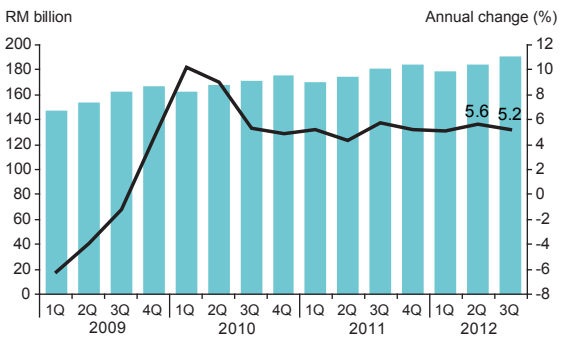
ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE THIRD QUARTER OF 2012

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.