% of GDP	*48.0*	*49.7*	*48.5*	*49.0*	*49.9*
External debt	18.1	18.1	16.9	17.9	17.3
% of GDP	*2.1*	*2.1*	*1.8*	*1.9*	*1.8*

[p] Preliminary

Source: Ministry of Finance

Federal Government Finance



[p] Preliminary

Source: Ministry of Finance

MONETARY AND FINANCIAL DEVELOPMENTS

Interest rates remained stable

The Overnight Policy Rate (OPR) was left unchanged at 3.00% during the third quarter of 2012. At the prevailing level of the OPR, monetary conditions remain supportive of economic activity.

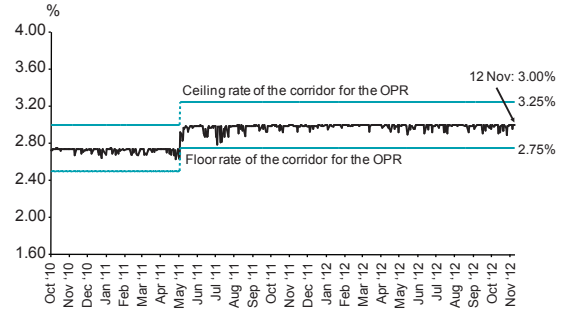
Reflecting the unchanged OPR, the average overnight interbank rate was stable during the quarter, moving within a range of 2.91% to 3.00% between 2 July and 28 September 2012. Interbank rates of other short-term maturities were also relatively stable.

Rates on interest rate swaps and the 3 month Kuala Lumpur Interbank Offer Rate (KLIBOR) futures remained relatively stable during the period, reflecting the continued expectations of market participants for the OPR to remain unchanged.

Retail deposit rates were stable during the quarter. The average quoted fixed deposit (FD) rates of commercial banks were relatively unchanged. As at end-September 2012, the average quoted FD rates of commercial banks for the tenures 1 to 12 months ranged between 2.91% to 3.16% respectively.

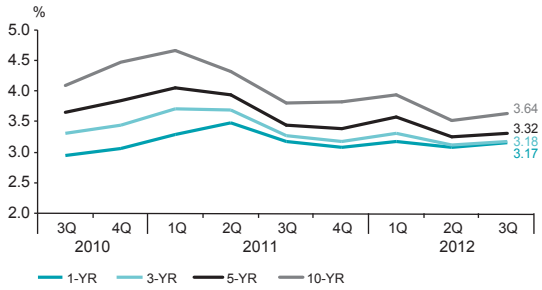
Borrowing costs were also relatively stable during the period. The average base lending rate (BLR) of commercial banks remained unadjusted at 6.53%, while the weighted average lending rate (ALR) on loans outstanding remained stable at 5.55% as at end-September 2012 (end-June 2012: 5.60%). The cost of borrowing for businesses and households remain below pre-crisis levels and supportive of economic activity.

Daily Weighted Average Overnight Interbank Rate



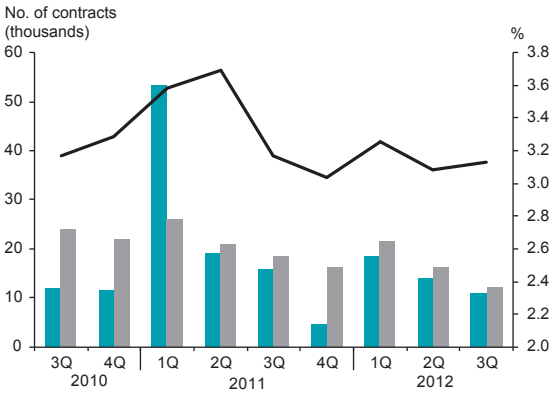
Source: Bank Negara Malaysia

Interest Rate Swap: Rates



Source: Bloomberg

3-Month KLIBOR Futures



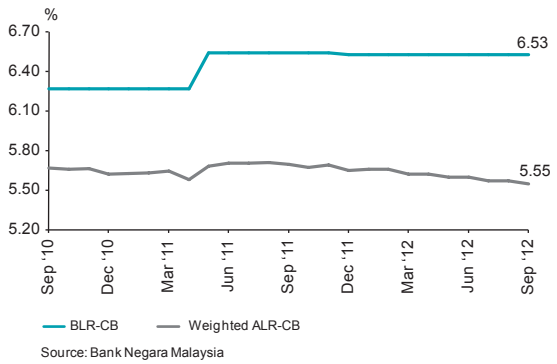
Source: Bursa Malaysia

Interest Rates

	2011	2012	
	3Q	2Q	3Q
	At end-period (%)		
Overnight Policy Rate (OPR)	3.00	3.00	3.00
Interbank rates			
Overnight	2.99	2.99	2.99
1-month	3.09	3.06	3.08
Base lending rate (BLR)			
Commercial banks	6.54	6.53	6.53
Weighted average lending rate (ALR)			
Commercial banks	5.70	5.60	5.55
Fixed deposit rates			
Commercial banks			
1-month	2.95	2.90	2.91
12-months	3.22	3.19	3.16

Source: Bank Negara Malaysia

Lending Rates of Commercial Banks (At end-period)



Source: Bank Negara Malaysia

Determinants of Broad Money, M3

	Change during the period				
	2011		2012		
	3Q	4Q	1Q	2Q	3Q
	RM billion				
M3	**28.2**	**53.7**	**38.7**	**26.7**	**29.0**
Net claims on Govt[2]	10.4	7.6	2.1	-1.2	0.8
Claims on private sector	20.2	35.7	23.1	53.3	26.9
Loans	*22.6*	*33.4*	*18.4*	*48.9*	*19.0*
Securities	*-2.4*	*2.2*	*4.7*	*4.4*	*7.9*
Net foreign assets[1]	-6.1	7.5	17.2	-8.2	21.7
BNM	*2.0*	*11.2*	*0.4*	*4.9*	*0.6*
Banking System	*-8.1*	*-3.8*	*16.8*	*-13.1*	*21.1*
Other influences[2]	3.8	3.0	-3.7	-17.2	-20.4

[1] Pre-revaluation
[2] For the period Dec 2011 - Aug 2012, data for net claims on Government and other influences have been revised due to a compilation error.

Source: Bank Negara Malaysia

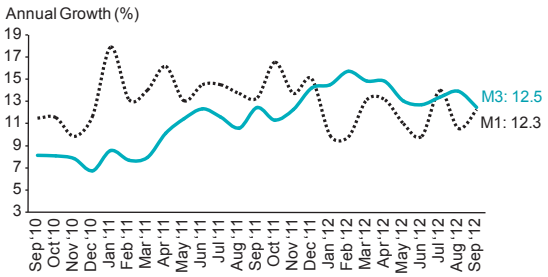
M3 continued to expand

The monetary aggregates continued to expand during the third quarter of 2012. M1, or narrow money, increased by RM8.6 billion. On an annual basis, M1 expanded by 12.3% as at end-September (end-June 2012: 9.9%). M3, or broad money, increased by RM27.5 billion on a quarter-on-quarter basis to record an annual growth rate of 12.5% as at end-September (end-June 2012: 12.8%).

The increase in M3 reflected both domestic and external factors. On the domestic side, M3 expanded following continued credit extension to the private sector, in line with the sustained pace of economic activity by the private sector, as well as higher government spending. On the external side, the expansionary impact on M3 was attributed to the increase in net capital inflows.

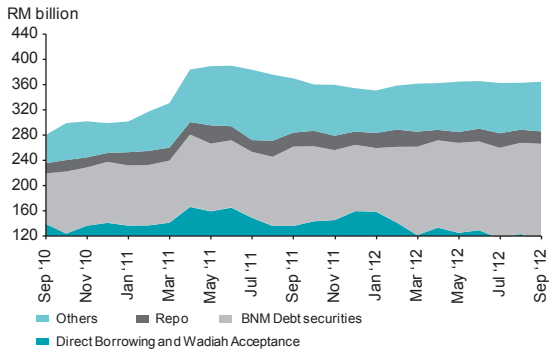
During the quarter, the higher banking system liquidity from capital inflows was sterilised by BNM mainly through the issuance of BNM debt securities.

Monetary Aggregates



Source: Bank Negara Malaysia

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

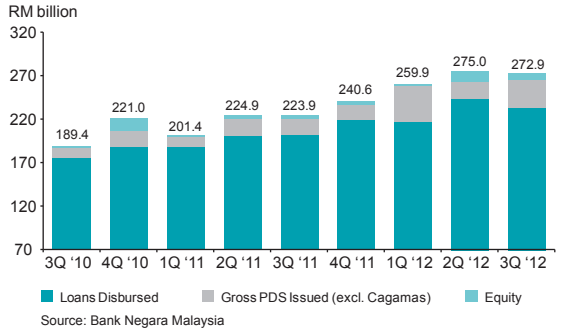


Source: Bank Negara Malaysia

Private sector financing activity was sustained

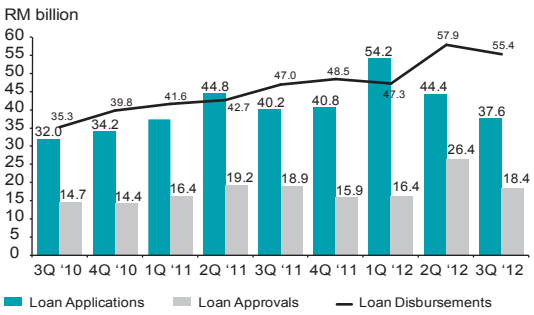
In the third quarter, financing conditions remained supportive of economic activity. Total gross financing raised by the private sector through the banking system and the capital market was RM272.9 billion (2Q 12: RM275.0 billion). The sustained financing was due mainly to the increase in net issuances of private debt securities (PDS) during the quarter. On a net basis, banking system loans and PDS outstanding expanded at an annual growth rate of 12.8% as at end-September (2Q 12: 13.0%).

Gross Private Sector Financing through Banking System and Capital Market



Source: Bank Negara Malaysia

Bank Lending to SMEs



Source: Bank Negara Malaysia

In the business sector, while loans outstanding from the banking system moderated slightly due to large repayments during the quarter, loans disbursed to businesses remained high. Most of the loans were disbursed mainly to the *construction; wholesale and retail, restaurants and hotels; agriculture* and *electricity, gas and water supply* sectors. Demand for new financing by businesses, however, declined slightly due to the absence of the exceptionally large loan applications recorded between March and June. On an annual basis, business loans outstanding expanded at a growth rate of 13.5% as at end-September (2Q 12: 14.2%).

Financing to the household sector continued to expand at a steady pace during the quarter to increase at an annual growth rate of 11.9% as at end-September (2Q 12: 11.8%). Household demand for financing remained resilient during the quarter, with continued loan applications for the *purchase of residential property, passenger cars* and *securities*.

Financing of the Private Sector through Banking System and Capital Market

	During the period (RM billion)					Annual growth (%)				
	2011		2012			2011		2012		
	3Q	4Q	1Q	2Q	3Q	3Q	4Q	1Q	2Q	3Q
Gross total financing	**223.9**	**240.6**	**259.9**	**275.0**	**272.9**	**18.2**	**8.9**	**29.1**	**22.3**	**21.9**
Loans disbursed*	202.1	219.7	216.7	243.4	233.3	14.8	16.3	14.9	21.2	15.4
Gross PDS (excl. Cagamas)	18.0	17.1	41.9	19.6	31.8	61.1	-2.1	260.6	-3.2	76.4
Equity	3.8	3.8	1.3	12.0	7.9	79.3	-73.9	19.8	214.2	106.1
Net total financing (A)+(B)	**31.4**	**32.1**	**45.8**	**54.3**	**33.3**	**13.4**	**12.5**	**13.3**	**13.0**	**12.8**
Banking system	25.9	31.7	25.0	48.8	28.6	13.1	12.9	12.5	13.0	12.9
Loans outstanding (A)	*24.6*	*31.2*	*19.7*	*44.1*	*20.9*	*13.8*	*13.6*	*12.2*	*12.6*	*11.9*
Holding of PDS	*1.3*	*0.5*	*5.3*	*4.8*	*7.7*	*3.4*	*3.6*	*17.3*	*18.6*	*28.3*
PDS outstanding (B)	6.8	0.8	26.1	10.2	12.4	11.9	9.3	16.5	14.0	15.5
Memorandum item										
Gross PDS (incl. Cagamas)	19.1	17.4	44.8	20.6	32.6	32.4	-5.2	266.5	-1.4	71.0

*Banking systems loans include loans sold to Cagamas

Source: Bank Negara Malaysia

Loan Indicators

	During the period (RM billion)					Annual growth (%)				
	2011		2012			2011		2012		
	3Q	4Q	1Q	2Q	3Q	3Q	4Q	1Q	2Q	3Q
Total										
Loan applications	184.9	192.3	195.4	220.1	180.0	4.9	10.9	16.0	10.2	-2.6
Loan approvals	98.6	104.0	89.8	111.3	94.1	8.1	13.4	2.4	1.1	-4.5
Loan disbursements	202.1	219.7	216.7	243.4	233.3	14.8	16.3	14.9	21.2	15.4
Loan repayments	188.2	195.5	205.4	210.6	224.0	13.9	16.5	22.2	21.2	19.0
Change in loans outstanding*	24.6	31.2	19.7	44.1	20.9	13.8	13.6	12.2	12.6	11.9
Of which:										
Business enterprises**										
Loan applications	86.0	95.7	105.3	115.2	81.4	1.5	16.6	32.3	19.2	-5.3
Loan approvals	46.5	52.5	45.3	57.9	41.5	6.3	20.8	16.5	4.3	-10.7
Loan disbursements	135.9	150.8	152.5	178.6	163.3	16.6	21.1	24.9	32.5	20.2
Loan repayments	130.2	137.8	145.8	152.9	161.9	14.6	21.9	32.8	30.8	24.4
Change in loans outstanding*	8.7	13.2	3.5	25.1	7.6	14.1	13.5	10.8	14.2	13.5
SMEs**										
Loan applications	40.2	40.8	54.2	44.4	37.6	25.7	19.3	43.7	-0.8	-6.3
Loan approvals	18.9	15.9	16.4	26.4	18.4	28.5	10.8	-0.4	37.6	-2.3
Loan disbursements	47.0	48.5	47.3	57.9	55.4	33.4	21.9	13.7	35.5	17.8
Loan repayments	41.9	43.9	46.0	46.8	51.6	23.6	17.2	23.4	27.9	23.3
Change in loans outstanding*	5.7	8.2	4.8	11.8	4.7	16.1	19.3	19.9	21.9	20.3
Large corporations										
Loan applications	45.8	54.9	51.1	70.8	43.8	-13.2	14.6	22.1	36.4	-4.4
Loan approvals	27.6	36.6	28.9	31.5	23.0	-5.0	25.8	28.9	-13.3	-16.4
Loan disbursements	88.8	102.3	105.1	120.7	107.9	9.3	20.7	30.7	31.2	21.4
Loan repayments	88.3	94.0	99.9	106.1	110.3	10.8	24.3	37.6	32.2	24.9
Change in loans outstanding*	3.0	5.0	-1.3	13.3	2.9	12.8	9.8	5.1	9.3	9.1
Households										
Loan applications	98.9	96.7	90.2	104.9	98.6	8.0	5.8	1.4	1.9	-0.2
Loan approvals	52.1	51.5	44.5	53.4	52.6	9.8	6.7	-8.8	-2.1	1.0
Loan disbursements	66.2	68.9	64.2	64.8	70.0	11.1	7.1	-3.5	-2.0	5.7
Loan repayments	58.0	57.7	59.5	57.7	62.1	12.4	5.2	2.1	1.4	7.0
Change in loans outstanding*	15.2	17.8	11.9	16.7	17.2	12.5	12.9	11.9	11.8	11.9

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

Source: Bank Negara Malaysia

Net funds raised in the capital market increased

Net funds raised in the capital market increased to RM28.7 billion in the third quarter (2Q 12: RM27.6 billion). As in the previous quarter, the bulk of funds were raised by the private sector, in particular from the issuance of private debt securities (PDS). New PDS issuances increased to RM32.6 billion (2Q 12: RM20.6 billion). Funds raised were mainly used for refinancing and for funding working capital, general corporate expenses and operating expenses. Funds raised from the equity market remained healthy at RM7.9 billion (2Q 12: RM12.0 billion), with the bulk raised via initial public offerings. After adjusting for redemptions, net funds raised by the private sector amounted to RM18.3 billion (2Q 12: RM 22.5 billion).

Net funds raised by the public sector also increased to RM10.4 billion (2Q 12: RM5.0 billion). Funds were raised through the new issuance of a 7.5-year Malaysian Government Securities (MGS), a 3.5-year Government Investment Issue (GII), the re-opening of a 5-year, 10-year and 15-year MGS as well as a re-opening of the 5-year and 10-year GII. In addition, funds were also raised via a RM2.6 billion issuance of the Government Housing Sukuk.

Net Funds Raised in the Capital Market

	2011		2012		
	3Q	4Q	1Q	2Q	3Q
	RM billion				
By Public Sector	**1.6**	**15.9**	**13.7**	**5.0**	**10.4**
Government securities, *net*	1.6	15.9	15.6	9.6	7.8
Malaysian Government Securities	*14.0*	*12.9*	*12.8*	*16.1*	*14.2*
Government Investment Issues	*10.8*	*6.1*	*12.0*	*11.1*	*11.1*
Less: Redemptions	*23.2*	*3.1*	9.2	17.6	17.5
Khazanah Bonds, *net*	-	-	-	-	-
Savings Bonds, *net*	(0.0)	(0.0)	(1.9)	(4.6)	-
Government Housing Sukuk, net					*2.6*
By Private Sector	**11.1**	**3.5**	**29.8**	**22.5**	**18.3**
Shares	3.8	3.8	1.3	12.0	7.9
Debt securities, *net*	7.3	(0.3)	28.5	10.5	10.3
Private Debt Securities	*19.1*	*17.4*	*44.8*	*20.6*	*32.6*
Less: Redemptions	*11.8*	*17.7*	*16.3*	*10.1*	*22.3*
Total	**12.7**	**19.4**	**43.5**	**27.6**	**28.7**

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

Source: Bank Negara Malaysia and Bursa Malaysia

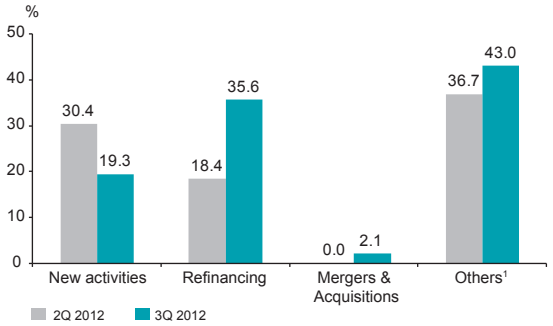
Loans by Sector

	Loans disbursed						Loans out-standing
	During the period					Share of total	Share of total
	3Q 11	4Q 11	1Q 12	2Q 12	3Q 12		
	(RM billion)					(%)	
Business enterprises	**135.9**	**150.8**	**152.5**	**178.6**	**163.3**	**70.0**	**45.0**
Large corporations	*88.8*	*102.3*	*105.1*	*120.7*	*107.9*	*46.2*	*29.0*
*SMEs**	*47.0*	*48.5*	*47.3*	*57.9*	*55.4*	*23.8*	*16.0*
Selected sectors							
Agriculture, hunting, forestry and fishing	5.3	6.1	5.7	8.1	7.1	3.0	2.5
Mining and quarrying	1.6	1.3	1.4	2.8	1.7	0.7	0.6
Manufacturing	44.9	47.4	46.3	55.4	53.1	22.8	8.9
Construction	10.8	14.0	11.9	11.9	16.1	6.9	4.2
Real estate	8.9	9.6	8.0	15.5	7.8	3.4	5.5
Electricity, gas and water supply	1.6	1.4	1.7	2.1	2.2	0.9	1.0
Wholesale, retail, restaurants and hotels	37.2	38.0	44.1	45.6	42.7	18.3	7.3
Transport, storage and communication	4.6	6.4	4.6	4.9	4.5	1.9	2.7
Finance, insurance and business services	13.0	16.4	21.5	24.4	20.7	8.9	7.0
Households	**66.2**	**68.9**	**64.2**	**64.8**	**70.0**	**30.0**	**55.0**
Purchase of residential properties	16.8	17.0	16.4	15.0	16.3	7.0	25.7
Consumption credit	40.3	41.6	37.1	40.0	42.7	18.3	19.1
Of which:							
Credit cards	*22.7*	*23.6*	*21.4*	*21.5*	*23.0*	9.9	2.9
Purchase of passenger cars	*8.8*	*9.3*	*8.6*	*10.2*	*10.8*	*4.6*	*11.3*
Others	9.1	10.3	10.7	9.7	11.0	*4.7*	*10.2*
Total	**202.1**	**219.7**	**216.7**	**243.4**	**233.3**	**100.0**	**100.0**

*Include loans to individual businesses.

Source: Bank Negara Malaysia

Private Debt Securities Issued by Purpose (% of total)



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

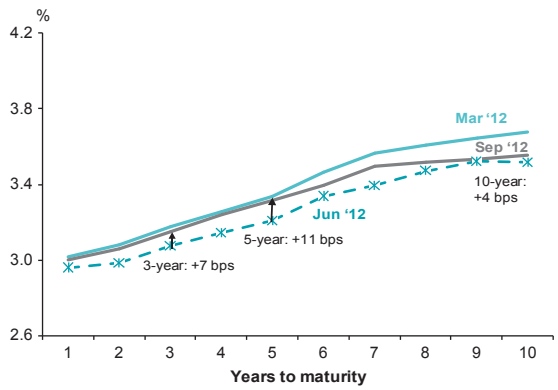
Source: Bank Negara Malaysia

MGS yields increased

From July to mid-August, MGS yields declined, continuing the trend from the second quarter, reflecting expectations that domestic monetary conditions would continue to remain accommodative. The decline in yields was also driven by continued demand by non-residents. This trend reversed during the last six weeks of the third quarter. MGS yields increased following large Government bond auctions in August and September. Overall, yields on the 3-year, 5-year and 10-year MGS increased by 7, 11 and 4 basis points respectively.

In the PDS market, corporate bond yields declined marginally. The 5-year AAA, AA and A-rated yield recorded a decline of 4, 5 and 3 basis points respectively from the previous quarter.

Trend in MGS Yields

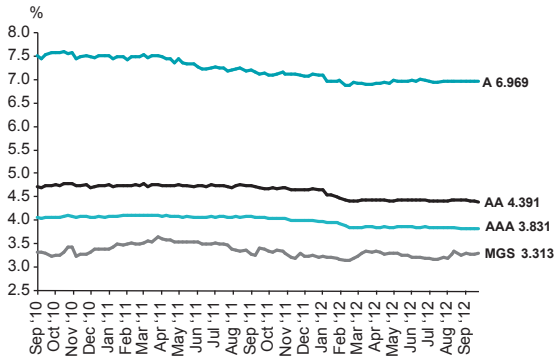


Source: Bank Negara Malaysia

Secondary trading in the bond market declined

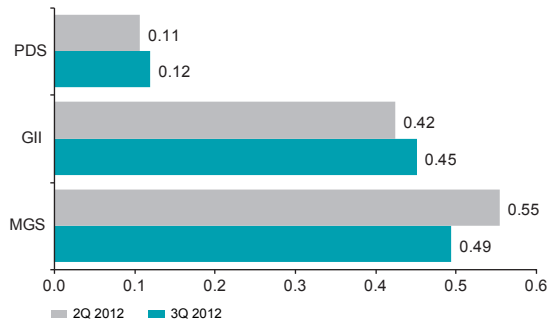
Total trading in the secondary market declined slightly to RM248 billion during the quarter (2Q 12: RM252 billion). The decline in turnover was mainly concentrated in the trading of MGS. The MGS registered a lower liquidity ratio of 0.49, while both the GII and PDS registered higher liquidity ratios of 0.45 and 0.12 respectively.

5-year MGS and 5-year Corporate Bond Yield



Source: Bank Negara Malaysia

Liquidity Ratio: Turnover / Outstanding



Source: Bank Negara Malaysia

Positive performance of KLCI

During the third quarter, the FBM (FTSE Bursa Malaysia) KLCI increased by 37.5 points, ending at 1,636.7 (end-June 2012: 1,599.2). In July and August, expectations for further stimulus measures in the advanced economies contributed to positive market sentiments and kept the indices in Malaysia and the region on an upward trend. There were, nonetheless, intermittent declines in the index following

heightened concerns over the ongoing European sovereign debt crisis. In September, larger and more frequent fluctuations in the movement of the index were recorded. While concerns over global growth prospects and profit-taking activities resulted in notable downward movements, announcement of further monetary easing by the US Federal Reserve lifted investor sentiments in the market. Overall, market capitalisation increased to RM1.42 trillion as at end-September 2012 (end-June 2012: RM1.37 trillion) while the daily average turnover decreased slightly to 1.20 billion units (2Q 12: 1.21 billion units) during the quarter. Open interest in the FBM KLCI futures decreased to 24,896 contracts as at end-3Q 2012 (2Q 12: 32,173).

On 12 November 2012, the KLCI closed higher at 1,637.59 points (since end-September 2012: 0.06 %), with market capitalisation of RM1.44 trillion (since end-September 2012: 1.61%).

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



Source: Bloomberg and Bank Negara Malaysia calculations

Ringgit appreciated against regional and most major currencies

During the quarter, the ringgit appreciated by 4.0% against the US dollar as further monetary easing in the advanced economies and expectations for progress in resolving the European sovereign debt crisis contributed to favourable investor sentiments towards Malaysia and regional economies. Domestically, the stronger than expected economic data for the second quarter added to investor interest towards Malaysia's financial assets. The ringgit also appreciated against the Japanese yen (1.7%) and euro (1.2%), but remained unchanged against the pound sterling. Against regional currencies, the ringgit strengthened in the range of 0.1% and 5.1%.

Bursa Malaysia: Selected Market Indicators

	2011		2012		
	As at end				
	Sept	Dec	Mar	June	Sept
Price indices					
Composite	1,387.1	1,530.7	1,596.3	1,599.2	1,636.7
FBMEMAS[1]	9,397.6	10,489.1	10,939.6	10,917.6	11,106.6
ACE Market[2]	3,598.0	4,068.6	4,583.8	4,354.7	4,304.7
Market capitalisation (RM billion)	1,172.3	1,284.5	1,355.4	1,367.9	1,417.3
No. of companies listed	952	941	939	927	931
	During the quarter				
	3Q	4Q	1Q	2Q	3Q
Average daily turnover					
Volume (million units)	1,018.9	1,615.5	2,019.9	1,205.8	1,197.8
Value (RM million)	1,887.4	1,411.7	1,977.8	1,517.1	1,683.8

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

Source: Bursa Malaysia

Bursa Malaysia: Market Turnover

	2011				2012					
	3Q		4Q		1Q		2Q		3Q	
	Billion units	RM billion	Billion units	RM billion	Billion units	RM billion	Billion units	RM billion	Billion units	RM billion
Turnover	63.2	117.0	98.5	86.1	119.2	116.4	76.0	95.6	73.1	102.7
Of which:										
Main Board	47.4	114.4	68.3	81.6	75.6	109.5	48.7	91.1	49.1	98.7
Of which										
Consumer Products	2.9	4.9	8.1	6.0	9.4	7.8	4.2	6.4	4.5	5.5
Industrial Products	7.9	12.9	14.6	10.7	13.3	16.7	10.7	10.1	10.0	8.9
Construction	3.3	6.1	2.7	4.1	2.8	4.9	1.5	2.8	1.9	3.4
Trading/Services	15.7	42.6	20.1	28.2	29.4	39.9	19.5	37.6	18.6	42.0
Finance	5.7	31.1	6.0	15.5	4.0	19.8	3.2	17.4	3.6	20.2
Properties	6.8	7.8	8.4	6.7	7.8	6.5	4.0	3.6	4.1	5.0
Plantations	1.9	5.6	2.0	4.9	1.7	5.8	1.5	7.1	1.8	7.8
Infrastructure	0.9	2.2	1.3	2.6	2.0	3.4	1.5	3.3	0.9	3.1
ACE Market[1]	9.8	1.5	18.7	2.7	27.7	4.3	19.8	3.2	18.5	3.3

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

Source: Bursa Malaysia

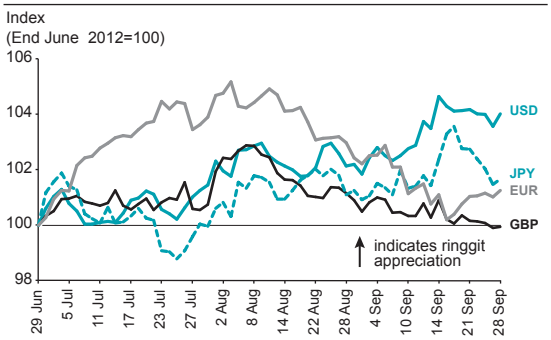
Between 1 October and 12 November 2012, the ringgit remained relatively unchanged against the US dollar (0.1%), but strengthened against the Japanese yen (2.6%), pound sterling (2.3%) and euro (1.7%). Within the region, the ringgit strengthened against the Indonesian rupiah (0.7%), but weakened against the Korean won (-2.2%), Philippine peso (-1.5%), Chinese renminbi (-0.9%) and Thai baht (-0.5%). The ringgit remained relatively unchanged against the Singapore dollar (-0.1%).

Market activity in foreign exchange derivatives rose

The volume of foreign exchange derivatives rose by 13.2% in the third quarter. The rise was primarily driven by activities in the foreign exchange swap market, which expanded by almost 20% from the volume recorded in the second quarter, as local banks continued to mobilise the excess US dollar liquidity in the banking system. There was also strong interest from importers to hedge their foreign currency exposure through forward buying of the US dollar, as the US dollar depreciated against most other currencies and the exchange rate levels became more attractive.

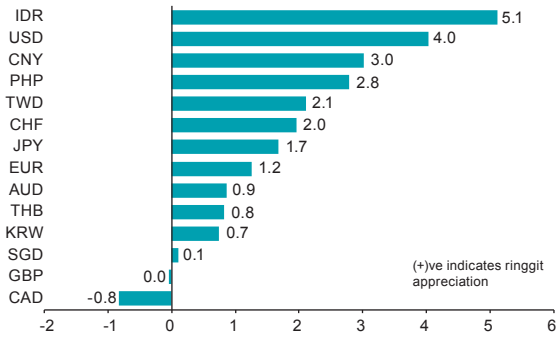
The cost of raising US dollar from cross currency swap transaction has also reduced substantially with the 5-year USD/RM cross-currency swaps narrowing from 153bps in July to 115bps in September. The reduction was mainly due to the increase in US dollar liquidity arising from continued monetary easing in advanced economies.

Ringgit Performance Against Major Currencies



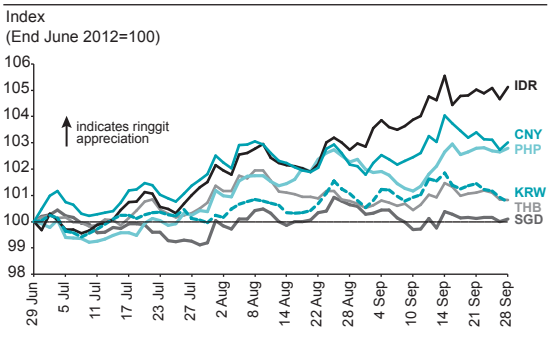
Source: Bank Negara Malaysia

Summary of Ringgit Performance Against Selected Currencies Percent Change (1 July - 28 September 2012)



Source: Bank Negara Malaysia

Ringgit Performance Against Regional Currencies



Source: Bank Negara Malaysia

Performance of Ringgit Against Selected Currencies

RM per foreign currency	As at end				% change since*		
	21 Jul 05	3Q 11	2Q 12	3Q 12	21 Jul 05	3Q 11	2Q 12
US dollar	3.8000	3.1910	3.1895	3.0660	23.9	4.1	4.0
Euro	4.6212	4.3160	4.0133	3.9639	16.6	8.9	1.2
Pound sterling	6.6270	4.9738	4.9804	4.9829	33.0	-0.2	0.0
100 Japanese yen	3.3745	4.1663	4.0198	3.9536	-14.6	5.4	1.7
Singapore dollar	2.2570	2.4537	2.5043	2.5018	-9.8	-1.9	0.1
100 Thai baht	9.0681	10.236	10.030	9.9481	-8.8	2.9	0.8
100 Philippine peso	6.8131	7.2746	7.5447	7.3402	-7.2	-0.9	2.8
100 Indonesian rupiah	0.0386	0.0362	0.0336	0.0320	20.7	13.2	5.1
100 Korean won	0.3665	0.2703	0.2775	0.2754	33.1	-1.8	0.7
Chinese renminbi	0.4591	0.4988	0.5018	0.4871	-5.7	2.4	3.0

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

Source: Bank Negara Malaysia

MANAGING RISKS TO FINANCIAL STABILITY

Financial stability remained intact

Overall, domestic financial stability had been preserved throughout the third quarter, supported by strong financial buffers both at the system and at the institutional levels. Financial market conditions continued to remain orderly as volatile portfolio flows were well intermediated by the markets. Confidence in the financial system remained intact during the quarter as financial intermediation continued to function efficiently to support domestic economic activity.

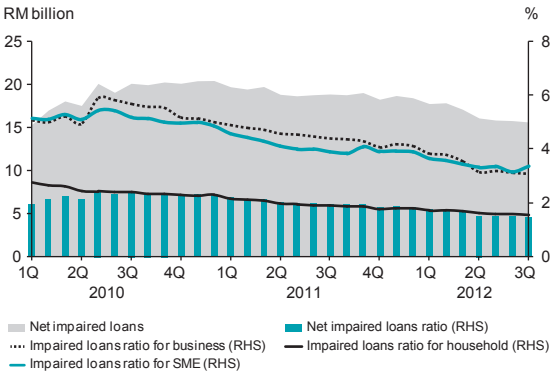
The stable operating environment during the quarter provided favourable support to credit exposures of financial institutions. The quality of the financing portfolio of banks improved with net impaired loans ratio at 1.4% (2Q 12: 1.5%), while loans-in-arrears were stable at 3.5% of total loans (2Q 12: 3.4%). The amount of capital charges by insurers for credit risks was stable at 3.4% of insurers' total capital.

The growth in household debts increased by 3.2% (2Q 12: 2.9%) attributable mainly to higher growth in financing for the purchase of residential properties (3.2%; 2Q 12: 2.9%). Accumulation of debts by households continued to be supported by a commensurate expansion in financial assets of 3.2% (2Q 12: 2.5%). As a result, household financial buffers were sustained at the aggregate level with household financial assets accounting for 2.3 times of household debts. The impairment level remained unchanged at 1.6% of household loans whilst arrears between one month and less than three months account for 2.7% of household loans, demonstrating households' continued ability to meet their debt obligations. Overall, household debt-to-GDP stood at 76.7% as at end-September 2012 (2Q 12: 75.4%).

Credit to businesses grew at a much slower pace of 1.9% during the quarter after a firm expansion of 6.6% during the previous quarter. The impaired loans ratio remained low and sustained at 3.1% of business loans with improvement in the debt servicing capacity of businesses as reflected by the higher interest coverage ratio (2Q 12: 6%; 1Q 12: 5.1%).

The outlook for credit risk remains firm, supported by sound economic fundamentals, sustained debt servicing capacity of borrowers, and continued sound risk management practices observed by financial institutions. The strong financial buffers of households is expected to provide continued flexibility for households to adjust to any changes in the income levels. Similarly, the strong financials of businesses, underpinned by low gearing levels and healthy cashflow positions, is expected to provide strong support to businesses to favourably manage any adverse developments in the business and operating environment. This is also affirmed by the improvement in the level of expected default frequency to 0.51% (2Q 12: 0.58%).

Banking System: Loan quality



Source: Bank Negara Malaysia

Exposures of financial institutions to market risk remained modest. Volatility in the domestic equity market eased further during the quarter to 7.3% (2Q 12: 7.9%), supported by positive market sentiments locally amidst a resumption in portfolio inflows. Trading liquidity in the equity market remained intact with the turnover ratio remained stable at 1.9 (2Q 12: 2.0), in line with sustained risk appetite. While yields were higher for the Malaysian Government Securities partly on account of portfolio rebalancing activities into equities, trading liquidity was sustained as demonstrated by stable turnover ratio and bid-ask spreads. The composition of banks' treasury assets in both ringgit and foreign currency denominations was largely unchanged. Banking system exposures to interest rate and equity risks remained stable at 4.8% and 0.6% of capital base respectively (2Q 12: 4.7%; 0.8%). The net open position in foreign currency exposures of banks was sustained at 6.7% of capital base (2Q 12: 6.6%). Similarly, interest rate and equity risks were well-contained for the insurance sector, declining to 3.2% and 6.4% (2Q 12: 3.3%; 6.7%) of total capital available respectively.

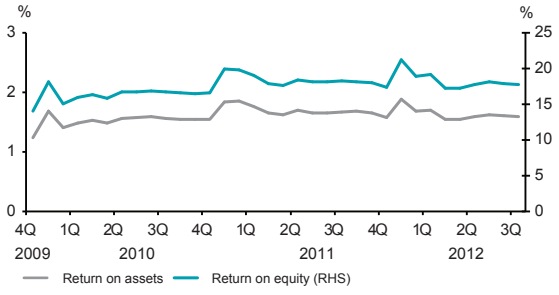
Potential risks arising from deleveraging by European financial institutions remained low. The domestic operations of the locally incorporated European banks in Malaysia showed no evidence of scaling back. The market share of assets, loans and deposits of these entities have remained stable and continued to be supported by strong operating performance and returns. Direct credit exposures of Malaysian financial institutions to European counterparties are limited, accounting for less than 8% of capital base for banks and 0.3% of capital available for insurers. Furthermore, the operations of Malaysian banks continue to be mainly supported by domestic funding sources.

The financial sector remained resilient amidst challenging environment

The capacity of the domestic financial sector to withstand potential economic and financial shocks continues to be well supported by strong capitalisation. Both the core capital ratio and risk-weighted capital ratio remained sound at 13% (2Q 12: 13.4%) and 14.8% (2Q 12: 15.1%) respectively. Banks' capital buffers (i.e. capital in excess of the minimum regulatory level of 8%) stood at more than RM70 billion. Banks continued to maintain high quality capital, in line with the expectations under the Basel III environment, with about 88.2% in Tier 1 capital, comprising mainly paid-up capital, share premium and reserves. Similarly, the insurance sector recorded a strong capital adequacy ratio of 218.6% (2Q 12: 216.7%) and a capital buffer in excess of RM20 billion.

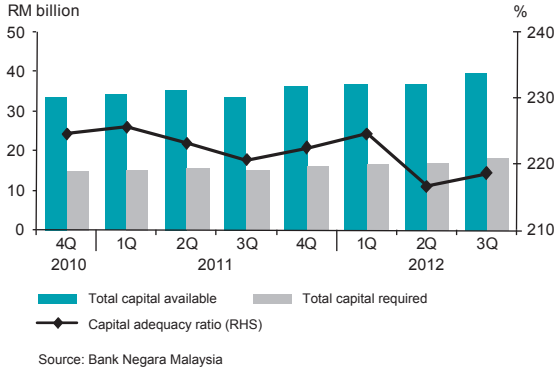
Profitability of the banking system was sustained, with returns on assets and equity of 1.6% (2Q 12: 1.6%) and 17.7% (2Q 12: 17.7%) respectively. Pre-tax profit for the quarter improved to RM7.4 billion (2Q 12: RM6.8 billion) attributable mainly to higher revenue from continued growth in financing activities and lower overhead costs. Net trading and investment income rose by 9.1% (2Q 12: -37.1%) amid improved general market sentiments.

Banking System: Profitability



Source: Bank Negara Malaysia

Insurance Sector: Capitalisation

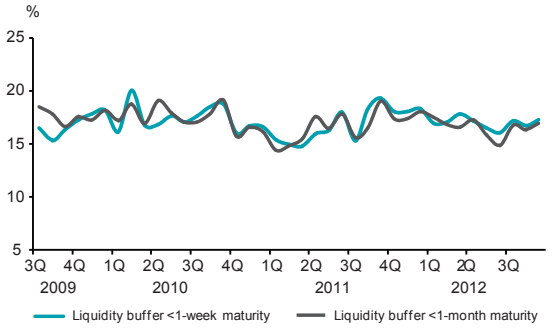


Source: Bank Negara Malaysia

The life insurance and family takaful businesses recorded higher excess of income over outgo totalling RM5.2 billion (2Q 12: RM4.1 billion) due to exceptional capital gains from the realisation of investments by one insurer. Excluding this exceptional gains, the excess of income over outgo was lower in the quarter at RM3.7 billion. The general insurance and takaful sector recorded lower profitability with underwriting and operating profits of RM359.7 million and RM688.4 million respectively (2Q 12: RM398.6 million; RM703.0 million respectively). This was attributed mainly to lower gross premium income from the marine, aviation & transit (MAT) business. The claims ratio for the Motor 'Act' cover (mandatory insurance cover required under the Road Transport Act 1987) continued to weigh on underwriting results, remaining high at 242.2% (2Q 12: 241.6%).

Banking sector resilience was further reinforced by the continued availability of ample liquidity to meet demands for deposit withdrawals and other liquidity obligations. Liquidity buffers to meet liquidity needs within 1 month improved to 17% of total deposits (2Q 12: 14.9%). The foreign currency liquidity mismatch positions of banks remained manageable in tandem with the further easing of onshore US dollar liquidity conditions. Banks maintained a positive mismatch position in the less than one week maturity bucket, while the negative mismatch position in the less than one month maturity bucket improved substantially to a shortfall of RM4.1 billion from a shortfall of RM7.9 billion in the second quarter, representing 2.3% of the capital base (2Q 12: 4.4%).

Banking System: Liquidity Buffer to Total Deposit Ratio



Source: Bank Negara Malaysia

Insurance and Takaful Sectors: Indicators

	2011		2012			
	2Q	3Q	1Q	2Q	3Q	3Q
	RM million					Annual Change (%)
Life Insurance & Family Takaful						
Excess of Income Over Outgo	3,780.0	1,315.0	3,912.9	4,115.7	5,240.7	298.5
General Insurance & General Takaful						
Operating profit	557.2	441.7	652.6	703.0	688.4	55.9
Claims ratio (%)	61.4	62.5	60.6	59.1	58.7	-3.8 (ppt)

Source: Bank Negara Malaysia

Governor's Speech at the Economic Symposium 2012: Overall Panel on "Global Policy Perspectives" United States, 1 September 2012

Keynote Address by

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

It is my honour to be invited to speak on this closing panel, to discuss global policy perspectives at this year's Economic Symposium, in this magnificent environment at Jackson Hole. My remarks will focus on global policies from the perspective of a policy-maker from an emerging economy, to discuss the evolving new frontiers of global policies, the global policy spillovers in particular to emerging economies, and on the policy priorities in emerging Asia in this environment.

The global economic and financial landscape has changed tremendously over this recent two decades. Yet the underlying motivation and progress in policy-making have not reflected these changes. The disparity between policy and the new landscape has become increasingly more evident since the 2008 global financial crisis. Policy-makers have thus been challenged in preventing the build-up of the risks and imbalances prior to the crisis, arresting and containing the crisis once it had erupted, and then managing its aftermath.

At the national level, these changes are well known. Driven largely by innovation and advances in technology, we now have more highly complex and more inter-connected financial systems with financial activity that has broadened to beyond the traditional financial intermediaries. More profound are the fundamental changes associated with the globalisation of finance, which has resulted in a more connected and inter-dependent world. Since the onset of the crisis, the policy response at the national level has been extensive and on an unprecedented scale, aimed to restore the functioning of the financial system and to arrest the steep deterioration in economic activity. Monetary policy was eased substantially, with interest rates brought down swiftly to historical lows. The cumulative fiscal expansion during the period 2007-2009, amounted to close to an average of four percent of GDP. Meanwhile, financial sector policies gave priority to stabilising financial markets and restoring credit flows.

While an economic depression has been averted, monetary accommodation has continued with large scale financial market interventions to support the recovery. Fiscal policy, however, shifted to address fiscal sustainability and the increased public indebtedness, following the massive stimulus and support to the financial sector. The challenge is to achieve this consolidation, while ensuring that the economic recovery and market confidence are not undermined.

On the wide-ranging financial reforms to address the weaknesses that led to the crisis and to strengthen the resilience of the financial sector, the emphasis has been on enhancing regulation and addressing macro-financial concerns to avoid the build-up of financial imbalances. These policies have also been supported by wide-ranging changes to the legislative framework and institutional structures.

An area of policy that has not been as extensive is the cross-border dimension of policy-making, despite the growing inter-dependence between economies. The increased connectivity of the world has been exemplified by the swift spread of financial and economic shocks throughout the global economy and international financial system in 2008, and the global supply chain disruption emanating from Japan in 2011.

Despite these changes, institutional arrangements and governance for policy cooperation and coordination have yet to reach the levels that are commensurate with the degree of global economic and financial integration. While individual efforts by any single economy are vital to ensure that they do not become a source of instability to other parts of the world, they can no longer guarantee collective stability. Emerging economies that are more open and integrated with the global economy and international financial system are the most affected by these developments.

The global financial crisis forcefully demonstrated the importance of the international dimension of policy. In the early stage of the crisis, the coordinated policy rate cuts, the enhancement of U.S. dollar liquidity facilities by several key central banks, and the unprecedented and concerted fiscal expansion effort turned the tide of the global recession. The establishment of the Financial Stability Board (FSB) in 2009, together with the Basel Committee of Banking Supervision, has also been at the centre of much of the work on global financial sector reform. While this represents a positive step, the efforts remain recent and modest in an environment where the underlying changes were built up over an extended period of time, and had already become entrenched and widespread.

Challenges Arising from Global Policy Spillovers

Let me now turn to the challenges arising from the global policy spillovers, in particular to emerging economies. With cross-border inter-dependence and contagion being very much a phenomenon of this new environment, such global policy spillovers are rapidly transmitted to other parts of the world through economic and financial flows. While the repercussions of the global economic and financial disruptions have been well recognised, less discussed have been the consequences of the global policy spillovers.

Significant and continuous spillovers have emanated from the wide-ranging policies in the advanced economies, including the unprecedented monetary easing, the fiscal stimulus then consolidation, the repair and resolution of the financial sector, the initiatives to reduce public and private sector indebtedness, and the consequences of the global regulatory reforms.

The highly accommodative global monetary environment has generated higher global liquidity. While contributing to the resumption of credit flows, it has exacerbated the recent surges in capital inflows to emerging economies. These inflows have resulted in significant strengthening of currencies, rising asset prices, stronger credit growth, and for some, overheating conditions in the economy.

These inflows have, however, been punctuated by reversals in capital flows, following deleveraging activities mainly by the banking groups in the crisis-affected countries. Deleveraging by sovereigns and by households, in particular the United States, have also reinforced this trend. The deleveraging by banks was, in particular, felt in 2009, following the actions by banks in the United States to strengthen their capital positions, and more recently by banks in the Europe to meet the new capital adequacy requirements. In view of the challenging conditions for capital raising, this is being achieved, in part, by asset reduction, either by asset sales, in particular in performing economies, or the withdrawal of credit lines.

These operations not only have implications on asset prices but on currency movements, as funds from the asset disposal are remitted back to the home country. The reversal of capital flows following such deleveraging is thus accompanied by a correction in asset prices and depreciation in the currencies. For emerging economies, the more developed and liberalised the financial markets, the more significant will be the impact of such activities, and the greater will be the amplitude of the volatility in the asset prices and currency movements.

Global policy spillovers have also been transmitted to the real economy through trade and investment flows. The world economy, including emerging economies, benefitted immensely from the fiscal stimulus that

supported the economic recovery. However, as the deterioration in fiscal sustainability became a concern, the effects of the pull-back in public expenditure on growth have contributed to slowing world trade and cross-border investment activity. Emerging economies, in particular in Asia, have seen the export sector slow significantly. While foreign direct investment continues to gravitate to emerging economies, in particular to Asia, the scale of such investment activity has also moderated.

Finally, the international regulatory reforms and the unilateral initiatives in a number of the major advanced economies have also had their intended and unintended consequences. The reforms, which have focused on building a stronger global regulatory framework and raising the resilience of the banking system, are still in their early stages of implementation. While it is too early to verify the concerns raised on the new prudential standards, the call has, however, been for the need to ensure that the benefits of greater systemic resilience will exceed any costs to the efficient functioning of the financial intermediation process and to the real economy.

For Asia, the new standards contribute positively for regional financial integration, as they promote a more consistent regional approach to regulation. They also work to strengthen regional financial stability arrangements, through more robust frameworks for the oversight of systemically important financial institutions at the regional level. These reforms have, therefore, encouraged increased communication and closer coordination on financial stability developments between regulators in the Asian region.

These financial reforms are, however, not without challenges for emerging economies. In particular, the standardised regulatory prescription goes against the grain of regulation that is proportionate to risk. Other unilateral regulatory initiatives, although not being imposed outside the respective countries, are also charting a path forward that is likely to have wider ramifications, given the significant cross-border operations of the affected institutions.

Policy Priorities in Emerging Asia

Let me turn to the policy priorities in emerging Asia. While most emerging economies entered the global financial crisis from a position of strength, policy-makers continue to be challenged by the weaker global economic environment and the effects of the global policy spillovers. While the emerging economies in Asia have been affected by these external developments, most have demonstrated resilience during this period. Let me confine my remarks to the policies that have contributed to this resilience. First, it is the payoff from a decade-long of policies and financial and economic reforms following the Asian financial crisis. Second, it is having an enhanced policy toolkit and the policy flexibility to manoeuvre in this environment. Third is the increased cooperation and collaboration in Asia, in the areas of surveillance, in the assessments of the risks and vulnerabilities to the region, and in the consideration of the policy options to address many of the new challenges.

An important policy shift following the Asian financial crisis is to rebalance the economy and to diversify our sources of growth. This has involved wide-ranging policies and reforms to promote domestic demand, in particular domestic consumption and investment activities by the private sector. Accommodative macroeconomic policies were generally supported by policies and reforms to strengthen the financial system, to ensure that domestic demand was supported by the financial sector. With rising incomes, private consumption and investment activities have expanded significantly to become the major engine of growth in Asia. Cumulatively, the increase in domestic demand in the region has transformed Asia into becoming a huge consumer market. This has also prompted greater inter-regional trade which has become mutually reinforcing on growth in the region. From being export-led, domestic demand has now become an important source of growth. Asia is, therefore, now shifting from being global producers to becoming global consumers.

The wide-ranging financial reforms in several emerging economies in Asia, have resulted in financial intermediaries with strong capital and liquidity buffers, and improved risk management and governance practices. This has allowed for the financial intermediation process to continue without disruption during the recent global financial crisis. The more comprehensive regulatory frameworks have also been complemented by enhanced surveillance arrangements and a relatively more intrusive supervisory oversight. Wide-ranging policy tools, including macro-prudential policies, have been relied upon to mitigate and manage the risks emanating from excesses and the build-up of imbalances in the financial system. The opportunity was also taken by most central banks in the region to normalise interest rates once recovery had commenced. Interest rates, while still remaining accommodative, were raised from their historical lows. Finally, with more developed financial markets, shocks were now more dispersed throughout the financial system. This has allowed the financial system to better intermediate highly volatile capital flows.

Despite this, the surges and reversals of capital flows continue to present a major challenge to policy. Specific policy strategies have also been adopted to reduce the prospect of being destabilised by these flows. Financial reforms following the Asian financial crisis have transitioned financial systems in Asia towards greater market orientation and increased exchange rate flexibility. This has facilitated greater capacity to adjust to the increased volatility in the financial system. Further progress on liberalisation has also increased the potential to undertake foreign exchange transactions, including engaging in outward portfolio and direct investments abroad. This has resulted in stronger two-way capital flows, contributing to more orderly conditions in the financial markets.

Liquidity management measures, prudential regulations including macro-prudential measures, and more interventionist measures that include restrictions on such flows, have also been implemented in varying degrees to cope with the volatile capital inflows. For the most part, prudential regulations, such as the imposition of ceilings and limits on external exposures, or minimum holding periods for specified domestic instruments, but which have not discriminated according to residency, have been implemented. Overall, they have enabled the financial sector, markets and the economy to function without disruption during the period of the global financial crisis.

While policies at the national level are important, these have been complemented by a higher level of regional collaboration and cooperation. The Asian region is now well ahead in the areas of surveillance arrangements, financial safety nets and crisis management. These frameworks, which have been put in place during the good times, are also being supported by ongoing work, in the area of building a consistent regulatory environment given the increasing presence of Asian banks in each others' jurisdictions. This is reinforced by cooperation among national supervisors and in the development of arrangements for cross-border resolution.

Regional platforms have been established for structured forums for the assessment of risks and vulnerabilities to the region, to increase the prospect for pre-emptive actions to be taken. Collaborative efforts are also ongoing in the area of building regional financial infrastructure, including the financial markets and payment systems to facilitate the efficient intermediation of financial resources in the region. Collaborative efforts are also accorded to the area of anti-money laundering, to ensure the integrity of the increasingly integrated financial systems in Asia. Finally, collaboration has also progressed in the area of capacity building, to strengthen the institutional capability of the central banks in the region to deal with the new challenges of the new environment.

Finally, one of the most significant but often under-appreciated trends across most economies in these recent two decades, is the significant rise of inequality within economies. The economic crisis has worsened this trend given the conditions of high unemployment in many parts of the world. In many areas of policy-making, inequality is often not given explicit consideration. In Asia, this is being addressed at two levels – at the national level

to develop inclusive financial systems and better social safety nets, and at the regional level, for regional initiatives to be inclusive, to ensure that regardless of the stage of development, countries in the group will build up their capacity and capability to benefit from the progress of the region.

Conclusion

Let me conclude my remarks; the new global policy frontiers are now addressing the challenges of the new global economic and financial landscape. Given the more connected and inter-dependent world, the call is for strengthening the cross-border dimension of policy-making.

Asia has taken advantage of this period of relative stability to advance economic and financial integration, and to strengthen our economic potential. Asia will, however, continue to be vulnerable to external developments and future shocks. To be in a better state of readiness to withstand these eventualities, the policy priority is to build resilience. Not only having the buffers and institutional capacity, but also to come together collectively to manage the new challenges, and thus be positioned to contribute constructively to global stability and growth.

Governor's Welcoming Address at the Global Islamic Finance Forum 2012 Kuala Lumpur, 19 September 2012

Welcoming Address by

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

This is a decade of profound change in the global financial landscape. The world is also being confronted by the repercussions of the ongoing global financial crisis. Despite this more challenging global financial and economic environment, Islamic finance has continued to remain on its growth trajectory. For Islamic finance, it has been a defining period. Its rapid growth and the intensification of its internationalisation in this decade is now enhancing its role in strengthening international economic linkages between different parts of the world.

It is my great pleasure and honour to welcome you this morning to this third Global Islamic Finance Forum (GIFF) 2012. First of all, let me express our gratitude to the Honourable Deputy Prime Minister of the Republic of Turkey, His Excellency Mr. Ali Babacan for accepting our invitation to deliver the Public Lecture at our gathering here today. We are most honoured by your presence and we immensely look forward to your address.

Islamic finance: Fostering global linkages

In this new era, in which the international dimension of Islamic finance has gained significance, Islamic finance has continued to demonstrate its viability and competitiveness in this more liberalised and globalised financial environment. The total Islamic financial assets size now has surpassed US$1 trillion – following unabated growth from the mid-1990s. There are now more than 600 Islamic financial institutions operating in more than 75 countries. Increasingly, existing Islamic banking institutions are expanding their operations with presence in new jurisdictions. This is resulting in increased cross border financial flows. There has also been increased international participation in Islamic financial markets.

Since the late 1990s the Sukuk market has emerged as an important form of intermediation in Islamic finance. It has been instrumental in the financing structures for infrastructure projects, investments in the utilities sectors, in particular for water and power projects, and in the services sector, in education, healthcare and transportation. Islamic finance essentially offers clear value propositions to both global issuers and investors. For issuers, there is access to new sources of funds and liquidity. And in introducing a new asset class, investors gain from portfolio diversification and new investment opportunities that are aligned to productive investment activities.

Internationalisation of Islamic finance: Mutually-reinforcing benefits

Islamic finance draws its strength from serving the real economy. An important feature of Islamic finance is that it involves financial transactions that must be accompanied by an underlying economic transaction. And when it is cross border, it will facilitate financial flows that will support international trade and investment flows. It will contribute towards bridging economies and enhancing our economic connectivity with each other.

In this current global environment in which emerging economies are demonstrating their resilience with the ability to sustain growth despite the moderation in global expansion, there is tremendous prospects for mutually reinforcing growth from increased economic connectivity. Trade among the expanding emerging economies now account for more than half of the world trade. This growing demand in emerging economies is also generating investment opportunities. In this environment, Islamic finance has an important potential to facilitate trade and investment flows that will be mutually reinforcing. In evolving Malaysia as an

Islamic financial hub, our aspiration is to be a hub that is linked to a network of other financial hubs. In so doing, it will enhance our economic linkages with other parts of the world.

The increased internationalisation of Islamic finance would thus influence the patterns of global financial and economic integration, and in particular facilitate the revival of financial and economic integration between the countries along the old silk road from Asia to Turkey and the Middle East, and Africa and to the more established financial markets and developed economies. The start of this decade has already witnessed the shifting of trade activities to the emerging economies, which now account for 63 percent or US$37 trillion of world trade as at end-2011, an increase of 17 percent from a decade ago.

While the Islamic banking sector has been important in intermediating cross border financial flows, the sukuk market has become an important segment of Islamic finance that offers a distinct platform upon which international inter-linkages are fostered. The sukuk market has demonstrated its ability to effectively intermediate funds across borders, contributing towards the efficient allocation of funds in the global financial system.The sukuk epitomises a truly global product for international fund raising and investment activities. An increasing number of multilateral agencies, sovereigns, Government agencies and corporations, including multinational corporations have relied on the sukuk market as a source of financing. And the diverse composition of the sukuk investors across continents has added further depth to the international dimension of the sukuk market. In Malaysia, the sukuk market has evolved into a multi-currency denominated sukuk market with pioneering sukukissuances in U.S dollars, Singapore dollar and the Renminbi.

Internationalisation of Islamic Finance: Key Success Factors

The new horizon that is emerging is the rapid internationalisation in Islamic finance which needs to be strongly underpinned by three key factors to ensure its sustainability. Firstly, the wide range of global supply of high-quality Islamic financial products and services that are able to meet the requirements of international businesses. In this phase of growing international transactions, Islamic finance needs to be dynamic and innovative, with an emphasis on the development of diversified and comprehensive Shariah-compliant financial solutions to meet the differentiated needs of various businesses, including the requirements of international businesses and thus facilitate cross-border investments.

Secondly, is having diverse and dynamic intermediaries and market participants that have a global focus. This includes having Islamic banking, takaful and capital market players that venture beyond domestic boundaries to tap global opportunities. Global ancillary services that are proficient in the Shariah, also have an important role in providing supportive professional services for such intermediaries and market players to effectively embark on such cross-border activities.

In addition, having the required talent is another imperative in steering the Islamic financial sector towards increased internationalisation. The new financial landscape will require world-class business talent and boards with knowledge of the risks associated with internationalisation. Greater collaboration between the industry and education service providers will be important in supporting the talent requirements of the industry in its new phase of development. Today, we will witness the signing of a Memorandum of Agreement between an industry player and an academic institution for the establishment of an Islamic wealth management research centre. This commendable effort is dedicated to producing applied research in the area of Islamic wealth management. It is envisaged to spur innovation that will bring with it global benefits and that would also contribute towards setting industry standards in this key component of the Islamic financial industry.

Thirdly, effective linkages and connections between global financial markets will be facilitated by business enablers, particularly in the area of legislation, taxation and regulation. The new global landscape of growing cross-border financial flows between regions that have national and cultural differences also underscores the need for enhanced recognition

and understanding of practices in the different jurisdictions. This imperative translates into high demands on the use of standardised documents and agreements among financial market players, so as to increase market efficiency, transparency and uniformity, as well as to reduce the cost of transactions as we strive towards seamless global inter-linkages. Standardised documentation and practices for a number of products have already been adopted between jurisdictions through bilateral and multilateral agreements. This has facilitated issuance of financial market instruments, contributing towards enhanced liquidity in Islamic financial markets and greater inter-market linkages.Greater understanding and clarity on Shariah matters, will also contribute towards convergence and harmonisation of such interpretations across jurisdictions and thus contribute towards the development of Islamic financial products and services.

Realising cross-border potentials and Bridging Economies

With its international outreach and ability to provide comprehensive financial solutions, Islamic finance beckons us with a new frontier that presents new opportunities. As we enter into a more uncertain global environment, it also promptsus to revisit strategies to enhance the resilience of Islamic finance.

The theme of this year's Global Islamic Finance Forum 2012, "Internationalisation of Islamic Finance: Bridging Economies" focuses on the international prospects surrounding the Islamic finance industry and its tremendous potential role in strengthening cross-border economic linkages. More than 500 participants from over 50 countries across the continents gather today in this Forum to explore this prospect. In its featured plenary and multi-track programmes which include the Regulators Forum, the International Shariah Scholars Forum, the Global Islamic Liquidity Management Conference and the Global Islamic Finance Taxation Forum, a new highlight is the Bridging Economies Forum that aims to discuss the Islamic finance prospects and opportunities across regions, and to explore possible market linkages that can be generated through Islamic finance. Several important signings of MoUs will also be taking place during this Forum, highlighting increased commitment and international cooperation.

Let me now conclude with an extension of our appreciation to the panel of distinguished speakers for their contribution to GIFF 2012. I would also like to once again, express our gratitude to the Honourable Deputy Prime Minister of the Republic of Turkey, His Excellency Mr. Ali Babacan for being with us today to speak at this event.

Governor's Keynote Address at the Seminar on Renminbi Trade Settlement and Investment in Malaysia: Future Prospects Kuala Lumpur, 27 September 2012

Keynote Adress by

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

This decade has seen significant change in the configuration of the global economy. In this evolving global landscape, Asia is emerging as an increasingly important component of the world economy. During this period, most of the Asian economies have experienced remarkable growth, despite the most challenging environment. With rising incomes in the region, Asia has also become a huge cumulative market. This trend has in turn prompted greater intra-regional trade and investment activities. A more recent trend in the Asian region is the greater financial integration that is facilitating greater cross-border financial flows in the region that is funding productive investment activities in the region.

Following the recent global financial crisis, the most pressing challenge for the world economy is to achieve economic strength that is sustainable. While most national economies have implemented wide ranging policy measures to promote growth, equally important are the efforts to sustain world trade which will be mutually reinforcing to global growth. China's economic journey in this global shift and the growing influence of renminbi ushers us into a new exciting era. China, by its sheer size and its economic performance has significant potential to contribute to world growth. Its demand, trade and cross-border investment activities will reinforce this potential. The recent trend for the use of renminbi for settlement of trade and cross-border investment activities will facilitate this potential.

It is my great pleasure to welcome you to this Seminar on "Renminbi Trade Settlement and Investment". I would like to take this opportunity to extend a very warm welcome to our guest speakers from the People's Bank of China and the Ministry of Commerce (Mofcom) of the People's Republic of China. I also wish to welcome our panellists from the financial industry and the corporate sector that are here today to share their experiences in operating in the current challenging economic and financial environment.

The economic relationship between Malaysia and China is longstanding and grounded on strong foundations. Today, China is Malaysia's largest trading partner accounting for 14% of our country's total trade. Malaysia also ranks as China's most significant trading partner in the Asean region. Our trade with China has continued to expand, increasing by 20% annually, in this recent two decades. Our bilateral trade with China is now seven times higher than the level in the early 1990's.

Our economic relations have also evolved and expanded beyond the area of trade - into the services sector, particularly the financial sector, tourism and education. China is among the top five tourism markets for Malaysia and Chinese nationals represent the largest foreign student population in Malaysia's private universities and colleges. Bilateral investment is also gaining importance, notably with the two recent Government-to-Government agreements, involving the establishment of an industrial park in both countries. The cornerstone to the strength of our bilateral economic relations is the ability to continually harness the synergies and economic complementarities that exists between our economies.

The use of renminbi for trade settlement provides a natural hedge for businesses with renminbi obligations. It also generates cost savings and minimises exchange rate risks, in particular, it reduces the exposure to exchange rate fluctuations of a third currency. While the dollar will continue to remain an important currency for settlement of trade obligations, the

availability of renminbi would provide companies with an additional currency for such trade settlement.

The benefits to be gained can be significant given the large and increasing trade base with China which stood at RM167 billion in 2011. By undertaking the transactions in local currency, exporters and importers in China would be able to eliminate the hedging and conversion costs. The reduction in transaction costs for the exporters and importers will contribute towards more competitive pricing for both exporters and importers. The full potential benefits are however expected to be realised in stages. The benefits will rise as the trade volume settled in renminbi increases and reaches a critical volume in terms of size which will in turn allow for the realisation of economies of scale.

For the renminbi to be considered an option for both exporters and importers to settle their trade obligations in addition to the major currencies, there needs to be an efficient and cost-competitive source of financing in renminbi and the availability of a diversified investment avenue. In particular, it is recognised that discernible progress in three areas are needed to be put in place at an early stage to support the use of renminbi, that is, to improve access to renminbi liquidity, to have the supporting infrastructure and framework and to provide information on the use of the renminbi for trade and productive investment transactions. More than three years ago, in early 2009, the Bank entered into a Currency Swap Arrangement (CSA) Agreement with the People's Bank of China, which was renewed early this year with an expanded amount of RMB 180 billion. The objective is to ensure a ready supply of renminbi in the domestic financial markets to meet the demand by businesses.

An important piece of the infrastructure that was put in place in 2010 was the provision of direct quotes between renminbi and ringgit in the interbank foreign exchange market on the China Foreign Exchange Trade System (CFETS). Efforts were also made to enhance the transparency in the exchange rate between renminbi and ringgit for the trade-related settlement transactions. In March this year, the real time gross settlement system in Malaysia was expanded to include settlement services in renminbi. This serves to provide a safe and efficient clearing and settlement platform that supports trade and investment flows in renminbi.

A nationwide awareness program by the Bank in collaboration with the banking institutions and the business chambers is also creating greater awareness on renminbi for trade settlement and investment. The Bank has also participated in the Chinese interbank bond market. In 2011 alone, the size of renminbi trade settlement in Malaysia expanded by four times from the level a year ago, reflecting a growing interest in renminbi as a settlement currency.

The expansion in renminbi usage has also been underpinned by a diffusion of corporate players, both in size and across the sectors. Not only has the number of corporate players increased, but there has been a shift in relative significance in the use of renminbi as a trade settlement currency from the smaller to the larger corporations. There has also been more widespread corporate participation from a larger cross-segment of economic activities, namely the commodity based industries, manufacturing and services sectors that also includes tourism and education. There has also been an increase in the number of financial institutions participating in renminbi trade settlements. There are now 19 financial institutions that facilitated such trade settlements, double the number in 2009.

More recently, there has been an increase in the use of the renminbi as an investment and funding currency. In the first seven months of this year, renminbi deposits in the banking system had tripled. Also evident is the growing interest in raising financing in renminbi to meet funding requirements, with two issuances of offshore renminbi sukuk out of Malaysia and a renminbi bond issuance by a Malaysian corporation.

The progress made thus far, while modest, has significant potential given the significant volume of bilateral cross-border trade and foreign direct investment between our economies. Trade settled in renminbi currently

only represents slightly above 1% of Malaysia's bilateral trade with China. There is therefore a significant potential for this to increase. In addition, funding and foreign direct investment activities in renminbi have also increased with the greater awareness on the use of renminbi for the settlement of trade and direct investment transactions and on the potential to raise financing by businesses.

Important to this initiative is the access to a wider array of portfolio investment avenues in renminbi. The availability of renminbi bonds and sukuk as well as other financial products for portfolio investment will not only encourage renminbi receivables, but it will also help to build a pool of trade-driven renminbi liquidity in the Malaysian market. Another important channel that would support the use of renminbi in trade and investment is repatriation into China as foreign direct investment in real sector activities.

Raising funding in renminbi has also emerged as a further form of business in the Malaysian financial system. This has mainly been in the conventional channels by the banking institutions and the issuance of renminbi instruments in the bond and sukuk market in Malaysia. Malaysia not only has the largest debt securities market in Southeast Asia, but it is also a leading international centre for sukuk issuance. Both markets are evolving as a multi-currency bond and sukuk market. Malaysia is well positioned to realise this growth potential in renminbi bond and sukuk, given our market size and supporting infrastructure.

As the renminbi market expands, more information would be needed to provide awareness on market developments. As we transition to using other currencies for trade settlement it will also require businesses to gain new expertise, develop new arrangements and build new networks.

Let me now conclude my remarks. As Asia, and in particular, China's greater prominence in the global economy, a dynamic response is required in this new operating environment that is now before us. One of the changes that will shape the international financial system in the years to come is the wider role of the renminbi in trade and finance. While existing international reserve currencies will remain to be important, this development will represent an additional currency in the international financial system. This is an expected development as the world economy becomes increasingly multi-polar.

In a more complex and more challenging economic and financial environment that is prone to greater volatility and increased uncertainty, there will be a greater trend to diversify risks. In allowing for diversification, it will also contribute to overall global stability in the international financial system. On our part, the Bank is committed to collaborate with the Chinese authorities to facilitate the use of renminbi that is anchored on real sector activities for the mutual benefit of our economies. Today's seminar will discuss issues concerning the use of renminbi in trade and investment. In this note, I wish you all a successful and productive engagement.

CALENDAR OF EVENTS
July – September 2012

5 July 2012

At its fourth meeting for 2012, the Bank's Monetary Policy Committee (MPC) decided to maintain the Overnight Policy Rate (OPR) at 3.00%. The MPC's assessment was that there continues to be considerable uncertainties in the global economic and financial environment. Going forward, the MPC will continue to carefully assess the evolving economic conditions and their implications on the overall outlook for inflation and growth of the Malaysian economy. At its subsequent meeting on 6 September, the MPC kept the OPR at the same level, citing that the current stance of monetary policy is accommodative and supportive of the economy.

12 July 2012

The Bank announced that the new Malaysian banknotes series will come into circulation starting 16 July 2012. The new banknotes uses state of the art banknote technology to enhance security features including watermark portrait with pixel and highlighted numerals while the visually impaired are able to use specific features such as tactile identification to identify and distinguish different denominations. The new banknotes co-circulates with the existing banknotes which remain as legal tender. Members of the public will be able to obtain the new banknotes through their normal business transactions. Subsequently on 10 August 2012, the Bank informed the general public that there is sufficient supply of the new banknotes to meet festive demand for payments and business transactions, with all commercial banks required to ensure that their branches have sufficient supply of banknotes to meet public demand.

15 August 2012

The Bank announced that the Malaysian economy recorded a higher growth of 5.4% in 2Q 2012 (1Q 2012: 4.9%) despite the challenging external environment. Growth was driven by stronger domestic demand, supported by both robust private and public sector spending. On the supply side, most economic sectors continued to expand led by the services, manufacturing and construction sectors. Meanwhile, the headline inflation rate moderated to 1.7% in 2Q 2012(1Q 2012: 2.3%), attributed mainly to moderation in the food and non-alcoholic beverages amid a decline in prices of meat and vegetables.

On the same day, the Bank also introduced the framework for agent banking towards achieving a more inclusive financial sector. Recommended under the Financial Sector Blueprint, this initiative allows financial institutions to reach out to the underserved population particularly in rural areas in a more cost efficient manner through the use of non-bank retail outlets. Authorized banking agents will provide basic banking services such as deposits and withdrawals, fund transfers, bill payments and financing repayments. The Bank also issued the Guidelines on Agent Banking to the financial institutions to ensure that agent banking is conducted in a safe and reliable manner. The Guidelines outlined the requirements to be observed by financial institutions in the areas of governance and oversight, management of agents, customer protection, awareness and education. All authorised banking agents will display a national agent banking logo together with the logo of the financial institutions to facilitate the public to identify the authorised agents and the availability of the basic banking services.

23 August 2012

Governor Dr. Zeti was named as one of the world's six best Central Bankers for 2012 by the Global Finance magazine. She has been given the "A" rating for the eighth time (out of nine years) in the magazine's annually-published feature entitled "Central Banker Report Card" for successes mainly in areas such as inflation control, economic growth goals, currency stability and interest rate management.

1 September 2012

In her speech at the Economic Symposium 2012 in Jackson Hole, United States, Governor Dr. Zeti highlighted that the new global policy frontiers are now addressing the challenges of the new global economic and financial landscape. Given the more connected and inter-dependent world, the call is for strengthening the cross-border dimension of policy-making. She added that Asia has taken advantage of this period of relative stability to advance economic and financial integration, and to strengthen the economic potential. Although Asia will continue to be vulnerable to external developments and future shocks, to be in a better state of readiness to withstand these eventualities, the policy priority is to build resilience. This includes not only having the buffers and institutional capacity, but also to come together collectively to manage the new challenges, and thus be positioned to contribute constructively to global stability and growth.

18 – 20 September 2012

The Bank hosted the third Global Islamic Finance Forum (GIFF) 2012 themed "Internationalisation of Islamic Finance: Bridging Economies" in Kuala Lumpur. A key international event in the calendar of Islamic finance, the GIFF 2012 brought together regulators, scholars and financial industry players to discuss and exchange insights on the growth potential and opportunities in the internationalisation of Islamic finance. In her welcoming address at GIFF 2012, Governor Dr. Zeti emphasised that the new horizon that is emerging is the rapid internationalisation in Islamic finance which needs to be strongly underpinned by three key factors to ensure its sustainability. Firstly, a wide range of global supply of high quality Islamic finance products and services that are able to meet the international businesses' requirements. Secondly, diverse and dynamic intermediaries and market participants that have a global focus, besides having the required talents. Thirdly, effective linkages and connections between global financial markets will be facilitated by business enablers, particularly in the areas of legislation, taxation and regulation. In conjunction with GIFF 2012, an eminent Islamic banker who is Dubai-based Fajr Capital's CEO, Iqbal Khan, was named as the second recipient of the Royal Award for Islamic Finance for his exceptional leadership and dedication in Islamic finance. The Award is regarded as a global benchmark in identifying exceptional individual who has made outstanding contributions to the development of Islamic finance globally.

19 September 2012

The Bank accorded "Emas" status for the issuances of Axiata Group Berhad (Axiata) RMB1 billion sukuk, the Islamic Development Bank (IDB) USD800 million sukuk and Khazanah Nasional Berhad (Khazanah) USD357.8 million exchangeable sukuk. These sukuk issuances follow a series of foreign currency Islamic financing instruments previously issued in Malaysia since 2009 as Malaysia increasingly becomes a multi-currency sukuk market.

27 – 28 September 2012

The Bank conducted two seminars in Kuala Lumpur and Penang on Renminbi Trade Settlement and Investment in Malaysia to enhance public awareness on prospects of using renminbi for the purposes of trade settlement and investment. The seminars attracted more than 800 participants, comprising mainly senior officials from the financial and corporate sectors. Several topics of key interest were presented to the businesses including value proposition for the use of renminbi in business dealings with China; regulatory and operational aspects on the use of renminbi; and the potential for funding and foreign direct investment activities in renminbi. In her keynote address at the seminar in Kuala Lumpur, Governor Dr. Zeti underlined that while existing international reserve currencies will remain important, the availability of the renminbi provides companies with an additional currency to be deployed for business dealings with China. She added that Malaysian exporters and importers needed to have greater awareness of the facilities available to conduct their trade and investment activities. She also remarked that the wider role of the renminbi in trade and finance is one of the changes that will shape international finance and thus will present as an additional reserve currency in the international financial system.