DEVELOPMENTS IN THE FIRST QUARTER OF 2005

International Economic Environment

Global economy expanded at a moderate pace

The global economy expanded at a more moderate pace in the first quarter amidst high oil prices. Growth continued to be led by the United States (US) and the People's Republic of China (PR China) while growth improved in Japan and remained subdued in the euro zone.

The **US** economy moderated to 3.1% in the first quarter, largely due to marked slowdown in business spending (4.7%, 4Q 2004: 14.5%) and a larger trade deficit. The household sector continued to hold up as evidenced from positive economic indicators such as new home sales, retail sales and unemployment rate. Trade deficit hit a new record due mainly to high oil prices. Against the backdrop of improving labour market conditions and gradually rising inflationary pressures, the Fed raised Federal funds rate further by 25 basis points each on 2 February and 22 March to 2.75% by the end of the quarter. Meanwhile, growth remained sluggish in the **euro area** as reflected in the weak indicators, notably the German IFO business climate index, which fell in April for the third consecutive month. Growth in the **United Kingdom** economy was sustained but showed signs of easing as industrial output contracted for the third consecutive quarter. In **Japan**, while deflationary pressures persist, recovery remains on track in 1Q, supported by household consumption amid improving labour market.

Global crude oil futures prices touched USD57.76 on 17 March, driven by continued strong demand and a lack of refining capacity. Although a new peak was reached on 4 April (USD58.28), prices have since eased in response to slowing economic growth in the US, rising US crude supplies and high OPEC production.

Industrial Countries: Real GDP growth

	2004			2005	Key contributing factors for 1Q growth
	1Q	4Q	Year	1Q	
	Annual change (%)				
US[1]	4.0	3.8	4.4	3.1[a]	Growth was supported mainly by strong inventory-rebuilding and sustained consumption. Slowdown in investment came mainly from slower growth in spending on equipment and software. Net exports exerted a larger drag on growth.
UK	3.0	2.9	3.1	2.8	Sustained growth, driven by the services sector as manufacturing output declined for the third consecutive quarter.
Euro zone	1.6	1.6	2.0	1.4[p]	A net export-driven rise led to an increase of 1.1% in GDP of Germany. Germany accounts for about one-third of the overall GDP for the euro zone. However, Italy and Netherlands recorded negative growth.
Japan[1]	6.0	0.1[r]	2.6	5.3[p]	Better-than-expected growth was driven by a turnaround in consumption and stronger capital spending.

[1] Annualised basis
[r] Revision
[a] Advance estimate
[p] Preliminary
Source: National authorities

In the **Asian** region, growth remained strong with broad-based expansion, led by PR China. Exports and industrial production remained favourable with several countries

maintaining strong growth despite the slowdown in the electronics cycle.

Regional Countries: Real GDP growth

	2004			2005	Key contributing factors for 1Q growth
	1Q	4Q	Year	1Q	
	Annual change (%)				
PR China	9.8	9.5	9.5	9.5	Supported by strong consumer spending and exports.
Indonesia	5.0	6.7	5.1	6.4	Supported by investments.
Korea	5.3	3.3	4.6	2.7	Moderation in exports and decline in construction investments.
Singapore	7.9	6.5	8.4	2.5	Slower expansion in the manufacturing sector notably in the biomedical cluster.
Chinese Taipei	6.7	3.3	5.7	2.5	Slower expansion due to sluggish exports and high oil prices.

Source: National authorities

In most regional countries, inflation edged upwards due to record high oil prices, rise in food prices as a result of the drought as well as the partial removal of fuel subsidies by several regional countries. In Indonesia, inflation reached a 27-month high of 8.8% in March following the rise in domestic fuel prices.

In the region, Thailand, Chinese Taipei, Indonesia, the Philippines and India raised interest rates during the first quarter to contain inflationary pressures arising mainly from higher oil prices. Meanwhile in Singapore, the authorities have maintained its policy of a modest and gradual appreciation of the Singapore dollar as inflationary pressures continue to be a concern over the medium term.

In the **foreign exchange market**, the depreciating trend of the US dollar stabilised during the first quarter in view of expectations for a faster pace of monetary tightening in the US coupled with the stronger economic performance in the US relative to other major industrialised countries. Meanwhile, most of the regional currencies appreciated initially before easing on concerns of more interest rate hikes in the US.

Going forward, the pace of expansion in the global economy is expected to be constrained by high oil prices, higher inflationary pressures and reduction in monetary accommodation. In the US, the Fed raised rates for the eighth consecutive time by another 25 basis points to 3% on 3 May. However, monetary policy is expected to remain accommodative with gradual interest rates hikes, mainly to contain inflationary expectations. Growth prospects for the Asian region remain favourable supported by the strong pace of growth in PR China and sustained domestic demand. While the global electronics industry is consolidating after reaching its peak in mid-2004, the downcycle is forecast to be modest in view of the continued global demand, speedier inventory adjustments and relatively low inventory levels.

Developments in the Malaysian Economy

Growth driven by the major economic sectors…

The Malaysian economy remained resilient in the first quarter of 2005, expanding by 5.7%. Growth was driven by the major sectors of the economy, namely services, manufacturing and the primary commodity sectors. The services sector growth remained firm supported by consumption, tourism and telecommunication activities, while the primary commodity sector grew further mainly on account of higher production of

crude palm oil and natural gas. Although the manufacturing sector was affected by the ongoing global semiconductor downcycle, the diversified industrial structure provided support to moderate the impact. Of significance, resource-based industries continued to perform strongly. Meanwhile, the construction sector remained weak due mainly to slower activity in the civil engineering segment.

Quarterly GDP by Kind of Economic Activity at 1987 Prices

	2004			2005
	1Q	4Q	Year	1Q
	Annual change (%)			
Agriculture	3.8	7.3	5.0	6.0
Mining	5.9	4.4	3.9	3.3
Manufacturing	12.5	5.5	9.8	5.6
Construction	0.9	-2.6	-1.5	-2.4
Services	6.4	6.5	6.8	6.0
Real GDP (Ann. Chg.)	**7.8**	**5.8**	**7.1**	**5.7**
Real GDP (Preceding Chg.)	**-3.2**	**1.9**	**7.1**	**-3.3**

Source: Department of Statistics, Malaysia

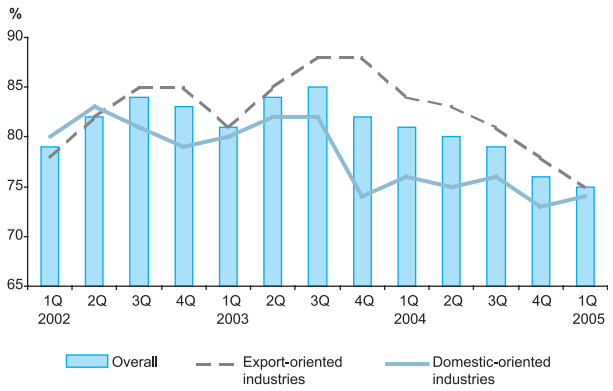
Continued growth in the manufacturing sector

Value added in the **manufacturing sector** expanded by 5.6% in the first quarter of 2005 (4Q 2004: 5.5%). In the **export-oriented industries**, output growth moderated slightly to 5.3% in the first quarter (4Q 2004: 7.8%), as the moderation in output of electronics was cushioned by higher output of the resource-based industries. Domestic manufacturers in the electronics and electrical (E&E) products segment continued with their inventory adjustment exercise and rationalised production during the quarter under review.

Nevertheless, resource-based industries such as chemicals, rubber products and off-estate processing industries, which account for about one-fourth of the manufacturing production index expanded at a rapid pace during the quarter. Output of chemical products expanded by 15.6% (4Q 2004: 13.3%), driven by robust expansion in the production of plastic products and industrial gases. The strong performance in the commodity sector also led to higher activity in the related downstream industries. The increase in output of industrial gases and off-estate processing (24.6%; 4Q 2004: 17.9%) reflected the strong natural gas and crude palm oil production during the quarter. The consolidation process undertaken by the rubber gloves companies has further enhanced their competitiveness in the global market, leading to higher output growth of the rubber products industry (11.4%; 4Q 2004: 9.1%).

Output of **domestic-oriented industries** expanded by 5.7% (4Q 2004: 6.3%) during the quarter. Growth in output was registered in almost all the sub-sectors, particularly in the transport equipment, fabricated metal, paper and petroleum products industries, which more than offset the contraction in the construction-related materials industries. The latter was affected by the weak performance of the construction industry. Meanwhile, output in the transport equipment industry continued to expand at a robust pace of 13.1% (4Q 2004: 17.8%), as evidenced by the higher passenger car sales during the quarter. The strong demand for passenger cars was supported by the favourable financial position of households and attractive financing packages and, to some

Capacity Utilisation in the Manufacturing Sector



Performance in the Manufacturing Sector

	2004			2005
	1Q	4Q	Year	1Q
	Annual change (%)			
Value Added (Constant Price)	**12.5**	**5.5**	**9.8**	**5.6**
Overall Production	**16.5**	**7.5**	**12.7**	**5.4**
Export-oriented industries	**19.3**	**7.8**	**14.2**	**5.3**
Of which :				
Electronics	34.1	9.6	25.0	-0.1
Electrical	-6.9	-13.8	-9.4	-6.5
Textiles & wearing apparel	-10.8	-14.5	-11.7	-4.1
Chemicals and chemical products	16.9	13.3	14.1	15.6
Off-estate processing	3.3	17.9	4.0	24.6
Rubber products	24.1	9.1	14.8	11.4
Wood and wood products[1]	13.9	5.1	12.7	-3.7
Domestic-oriented industries	**7.6**	**6.3**	**7.1**	**5.7**
Of which :				
Transport equipment	0.8	17.8	8.6	13.1
Fabricated metal products	35.4	21.4	29.2	16.1
Iron & steel and non-ferrous metal	6.2	4.7	4.4	-4.5
Non-metallic mineral products	-1.2	-4.8	-4.9	-3.7
Petroleum products	-1.9	5.4	1.3	10.4
Food	7.3	-0.5	3.0	-0.8
Total Manufactured Exports	**17.4**	**13.5**	**19.7**	**11.8**
Of which :				
Electronics and electrical products	15.1	7.5	15.3	9.7
Wood and wood products	28.3	12.4	29.5	16.8
Furniture & parts	15.1	16.2	17.8	10.3
Textiles, clothing & footwear	16.8	14.0	17.9	4.0
Rubber products	19.9	14.5	19.3	12.3
Optical & scientific equipment	11.1	19.6	26.3	22.9
Chemical and chemical products	26.0	26.9	31.0	20.2
Petroleum products	20.0	57.1	42.2	18.0
Transport equipment	47.0	108.7	65.0	51.0

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

Source: Department of Statistics, Malaysia

extent in anticipation of higher car prices upon the implementation of the new tariff structure in July 2005. Similarly, production of paper products industry expanded by double-digit growth of 15.7% (4Q 2004: 3.8%) due to increased demand for packaging activities.

Overall capacity utilisation for the manufacturing sector in the first quarter of 2005 was sustained (75%; 4Q 2004: 76%), with the export-oriented and domestic-oriented industries operating at 75% and 74% respectively (4Q 2004: 78% and 73%).

Sustained expansion in the services sector

Growth in the **services sector** was sustained at 6% (4Q 2004: 6.5%) as all sub-sectors continued to expand in line with higher consumption, tourism and telecommunication activities. Growth in the wholesale and retail trade, hotels and restaurants sub-sector strengthened to 7.7% (4Q 2004: 6.9%) underpinned by strong growth in domestic consumption as reflected by the high growth in sales of motor vehicles and credit card spending. Higher retail spending by

Performance of the Services Sector (Value Added)

	2004			2005
	1Q	4Q	Year	1Q
	Annual change (%)			
Intermediate Services	**7.4**	**6.9**	**7.1**	**6.6**
Transport, storage & communication	7.9	9.3	8.5	10.4
Finance, insurance, real estate & business services	7.1	5.6	6.3	4.4
Final Services	**5.7**	**6.3**	**6.6**	**5.6**
Electricity, gas & water	8.7	7.3	8.2	5.7
Wholesale & retail trade, hotels & restaurants	5.3	6.9	7.1	7.7
Government services	5.9	7.2	6.5	3.2
Other services	4.9	3.7	4.9	4.1
Total Services	**6.4**	**6.5**	**6.8**	**6.0**

Source: Department of Statistics, Malaysia

Selected Quarterly Indicators in the Services Sector

	2004			2005
	1Q	4Q	Year	1Q
	Annual change (%)			
Tourism-related indicators				
Hotel occupancy rate (%)	56.4	62.7	60.8	60.7
Tourist arrivals	38.4	15.4	48.5	4.6
Total passenger traffic at all airports	10.8	11.2	18.9	6.6
Consumption-driven indicators				
Total consumption credit	11.4	16.4	16.4	17.4
Imports of consumption goods	14.8	16.4	24.1	10.4
Total sales of passenger cars	-0.2	27.3	17.0	13.7
Cellular phone penetration rate (%)	46.2	55.9	55.9	60.9
Trade-related services indicators				
Cargo handled (All airports)	6.6	10.2	10.5	5.3
Container cargo handled (Port Klang and PTP)	15.8	3.6	11.2	4.7
Cargo revenue (Railway)	-1.2	12.2	7.6	7.7

Source: Various sources

consumers in aid of the Tsunami victims also contributed to the growth. The sub-sector was further supported by increased tourism and travel activities during the quarter with tourist arrivals exceeding 4.1 million.

The transport, storage and communication sub-sector recorded a double-digit growth, driven mainly by strong activity in the telecommunication services industry. This was evidenced by the high usage of the voice and data services in the mobile segment. Meanwhile, the transportation segment was supported by continued expansion in port, shipping and air cargo activities. The finance, insurance, real estate and business services sub-sector expanded by 4.4% (4Q 2004: 5.6%) supported by increased banking activities, including credit activity and fee-based services, as well as insurance activities. The utilities sub-sector grew by 5.7% (4Q 2004: 7.3%) due mainly to sustained demand for electricity by both the industrial and commercial sectors.

Favourable performance in the primary commodity sector

The **primary commodity sector** grew further during the quarter with both the agriculture and mining sectors expanding by 6% and 3.3% respectively (4Q 2004: 7.3% and 4.4% respectively). Growth in the agriculture sector was underpinned by strong performance in the palm oil sector for the second successive quarter, while the expansion in the mining sector was driven by higher natural gas production.

In the **agriculture sector**, production of crude palm oil grew strongly by 27.5% (4Q 2004: 16.5%), recording the highest level ever of 3.4 million tonnes in the first quarter, which is traditionally a low output period. Monthly production consistently breached the 1 million tonne threshold each month during the quarter, a historic occurrence in the Malaysian palm oil industry. The strong performance was due to the substantial rise in productivity, as well as further expansion in matured oil palm areas in Sabah and Sarawak. The positive developments in the palm oil industry also induced replanting activity in Peninsular Malaysia, to replace older, low-yielding oil palm trees. Yields, both in terms of fresh fruit bunches (FFB) and oil extraction rates (OER), were significantly higher during the quarter, at 4.35 tonnes per hectare and 20.19% respectively, compared to the corresponding period in 2004 (3.69 tonnes per hectare and 19.86% respectively). Meanwhile, rubber production declined by 9.4% as the onset of wintering caused latex output to decline. Similarly, growth in other agriculture activities was also subdued during the quarter. In

particular, output from fishery activities declined by 16.5%.

Performance of the Agriculture Sector

	2004			2005
	1Q	4Q	Year	1Q
	Annual change (%)			
Value Added (at 1987 prices)	**3.8**	**7.3**	**5.0**	**6.0**
Production[1]				
Of which:				
Crude palm oil	2.5	16.5	4.7	27.5
Crude palm kernel oil	3.8	11.8	-0.1	27.2
Rubber	19.3	7.2	19.7	-9.4
Saw logs	-15.2	3.8	0.2	-1.7
Cocoa	-33.5	17.9	-7.8	-5.2
Exports (RM million)	**13.8**	**1.2**	**7.4**	**5.7**
Of which:				
Palm oil				
('000 tonnes)	5.1	2.3	-5.6	14.3
(RM/tonne)	6.5	-6.1	5.5	-15.6
(RM million)	11.9	-3.9	-0.4	-3.6
Palm kernel oil				
('000 tonnes)	35.4	-24.7	-8.3	26.0
(RM/tonne)	27.8	38.9	46.9	10.9
(RM million)	73.1	4.5	34.7	39.8
Rubber				
('000 tonnes)	23.3	16.6	16.7	-0.9
(Sen/kilogramme)	36.6	2.6	24.3	-2.0
(RM million)	68.4	19.6	45.1	-2.9
Sawn timber				
('000 cu.metres)	5.9	16.3	13.5	16.4
(RM/cu.metre)	-12.2	-10.2	-10.4	6.0
(RM million)	-7.1	4.4	1.7	23.4
Saw logs				
('000 cu.metres)	-13.5	-17.9	-5.9	42.2
(RM/cu.metre)	1.0	6.2	8.9	4.4
(RM million)	-12.6	-12.8	2.5	48.4
Cocoa beans				
('000 tonnes)	-76.0	-15.6	-27.7	183.4
(RM/tonne)	-20.3	-5.9	-12.6	0.7
(RM million)	-80.9	-20.6	-36.8	185.3

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

Source: Malaysian Palm Oil Board (MPOB)
Malaysian Rubber Board (MRB)
Forestry Department (Peninsular Malaysia, Sabah and Sarawak)
Malaysian Cocoa Board (MCB)
Department of Statistics, Malaysia

In the **mining sector**, production of natural gas grew significantly by 19.8% to reach a new record of 6,352 million standard cubic feet per day. The strong production was driven mainly by higher capacity utilisation of the Malaysia Liquefied Natural Gas (MLNG) plants in Sarawak and Gas Processing Plants (GPPs) in Peninsular Malaysia. This was induced by higher demand for natural gas by both domestic (mainly power producers and industrial users) and external users.

Performance of the Mining Sector

	2004			2005
	1Q	4Q	Year	1Q
	Annual change (%)			
Value Added (at 1987 prices)	**5.9**	**4.4**	**3.9**	**3.3**
Production				
Of which:				
Crude oil and condensates				
('000 barrels)	8.0	1.4	3.6	-5.2
Natural gas (net)				
(million standard cubic feet)	2.3	10.3	4.0	19.8
Exports (RM million)	**15.5**	**44.7**	**38.2**	**36.3**
Of which:				
Crude oil & condensates				
('000 tonnes)	4.1	-11.0	1.0	0.5
(USD/barrel)	4.4	53.3	34.8	36.3
(RM million)	8.6	36.4	36.1	37.0
Liquefied natural gas				
('000 tonnes)	18.3	19.4	19.7	17.6
(RM/tonne)	-2.3	15.9	6.8	12.8
(RM million)	15.6	38.5	27.9	32.7

Source: PETRONAS
Department of Statistics, Malaysia

While output of crude oil (including condensates) declined by 5.2% during the quarter (1Q 2004: +8%), the quarterly output remained at a high level of 740,383 barrels per day. Crude oil prices registered record highs during the quarter supported mainly by fundamental factors. The strong global demand, particularly from the US and PR China, and minimal supply growth amidst production operating close to full capacity in the major oil producing countries resulted in the significant increase in prices. In line with developments in the global oil market, the Malaysian Tapis Blend crude oil prices

breached the USD50 mark in late February, sustained the rise and peaked at USD59.50 per barrel on 17 March. This higher level compared to benchmark oil grades such as West Texas Intermediate reflects its status as a premium oil grade in the international market. Prices closed the quarter at USD55.

Subdued construction activity

The **construction sector** contracted by 2.4% (4Q 2004: -2.6%) due mainly to lower civil engineering activity arising from fewer public sector projects. However, the residential and non-residential segments continued to be supported by demand for houses as well as office and retail space. Overall, the weaker performance of the construction sector during the quarter was also partly due to the slow return of legal foreign workers following the Amnesty programme, which had caused delays in some projects. Nevertheless, going forward, the industry is expected to benefit from the RM2.4 billion worth of Government projects that have been brought forward for immediate implementation from the Ninth Malaysia Plan.

Construction Indicators

	2004			2005
	1Q	4Q	Year	1Q
	Annual change (%)			
New sales and advertising permits	44.0	-19.4	-5.9	2.3
Housing approvals	48.9	-34.9	-14.1	11.2
Production of construction-related materials	2.2	-0.4	-0.6	-4.1
Loans approved for construction	-36.8	-14.8	2.3	47.6
Imports of construction materials & mineral products	19.0	15.8	42.1	15.5*

* Jan.-Feb.'05

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

Resilient domestic demand

Domestic demand remained resilient in the first quarter of 2005. Private sector continued to provide the main impetus to growth while the Government remained on track with its fiscal consolidation programme. Expansion in private sector expenditure was mainly supported by robust consumer spending activities.

GDP by Expenditure Components (at Constant 1987 prices)

	2004			2005
	1Q	4Q	Year	1Q
	Annual change (%)			
Aggregate Domestic Demand (excluding stocks)	7.6	6.7	7.5	5.9
Consumption	9.5	8.6	9.5	7.6
Private sector	*8.9*	*10.2*	*10.5*	*10.1*
Public sector	*11.8*	*4.2*	*6.0*	*-2.3*
Gross Fixed Capital Formation	3.5	2.2	3.1	2.0
Exports of Goods and Services	16.4	10.2	16.3	9.5
Imports of Goods and Services	21.0	12.9	20.7	7.6
GDP	**7.8**	**5.8**	**7.1**	**5.7**

Source: Department of Statistics, Malaysia

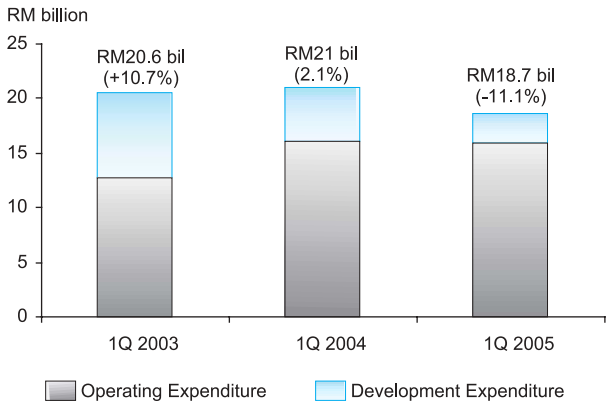
Private consumption remained strong in the first quarter, rising by 10.1% (4Q 2004: 10.2%). Consumers' willingness to spend was buoyed by rising disposable incomes and the stable employment market. Sustained high export earnings and favourable commodity prices ensured that wage growth remained positive. At the same time, employment prospects remained stable as job vacancies increased strongly while retrenchments remained low. Attractive sales promotions held for festive

celebrations and school holidays during the quarter provided further stimulus to consumption.

The findings of the Malaysian Institute of Economic Research (MIER)'s consumer sentiments survey indicate that consumers remained optimistic on job prospects and income expectations, given the strong economic fundamentals. As a result, MIER's Consumer Sentiments Index (CSI) rose by 11.6 points to 120.9 points (4Q 2004: 109.3 points). Other major consumption indicators such as the sales of passenger cars, imports of consumption goods, credit card transactions, and loans disbursed for consumption credit and consumer-oriented businesses, also supported the positive trend in private consumption.

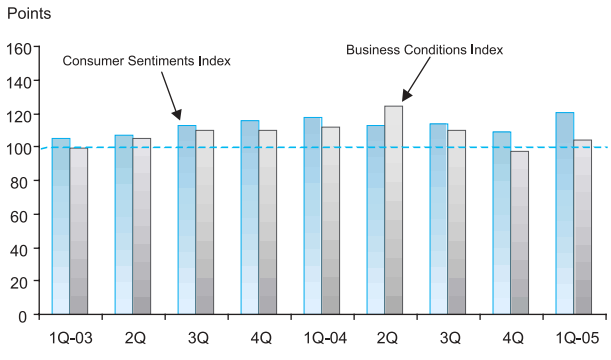
Meanwhile, **public consumption** declined by 2.3% during the quarter (4Q 2004: +4.2%) mainly on account of lower expenditure on supplies and services as well as defence.

Lower Federal Government Spending



Gross fixed capital formation recorded a growth of 2% in the first quarter (4Q 2004: 2.2%). Domestic investment was mainly supported by private sector capital spending as the Federal Government's development expenditure declined. Business confidence improved as indicated by MIER's Business Conditions Index, which breached the 100-point threshold level to 104.1 points (4Q 2004: 97.3 points), suggesting that manufacturers remained optimistic on sales and production expectations. The growth in investment activities was supported by the sustained growth in financing activities by the banking system. Besides investment in the manufacturing sector, sustained inflows of foreign direct investment into the oil and gas sector and increased imports of mining equipment suggests higher capital spending activities in the upstream segment of the sector, particularly in exploration and development activities.

Improved consumer and business confidence



The Federal Government continued to ensure that bulk of the development expenditure was channelled into essential projects such as provisions and maintenance

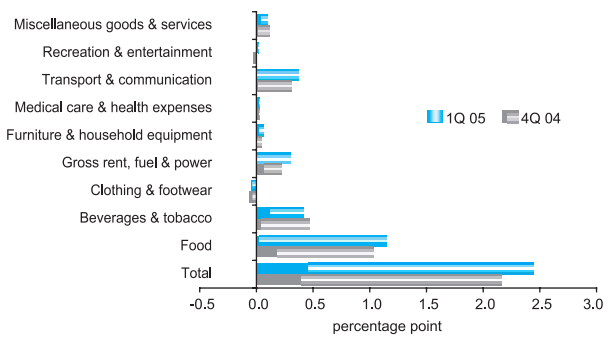
of transportation infrastructure, education and industrial training, agriculture and rural development, housing programme and health services.

Inflation increased moderately

The annual rate of inflation, as measured by the **Consumer Price Index** (CPI), increased to 2.4% (4Q 2004: 2.1%). The increase was driven mainly by the higher prices of food and transport. The increase in prices of food was due to the higher demand for food given the festivals during the quarter coupled with tight supplies amid adverse weather conditions. Meanwhile, the increase in prices of transport was caused mainly by the 10% increase in toll charges in January.

The **Producer Price Index** (PPI) increased at a slower rate of 5.1% (4Q 2004: 7.7%), due mainly to the decline in prices of crude palm oil and the slower rate of increase in crude oil prices. Excluding commodities, the PPI, however, was only slightly higher at 2.5% in the first quarter (4Q 2004: 2.2%).

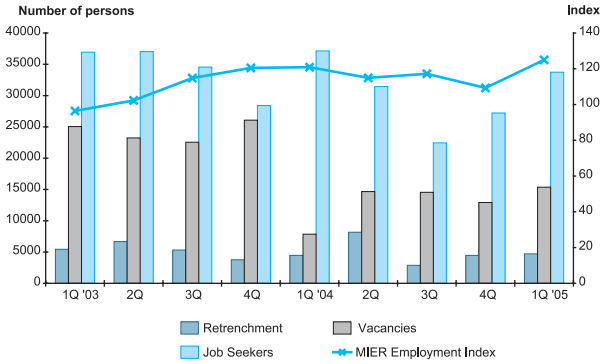
Contribution to Inflation



Labour market conditions improved significantly

Labour market conditions in the first quarter improved significantly, underpinned by strong growth in productivity. Vacancies reported to the authorities rose sharply (15,369 positions; 1Q 2004: 7,850 positions), while retrenchments remained low (4,709 persons; 1Q 2004: 4,463 persons). Registered unplaced jobseekers were also lower (33,740 persons; 1Q 2004: 37,143 persons). In the same period, growth in labour productivity, as measured by real sales value of products per employee in the manufacturing sector, rose by 14.7% exceeding the 1.6% growth in real wages per employee. The overall positive job sentiment was also reflected in the MIER Employment Index, which gained 15.7 points over the previous quarter to reach 125 points in the first quarter of 2005 (1Q 2004: 120.9 points).

Labour Market Conditions Improved Significantly

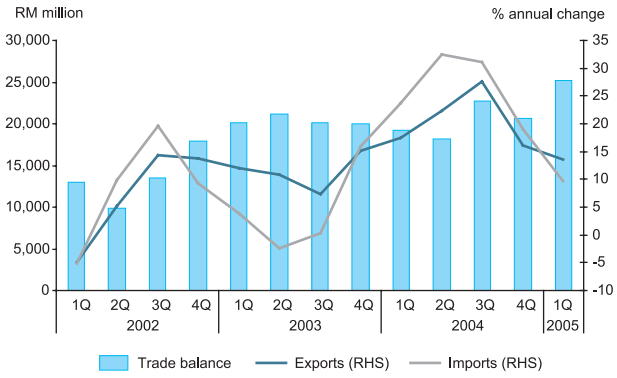


Trade account recorded a larger surplus

The **trade surplus** was larger at RM25.2 billion in the first quarter (4Q 2004:

RM20.6 billion), the largest quarterly surplus recorded. Gross exports and imports continued to expand by 13.5% and 9.8% respectively, in line with the growth in production and investment.

Trade balance



Gross exports grew by 13.5% in the first quarter of 2005 (4Q 2004: 16.1%). Exports of **manufactured goods** continued to increase at a double-digit rate of 11.8% in the first quarter of 2005 (4Q 2004: 13.5%). Despite the slower output expansion of E&E products, export growth of these products was higher at 9.7% (4Q 2004: 7.5%), reflecting the ongoing inventory adjustment by manufacturers. During the quarter, exports of resource-based products remained robust, led mainly by exports of chemical, petroleum, wood and rubber products. Exports of chemicals and petroleum products expanded by 20.2% and 18% respectively (4Q 2004: 26.9% and 57.1% respectively) due mainly to the higher prices arising from the increase in oil prices during the quarter. Meanwhile, exports of wood products increased further by 16.8% (4Q 2004: 12.4%) fuelled by strong demand from the North Asian region, particularly Japan, PR China and Korea. In line with the higher global demand for safety and high quality natural rubber gloves, growth in exports of rubber products was sustained. Overall, the increase in exports of manufactured goods during the quarter was due to increases in volume (5.9%) as well as unit value (5.6%).

Agriculture exports registered a moderate increase of 5.7% during the quarter supported mainly by exports of minor agriculture commodities such as saw logs, sawn timber, palm kernel oil and cocoa. Meanwhile, exports of major crops, namely palm oil and rubber declined. Despite the strong purchases by Pakistan and the European Union (EU), palm oil exports fell by 3.6% during the quarter. The decline was due to the lower prices (RM1,490 per tonne), from the exceptionally high levels seen in the corresponding period of 2004 (RM1,766 per tonne). Export receipts from rubber also declined by 2.9% due to both lower export volume (-0.9%) as well as lower prices (-2%).

Trade Account

	2004			2005
	1Q	4Q	Year	1Q
	Annual change (%)			
Gross Exports	**17.5**	**16.1**	**20.8**	**13.5**
Manufacturing	*17.4*	*13.5*	*19.7*	*11.8*
Agriculture	*13.8*	*1.2*	*7.4*	*5.7*
Minerals	*15.5*	*44.7*	*38.2*	*36.3*
Gross Imports	**23.7**	**19.1**	**26.4**	**9.8**
Capital goods	*30.9*	*37.2*	*36.0*	*-0.3*
Intermediate goods	*21.1*	*13.5*	*22.2*	*10.4*
Consumption goods	*14.8*	*16.4*	*24.1*	*10.4*
Trade balance (RM bil)	**19.2**	**20.6**	**80.7**	**25.2**

Source: Department of Statistics, Malaysia

Mineral exports continued to expand at a strong pace of 36.3% mainly benefiting from the high prevailing crude oil prices. Malaysian crude oil export prices strengthened significantly by 36.3% to an average of USD46.42 per barrel in line with developments in the international oil markets during the quarter. Major buyers, particularly Indonesia, India and Thailand, increased their purchases significantly by 92.8%, 48.9% and 8.1%, respectively. LNG exports also rose sharply by 32.7%, supported by both higher prices (12.8%) and higher volume (17.6%). The latter was due to higher demand for natural gas from Malaysia's largest LNG buyer, Japan (27.8%), as well as Korea (13%).

In the first quarter of 2005, Malaysia's trade with the regional countries (excluding Japan) continued to increase, with a higher share of 47.1%. The impetus to the growth stemmed mainly from stronger growth of exports to ASEAN, PR China and Hong Kong China, particularly in exports of E&E products, and chemicals. Export growth was supported by the extensive production networks and linkages in the region arising from relocation of companies into PR China and ASEAN countries as well as increased outsourcing activity. On the import side, Malaysia continued to source components from regional countries, particularly Singapore, Thailand, PR China and Chinese Taipei. The regional import share was sustained at 48.7% (4Q 2004: 48.1%), reflecting mainly imports of machinery, appliances and parts, chemicals and manufactures of metal.

Meanwhile, exports to both the US and Japan registered higher growth of 12.1% and 14.7% respectively (4Q 2004: 9.8% and 9.9% respectively), driven mainly by higher demand for E&E products, optical and scientific equipment and resource-based products, namely chemicals, wood and petroleum products. A significant development during the quarter was the

Malaysia: Direction of exports

	2004			2005	2004			2005	2004			2005
	1Q	4Q	Year	1Q	1Q	4Q	Year	1Q	1Q	4Q	Year	1Q
	RM billion				Share of total exports (%)				Annual change (%)			
United States	**19.3**	**23.2**	**90.2**	**21.6**	**17.9**	**18.3**	**18.8**	**17.6**	**12.0**	**9.8**	**15.8**	**12.1**
European Union (EU)[1]	**13.9**	**15.7**	**60.4**	**14.6**	**12.9**	**12.4**	**12.6**	**11.9**	**18.0**	**18.4**	**20.9**	**5.2**
Selected ASEAN countries[2]	**26.9**	**32.0**	**119.7**	**32.5**	**25.0**	**25.3**	**24.9**	**26.6**	**17.5**	**18.2**	**22.3**	**20.7**
North East Asia	**21.9**	**24.3**	**93.4**	**23.5**	**20.3**	**19.2**	**19.4**	**19.2**	**23.4**	**11.5**	**20.7**	**7.2**
People's Republic of China	*7.2*	*8.3*	*32.1*	*8.0*	*6.7*	*6.6*	*6.7*	*6.5*	*36.2*	*8.9*	*24.6*	*10.7*
Hong Kong China	*6.4*	*7.3*	*28.7*	*7.1*	*6.0*	*5.8*	*6.0*	*5.8*	*8.6*	*6.4*	*11.5*	*9.7*
Chinese Taipei	*3.6*	*4.1*	*15.8*	*3.1*	*3.3*	*3.2*	*3.3*	*2.5*	*6.5*	*7.4*	*10.0*	*-14.4*
Korea	*4.7*	*4.6*	*16.8*	*5.4*	*4.4*	*3.6*	*3.5*	*4.4*	*47.7*	*32.0*	*45.7*	*14.9*
India	**2.7**	**3.2**	**11.4**	**3.7**	**2.5**	**2.5**	**2.4**	**3.0**	**22.0**	**17.4**	**18.3**	**37.0**
Total exports	**107.8**	**126.7**	**480.7**	**122.4**	**100.0**	**100.0**	**100.0**	**100.0**	**17.5**	**16.1**	**20.8**	**13.5**

[1] Includes the 10 new member states
[2] Include Singapore, Thailand, Indonesia, Philippines, Brunei Darussalam and Viet Nam

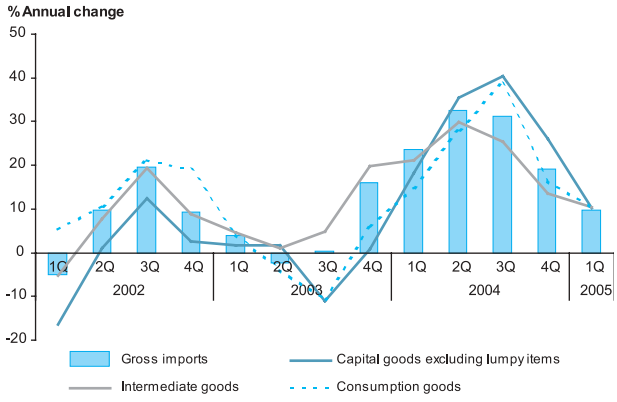
Source: Department of Statistics, Malaysia

stronger export growth to India of 37% to account for a higher export share of 3% (4Q 2004: 2.5%), reflecting mainly higher exports of chemicals, metal products, optical and scientific equipment and petroleum-related products.

Gross imports increased at a more moderate pace of 9.8%. Import growth reflected expansion in production and exports of manufactured goods as well as domestic consumption and private investment activity. Imports of **intermediate goods** expanded by 10.4%, supported by imports of industrial supplies such as metal products, iron and steel products and resource-based inputs, namely chemicals, rubber products and wood pulp. The continued growth in demand for passenger cars led to higher imports of parts and accessories of transport equipment. Stronger growth in imports of fuel and lubricants reflected mainly the high oil prices.

Imports of **capital goods** remained high at RM12.2 billion during the quarter. The growth of capital imports excluding lumpy items remained strong at 10.1%, reflecting capacity expansion and upgrading of technology in manufacturing, services and mining sectors. Imports of machinery and office equipment registered strong growth. The extension of network infrastructure and introduction of new technologies, in particular, the third-generation (3G) technology by telecommunication companies caused imports of telecommunication equipment to record robust growth. Increased exploration and downstream activities in the oil and gas industry in the wake of high prices of

Import growth



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

	2004			2005
	1Q	4Q	Year	1Q
	Annual change (%)			
CAPITAL GOODS	**30.9**	**37.2**	**36.0**	**-0.3**
Capital goods (except transport equipment)	20.0	30.4	28.3	8.1
Transport equipment	221.4	90.8	151.0	-55.7
INTERMEDIATE GOODS	**21.1**	**13.5**	**22.2**	**10.4**
Food and beverages, mainly for industry	32.9	25.1	52.9	-7.9
Industrial supplies, n.e.s.	25.6	29.2	38.9	16.0
Fuel and lubricants	-2.2	68.4	41.8	95.7
Parts and accessories of capital goods (except transport equipment)	20.8	-0.3	10.9	-0.3
Parts and accessories of transport equipment	17.8	38.9	35.0	41.2
CONSUMPTION GOODS	**14.8**	**16.4**	**24.1**	**10.4**
Food and beverages, mainly for household consumption	19.3	18.9	31.3	9.6
Transport equipment, non-industrial	-31.1	-34.4	-6.7	-16.2
Consumer goods, n.e.s.	13.6	16.7	20.8	11.7
Durables	*11.9*	*18.5*	*21.1*	*9.1*
Semi-durables	*15.8*	*8.2*	*17.7*	*5.2*
Non-durables	*12.9*	*22.4*	*23.0*	*17.8*
DUAL USE GOODS	**28.0**	**43.5**	**39.8**	**17.0**
OTHERS	**7.5**	**4.7**	**10.8**	**-6.0**
RETAINED IMPORTS	**21.9**	**17.3**	**24.3**	**8.7**
RE-EXPORTS	**89.6**	**77.6**	**102.9**	**35.3**
GROSS IMPORTS	**23.7**	**19.1**	**26.4**	**9.8**

Source: Department of Statistics, Malaysia

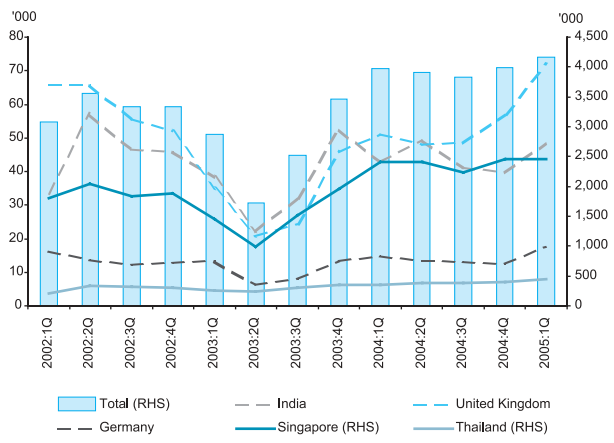
petroleum led to higher imports of construction and mining equipment.

Consonant with sustained private consumer spending and higher demand during the festivities, imports of **consumption goods** increased by 10.4%. Growth in consumption imports was mainly supported by higher demand for food and beverages and consumer goods. Reflecting continued demand for assembling and packing activities in free commercial zones, imports for re-exports grew by 35.3% during the quarter.

Higher tourist arrivals

Tourist arrivals increased by 4.6% to 4.2 million in the first quarter of 2005, despite the Tsunami, which hit the region on 26 December 2004. The increase in tourist arrivals was attributed mainly to visitors from Singapore and Thailand, which together accounted for 69.5% of total arrivals. International events, such as Formula One Petronas Malaysia Grand Prix has also contributed to the improvement in tourist arrivals. Visitors from India increased by 22.3% from the preceding quarter, supported by improved economic performance and greater connectivity with the increase in gateway points to India. Promotional campaigns and attractive travel packages also caused a 29.6% increase in long-haul tourists from Europe.

Quarterly Tourist Arrivals



While inflows of FDI were sustained, portfolio investment moderated

On a cash basis, gross inflows of **foreign direct investment (FDI)** were sustained at RM4.4 billion in the first quarter of 2005 (4Q 2004: RM4.7 billion). The inflows were channelled mainly into the services sector, particularly in the business and support services as well as the wholesale and retail trade sub-sectors. FDI inflows into the manufacturing sector were mainly for the E&E, petroleum-related activities as well as cable and wires industries. The oil and gas sector continued to receive new FDI flows particularly from foreign production sharing partners in Canada and the US. After adjustments for outflows due to repayment of loans to related companies and liquidation of foreign-owned businesses in Malaysia, net FDI registered an outflow of RM0.8 billion (4Q 2004: +RM1.7 billion).

Gross outflows for **overseas investment** increased to RM28 billion (4Q 2004: -RM18.1 billion) due to higher short-term loan extension by non-resident controlled companies in Malaysia to their related companies abroad arising from their centralised treasury operations. Nevertheless, these outflows were largely

offset by inflows arising from repayment of short-term inter-company loans during the quarter. After adjusting for inflows due mainly to repayment of inter-company loans from abroad, overseas investment recorded a net outflow of RM3.2 billion in the first quarter of 2005 (4Q 2004: -RM3.6 billion). Overseas investments were effected mainly by companies in the services sector, particularly the transport and communications sub-sector, reflecting the acquisition of a mobile operator in Indonesia. In the manufacturing sector, overseas investments were mainly directed into the petroleum-related activities and semiconductors and other electronic component industries. Meanwhile, companies in the oil and gas sector continued to invest abroad, with overseas investment channelled mainly to the Asian and African regions.

Meanwhile, net inflows of **portfolio investment** moderated to RM3 billion (4Q 2004: RM10.4 billion), as fund managers reallocated their equity portfolio in the Asian region.

External debt declined

Malaysia's total external debt declined to RM195 billion or USD51.3 billion as at end-March 2005 (4Q 2004: RM200.5 billion or USD52.8 billion), equivalent to 43.9% of GNP. **Medium- and long-term external debt** was lower at RM154.3 billion or USD40.6 billion (4Q 2004: RM156.6 billion or USD41.2 billion), due largely to net repayment of external loans by both the Federal Government and the non-financial public enterprises (NFPEs). The NFPEs registered a net repayment of RM2.5 billion, reflecting significantly lower drawdown while repayment was larger. The repayments, including the maturity of a US dollar-denominated bond, were effected mainly by the NFPEs in the manufacturing sector. Meanwhile, the private sector recorded a net drawdown, mainly by the companies in the agriculture and oil and gas sectors.

External Debt Outstanding

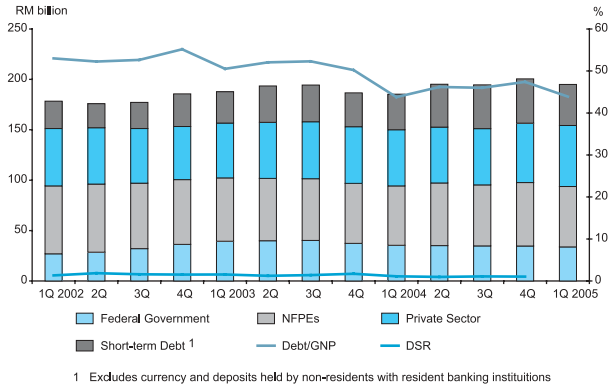
	2004		2005
	1Q	4Q	1Q [p]
	RM billion		
Medium- and Long-term debt	150.0	156.6	154.3
Public sector	94.3	97.7	93.7
Private sector	55.7	58.9	60.6
Short-term debt [1]	35.3	44.0	40.7
Total external debt	185.3	200.5	195.0
- USD billion equivalent	48.8	52.8	51.3

[1] Excludes currency and deposits held by non-residents with resident banking institutions

[p] Preliminary

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

External Debt Outstanding



1 Excludes currency and deposits held by non-residents with resident banking instituitions

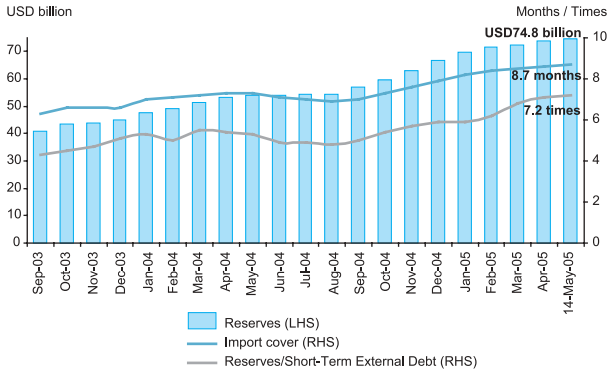
The total **short-term external debt** was lower at RM40.7 billion or USD10.7 billion (4Q 2004: RM44 billion), reflecting lower

short-term borrowings by both the banking and non-bank private sectors. As at end-March, the short-term debt remained low, accounting for 20.9% of total external debt and is about 14.8% of the net international reserves.

International reserves continued to increase

The international reserves of Bank Negara Malaysia increased further in the first quarter of 2005. As at 31 March 2005, the net international reserves stood at RM275.2 billion or USD72.4 billion, an increase of RM21.6 billion or USD5.7 billion since end-2004. The increase in reserves during the quarter was supported mainly by sustained repatriation of export earnings, inflows of FDI and portfolio funds. Meanwhile, outflows reflected mainly payments for imports of goods and services, repatriation of profits and dividends, and repayments of external loans. The reserves level has also taken into account the quarterly adjustment of the foreign exchange revaluation loss amounting to USD1.2 billion.

Net International Reserves (as at end-period)



The reserves increased further to RM284.4 billion or USD74.8 billion as at 14 May 2005, reflecting continued repatriation of export earnings and inflows of FDI and portfolio investment. The reserves position is adequate to finance 8.7 months of retained imports and is 7.2 times the short-term external debt.

Improved Fiscal Position

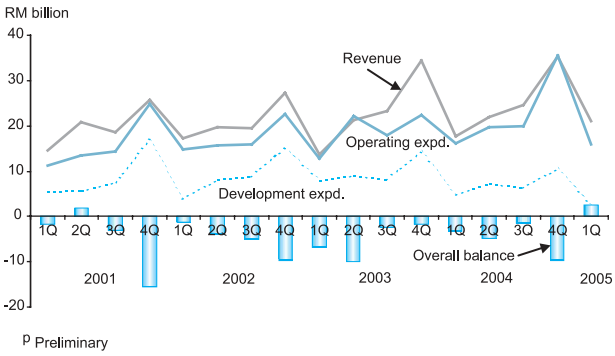
The Federal Government recorded a small fiscal surplus of RM2.6 billion or 2.3% of GDP in the first quarter due to strong revenue collection and lower development expenditure. Strong revenue performance was recorded in the first quarter, mainly from higher petroleum-based revenue. Most

Federal Government Finance

	2004			2005
	1Q	4Q	Year	1Q[p]
	RM billion			
Revenue	17.7	35.3	99.4	21.1
% growth	*29.3*	*2.5*	*7.3*	*19.2*
Operating expenditure	16.2	35.5	91.3	15.9
% growth	*26.7*	*58.3*	*21.4*	*-1.5*
Current account	**1.6**	**-0.2**	**8.1**	**5.2**
% of GDP	***1.5***	***-0.2***	***1.8***	***4.5***
Gross development expenditure	4.9	10.5	28.9	2.8
% growth	*-38.0*	*-26.8*	*-26.7*	*-42.9*
Loan recoveries	0.1	1.0	1.3	0.2
Overall balance	**-3.2**	**-9.8**	**-19.4**	**2.6**
% of GDP	***-3.1***	***-8.3***	***-4.3***	***2.3***
Memo item:				
Total gross expenditure	21.0	46.0	120.2	18.7
% growth	*2.1*	*25.1*	*4.9*	*-11.1*
Total Federal Government debt (as at end period)	194.3	216.6	216.6	223.1
% of GDP	*43.2*	*48.2*	*48.2*	*47.4*
Domestic debt	157.0	182.0	182.0	189.3
% of GDP	*34.9*	*40.5*	*40.5*	*40.2*
External debt	37.3	34.7	34.7	33.8
% of GDP	*8.3*	*7.7*	*7.7*	*7.2*

[p] Preliminary

Federal Government Finance[p]



[p] Preliminary

major sources of indirect taxes registered better growth reflecting the higher domestic aggregate demand. Given the ample liquidity in the domestic market, funds were raised entirely from domestic sources. As at end-March 2005, total outstanding debt of the Federal Government amounted to RM223.1 billion or 47.4% of GDP. The external debt of the Federal Government continues to remain low at 7.2% of GDP.