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Calendar of Events

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ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE SECOND QUARTER OF 2015

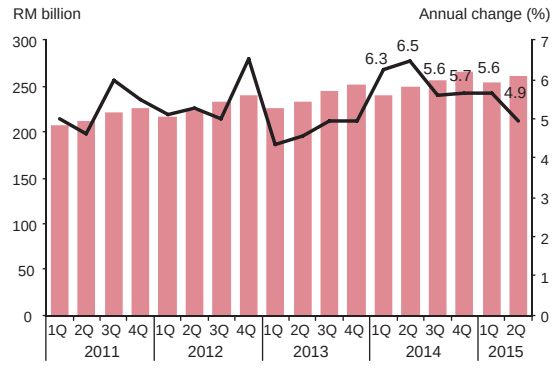
OVERVIEW

The global economy expanded at a moderate pace in the second quarter of 2015. In the major advanced economies, growth in the US and the UK continued to improve while the pace of economic activity in the euro area and Japan was more modest. Growth in most Asian economies moderated in the second quarter. Domestic demand continued to support growth in an environment of weak export performance. Several central banks in major and emerging economies lowered policy rates amid rising growth concerns and low inflation.

The Malaysian economy grew by 4.9% in the second quarter of 2015

The Malaysian economy recorded a growth of 4.9% in the second quarter of 2015 (1Q 2015: 5.6%), driven mainly by private sector demand. On the supply side, growth was underpinned by the major economic sectors. On a quarter-on-quarter seasonally-adjusted basis, the economy grew by 1.1% (1Q 2015: 1.2%).

The Malaysian economy expanded in the second quarter (at constant 2010 prices)



Source: Department of Statistics, Malaysia

The private sector remained the key driver of growth during the quarter. Private consumption expanded at a more moderate rate of 6.4% (1Q 2015: 8.8%) as households adjust to the implementation of the Goods and Services Tax (GST). Private investment grew more moderately by 3.9% (1Q 2015: 11.7%), due to a decline in spending on machinery and equipment, especially in the transportation segment, and slower investment in dwelling services. Growth in public investment turned negative in the second quarter (-8.0%; 1Q 2015: 0.5%), attributed mainly to the near completion of a few projects by public enterprises, which more than offset the positive growth of capital expenditure by the Federal Government. Meanwhile, public consumption recorded a higher growth of 6.8%; (1Q 2015: 4.1%) following the stronger expansion in supplies and services expenditure amid sustained growth in emoluments.

On the supply side, the major economic sectors registered more moderate growth during the quarter. The lower growth in the services sector was the outcome of a slower expansion in most sub-sectors while the moderation in manufacturing sector was due to the more modest performance in export oriented industries. Growth in the mining sector was affected mainly by the lower production of natural gas. The construction sector also recorded lower growth due to a moderation in real activity in the residential, non-residential and civil engineering sub-sectors. The agriculture sector turned around to record positive growth amid higher production of palm oil.

Inflation, as measured by the annual change in the Consumer Price Index (CPI), increased to 2.2% in the second quarter of 2015 (1Q 2015: 0.7%) reflecting mainly the impact of the implementation of the Goods and Services Tax (GST) on 1 April. The price increases were broad-based, with all twelve categories of the CPI basket registering higher inflation in the second quarter compared to the first quarter. Meanwhile, prices in the *transport* category declined at a lower rate of 3.6% in the second quarter (1Q 2015: -7.6%), reflecting the upward adjustment of domestic fuel prices.

The trade surplus amounted to RM20.4 billion in the second quarter of 2015 (1Q 2015: RM21.3 billion). Gross exports declined by 3.7% (1Q 2015: -2.5%), due mainly to the contraction in the exports of commodities and resource-based manufactured products. Similarly, gross imports recorded a contraction of 5.2% during the quarter (1Q 2015: +0.2%), weighed down by weaker performance of all import categories, except for consumption imports.

The international reserves of BNM amounted to RM389.1 billion (equivalent to USD105.5 billion) as at 30 June 2015. This reserves level has taken into account the quarterly adjustment for foreign exchange revaluation changes.

As at 31 July 2015, the reserves position amounted to RM364.7 billion (equivalent to USD96.7 billion). It is sufficient to finance 7.6 months of retained imports, significantly higher than the 3-month international threshold. The reserves to short-term external debt coverage of 1.1 times is adequate for a country with a relatively high degree of financial openness.

Interest rates remained stable

The Monetary Policy Committee (MPC) maintained the Overnight Policy Rate (OPR) at 3.25% at its meetings during the second quarter of 2015. At the prevailing level of the OPR, monetary conditions remained supportive of economic activity. Despite increased volatility in international financial markets, interest rates in the domestic money market have remained stable. The average overnight interbank rate traded within a range of 3.16% and 3.25% during the quarter, while interbank rates for other short-term maturities (less than 1 month) were relatively steady. For the quarter as a whole, while the 3-month Kuala Lumpur Interbank Offered Rates (KLIBOR) declined from 3.73% to 3.69%, 3-month KLIBOR futures remained relatively stable, reflecting market expectation for the policy interest rate to be unchanged. In terms of retail rates, both deposit and lending rates to the economy were broadly stable throughout the quarter. The average base rate (BR) of banks at the end of the second quarter was slightly lower at 3.88%, as two banks revised their BR downwards in June following the downward trend in KLIBOR.

The monetary aggregates moderated in the second quarter. M3, or broad money, declined by RM7.2 billion on a quarter-on-quarter basis while still recording an annual growth rate of 6.0% as at end-June (end-March 2015: 7.9%). The decrease in M3 during the quarter was driven mainly by lower net claims on the Government, reflecting private sector purchase of Malaysian Government Securities (MGS) and Government Investment Issues (GII), which were raised in anticipation of the maturity of Government bonds in 2H 2015. The moderation in M3 was also on account of lower net foreign assets of the financial system following net external outflows during the quarter. Nevertheless, the decrease in M3 was partially offset by the continued extension of credit to households and businesses. In the banking system, liquidity conditions remained ample at both the institutional and system-wide levels. The level of surplus liquidity placed with BNM was relatively stable during the quarter.

Total gross financing raised by the private sector through the banking system and the capital market amounted to RM290.1 billion (1Q 2015: RM282.6 billion). On a net basis, outstanding banking system loans and PDS expanded at a stable growth rate of 8.3% during the quarter (1Q 2015: 8.3%). The amount of loans disbursed to businesses increased during the quarter with a higher level of credit being extended mainly to the w*holesale and retail trade, and restaurants and hotels; manufacturing; agriculture* and *transport, storage and communication* sectors. In particular, financing for SMEs continued to be strong, with outstanding SME loans growing at a steady growth rate of 17.2% (1Q 2015: 17.2%). Outstanding household loans growth moderated to 8.7% in the second quarter (1Q 2015: 9.8%). Net funds raised in the capital market increased to RM39.3 billion (1Q 2015: RM21.0 billion), due mainly to higher net issuances of government and private debt securities.

The ringgit and other regional currencies continued to be driven by shifts in investor sentiments and portfolio investments throughout the quarter. Overall, the ringgit depreciated by 1.8% against the US dollar during the quarter. The ringgit also depreciated against the Japanese yen (-0.1%), the Australian

dollar (-2.5%), the euro (-5.2%), and the pound sterling (-7.7%). Against all regional currencies except the Thai baht (2.0%), the ringgit depreciated by between 0.1% and 3.9%.

Between 1 July and 11 August 2015, the ringgit depreciated against the US dollar by 4.2%. Against other major currencies, the ringgit also depreciated against the euro (-2.4%), the Japanese yen (-2.4%) and the pound sterling (-3.3%), but appreciated against the Australian dollar (0.3%). The ringgit depreciated against most regional currencies.

Domestic financial stability continues to be preserved

Financial system resilience remained intact despite persistent volatility in the global and domestic financial markets during the quarter. The domestic financial markets continued to function in an orderly manner. Combined with continued ample domestic liquidity and institutional soundness, financial intermediation activities continued to function efficiently to support the financial and financing needs of the domestic economy. In the near term, domestic financial system stability is expected to be maintained, thus providing continued support to real sector activities amidst challenging operating environment. Stress tests[1] conducted by the Bank have also shown that banks' and insurers' are expected to remain well capitalised under a simulated scenario of significant portfolio outflows.

Banks' capitalisation was maintained at strong levels. At end-2Q 2015, the common equity tier-1 capital ratio, tier-1 capital ratio and total capital ratio stood well above the minimum regulatory levels at 12.3%, 13.1% and 15.2% respectively. More than 80% of banks' total capital consists of high quality capital comprising retained earnings, paid-up capital and reserves. The capital buffer of the banking system was sustained in excess of RM100 billion. Similarly, the capital adequacy ratio for the insurance sector remained strong at 239.1% (1Q 2015: 245.7%) with an excess capital buffer above RM28.5 billion.

Domestic demand will remain the key driver of growth

Going forward, the global economy is projected to remain on a moderate growth path, with diverging growth momentum across major economies. Overall global growth is expected to continue to benefit from low oil prices, but the impact will vary across economies. In Asia, with export growth remaining moderate, domestic demand is expected to remain the key driver of growth. Global growth, however, has become more vulnerable to increased downside risks. Any adverse developments in Europe, increased uncertainty over policy adjustments in the advanced and emerging economies and a re-emergence of geopolitical tensions could result in further international financial market volatility.

The Malaysian economy is expected to remain on a steady growth path, with domestic demand continuing to be the key driver of growth. Private consumption is expected to continue to adjust to the introduction of the Goods and Services Tax (GST), although wage growth and stable labour market conditions would provide support to household spending. Investment activity will be supported by capital spending in the manufacturing and services sectors, as well as for infrastructure projects. These developments will contribute towards offsetting the weaker performance of the external sector.

[1] This assessment has incorporated a range of extreme shock parameters, including mark-to-market losses from holdings of equities, interest rate risk in the trading books and foreign currency exposures in the balance sheets and credit losses from businesses affected by significant exchange rate volatility.

DEVELOPMENTS IN THE SECOND QUARTER OF 2015

INTERNATIONAL ECONOMIC ENVIRONMENT

Moderate expansion in global economic activity

The global economy expanded at a moderate pace in the second quarter of 2015. In the major advanced economies, growth in the US and the UK continued to improve while the pace of economic activity in the euro area and Japan was more modest. Growth in most Asian economies moderated in the second quarter. Domestic demand continued to support growth in an environment of weak export performance. Several central banks in major and emerging economies lowered policy rates amid rising growth concerns and low inflation.

Global financial markets remained volatile in the second quarter. Investor sentiments were affected by uncertainties surrounding the timing and magnitude of interest rate normalisation by the US Federal Reserve (Fed) and adverse developments surrounding the Greek debt crisis. In Asia, equity markets were further weighed down by concerns over weaker-than-expected economic data releases in the region. In PR China, equity markets rose during the earlier part of the quarter supported by capital market liberalisation measures introduced since the fourth quarter of last year and continued easing measures by the government to support economic growth. Nevertheless, this trend reversed in mid-June following concerns over an overvaluation in Chinese stocks.

The US economy continued to expand at a more moderate pace (2.3%; 1Q 2015: 2.9%). On a seasonally adjusted annualised basis, the growth momentum strengthened to 2.3% (1Q 2015: 0.6%), as the temporary factors that weighed on growth in the first quarter, namely harsh winter conditions and port congestion, diminished. Private consumption activity was sustained in the second quarter as households continued to benefit from lower oil prices, stronger labour market conditions and improved household balance sheets. However, growth of fixed investment moderated, due mainly to the continued decline in oil and gas-related capital expenditure. Headline inflation registered flat growth in the second quarter of 2015 (1Q 2015: -0.1%), amid low oil prices.

Economic activity in the euro area continued to improve modestly in the second quarter. Domestic demand conditions were supported by low energy prices, accommodative monetary policy and better labour market conditions in a few key economies, including Germany. Despite the escalation of the Greek debt and economic crisis, business and consumer sentiments continued to improve during the quarter, with the manufacturing PMI increasing to 52.2 (1Q 2015: 51.4). Headline inflation turned around to register positive growth during the quarter (0.2%; 1Q 2015: -0.3%), due to an increase in the cost of food and services.

The UK economy grew at a more moderate pace in the second quarter (2.6%; 1Q 2015: 2.9%). The continued expansion of economic activity was driven mainly by the services sector, particularly the business services and finance sub-sector. Headline inflation registered 0% growth during the quarter (1Q 2015: 0.1%), amid lower prices of housing and household expenditures as well as clothing and footwear.

Economic activity in Japan expanded modestly in the second quarter. The improvement in indicators was, however, due in part to base effect arising from the consumption tax increase on 1 April 2014. Retail sales rebounded across a broad segment of goods (2.9%; 1Q 2015: -4.8%), while business sentiments improved during the quarter as reflected by the increase in the Tankan survey index for large manufacturers. On the external front, export growth moderated to 6.7% (1Q 2015: 9.1%) amid lower demand from Western Europe and the US. Inflation (excluding fresh food) experienced a broad-based moderation to 0.2% (1Q 2015: 2.1%). Core inflation (excluding food and energy) was also lower (0.5%; 1Q 2015: 2.1%).

Advanced Economies: Real GDP Growth

	2014		2015		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
US	2.6	2.2	2.9[r]	2.3[a]	2.6[a]
UK	3.0	2.8	2.9[r]	2.6[p]	2.7[p]

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

Source: National authorities

The stance of monetary policy in the advanced economies remained accommodative, despite continued divergence in direction of monetary policy across economies. Amid ongoing improvements in the US labour market, the Fed continued to signal that an increase in interest rates would be likely in the second half of the year.

Most central banks reaffirmed their commitment to maintain accommodative monetary conditions, with several central banks reducing policy rates, amid lower inflation and rising growth concerns. The European Central Bank (ECB) and the Bank of Japan (BOJ) maintained their asset purchase programmes during the quarter. The ECB reaffirmed its intention to purchase EUR60 billion of assets per month until end-September 2016 or until medium-term inflation is close to 2%. Likewise, the BOJ reiterated its commitment to increase the monetary base by JPY80 trillion annually. The Bank of England (BOE) also maintained the stock of its purchased assets at GBP375 billion. Meanwhile, the Reserve Bank of New Zealand reduced its key policy rate in June and July by a cumulative 50 basis points to 3.00%, while the Reserve Bank of Australia and Norway's Norges Bank lowered their key policy rates by 25 basis points each to 2.00% and 1.00%, respectively in the second quarter. In July, the Bank of Canada reduced its key policy rate by 25 basis points to 0.50%. Similarly, the Sveriges Riksbank (Swedish National Bank) lowered its key policy rate by 10 basis points to -0.35% and extended its purchase of government bonds by a further SEK45 billion.

In PR China, economic growth was sustained in the second quarter (7.0%; 1Q 2015: 7.0%). By industry, growth improvements in the primary (agriculture and mining) and tertiary (services) sectors offset the slower expansion across secondary (industry and construction) industries. During the quarter, the Chinese government announced a series of wide-ranging policy measures such as infrastructure investment and increased lending to targeted sectors to support economic momentum. In addition, further monetary policy easing measures were also introduced following the stock market correction towards the end of the quarter. Nevertheless, growth continued to face headwinds from ongoing reforms to rebalance the key drivers of the economy. Inflation increased to 1.4% in the second quarter (1Q 2015: 1.2%) amid higher prices of food as well as higher prices in the recreation, education and cultural sub-sector.

In Asia, most economies growth continued to expand, albeit at a more moderate pace. Growth in the Chinese Taipei economy slowed sharply to 0.6% in the second quarter (1Q 2015: 3.4%), due to a decline in exports which offset the improvement in domestic demand. Growth in Indonesia was sustained at 4.7% in the second quarter, as a moderation in investment activity was offset by an improvement in net exports, amid sustained private consumption growth. In Korea, growth moderated to 2.2% (1Q 2015: 2.5%), on account of weaker external demand amid a continued expansion in domestic demand. In Singapore, growth moderated to 1.8% (1Q 2015: 2.8%), due mainly to a contraction in manufacturing activity, particularly the biomedical engineering and transport engineering clusters.

Regional Countries: Real GDP Growth

	2014		2015		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
Chinese Taipei	3.9	3.6	3.4	0.6[a]	2.0[a]
Indonesia	5.0	5.1	4.7	4.7	4.7
Korea	3.4	3.7	2.5	2.2[a]	2.3[a]
PR China	7.4	7.4	7.0	7.0	7.0
Singapore	2.3	3.4	2.8[r]	1.8[p]	2.3[p]

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

Source: National authorities

Inflationary pressures remained subdued in most Asian economies, as prices continued to be weighed down by lower energy prices. Of note, Thailand, Singapore and Chinese Taipei experienced deflation in the second quarter. Nonetheless, inflation rose in Indonesia, primarily as the outcome of an increase in the price of fuel, following the fuel subsidy rationalisation.

Against this backdrop, monetary policy remained accommodative in the region with a few central banks lowering their policy rates during the quarter. Amid moderate domestic economic activity, the Bank of Thailand and the Reserve Bank of India lowered their key policy rates by 25 basis points each to 1.50% and 7.25%, respectively. Similarly, the Bank of Korea reduced its policy rate by 25 basis points to a record low of 1.50% as downside risks to growth increased following weak export growth and the outbreak of the Middle East Respiratory Syndrome (MERS) which dampened domestic demand. Meanwhile, the People's Bank of China (PBoC) eased monetary conditions further during the quarter to boost credit growth and support economic activity. The PBoC reduced the one-year benchmark lending and deposit rates to 4.85% and 2.00%, respectively (Previous: 5.35% and 2.50%, respectively). In April, the PBoC lowered the reserve requirement ratio by 100 basis points for all banks, and in June, the ratio was lowered further by 50 basis points for banks lending to small and medium enterprises as well as the agriculture sector.

Brent crude oil prices improved to an average of USD63 per barrel in the second quarter (1Q 2015: USD55 per barrel). This is due to a decline in US shale oil production and the Fed's decision to not raise interest rates in June, both of which helped improve sentiments in the oil market during the first two months of 2Q 2015. Price hit a year high of USD68 per barrel on 4 May 2015. However, the Fed's indication of a possible interest rate hike sometime in the second half of 2015 triggered a minor sell-off in the oil markets towards the end of the quarter, causing oil prices to moderate to USD62 per barrel on 29 June 2015.

Most major currencies appreciated against the US dollar in the second quarter. In the first two months of the quarter, the improvement in economic activity in the UK and the euro area provided some support to the pound sterling and the euro. However, the strength of these currencies was affected by higher uncertainty surrounding the Greek debt crisis during the quarter. The Japanese yen weakened amid BOJ's commitment to maintain accommodative monetary policy. In the rest of Asia, most regional currencies depreciated against the US dollar as better US economic data releases reinforced market expectations for the Fed to increase interest rates by end-2015. In addition, concerns over moderating economic activity in the region, including PR China and heightened uncertainty from the Greek debt crisis also weighed on the region's currency performance.

Going forward, the global economy is projected to remain on a moderate growth path, with diverging growth momentum across major economies. Overall global growth is expected to continue to benefit from low oil prices, but the impact will vary across economies. In Asia, with export growth remaining moderate, domestic demand is expected to remain the key driver of growth. Global growth, however, has become more vulnerable to increased downside risks. Any adverse developments in Europe, increased uncertainty over policy adjustments in the advanced and emerging economies and a re-emergence of geopolitical tensions could result in further international financial market volatility.

DEVELOPMENTS IN THE MALAYSIAN ECONOMY

The Malaysian economy grew by 4.9% in the second quarter

The Malaysian economy registered a growth of 4.9% in the second quarter of 2015 (1Q 2015: 5.6%). Private sector expenditure remained the key driver of growth (5.7%; 1Q 2015: 9.6%), and contributed towards a continued expansion in domestic demand. This helped to offset the negative contribution from net exports during the quarter. On a quarter-on-quarter seasonally-adjusted basis, the economy recorded a growth of 1.1% (1Q 2015: 1.2%).

Continued expansion in domestic demand

Domestic demand expanded by 4.6% in the second quarter of 2015 (1Q 2015: 7.9%). This was driven mainly by private sector activity, which grew by 5.7% (1Q 2015: 9.6%) following continued growth in consumption and investment activities. **Private consumption** growth moderated to 6.4% (1Q 2015: 8.8%), as households adjust to the implementation of GST. However, continued wage growth and stable labour market conditions remained supportive of overall consumer spending. **Private investment** registered a growth of 3.9% (1Q 2015: 11.7%), supported by continued capital expenditure in the manufacturing sector, particularly in the export-oriented industries.

Public sector expenditure expanded by 0.9% in the second quarter (1Q 2015: 2.5%). **Public consumption** recorded a higher growth of 6.8% (1Q 2015: 4.1%), reflecting a stronger expansion in supplies and services, and sustained growth in emoluments. However, **public investment** registered a negative growth of 8.0% (1Q 2015: +0.5%) due to the decline in investments by the public enterprises following the near completion of a few large projects. The Federal Government spending on fixed assets remained positive during the quarter.

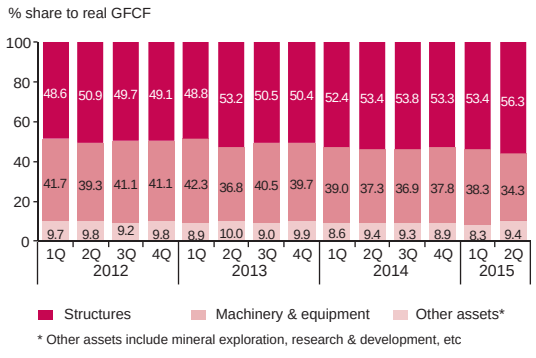
In terms of total investment, **gross fixed capital formation** moderated to 0.5% during the quarter (1Q 2015: 7.9%), supported mainly by the private sector capital expenditure. By type of assets, investment was mainly supported by growth in investment on structures (5.9%; 1Q 2015: 9.9%), which cushioned the decline in investment in machinery and equipment (-7.5%; 1Q 2015: 5.8%).

GDP by Expenditure Components
(at constant 2010 prices)

	Share 2014 (%)	2014		2015		
		2Q	1H	1Q	2Q	1H
		Annual change (%)				
Aggregate Domestic Demand (excluding stocks)	91.5	5.6	6.6	7.9	4.6	6.2
Private Sector	68.5	7.9	8.4	9.6	5.7	7.6
Consumption	*51.8*	*6.5*	*6.7*	*8.8*	*6.4*	*7.6*
Investment	*16.6*	*11.6*	*13.1*	*11.7*	*3.9*	*7.5*
Public Sector	23.0	-1.4	1.0	2.5	0.9	1.7
Consumption	*13.6*	*-0.2*	*5.5*	*4.1*	*6.8*	*5.5*
Investment	*9.5*	*-3.2*	*-4.8*	*0.5*	*-8.0*	*-3.7*
Net Exports	9.3	51.7	25.3	-10.2	-10.5	-10.4
Exports of Goods and Services	*76.1*	*8.7*	*8.3*	*-0.6*	*-3.7*	*-2.2*
Imports of Goods and Services	*66.8*	*4.5*	*6.1*	*1.0*	*-2.8*	*-0.9*
GDP	**100.0**	**6.5**	**6.4**	**5.6**	**4.9**	**5.3**
GDP (q-o-q growth, seasonally adjusted)	**-**	**1.6**	**-**	**1.2**	**1.1**	**-**

Source: Department of Statistics, Malaysia

GFCF by Type of Assets



* Other assets include mineral exploration, research & development, etc

Source: Department of Statistics, Malaysia

GDP by Economic Activity
(at constant 2010 prices)

	Share 2014 (%)	2014		2015		
		2Q	1H	1Q	2Q	1H
		Annual change (%)				
Agriculture	9.2	6.7	4.6	-4.7	4.6	0.0
Mining	9.0	2.1	1.0	9.6	6.0	7.8
Manufacturing	23.0	7.3	7.2	5.6	4.2	4.9
Construction	4.3	10.0	14.5	9.7	5.6	7.7
Services	53.5	6.4	6.5	6.4	5.0	5.7
Real GDP	**100.0[1]**	**6.5**	**6.4**	**5.6**	**4.9**	**5.3**
Real GDP (q-o-q seasonally adjusted)	**-**	**1.6**	**-**	**1.2**	**1.1**	**-**

[1] Numbers do not add up due to rounding and exclusion of import duties component

Source: Department of Statistics, Malaysia

Moderation in major economic sectors

On the supply side, the major economic sectors registered more moderate growth during the quarter. The lower growth in the services sector was to the outcome of a slower expansion in most sub-sectors while the moderation in manufacturing sector was due to the more modest performance in export-oriented industries. Growth in the mining sector was affected mainly by the lower production of natural gas. The construction sector also recorded lower growth, due to a moderation in real activity in the residential, non-residential and civil engineering sub-sectors. The agriculture sector turned around to record positive growth amid higher production of palm oil.

The **services sector** grew by a more moderate rate of 5.0% in the second quarter (1Q 2015: 6.4%) due to slower growth in most sub-sectors. The wholesale and retail trade sub-sector recorded a moderate growth in tandem with lower growth in household spending following the implementation of GST. The finance and insurance sub-sector registered a marginal growth, weighed down by the insurance segment. Expansion in the real estate and business services sub-sector was supported mainly by the professional services segment. In the information and communication sub-sector, growth was driven by strong demand for data communication services amid attractive packages from telecommunications companies. Growth of the transportation and storage sub-sector was mainly supported by trade-related activity.

The **manufacturing sector** recorded a lower growth of 4.2% (1Q 2015: 5.6%) which was the result of the more modest performance in export-oriented industries. The performance of the export-oriented industries was affected by weaker global demand particularly for electronics and electrical products. However, the domestic-

Performance of the Services Sector (value added at constant 2010 prices)

	Share 2014 (%)	2014		2015		
		2Q	1H	1Q	2Q	1H
		Annual change (%)				
Intermediate Services	**38.4**	**5.2**	**5.6**	**5.7**	**4.8**	**5.3**
Finance & insurance	13.7	0.9	1.8	1.9	0.2	1.0
Real estate & business services	7.9	7.6	7.9	7.6	6.2	6.9
Transport & storage	6.5	4.8	4.8	5.7	5.4	5.5
Information & communication	10.2	9.5	9.8	9.6	9.3	9.5
Final Services	**61.6**	**7.1**	**7.1**	**6.8**	**5.1**	**5.9**
Wholesale & retail trade	26.9	9.3	8.9	9.8	5.9	7.8
Food & beverages and accommodation	5.1	5.9	6.1	7.3	6.6	6.9
Utilities	4.8	2.9	3.1	3.7	3.9	3.8
Government services	16.5	6.8	7.2	3.9	4.1	4.0
Other services	8.2	4.3	4.8	4.6	4.7	4.7
Total Services	**100.0**[1]	**6.4**	**6.5**	**6.4**	**5.0**	**5.7**

[1] Numbers do not add up due to rounding

Source: Department of Statistics, Malaysia

Selected Quarterly Indicators in the Services Sector

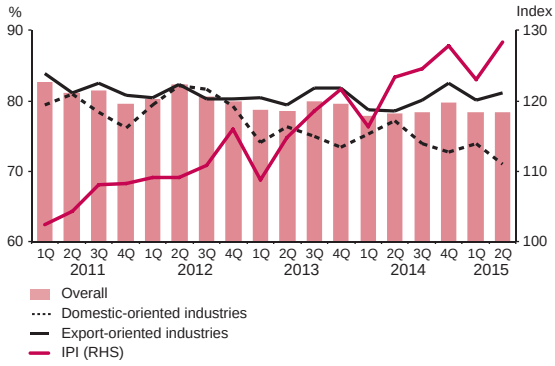
	2014		2015		
	2Q	1H	1Q	2Q	1H
	Index				
MIER Consumer Sentiments Index	100.1	98.5	72.6	71.7	72.2
MIER Retail Trade Index	89.6	88.0	85.4	76.8	81.1
MIER Tourism Market Index	96.7	106.3	100.7	84.7	92.7
	Annual change (%)				
Total passenger traffic at all airports	5.9	12.0	-0.8	1.6	0.4
Total consumption credit outstanding	4.4	4.4	3.5	2.7	2.7
Total loans outstanding	9.3	9.3	9.2	9.1	9.1
Loans outstanding to the wholesale & retail trade, hotels & restaurants	6.4	6.4	9.3	8.2	8.2
Imports of consumption goods	7.1	11.1	4.4	25.4	15.2
Total sales of motor vehicles	11.2	6.3	5.3	-11.2	-3.3
Container cargo handled (Port Klang and PTP)	7.2	5.5	12.9	6.0	9.3

Source: Various sources

oriented industries recorded a stronger growth, supported by better performance in the transport-equipment industries.

Overall capacity utilisation rate in the manufacturing sector remains unchanged in the second quarter (78%; 1Q 2015: 78%). The slight improvement in the export-oriented industries' capacity utilisation (81%, 1Q 2015: 80%) offsets the lower capacity utilisation in the domestic-oriented industries (71%, 1Q 2015: 74%).

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

Growth in the **construction sector** moderated to 5.6% in the second quarter (1Q 2015: 9.7%) following slower expansion in the residential, non-residential and civil engineering sub-sectors. The moderation in the residential sub-sector was attributable to lower construction activity in residential projects. Growth in the non-residential sub-sector was also slower, but was firm, supported by the construction of commercial, education and healthcare buildings. The civil engineering sub-sector expanded at a slower pace, reflecting the completion and near-completion of large transportation and utility projects. Growth in the special trade sub-sector was slightly stronger, underpinned by activity for earthworks, land clearing and land reclamation works.

The **agriculture sector** turned around to register a positive growth of 4.6% (1Q 2015: -4.7%), amid higher production of palm oil. Meanwhile, growth in the **mining sector** was lower (6.0%; 1Q 2015: 9.6%) due mainly to a decline in the output of natural gas.

Performance of the Manufacturing Sector

	Share in 2014 (%)	2014		2015		
		2Q	1H	1Q	2Q	1H
		Annual Change (%)				
Value Added (at constant 2010 prices)	**100.0**	**7.3**	**7.2**	**5.6**	**4.2**	**4.9**
Export-oriented industries	63.6	4.9	6.1	7.0	4.0	5.5
Domestic-oriented industries	36.4	11.5	9.1	2.8	4.5	3.7
Overall Manufacturing Production[1]	**100.0**	**7.4**	**7.2**	**5.7**	**4.1**	**4.8**
Export-oriented industries	**77.6**	**6.1**	**6.5**	**5.1**	**4.3**	**4.7**
Electronics and electrical products cluster	**25.0**	**13.5**	**14.0**	**10.7**	**4.7**	**7.6**
Of which:						
Electronics	15.3	15.1	17.0	-0.2	-6.1	-3.3
Electrical products	7.6	8.2	7.3	40.5	37.7	39.0
Primary-related cluster	**52.6**	**2.5**	**2.8**	**2.2**	**4.0**	**3.1**
Of which:						
Chemicals and chemical products	14.3	-2.1	-0.5	9.9	5.5	7.6
Petroleum products	21.0	-0.5	3.0	2.1	0.9	1.5
Rubber products	2.5	-1.6	-0.1	-1.3	7.6	3.1
Off-estate processing	6.4	21.4	12.1	-20.2	7.3	-5.9
Domestic-oriented industries	**22.4**	**11.5**	**9.5**	**7.6**	**3.5**	**5.4**
Construction-related cluster	**11.3**	**4.6**	**3.9**	**6.9**	**2.8**	**4.8**
Of which:						
Construction-related products	8.2	6.6	4.0	8.1	2.9	5.4
Fabricated metal products	3.1	0.9	3.7	4.7	2.8	3.7
Consumer-related cluster	**11.1**	**18.8**	**15.5**	**8.3**	**4.1**	**6.1**
Of which:						
Transport equipment	5.5	29.8	24.7	9.2	6.0	7.4
Food, beverage & tobacco products	5.4	6.6	5.5	7.5	1.7	4.5

[1] Industrial Production Index (2010=100)

Source: Department of Statistics, Malaysia

Indicators for the Construction Sector

	2014		2015		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
Value of construction work done	10.8	15.7	15.1	8.2	11.6
Residential	18.1	24.9	19.5	7.8	13.5
Non-residential	14.5	17.1	24.3	15.5	19.8
Civil engineering	1.8	6.0	4.2	1.5	2.9
Special trade[1]	9.8	27.5	4.2	7.4	5.7
Housing approvals	21.4	6.5	-24.2	-3.8[3]	-14.8[4]
Production[2] of construction-related materials					
Hydraulic cement	7.2	4.3	20.2	12.8	16.3
Other articles of concrete, cement and plaster n.e.c	43.5	40.3	20.9	4.9	12.6
Other porcelain and ceramic products	17.5	16.4	31.2	21.6	26.1
Prefabricated structural components for building or civil engineering of cement, concrete or artificial stone	-6.4	-2.0	-13.3	-6.4	-9.9
Capital imports (excluding lumpy items)	0.9	-1.2	11.0	-3.1	3.6
Loans for the construction sector					
Approval	-16.7	-24.5	21.4	46.0	35.4
Disbursement	4.4	13.8	3.2	5.7	4.4

[1] Works such as site preparation, electrical installation and painting
[2] Industrial Production Index (2010=100)
[3] Apr-May 2015
[4] Jan-May 2015

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

Performance of the Agriculture Sector

	Share in 2014 (%)	2014		2015		
		2Q	1H	1Q	2Q	1H
		Annual change (%)				
Value Added (at constant 2010 prices)	**100**	**6.7**	**4.6**	**-4.7**	**4.6**	**0.0**
Industrial Crops	**62.7**	**8.7**	**4.6**	**-11.0**	**6.2**	**-2.4**
Of which:						
Oil palm	47.9	12.8	7.8	-11.7	10.4	-0.4
Rubber	6.9	-16.1	-13.2	5.0	-5.2	0.8
Food Crops	**37.3**	**5.0**	**6.2**	**4.0**	**2.5**	**3.3**
Of which:						
Fishing	8.6	-0.5	1.6	4.4	-0.1	2.2
Livestock	10.8	6.3	7.4	4.3	3.1	3.7

Source: Department of Statistics, Malaysia

Performance of the Mining Sector

	Share 2014 (%)	2014		2015		
		2Q	1H	1Q	2Q	1H
		Annual change (%)				
Value Added (at constant 2010 prices)	**100**	**2.1**	**1.0**	**9.6**	**6.0**	**7.8**
Production						
Of which:						
Crude oil and condensates	-	1.8	-0.9	20.4	14.4	17.4
Natural gas	-	1.8	2.0	-1.2	-2.7	-2.0

Source: Department of Statistics, Malaysia

Headline inflation increased in the second quarter

Inflation, as measured by the annual change in the Consumer Price Index (CPI), increased to 2.2% in the second quarter of 2015 (1Q 2015: 0.7%) reflecting mainly the impact of the implementation of the Goods and Services Tax (GST), which replaced the Sales and Services Tax (SST) on 1 April. The price increases were broad-based, with all twelve categories of the CPI basket registering higher inflation in the second quarter compared to the first quarter. Meanwhile, prices in the *transport* category declined at a lower rate of 3.6% in the second quarter (1Q 2015: -7.6%) reflecting the upward adjustment of domestic fuel prices.

The Producer Price Index (PPI) declined further on an annual basis in the second quarter (2Q 2015: -6.1%, 1Q 2015: -5.4%), driven mainly by lower prices in the *mineral, fuels and lubricants* and *animal and vegetable oils and fat* categories, due to the lower prices of global commodities. Prices of commodity-related components declined further by 19.1% (1Q 2015: -16.7%). Meanwhile, prices of non-commodity-related components increased at a relatively steady rate of 1.4% during the quarter (1Q 2015: 1.1%).

Consumer Price Index

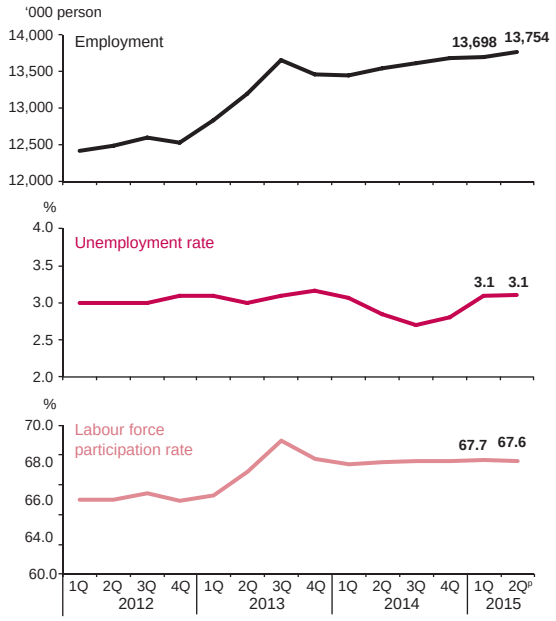
Category	Weights (%) (2010=100)	1Q 2015	2Q 2015
		Annual change, %	
Total	**100.0**	**0.7**	**2.2**
Food and non-alcoholic beverages	30.3	2.5	3.3
Housing, water, electricity, gas and other fuels	22.6	2.1	2.5
Transport	14.9	-7.6	-3.6
Others	32.2	1.6	3.6

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Stable labour market conditions

Labour market conditions remained broadly stable during the second quarter[2]. The unemployment rate remained low at 3.1% (1Q 2015: 3.1%), and the labour force participation rate was sustained at 67.6% (1Q 2015: 67.7%). During the quarter, employment was supported by job gains in the services sector, especially in the wholesale and retail as well as the transportation, storage and communications sub-sectors. Meanwhile, total layoffs (which comprise involuntary retrenchments and voluntary separation schemes) reported to the Ministry of Human Resources increased to 3,688 persons (1Q 2015: 3,184 persons). A proportion of these layoffs are partly attributable to corporate restructuring exercises undertaken by a few large firms during the quarter. Nonetheless, demand for labour was broadly sustained in the second quarter, as new job advertisements posted on Jobstreet.com improved to 70,434 posts (1Q 2015: 63,312 posts), mostly driven by higher labour demand in the services, manufacturing and construction sectors.

Labour Market Indicators



Source: Department of Statistics, Malaysia

Wage growth, as reflected by aggregate real wages in the manufacturing sector, continued to expand albeit modestly at 2.3% (1Q 2015: 5.3%). Wage growth was mainly supported by expansion in wages in the export-oriented industries.

External position remained resilient in the second quarter

The current account continued to record a surplus of RM7.6 billion in the second quarter, equivalent to 2.7% of GNI (1Q 2015: RM10.0 billion or 3.7% of GNI). The sizeable surplus is due to a surplus in the goods account, amid a lower deficit in the primary income account.

Balance of Payments[1]

	2014		2015		
	2Q	1H	1Q	2Q	1H
	RM billion				
Current Account	**15.0**	**34.5**	**10.0**	**7.6**	**17.6**
(% of GNI)	*5.7*	*6.6*	*3.7*	*2.7*	*3.2*
Goods	27.3	58.5	27.5	23.3	50.9
Services	-1.6	-2.1	-3.8	-4.6	-8.3
Primary income	-8.0	-14.5	-8.5	-5.1	-13.6
Secondary income	-2.8	-7.4	-5.3	-6.0	-11.3
Financial Account	**-11.0**	**-49.2**	**-29.7**	**2.3**	**-27.4**
Direct investment	-3.8	-18.3	-1.2	-3.9	-5.2
Assets	*-16.5*	*-37.1*	*-9.8*	*-17.8*	*-27.6*
Liabilities	*12.7*	*18.8*	*8.6*	*13.9*	*22.4*
Portfolio investment	7.2	-7.0	-7.9	-11.8	-19.6
Assets	*-10.4*	*-18.0*	*-7.4*	*-8.1*	*-15.4*
Liabilities	*17.6*	*10.9*	*-0.5*	*-3.7*	*-4.2*
Financial derivatives	0.2	-1.3	0.0	-0.4	-0.4
Other investment	-14.5	-22.6	-20.6	18.4	-2.1
Errors & omissions[2]	-5.0	-3.6	4.0	-0.3	3.7
Overall Balance	**-1.0**	**-18.3**	**-15.7**	**8.5**	**-7.2**

Assets: (-) denotes outflows due to the acquisition of assets abroad by residents
Liabilities: (+) denotes inflows due to the incurrence of foreign liabilities
[1] In accordance with the Sixth Edition of The Balance of Payments and International Investment Position Manual (BPM6) by the International Monetary Fund (IMF)
[2] Includes unrealised foreign exchange revaluation gains/losses on international reserves

Source: Department of Statistics, Malaysia

Trade Account

	Share 1H 2015 (%)	2014		2015		
		2Q	1H	1Q	2Q	1H
		Annual change (%)				
Gross Exports	**100.0**	**14.4**	**12.5**	**-2.5**	**-3.7**	**-3.1**
Manufactured	79.5	13.8	13.2	0.1	2.2	1.2
E&E	*35.2*	*13.0*	*12.7*	*6.9*	*3.1*	*4.9*
Non-E&E	*44.3*	*14.4*	*13.5*	*-4.7*	*1.4*	*-1.6*
Resource based	*22.4*	*15.1*	*12.0*	*-12.3*	*-5.5*	*-8.9*
Non-resource based	*21.9*	*13.7*	*15.2*	*4.7*	*9.4*	*7.1*
Commodities	19.9	16.7	10.9	-10.4	-22.9	-16.7
Minerals	*11.5*	*25.2*	*16.0*	*-6.9*	*-35.8*	*-21.4*
Agriculture	*8.4*	*5.6*	*3.9*	*-15.9*	*-2.7*	*-9.3*
Gross Imports	**100.0**	**8.5**	**7.1**	**0.2**	**-5.2**	**-2.6**
Intermediate goods	59.1	2.6	3.4	3.0	-4.6	-0.9
Capital goods	14.3	8.4	0.9	8.4	-12.6	-2.7
Consumption goods	8.8	7.1	11.1	4.4	25.4	15.2
Re-exports and dual-use goods	17.7	31.5	23.3	-15.0	-12.9	-13.9
Trade balance (RM billion)	**–**	**18.5**	**44.8**	**21.3**	**20.4**	**41.7**

Source: MATRADE and Department of Statistics, Malaysia

[2] Based on preliminary data

In the second quarter of 2015, both gross exports and imports recorded a contraction of 3.7% and 5.2%, respectively (1Q 2015: -2.5% and +0.2%, respectively). The decline in gross exports was due mainly to the contraction in exports of commodities and resource-based manufactured products, while the growth of gross imports was weighed down by the weaker performance of all import categories, except for consumption imports. As a result, the trade surplus amounted to RM20.4 billion (1Q 2015: RM21.3 billion).

Commodity exports declined further due mainly to lower prices for major commodities. Of significance, mineral exports were weighed down particularly by the significant decline in LNG prices, reflecting the pricing lag effect between LNG and oil prices. Growth of manufactured exports was supported by expansion in electronics and non-resource based manufactured products. Despite a decline in electrical products, growth of E&E exports expanded at a faster pace due to higher demand for semiconductors and electronics equipment and parts. Exports of non-resource based manufactured products turned around to record a positive growth in 2Q 2015, supported largely by continued expansion in exports of machinery and appliances and stronger demand for manufactures of metal. In terms of destination, exports to the US and PR China continued to expand, while exports to the region declined, reflecting mainly lower exports to Hong Kong, Korea, Chinese Taipei and most of the ASEAN economies during the quarter.

Growth of gross imports declined in the second quarter of 2015, reflecting broad-based decline in major import categories, except for consumption imports. The weak growth of intermediate imports was due mainly to the lower imports of industrial supplies and fuel-related inputs, while the contraction in capital imports was in tandem with the more moderate growth in private investment amid lower imports of transport equipment. Meanwhile, re-export activity remained weak amid lower commodity prices during the quarter. Nevertheless, consumption imports recorded a higher growth, accounted mainly by higher imports of food and beverages and consumer goods, ranging from durable to non-durable goods.

Malaysia: Direction of Exports

	Share 1H 2015 (%)	2014		2015		
		2Q	1H	1Q	2Q	1H
		Annual change (%)				
United States	**9.2**	**13.4**	**8.9**	**14.9**	**4.0**	**9.1**
European Union (EU)	**9.9**	**15.9**	**17.1**	**1.7**	**4.4**	**3.1**
Japan	**9.9**	**12.5**	**10.3**	**-2.5**	**-26.8**	**-14.0**
Selected ASEAN countries[1]	**27.7**	**13.7**	**8.2**	**-2.3**	**-1.0**	**-1.6**
North East Asia	**23.9**	**14.7**	**17.3**	**-7.1**	**2.0**	**-2.6**
People's Republic of China	*12.6*	*3.3*	*9.2*	*-12.6*	*17.1*	*1.8*
Hong Kong SAR	*5.0*	*41.5*	*38.4*	*7.2*	*-7.9*	*-1.0*
Korea	*3.3*	*10.6*	*13.3*	*-8.9*	*-15.5*	*-11.7*
Chinese Taipei	*3.0*	*28.7*	*28.4*	*-3.8*	*-16.9*	*-11.1*
West Asia[2]	**2.9**	**-9.1**	**-5.2**	**-8.0**	**-10.1**	**-9.1**
India	**4.1**	**18.7**	**14.2**	**12.1**	**-2.9**	**3.9**
Total exports	**100.0**	**14.4**	**12.5**	**-2.5**	**-3.7**	**-3.1**

[1]Singapore, Thailand, Indonesia, Philippines, Brunei Darussalam and Vietnam
[2]United Arab Emirates, Saudi Arabia, Oman, Iraq, Qatar, Kuwait, Jordan, Lebanon, Bahrain, Syria, Palestine, Yemen and Iran

Source: Department of Statistics, Malaysia

The services account recorded a higher deficit of RM4.6 billion in the second quarter (1Q 2015: -RM3.8 billion), due mainly to lower travel receipts amid larger services payments. While the decrease in net travel receipts was attributable to a lower number of tourist arrivals, higher payments were mainly payments for trade- and investment-related services, such as transportation, telecommunication, construction and other services.

The primary income deficit narrowed further to RM5.1 billion during the quarter (1Q 2015: -RM8.5 billion), reflecting mainly a higher net receipt of investment income. During the quarter, investment income accrued to Malaysian companies investing abroad was higher, particularly in the mining and services sector. Income accrued to foreign direct investors was sustained. Meanwhile, the higher net payment in the secondary income account (-RM6.0 billion; 1Q 2015: -RM5.3 billion) was due mainly to higher outward remittances, particularly by foreign workers due to festive season.

The **financial account** recorded a net inflow of RM2.3 billion (1Q 2015: -RM29.7 billion), attributed mainly to net inflows in the other investment account.

Direct investment registered a net outflow of RM3.9 billion (1Q 2015: -RM1.2 billion), as the accumulation of direct investment assets more than offset the incurrence of direct investment liabilities.

On the assets side, the accumulation of foreign assets resulted in a higher outward direct investment of RM17.8 billion (1Q 2015: -RM9.8 billion). Of these, **Direct Investment Abroad** (DIA) amounted to RM16.4 billion (1Q 2015: -RM11.1 billion). The bulk of DIA was due to the extension of long-term loans by the national oil company to its affiliated company to facilitate the acquisition of oil and gas-related assets abroad. Meanwhile, DIA by companies in the services and the manufacturing sector remained sizeable.

On the liabilities side, inward direct investment rose to RM13.9 billion (1Q 2015: +RM8.6 billion). Of these, Foreign Direct Investment (FDI) registered a larger inflow of RM12.5 billion (1Q 2015: RM9.9 billion). Higher FDI was due mainly to higher injection of equity capital in the manufacturing sector, particularly for the acquisition of assets in the petrochemical-related industry and capital expenditure in electrical and electronics industry. There were also significant investments into the services and oil and gas sectors.

Portfolio investment recorded a higher net outflow of RM11.8 billion (1Q 2015: -RM7.9 billion). During the quarter, portfolio investment by residents amounted to RM8.1 billion, as fund managers undertook the strategy to diversify into financial assets abroad to enhance returns amid purchases of debt securities by domestic financial institutions. Portfolio investment by non-residents recorded an outflow of RM3.7 billion, due mainly to larger liquidation of equity securities. Meanwhile, there was a small net inflow of debt securities by non-residents, as the redemption of Bank Negara Monetary Notes (BNMNs) upon maturity was offset by the higher purchases of Malaysian Government Securities (MGS), Treasury Bills and the issuances of the Global Sukuk by the Malaysian Government.

Other investment recorded a net inflow of RM18.4 billion (1Q 2015: -RM20.6 billion). During the quarter, the banking sector repatriated maturing interbank deposits which had been placed abroad. At the same time, there was a net placement of interbank deposits by non-resident financial institutions into the domestic banking system. Export-oriented businesses continued to extend trade credit to their overseas trading partners, resulting in a net outflow in the non-bank sector.

Following these developments, the overall balance of payments registered a surplus of RM8.5 billion in the second quarter (1Q 2015: -RM15.7 billion). Errors and omissions amounted to –RM0.3 billion, partly reflecting the foreign exchange revaluation on international reserves.

Manageable external debt

Malaysia's external debt[3] stood at RM794.3 billion, equivalent to USD208.4 billion or 68.1% of GDP as at end-June 2015 (end-March: RM768.1 billion or USD205.1 billion, equivalent to 65.9% of GDP). More than half of the external debt was of medium to long-term tenure (57.1%). By currency, about 40% of the total external debt is denominated in ringgit, mainly in the form of non-resident holdings of ringgit-denominated debt securities and deposits. During the quarter, the rise in external debt reflected partly further valuation effect from the depreciation of the ringgit, apart from net drawdown of external debt.

The ringgit depreciation affected mainly the offshore borrowing which increased by 5.1% to RM419.9 billion as at end-June 2015 (end-March: RM399.3 billion). Offshore borrowing, nevertheless, remained low at 36% of GDP compared to 60% of GDP during the Asian Financial Crisis in 1997-98. The valuation effects of the strengthening of most regional and major currencies against ringgit during the quarter are contained as offshore borrowing by corporations, namely public enterprises and non-bank private corporations, are largely hedged, either naturally through foreign currency earnings, or through the use of financial instruments. A significant share of their borrowings is intercompany loan with flexible and concessionary terms. In addition, banking sector's offshore borrowings are mostly covered by their corresponding external assets.

Excluding foreign exchange revaluation changes, offshore borrowing increased at a more moderate pace of 3.1%, reflecting largely the net drawdown of interbank borrowing associated mainly with the banking sector's centralised foreign currency liquidity management operations. There was also net drawdown of offshore borrowing, consisting mainly intercompany loans by non-bank private corporations. Similarly, the Federal Government recorded a net drawdown during the quarter following the issuances of 10-year and 30-year sukuk amounting to USD1.5 billion. Part of the proceeds from the issuances was used to redeem the USD1.25 billion 1Malaysia Sukuk Global that matured during the quarter. Of significance, the outstanding offshore borrowing by the Federal Government remained low at 4.5% of total offshore borrowing and 1.6% of GDP. During the quarter, there was a net repayment of offshore borrowing by the public enterprises.

Non-resident deposits increased by 4.8% to RM95.7 billion, equivalent to USD25.1 billion as at end-June 2015 (end-March: RM91.3 billion; USD24.4 billion), partly due to the valuation effect of foreign-currency denominated deposits. Excluding valuation effects, non-resident deposits increased by 3.8%. Non-resident holdings of ringgit-denominated debt securities, however, declined to RM209.2 billion (end-March: RM210.5 billion). The decline was largely attributed to the liquidation of BNMNs by non-residents, which was partially offset by the increase in non-resident holdings of the MGS and Treasury Bills.

The share of short-term external debt declined to 42.9% of the total external debt (end-March: 45.1%) due mainly to the lower non-resident holdings of BNMNs. The short-term external debt remained manageable with reserves coverage of 1.1 times. About two-third of the short-term external debt is held by the banking sector, which does not pose an immediate claim on international reserves given that this debt is mostly covered by the banks corresponding external assets. In addition, the bulk of the remaining short-term external debt is trade credits which are generally backed by export earnings.

Outstanding External Debt

	2014		2015
	end-June	end-Mar	end-June
	RM billion		
Offshore borrowing[1]	337.8	399.3	419.9
USD billion equivalent	*104.1*	*106.6*	*110.1*
Medium- and long-term	*205.3*	*242.3*	*256.2*
Public sector	98.7	117.3	119.4
Private sector	106.6	125.0	136.8
Short-term	*132.6*	*157.0*	*163.6*
NR holdings of dom. debt securities	243.8	210.5	209.2
Medium- and long-term	*168.1*	*168.6*	*186.4*
Short-term	*75.8*	*41.9*	*22.8*
NR deposits	84.4	91.3	95.7
Others[2]	64.2	67.0	69.5
Medium- and long-term	*10.0*	*10.9*	*11.0*
Short-term	*54.3*	*56.1*	*58.5*
Total external debt	**730.3**	**768.1**	**794.3**
USD billion equivalent	*225.1*	*205.1*	*208.4*
External Debt (Redefined)			
Total debt/GDP (%)	66.0	65.9	68.1
Short-term debt[3]/Total debt (%)	47.5	45.1	42.9
Reserves/Short-term debt[3] (times)	1.2	1.1	1.1[5]
External Debt (Previous definition)			
Total debt/GDP (%)	30.5	34.3	36.0
Short-term debt[4]/Total debt (%)	39.2	39.3	39.0
Reserves/Short-term debt[4] (times)	3.2	2.5	2.2[5]

[1] Equivalent to the external debt as previously defined, comprised mainly foreign currency loans raised, and bonds and notes issued offshore.
[2] Comprise trade credits, IMF allocation of SDRs and miscellaneous.
[3] Short-term offshore borrowing, NR holdings of short-term domestic debt securities, NR deposits and other short-term debt.
[4] Equivalent to short-term offshore borrowing.
[5] Based on international reserves as at 31 July 2015.

Note: NR refers to non-resident

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

[3] This refers to the external debt as redefined, effective from the first quarter of 2014. Apart from the offshore borrowing covered under the previous definition, the redefined external debt also includes non-resident holdings of ringgit debt securities, non-resident deposits with the banking system and other debt liabilities to non-residents. For more information, please refer to the box article titled 'The Redefinition of External Debt' in the Quarterly Bulletin on Economic and Financial Developments in the Malaysian Economy in the First Quarter of 2014.

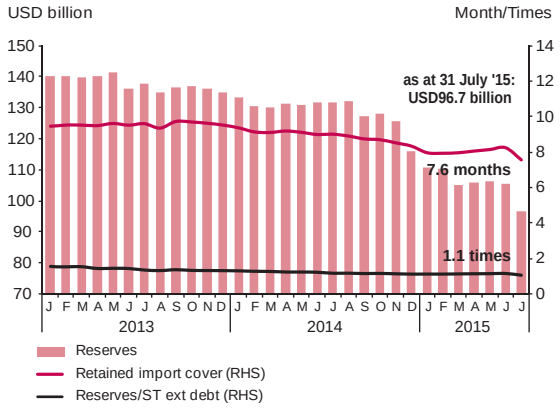
International reserves remained ample to meet international obligations

The international reserves of BNM amounted to RM398.1 billion (equivalent to USD105.5 billion) as at 30 June 2015. This reserves level has taken into account the quarterly adjustment for foreign exchange revaluation changes.

As at 31 July 2015, the reserves position amounted to RM364.7 billion (equivalent to USD96.7 billion). It is sufficient to finance 7.6 months of retained imports, significantly higher than the 3-month international threshold. The reserves to short-term external debt coverage of 1.1 times is adequate for a country with a relatively high degree of financial openness.

The decline in international reserves had been anticipated and is a natural outcome when facing sharp capital reversal. It has fallen below USD100 billion before in the aftermath of the Global Financial Crisis and remained below that level for almost two years from end-2008 to end-2010. The international reserves remain ample to facilitate international transactions without disruptions.

Net International Reserves (as at end period)

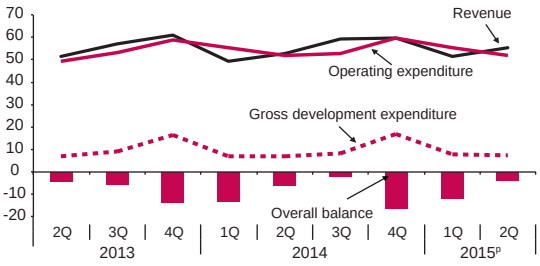


Source: Bank Negara Malaysia

Fiscal position improved in the second quarter due to higher revenue and lower expenditure

In the second quarter of 2015, the Federal Government recorded a lower fiscal deficit of 1.4% of GDP (1Q 2015: -4.2% of GDP). This was due to the sustained increase in revenue amid a smaller increase in operating expenditure. Revenue increased by 4.9% (1Q 2015: 4.8%), due mainly to higher tax collection. Operating expenditure grew marginally by 0.2% (1Q 2015: 0.4%), primarily driven by the lower spending on subsidies. Growth of development expenditure also moderated to 3.5% (1Q 2015: 13.2%), with the bulk of expenditure mainly channelled to the social sector, particularly for housing and higher education. As at end-June 2015, total outstanding debt of the Federal Government amounted to RM627.5 billion or 53.8% of the estimated 2015 GDP.

Federal Government Finance



p Preliminary

Source: Ministry of Finance, Malaysia

Federal Government Finance[p]

	2014		2015		
	2Q	1H	1Q	2Q	1H
	RM billion				
Revenue	52.7	101.8	51.5	55.3	106.8
% annual growth	*2.1*	*6.8*	*4.8*	*4.9*	*4.9*
Operating expenditure	51.7	106.9	55.4	51.8	107.3
% annual growth	*5.2*	*7.9*	*0.4*	*0.2*	*0.3*
Current account	**0.9**	**-5.1**	**-3.9**	**3.4**	**-0.5**
% of GDP	***0.3***	***-0.9***	***-1.4***	***1.2***	***-0.1***
Net development expenditure	7.0	14.0	7.9	7.3	15.1
% annual growth	*2.7*	*-10.6*	*13.2*	*3.5*	*8.3*
Overall balance	**-6.1**	**-19.1**	**-11.8**	**-3.8**	**-15.6**
% of GDP	***-2.2***	***-3.5***	***-4.2***	***-1.4***	***-2.8***
Memo item:					
Total net expenditure	58.7	120.9	63.3	59.1	122.4
% annual growth	*4.9*	*5.4*	*1.8*	*0.6*	*1.2*
Total Federal Government debt (as at end-period)	568.9	568.9	596.8	627.5	627.5
% of GDP	*51.4*	*51.4*	*51.2*	*53.8*	*53.8*
Domestic debt	397.0	397.0	418.9	429.2	429.2
% of GDP	*35.9*	*35.9*	*35.9*	*36.8*	*36.8*
External debt	171.9	171.9	177.9	198.3	198.3
% of GDP	*15.5*	*15.5*	*15.3*	*17.0*	*17.0*
Non-resident holdings of RM-denominated Federal Government debt	*155.6*	*155.6*	*160.2*	*179.5*	*179.5*
% of GDP	*14.1*	*14.1*	*13.7*	*15.4*	*15.4*
Offshore borrowing	*16.2*	*16.2*	*17.6*	*18.8*	*18.8*
% of GDP	*1.5*	*1.5*	*1.5*	*1.6*	*1.6*

p Preliminary

Note: Beginning first quarter of 2015, GDP has been rebased from base year 2005 to base year 2010

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

MONETARY AND FINANCIAL DEVELOPMENTS

Interest rates remained stable

The Monetary Policy Committee (MPC) maintained the Overnight Policy Rate (OPR) at 3.25% during the second quarter of 2015. At the prevailing level of the OPR, monetary conditions remained supportive of economic activity.

Despite increased volatility in international financial markets, interest rates in the domestic money market have remained stable. The average overnight interbank rate traded within a range of 3.16% and 3.25% during the quarter, while interbank rates for other short-term maturities (less than 1 month) were relatively steady. The Kuala Lumpur Interbank Offered Rates (KLIBOR) continued its moderation following BNM's announcement on 30 January 2015 on the arrangements to facilitate transition to the full implementation of the Liquidity Coverage Ratio (LCR) by 2019. Reverse repo operations by BNM to inject liquidity in the interbank market also helped ease the downtrend in rates, especially for the longer tenures. For the quarter as a whole, 3-month KLIBOR declined from 3.73% to 3.69%. 3-month KLIBOR futures remained relatively stable, reflecting market expectation for the policy interest rate to be unchanged.

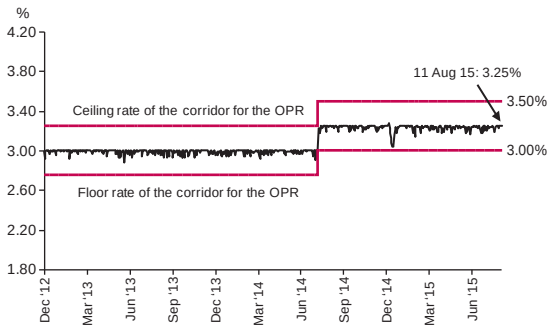
Retail rates in terms of deposit and lending rates were broadly unchanged throughout the quarter. The average fixed deposit (FD) rates of commercial banks for the tenures 1 to 12 months ranged from 3.08% to 3.31%. The average base rate (BR) of banks at the end of the second quarter was slightly lower at 3.88%, as two banks revised their BR downwards in June following the downward trend in KLIBOR. Several other banks followed suit to lower their BR at the beginning of July. Meanwhile, the weighted average lending rate (ALR) on outstanding loans declined slightly (end-June 2015: 5.44%; end-March 2015: 5.48%).

Interest Rates

	2014	2015	
	2Q	1Q	2Q
	At end-period (%)		
Overnight Policy Rate (OPR)	3.00	3.25	3.25
Interbank rates			
Overnight	3.00	3.24	3.24
1-month	3.54	3.28	3.48
Base lending rate (BLR)			
Commercial banks	6.53	6.79	6.79
Base rate (BR)			
Commercial banks	-	3.90	3.88
Weighted average lending rate			
Commercial banks	5.37	5.48	5.44
Fixed deposit rates			
Commercial banks			
1-month	2.91	3.08	3.08
12-month	3.15	3.31	3.31

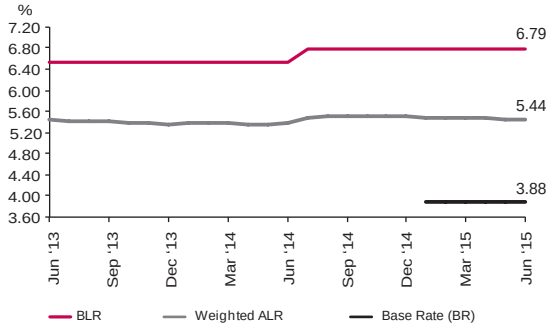
Source: Bank Negara Malaysia

Daily Weighted Average Overnight Interbank Rate



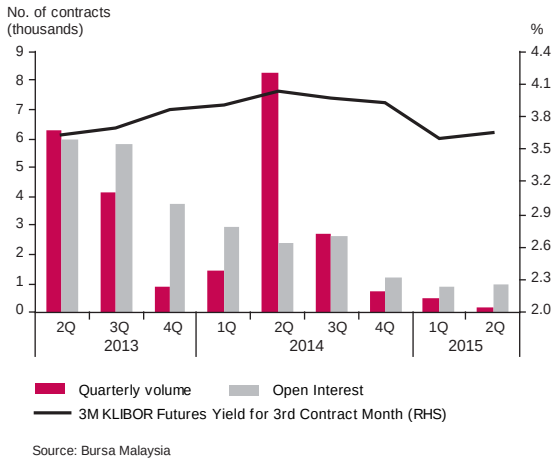
Source: Bank Negara Malaysia

Lending Rates of Commercial Banks (At end-period)



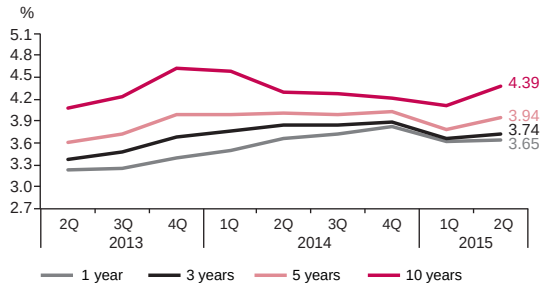
Source: Bank Negara Malaysia

3 Month KLIBOR Futures



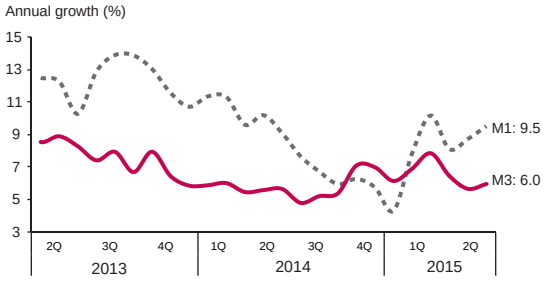
Source: Bursa Malaysia

Interest Rate Swap: Rates



Source: Bloomberg

Monetary Aggregates



Source: Bank Negara Malaysia

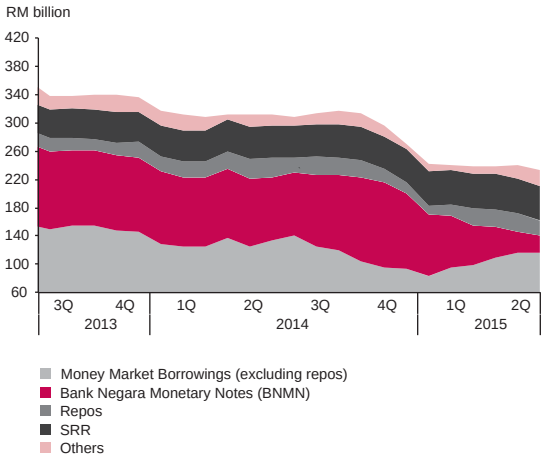
M3 moderated during the quarter

M1, or narrow money, increased marginally by RM0.2 billion during the quarter. On an annual basis, M1 grew at a rate of 9.5% as at end-June (end-March 2015: 10.2%). M3, or broad money, declined by RM7.2 billion on a quarter-on-quarter basis while still recording an annual growth rate of 6.0% as at end-June (end-March 2015: 7.9%).

The decrease in M3 during the quarter was driven mainly by lower net claims on the Government, reflecting private sector purchase of Malaysian Government Securities (MGS) and Government Investment Issues (GII), which were raised in anticipation of the maturity of Government bonds in 2H 2015. The moderation in M3 was also on account of lower net foreign assets of the financial system following net external outflows during the quarter. Nevertheless, the decrease in M3 was partially offset by the continued extension of credit to households and businesses.

In the banking system, liquidity conditions remained ample at both the institutional and system-wide levels. The level of surplus liquidity placed with BNM was relatively stable during the quarter. Nevertheless, the composition of monetary instruments used to absorb surplus liquidity was adjusted to provide banks with greater flexibility in managing their liquidity position. In particular, the issuance of BNM bills were replaced with other instruments of a shorter maturity, such as money market borrowings and repos, allowing the surplus liquidity of banks placed with BNM to mature more frequently so that banks can meet any sudden withdrawal of funds due to foreign outflows.

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



Source: Bank Negara Malaysia

Determinants of Broad Money, M3

	Change during the period				
	2014		2015		
	2Q	1H	1Q	2Q	1H
	RM billion				
M3	**19.5**	**41.2**	**35.9**	**-7.2**	**28.7**
Net claims on Government	2.9	9.9	-4.6	-20.4	-25.1
Claims on private sector	29.0	53.4	28.2	22.6	50.8
Loans	*26.5*	*51.1*	*25.1*	*21.7*	*46.9*
Securities	*2.6*	*2.3*	*3.1*	*0.9*	*4.0*
Net foreign assets[1]	4.6	8.4	-1.5	-13.9	-15.4
BNM	*3.1*	*-14.9*	*-25.0*	*-2.1*	*-27.1*
Banking System	*1.5*	*23.3*	*23.5*	*-11.8*	*11.7*
Other influences	-17.0	-30.5	13.8	4.5	18.3

[1] Pre-revaluation

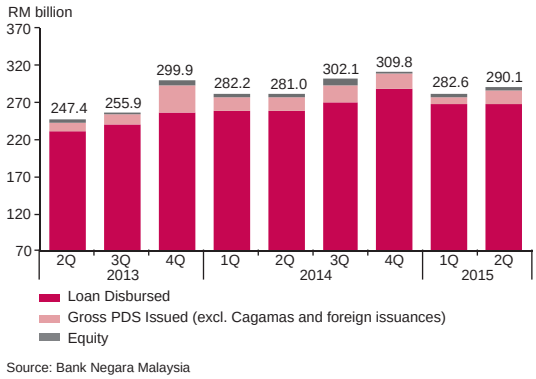
Note: Numbers may not add up due to rounding

Source: Bank Negara Malaysia

Private sector financing activity was sustained in the second quarter

In the second quarter, total gross financing raised by the private sector through the banking system and the capital market amounted to RM290.1 billion (1Q 2015: RM282.6 billion). On a net basis, outstanding banking system loans and PDS expanded at a stable growth rate of 8.3% during the quarter (1Q 2015: 8.3%).

Gross Private Sector Financing through the Banking System and Capital Market

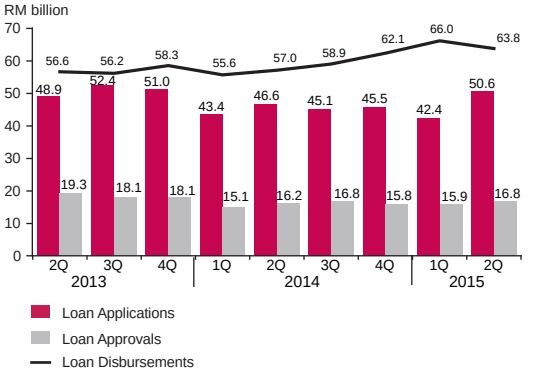


Source: Bank Negara Malaysia

Net lending to businesses by the banking system expanded by RM8.1 billion during the quarter (1Q 2015: RM9.8 billion). On an annual basis, outstanding business loans grew at a slower pace of 8.7% as at end-June (end-March 2015: 8.9%). Nonetheless, the amount of loans disbursed to businesses increased during the quarter with a higher level of credit being extended mainly to the *wholesale and retail trade, and restaurants and hotels; manufacturing; agriculture* and *transport, storage and communication* sectors. In particular, financing for SMEs continued to be strong, with outstanding SME loans growing at a steady rate of 17.2% (1Q 2015: 17.2%). Demand for new financing by businesses remained strong, with higher loan applications compared to the previous quarter by both large corporates and SMEs. This was matched by higher loan approvals to both segments.

Net financing to the household sector expanded by RM12.9 billion in the second quarter (1Q 2015: RM16.3 billion). On an annual basis, outstanding household loans growth moderated to 8.7% during the quarter (1Q 2015: 9.8%).

Bank Lending to SMEs



Source: Bank Negara Malaysia

Financing of the Private Sector through the Banking System and Capital Market

	During the period (RM billion)					Annual growth (%)				
	2014		2015			2014		2015		
	2Q	1H	1Q	2Q	1H	2Q	1H	1Q	2Q	1H
Gross total financing	**281.0**	**563.2**	**282.6**	**290.1**	**572.7**	**13.6**	**14.8**	**0.1**	**3.2**	**1.7**
Loans disbursed	258.1	516.5	267.4	266.7	534.1	11.5	14.4	3.5	3.3	3.4
Gross PDS[1]	17.7	37.3	10.5	20.1	30.6	59.8	12.6	-46.5	13.4	-18.0
Equity	5.2	9.4	4.7	3.3	8.0	7.2	61.2	11.3	-36.4	-15.0
Net total financing (A)+(B)	**28.8**	**61.1**	**26.0**	**32.2**	**58.2**	**9.1**	**9.1**	**8.3**	**8.3**	**8.3**
Banking system	27.7	49.9	23.7	27.1	50.9	9.2	9.2	9.2	8.9	8.9
*Loans outstanding (A)**	*25.8*	*46.8*	*22.2*	*25.8*	*48.0*	*9.3*	*9.3*	*9.2*	*9.1*	*9.1*
Holding of PDS	*1.9*	*3.1*	*1.5*	*1.3*	*2.9*	*7.4*	*7.4*	*8.2*	*7.4*	*7.4*
PDS outstanding (B)	3.0	14.3	3.8	6.4	10.2	8.5	8.5	5.4	6.1	6.1
Memorandum item										
Gross PDS[2]	18.5	39.1	10.9	20.5	31.5	56.5	13.4	-46.8	10.8	-19.5

* Banking systems loans include loans sold to Cagamas
[1] Excluding Cagamas and foreign issuances
[2] Including Cagamas and foreign issuances
Note: Numbers may not add up due to rounding

Source: Bank Negara Malaysia

Loan Indicators

	During the period (RM billion)					Annual growth (%)				
	2014		2015			2014		2015		
	2Q	1H	1Q	2Q	1H	2Q	1H	1Q	2Q	1H
Total										
Loan applications	207.2	392.9	178.5	207.4	385.9	-0.7	-0.8	-3.9	0.1	-1.8
Loan approvals	98.1	189.3	94.0	102.5	196.5	-5.6	-1.1	3.1	4.5	3.8
Loan disbursements	258.1	516.5	267.4	266.7	534.1	11.5	14.4	3.5	3.3	3.4
Loan repayments	239.7	485.6	255.6	243.4	499.0	15.5	16.9	4.0	1.5	2.8
Change in loans outstanding*	25.8	46.8	22.2	25.8	48.0	9.3	9.3	9.2	9.1	9.1
Of which:										
Business enterprises[1,2]										
Loan applications	91.2	177.5	78.4	97.6	176.0	-0.4	0.7	-9.1	6.9	-0.8
Loan approvals	35.1	69.9	39.9	47.0	86.9	-18.1	-9.6	14.5	33.8	24.2
Loan disbursements	180.9	364.9	189.0	193.2	382.2	14.1	18.6	2.7	6.8	4.8
Loan repayments	175.8	355.4	187.8	178.0	365.8	21.3	22.9	4.6	1.2	2.9
Change in loans outstanding*	8.3	19.3	9.8	8.1	17.9	7.3	7.3	8.9	8.7	8.7
SMEs[1]										
Loan applications	46.6	90.0	42.4	50.6	93.0	-4.8	-2.8	-2.4	8.6	3.3
Loan approvals	16.2	31.3	15.9	16.8	32.7	-15.8	-11.1	5.5	3.7	4.6
Loan disbursements	57.0	112.6	66.0	63.8	129.9	0.7	0.4	18.9	11.9	15.4
Loan repayments	53.9	106.5	60.3	61.4	121.7	4.7	3.4	14.4	14.0	14.2
Change in loans outstanding*	5.4	12.5	14.5	6.6	21.0	11.2	11.2	17.2	17.2	17.2
Large corporations[2]										
Loan applications	44.6	87.5	36.1	47.0	83.0	4.6	4.6	-15.8	5.2	-5.1
Loan approvals	18.9	38.7	24.0	30.2	54.2	-20.0	-8.4	21.3	59.7	40.1
Loan disbursements	123.8	252.2	123.0	129.3	252.3	21.6	29.0	-4.2	4.5	0.0
Loan repayments	122.0	248.8	127.5	116.6	244.1	30.5	33.7	0.6	-4.4	-1.9
Change in loans outstanding*	2.9	6.8	-4.7	1.5	-3.2	4.3	4.3	2.3	1.7	1.7
Households										
Loan applications	116.0	215.4	100.1	109.8	209.9	-0.9	-1.9	0.7	-5.4	-2.6
Loan approvals	63.0	119.3	54.1	55.5	109.7	3.2	4.7	-3.9	-11.9	-8.1
Loan disbursements	77.3	151.7	78.4	73.5	151.9	5.8	5.5	5.4	-4.9	0.1
Loan repayments	63.9	130.2	67.8	65.4	133.2	1.9	3.3	2.2	2.3	2.2
Change in loans outstanding*	18.5	34.5	16.3	12.9	29.2	11.5	11.5	9.8	8.7	8.7

* The annual growth is for end-period.
[1] Include loans to individual businesses.
[2] Include domestic financial institutions, government, domestic other entities and foreign entities, except for loan outstanding which refers to businesses only.
Note: Numbers do not add up due to rounding

Source: Bank Negara Malaysia

Loans by Sector

	Loans disbursed						Loans out-standing
	During the period (RM billion)					Share of total (%)	Share of total (%)
	2Q 2014	1H 2014	1Q 2015	2Q 2015	1H 2015		
Business enterprises[1,*]	**180.9**	**364.9**	**189.0**	**193.2**	**382.2**	**71.6**	**43.0**
Large corporations[1]	*123.8*	*252.2*	*123.0*	*129.3*	*252.3*	*47.2*	*25.2*
*SMEs**	*57.0*	*112.6*	*66.0*	*63.8*	*129.9*	*24.3*	*17.8*
Selected sectors[1]							
Agriculture, hunting, forestry and fishing	7.2	15.9	8.8	13.6	22.4	4.2	2.5
Mining and quarrying	3.9	7.4	7.0	3.9	10.9	2.0	0.9
Manufacturing	52.8	107.2	50.4	51.8	102.2	19.1	7.3
Construction	14.5	31.3	17.4	15.3	32.7	6.1	4.2
Real estate	11.7	24.7	13.3	12.1	25.3	4.7	6.4
Electricity, gas and water supply	2.1	4.7	1.8	2.5	4.3	0.8	0.8
Wholesale and retail trade, restaurants and hotels	52.8	106.5	47.0	49.0	96.0	18.0	7.4
Transport, storage and communication	7.4	13.1	6.1	6.7	12.8	2.4	2.5
Finance, insurance and business services	21.2	40.1	24.9	23.2	48.1	9.0	6.9
Households	**77.3**	**151.7**	**78.4**	**73.5**	**151.9**	**28.4**	**57.0**
Purchase of residential properties	20.0	39.7	21.0	21.7	42.7	8.0	28.1
Consumption credit	42.1	82.4	44.4	40.8	85.2	16.0	17.2
Of which:							
Credit cards	*24.5*	*48.7*	*26.3*	*24.0*	*50.2*	*9.4*	*2.5*
Purchase of passenger cars	*9.6*	*18.6*	*10.8*	*9.3*	*20.1*	*3.8*	*10.3*
Others	15.2	29.6	13.0	11.0	24.0	4.5	11.7
Total	**258.1**	**516.5**	**267.4**	**266.7**	**534.1**	**100.0**	**100.0**

* Include loans to individual businesses.
[1] Include domestic financial institutions, government, domestic other entities and foreign entities.
Note: Numbers do not add up due to rounding

Source: Bank Negara Malaysia

Higher net funds raised in the capital market

Net funds raised in the capital market increased to RM39.3 billion in the second quarter (1Q 2015: RM21.0 billion). The increase was due mainly to higher net issuances of government and private debt securities.

Net funds raised by the public sector increased during the quarter to RM30.1 billion (1Q 2015: RM13.2 billion). Funds were raised through new issuances of a 5-year Malaysian Government Security (MGS) and 3-year and 10-year Government Investment Issue (GII), as well as the re-opening of a 7-year, 10-year and 20-year MGS and 5-year and 7-year GII. Additionally, funds were raised via a RM3.5 billion issuance of the Government Housing Sukuk. There were no redemptions during the quarter.

In the private sector, net funds raised were also higher at RM9.1 billion (1Q 2015: RM7.8 billion), due mainly to higher net issuances of private debt securities (PDS). Funds raised in the PDS market were mainly driven by issuances in the *finance, insurance, real estate and business services* sector. Meanwhile, equity issuances during the quarter moderated to RM3.3 billion (1Q 2015: RM4.7 billion).

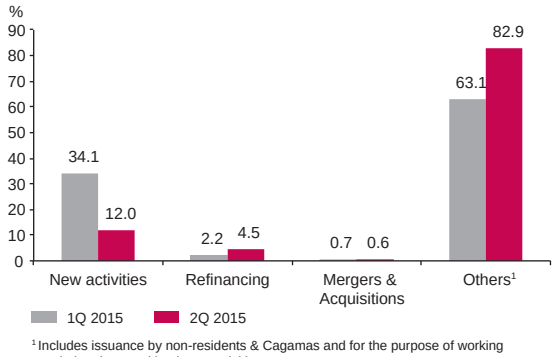
Net Funds Raised in the Capital Market

	2014		2015		
	2Q	1H	1Q	2Q	1H
	RM billion				
By Public Sector	**8.5**	**32.5**	**13.2**	**30.1**	**43.3**
Government Securities, *Gross*	24.6	52.1	27.0	30.1	57.1
Malaysian Government Securities	11.9	26.4	13.5	12.5	26.0
Government Investment Issues	10.0	19.1	9.5	14.1	23.6
Sukuk Pinjaman Perumahan Kerajaan	*2.6*	6.6	4.0	3.5	7.5
Less: Redemptions	16.0	19.5	13.8	-	13.8
Malaysian Government Securities	16.0	16.0	11.8	-	11.8
Government Investment Issues	-	3.5	2.0	-	2.0
Sukuk Pinjaman Perumahan Kerajaan	-	-	-	-	-
By Private Sector	**8.7**	**24.0**	**7.8**	**9.1**	**16.9**
Shares	5.2	9.4	4.7	3.3	8.0
Private Debt Securities, *Net*	3.5	14.7	3.1	5.8	9.0
Private Debt Securities, Gross	*18.5*	*39.1*	*10.9*	*20.5*	*31.5*
Less: Redemptions	*15.0*	*24.4*	*7.8*	*14.7*	*22.5*
Total	**17.2**	**56.6**	**21.0**	**39.3**	**60.2**

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

Source: Bank Negara Malaysia and Bursa Malaysia

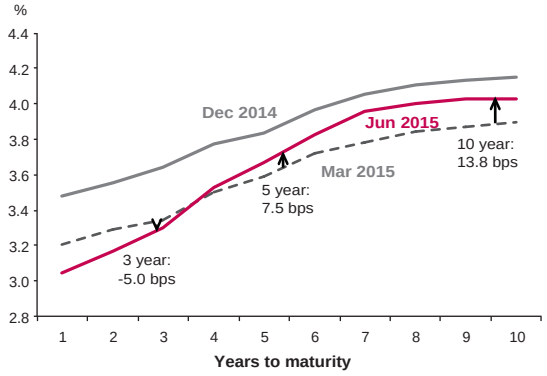
Private Debt Securities Issued by Purpose (% of total)



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

Source: Bank Negara Malaysia

Trend in MGS Yields

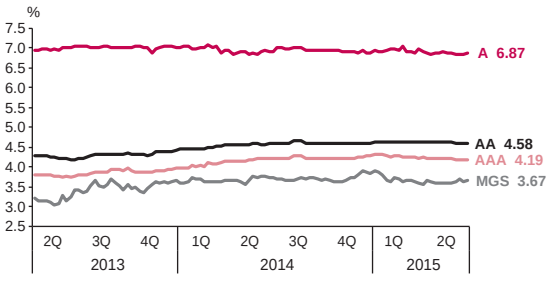


Source: Bank Negara Malaysia

Marginal increase in medium- to long-term bond yields

Despite increased volatility in the global financial markets, MGS yields remained broadly stable in the first two months of the second quarter. Beginning June, however, MGS yield curve steepened due to the sell-off by investors in the medium- and long-term bonds amid increased expectations of an interest rate hike by the Fed. This was also observed in other regional bond markets. Short-term yields remained on a downward trend on account of continued buying by investors amid market expectations for an unchanged overnight policy rate. For the quarter as a whole, yield on the 3-year declined by 5 basis points while the 5-year and 10-year MGS yields increased marginally by 7.5 and 13.8 basis points respectively. In the PDS market, yields remained stable on account of sustained demand by domestic investors.

5 year MGS and 5 year Corporate Bond Yield

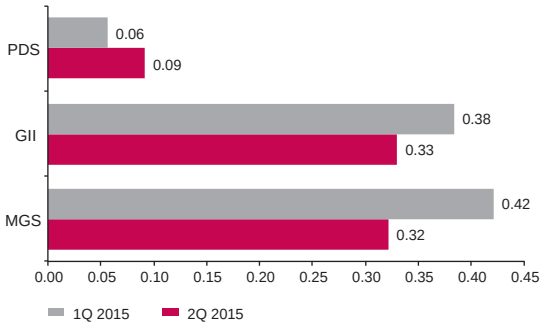


Source: Bank Negara Malaysia

Secondary trading in the bond market declined

Total trading in the secondary market was lower at RM218.5 billion during the quarter (1Q 2015: RM238.4 billion), as investors remained cautious from the increased volatility in the global financial markets. The decline in turnover was mainly concentrated in the trading of MGS and GII which registered lower liquidity ratio of 0.32 and 0.33 respectively.

Liquidity Ratio: Value of Bond Traded / Outstanding



Source: Bank Negara Malaysia

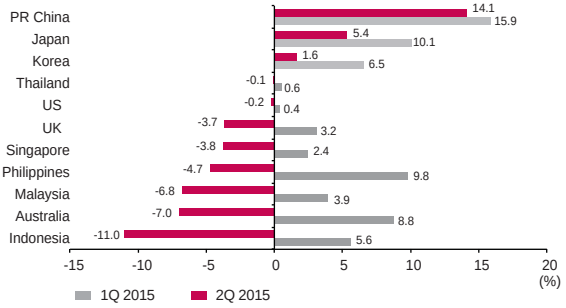
FBM KLCI declined during the quarter

The FBM (FTSE Bursa Malaysia) KLCI declined by 6.8% to close at 1,706.6 points as at end-June 2015 (end-March 2015: 1,830.8 points). The decline was mainly driven by the liquidation of non-resident investors holdings amid increased expectations of an interest rate hike by the Fed before the year-end. In tandem with regional equity markets, sentiments were further affected towards the end of the quarter amid heightened investors' risk aversion following concerns on Greece debt crisis.

Overall, market capitalisation declined to RM1.66 trillion as at end-June 2015 (end-March 2015: RM1.74 trillion) while the daily average turnover declined to 1.92 billion units (1Q 2015: 2.11 billion units) during the quarter.

On 11 August 2015, the KLCI ended lower at 1636.7 points (since end-June 2015: -4.1%), with market capitalisation of RM1.60 trillion (since end-June 2015: -3.7%).

Performance of Selected Global and Regional Equity Markets in 2015 (% growth QoQ)



Source: Bloomberg and Bank Negara Malaysia calculations

Bursa Malaysia: Selected Market Indicators

	2014	2015	
	As at end		
	June	Mar	June
Price Indices			
Composite	1,882.7	1,830.8	1,706.6
FBMEMAS[1]	13,049.8	12,563.4	11,771.9
ACE Market[2]	6,668.8	7,120.2	6,220.3
Market capitalisation (RM billion)	1,770.4	1,737.5	1,659.0
No. of companies listed	906	903	905
	During the period		
	2Q	1Q	2Q
Average daily turnover			
Volume (million units)	1,876.3	2,107.4	1,918.0
Value (RM million)	2,192.4	2,177.4	2,002.1

[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

	2014				2015					
	2Q		1H		1Q		2Q		1H	
	Billion units	RM billion	Billion units	RM billion	Billion units	RM billion	Billion units	RM billion	Billion units	RM billion
Turnover	118.2	138.1	238.9	265.5	124.3	128.5	120.8	126.1	245.2	254.6
Of which:										
Main Board	91.4	131.8	182.7	251.5	75.8	117.7	72.7	114.1	148.5	231.8
Of which										
Consumer Products	6.2	6.0	14.6	13.2	7.4	6.4	6.2	6.2	13.7	12.6
Industrial Products	16.2	12.5	35.0	25.6	12.8	11.1	14.3	12.4	27.0	23.4
Construction	5.1	7.1	9.1	13.0	3.7	5.9	4.6	7.0	8.3	12.9
Trading/Services	36.4	54.8	70.3	106.7	32.7	55.4	31.2	52.1	63.9	107.6
Finance	3.9	27.0	7.3	45.8	3.5	21.3	3.0	18.3	6.4	39.6
Properties	11.9	9.7	22.4	17.5	5.4	4.8	5.3	4.9	10.7	9.7
Plantations	1.5	5.5	3.2	10.9	1.0	3.5	1.0	3.4	2.0	6.9
Infrastructure	1.5	4.4	3.0	9.1	1.0	4.4	1.1	5.3	2.1	9.7
ACE Market[1]	22.9	5.5	49.8	12.6	41.2	8.7	40.3	9.9	81.5	18.7

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

Source: Bursa Malaysia

Ringgit depreciation driven by external and domestic factors

Movements of the ringgit and other regional currencies continued to be driven by shifts in investor sentiments and portfolio investments throughout the quarter. While weaker US economic indicators in April had initially led to the inflow of funds into regional financial markets, an improvement in economic data in May and June led to a shift in expectations on the timing of interest rate normalisation by the Fed. This shift, together with concerns surrounding developments in Greece led to decreased interest in regional financial assets. The ringgit, however, faced larger adjustments due to lower global crude oil prices and uncertainty over the impending rating agency decision on Malaysia's sovereign credit ratings.

Overall, the ringgit depreciated by 1.8% against the US dollar during the quarter. The ringgit also depreciated against the Japanese yen (-0.1%), the Australian dollar (-2.5%), the euro (-5.2%), and the pound sterling (-7.7%). Against all regional currencies except the Thai baht (2.0%), the ringgit depreciated by between 0.1% and 3.9%.

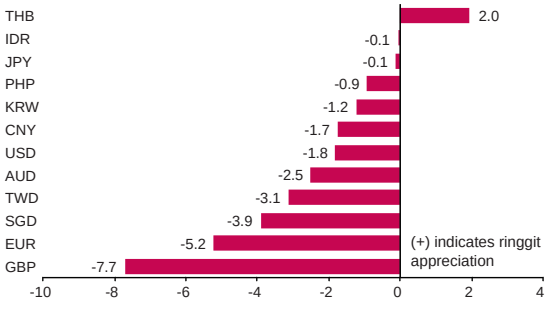
Between 1 July and 11 August 2015, the ringgit depreciated against the US dollar by 4.2%. Against other major currencies, the ringgit also depreciated against the euro (-2.4%), the Japanese yen (-2.4%) and the pound sterling (-3.3%), but appreciated against the Australian dollar (0.3%). The ringgit depreciated against most regional currencies.

Market activity in the foreign exchange derivatives market rose with higher volatility in the financial markets

Foreign exchange derivatives volume grew by 11.0% (qoq) in the second quarter of 2015 (1Q 2015: -5.6%). There was a rise mainly in foreign exchange forward and swap activities by residents, which expanded by 46.9% from 1Q 2015 as local exporters took advantage of the appreciating US dollar to hedge their foreign currency exposure through forward selling of the US dollar. The foreign exchange swap market was also active as interbank players facilitated increased trading and hedging in a more volatile market environment. During the quarter, average 1-month implied ringgit volatility was at 8.9%, slightly above the historical average of 6.0-8.0%

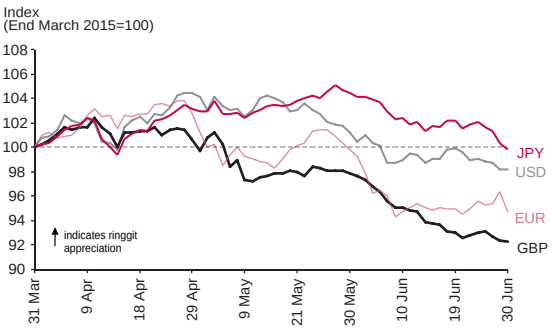
Meanwhile, the implied cost of borrowing US dollar through the cross-currency swap market initially decreased, with the 5-year USD/MYR cross-currency swap falling from 83 bps to 75 bps in April 2015. However, heightened risk sentiment arising from uncertainties on the timing of the Fed rate hike and outcome of Greece debt problems led to a correction back to 83 bps by June 2015.

Summary of Ringgit Performance against Selected Currencies Percent Change (1 April - 30 June 2015)



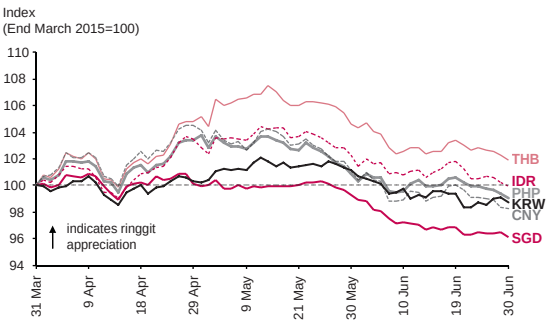
Source: Bank Negara Malaysia

Ringgit Performance against Major Currencies



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 2005	2Q 2014	1Q 2015	2Q 2015	21 Jul 2005	2Q 2014	1Q 2015
US dollar	3.8000	3.2105	3.7165	3.7855	0.4	-15.2	-1.8
Euro	4.6212	4.3806	4.0153	4.2364	9.1	3.4	-5.2
Pound sterling	6.6270	5.4672	5.4935	5.9527	11.3	-8.2	-7.7
Australian dollar	2.8823	3.0235	2.8329	2.9059	-0.8	4.0	-2.5
100 Japanese yen	3.3745	3.1690	3.0903	3.0946	9.0	2.4	-0.1
Singapore dollar	2.2570	2.5703	2.6997	2.8096	-19.7	-8.5	-3.9
100 Thai baht	9.0681	9.8937	11.423	11.205	-19.1	-11.7	2.0
100 Philippine peso	6.8131	7.3589	8.3111	8.3899	-18.8	-12.3	-0.9
100 Indonesian rupiah	0.0386	0.0269	0.0284	0.0284	36.0	-5.3	-0.1
100 Korean won	0.3665	0.3173	0.3342	0.3384	8.3	-6.2	-1.2
100 New Taiwan dollar	11.890	10.751	11.874	12.257	-3.0	-12.3	-3.1
Chinese renminbi	0.4591	0.5172	0.5993	0.6099	-24.7	-15.2	-1.7

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

Source: Bank Negara Malaysia

MANAGING RISKS TO FINANCIAL STABILITY

Domestic financial stability was preserved

Financial system resilience remained intact despite persistent volatility in the global and domestic financial markets during the quarter. The domestic financial markets continued to function in an orderly manner. Combined with continued ample domestic liquidity and institutional soundness, financial intermediation activities continued to function efficiently to support the financial and financing needs of the domestic economy. In the near term, domestic financial system stability is expected to be maintained, thus providing continued support to real sector activities amid a challenging operating environment. Stress tests[4] conducted by the Bank have also shown that banks and insurers are expected to remain well capitalised under a simulated scenario of significant portfolio outflows.

Credit risk exposures remained manageable, underpinned by sustained debt servicing capacity

Credit risk exposures of financial institutions were stable during the quarter supported by sustained debt servicing capacity of most borrowers. Loans-in-arrears of between one and three months remained low at 2.2% (1Q 2015: 2.4%) of total loans. The net loan impairment ratio was unchanged at 1.2%. In the insurance industry, credit exposures, mainly in the form of holdings of private debt securities, increased slightly to 4.1% (1Q 2015: 3.9%) of total capital available.

Credit risk associated with exposures to the household sector remained well-contained on account of continued balance sheet strength of most households. The expansion in household borrowings moderated further to 1.6% for the quarter (1Q 2015: +1.9%). This was driven by the slower growth in outstanding credit card balances and financing for the purchase of securities. On an annual basis, growth in household borrowings also moderated to 8.3% in 2Q 2015 (1Q 2015: +9.1%). Expansion in financing for the purchase of residential properties remained strong at 11.9% (yoy). At the aggregate level, households continued to maintain strong buffers - household financial assets remained above two times of debt. In value terms, financial assets of households were little changed from the preceding quarter as the increase in deposit and deposit-like instruments was moderated by the lower value of equities and unit trust funds, in line with overall financial market performance. On an annual basis, household financial assets recorded a growth of 5.2%. The high quality of loans extended to the household sector was sustained. Impairment and delinquency levels are stable and low at 1.1% and 1.6% of total household borrowings respectively. Overall underwriting standards were also generally sustained, where about 80% of new loans were approved to borrowers with an aggregate debt service ratio not exceeding 60%.

Potential credit losses on exposures to the business sector remained manageable on account of sustained overall financial strength of businesses. Developments in commodity prices and ringgit exchange rates have had limited impact on the debt servicing capacity of most Malaysian businesses. The leverage position of Malaysian businesses[5], as measured by the median debt-to-equity ratio, was stable at 41.3% (4Q 2014: 41.5%) at end-1Q 2015. The median interest coverage ratio (ICR), on the other hand, improved slightly to 6.5 times (4Q 2014: 6.3 times), while the ratio of current assets-to-current liabilities was unchanged at 1.8 times. The strong financials were sustained despite higher borrowings particularly foreign currency debt. Total business sector borrowings grew by 1.4% during the quarter (1Q 2015: +3.5%) driven largely by a strong growth of 11.1% (4Q 2014: +2.4%) in the external debt of non-financial corporations in 1Q 2015. The strong expansion in external debt was attributed to a sizeable

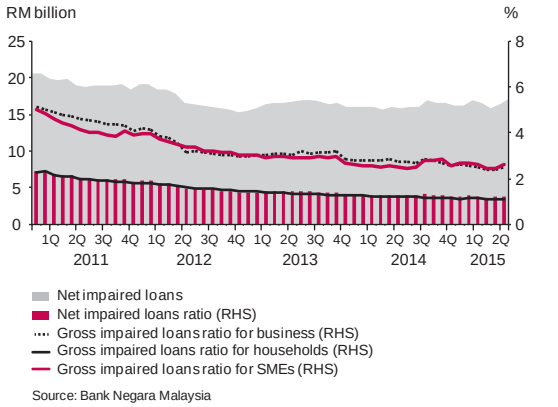
[4] This assessment has incorporated a range of extreme shock parameters, including mark-to-market losses from holdings of equities, interest rate risk in the trading books and foreign currency exposures in the balance sheets and credit losses from businesses affected by significant exchange rate volatility. Based on preliminary data

[5] Based on 160 companies listed on Bursa Malaysia with market capitalisation of 80% (excluding financial institutions) covering 10 key economic sectors

foreign currency denominated bond issuance by a domestic conglomerate in the oil and gas sector. Excluding this issuance, external debt of non-financial corporations only expanded by 3% during the quarter. On a sectoral basis, a higher median ICR was more evident in the domestic-oriented industries (particularly the construction and infrastructure) which benefitted from lower raw material prices. On the other hand, the median ICR for crude and palm oil producers almost halved due to weaker commodity prices but remained sound at 4.5 times, well above the general prudent threshold of two times. The risk of overall potential delinquency, using the expected default frequency as a proxy, was stable at 0.21% (1Q 2015: 0.19%).

The Malaysian House Price Index (MHPI) recorded a moderate increase of 8% in 4Q 2014 (3Q 2014: +7.9%). Preliminary MHPI data indicated a further moderation in its pace of growth for 1Q 2015. The total number of housing transactions remained subdued registering a marginal annual growth of 1.5%, while in value terms, total transactions declined by 3.3%. This trend was partly attributed to less new launches in properties priced above RM1 million. Debt-funded speculative purchases of residential properties remained well-contained, accounting for a stable small share of 2.8% of individuals with existing housing loans.

Banking System: Loan quality



Source: Bank Negara Malaysia

Domestic financial market conditions remained orderly

During the quarter, portfolio investments recorded a net outflow position of RM11.8 billion (1Q 2015: net outflows position of RM7.9 billion), in line with global and regional developments. Average volatility of the FBM KLCI and 10-year MGS yields eased slightly to 8.9% (1Q 2015: 11.7%) and 11.8% (1Q 2015: 13%) respectively. The FBM KLCI ended the quarter lower at 1,706.6 points (1Q 2015: 1,830.8 points) in line with other regional equity markets amid concerns due to the developments in Greece and as investors rebalance investment portfolios in anticipation of the start of a hike in US interest rates. Consequently, overall market capitalisation decreased to RM1.66 trillion (1Q 2015: RM1.74 trillion). The yield curve steepened as yields for the 10-year MGS rose slightly to 4.03% (1Q 2015: 3.89%), while yields at the shorter term of the curve declined (3-year MGS decreased to 3.30% (1Q 2015: 3.35%)) due to strong demand for shorter tenures from foreign investors. The price-to-earnings ratio of the FBM KLCI remained broadly stable at 17 times, underpinned by strong economic fundamentals. Trading liquidity, both in terms of price and volume, also remained intact. The bid-ask spreads for the MGS and FBM KLCI were unchanged at 0.1% and 0.4% of the mid-price respectively. The turnover ratio for the MGS and FBM KLCI was lower at 10.3% (1Q 2015: 14.5%) and 1.8% (1Q 2015: 2%).

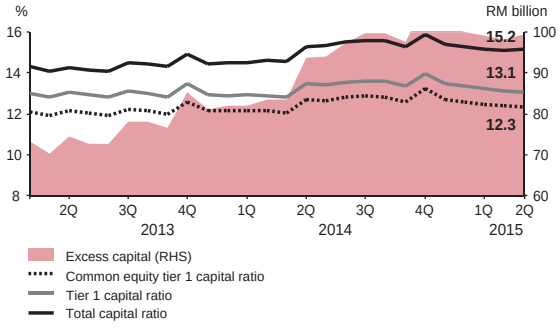
Financial institutions' exposures to market risks were well-contained

Overall risk-taking behaviour of financial institutions was broadly unchanged, with continued active market risk management and hedging strategies observed. Banks' exposures to interest rate risk in the trading book remained limited at 1.4% of total capital. Exposures to equity risk remained small at 0.8% of total capital (1Q 2015: 1.2%). The foreign exchange net open position narrowed marginally to 5.2% (1Q 2015: 5.9%) of total capital during the quarter on account of active management of foreign currency exposures by banks in light of the heightened exchange rate movement in the recent period. Similarly, market risk exposures of the insurance industry remained stable and manageable at 13.3% of total capital. Equity risk continues to form the bulk of insurers' market risk exposures at 7.9% of total capital.

Financial institutions continued to remain sound and resilient

Banks' capitalisation was maintained at strong levels. At end-2Q 2015, the common equity tier-1 capital ratio, tier-1 capital ratio and total capital ratio stood well above the minimum regulatory levels at 12.3%, 13.1% and 15.2% respectively.

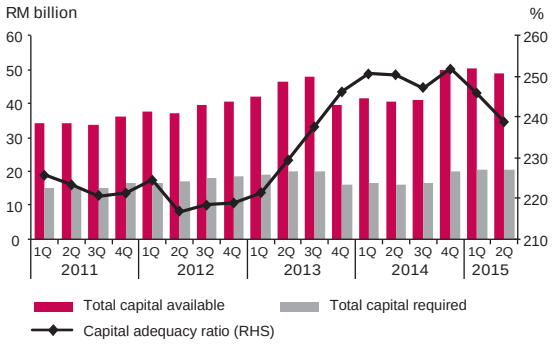
Banking System: Basel III Capitalisation



Source: Bank Negara Malaysia

More than 80% of banks' total capital consists of high quality capital comprising retained earnings, paid-up capital and reserves. The capital buffer of the banking system was sustained in excess of RM100 billion above the regulatory minimum. Similarly, the capital adequacy ratio for the insurance sector remained strong at 239.1% (1Q 2015: 245.7%) with an excess capital buffer of RM28.5 billion.

Insurance Sector: Capitalisation



Source: Bank Negara Malaysia

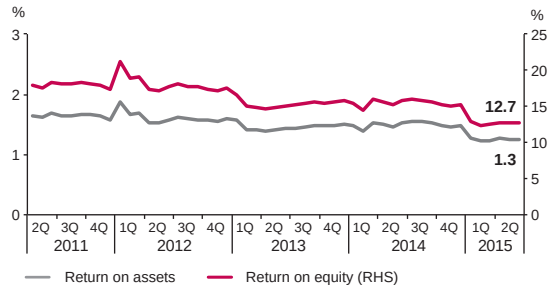
The banking system registered a pre-tax profit totalling RM7.5 billion (1Q 2015: RM7.0 billion) in the second quarter, mainly due to higher contribution of revenue from financing-related activities and dividend income from subsidiaries. Returns on assets and equity were sustained at 1.3% (1Q 2015: 1.2%) and 12.7% (1Q 2015: 12.4%) respectively. The operating profit for the general insurance and takaful operators totalled RM681.7 million (1Q 2015: RM781.1 million) on account of lower underwriting profit, mainly due to higher claims liabilities. Excess income over outgo for the life insurers and family takaful operators declined to RM1.9billion (1Q 2015: RM5.3billion) due to a net capital loss of RM1.1 billion (1Q 2015: net capital gain of RM2.1 billion) arising from higher valuation losses on the equity investments, in line with overall FBM KLCI performance.

Insurance and Takaful Sectors: Indicators

	2014		2015		
	2Q	1H	1Q	2Q	1H
	RM million				
Life insurance & family takaful					
Excess of income over outgo	4,593	7,804	5,336	1,907	7,243
General insurance & general takaful					
Operating profit	804	1,628	781	682	1,463
Claims ratio (%)	57.0	57.0	50.3	57.4	57.4
	Annual Change (%)				
Life insurance & family takaful					
Excess of income over outgo	-0.7	-7.2	66.2	-58.5	-7.2
General insurance & general takaful					
Operating profit	4.3	7.8	-5.2	-15.2	-10.1
Claims ratio (percentage points)	-3.4	-3.4	-4.7	0.4	0.4

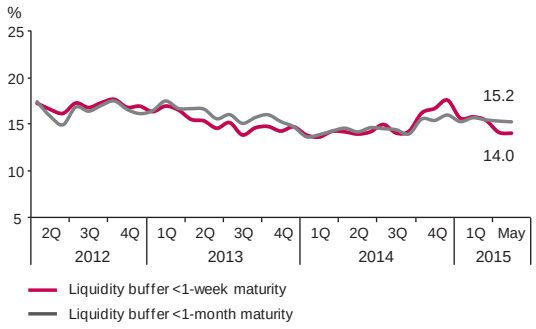
Source: Bank Negara Malaysia

Banking System: Profitability



Source: Bank Negara Malaysia

Banking System: Liquidity Buffer to Total Deposit Ratio



Source: Bank Negara Malaysia

Liquidity in the banking system remained ample. As at end-May 2015, liquidity buffers for maturities over the 1-week and 1-month horizons remained well above the minimum regulatory levels at 14% (1Q 2015: 15.4%) and 15.2% (1Q 2015: 15.4%) of total deposits respectively. Banks recorded USD liquidity surpluses of RM12.4 billion (1Q 2015: surplus of RM20 billion) and RM 5 billion (1Q 2015: surplus of RM2.4 billion) in the less than 1-week and 1-month maturity bucket respectively. At end-June 2015, banks' net interbank placements and reverse repo with Bank Negara Malaysia, which can be unwound to meet liquidity needs, increased to a level above RM120 billion. The Basel III Liquidity Coverage Ratio (LCR) standards came into effect on 1 June 2015 and will be gradually phased in by 2019[6]. At end-June 2015, the banking system LCR stood at 119%, with all banks reporting LCR levels that are comfortably above the current minimum regulatory requirement of 60%. The loan-to-deposit ratio remained stable at 88% at end-June 2015.

Financial institutions' external exposures continued to expand in line with regional operations, including centralised liquidity management, trade and investment activities. During the first quarter of 2015, external assets of banks grew at a faster pace (+11.7) than external liabilities (+1.7%) in line with developments in many of the regional economies. Deposit placements, mainly with banks in Singapore, Hong Kong and US contributed to more than half of the growth in external assets. Net external liabilities of the banking system, largely in the form of custodian-related activities and capital funds of locally incorporated foreign banks, declined to RM110 billion during the first quarter of the year (4Q 2014: RM131 billion).

[6] In the first phase, compliance is set at 60% with progressive increment of 10% each year to the full compliance beginning 2019.

Invest Malaysia 2015 - "Facing Malaysia's Current Economic Challenges" Kuala Lumpur, 23 April 2015

Speech by

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

It gives me great pleasure to be here at Invest Malaysia 2015. This event takes place at a time of major transformative change in the world, in the region and in our country. These changes include the world becoming more inter-connected, integrated and interdependent within and across countries. It also reflects the significant shifts in demographic structures occurring in major parts of the world and the marked transformation in the international financial landscape following the international regulatory reforms prompted by the recent Global Financial Crisis. Slower but nevertheless equally far-reaching are the changes in the institutional arrangements that are altering international and regional circumstances. A further fundamental change is the greater reliance on unprecedented and unconventional monetary policy responses that has brought us into uncharted territory. And finally, the world is also being transformed by the more significant cross-border financial, information and talent flows.

My remarks today will touch on three key areas: the current challenges confronting the global and domestic economy in this new environment; the intrinsic strengths of the Malaysian economy that will enable us to navigate through these more challenging times; and finally on the new changing profile of Malaysia's investment landscape and what it means for the prospects of our economy.

Key Challenges and Prospect for the World and Domestic Economy

We meet today at the time when the international economic and financial environment has become immensely more challenging. To a large extent, this has been due to the significantly higher degree of uncertainty that has prevailed on several fronts in the world today. Firstly, is the uncertainty about the prospects for global growth in the aftermath of the Global Financial Crisis. The persistence of this uncertainty is now having its implication on sentiment and confidence. Secondly, are the conditions in the commodity and financial markets that have become more volatile. The massive shifts in global liquidity are precipitating volatile capital flows with its immense implications on the asset and foreign exchange markets.

Thirdly, is the increased uncertainty prevailing in the policy environment in the global economy in terms of the extent and timing of policy changes. In particular, is the uncertainty with respect to the timing of the exit from the highly accommodative policies and the implications of the divergent monetary policy stance that are being pursued in the major economies. Fourthly, is the uncertainty related to the implementation of the structural reforms to address the structural rigidities and deficiencies that surfaced during the Global Financial Crisis. Fifth and finally, are also considerable geopolitical uncertainties prevailing in the world today. Cumulatively, these developments have compounded the uncertainties surrounding the global economy.

In this environment of great uncertainty, a more moderate recovery of the global economy has been projected for 2015. The most pressing challenge, therefore for the global economy, is to generate an economic recovery that is balanced and sustainable. Although the growth momentum has improved in a number of major economies, the growth has thus far been modest. In addition, weaknesses in several major economies continue to point to a global economy that remains vulnerable to downside risks.

While the growth performance in most emerging economies is projected to moderate, collectively emerging market economies remain an important driver of growth of the world economy. A less robust external sector, slower domestic demand and specific domestic factors are amongst the reasons for this growth performance. In Asia, the growth for 2015 is projected to be sustained at 6.4%, while growth in the ASEAN-5 is projected to be in the region of 5%.

A further phenomenon affecting the global economic performance is the significant decline in global oil prices. While this has partially offset the weaker-than-expected growth momentum in some of the advanced countries, it has, in different degrees, adversely affected the oil exporting economies resulting in divergent growth performance across and within regions. Overall, however, the global economy is expected to benefit from the lower oil prices. A further recent development is the consequences of the unprecedented and divergent monetary policies being pursued in the major economies which have now resulted in significant policy spillovers to other parts of the world. Against this backdrop, the financial markets are therefore expected to remain in a state of heightened volatility during this year.

Given the degree of openness of the Malaysian economy and the financial system, we are of course affected by these global developments. These effects, however, need to be seen from the perspective of our underlying conditions. Malaysia is affected by these external developments through trade and capital flows. The diversified structure of our economy and of our exports has reduced the impact of the effects of the plummeting oil prices on the economy. While the current account of the balance of payments is expected to narrow, it is projected to remain in surplus. The global shifts in liquidity have caused sizeable outflows from emerging economies, including Malaysia, resulting in volatility in our financial markets and depreciations in our currencies. Despite these developments, after a stellar performance in 2014, the economy is projected to remain on a steady growth trajectory with an economic growth being in the region of 4.5 – 5.5% in 2015 with the growth mainly being driven by domestic demand.

Solid Macro Economic Fundamentals

Building the foundations and resilience is the best line of defense to deal with the spillovers from external developments and on future shocks. Malaysia has, over several decades demonstrated time and time again, the ability to emerge from commodity price shocks, financial crisis and spill overs from disruptions generated from other parts of the world. While Malaysia will always be affected by such external developments, the strategy has been to have the flexibility to absorb and adjust and the strength to rapidly rebound. While each crisis or setback has been different, there are several common features that have allowed Malaysia to rapidly recover from such shocks.

For each respective major shock confronting our economy, Malaysia has registered V-shaped recoveries. This has essentially reflected the flexibility of the economy to adjust and the early and comprehensive policy response. The ensuing periods were often marked by structural reforms and institutional development that were designed to rebuild the fundamentals of the economy, address the weaknesses and vulnerabilities and to forge new areas of growth. This has, decade after decade, resulted in vital changes in our economic structure, from being export-led to now being predominantly domestic demand-driven, and from being over-reliant on specific sectors to having a more diversified economic structure with the manufacturing and services sectors having now transitioned to higher value added activities.

In essence, the structure of the economy has now become significantly more diversified in terms of sources of growth. While the export sector remains an integral component of our economy, domestic demand has now become the key driver of growth, anchored by strong private sector activity that now accounts for 70% of GDP. Underpinning the robust domestic demand is the sustained consumption spending and the revival of investment activity by the private sector. On the external balance, the more diversified exports and markets has allowed the balance of payments position to remain sound. Thus, despite the fall in commodity prices, the trade

and current account is expected to remain positive, sustained by manufactured exports while the financial account is expected to adjust in an orderly manner.

During this same period, the financial sector restructuring, rationalisation and reforms, the institutional development, the strengthening of the regulatory, supervisory and legal framework and the development of the domestic financial markets have also diversified the financial sector and has enhanced its ability to disperse external shocks throughout the system. In particular, the financial reforms also involved the transition to greater market orientation and more liberalised financial system which has allowed for greater flexibility to adjust to the effects of shifts in global liquidity. The now deep and robust financial system is also underpinned by high levels of capitalisation and sufficient levels of liquidity. This has ensured that financial intermediation continues to be effective in providing support to economic activity.

It is therefore not the recent policies nor the new measures that have placed Malaysia on a stronger position to manage the external challenges. Rather it is the economic restructuring and financial reforms and development undertaken during the recent two decades and the building of several layers of buffers that has allowed us to weather the current challenging operating environment.

Further solid fundamentals include the relatively low rate of inflation, the low levels of unemployment, the high rate of savings and the manageable levels of external debt with the majority of debt in medium- to long-term tenures and with more than 40% of the external debt being denominated in ringgit. This, together with the ample international reserves, accords the economy with the policy flexibility to manage external risks. The combination of these factors will cumulatively enable a more effective policy response to mitigate the impact of any external shocks on domestic demand. While monetary policy has remained accommodative and access to financing has been enhanced, wide-ranging measures including macro prudential and tax measures have been implemented to rein in excessive leverage and excessive risk-taking to ensure growth is achieved without compromising our future prospects.

Malaysia's New Investment Landscape

As Malaysia progresses, so has the nature and profile of our investments. Compared to the 1990s, the current investment landscape is driven by the private sector, is geographically and sectorally more diverse, and is focused on high value-added activities and new growth areas.

Since 2010, Malaysia has experienced an investment renaissance and continues to benefit from a long-standing track record of being a profit centre for large multinational companies. Malaysia continues to be a recipient of foreign direct investment (FDI). This is also reinforced by a high level of capital spending undertaken by Malaysian companies. Regional economic corridors established has also expanded and transformed the Malaysian investment landscape to be more geographically diverse and extending the development throughout Malaysia.

The emergence of new growth areas in Malaysia such as renewable energy (e.g. solar) and semiconductors in fast-growing segments such as automotive, medical devices and telecommunications, has enabled Malaysia to be plugged into the global supply chain. Investment in the manufacturing sector has moved towards higher value-added activities, shifting from basic production and assembly to producing goods which have advance applications such as in the automotive and healthcare sectors.

As a country which is strategically located within close radius of two of the most populous economies in the world, PR China and India, Malaysia is centrally located in Asia, more broadly, and in ASEAN, in particular. With the conception of the ASEAN Economic

Community (AEC), companies would benefit from the stronger economic inter linkages through greater cross border liberalisation and increased intra-ASEAN trade. Firms in this region will gain greater market access to 630 million people that are generating economic region that is worth USD2.4 trillion.

The increasing importance of Asia in the global economy has raised international interest to better understand Asia - the economies, businesses and the people that comprise the region. On that note, I would like to mention that Bank Negara Malaysia has entered into a collaboration agreement with the Massachusetts Institute of Technology Sloan School of Management (MIT Sloan) to establish the Asia School of Business (ASB) in Kuala Lumpur. ASB is envisioned to be a premier business school that develops transformative and principled leaders that will contribute to a better future and the advancement of the emerging world.

Conclusion

Let me conclude my remarks. We are now experiencing a phase of modest growth in the global economy, in an environment that is characterised by heightened uncertainty and volatile financial markets. The Malaysian economy has withstood these challenging times, supported by our strong initial conditions and early and comprehensive policy responses. The intrinsic strength of the economy, reinforced with policies to encourage greater investments that would serve to ensure greater economic sustainability for the future. Finally, active regionalisation is an important strategy for Asia to enhance regional economic prosperity. Malaysia actively participates in the efforts to strengthen linkages within the ASEAN community and to creating opportunities to foster greater economic integration. These efforts will place ASEAN on a path to realising its economic potential and enable the region to collectively prosper.

ASEAN SME Conference 2015 - "Connecting ASEAN SMEs through Financial Integration" Kuala Lumpur, 27 May 2015

Speech by

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

It is my pleasure to be here this afternoon to speak at this inaugural ASEAN SME Conference. This conference takes place at a challenging and yet exciting time for the ASEAN region. While there continues to be uncertainty on the future prospects for the global economy, the ASEAN economies have demonstrated a high degree of resilience. The ASEAN economies have benefitted from the efforts for more than a decade to strengthen the foundations of our economies and financial systems. Our potential is now being further enhanced by steps to intensify regional economic and financial integration. In particular, ASEAN has taken the opportunity during our period of growth and stability within this decade to remain steadfast in advancing our efforts to forge greater economic and financial integration to unlock the immense opportunities in the region including for the SME business community.

My remarks today will touch on three areas; the significant intrinsic potential of the ASEAN economic bloc, how the SME sector would stand to benefit from these prospects, and how greater financial integration can serve as a catalyst for the growth and development of SMEs.

ASEAN: A Growth Centre in the Global Economy

ASEAN has emerged centre stage in the global economy and has been recognised as one of the most dynamic regions in the world. The region has sustained high economic growth with a long-term average GDP growth of 5.3%, higher than the global growth average of 3.6%. Currently, as a single entity, ASEAN is the 6th largest economy in the world with a GDP close to USD2.5 trillion. With a projected annual GDP growth of 5.4%[1] over the next six years, the region is poised to reach an economic size of USD3.7 trillion by 2020, four times the size it was a decade ago. The strong growth and dynamism of the region is supported by its favourable demographic structure. With a population of more than 630 million people and a burgeoning middle class, ASEAN is rapidly transforming into a thriving hub for consumer demand. By 2020, ASEAN is expected to account for more than USD2 trillion of additional consumption. This is being reinforced by rising incomes in the region, with per capita income almost trebling in this recent decade.

The rapid progress of economic integration in ASEAN has enabled the region to harness the benefits arising from the diversity and complementarities that exist across the ASEAN economies. Amid the strengthening of cross-border supply chains in the region, intra-ASEAN trade and investment activity have increased significantly over these recent 15 years. Intra-regional trade now accounts for almost a quarter of the region's total trade while intra-regional investment activity has quadrupled to 17% of total investment since 2000.

The vibrant SME sectors in the respective ASEAN economies have been an important part of this commendable economic progress. Indeed, going forward, the development and growth of ASEAN SMEs will have significant potential to contribute to the region's prospects and become a key source for the future growth of the region. It is estimated that SMEs would account for between 20 to 50% of GDP across the ASEAN economies, constituting more than 96% of enterprises in the region, and contributing 50 to 80% of total employment.

[1] International Monetary Fund World Economic Outlook (April 2015)

While SMEs continue to contribute significantly to domestic economic growth, intra-regional trade in ASEAN remains driven by large multi-national companies with the SME sector mainly having a supporting role in the regional production network. The next phase of the ASEAN economic integration process should therefore be focused on enhancing the role of SMEs in contributing towards greater cross-border economic activity. To realise this, policy initiatives are being geared to ensure that SMEs in our region will be plugged into the regional and global value chains.

Leveraging on ASEAN's Growth Prospects

The recent drive for the greater economic and financial integration of ASEAN has paved the way for SMEs to expand and thrive. Firstly, ASEAN has enabled SMEs in the region to **gain access to a larger and more extensive marketplace**. The realisation of ASEAN into an integrated economic community means that the potential benefits for SMEs in the region are no longer constrained by national borders. With easier cross-border flow of goods, services, capital and people, ASEAN offers significant market opportunities for SMEs. Given the large consumer base in ASEAN, SMEs can also utilise ASEAN as a platform to strengthen competitiveness before entering into the global market.

Secondly, the **lowering of regulatory barriers to trade** within ASEAN has further increased the potential for SMEs. The standardisation of trade procedures, the removal of tariff and non-tariff barriers and the improvement of regulatory frameworks across the region has been an additional enabling factor. This will not only provide SMEs with a level playing field in conducting businesses across the region, but will also maximise the competitive advantage of the individual ASEAN economies. This is evidenced by the emergence of regional supply chains, where reductions in tariffs on imported raw materials have resulted in lower production costs, while the removal of tariffs on a wide range of finished products for export within ASEAN will also benefit SMEs that trade within the region. Thus, the lowering of tariffs within the region and the large regional market will provide an environment for SMEs to grow and achieve the production scale and efficiency required to compete in the global marketplace. Additionally, an integrated ASEAN market will also serve to facilitate the meeting of global standards as SMEs upgrade to meet the more harmonised compliance requirements across the region.

Thirdly, SMEs will also benefit from the **drive to strengthen connectivity** in the ASEAN region. As highlighted in the Master Plan on ASEAN Connectivity, a comprehensive roadmap of strategies has been outlined to address connectivity challenges on three key areas, namely physical infrastructure, institutions and the people in ASEAN. Increased connectivity across all three dimensions will provide the physical and soft elements needed to create the enabling business environment for SMEs.

Fourthly, various **SME-specific policies by the ASEAN member countries** will also benefit SMEs in the region. This includes the establishment of a regional SME internship programme which has assisted SMEs in seven ASEAN countries to enhance the skills of their employees through structured staff exchanges and capacity building workshops. A further initiative is the recent launch of the online ASEAN Marketplace which aims to provide SMEs with information on the business environment in each respective ASEAN country and a business directory of SMEs to facilitate the access to the markets in the region as well as the potential for collaboration of SMEs across the region. To date, more than 1,000 SMEs across the region have registered with this online portal. It is expected to attract more than 20,000 businesses during the course of this year. Moving forward, the ASEAN Strategic Action Plan for SME Development 2016-2025 will also focus on promoting productivity, technology and innovation, access to financing, enhancing market access and internationalisation, while also enhancing the policy and regulatory environment, and promoting entrepreneurship and human capital development.

Fifth and finally, SMEs in the region will also benefit from **ASEAN's strategic economic linkages** with the greater Asia and with other parts of the world, including the advanced economies and other emerging regions. Several countries have entered into bilateral agreements, including trade agreements with ASEAN to enhance economic cooperation. These multilateral and bilateral engagements have the potential to create many new business opportunities for ASEAN SMEs.

Greater Financial Integration as a Catalyst of Growth for SMEs

Let me now turn to the prospects for greater regional financial integration and its potential to support growth for the ASEAN SMEs. Given the region's high savings rate of approximately 30% of GDP, there is immense scope to benefit from greater financial integration in the region. An intensification of financial integration in ASEAN will serve to enhance the more effective intermediation of funds and thus the efficient allocation of resources in the region. It will allow for excess savings in one country to be channelled into productive investments in another country within the region, thereby acting as a catalyst to achieve a growth that is mutually reinforcing for the economies in the region.

The bulk of ASEAN's surplus funds, however, are currently intermediated mainly through the international financial markets before being reinvested back into the region. In particular, more than 90% of cross-border portfolio investment flows are channelled to the advanced economies. Given the USD 1 trillion infrastructure funding required by ASEAN in the next decade[2], greater financial integration will facilitate the re-channelling of at least a part of the region's surplus funds towards productive investment opportunities in the region. Regional financial integration will also allow for more efficient risk diversification of assets to include foreign assets from within the region. This will not only reduce vulnerability to external developments but will contribute to achieving more stable conditions in the regional financial markets.

Following the development of the domestic financial systems in ASEAN, the next phase of development is to foster greater financial integration in the banking, insurance and capital markets and in the linking of the payment and settlement systems. The growing presence of regional financial institutions will be an important contributor to the development of SMEs in ASEAN. The availability of cross-border financing will enable SMEs to innovate, invest and further expand within the region. Beyond financing, SMEs can also leverage on the extensive networks and advisory services of regional banks to facilitate matching with regional clients and entry into new markets. This can be an important source of information on country-specific dynamics and requirements for the SMEs before venturing into new markets in the region.

The digital age also augurs well for SME businesses. The use of technology such as mobile and internet banking have enabled financial institutions to provide quality and affordable financial services to a regional SME client base. It is paramount for SMEs to embrace these technological enhancements. This includes the adoption of end-to-end supply chain management solutions that integrate the production and financial flows of SME activities, allowing for greater expansion into regional production networks.

Together with digitalisation, the financial integration process will catalyse the convergence of institutional frameworks across ASEAN countries to create a more effective regional financing ecosystem. Such institutional infrastructures and instruments include credit guarantee schemes and credit and collateral registries. Another example is the ASEAN SME Working Group's methodology for the ASEAN Benchmark for SME Credit Rating to facilitate the establishment of credit bureaus in ASEAN member states. Through these credit bureaus, financial institutions would have wider access to reliable credit records of SMEs, thereby

[2] As estimated by the Asian Development Bank.

increasing the access to financing for the SMEs.

The promotion of deeper financial inclusion can be regarded as the final mile in enhancing and enriching the regional financial integration process. The ASEAN Finance Ministers' and Central Bank Governors' Meeting in March this year elevated financial inclusion as a regional policy priority. Indeed, ASEAN will continue to coordinate and intensify efforts to advance financial inclusion, including addressing cross-border financing issues for SME trade financing and investments. This is critical to ensure the benefits of regional integration are experienced by all in the region.

Conclusion

While the future for ASEAN looks promising, ASEAN businesses, including SMEs, need to consider and explore an ASEAN strategy and to view ASEAN as an increasingly integrated market. Having such regional or international perspectives may prove to be a game changer for SMEs, paving a path towards sustained growth, increased job creation, and higher innovation capacity.

A crucial element in the ASEAN economic agenda is the development of the SME sector which will contribute to stronger and more equitable growth in the region. The next frontier for SMEs is to emerge as regional players that are not constrained by the domestic consumer base. SMEs possess the potential to participate in global production networks by riding on ASEAN's intrinsic strengths and prospects, multiple SME-focused policy initiatives as well as the continued wave of regional financial integration. This will allow for the transition for SMEs to benefit immensely from the ongoing regional economic and financial integration and thus contribute towards a balanced and sustainable growth of our region.

CALENDAR OF EVENTS
April – June 2015

9 April 2015

The Massachusetts Institute of Technology Sloan School of Management (MIT Sloan) and the Bank have entered into a 10-year collaboration to establish Asia School of Business (ASB) in Kuala Lumpur. The ASB is envisioned to be a premier business school that develops transformative and principled leaders who will contribute to a better future and the advancement of the emerging world.

The School will offer both degreed and non-degreed programmes to serve the needs of Asia and the broader global economy. The first MBA programme is scheduled to be launched in September 2016, with non-degreed executive education programmes launching in September 2015.

17 April 2015

The Bank and the People's Bank of China signed an agreement to renew its currency swap arrangement for a further term of three years with the size maintained at RMB180 billion / MYR90 billion. The original arrangement was established in 2009 and first renewed in 2012. The renewed bilateral currency swap arrangement reinforces the on-going commitment by both central banks in promoting the use of local currencies for payment settlement. The currency swap arrangement will further reinforce the economic and financial linkages as well as promote bilateral trade and investment flows between Malaysia and PR China.

23 April 2015

In her speech at Invest Malaysia 2015 themed "Facing Malaysia's Current Economic Challenges", Governor Dr. Zeti highlighted that the global economy is experiencing modest growth characterised by heightened uncertainty and volatile financial markets. However, the Malaysian economy has withstood the challenging times, led by strong fundamentals, including a diversified economy, a low and stable inflation rate and robust financial sector as well as comprehensive polices. These will ensure future economic sustainability. She also pointed out the changing nature of investments in the Malaysian economy, increasingly focussed on new growth areas and higher valued-added activities.

25 April 2015

The Bank issued commemorative coins in conjunction with the hosting of the ASEAN 2015 Summit in Kuala Lumpur, Malaysia. The ASEAN 2015 Summit paves the way for the establishment of an ASEAN Community, a key milestone towards realising ASEAN's shared vision of a peaceful, stable and prosperous region. The three pillars that form the basis of the overall ASEAN Community comprises the ASEAN Political Security Community (APSC), ASEAN Economic Community (AEC) and ASEAN Socio-Cultural Community (ASCC). The ASEAN Community reflects the vigorous spirit of togetherness and strong bond between the ten ASEAN member states and their people.

28 April 2015

The Bank announced the appointment of Encik Mohd. Adhari bin Belal Din as Assistant Governor effective 1 May 2015. Encik Mohd. Adhari is responsible for Strategic Management, Human Capital Development Centre, IT Services and Strategic Human Capital Departments.

Meanwhile, Assistant Governor Encik Marzunisham bin Omar, in charge of the Economics, Monetary Policy, International and Statistical Services Departments, was seconded to the International Monetary Fund (IMF) as Executive Director for duration of two years effective 1 May 2015. Arising from this, Assistant Governor Encik Shaik Abdul Rasheed bin Abdul Ghaffour covers this portfolio effective 1 May 2015.

7 May 2015

The Bank decided to maintain the Overnight Policy Rate at 3.25 percent at its third Monetary Policy Committee (MPC) meeting for the year. The MPC's assessment was that the global economic expansion remains moderate, with divergent growth momentum across economies in the first quarter of 2015. In most of Asia, growth has been sustained by the continued expansion in domestic demand. Going forward, global economic growth is expected to improve although at a moderate pace.

For Malaysia, latest indicators suggest that domestic demand has continued to support growth in the first quarter. Looking ahead, the Malaysian economy is expected to remain on a steady growth path, with domestic demand remaining as the key driver of growth. At the current level of the OPR, the stance of monetary policy remains accommodative and supportive of economic activity. The MPC will continue to carefully assess external and domestic developments and their implications on the risks to inflation and the Malaysian economy.

11 May 2015

The Bank launched its first mobile application (app) called "My Ringgit" at Sasana Kijang. "My Ringgit" app is the Bank's latest initiative to educate members of the public about the security features of the Malaysian currency.With the app, users can utilise the 'Feel, Look, Tilt and Check' method to authenticate the security features. The app also features other information such as the handling of counterfeit or soiled currency notes, as well as the locations of Coin Deposit Machines (CoDM).

15 May 2015

At its 1st Quarter 2015 GDP press conference, the Bank announced that the Malaysian economy expanded by 5.6% driven mainly by the private sector demand. On the supply side, growth was supported by the major economic sectors. On a quarter-on-quarter seasonally-adjusted basis, the economy recorded a growth of 1.2% (4Q 2014: 1.8%). Meanwhile, the headline inflation rate averaged significantly lower at 0.7% in the first quarter of 2015, attributed mainly to the decline in prices in the transport category. This follows the downward revision of domestic fuel prices in January and February amid lower global oil prices.

27 May 2015

Governor Dr. Zeti in her speech at the ASEAN SME Conference 2015 - “Connecting ASEAN SMEs through Financial Integration”, said that ASEAN has grown to be one of the most dynamic regions in the world. She also added that its potential is now being further enhanced by intensifying measures in promoting regional economic and financial integration. Amidst these developments, SMEs can emerge as regional players that are not constrained by the domestic consumer base. They also have the ability to participate in global production networks by riding on ASEAN’s strengths and prospects. All these will allow the SMEs sector to contribute towards a balanced and sustainable growth of our region.

Acronyms and Abbreviations

ABIF	ASEAN Banking Integration Framework
ADB	Asian Development Bank
AFI	Alliance for Financial Inclusion
ALR	average lending rate
APN	Asian Payment Network
BI	Bank Indonesia
BIS	Bank for International Settlements
BLR	base lending rate
BNM	Bank Negara Malaysia
BNMN	Bank Negara Monetary Notes
BoE	Bank of England
BoJ	Bank of Japan
BR	Base Rate
CET1	common equity tier 1
CMP	Commodity Murabahah Programme
CoFC	consumption of fixed capital
CPI	Consumer Price Index
DIA	direct investment abroad
DOSM	Department of Statistics, Malaysia
DSR	debt service ratio
E&E	electronics and electrical
E&O	Errors and Omissions
ECB	European Central Bank
EOR	enhanced oil recovery
ETP	Economic Transformation Programme
EU	European Union
FBM KLCI	FTSE Bursa Malaysia Kuala Lumpur Composite Index
FD	fixed deposit
FDI	foreign direct investment
Fed	Federal Reserve
FOMC	Federal Open Market Committee
FSB	Financial Stability Board
FX	foreign exchange
GDP	Gross Domestic Product
GFCF	gross fixed capital formation
GFP	goods for processing
GIFF	Global Islamic Financial Forum
GII	Government Investment Issues
GNI	Gross National Income
GST	Goods and Services Tax

HoA	Heads of Agreement
HQLA	high-quality liquid asset
HSDPA	High-Speed Downlink Packet Access
ICR	interest coverage ratio
IDB	Islamic Development Bank
IILM	International Islamic Liquidity Management
IMF	International Monetary Fund
IT	information technology
JCC	Japanese Crude Cocktail
KLCI	Kuala Lumpur Composite Index
KLIBOR	Kuala Lumpur Interbank Offered Rate
LCR	Liquidity Coverage Ratio
LNG	liquefied natural gas
MGS	Malaysian Government Securities
MHPI	Malaysia House Price Index
MIDA	Malaysian Investment Development Authority
MIER	Malaysian Institute of Economic Research
MoU	Memorandum of Understanding
MPC	Monetary Policy Committee
MSIC	Malaysia Standard Industrial Classifications
NBFI	non-bank financial institutions
OPEC	Organisation of the Petroleum Exporting Countries
OPR	Overnight Policy Rate
PBOC	People's Bank of China
PDS	private debt securities
PMI	Purchasing Managers' Index
PPI	Producer Price Index
PTP	Port of Tanjung Pelepas
QAB	Qualified ASEAN Banks
QE	quantitative easing
RBI	Reserve Bank of India
RM	Ringgit Malaysia
SDA	Special Deposit Account
SME	small and medium enterprise
SNA	System of National Accounts
SNB	Swiss National Bank
SRR	Statutory Reserve Requirement
SST	Sales and Services Tax