BNM Annual Report 2010 & Financial Stability and Payment Systems Report 2010

Briefing to Analysts & Fund Managers

by
Dato' Muhammad bin Ibrahim
Deputy Governor

23 March 2011

Briefing to cover:

- Economic and financial developments in 2010
- Prospects for 2011
- Policy Direction

Malaysian economy expanded strongly by 7.2% in 2010

Annual change (%)	2009	2010[p]
Domestic demand	**-0.5**	**6.3**
Private consumption	0.7	6.6
Public consumption	3.1	0.1
Gross fixed capital formation	-5.6	9.4
Private investment	*-17.2*	13.8
Public investment	*8.0*	5.5
Net exports	**5.0**	**-24.2**
Exports of G&S	-10.4	9.8
Imports of G&S	-12.3	14.7
Real GDP	**-1.7**	**7.2**

[p] preliminary

- Growth driven mainly by robust domestic demand and primarily by private sector activity
- Public sector continued to play a crucial role in supporting the domestic economy in 2010
- External demand, which rebounded strongly in the first half of the year, moderated in the second half-year in tandem with the moderation in global trade

Source: Department of Statistics, Malaysia

Strong growth in all sectors, in line with the robust domestic demand and rebound in exports

Annual change (%)	2009	2010p
Agriculture	0.4	1.7
Mining	-3.8	0.2
Manufacturing	-9.4	11.4
Construction	5.8	5.2
Services	2.6	6.8
Real GDP	**-1.7**	**7.2**

p preliminary

Source: Department of Statistics, Malaysia

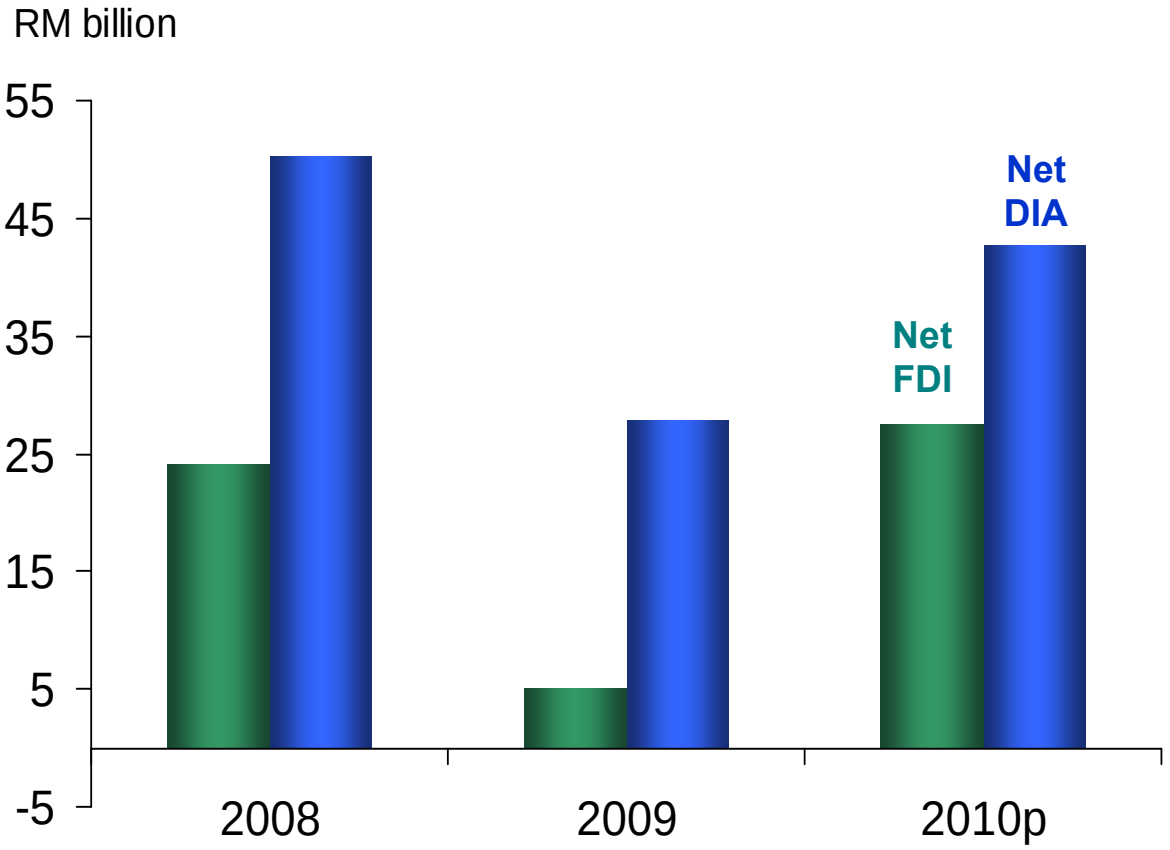
Overall balance of payments remained strong in 2010

	2009	2010[p]
	RM billion	
Current Account	**112.1**	**90.5**
% of GNI	*17.5*	*12.2*
Goods	*141.7*	*136.6*
Services	*4.7*	*0.9*
Income	*-14.6*	*-25.2*
Capital Account	**-0.2**	**-0.2**
Financial Account	**-80.2**	**-21.9**
Direct Investment	**-22.9**	**-15.0**
In Malaysia	*5.0*	*27.6*
Abroad	*-27.9*	*-42.6*
Portfolio Investment	**-1.7**	**44.9**
Financial Derivatives	**2.5**	**-0.8**
Other Investment	**-58.1**	**-51.1**
E & O	**-17.9**	**-71.1**
Rev. Gain (+)/Loss (-)	*10.7*	*-32.6*
Overall Balance	**13.8**	**-2.6**
Reserves	**331.3**	**328.6**
(USD billion equivalent)	**96.7**	**106.5**

- Current account surplus narrowed to 12.2% of GNI
- Financial account recorded smaller net outflow due to higher portfolio and FDI inflows
- Reserves remained high at USD110.4 billion at 15 March 2011

[p] preliminary Source: Department of Statistics, Malaysia

Higher foreign direct investment and direct investment abroad in 2010



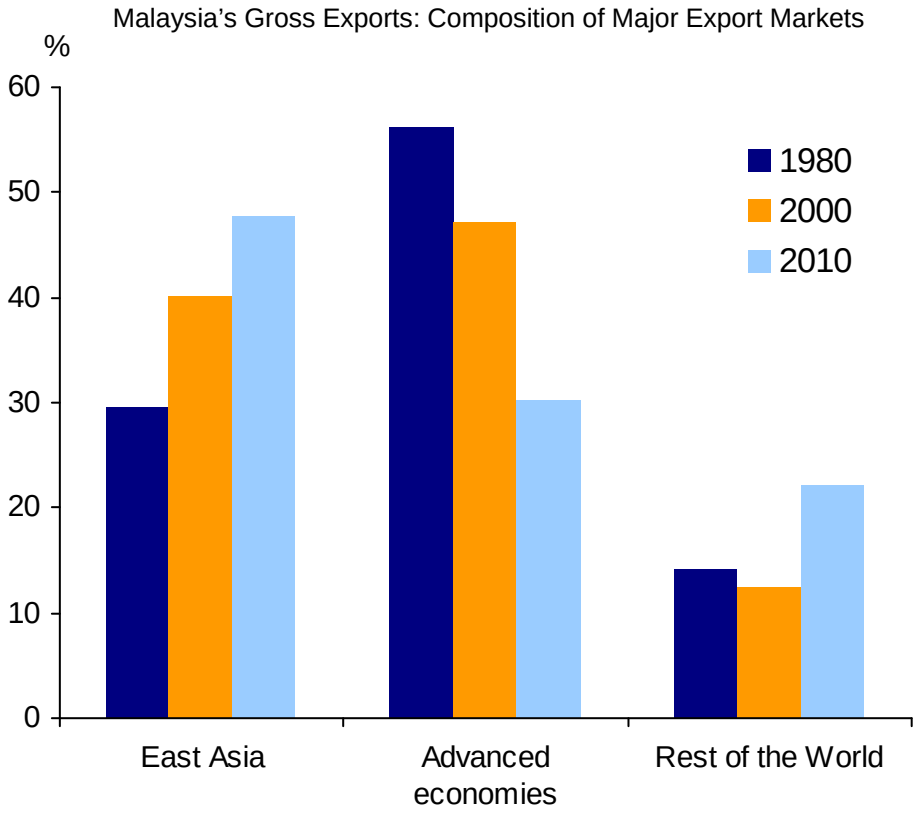
- **Higher FDI inflows**
  - Improved global and domestic economic conditions
  - Better corporate earnings
- **Direct investment abroad (DIA) was also higher**
  - Malaysian companies continued to tap profitable opportunities in other regions
  - Outflows into services, oil and gas and manufacturing

p preliminary

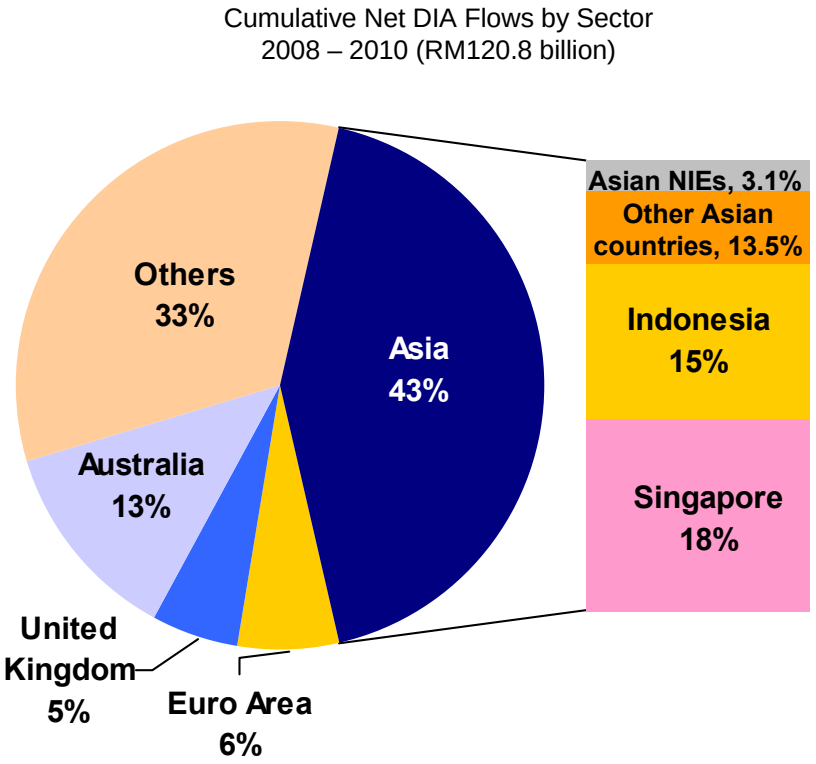
Source: Department of Statistics, Malaysia

The rise of economic integration in East Asia has benefited Malaysia through trade and investment channels

East Asia is now Malaysia's main export market



Almost half of investment abroad by Malaysian companies is in Asia



Source: BNM Annual Report 2010, White Box: Rise of Economic Integration in East Asia: The Malaysian Perspective

External debt remained low

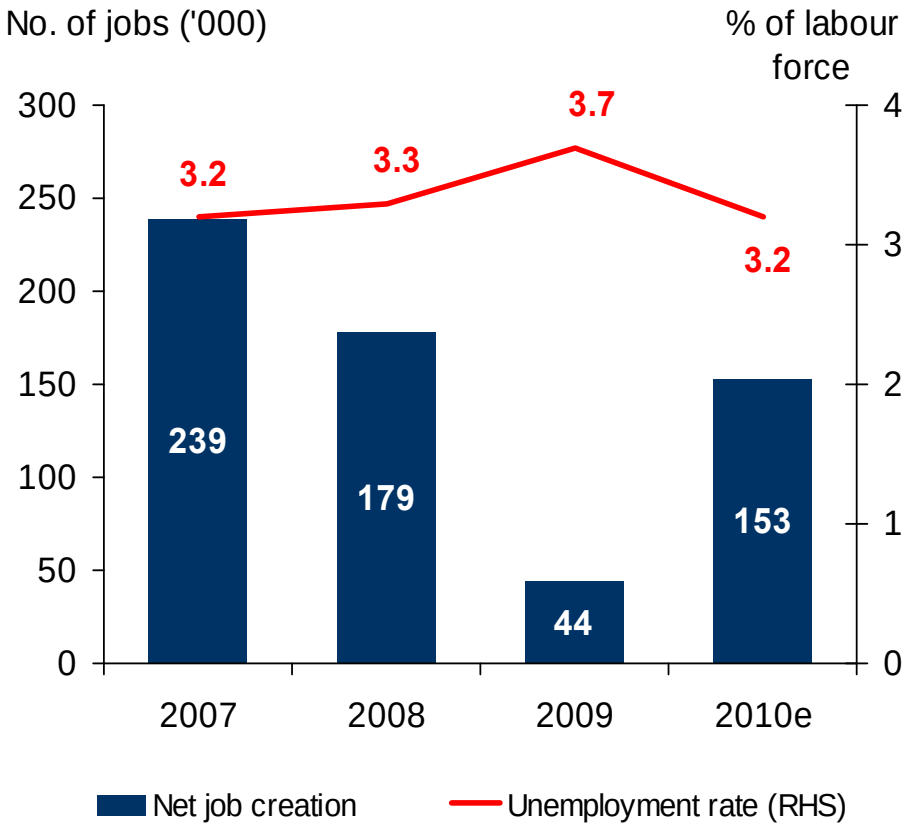
	end-Dec 2009	end-Dec 2010
	RM billion	
Total External Debt	**233.1**	**226.3**
(USD bn equiv.)	*67.4*	*72.6*
Medium- and long-term	155.4	146.9
Short-term	77.8	79.4
	%	
External Debt/GNI	*35.1*	*30.2*
Short-Term Debt /Reserves	*23.5*	*24.2*

- External debt declined to RM226.3 billion (equivalent to 30.2% of GNI)
- Lower medium- and long-term debt due to:
  - revaluation gains following appreciation of ringgit and;
  - net repayment position of the private sector
- Short-term debt increased but remains manageable

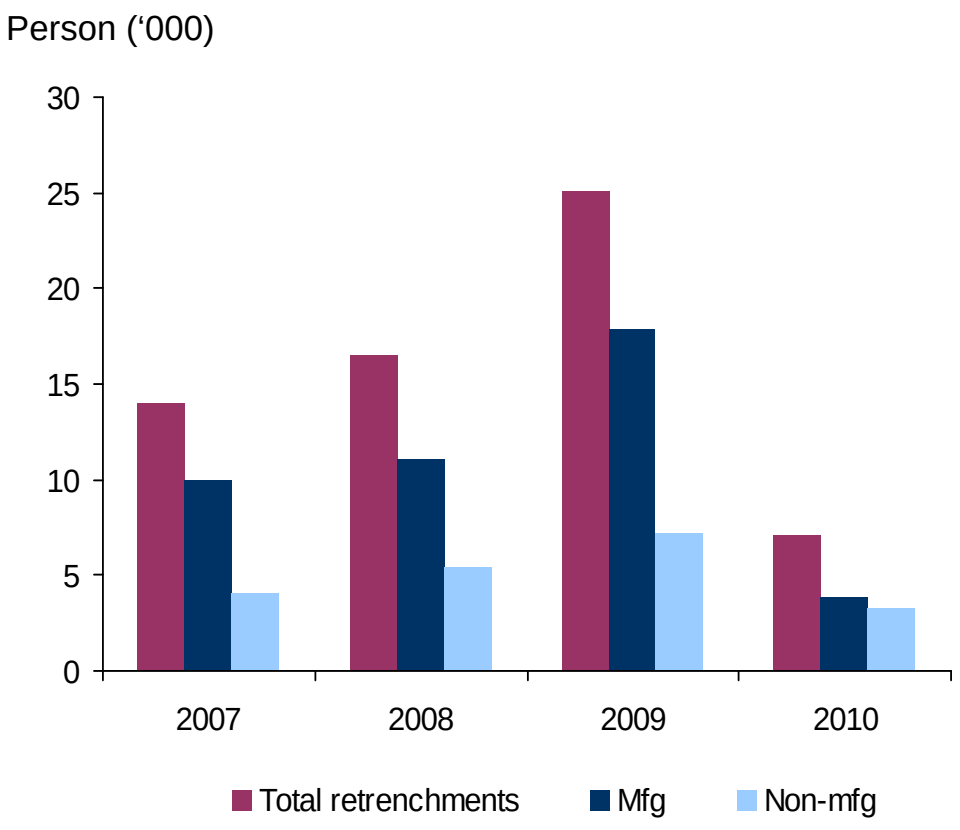
Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Labour market conditions improved in 2010 following strong gains in employment

Higher net job creation & lower unemployment rate in 2010



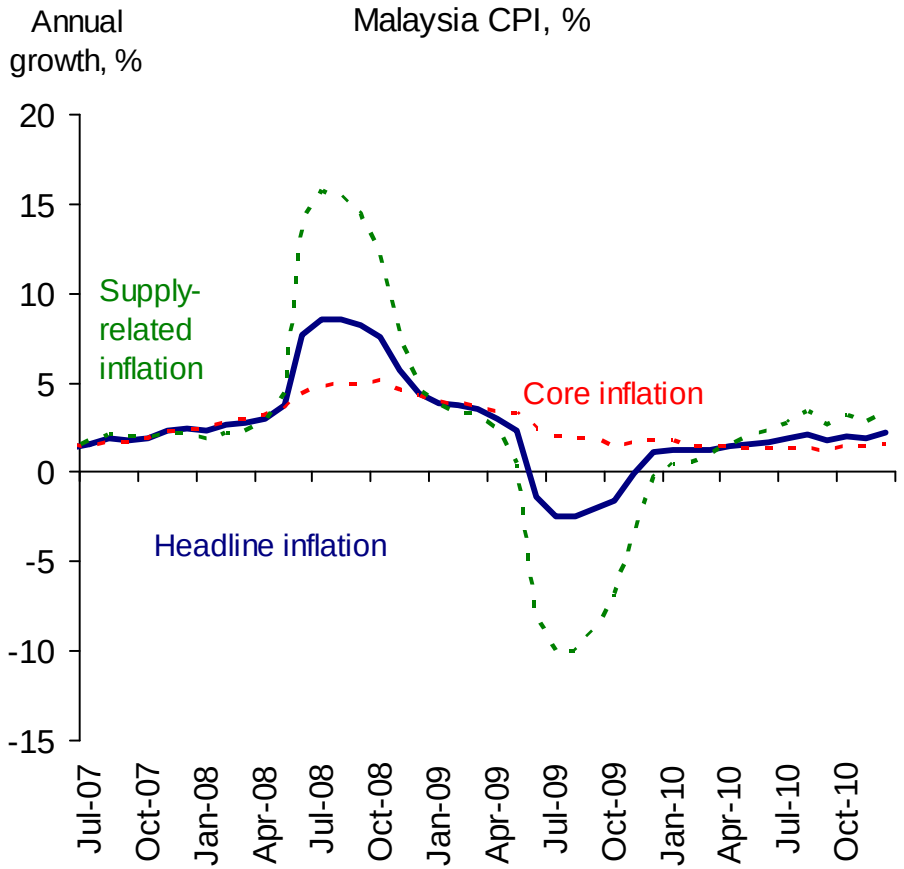
While retrenchments declined significantly

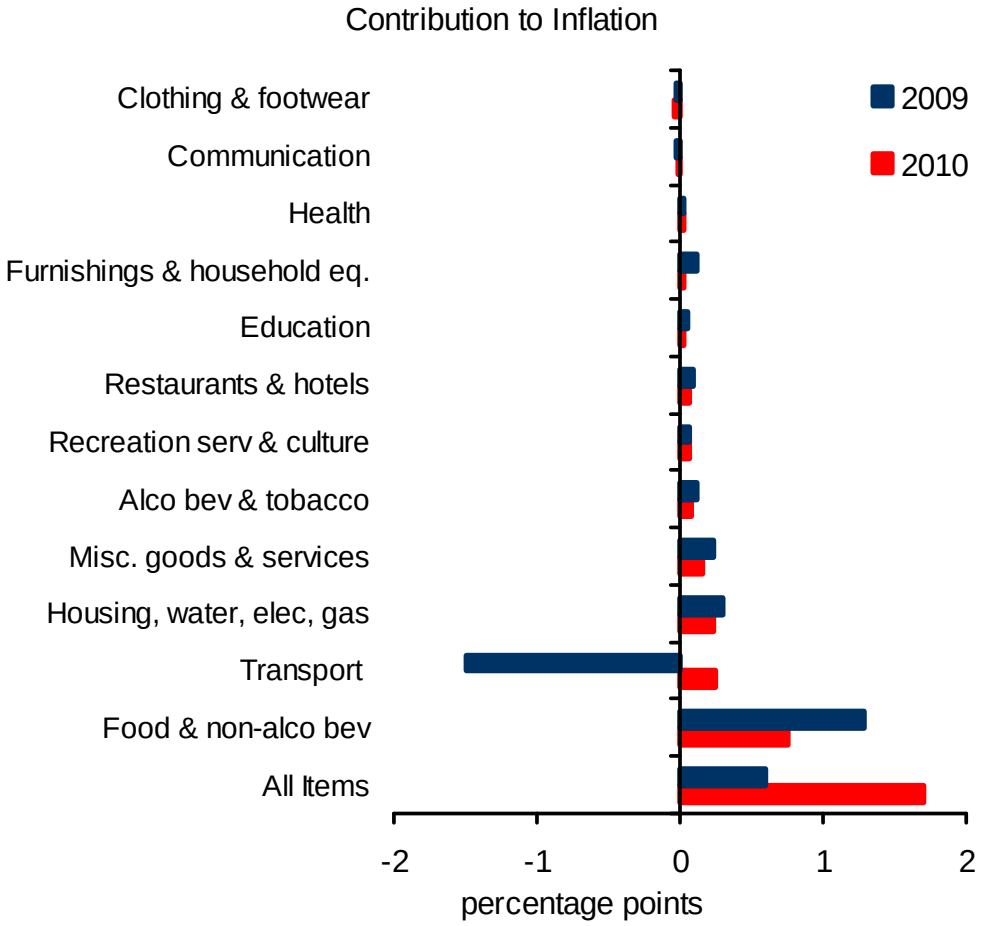


Source: Economic Planning Unit and Ministry of Human Resources

Inflation was modest in 2010

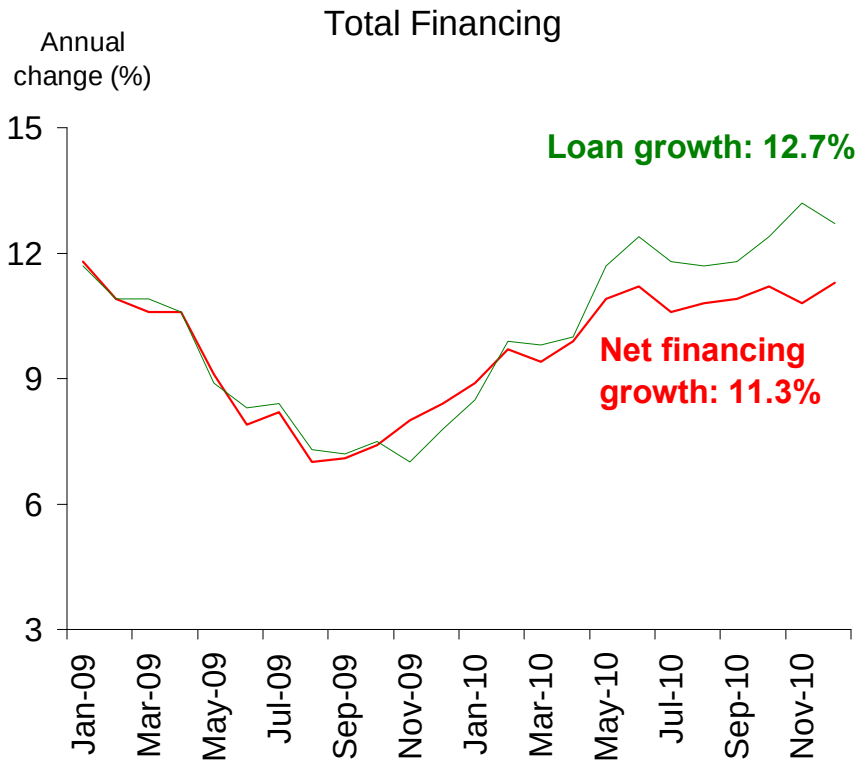
- Inflation edged to 1.7% in 2010 (2009: 0.6%), reflecting increases in the food and transport



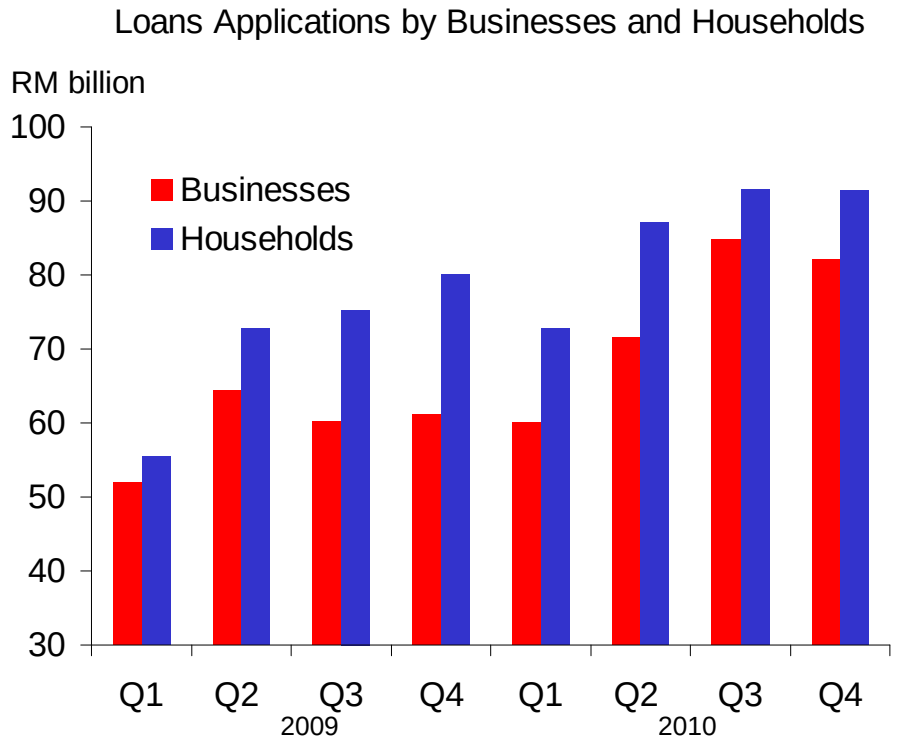


Financing conditions expected to remain favourable

Net financing growth sustained…

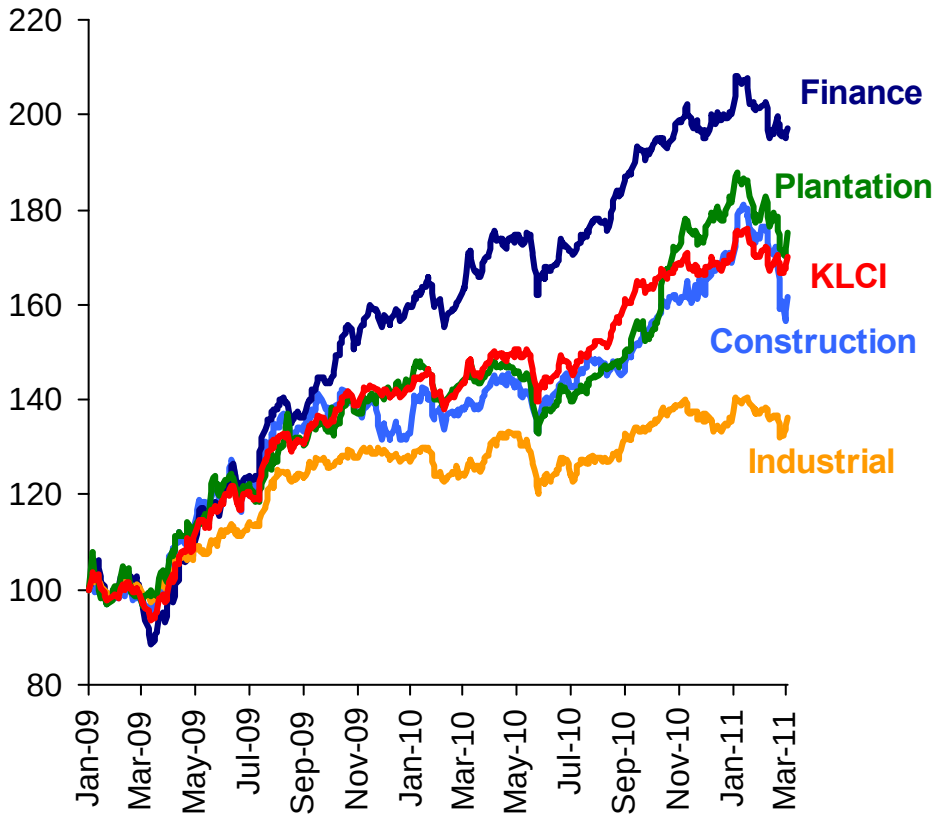


…supported by robust demand for loans from businesses and households

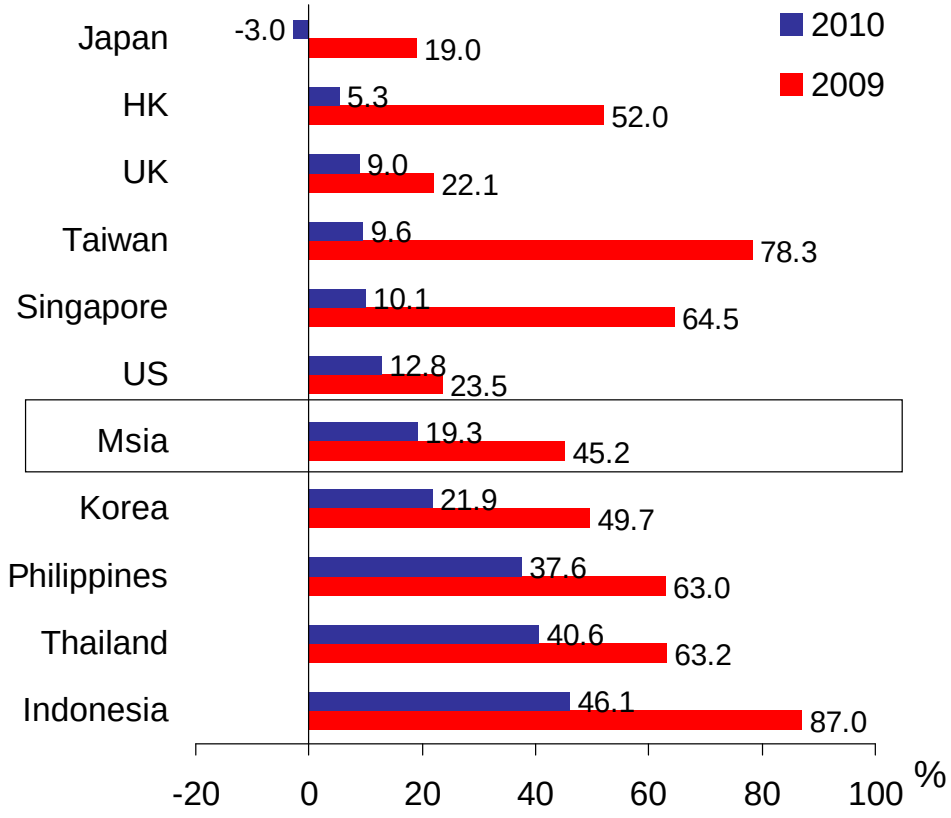


Domestic equity market had sustained growth in line with regional trends

KLCI and Bursa Malaysia sectoral indices



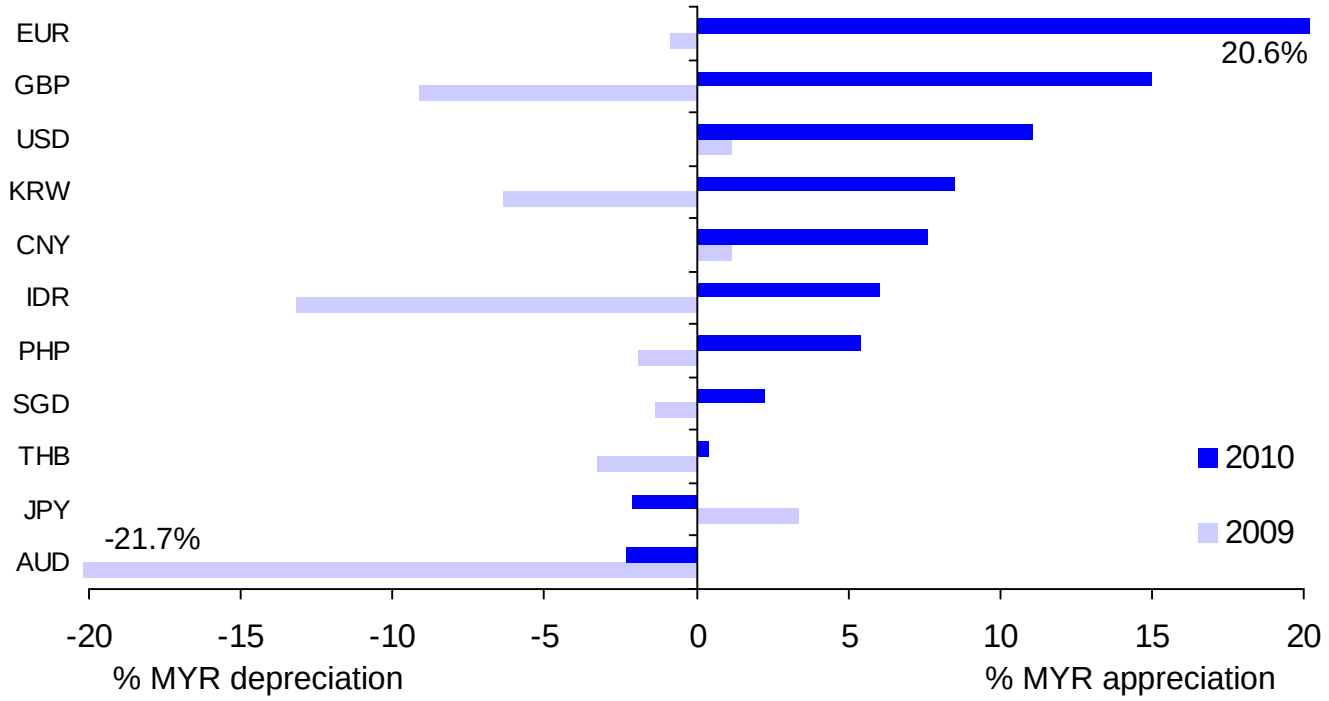
Performance of Major Indices (% growth)



Ringgit performance driven by external and domestic developments

- MYR appreciated against most currencies in 2010 following a relatively subdued performance in 2009
- Despite volatile capital flows, ringgit adjustments have been orderly

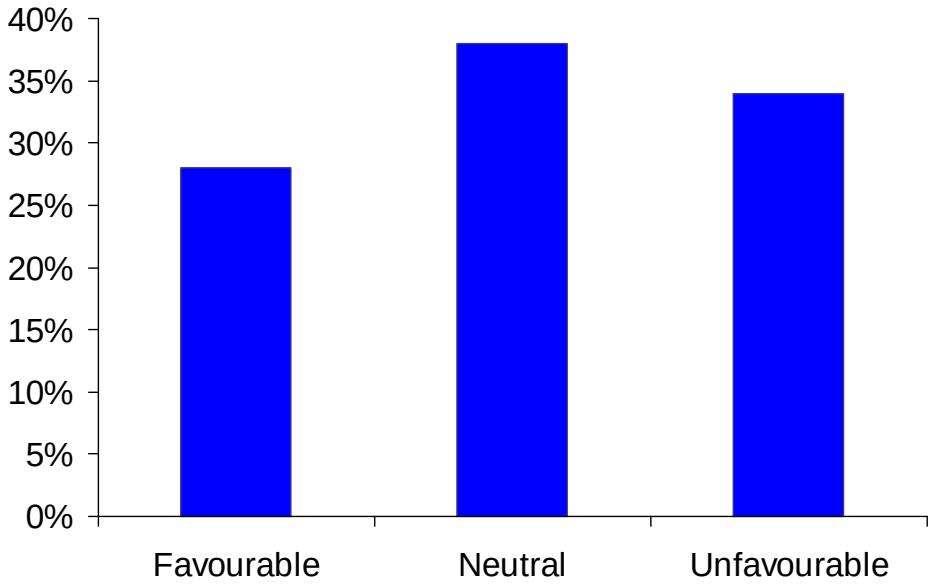
MYR performance against selected currencies in 2009 and 2010



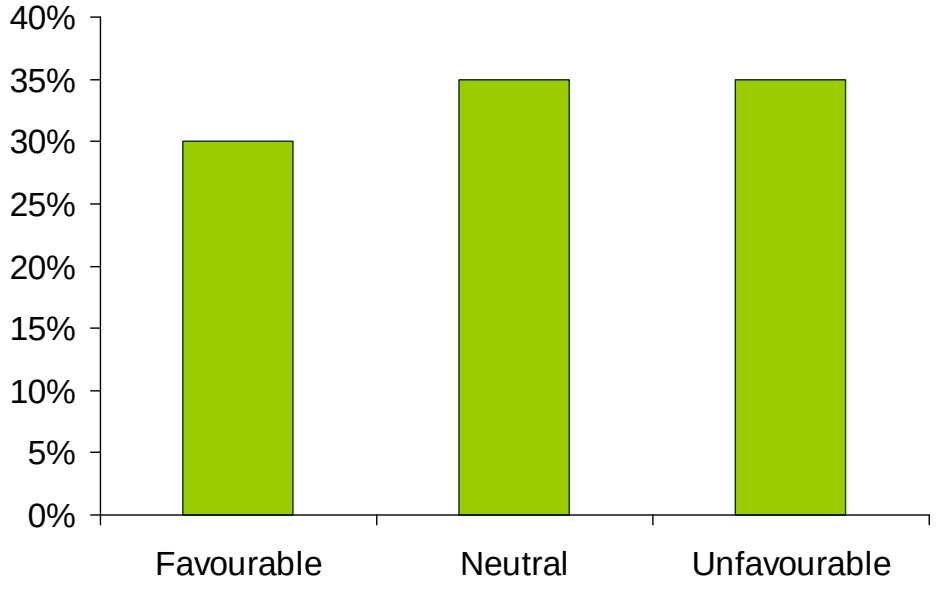
The impact of ringgit appreciation on the economy has been manageable

Quarterly sectoral survey* 4Q 2010
Impact of ringgit appreciation on profit margins

Impact on profit margin thus far



Impact on profit margin if ringgit appreciates further



* Based on a survey of 177 companies, of which 109 are manufacturing, 43 non-financial services and 25 Constructions

Measures undertaken to allow more efficient management of foreign financial transactions

To allow more efficient management of foreign transactions, several measures have been undertaken, including:

- Allow settlements in local currencies
- Facilitate hedging activities by residents
- Allow unlimited holding of foreign currency accounts
- Allow settlement of transactions in foreign currency by exporters and importers

Prospects for 2011

Challenge for global economy going into 2011 is sustaining growth with job creation

Global growth projection for 2011

	2009	2010	2011[f]
	Annual change (%)		
World GDP	**-0.6**	**5.0**	**4.4**
World Trade	**-10.7**	**12.0**	**7.1**
US	-2.6	2.8	3.0
Euro area	-4.1	1.7	1.5
Japan	-6.3	3.9	1.6
Developing Asia [1/]	7.0	9.3	8.4
China	9.2	10.3	9.6
ASEAN-5 [2/]	1.7	6.7	5.5

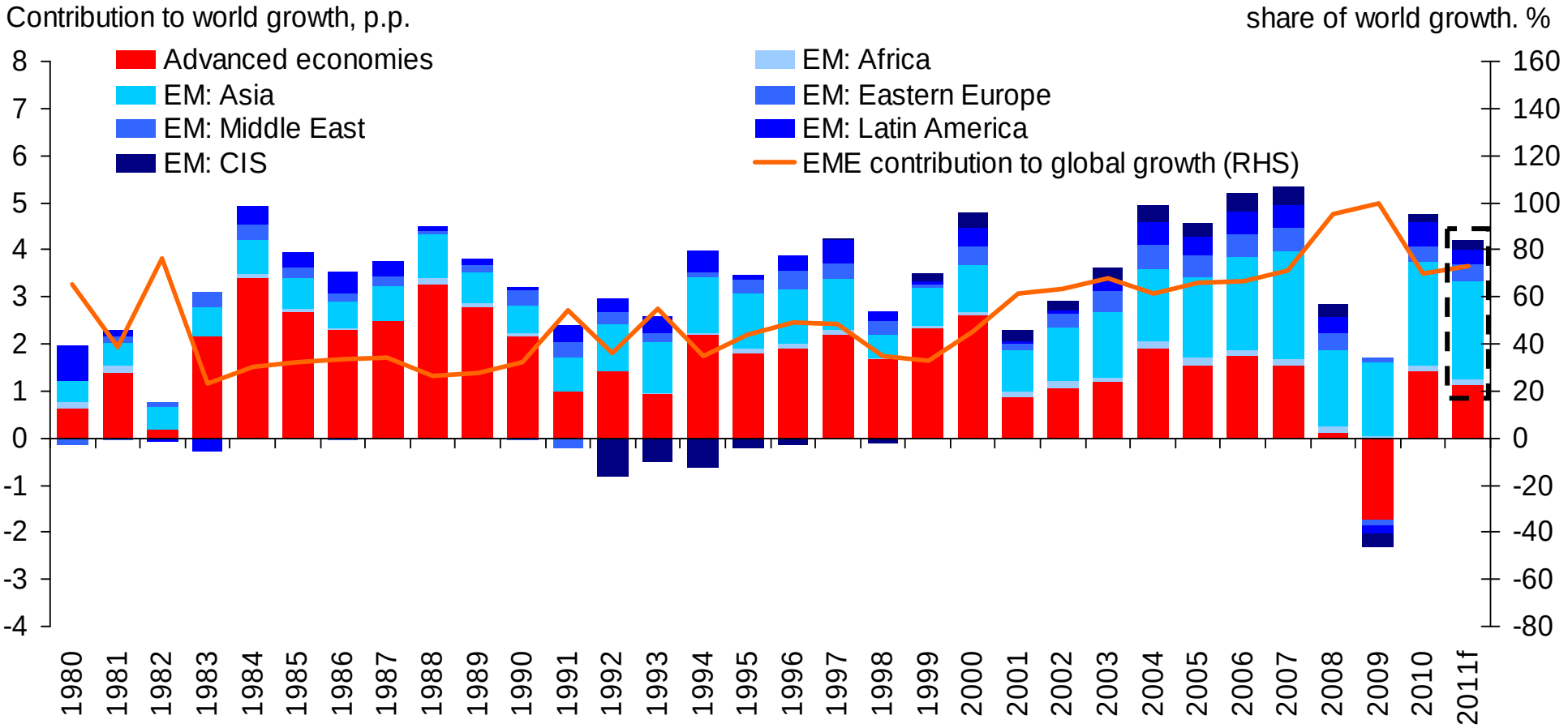
Note: Forecasts for 2011 are IMF's projections
1/ IMF: Asia ex-NIEs
2/ IMF: Indonesia, Malaysia, Philippines, Thailand and Vietnam

- **Significant improvement in 2010**
- **Continued recovery in advanced economies although growth remains slow**
- **Strong growth in emerging economies, particularly in Asia underpinned by domestic demand and recovery in world trade**
- **More recently, rising commodity and energy prices are leading to higher global inflation**

Source: National authorities, IMF World Economic Outlook, January 2011 Update

Global growth mainly from EMEs in 2011

While accounting for 47% of global economy, emerging economies expected to contribute more than 70% of global growth

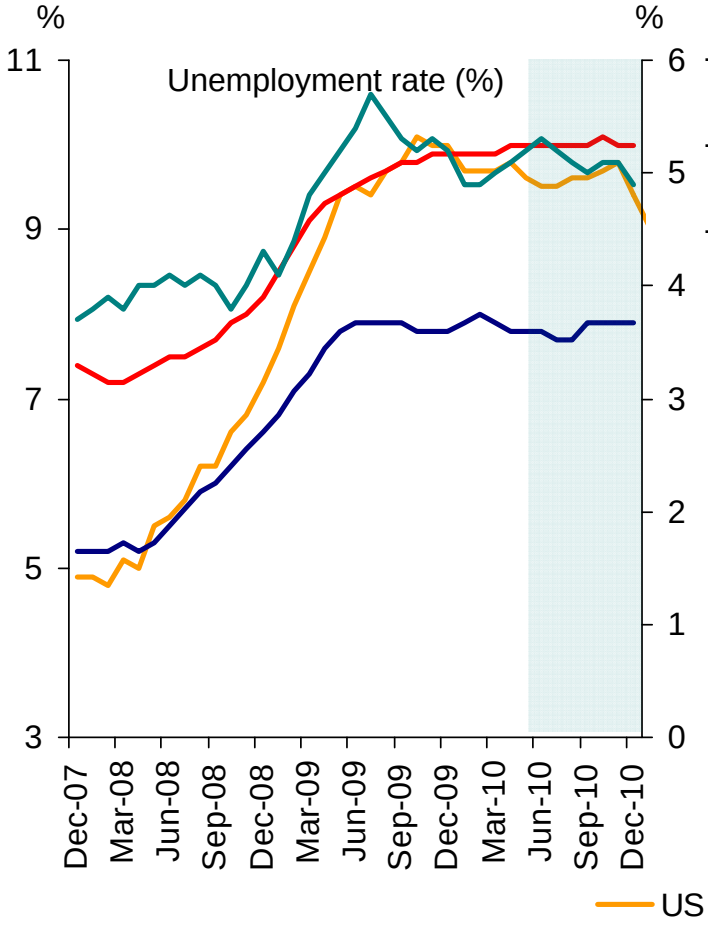


Source: IMF World Economic Outlook

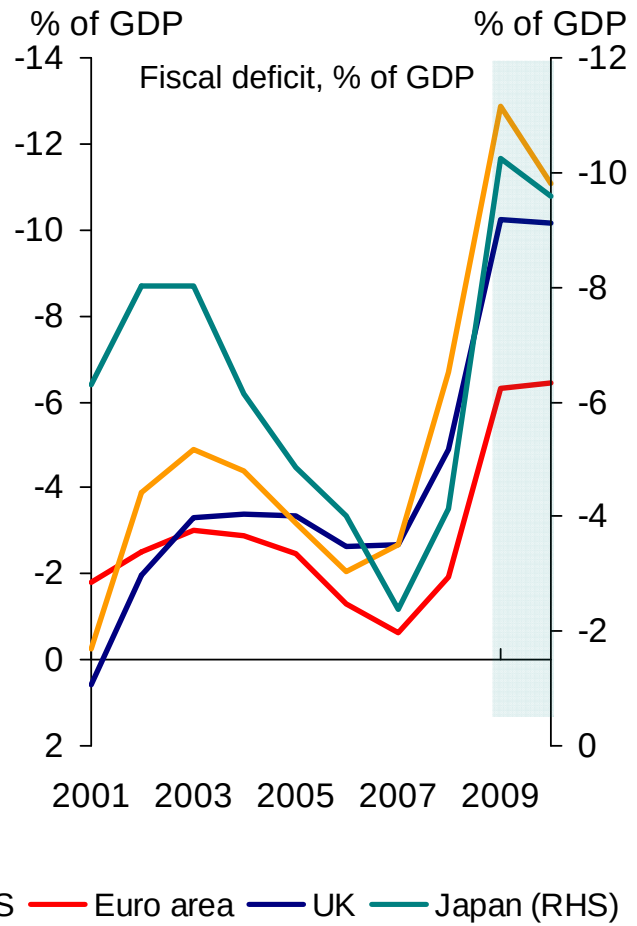
Note: CIS is the Commonwealth of Independent States, formerly Soviet republics

Advanced economies still need to address structural problems

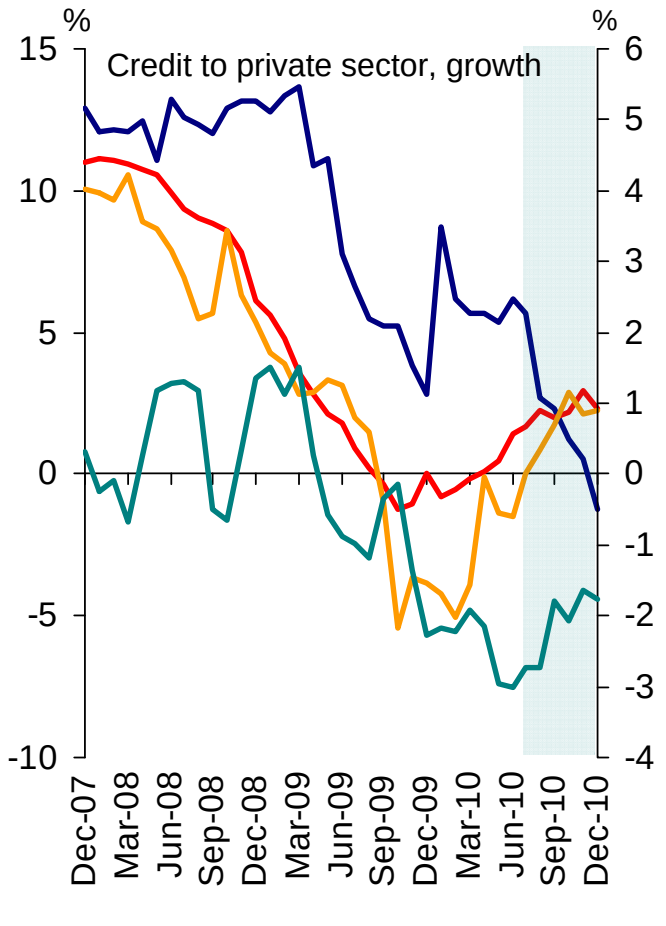
1 High unemployment rate



2 High fiscal deficit



3 Restrained credit conditions

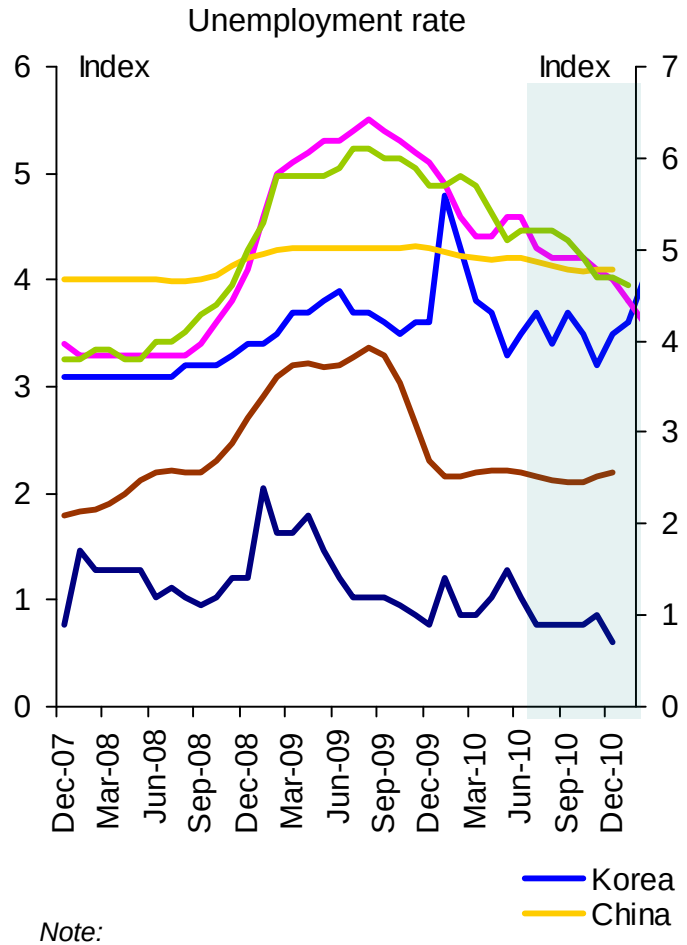


US — Euro area — UK — Japan (RHS)

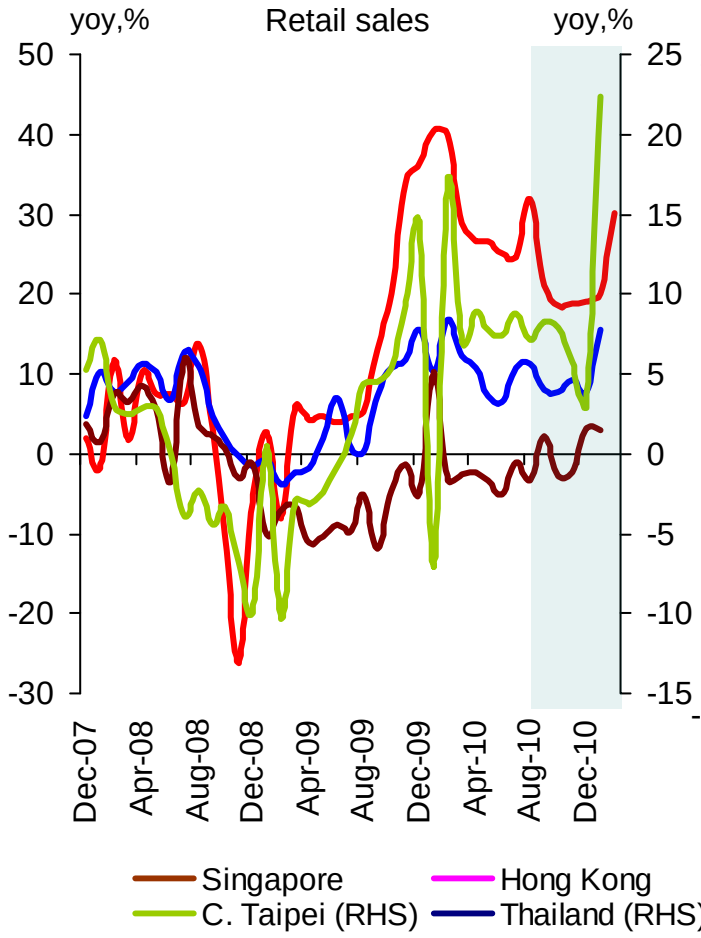
Source: National authorities, Haver, IMF

Regional economies supported by resilient domestic demand

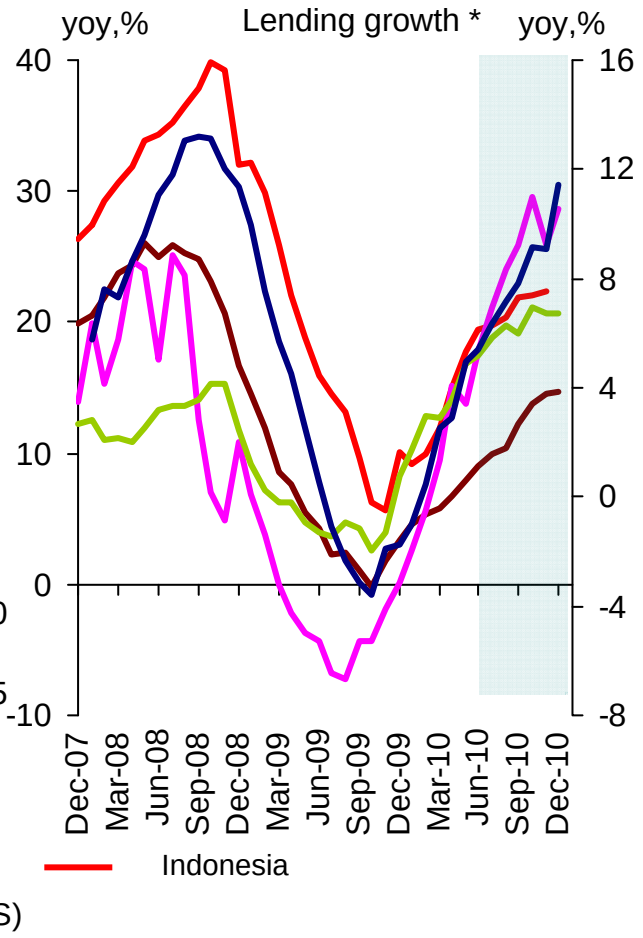
1 Unemployment trending down



2 Rising retail sales



3 Continued access to credit

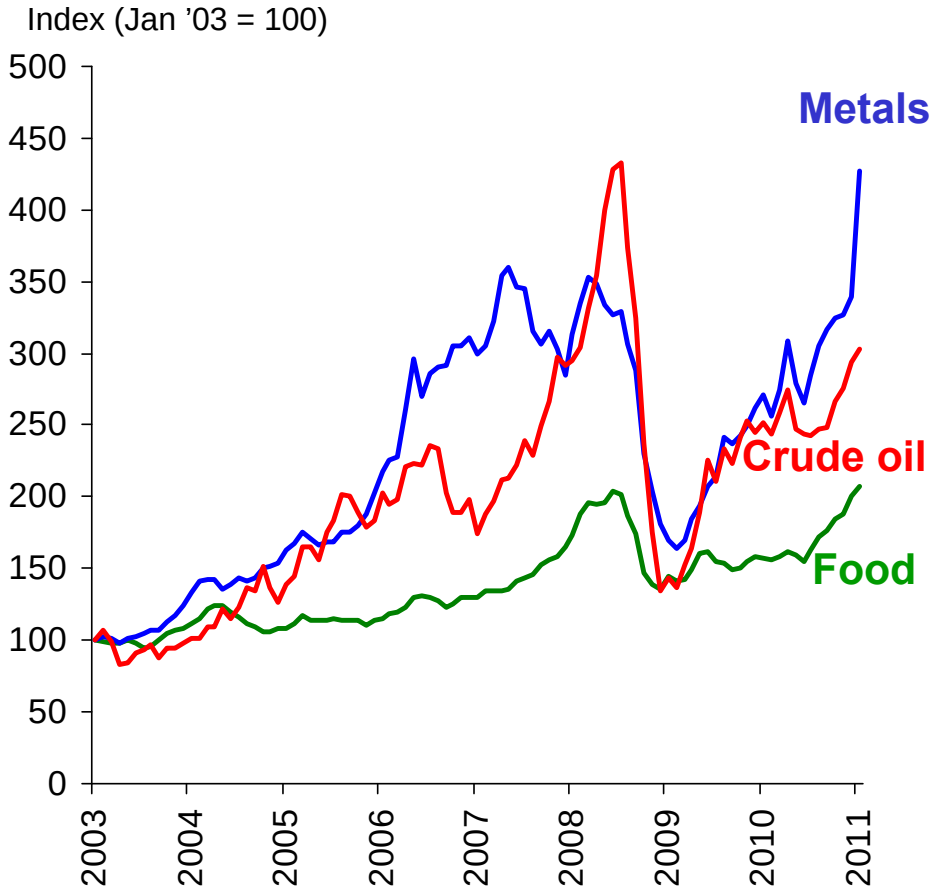


Note:
** Refers to loans as reported in banks' balance sheet, except for Indonesia which refers to loans outstanding*

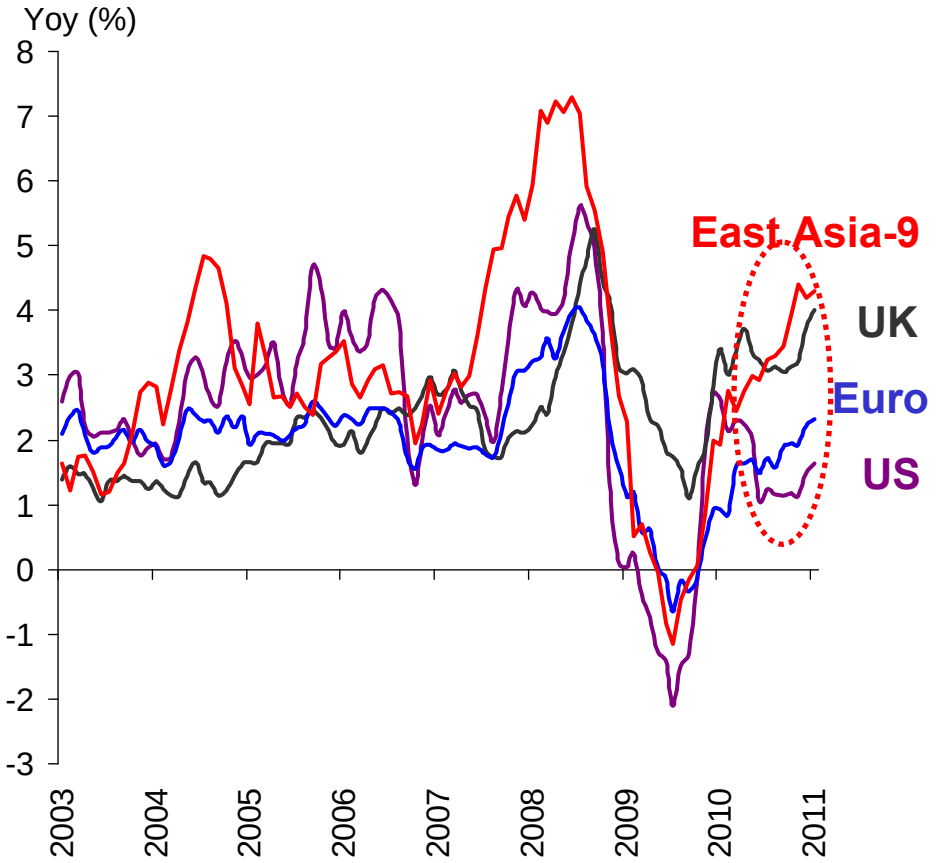
Source: National authorities, Haver

Rising commodity prices have increased the risk to higher global inflation

Rising commodity prices amid supply disruptions and geopolitical tensions…

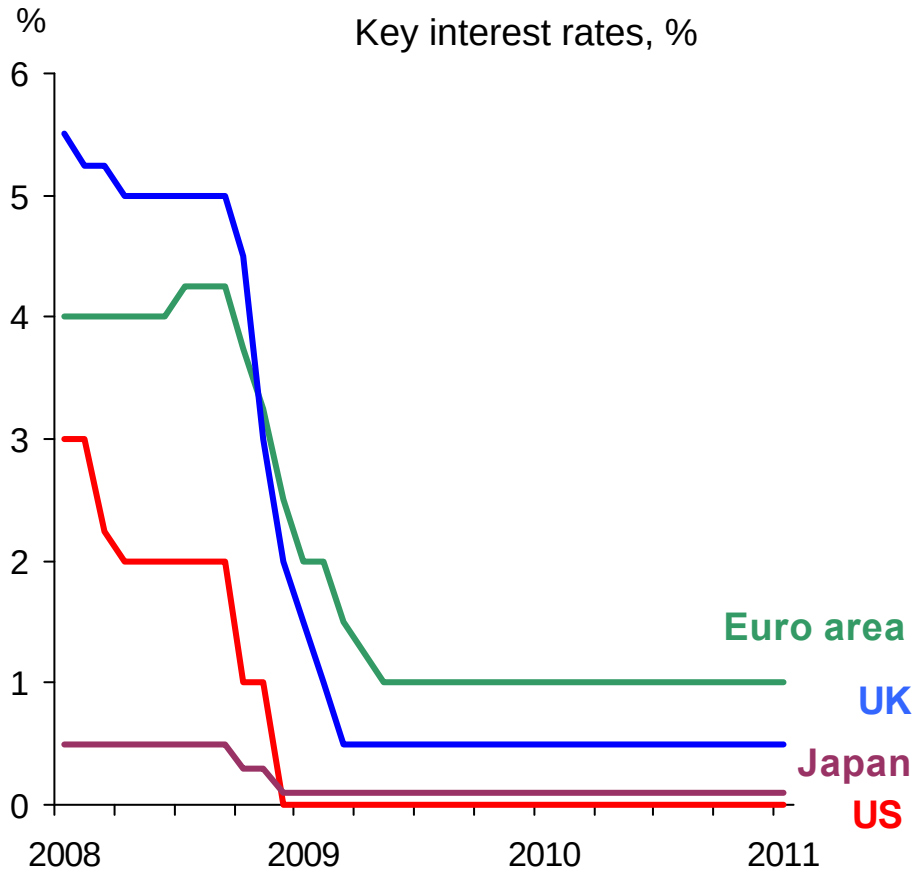


…driving up inflation in most economies

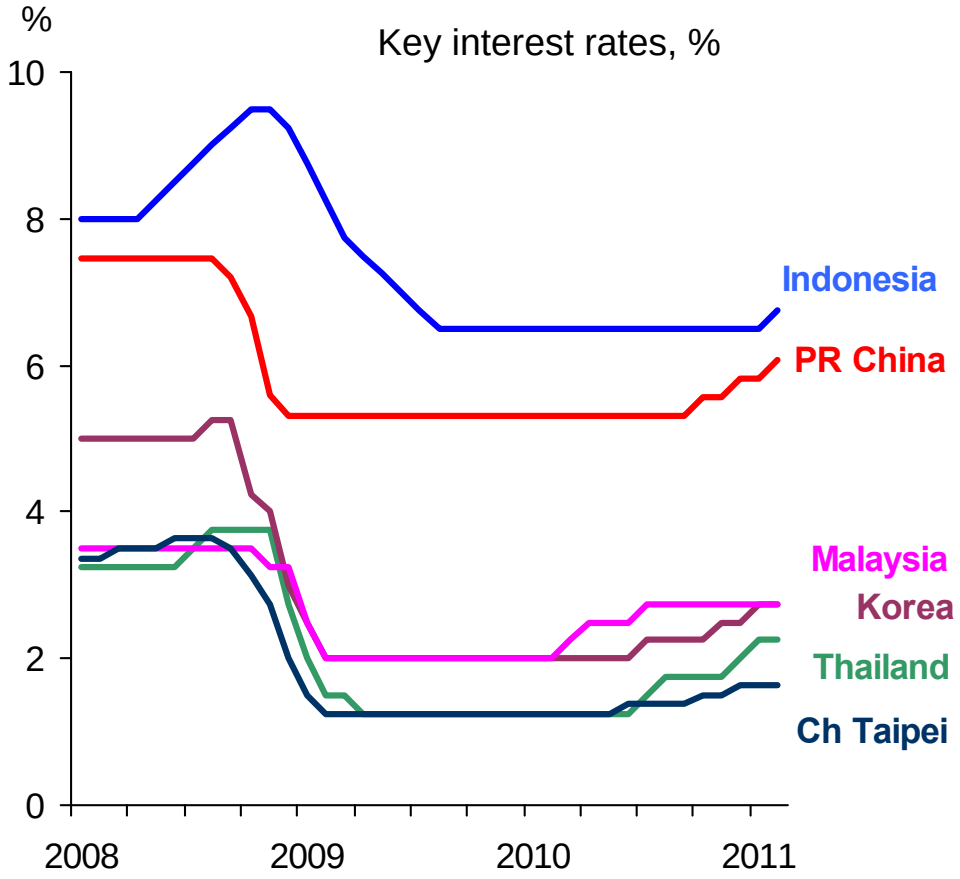


Different degrees of monetary policy response

Some advanced economies are expected to begin to normalise rates this year…



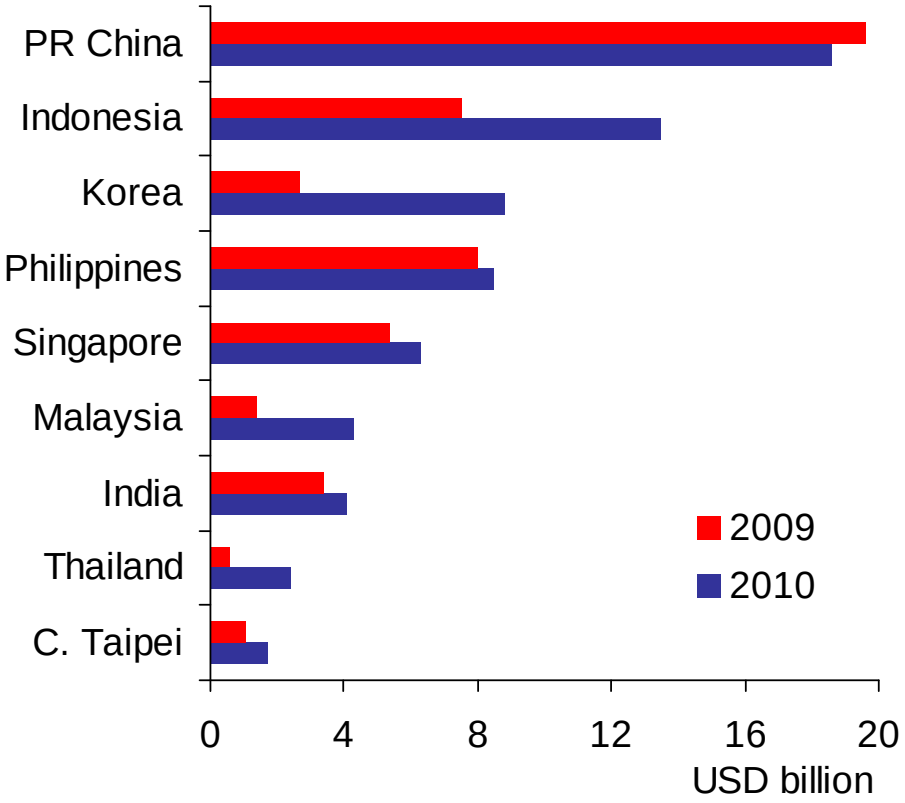
…while most regional economies have started to normalise or tighten since 2010



Global shifts in liquidity: Volatile capital flows…

Large capital inflows driven by growth differentials and the search for yield…

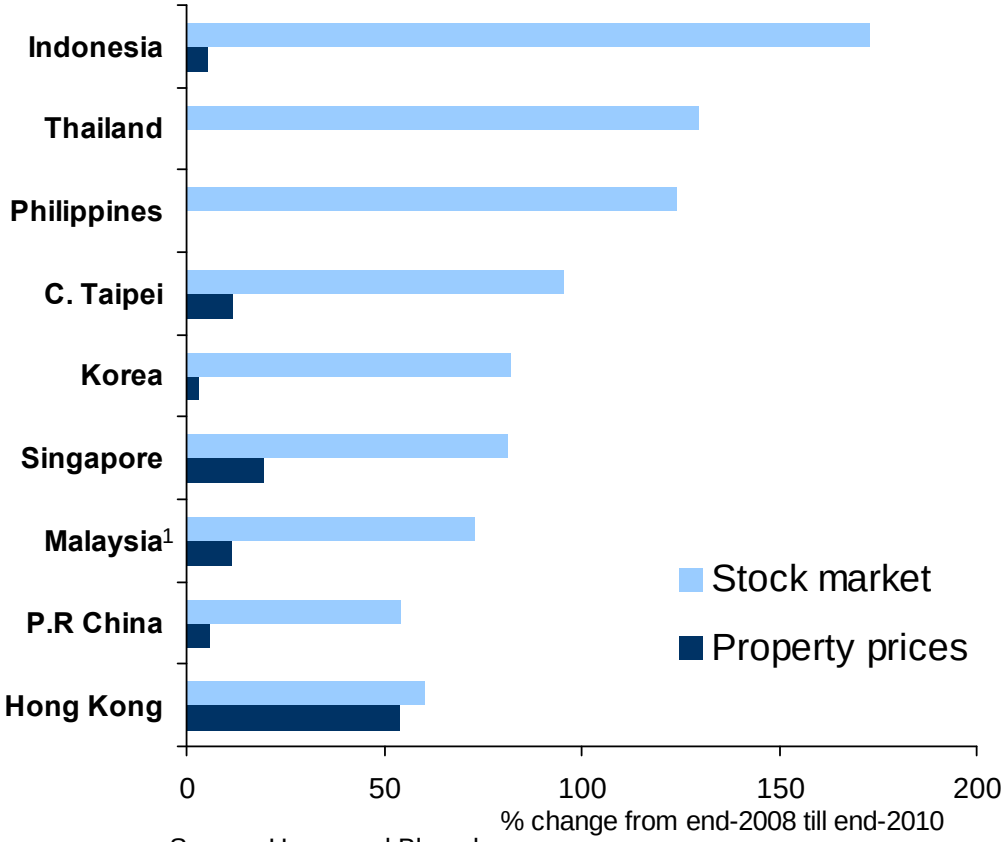
Total flows into equity and bond markets



Source: EFPR

…driving stock and property prices higher

Stock market and property price performance

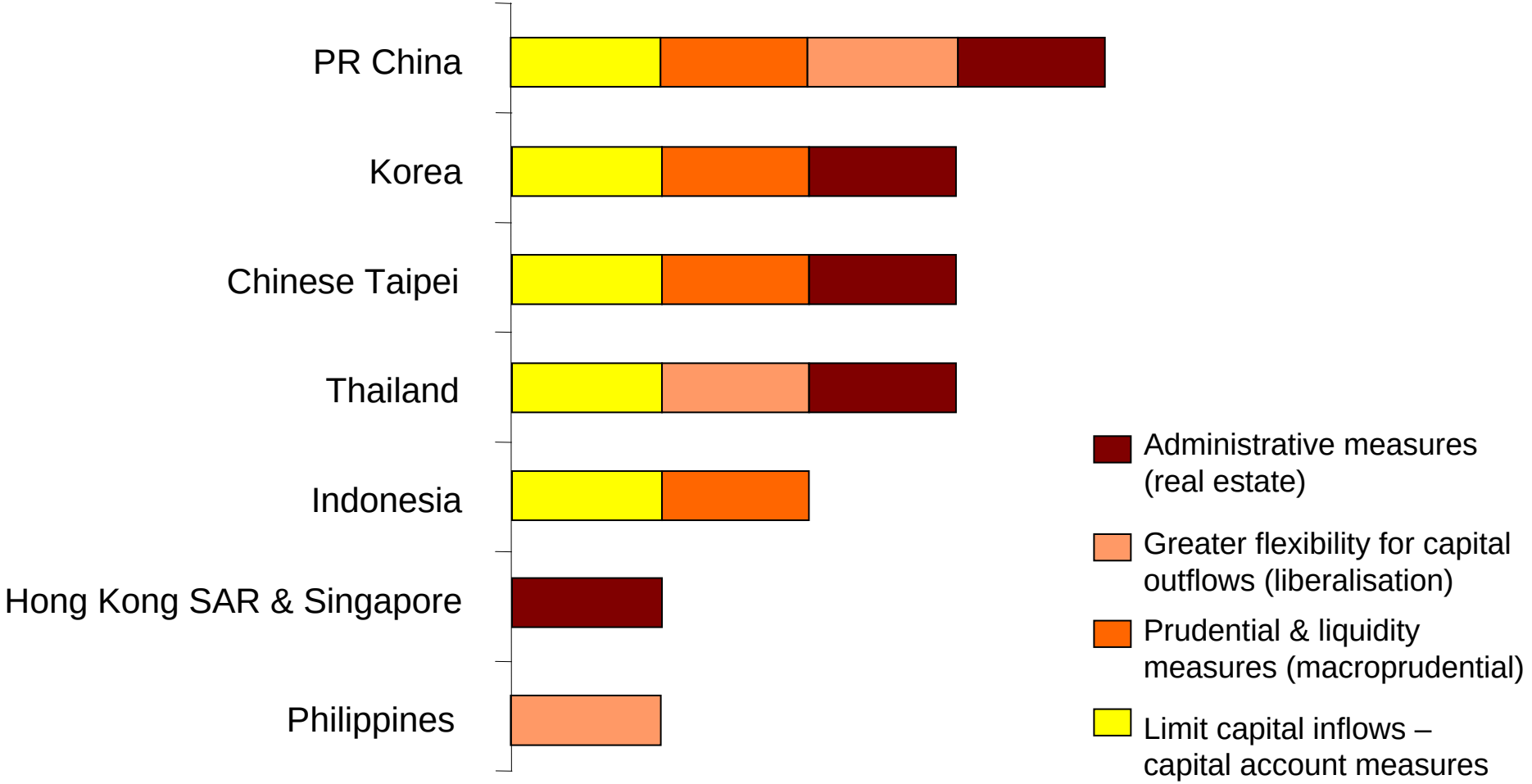


Source: Haver and Bloomberg

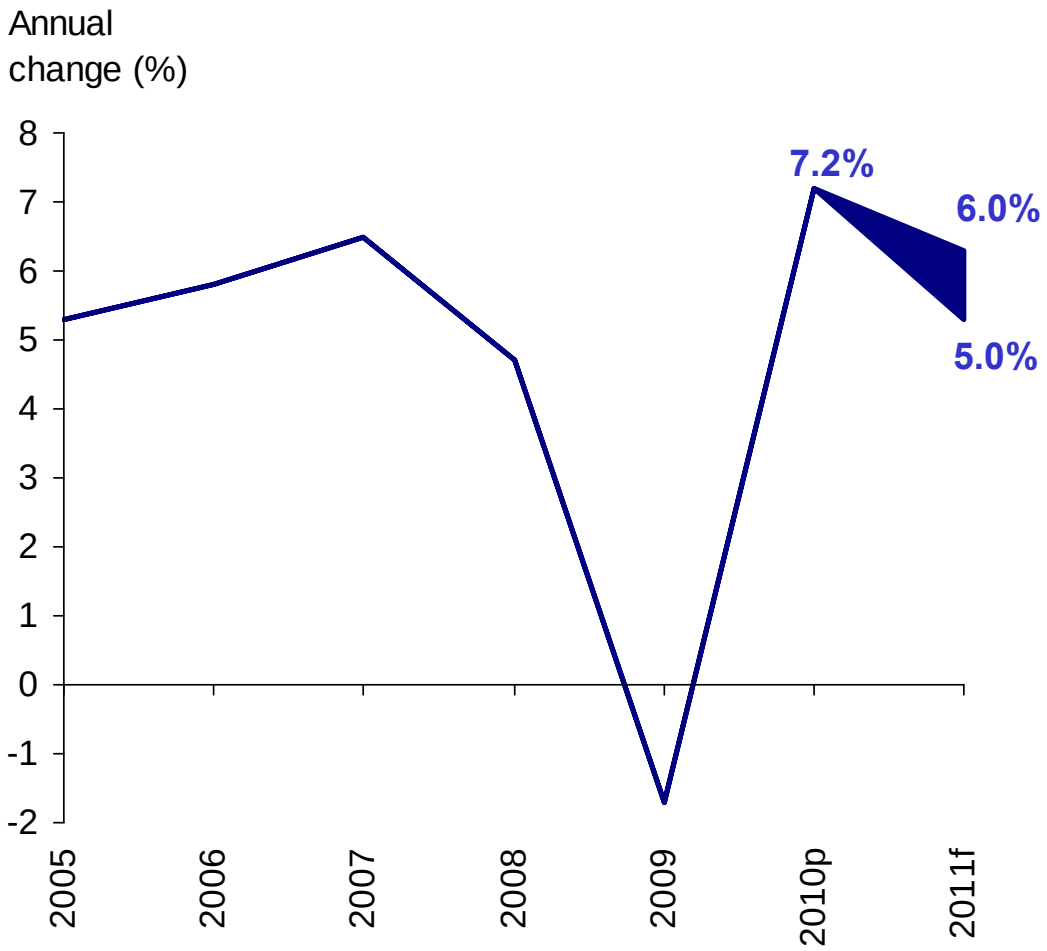
1/ till 3Q 10 for property prices

…prompting measures to manage these flows

Measures introduced in the region to manage capital flows



The Malaysian economy is projected to grow by 5% – 6% in 2011



p preliminary f forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

- **Slower growth in 1H 2011**
  - High base in 1H 2010, particularly for exports and investment
  - Lower demand for electronic exports
- **Growth is expected to improve in 2H**
  - Stronger expansion of domestic demand, particularly, private consumption and investment
  - Higher exports

Strong growth in domestic demand to be driven by private sector activity

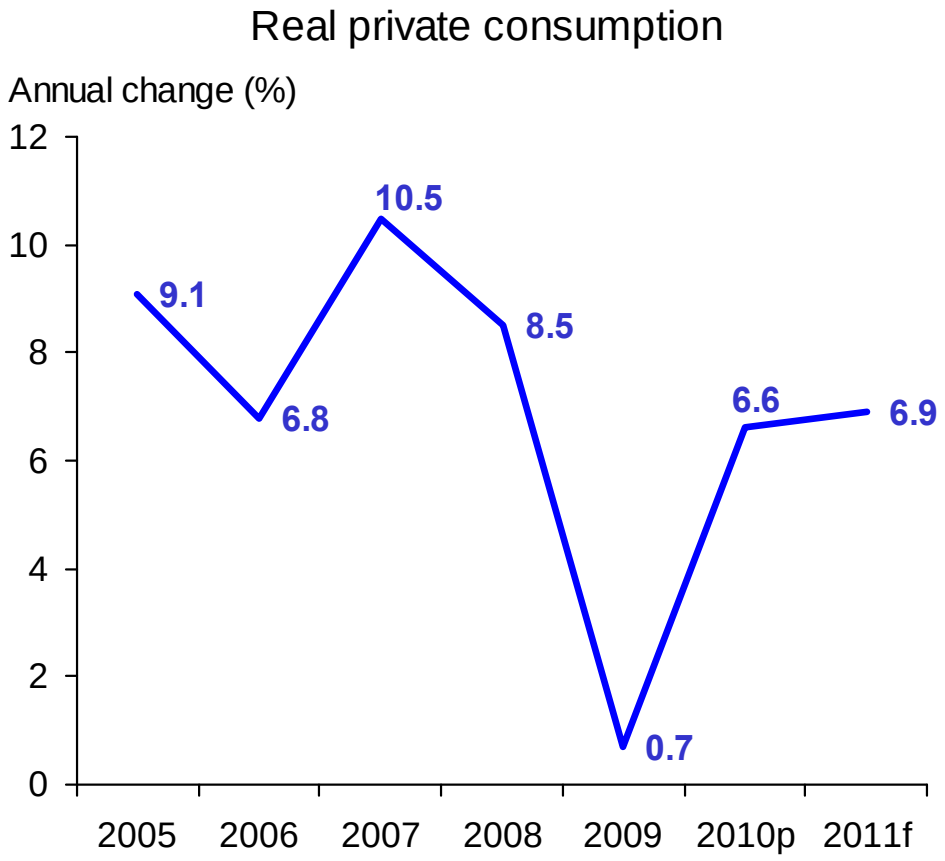
	2010p	2011f	2010p	2011f
	Annual change (%)		Contribution to growth (p.p)	
Domestic demand	**6.3**	**6.7**	**5.6**	**6.0**
Private sector	**7.8**	**7.4**	**4.9**	**4.7**
Consumption	*6.6*	*6.9*	*3.6*	*3.7*
Investment	*13.8*	*9.7*	*1.4*	*1.0*
Public sector	**2.5**	**5.1**	**0.6**	**1.3**
Consumption	*0.1*	*7.2*	*0.0*	*1.0*
Investment	*5.5*	*2.7*	*0.6*	*0.3*
Net exports	**-24.2**	**2.3**	**-3.3**	**0.2**
Exports of G&S	*9.8*	*2.7*	*10.5*	*3.0*
Imports of G&S	*14.7*	*2.8*	*13.8*	*2.8*
Real GDP	**7.2**	**5.0~6.0**	**7.2**	**5.0~6.0**

p preliminary f forecast

- **Private domestic demand to be the main growth driver**
  - Strong private consumption
  - Rising investment activity
- **Public sector to remain supportive of growth**

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Strong expansion in private consumption



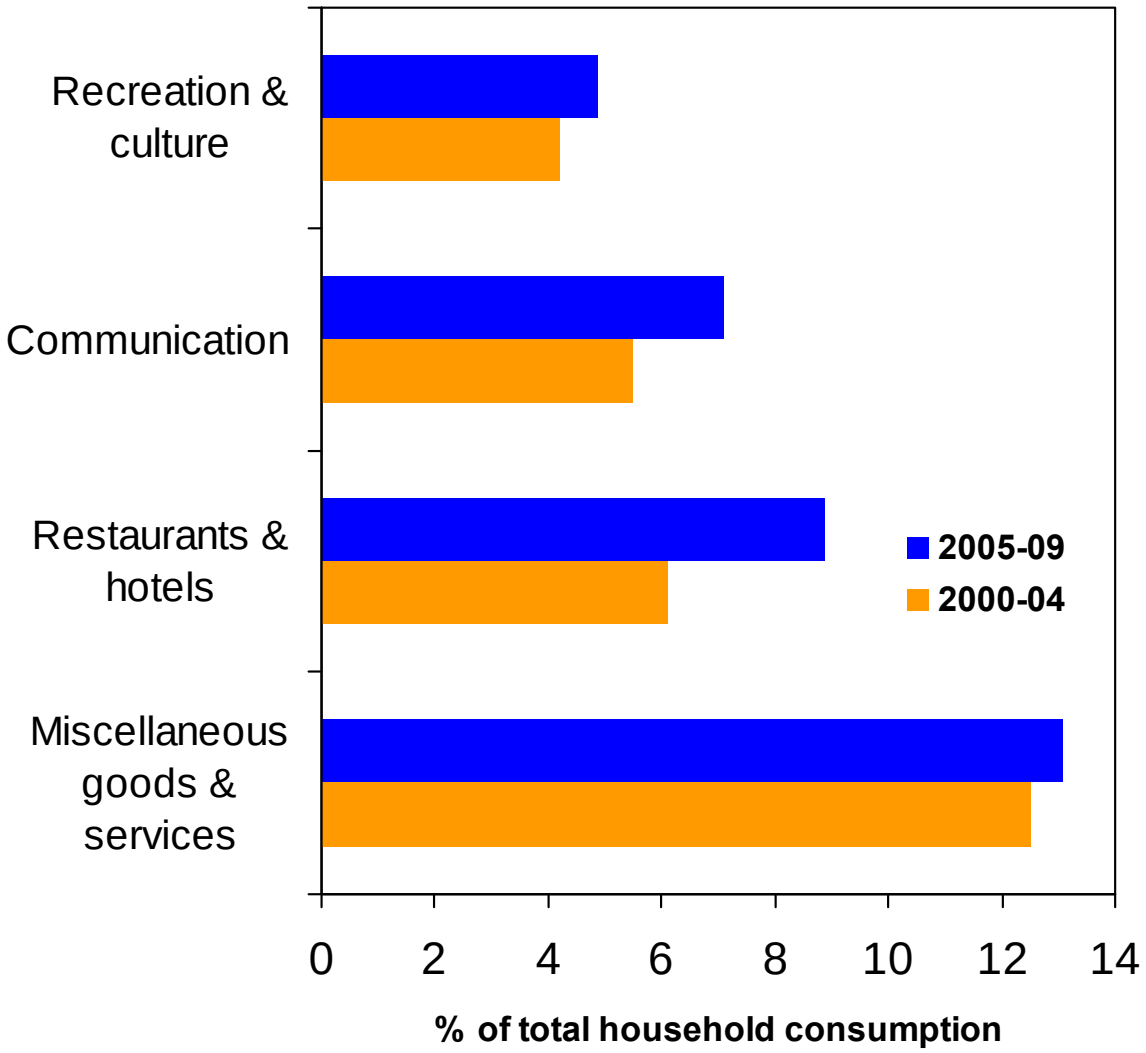
p preliminary f forecast

Stronger expansion in consumer spending supported by:

- Favourable labour market conditions
- Rising disposable incomes
- Sustained consumer confidence
- Continued access to credit

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

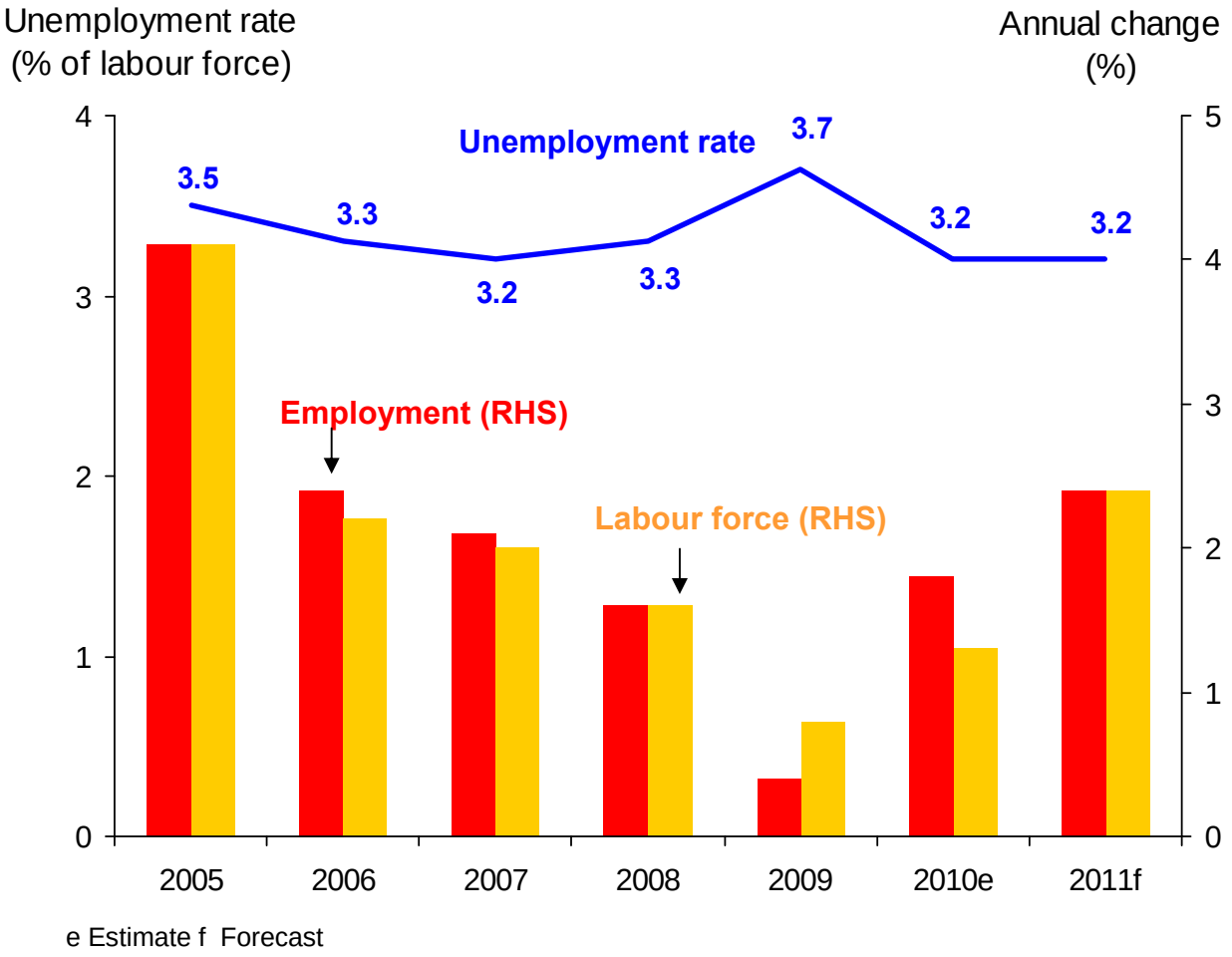
Household expenditure on discretionary items has increased in recent years



- **The changing patterns of household spending reflected mainly growing affluence, supported by**
  - Steady rise in disposable income
  - Accumulation of wealth
- **Other key factors**
  - Favourable demographic (i.e. young and large working-age population)
  - Increased financial deepening and inclusion
  - Technological developments

Source: Department of Statistics, Malaysia

Labour market conditions expected to remain favourable in 2011



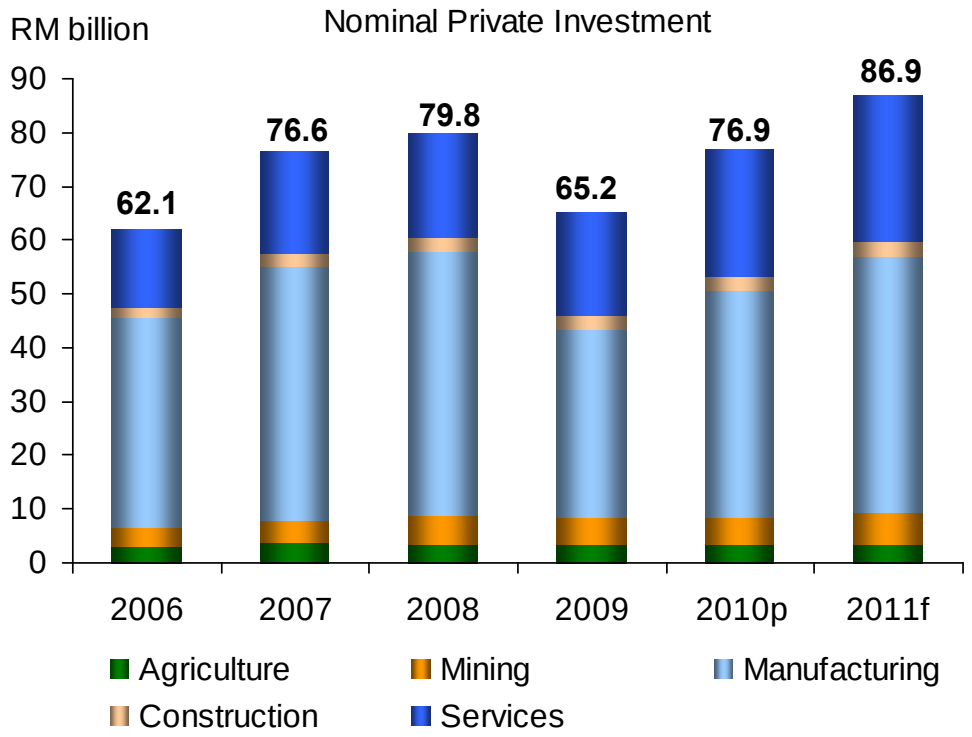
e Estimate f Forecast

- **Unemployment rate to remain stable at 3.2% in 2011**
  - supported mainly by growth in domestic-oriented sectors

Source: Economic Planning Unit

Strong performance in private investment

Annual change (%)	2009	2010p	2011f
Real private investment	-17.2	13.8	9.7

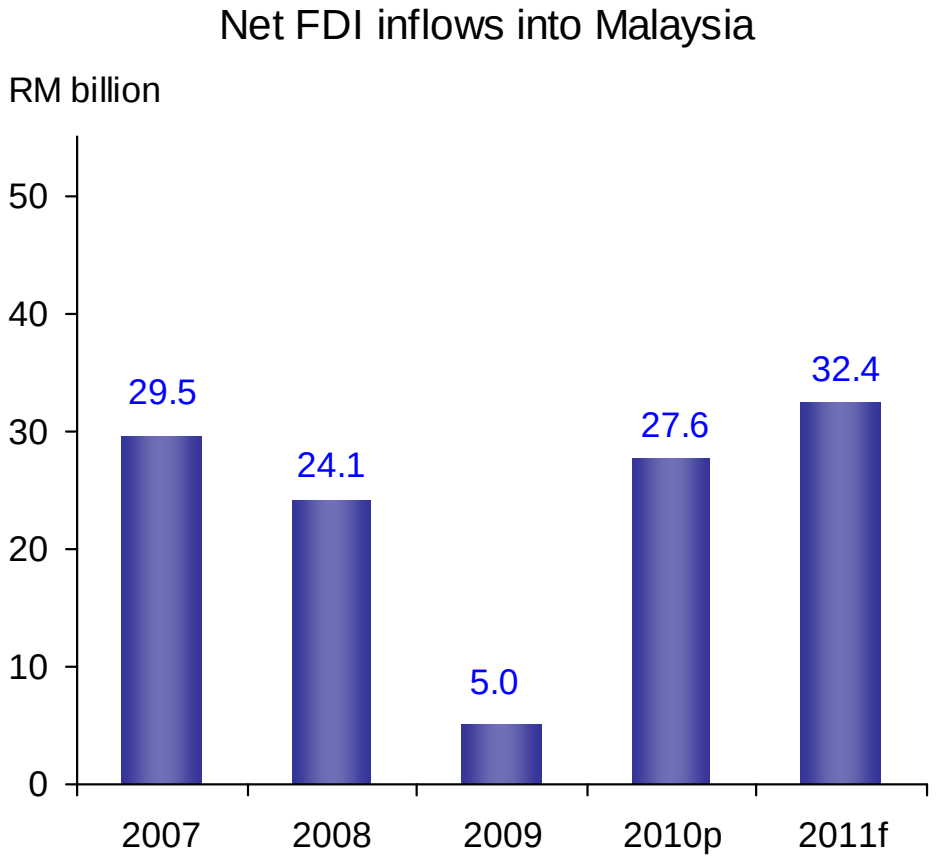


p preliminary f forecast

- **Increased capital spending in all economic sectors**
  - Key sectors: services, manufacturing and mining
- **Factors supporting private investment:**
  - Expansion of new growth areas
  - Strengthening domestic demand
  - Implementation of Government initiatives
  - Sustained business confidence

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

FDI to increase further in 2011



- **Higher net inflows of FDI in 2011**
  - Better corporate earnings
  - Rising business confidence
  - Further improvement in global FDI flows
  - Liberalisation
  - Implementation of Government ETP projects

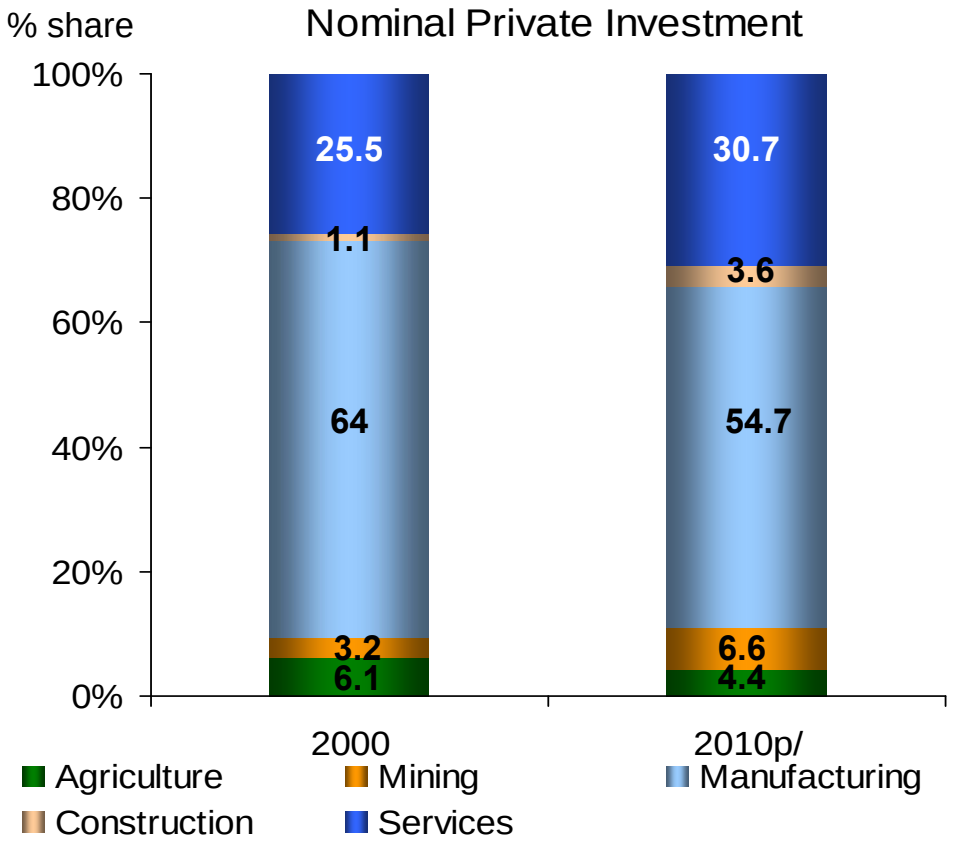
- **Inflows channeled mainly into the manufacturing, services, and oil and gas sectors**

p preliminary f forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Positive trends in private investment are expected to continue moving forward

Sectoral distribution of private investment has become more diversified



Two distinct changes can be observed in the recent decade

- Increasing diversity in the investment spending across the various economic sectors
- More capital expenditure channelled into higher value-added, technologically-intensive projects across the different sectors of the economy
  - **Manufacturing**: Renewable energy, high-end electronic products, machinery and equipment, medical devices industry
  - **Services**: Shared services and outsourcing, communication and transport & storage infrastructure

Source: Department of Statistics, Malaysia, Bank Negara Malaysia

Public sector will remain supportive of domestic economic activity

	2010[p]	2011[f]
	Annual change (%)	
Public sector	**2.5**	**5.1**
Consumption	0.1	7.2
Investment	5.5	2.7
	Contribution to growth (p.p)	
Public sector	0.6	1.3

[p] preliminary [f] forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

External trade to expand in 2011

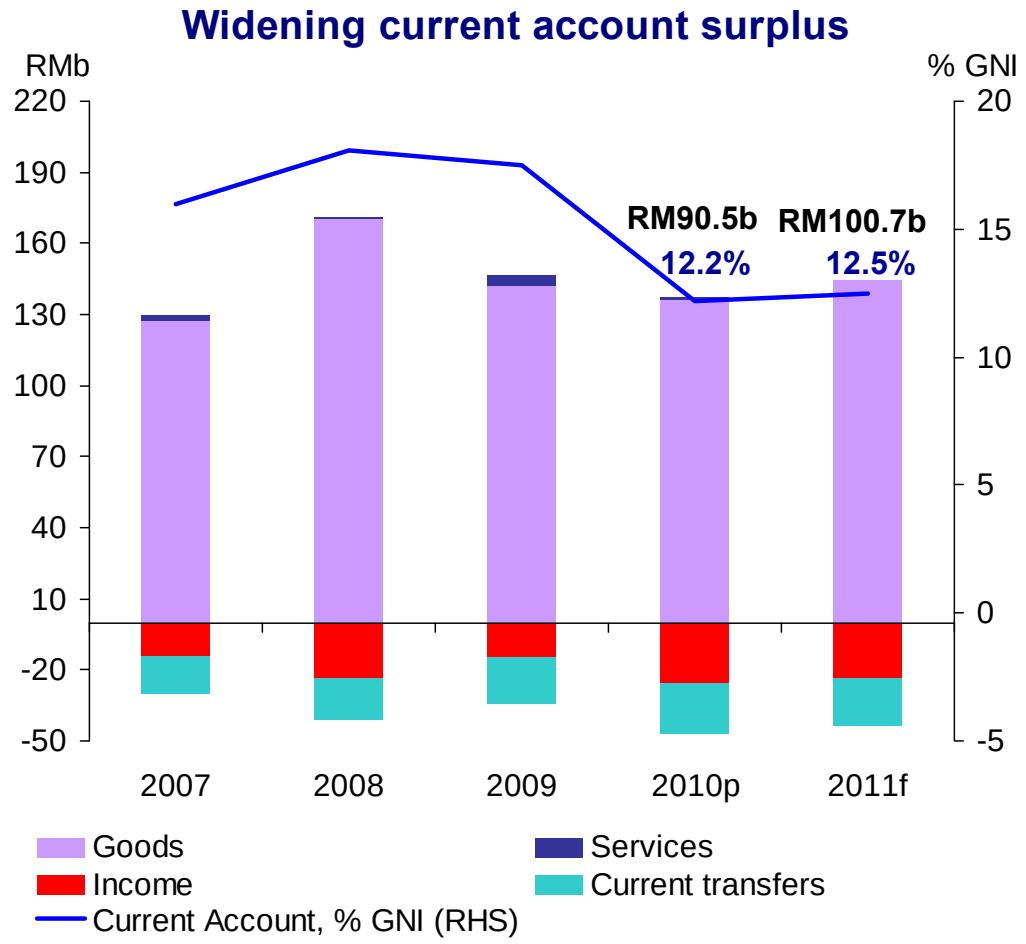
Annual change (%)	2010[p]	2011[f]
Gross exports	**15.6**	**5.4**
Manufactured	**13.0**	**4.4**
E&E	*9.9*	*3.7*
Non-E&E	*17.3*	*5.2*
Commodities	**26.9**	**10.1**
Agriculture	*30.8*	*12.4*
Minerals	*23.4*	*8.0*
Gross Imports	**21.7**	**5.7**
Capital	*16.2*	*10.3*
Intermediate	*22.1*	*5.3*
Consumption	*10.1*	*8.4*
Trade balance (RM bn)	**110.2**	**114.6**

- **Exports**
  - Moderation from the high base of 2010, particularly in manufactured exports
  - **But**, strong support from commodity exports due to higher prices and sustained regional demand
- **Imports**
  - Modest growth in intermediate imports
  - Growth in capital and consumption imports reflects strong domestic demand

[p] preliminary [f] forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Current account to remain in surplus



p preliminary f forecast

- Larger trade surplus supported by higher commodity exports
- Services surplus, benefiting from higher tourism receipts
- Lower income deficit
  - Higher earnings by Malaysian companies investing abroad
  - Lower repatriation of profits and dividends by MNCs

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Broad-based growth across all sectors

Annual change (%)	2010[p]	2011[f]
Agriculture	1.7	3.4
Mining	0.2	2.0
Manufacturing	11.4	5.7
Construction	5.2	5.4
Services	6.8	5.9
Real GDP	7.2	5.0 ~ 6.0

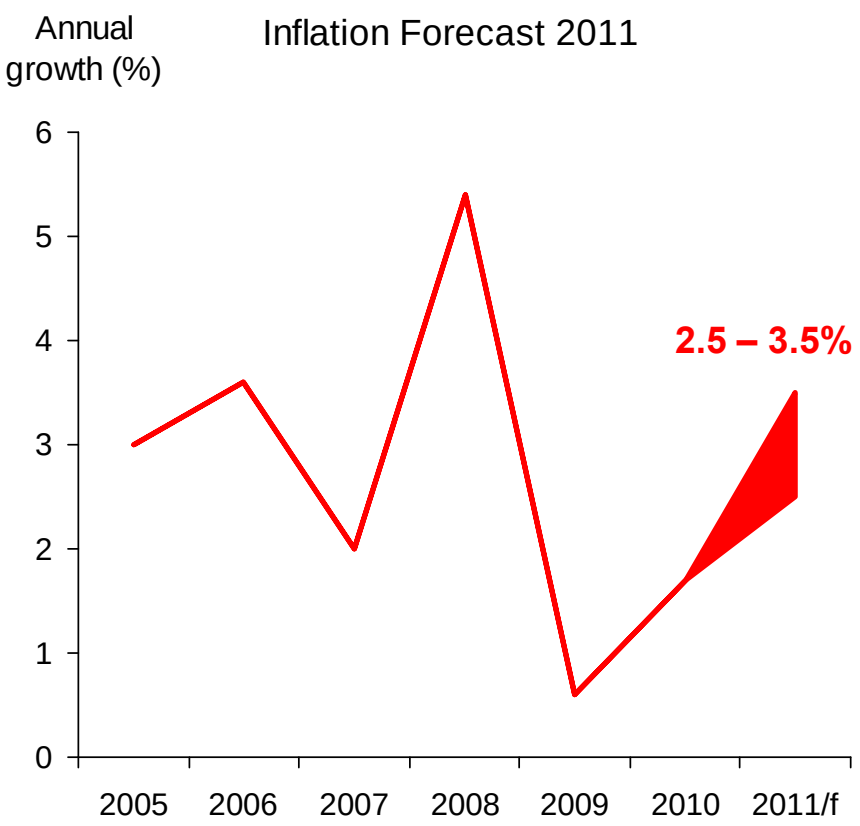
- Supported mainly by the continued growth of domestic economic activity
- Trade-related services and export-oriented manufacturing industries to record slower growth in line with the expected moderation in external demand

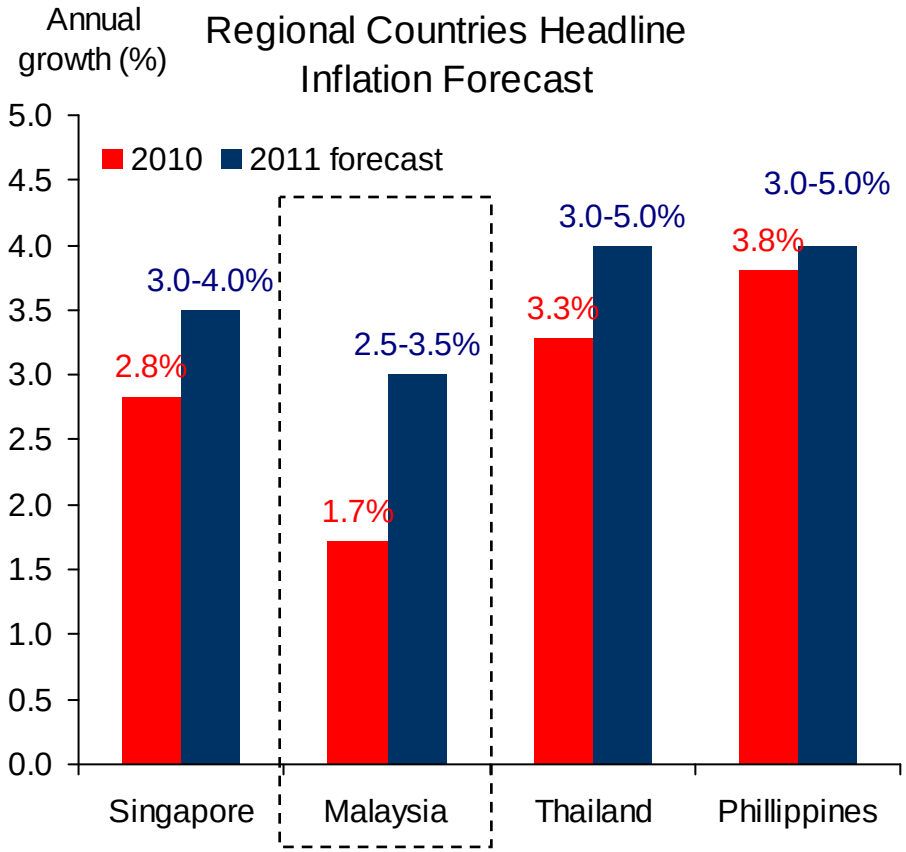
p preliminary f forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Headline inflation to range between 2.5 – 3.5% in 2011

- Driven mainly by higher global commodity and energy prices, inflation is expected to increase in 2011.
- This trend is similar to other regional economies





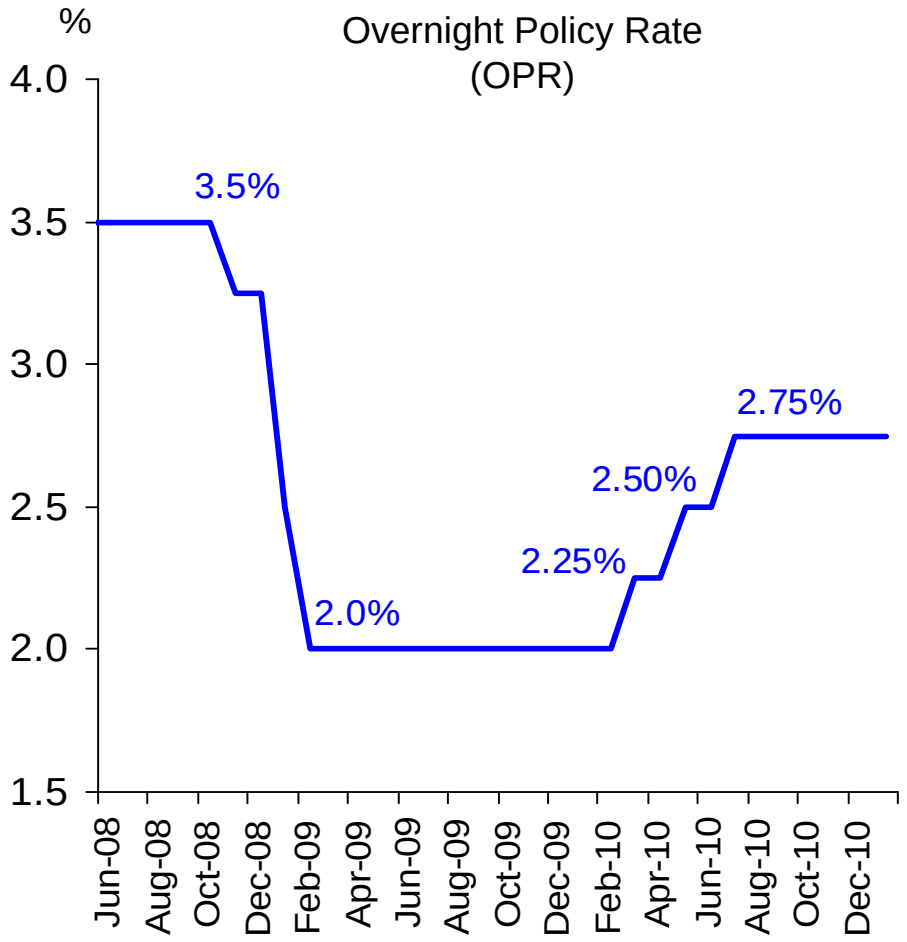
Note: Inflation forecast refer to the central bank official forecast

Malaysia has adopted a comprehensive approach to manage inflationary pressures from commodity prices

In addition to macroeconomic policies, other measures taken are

- Increasing food production and its distributional efficiency
- Promoting greater energy efficiency by households and industry
- A more gradual subsidy rationalisation programme
- Providing income support to targeted groups

Monetary policy in 2011 will remain supportive of growth, while managing risks to inflation

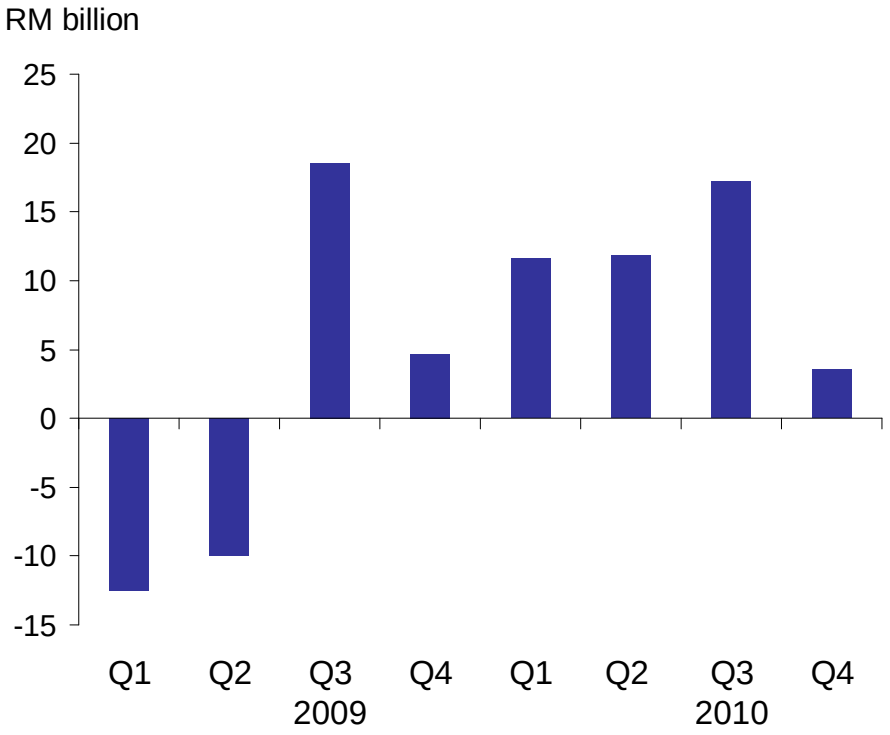


- **Given improved economic outlook, the OPR was adjusted in 2010 to**
  - Normalise monetary conditions
  - Prevent the risk of financial imbalances
- **For 2011, focus of monetary policy is to manage the risk of a more modest growth and higher inflation**
  - Monetary policy has the flexibility to remain accommodative
  - The degree of accommodation may however, need to be reviewed to ensure sustainable economic growth

Two-way capital flows expected to continue

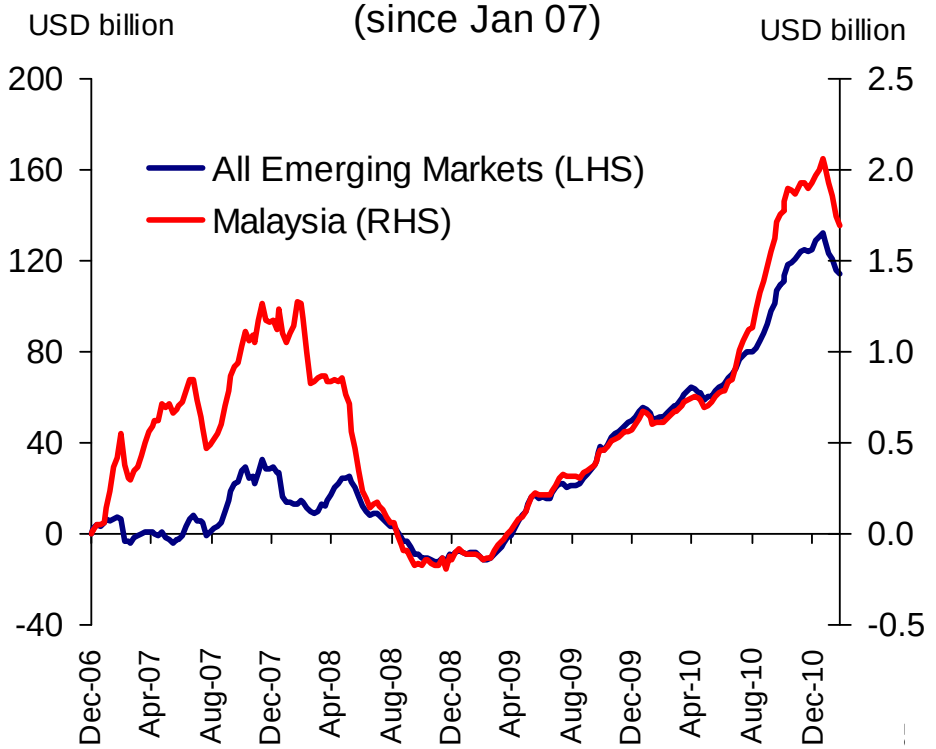
- In 2010, the capital inflows to Malaysia went into both the bond and equity markets
- Strong economic fundamentals and positive prospects will continue to attract portfolio inflows
- But this is likely to be interrupted by intermittent reversals driven by external events

Net Portfolio Investment into Malaysia



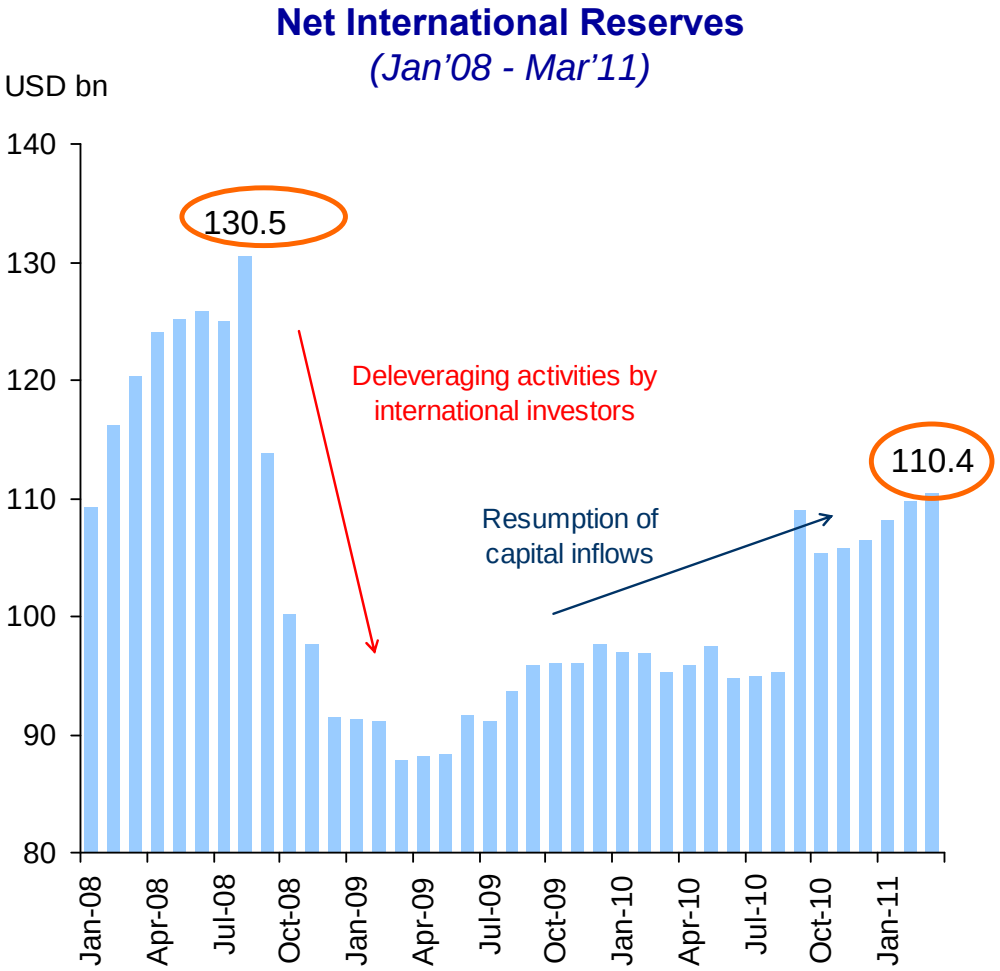
Source: Department of Statistics Malaysia

Cumulative net equity fund flows (since Jan 07)



Source: Emerging Portfolio Fund Research Global

Large inflows have also led to increases in international reserves



- **Large inflows have led to increases in international reserves**
  - Since the resurgence of capital inflows in 2H 2009, net international reserves at USD110.4 bn in 15 March-11.
  - During previous episode in Aug-08: USD130.5 bn

Source: BNM

Capital flows currently well intermediated

Large inflows have increased liquidity in the domestic financial system but, this has been well managed

- More diversified and developed financial system has helped to intermediate the capital flows
- Managed float regime has the necessary flexibility for the exchange rate to adjust to changing conditions
- Wider range of instruments for effective monetary operations
- Rigorous surveillance and information systems
- Stronger fundamentals and a healthy level of international reserves
- Closer cooperation and communication among central banks