DEVELOPMENTS IN THE SECOND QUARTER OF 2005

International Economic Environment

Global economy showed improved performance

Global growth in the second quarter remained strong. Growth in the United States (US) and the People's Republic of China (PR China) was sustained while there were stronger signs of recovery in the euro area and Japan.

The **US** economy expanded by 3.4% in the second quarter. Strong consumer spending, investment and exports supported the broad-based expansion, while strong demand allowed inventories to fall for the first time since the second quarter of 2003. Most of the economic indicators such as consumer confidence, capacity utilisation and unemployment pointed towards sustained economic activities. To contain inflationary pressures amidst strong growth, the Federal Reserve continued to raise policy interest rate by 25 basis points each on 3 May, 30 June and 9 August to reach 3.5%. In **Japan**, domestic demand showed signs of recovery. Firm consumption, capital spending and a rebound in exports supported growth in the second quarter at 1.1%. In the **euro area**, GDP growth was sustained at 1.2% as Italy and Netherlands rebounded from the negative growth in the first quarter. However, high unemployment and weak domestic demand persisted. Meanwhile, the **United Kingdom** economy recorded the slowest quarterly expansion of 1.7% since 1993, with a further weakening of the manufacturing sector and a more modest expansion in the services sector.

Industrial Countries: Real GDP growth

	2004		2005			Key contributing factors for 2Q growth
	2Q	1H	1Q	2Q	1H	
	Annual change (%)					
US[1]	3.5[r]	3.9	3.8	3.4[a]	3.6[p]	Broad-based expansion supported by strength in consumer spending, investment and exports.
UK	3.7	3.6	2.1	1.7[p]	1.9[p]	Growth was supported by the services sector while industrial production continued to decline.
Euro area	2.1	1.8	1.4	1.2[p]	1.3[p]	Sustained growth as Italy and Netherlands rebounded from negative growth in 1Q.
Japan[1]	-0.6	2.3	5.4[r]	1.1[a]	3.1[p]	Recovery on track as domestic demand strengthened. Strong capital spending and private consumption supported growth.

[1] Annualised basis
[r] Revised
[a] Advanced estimate
[p] Preliminary
Source: National authorities

Global **crude oil prices** were volatile in the second quarter. Having declined to below USD50 per barrel (p/b) in May, prices of crude oil futures increased to surpass USD60 p/b towards the end of June. In addition to adverse weather conditions and geopolitical risks, fundamental factors such as continued strong global demand, especially from the US and PR China, and limited spare production and refining capacity continued to support high oil prices. Price of oil futures reached a new high of USD67.10 p/b on 12 August.

In the **Asian** region, growth improved in the second quarter, supported by several positive developments including the turnaround in the biomedical sector in Singapore, a pick-up in domestic demand in Korea, stronger consumer spending in Chinese Taipei and continued strong growth in PR China.

Regional Countries: Real GDP growth

	2004		2005			Key contributing factors for 2Q growth
	2Q	1H	1Q	2Q	1H	
	Annual change (%)					
PR China	9.6	9.7	9.4	9.6	9.5	Supported by strong investments and exports.
Indonesia	4.5	4.8	6.2	5.5	5.9	Underpinned by strong private consumption and investment.
Singapore	12.3	10.1	2.8	5.2	4.0	Attributed to an expansion in the biomedical and services sectors.
Korea	5.5	5.4	2.7	3.3[a]	3.0[a]	Supported by private consumption, investment and construction.
Chinese Taipei	7.9	7.3	2.5	3.0	2.8	Slowing exports were offset by stronger domestic spending.

[a] Advanced estimate
Source: National authorities

In most regional countries, inflationary pressures have edged upwards due to larger pass-through of high oil prices following partial or complete removals of fuel subsidies in several countries including Indonesia, Thailand and Malaysia. Thailand, Chinese Taipei, Indonesia, the Philippines and India raised interest rates during the second quarter to contain inflationary pressures. In addition, higher oil prices and weaker exports have prompted Thailand, Chinese Taipei and Korea to revise downwards their 2005 GDP growth forecast.

In the **currency markets**, the USD continued to record broad-based appreciation against the other major currencies, with the USD reaching a near nine-month high against the yen and the pound by end-June. Factors supporting the strength in the USD were yield differentials in favour of the USD and the relatively more favourable US economic indicators compared to the other major industrial countries.

On 21 July 2005, PR China announced a change in their exchange rate regime by adopting a managed float exchange rate regime with reference to a basket of currencies. The exchange rate of the USD against the RMB was adjusted to 8.11 yuan per USD (earlier: 8.28 yuan per USD). The daily trading price of the USD against the RMB in the inter-bank foreign exchange market would be allowed to float within a band of +/- 0.3% around the central parity published by the People's Bank of China (PBoC), while the trading prices of the non-USD currencies against the RMB will be allowed to move within a certain band announced by the PBoC.

Going forward, while high oil prices and rising inflationary pressures are a concern, the momentum of global demand is expected to be sustained in the second half of the year following favourable indicators from the US and more recently from the euro area and Japan. Prospects are also reinforced by an expected improvement in the global electronic sector in the latter part of the year.

Developments in the Malaysian Economy

Services sector continued to record strong growth…

The Malaysian economy expanded by 4.1% in the second quarter of 2005 (1Q 2005:

5.8%), driven mainly by private sector activity. The services sector provided the main impetus to growth, contributing to 3.1 percentage points to growth, underpinned by strong consumer spending, travel and business activity. Meanwhile, the manufacturing sector expanded at a more moderate pace, sustained by growth in selected resource-based industries as well as improvement in the electronics industry. Performance of the primary commodity sector was mixed, with continued expansion in the agriculture sector, while the mining sector recorded a decline following a contraction in crude oil production.

Quarterly GDP by Kind of Economic Activity at 1987 Prices

	2004		2005		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
Agriculture	3.7	3.8	6.0	3.2	4.5
Mining	0.8	3.3	3.4	-1.6	0.9
Manufacturing	11.9	12.2	5.7	3.2	4.4
Construction	-1.5	-0.4	-2.4	-2.0	-2.2
Services	8.1	7.3	6.2	5.4	5.8
Real GDP (Ann. Chg.)	**8.4**	**8.1**	**5.8**	**4.1**	4.9
Real GDP (Preceding Chg.)	**4.5**	**0.3**	**-3.2**	**2.7**	-0.9

Source: Department of Statistics, Malaysia

Growth in the **services sector** remained firm, expanding by 5.4% in the second quarter, supported by both intermediate and final services segments which grew by 5.1% and 5.6% respectively. The wholesale and retail trade, hotels and restaurants; transport, storage and communication; and electricity, gas and water sub-sectors, which account for about one-fourth of the entire GDP continued to expand rapidly in line with the expansion in business activities and strong consumer demand. The hospitality and transport activities were enhanced by continued increase in tourist arrivals, particularly from Korea, India and Singapore. Foreign tourist arrivals grew by 2.5% in the second quarter (1Q 2005: 4.6%). In addition, the telecommunications industry continued to perform strongly, led by the mobile segment, following the introduction of attractive packages which increased subscriber base and usage of new mobile data features. The quarter also saw the launch of the third-generation (3G) mobile phone services in the country in selected areas of the western region of Peninsular Malaysia. The 3G technology offer high value-added services such as faster transmission of information via text, digitised voice, video mail and multimedia.

Meanwhile, the finance, insurance, real estate and business services sub-sector increased by 4.7% during the quarter. This sector was supported by continued bank lending activities and further reinforced by

Performance in the Services Sector (Value Added)

		2004		2005		
	% share	2Q	1H	1Q	2Q	1H
		Annual change (%)				
Intermediate Services	**41.5**	**7.9**	**7.7**	**6.9**	**5.1**	**6.0**
Transport, storage & communication	15.2	9.1	8.5	10.4	5.9	8.1
Finance, insurance, real estate & business services	26.3	7.2	7.2	4.8	4.7	4.8
Final Services	**58.5**	**8.3**	**7.0**	**5.8**	**5.6**	**5.7**
Electricity, gas & water	7.2	8.6	8.7	5.9	6.0	5.9
Wholesale & retail trade, hotel & restaurants	24.9	10.4	7.8	7.7	7.1	7.4
Government services	12.8	6.0	5.9	3.2	3.1	3.2
Other services	13.6	6.5	5.7	4.7	4.8	4.8
Total Services	**100**	**8.1**	**7.3**	**6.2**	**5.4**	**5.8**

Source: Department of Statistics, Malaysia

Selected Quarterly Indicators in the Services Sector

	2004			2005	
	2Q	3Q	4Q	1Q	2Q
	Annual change (%)				
Hotel occupancy rate (%)	58.4	65.6	62.7	60.7	61.5
Tourist arrivals	127.4	51.5	15.4	4.6	2.5
Total passenger traffic at all airports	44.6	15.2	11.2	6.6	5.5
Total consumption credit outstanding	13.3	14.7	16.4	17.4	17.8
Loan outstanding to the wholesale & retail trade, restaurants & hotels	6.7	9.5	11.0	12.7	12.6
Imports of consumption goods	28.0	38.8	16.4	10.7	4.1
Total sales of new motor vehicles	24.5	22.3	29.8	21.8	8.1
Cellular phone penetration rate (%)	48.5	50.8	56.5	60.9	63.3
SMS traffic	45.2	53.0	77.8	70.6	91.0
Cargo handled (All airports)	11.3	13.7	10.2	5.3	5.3
Container cargo handled (Port Klang and PTP)	17.8	8.8	3.6	4.7	2.1
Cargo revenue (Railway)	-0.4	19.9	12.2	7.7	4.2

Source: Various sources

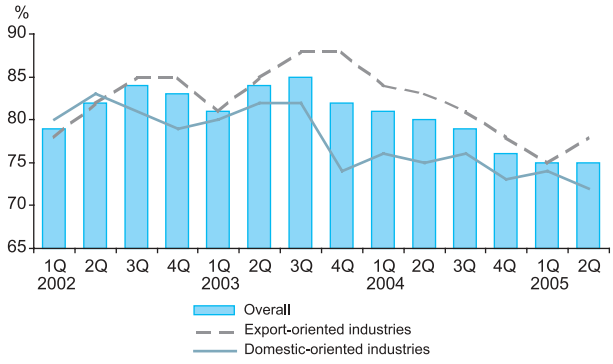
strong insurance activities, particularly the life insurance segment. Growth in the utilities sub-sector continued to remain firm at 6% (1Q 2005: 5.9%) reflecting demand for electricity from all categories of users, namely, industrial, commercial and households.

Moderate expansion in the manufacturing sector ...

Value added in the **manufacturing sector** expanded by 3.2% in the second quarter of 2005 (1Q 2005: 5.7%). Output of the **export-oriented industries** grew by 4.1% (1Q 2005: 5.4%) supported by continued expansion of selected resource-based industries, and an improvement in the electrical and electronics products industry (1.1%; 1Q 2005: -1.2%). During the quarter, resource-based industries, such as chemical products and off-estate processing industries sustained double-digit growth rates of 10.6% and 18.9% respectively (1Q 2005: 16% and 24.6% respectively). The expansion in the chemical products industry was led by higher production of plastic products in response to the strong demand from the regional countries. Off-estate processing benefited from the strong output of crude palm oil production during the quarter. Meanwhile, output of rubber products declined marginally by 0.1% (1Q 2005: 10.9%) due partly to the lower output of tyres arising from difficulty in sourcing components.

The **domestic-oriented industries** recorded a decline in production (-1.3%; 1Q 2005: 6.4%). Strong growth in the transport equipment and beverages industries (9.7% and 21.1% respectively) was offset by contraction in the output of fabricated metal and construction-related industries (-12.5% and -5.2% respectively). Non-metallic mineral products, basic metals and fabricated metal products were affected by the subdued performance in the

Capacity Utilisation in the Manufacturing Sector



Performance in the Manufacturing Sector

	2004		2005		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
Value Added (Constant Price)	**11.9**	**12.2**	**5.7**	**3.2**	**4.4**
Overall Production	**15.7**	**16.1**	**5.6**	**2.9**	**4.2**
Export-oriented industries	**18.2**	**18.7**	**5.4**	**4.1**	**4.7**
Of which:					
Electronics and electrical products	23.9	24.5	-1.2	1.1	0.0
Electronics	33.0	33.6	-0.1	3.2	1.6
Electrical	-7.7	-7.3	-7.1	-9.2	-8.2
Textiles & wearing apparel	-7.8	-9.3	-4.4	-5.6	-5.0
Chemicals and chemical products	18.2	17.6	16.0	10.6	13.3
Off-estate processing	-5.9	-1.8	24.6	18.9	21.6
Rubber products	21.2	22.6	10.9	-0.1	5.3
Wood and wood products[1]	20.9	17.5	-3.4	-6.5	-5.0
Domestic-oriented industries	**7.5**	**7.5**	**6.4**	**-1.3**	**2.5**
Of which:					
Transport equipment	10.0	5.3	13.5	9.7	11.5
Fabricated metal products	23.9	29.1	15.9	-12.5	0.8
Iron & steel and non-ferrous metal	9.0	7.6	-3.6	-6.3	-5.0
Non-metallic mineral products	-8.6	-5.1	-3.6	-4.1	-3.8
Petroleum products	-5.1	-3.5	10.4	5.8	8.1
Food	7.6	7.5	2.3	6.2	4.2
Total Manufactured Exports	**20.7**	**19.1**	**12.0**	**9.2**	**10.6**
Of which:					
Electronics and electrical products	18.1	16.7	9.9	8.7	9.3
Semiconductors	7.1	5.9	6.4	-3.3	1.3
Electronics equipment and parts	22.9	21.1	9.7	21.6	15.9
Electrical appliance	28.7	27.6	15.3	6.3	10.5
Wood and wood products	32.3	30.4	16.8	4.5	10.4
Furniture & parts	15.3	15.2	10.3	11.9	11.1
Rubber products	21.6	20.8	11.9	9.4	10.6
Optical & scientific equipment	33.5	22.8	22.9	-4.3	7.5
Chemical and chemical products	28.1	27.1	20.7	3.1	11.4
Petroleum products	26.0	22.7	18.0	44.6	30.3

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

Source: Department of Statistics, Malaysia

construction sector. Meanwhile, the transport equipment industry continued to remain robust, benefiting from the high level of passenger car sales driven by the low interest rates and the launch of new car models during the year.

The **overall capacity utilisation** of the manufacturing sector remained at 75% in the second quarter of 2005 (1Q 2005: 75%). The capacity utilisation rate of the export-oriented industries increased to 78% (1Q 2005: 75%), while the domestic-oriented industries operated at 72% (1Q 2005: 74%).

Mixed performance in the commodity sector ...

The **agriculture sector** recorded a growth of 3.2% in the second quarter of 2005

Performance in the Agriculture Sector

	2004		2005		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
Value Added (at 1987 prices)	**3.7**	**3.8**	**6.0**	**3.2**	**4.5**
Production[1]					
Of which:					
Crude palm oil	-5.8	-2.3	27.5	14.5	20.3
Crude palm kernel oil	-10.9	-4.4	27.2	25.1	26.1
Rubber	29.8	23.9	-9.2	-6.7	-8.1
Saw logs	4.4	-3.8	-2.2	-15.8	-10.2
Cocoa	-8.5	-22.5	-11.9	-29.9	-21.2
Exports (RM million)	**12.0**	**12.9**	**6.2**	**5.3**	**5.7**
Of which:					
Palm oil					
('000 tonnes)	-12.1	-4.4	13.9	29.0	21.6
(RM/tonne)	16.9	11.9	-15.7	-21.1	-18.6
(RM million)	2.8	7.0	-4.0	1.8	-1.0
Palm kernel oil					
('000 tonnes)	26.1	30.2	14.5	8.9	11.5
(RM/tonne)	60.7	45.0	8.3	-2.1	2.3
(RM million)	102.6	88.9	24.1	6.6	14.1
Rubber					
('000 tonnes)	12.0	17.6	-0.8	5.3	2.2
(Sen/kilogramme)	36.0	36.2	-2.2	-3.2	-2.6
(RM million)	52.3	60.1	-2.9	2.0	-0.5
Sawn timber					
('000 cu.metres)	15.6	11.0	47.8	10.4	27.3
(RM/cu.metre)	-17.8	-15.3	-10.3	17.5	3.0
(RM million)	-4.9	-6.0	32.6	29.7	31.1
Saw logs					
('000 cu.metres)	-11.5	-12.4	42.2	15.4	26.9
(RM/cu.metre)	20.2	11.7	4.4	-5.1	-1.4
(RM million)	6.4	-2.1	48.4	9.5	25.1
Cocoa beans					
('000 tonnes)	-8.3	-42.3	183.4	-15.8	25.8
(RM/tonne)	-12.9	-14.0	0.7	-6.9	-6.1
(RM million)	-20.1	-50.4	185.3	-21.6	18.1

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

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

(1Q 2005: 6%). Production of crude palm oil continued to grow at a strong pace of 14.5% (1Q 2005: 27.5%) to 3.75 million tonnes, the highest quarterly level recorded. The strong performance was supported by growth in productivity, both in terms of fresh fruit bunches (FFB), which rose to 4.68 tonnes per hectare (1Q 2005: 4.35 tonnes per hectare), and oil extraction rate (OER), which increased to 20.04% (2Q 2004: 19.99%). The stronger yields were mainly in Sabah (produces approximately 30% of Malaysia's palm oil), due to a higher percentage of trees that are in their peak production period. Thus, the monthly average production of crude palm oil was significantly higher at 1.25 million tonnes (2Q 2004: 1.09 million tonnes). In contrast, rubber production declined for the second consecutive quarter by 6.7% as dry weather spells led to lower latex output. The dry weather has also caused irrigation problems in paddy-growing regions, thus causing a significant reduction in paddy output during the quarter.

Meanwhile, the **mining sector** was affected by lower production of crude oil (including condensates), which declined by 9.2% to 670,523 barrels per day. The decline was a result of the shutdowns of several oil fields and plants for maintenance purposes. Crude oil prices continued to be volatile during the quarter, underlining the fine balance between supply and demand and the tight spare capacity in the major oil producing countries. This was further aggravated by refinery constraints in major consuming countries which led to the increase in the price of Tapis Blend. Tapis Blend, which commands a premium due to its superior qualities,

Performance in the Mining Sector

	2004		2005		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
Value Added (at 1987 prices)	**0.8**	**3.3**	**3.4**	**-1.6**	**0.9**
Production					
Of which:					
Crude oil and condensates ('000 barrels)	-0.2	3.8	-5.2	-9.2	-7.2
Natural gas (net) (million standard cubic feet)	4.0	3.1	19.8	12.1	16.0
Exports (RM million)	**43.9**	**28.3**	**34.8**	**31.5**	**33.1**
Of which:					
Crude oil & condensates					
('000 tonnes)	4.4	4.3	-1.1	-5.3	-3.2
(USD/barrel)	33.6	17.7	36.0	43.4	39.6
(RM million)	39.5	22.7	34.5	35.7	35.1
Liquefied natural gas					
('000 tonnes)	34.1	25.5	17.6	2.5	10.2
(RM/tonne)	1.5	-0.5	12.8	14.0	13.3
(RM million)	36.0	24.8	32.7	16.8	24.9

Source: PETRONAS
Department of Statistics, Malaysia

breached the USD60 mark in early April, before stabilizing in the range of USD55 - 58 per barrel during the rest of the quarter.

Meanwhile, natural gas production continued to increase at a double-digit rate of 12.1% to 5,657 million standard cubic feet per day (1Q 2005: 19.8%). The higher production was driven mainly by higher capacity utilisation of the Malaysia Liquefied Natural Gas (MLNG) plants in Sarawak and Gas Processing Plants (GPPs) in Peninsular Malaysia, induced by higher demand from LNG importing countries (Japan and Chinese Taipei).

Contraction in construction activity …

The **construction sector** contracted by 2% (1Q 2005: -2.4%) due mainly to lower activity in the civil engineering sub-sector.

Activity in the residential and non-residential segments continued to expand, supported by demand for houses and office space. In particular, the renewed interest in office space was reflected by the increase in occupancy rates and incoming supply in the Klang Valley. Amidst the consolidation in the civil engineering sub-sector, Malaysian construction companies continued to bid for overseas projects to diversify their earnings base. Their initiatives have showed positive results with Malaysian contractors successfully securing several infrastructure projects in India and the Middle East.

Construction Indicators

	2004		2005		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
New sales and advertising permits	0.7	18.9	2.3	10.1	6.2
Housing approvals	-14.9	8.5	11.2	-26.9	-7.8
Production of construction-related materials	-0.8	0.7	-3.6	-5.2	-4.4
Loans approved for construction	31.2	-6.4	47.6	-14.5	8.7
Imports of construction materials & mineral products	56.8	37.1	6.1	-7.3[1]	0.1[2]

[1] *Apr.-May 2005*
[2] *Jan.-May 2005*

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

Private sector spending remains strong

Domestic demand increased by 5.6% in the second quarter of 2005. The private sector continued to provide the main impetus to growth, while there continued to be on-going progress in the Government fiscal consolidation programme.

Private consumption continued to increase strongly in the second quarter, expanding by 7.4% (1Q 2005: 10.1%).

GDP by Expenditure Components (at Constant 1987 prices)

	2004		2005		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
Aggregate Domestic Demand (excluding stocks)	8.8	8.2	5.9	5.6	5.8
Consumption	11.3	10.4	7.6	5.1	6.3
Private sector	*11.9*	*10.4*	*10.1*	*7.4*	*8.7*
Public sector	*9.4*	*10.5*	*-2.3*	*-2.4*	*-2.4*
Gross Fixed Capital Formation	3.5	3.5	2.0	6.7	4.5
Exports of Goods and Services	20.4	18.4	9.5	7.9	8.6
Imports of Goods and Services	25.8	23.5	7.6	6.9	7.3
GDP	**8.4**	**8.1**	**5.8**	**4.1**	**4.9**

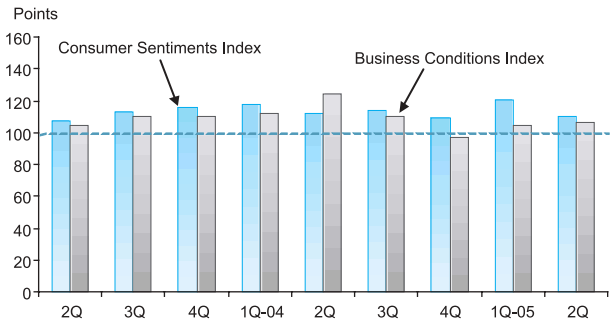
Source: Department of Statistics, Malaysia

Stable income and employment market conditions, amidst high savings and competitive credit market conditions led to sustained strong consumer spending. The findings of the consumer sentiments survey of the Malaysian Institute of Economic Research (MIER) indicated that consumers remained optimistic although there was some concern on rising prices. The MIER's Consumer Sentiment Index (CSI) remained above the 100-point threshold at 109.8 points (1Q 2005: 120.9 points), signifying continued expansion in household consumption. Other major consumption indicators such as loans approved and disbursed for consumption credit and consumer-oriented businesses, credit card transactions and imports of consumption goods, also supported the positive trend in private consumption.

Meanwhile, **public consumption** declined during the quarter (-2.4%; 1Q 2005: -2.3%) mainly on account of lower expenditure on defence.

Gross fixed capital formation strengthened to 6.7% in the second quarter (1Q 2005: 2%) even as the Federal Government's investment activities continued to decline. Investment indicators suggest that private capital spending increased firmly during the quarter. MIER's Business Conditions Index improved to 106 points (1Q 2005: 104.1 points). Other major indicators, especially imports of capital goods, sales of commercial vehicles and loans disbursed to businesses, also reflected stronger investment activities in the second quarter.

Consumer and business confidence remain optimistic

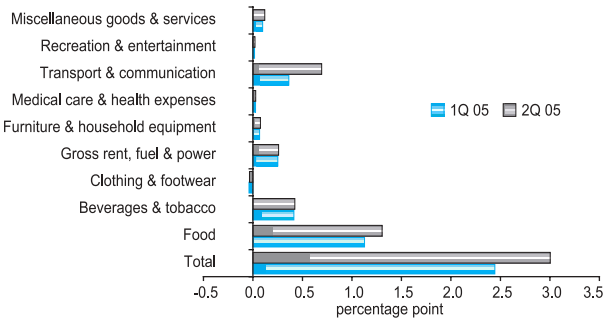


Cost factors led to higher inflation

The annual rate of inflation, as measured by the **Consumer Price Index** (CPI), increased to 3% (1Q 2005: 2.4%). The increase was driven mainly by the higher prices of food and transportation. The increase in prices of food was due to the higher prices of both food at home and food taken away from home. Meanwhile, the increase in prices of transportation was due mainly to the increase in bus and taxi fares as well as higher retail prices of petroleum products, which became effective in May.

The **Producer Price Index** (PPI) increased at an annual growth of 6.2% (1Q 2005: 5.1%), driven by higher prices of crude oil, which more than offset the decline in the prices of rubber and crude palm oil. Excluding commodities, the PPI, however, was stable at 2.2% in the second quarter (1Q 2005: 2.5%).

Contribution to Inflation



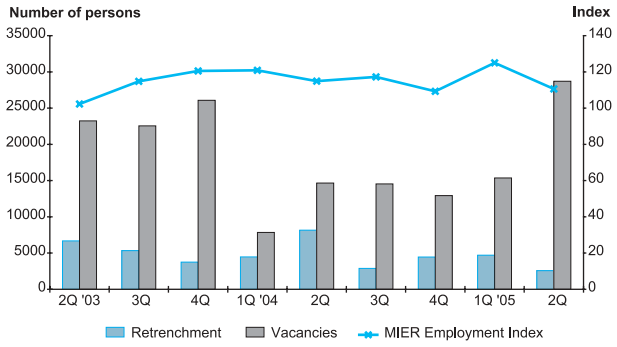
Labour market conditions continued to improve

Labour market conditions in the second quarter continued to improve. Vacancies reported to the authorities increased (28,715 positions; 1Q 2005: 15,369 positions), while retrenchments were lower (2,570 persons; 1Q 2005: 4,709 persons). The number of unplaced jobseekers rose to 82,708 persons as at end of June 2005 (33,740 persons as at end March 2005). However, while a record high, the data is not comparable with past series. With effect from May 2005, the registration period during which jobseekers

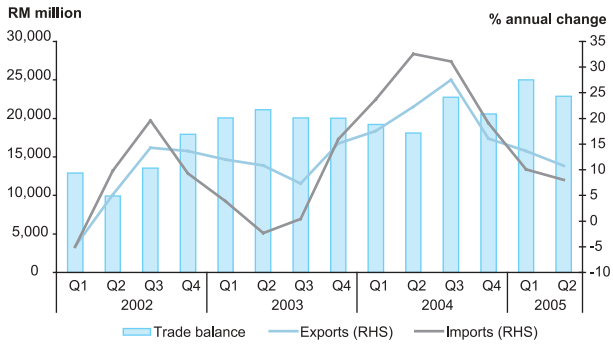
are deemed to be actively seeking jobs was lengthened to six months (three months previously).

Growth in labour productivity during the quarter, as measured by real sales value of products per employee in the manufacturing sector, rose by 10.2%. Real wages per employee declined by 0.4%.

Labour Market Conditions Improved



Trade balance



Exports and imports continued to expand

The **trade account** recorded a large surplus of RM22.9 billion (1Q 2005: RM25 billion). Gross exports and imports continued to expand, albeit at more moderate rates of 10.8% and 8% respectively.

Gross exports grew by 10.8% in the second quarter of 2005 (1Q 2005: 13.7%) supported mainly by robust growth in mineral exports (31.5%) and reinforced by expansion in manufactured goods (9.2%) and agriculture commodities (5.3%). Exports of **manufactured goods** expanded by 9.2% (1Q 2005: 12%), reflecting an increase of 8.7% in electronics and electrical (E&E) products (1Q 2005: 9.9%). While external demand for semiconductors remained subdued, exports of personal computers and laptops had improved. Of significance, exports of resource-based products continued to be robust, led mainly by exports of petroleum, furniture and rubber products. Despite the increase in cost of raw materials, exports of rubber products continued to expand by 9.4% (1Q 2005: 11.9%), reflecting the strong global demand for high quality natural rubber gloves. Overall, the increase in exports of manufactured goods during the quarter was due to increases in both unit value (3%) and volume (6.1%).

Mineral exports continued with its strong trend seen in recent quarters, expanding by 31.5% during the quarter. Malaysia being a net exporter of crude petroleum benefited from the upward trend in crude oil prices, as Malaysian crude oil is of the premium light and sweet grade, and hence earned a higher price compared with the heavy and sour crude grade. In line with these developments, Malaysian crude oil export prices strengthened significantly during the

quarter, rising by 43.4% to average USD54.28 per barrel. However, export volume fell during the quarter (-5.3%), in line with the contraction in crude oil production during the quarter. Exports of liquefied natural gas (LNG) rose by 16.8%, supported by both higher prices (14%) and volume (2.5%). LNG prices hit a record monthly high of RM918 per tonne in June 2005. Higher demand for LNG was most evident from Malaysia's major LNG buyers, namely Chinese Taipei (46.6%) and Japan (5.6%).

Trade Account

	2004		2005		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
Gross Exports	**22.3**	**20.0**	**13.7**	**10.8**	**12.2**
Manufacturing	*20.7*	*19.1*	*12.0*	*9.2*	*10.6*
Agriculture	*12.0*	*12.9*	*6.2*	*5.3*	*5.7*
Minerals	*43.9*	*28.3*	*34.8*	*31.5*	*33.1*
Gross Imports	**32.6**	**28.2**	**10.1**	**8.0**	**9.0**
Capital goods	*37.0*	*34.0*	*0.7*	*17.0*	*9.2*
Intermediate goods	*29.9*	*25.6*	*10.6*	*5.8*	*8.0*
Consumption goods	*28.0*	*21.5*	*10.7*	*4.1*	*7.2*
Trade balance (RM bil)	**18.1**	**37.3**	**25.0**	**22.9**	**47.9**

Source: Department of Statistics, Malaysia

Agriculture exports rose by 5.3% (1Q 2005: 6.2%), supported by increases in export receipts from sawn timber, saw logs and palm kernel oil. Meanwhile, proceeds from palm oil, the largest export item, increased, albeit marginally by 1.8% during the quarter due entirely to lower prices (declined by 21.1% to RM1,449 per tonne), from the exceptionally high levels seen in the corresponding period of 2004 (RM1,835 per tonne). However, shipments remained robust, growing by 29%, in response to strong purchases by the European Union (64.8%), for the purpose of producing biodiesel. In addition, palm oil exports to the People's Republic of China increased by 32.1% reflecting the highest monthly level in May (357,200 tonnes), while exports to India rebounded strongly by 49.5%, after six straight quarters of decline, due to lower- than- expected harvests of domestic rapeseed crop.

Malaysia's trade with the regional countries (excluding Japan) grew by 11.8%, with the export share sustained at 44.3%. The growth emanated mainly from exports

Malaysia: Direction of exports

	2004		2005			2004		2005			2004		2005		
	2Q	1H	1Q	2Q	1H	2Q	1H	1Q	2Q	1H	2Q	1H	1Q	2Q	1H
	RM billion					Share of total exports (%)					Annual change (%)				
United States	**22.8**	**42.0**	**21.6**	**27.0**	**48.6**	**19.3**	**18.6**	**17.6**	**20.6**	**19.2**	**15.6**	**13.9**	**12.2**	**18.4**	**15.6**
European Union (EU) [1]	**14.6**	**28.5**	**14.6**	**15.0**	**29.6**	**12.4**	**12.6**	**11.9**	**11.5**	**11.7**	**18.4**	**18.2**	**5.3**	**2.6**	**4.0**
Selected ASEAN countries[2]	**28.9**	**55.8**	**32.6**	**33.8**	**66.3**	**24.5**	**24.7**	**26.6**	**25.8**	**26.2**	**21.5**	**19.5**	**20.9**	**16.9**	**18.8**
North East Asia	**23.1**	**45.0**	**23.5**	**24.1**	**47.6**	**19.6**	**19.9**	**19.2**	**18.4**	**18.8**	**26.9**	**25.2**	**7.3**	**4.2**	**5.7**
People's Republic of China	*8.1*	*15.3*	*8.0*	*8.3*	*16.2*	*6.8*	*6.8*	*6.5*	*6.3*	*6.4*	*30.2*	*33.0*	*10.8*	*2.4*	*6.4*
Hong Kong China	*7.5*	*14.0*	*7.1*	*7.9*	*15.0*	*6.4*	*6.2*	*5.8*	*6.1*	*5.9*	*25.3*	*17.0*	*9.7*	*5.2*	*7.3*
Chinese Taipei	*3.8*	*7.4*	*3.1*	*3.8*	*6.8*	*3.3*	*3.3*	*2.5*	*2.9*	*2.7*	*11.2*	*8.9*	*-14.4*	*-1.4*	*-7.7*
Korea	*3.7*	*8.4*	*5.4*	*4.1*	*9.5*	*3.1*	*3.7*	*4.4*	*3.2*	*3.8*	*43.4*	*45.8*	*14.9*	*11.8*	*13.6*
India	**2.7**	**5.4**	**3.7**	**3.3**	**6.9**	**2.3**	**2.4**	**3.0**	**2.5**	**2.7**	**10.5**	**15.9**	**37.0**	**19.0**	**27.9**
Total exports	**118.0**	**225.8**	**122.6**	**130.7**	**253.3**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**22.3**	**20.0**	**13.7**	**10.8**	**12.2**

[1] Includes the 10 new member states

[2] Singapore, Thailand, Indonesia, Philippines, Brunei Darussalam and Viet Nam

Source: Department of Statistics, Malaysia

to Singapore, Thailand, Indonesia, Hong Kong China and Korea. Major exports that recorded increases were E&E products, metal products, refined petroleum products and rubber products. Increased sourcing of components from regional countries caused growth in imports from these countries to outpace export growth. Hence, the trade balance with regional countries narrowed to RM6.1 billion (1Q 2005: RM8.6 billion). The key imports from the region included machinery, appliances and parts, chemicals, manufactures of metal and plastics.

Exports to the United States (US) in the second quarter grew strongly reflecting mainly higher demand for E&E products, particularly computers and laptops. Export growth to Australia strengthened by 17.1% (1Q 2005: 16.6%) on account of resource-based products.

The increase in **gross imports** of 8% reflected expansion in private investment activity and demand for inputs for the production of exports of manufactured goods as well as domestic consumption. Imports of **intermediate goods**, which were inputs used for manufactured goods, expanded by 5.8%. The growth in intermediate imports was supported mainly by higher imports of primary materials used by the food and beverages industry, electronics and industrial supplies, particularly metal and chemical products. Consistent with the growth in the motor assembly industry, imports of transport equipment as well as parts and accessories of motor vehicles continued to expand. Higher oil prices also led to growth in imports of fuel and lubricants.

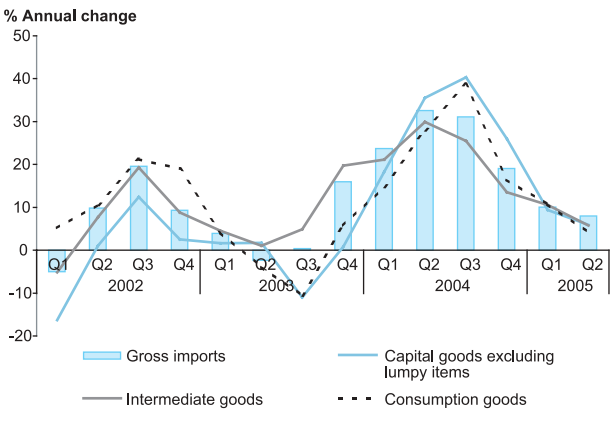
Imports of **capital goods** expanded by 17%. Capital imports excluding lumpy

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

	2004		2005		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
CAPITAL GOODS	**37.0**	**34.0**	**0.7**	**17.0**	**9.2**
Capital goods (except transport equipment)	34.4	27.4	7.3	9.5	8.5
Transport equipment	106.4	174.1	-43.0	147.2	15.8
INTERMEDIATE GOODS	**29.9**	**25.6**	**10.6**	**5.8**	**8.0**
Food and beverages, mainly for industry	111.1	66.2	-7.9	-12.5	-10.4
Industrial supplies, n.e.s.	49.1	37.4	16.0	7.5	11.3
Fuel and lubricants	23.1	11.3	95.7	41.6	63.9
Parts and accessories of capital goods (except transport equipment)	18.1	19.4	0.1	-0.7	-0.3
Parts and accessories of transport equipment	47.8	31.8	40.9	56.4	49.0
CONSUMPTION GOODS	**28.0**	**21.5**	**10.7**	**4.1**	**7.2**
Food and beverages, mainly for household consumption	37.8	28.2	9.5	2.7	6.0
Transport equipment, non-industrial	16.1	-10.8	-16.2	-20.4	-18.5
Consumer goods, n.e.s.	22.9	18.5	12.2	5.7	8.7
Durables	*19.1*	*15.5*	*11.3*	*20.3*	*16.0*
Semi-durables	*24.1*	*20.2*	*3.4*	*-3.9*	*-0.6*
Non-durables	*23.9*	*18.7*	*19.2*	*5.9*	*11.9*
DUAL USE GOODS	**34.8**	**31.4**	**17.0**	**38.3**	**27.9**
OTHERS	**6.6**	**7.0**	**-6.0**	**1.5**	**-2.2**
RETAINED IMPORTS	**30.3**	**26.2**	**9.0**	**7.9**	**8.4**
RE-EXPORTS	**117.3**	**103.6**	**35.3**	**9.3**	**21.2**
GROSS IMPORTS	**32.6**	**28.2**	**10.1**	**8.0**	**9.0**

Source: Department of Statistics, Malaysia

Import growth

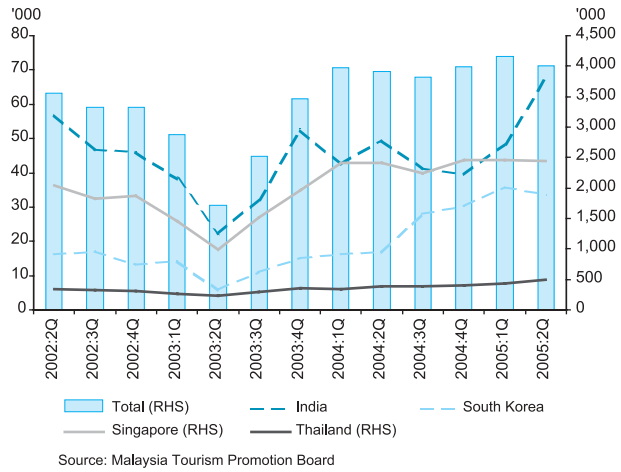


items grew by 5.9%. The increase in imports for capacity expansion and upgrading of technology occurred in the services sector, as evidenced by the strong growth in imports of office equipment and generators, turbines and electric motors. Imports of office equipment strengthened as corporations in the services industry improved their service delivery by upgrading infrastructure in information technology. Strong external demand for commodity exports and fleet expansion to service new markets also led to higher imports of aircraft and ships. Growth in imports of **consumption goods** of 4.1% reflected mainly growth in imports of processed food and beverages for household consumption and consumer goods.

Continued growth in tourist arrivals

Tourist arrivals increased by 2.5% to 4 million visitors in the second quarter of 2005. The increase in arrivals was attributed to visitors from Singapore, Thailand and Indonesia which together accounted for 78.6% of tourist arrivals. Visitors from South Korea, India, Australia and New Zealand also increased, supported by attractive promotional packages and greater connectivity with more flights and gateway points.

Quarterly Tourist Arrivals



Source: Malaysia Tourism Promotion Board

Higher inflows of FDI and portfolio investment

In the financial account, gross inflows of **foreign direct investment (FDI)**, based on cash basis, increased to RM8.7 billion in the second quarter of 2005 (1Q 2005: RM5 billion), reflecting larger inflows of inter-company loans and equity capital. More than a third of the FDI inflows were channelled into the oil and gas sector, particularly in the form of loans extended by a foreign company to its subsidiary in Malaysia. Meanwhile, FDI inflows into the services sector were channelled mainly into the financing, insurance and business services, as well as restaurants, hotels, wholesale and retail trade sub-sectors. In the manufacturing sector, FDI inflows were received mainly by companies in the petroleum products, photographic and optical products as well as electrical and electronics sub-sectors. After adjustments for outflows due mainly to larger repayment of loans to related companies abroad, net FDI recorded an inflow of RM3 billion.

Overseas investment recorded a gross outflow of RM21 billion (1Q 2005: -RM30 billion), reflecting mainly short-term loan extension by non-resident controlled companies in the oil and gas sector to their related companies abroad arising from their

centralised treasury operations. These outflows were largely offset by inflows arising from repayment of short-term inter-company loans during the quarter. Overseas investment by companies in the manufacturing, services and oil and gas sectors was sustained during the quarter. After adjusting for inflows mainly from repayment of inter-company loans from abroad, overseas investment recorded a net outflow of RM2.6 billion (1Q 2005: -RM3.2 billion).

Meanwhile, **portfolio investment** recorded a higher net inflow of RM4.5 billion (1Q 2005: RM2.8 billion). The increase during the quarter reflected mainly sustained foreign interest, particularly in the debt securities.

External debt declined

Malaysia's total external debt declined further to RM196.2 billion or USD51.6 billion as at end-June 2005 (1Q 2005: RM198 billion or USD52.1 billion), equivalent to 44.2% of GNP. The lower **medium and long-term external debt** at RM152.7 billion (1Q 2005: RM157.1 billion),

External Debt Outstanding

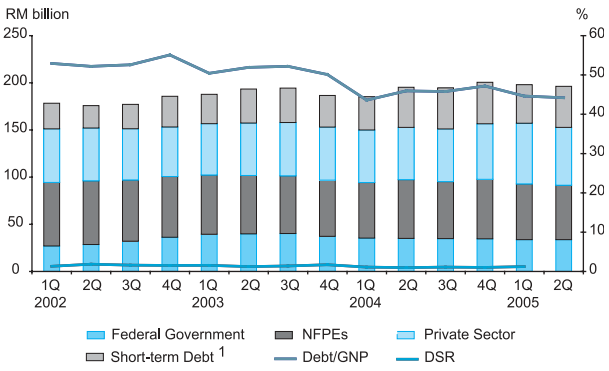
	2004	2005	
	2Q	1Q	2Q[p]
	RM billion		
Medium- and Long-term debt	152.7	157.1	152.7
Public sector	97.3	92.9	91.4
Private sector	55.4	64.2	61.3
Short-term debt[1]	42.6	40.9	43.5
Total external debt	195.3	198.0	196.2
- USD billion equivalent	51.4	52.1	51.6

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

[p] Preliminary

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

External Debt Outstanding



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

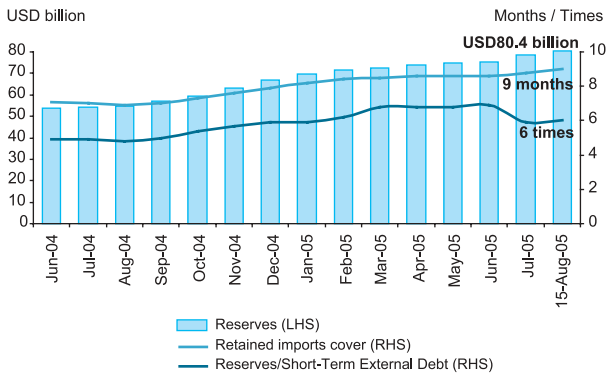
was attributable to net repayment of external loans by both the private sector and the non-financial public enterprises (NFPEs). Net repayment of the private sector amounted to RM2.7 billion during the quarter, mainly by companies in the agriculture, utilities and manufacturing sectors. The NFPEs registered a smaller net repayment of RM0.9 billion. Meanwhile, the Federal Government recorded a small net drawdown of external loan (RM0.3 billion) during the quarter due mainly to scheduled drawdown of loans committed earlier.

The total **short-term external debt** increased to RM43.5 billion or USD11.4 billion (1Q 2005: RM40.9 billion), reflecting increases in the short-term borrowings of both the banking and non-bank private sectors. The bulk of the increase of the non-bank private sector emanated from the revolving credit facilities. As at end-June, the short-term external debt remained low, accounting for only 22.2% of total external debt and is about 15.2% of the net international reserves.

International reserves increased amidst orderly transition to a managed float

The international reserves of Bank Negara Malaysia amounted to RM285.8 billion (USD75.2 billion) as at 30 June 2005. The reserves increased to RM298.7 billion or equivalent to USD78.7 billion as at 29 July 2005. About two-thirds of the inflows in July had occurred on the day following the announcement of the change in the exchange rate regime to a managed float. The flows were normalised in the subsequent days and the price discovery process has been orderly. The transactions in July were mainly for international trade, FDI and portfolio investment. It also reflected the transactions for payments for imports of goods and services, repatriation of dividends and overseas investment by Malaysian companies. International reserves amounted to RM305.2 billion or equivalent to USD80.4 billion as at 15 August 2005. During this period, there was a major drawdown of an external loan. The reserves position is adequate to finance 9 months of retained imports and is 6 times the short-term external debt.

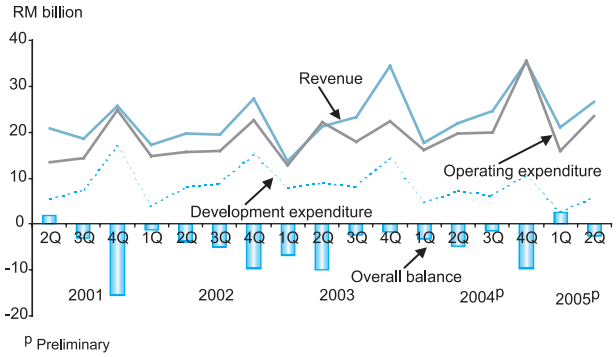
Net International Reserves (as at end-period)



Lower fiscal deficit

Despite the higher petroleum-related expenditure, improved revenue collection by the Federal Government has contained the fiscal deficit at a lower level of RM2.7 billion or 2.3% of GDP in the second quarter of 2005

Federal Government Finance



p Preliminary

Federal Government Finance p

	2004		2005		
	2Q	1H	1Q	2Q	1H
	RM billion				
Revenue	21.8	39.6	21.1	26.6	47.7
% growth	*2.9*	*13.3*	*19.2*	*21.9*	*20.7*
Operating expenditure	19.7	35.9	15.9	23.4	39.3
% growth	*-11.4*	*2.5*	*-1.5*	*18.7*	*9.6*
Current account	**2.1**	**3.7**	**5.2**	**3.2**	**8.4**
% of GDP	***1.9***	***1.7***	***4.5***	***2.7***	***3.6***
Gross development expenditure	7.3	12.1	2.8	5.9	8.7
% growth	*-19.9*	*-28.3*	*-42.9*	*-18.3*	*-28.1*
Loan recoveries	0.2	0.3	0.2	0.1	0.2
Overall balance	**-4.9**	**-8.1**	**2.6**	**-2.7**	**-0.1**
% of GDP	***-4.5***	***-3.8***	***2.3***	***-2.3***	***...***
Memo item:					
Total gross expenditure	**27.0**	**48.0**	**18.7**	**29.3**	**48.0**
% growth	*-13.8*	*-7.5*	*-11.1*	*8.7*	*0.1*
Total Federal Government debt (as at end-period)	197.8	197.8	223.1	222.6	222.6
% of GDP	*44.0*	*44.0*	*47.4*	*47.3*	*47.3*
Domestic debt	160.8	160.8	189.3	188.9	188.9
% of GDP	*35.8*	*35.8*	*40.2*	*40.2*	*40.2*
External debt	37.0	37.0	33.8	33.7	33.7
% of GDP	*8.2*	*8.2*	*7.2*	*7.2*	*7.2*

p Preliminary

(2Q 2004: -4.5% of GDP). Revenue receipts strengthened, reflecting mainly the higher collection from petroleum income tax and most major categories of indirect taxes; especially excise duty given the strong growth in car sales. Total expenditure rose at an annual rate of 8.7%, due to higher operating expenditure as increases in oil prices resulted in higher payments of subsidies. On 5 May, the Government raised the prices of retail petroleum products for the second time during the year to help mitigate some of the impact of the high oil prices. Given the ample liquidity condition in the domestic banking system, the Government's financing requirements were met mainly from domestic sources. As at end-2Q 2005, total outstanding debt of the Federal Government amounted to RM222.6 billion or 47.3% of GDP. The external debt of the Federal Government continues to remain low, at 17.2% of the nation's outstanding external debt or 7.2% of GDP.