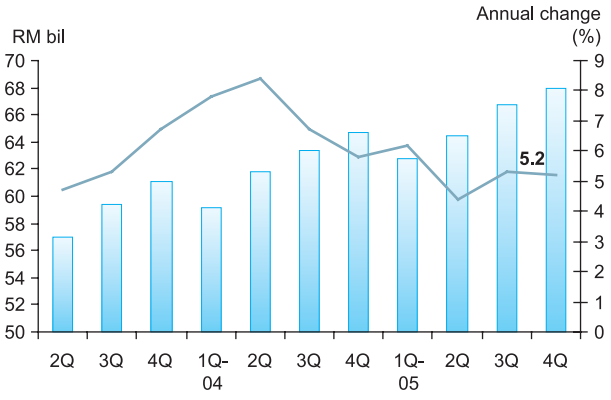
Economic and Financial Developments in the Malaysian Economy in the Fourth Quarter of 2005

OVERVIEW

Sustained growth driven by domestic and external demand

The Malaysian economy expanded at a strong annual rate of 5.2% in the fourth quarter of 2005. The manufacturing and services sectors were the main drivers of this growth. A stronger upturn in exports provided added support to domestic private sector activities. Higher consumer sentiment and sustained business confidence underpinned the strong growth. For the whole of 2005, the combination of strong domestic demand and exports resulted in an overall growth in real gross domestic product (GDP) of 5.3%.

Sustained real GDP growth in 4Q 2005



Source: Department of Statistics, Malaysia

Domestic demand continued to increase, expanding by 7.3%, due to strong private consumption and investment spending. Private consumption remained robust, registering a growth of 9% in the fourth quarter. The improvement in the employment market, payment of year-end bonuses, firm commodity prices and strong export earnings enhanced consumer optimism and encouraged spending. Almost all major consumption indicators, including disbursements of consumption credit loans and imports of consumption goods, pointed to strong consumer spending. Public consumption also increased due to higher expenditure on emoluments, supplies and services and defence.

Gross fixed capital formation grew by 0.4%. Private sector investments remained strong due to capacity expansion, upgrading and new investments across the economy and in particular in the manufacturing and upstream oil and gas sectors. Public development expenditure was higher in the fourth quarter resulting in an overall fiscal deficit of 3.8% of GDP for the year as a whole.

In terms of sectoral origin, value added in the manufacturing sector strengthened during the fourth quarter to expand by 7.3%, significantly higher than the 3.5% recorded during the previous quarter. The resulting contribution to overall growth was 2.3 percentage points. This strong performance was led by the strong revival in external demand for electronics products, and further

reinforced by stronger expansion in the chemical products, textiles and wearing apparel, transport equipment and petroleum products industries. Output of electronics and electrical (E&E) products improved notably to register a double-digit growth, supported by strong external demand for computers, computer-related products and semiconductors.

Strong consumer spending and favourable trade and business activities, including in the financial services led to a growth of 6% in the services sector. Meanwhile, the construction, agriculture and mining sectors recorded declines during the quarter. The decline in the construction sector, however, was smaller, while in the agriculture and mining sectors, lower production of key commodities was partly caused by poor weather conditions.

Inflation, as measured by the Consumer Price Index (CPI), was unchanged at 3.4% in the fourth quarter of 2005[1]. Almost all CPI categories registered increases, although there was a moderation in the price increases in the beverages and tobacco, and transport and communication categories, following the lapse of the effects of the 2004 price adjustments. Conditions in the labour market continued to improve with the upward trend in job vacancies becoming entrenched. The strength in the labour market was also supported by the strong growth in labour productivity.

On the external front, the trade balance recorded a larger surplus of RM28.6 billion (3Q 2005: RM23.3 billion). Gross exports grew strongly by 12.6% in fourth quarter of 2005, led mainly by the double-digit growth in exports of manufactured goods (13.1%) and growth in both volume and prices of commodity exports. The growth in manufactured exports was led mainly by the strong pick-up in exports of E&E products, in line with the upturn in the global semiconductor cycle. Growth in the E&E exports more than doubled to 14.7% (3Q 2005: 6.8%) due to higher shipment of semiconductors, computers and parts, and industrial electrical machinery. Exports of chemical and rubber products were also higher due to strong external demand. Although receipts from palm oil declined, overall receipts from agriculture exports turned around to record a positive growth as receipts from saw logs, sawn timber and, in particular, rubber were much higher. Rubber exports strengthened notably supported by the strong increase in price (28.7%). Similarly, reflecting the substantially higher prices for crude oil and liquefied natural gas (LNG), receipts from mineral exports remained high.

Gross imports grew by 7.5%. Imports of intermediate goods, which are inputs for manufactured goods, expanded at a stronger rate of 7.7% in line with the upturn in global demand for E&E exports. Overall imports of capital goods recorded a decline of 5.9%. However, capital imports excluding transport equipment, rose by 6%, an indication that capacity expansion and upgrading activities in the economy, have continued. Reflecting the sustained private consumption activities, imports of consumption goods increased by 4.4%.

[1] This is based on the previous base reference period for the CPI (2000 = 100).

In the financial account, net foreign direct investment (FDI), recorded a higher inflow of RM2.3 billion. These FDI inflows were broad-based, channelled mainly into the manufacturing, services and oil and gas sectors. As this FDI data is on a cash basis, it does not capture retained earnings and investment in the form of imported machinery and equipment. There was also a higher net outflow in portfolio investment. Meanwhile, overseas investment recorded a net inflow of RM1.9 billion due mainly to repayment of inter-company loans from abroad.

The net international reserves of Bank Negara Malaysia amounted to RM266.4 billion (USD70.5 billion) as at 31 December 2005. As at 15 February 2006, the reserves amounted to RM270.4 billion (USD71.6 billion), sufficient to finance 7.7 months of retained imports and is 6.7 times the short-term external debt.

Monetary policy remained supportive of economic activities

In the fourth quarter, indicators pointed to strong economic growth and economic activity was expected to gain momentum going into 2006. At the same time, the inflation rate was expected to remain close to the prevailing level for some time. Consequently, the OPR was increased by 30 basis points to 3% on 30 November 2005. Notwithstanding the increase, the OPR continued to be below its neutral level and therefore, monetary policy continued to remain supportive of economic activity.

Following the increase in the OPR, the daily weighted average overnight interbank rate moved within a range of 2.97% - 3.01% and averaged 3.00%. Interbank rates for other tenures also rose in December.

Gross financing to the private sector through banking system loans and the capital market remained firm, expanding at a combined annual rate of 7.8% in the fourth quarter of 2005. On a net basis, banking system loans and private debt securities (PDS) outstanding increased at a combined annual rate of 9.3%.

Bank lending activity remained firm in the fourth quarter of 2005, with total loans outstanding expanding at an annual rate of 8.6% at the end of the quarter. Loans outstanding to businesses increased by 3% on an annual basis, driven by the growth in SME loans outstanding, which expanded by 8.7% on an annual basis. Loan disbursements to both large corporations and SMEs were also higher on an annual basis, but business loan applications and approvals moderated somewhat from the high levels recorded in the third quarter of 2005. Bank lending to households remained strong, with household loans outstanding growing by 15.1% on an annual basis at the end of the quarter.

Net funds raised by the public and private sectors through the capital market increased to RM12.6 billion in the fourth quarter of 2005, due to a strong increase in the amount of funds raised from the PDS market. A substantial share (52.6% of total, excluding Cagamas) of the funds raised through the PDS market during the quarter was for the financing of new economic activities. More than half or 51.6% of the PDS were also in Islamic instruments.

Narrow money, M1, expanded at an annual rate of 8.5% at the end of the fourth quarter (3Q 2005: 9.9%), while broad money, M3, increased at an annual rate of 8% at the end of the fourth quarter (3Q 2005: 10.9%).

The ringgit appreciated against the yen, pound sterling and euro, but depreciated against the US dollar over the fourth quarter of 2005. The US dollar strengthened amidst general expectations for further increases in the Fed Funds rate. Against regional currencies, the ringgit depreciated in the range of 0.1 - 5.6%. While the ringgit continued to depreciate against the regional currencies in early 2006, in early February this trend reversed. In February, the ringgit appreciated against most regional currencies in the range of 0.5 - 2.0%.

The banking system remained strong

The banking system remained strong in the fourth quarter of 2005. The risk-weighted capital ratio (RWCR) was 13.1% as at end-2005. Pre-tax profits for the quarter amounted to RM3.5 billion. This stronger performance was largely on account of higher net investment income and higher recoveries.

Asset quality of the banking system continued to improve with the decline in non-performing loans (NPLs) following the reclassification of some NPLs to performing accounts, write-offs and the lower incidence of new NPLs. With the decline, the net NPL ratio improved further to 4.6% based on the 6-month classification and 5.8% based on the 3-month classification.

Underlying trends support stronger near term growth

Prospects are for stronger growth in the Malaysian economy in 2006. Of significance, the outlook for global economic growth remains sound and would be driven by the upturn in the global investment and electronics cycle. Additional support is expected to come from Japan and the euro area, as domestic demand strengthens in these economies. Regional demand is also expected to remain robust supported by the recovery in the global electronics cycle, in particular in semiconductors, and sustained economic expansion in P.R. China, India and South Korea. Commodity prices have also shown signs of remaining firm. These trends would continue to have positive impact on both exports and private consumption. With high capacity utilization rates in both the domestic-oriented and export-oriented E&E industries in the manufacturing sector, private investment activities would be sustained. Thus private sector activities would continue to underpin growth. The latest DOSM leading index indicates that the Malaysian economy would continue to expand during 2006.

DEVELOPMENTS IN THE FOURTH QUARTER OF 2005

International Economic Environment

Growth in industrial economies was mixed in the fourth quarter but the regional economies showed stronger performance

Global economic growth was mixed in the fourth quarter. US growth moderated due to special factors while the recovery in Japan and the euro area was sustained. In the Asian region, growth remained strong in the People's Republic of China (P.R. China) and strengthened in several other regional economies.

Fourth quarter growth in the **US** slowed to 1.1% (3Q 2005: 4.1%). Purchases of motor vehicles slowed sharply due to the end of the special discounts offered during the third quarter. Business investments were also affected by the disruption to aircraft deliveries following a strike. In addition, a decline in national defence spending led to negative growth in government expenditure. Net exports were a larger drag on growth, recording a new record level deficit, due mainly to high oil imports following the impact of Hurricane Katrina. In **Japan**, growth was much stronger, rising by 5.5% (3Q 2005: 1.4%) which was the fastest growth rate in 5 years. Growth was supported by higher domestic demand as both private consumption and investments picked up on the back of rising income and corporate profit levels. Higher exports also contributed to the stronger growth. Meanwhile, the core consumer price index (excluding fresh food) rose successively in November and December while industrial production continued to expand. In the **euro area**, fourth quarter growth was just slightly stronger at 1.7% (3Q 2005: 1.6%). Growth continued to be supported by external demand as consumer spending remained weak. In the **UK**, initial estimates revealed that the growth performance in the fourth quarter was at 1.7% (3Q 2005: 1.7%).

Global **monetary policy** remained biased towards tightening. The US **Federal Reserve Board (Fed)** continued to raise the interest rate by 25 basis points at each of its November, December and January meetings, bringing the Fed funds rate to 4.50%. In its December monetary policy statement, the Fed dropped the often-repeated 'accommodative'

Industrial Countries: Real GDP growth

	2004		2005			Key contributing factors for 4Q growth
	4Q	Year	3Q	4Q	Year[e]	
	Annual change (%)					
US [1]	3.3	4.2	4.1	1.1[a]	3.5	Slowdown in growth due to special factors affecting consumer spending, business investment as well as goverment spending.
UK	2.7	3.2	1.7	1.7	1.8	Accelerated growth in the services sector.
Euro area	1.6	2.1	1.6	1.7	1.3	Growth continued to be supported by external demand as consumer spending remained weak.
Japan [1]	-1.3	2.3	1.4	5.5	2.8	Strong broad based expansion supported by domestic demand and exports.

[1] annualised basis

[a] advanced estimate

[e] estimate

Source: National authorities

term, thus signaling that rates have risen closer to neutral levels from the low of 1% in mid-2004. Meanwhile the **European Central Bank** raised its key refinancing rate by 25 basis points to 2.25% on 1 December, marking its first increase in five years.

Global **crude oil prices** eased from the peak recorded in end-August, hovering around USD60 per barrel in the fourth quarter. Mild weather in the Northern Hemisphere, recovering US oil production in the Gulf Coast and sufficient US oil inventories had eased fears of a shortage in supply. Nevertheless, oil prices remained supported by fundamental factors such as strong demand especially from US and China, tight supply, lack of refining capacity, risk of adverse weather conditions and geopolitical risks in selected oil-producing countries.

In the **Asian region**, economic growth strengthened, supported by stronger expansion in China and improved performance in other regional countries. Growth was stronger in Singapore, Philippines and Korea compared with the performance recorded in the third quarter. Exports continued to strengthen, based on continued recovery in demand for electrical and electronics goods. In terms of sectoral origin, services and manufacturing sectors remained the growth drivers.

Meanwhile, **inflation** in most regional countries has edged upwards compared with the third quarter due to higher oil prices and the pass-through effects from the complete/partial removal of fuel subsidies. To contain inflationary expectations and limit second-round effects, Indonesia, Korea, Thailand and India have raised interest rates.

In the **foreign exchange market**, the dollar strengthened against major currencies, namely, the euro, sterling and yen, supported by widening interest rate differentials in favour of the dollar. Meanwhile, most of regional currencies appreciated following the monetary policy tightening as well as inflows into the equity markets. The Philippine peso recorded the strongest appreciation, supported by a record estimated USD10bn remittances from overseas Filipino workers and improved investor sentiment following the improvement in the fiscal position. After the initial 2.1% appreciation in July since the change in the exchange rate regime, the yuan gained a further 0.5%. Speculation remained that the yuan would appreciate further during the course of the year.

Regional Countries: Real GDP growth

	2004		2005			Key contributing factors for 4Q growth
	4Q	Year	3Q	4Q	Year[e]	
	Annual change (%)					
PR China	9.5	10.1	9.8	9.9	9.9	Supported by strong exports and investment.
Singapore	6.9	8.7	7.6	8.7	6.4	Buoyed by strong expansion in biomedical, transport engineering and electronics clusters.
Hong Kong	7.1	8.6	8.3	7.6	7.3	Driven by exports and fixed investment.
C Taipei	3.3	6.0	4.4	6.4	4.1	Buoyed by strong exports.
Philippines	5.3	5.7	4.5	6.1	5.1	Driven mainly by the services and manufacturing sectors.
Korea	3.3	4.6	4.5	5.2[a]	4.0	Supported by capital investment and manufacturing.
Indonesia	6.7	5.1	5.6	4.9	5.6	Supported by the services and agriculture sectors.
Thailand	5.3	6.1	5.3	n.a.	n.a.	

[e] estimate
[a] advance estimates
Source: National authorities

Developments in the Malaysia Economy

Growth driven by manufacturing and services sectors…

In the fourth quarter of 2005, the Malaysian economy expanded by 5.2% (3Q 2005: 5.3%), supported mainly by the manufacturing and services sectors. The manufacturing sector, after experiencing a slowdown in the first half-year led by the global semiconductor down-cycle, showed visible signs of improvement in the fourth quarter of 2005. Value added growth in the manufacturing sector picked up strongly to expand by 7.3% (3Q 2005: 3.5%), contributing to 2.3 percentage points to overall GDP growth. The strong performance was led by the significant pick-up in the electronics and electrical products industry, and further reinforced by stronger expansion in the chemical products, textiles and wearing apparel, transport equipment and petroleum products industries. At the same time, the services sector expanded further by 6%, underpinned by continued consumption activity, as well as favourable performance in trade and business activities, including finance. Meanwhile, the agriculture and mining sectors were weaker during the quarter due to lower production of key commodities.

Quarterly GDP by Kind of Economic Activity at 1987 Prices

	2004		2005		
	4Q	Year	3Q	4Q	Year
	Annual change (%)				
Agriculture	7.3	5.0	0.9	-1.1	2.1
Mining	4.4	3.9	3.4	-2.0	0.8
Manufacturing	5.5	9.8	3.5	7.3	4.9
Construction	-2.6	-1.5	-1.4	-0.6	-1.6
Services	6.5	6.8	7.3	6.0	6.5
Real GDP (Ann. Chg.)	**5.8**	**7.1**	**5.3**	**5.2**	**5.3**
Real GDP (Preceding Chg.)	**1.9**	**7.1**	**3.5**	**1.8**	**5.3**

Source: Department of Statistics, Malaysia

Stronger growth in the manufacturing sector …

Value-added growth in the **manufacturing sector** strengthened to 7.3% (3Q 2005: 3.5%) in the fourth quarter of 2005 reflecting improvements in output of both export-oriented (8.7%, 3Q 2005: 4.6%) and domestic-oriented industries (-1.0%, 3Q 2005: -1.9%).

Performance in the Manufacturing Sector

	2004		2005		
	4Q	Year	3Q	4Q	Year
	Annual change (%)				
Value Added (Constant Price)	**5.5**	**9.8**	**3.5**	**7.3**	**4.9**
Overall Production	**7.5**	**12.7**	**3.1**	**6.6**	**4.5**
Export-oriented industries	**7.8**	**14.2**	**4.6**	**8.7**	**5.7**
Of which:					
Electronics and electrical	5.1	17.7	4.0	10.4	3.6
Electronics	9.6	25.0	6.6	13.8	5.9
Electrical	-13.8	-9.4	-9.2	-7.5	-8.3
Chemicals and chemical products	13.3	14.1	8.6	11.6	11.7
Wood and wood products[1]	5.1	12.7	-5.2	0.8	-3.7
Textiles & wearing apparel	-14.5	-11.7	6.4	8.6	1.3
Off-estate processing	17.9	4.0	7.3	-2.9	10.8
Rubber products	9.1	14.8	-3.7	0.3	1.7
Domestic-oriented industries	**6.3**	**7.1**	**-1.9**	**-1.0**	**0.4**
Of which:					
Non-metallic mineral products	-4.8	-4.9	-1.5	0.4	-2.2
Fabricated metal products	21.4	29.2	-15.1	-15.8	-7.5
Iron & steel and non-ferrous metal	4.7	4.4	-10.1	-13.4	-8.3
Food	-0.5	3.0	9.2	8.6	6.5
Transport equipment	17.8	8.6	12.7	15.4	12.9
Petroleum products	5.4	1.3	5.2	13.5	8.7
Total Manufactured Exports	**13.5**	**19.7**	**6.3**	**13.1**	**10.1**
Of which:					
Electronics and electrical products	7.5	15.3	6.8	14.7	10.0
Chemical and chemical products	26.9	31.0	1.3	4.7	7.1
Petroleum products	57.1	42.2	19.4	20.1	24.5
Optical & scientific equipment	19.6	26.3	-0.7	12.4	6.5
Wood and wood products	12.4	29.5	-14.9	6.7	2.1
Furniture & parts	16.2	17.8	3.0	0.8	6.0
Rubber products	14.5	19.3	10.0	19.4	12.4

[1]Output of furniture and parts are not captured in the wood production data.
Source: Department of Statistics, Malaysia

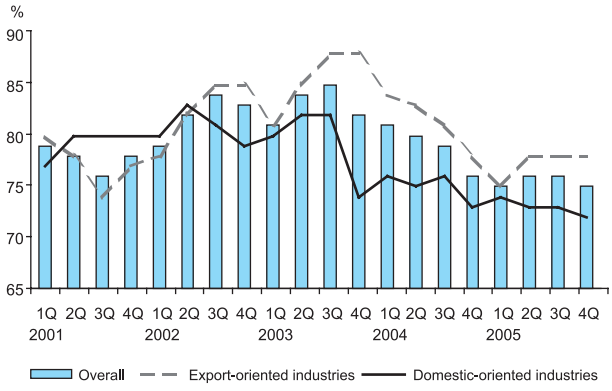
The stronger expansion in the **export-oriented industries** was driven mainly by the

pick-up in the electronics and electrical products (E&E) industry (10.4%, 3Q 2005: 4%), in tandem with the recovery in the global semiconductor sales. The domestic E&E industry benefited from the sustained strong demand for laptops due to the increasing popularity of wireless systems, as well as the improved worldwide demand for chips for various applications, including the automotive and communication segments. Output of the chemical products industry remained strong, expanding by 11.6% (3Q 2005: 8.6%), driven mainly by the favourable external demand for plastic products produced in Malaysia. Meanwhile, the textiles and wearing apparel industry expanded further in the final quarter of 2005 (8.6%, 3Q 2005: 6.4%), partly benefiting from the increase in demand from the US as the quota on China's exports of textile products imposed by the US authorities has been filled since July 2005.

The improvement in the production of **domestic-oriented industries** was due mainly to the strong performance in the transport equipment (15.4%, 3Q 2005: 12.7%) and petroleum products (13.5%, 3Q 2005: 5.2%) industries. The higher output growth in the transport equipment industry reflected the stronger car sales during the quarter, supported by continued income growth, attractive financing packages and launch of new variants of existing models. The higher output of petroleum products was due mainly to the intensified crude oil refining activities and production of lubricant oil. Meanwhile, the construction-related industries continued to remain subdued in line with the weak performance of the construction sector.

The overall **capacity utilisation** of the manufacturing sector during the quarter was sustained at 75% (3Q 2005: 76%), with the export-oriented and domestic-oriented industries operating at 78% and 72% respectively (3Q 2005: 78% and 73% respectively).

Capacity Utilisation in the Manufacturing Sector



Value added in the **services sector** grew further by 6% during the quarter (3Q 2005: 7.3%), reflecting expansion in all sub-sectors. The wholesale and retail trade, hotels and restaurants sub-sector grew by 7.1% (3Q 2005: 10%) as bonus payments and Year-end Sales (1 December 2005 to 31 January 2006), a new programme launched by the Ministry of Tourism, supported continued shopping and spending by consumers and tourists. In particular, the motor vehicle segment in the distributive trade industry was strong supported by double-digit growth in sales during the quarter (14.1%; 3Q 2005: 9.7%). The finance, insurance, real estate and business services sub-sector also continued to expand (5.5%; 3Q 2005: 6.5%) supported by increased bank lending activities

as well as higher growth in fee-based income. In addition, there was expansion in Islamic banking activities with three new Islamic banking subsidiaries and one foreign Islamic bank coming into operation during the year.

Performance in the Services Sector (Value Added)

	Share 2004	2004		2005		
		4Q	Year	3Q	4Q	Year
	%	Annual change (%)				
Intermediate Services	**41.5**	**6.9**	**7.1**	**5.7**	**5.5**	**5.7**
Transport, storage & communication	15.3	9.3	8.5	4.2	5.5	6.3
Finance, insurance, real estate & business services	26.3	5.6	6.3	6.5	5.5	5.4
Final Services	**58.5**	**6.3**	**6.6**	**8.5**	**6.4**	**7.1**
Electricity, gas & water	7.2	7.3	8.2	6.4	3.7	5.5
Wholesale & retail trade, hotels & restaurants	24.9	6.9	7.1	10.0	7.1	8.0
Government services	12.8	7.2	6.5	10.2	8.4	8.8
Other services	13.6	3.7	4.9	5.4	4.6	4.9
Total Services	**100**	**6.5**	**6.8**	**7.3**	**6.0**	**6.5**

Source: Department of Statistics, Malaysia

The transport, storage and communication sub-sector grew by 5.5% mainly supported by strong growth in the telecommunication industry and higher transport activities. The strong performance in the telecommunications industry was underpinned by the increase in subscriber base and higher usage of voice and data services in the cellular segment. The cellular penetration rate rose to 74.1% by end-year from 66.8% as at end-September 2005, while the short-messaging service (SMS) traffic grew by 157.9% during the quarter. Meanwhile, the higher growth in the transport segment was due to increased cargo following the pick-up in trade activities (10.3%; 3Q 2005: 8%). The Government services and utilities sub-sectors were supported by higher emoluments and sustained usage of electricity during the quarter.

Selected Quarterly Indicators in the Services Sector

	2004		2005		
	4Q	Year	3Q	4Q	Year
	Annual change (%)				
Total passenger traffic at all airports	11.2	18.9	5.6	1.9	4.8
Total consumption credit outstanding	16.4	16.4	18.6	18.7	18.7
Loan outstanding to the wholesale & retail trade, restaurants & hotels	11.0	11.0	12.6	8.3	8.3
Imports of consumption goods	16.4	24.1	5.2	4.4	6.0
Total sales of passenger cars	27.3	17.0	-2.7	11.6	4.8
Total sales of commercial vehicles	39.3	35.1	65.6	23.1	46.8
Cellular phone penetration rate (%)	56.5	56.5	66.8	74.1	74.1
SMS traffic	77.8	54.7	142.1	157.9	120.8
Cargo handled (all airports)	10.2	10.5	0.6	6.2	4.3
Container cargo handled (Port Klang and PTP)	3.6	11.2	5.2	7.8	4.9

Source: Various sources

Weaker performance in the commodity sector due to adverse weather conditions

The primary commodity sector recorded a weaker performance in the fourth quarter of 2005, partly due to the high base in the corresponding period of 2004 and partly due to weather-related factors. Both the agriculture and mining sectors were affected by lower production of major commodities including palm oil, rubber, crude oil and natural gas and other activities such as paddy planting, fishing and cultivation of cocoa.

In the **agriculture sector**, production of crude palm oil declined by 6% to 3.7 million tonnes (3Q 2005: +0.2%). The contraction was due entirely to lower yields of fresh fruit bunches (FFB) compared with the

Performance of the Agriculture Sector

	2004		2005		
	4Q	Year	3Q	4Q	Year
	Annual change in %				
Value Added (at 1987 prices)	**7.3**	**5.0**	**0.9**	**-1.1**	**2.1**
Production[1]					
Of which:					
Crude palm oil	16.5	4.7	0.2	-6.0	7.0
Crude palm kernel oil	11.8	-0.1	7.8	-5.4	12.1
Rubber	7.2	18.6	3.7	-4.5	-3.8
Saw logs	2.7	-0.1	-1.8	2.3	-0.8
Cocoa	17.9	-7.8	-19.0	-7.8	-16.3
Exports (RM million)	**1.2**	**7.4**	**-0.1**	**2.9**	**3.4**
Of which:					
Palm oil					
('000 tonnes)	2.3	-5.6	4.0	-0.2	10.9
(RM/tonne)	-6.1	5.5	-13.5	-7.6	-14.5
(RM million)	-3.9	-0.4	-10.0	-7.8	-5.2
Palm kernel oil					
('000 tonnes)	-24.7	-8.3	-14.3	14.6	4.0
(RM/tonne)	38.9	46.9	-5.8	-5.9	-1.9
(RM million)	4.5	34.7	-19.2	7.9	2.0
Rubber					
('000 tonnes)	16.6	16.7	4.4	-0.2	2.1
(Sen/kilogramme)	2.6	24.3	13.0	28.7	9.0
(RM million)	19.6	45.1	18.0	28.4	11.3
Sawn timber					
('000 cu.metres)	16.3	13.5	9.1	-4.1	15.5
(RM/cu.metre)	-10.2	-10.4	5.7	20.0	7.4
(RM million)	4.4	1.7	15.3	15.1	24.1
Saw logs					
('000 cu.metres)	-17.9	-5.9	-4.4	1.5	10.6
(RM/cu.metre)	6.2	8.9	14.7	17.0	7.6
(RM million)	-12.8	2.5	9.7	18.8	19.1
Cocoa beans					
('000 tonnes)	-15.6	-27.7	-77.6	-5.6	-2.1
(RM/tonne)	-5.9	-12.6	18.6	3.5	-1.8
(RM million)	-20.6	-36.8	-73.4	-2.3	-3.9

[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

exceptionally high FFB yields recorded in the corresponding period of 2004. Fresh fruit bunches yields declined by 8.3% to 4.76 tonnes per hectare (4Q 2004: 5.19 tonnes per hectare). In addition, adverse weather conditions also affected harvesting activities in the latter part of the quarter. Similarly, rubber production declined by 4.5%, as the rainy weather conditions had hindered tapping activities by smallholders, who account for 95% of total rubber output in Malaysia. Amidst the tight supply conditions in the major producing countries coupled with the rise in synthetic rubber prices following the upward trend in crude oil prices, Malaysian rubber prices strengthened significantly to average 605 sen per kilogram (3Q 2005: 552 sen per kilogram). Output of paddy was also lower during the quarter, as the adverse weather conditions had affected the crops. This was partially mitigated by a favourable performance in the livestock subsector, supported by strong domestic and external demand during the quarter.

The **mining sector** was affected by lower production of both crude oil and natural gas. Output of crude oil (including condensates) declined by 3% to 751,038 barrels per day during the quarter due partly to the high base in the fourth quarter of 2004 (4Q 2004: 774,191 barrels per day). Crude oil

Performance of the Mining Sector

	2004		2005		
	4Q	Year	3Q	4Q	Year
	Annual change in %				
Value Added (at 1987 prices)	**4.4**	**3.9**	**3.4**	**-2.0**	**0.8**
Production					
Of which:					
Crude oil and condensates ('000 barrels)	1.4	3.6	-2.4	-3.0	-4.9
Natural gas (net) (million standard cubic feet)	10.3	4.0	15.9	-0.5	11.3
Exports (RM million)	**44.7**	**38.2**	**25.8**	**22.7**	**27.8**
Of which:					
Crude oil and condensates					
('000 tonnes)	-11.0	1.0	-9.4	9.5	-1.8
(USD/barrel)	53.3	34.8	42.5	25.5	36.6
(RM million)	36.4	36.1	29.0	37.4	34.0
Liquefied natural gas					
('000 tonnes)	19.4	19.7	5.7	-1.8	5.9
(RM/tonne)	15.9	6.8	16.8	17.0	14.8
(RM million)	38.5	27.9	23.4	14.9	21.5

Source: PETRONAS
Department of Statistics, Malaysia

production was however higher compared to the level recorded in the preceding quarter of 745,178 barrels per day. In the case of natural gas, production declined marginally by 0.5% to 5,838 million standard cubic feet per day due to lower offtake by the major external buyers.

Smaller decline in construction activity…

Construction activity declined, albeit at a slower rate of 0.6% in the fourth quarter of 2005 (3Q 2005: -1.4%). While the civil engineering sub-sector remained subdued, the non-residential and residential sub-sectors continued to expand. The residential sub-sector was supported by sustained interest in new properties, especially in the prime locations. The non-residential sub-sector, particularly the office and retail segments were supported by strong business activities. The occupancy rates and rentals for both these segments remained favourable during the quarter.

Construction Indicators

	2004		2005		
	4Q	Year	3Q	4Q	Year
	Annual change (%)				
New sales and advertising permits	-19.4	-5.9	45.4	11.4	15.9
Housing approvals	-34.9	-14.1	2.8	2.8	-2.7
Production of construction-related materials	-0.4	-0.6	-5.5	-6.3	-5.1
Loans approved for construction	-14.8	2.3	-4.0	3.4	3.3
Imports of construction materials and mineral products	15.8	42.1	-23.7	0.7[1]	-7.9[2]

[1] Oct.-Nov. [2] Jan.-Nov.
Source: Ministry of Housing and Local Government and Department of Statistics, Malaysia

Domestic demand underpinned by private sector activities

Domestic demand continued to increase in the fourth quarter of 2005, expanding by 7.3% (3Q 2005: 9.4%). The expansion of private sector activities continued to drive growth during the quarter despite generally higher price levels and an increase in interest rates.

GDP by Expenditure Components (at Constant 1987 prices)

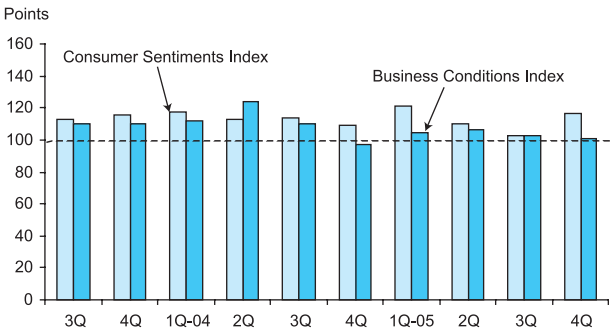
	2004		2005		
	4Q	Year	3Q	4Q	Year
	Annual change (%)				
Aggregate Domestic Demand (excluding stocks)	6.7	7.5	9.4	7.3	7.3
Consumption	8.6	9.5	9.3	10.0	8.5
Private sector	10.2	10.5	10.4	9.0	9.2
Public sector	4.2	6.0	5.9	12.8	5.9
Gross Fixed Capital Formation	2.2	3.1	9.6	0.4	4.7
Exports of Goods and Services	10.2	16.3	5.8	10.4	8.4
Imports of Good and Services	12.9	20.7	7.8	8.0	7.6
GDP	**5.8**	**7.1**	**5.3**	**5.2**	**5.3**

Source: Department of Statistics, Malaysia

Private consumption remained robust, registering a growth of 9% in the fourth quarter (3Q 2005: 10.4%). Almost all major consumption indicators pointed to a continued expansion in private consumption, including disbursements of consumption credit loans and imports of consumption goods. The strong consumer spending was supported by factors that enhanced income prospects such as the improvement in the employment market, the payment of year-end bonuses, firm commodity prices and strong export earnings. These factors, together with promotions held in conjunction with the festive celebrations and school holidays, have spurred household spending during the quarter. The growth in private consumption was also in line with an improvement in consumer confidence. The Malaysian Institute

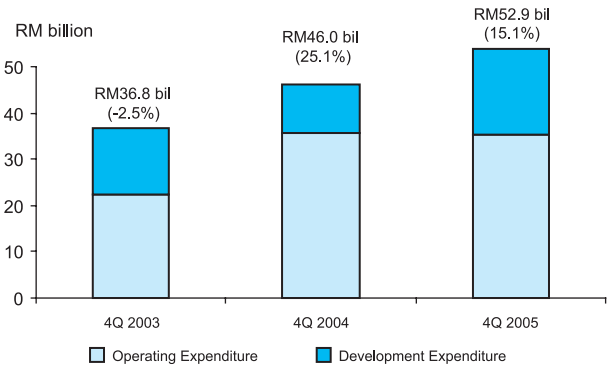
of Economic Research (MIER)'s Consumer Sentiments Index rose by 13.6 points to 116.1 points in the fourth quarter (3Q 2005: 102.5 points), signifying consumers' more optimistic view on the economic outlook, income level and job prospects. **Public consumption** was higher (12.8%, 3Q 2005: 5.9%) mainly due to increased expenditure on emoluments, supplies and services as well as defence.

Consumer confidence improved while business sentiment remained resilient



Gross fixed capital formation registered a growth of 0.4% (3Q 2005: 9.6%). Private sector capital spending remained strong, as indicated by the higher imports of machineries and equipment for use in the manufacturing and upstream oil and gas sectors. Domestic investment activity in both the manufacturing and oil and gas sectors was also supported by the continuous inflow of foreign direct investment during the fourth quarter. Other major investment indicators, namely loans extended to businesses and sales of commercial vehicles, also reflected sustained investment spending in the private sector. The MIER Business Conditions Index continued to hold above the 100-point benchmark since the first quarter of the year (100.5 points, 3Q 2005: 102.7 points), suggesting that business confidence remains resilient. Meanwhile, Federal Government's development expenditure increased further, with the bulk of the expenditure channelled towards the development of agriculture and rural areas, provision of education services as well as maintenance and construction of roads and bridges.

Higher Federal Government Spending



Inflation remained unchanged during the period

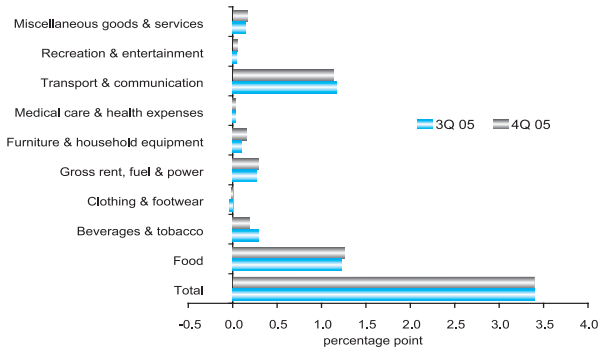
The annual rate of inflation, as measured by the **Consumer Price Index** (CPI), was unchanged at 3.4% in the fourth quarter of 2005[2] (3.4% in 3Q 2005). Almost all CPI categories registered increases, although there was a moderation in the price increases in the beverages and tobacco, and transport and communication categories, following the lapse of the effects of the 2004 price adjustments.

The annual growth of the **Producer Price Index** (PPI) moderated to 7.1% (9% in 3Q 2005) due to the slower increase in both

[2] This is based on the previous base reference for the CPI period (2000 = 100).

commodity- and non-commodity-related categories. The moderation in the PPI for commodity-related categories was mainly due to the slower growth in crude oil prices during the quarter. Excluding commodities, however, the PPI moderated even further to 1.7% (2.4% in Q3 2005) due mainly to the slower increase in the PPI for food and live animals, manufacturing- and chemical-related products.

Contribution to Consumer Price Inflation [1]



[1] This is based on the previous base reference for the CPI period (2000 = 100).

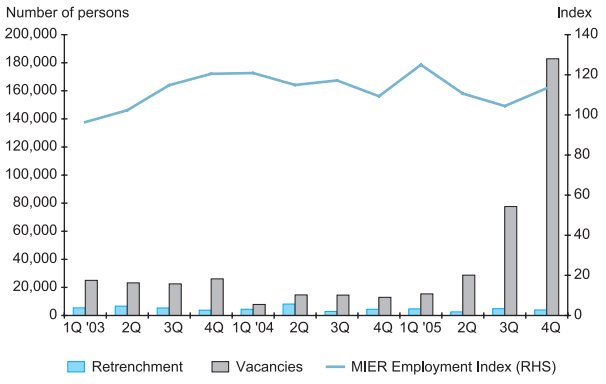
Labour market conditions improved further as vacancies rose and unplaced jobseekers and retrenchments declined

In the fourth quarter, the labour market conditions improved further with new job vacancies significantly outpacing both unplaced jobseekers and retrenchments.

Total quarterly vacancies reported to the authorities rose to a record high of 182,838 positions, significantly higher than the previous high reported in the third quarter (77,578 positions). More vacancies were recorded in all key economic sectors, in particular, the manufacturing sector. At the same time, there were fewer registered unplaced jobseekers as at end-December (72,573 persons) as the downward trend in unplaced jobseekers that began in September (102,795) continued into the fourth quarter. Similarly, total retrenchments also declined in the fourth quarter to 3,955 persons (3Q 2005: 4,875 persons). The overall positive job market climate was also reflected in the MIER Employment Index, which climbed 8.9 points from the previous quarter to 113.3 points in the fourth quarter.

Labour productivity developments were also positive. Labour productivity, as measured by real sales value of products per employee in the manufacturing sector, rose by 7%, surpassing the 0.6% growth in real wages per employee.

Labour Market Improved Further

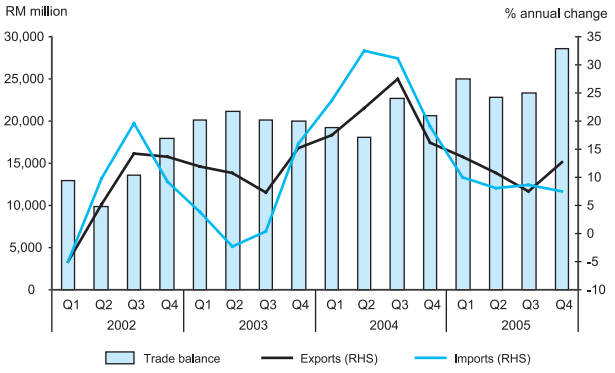


Exports and imports continued to expand

The **trade account** recorded a larger surplus of RM28.6 billion (3Q 2005: RM23.3 billion) as export growth of 12.6% (3Q 2005:

7.5%) outpaced import growth of 7.5% (3Q 2005: 8.6%). The stronger export growth was supported by the strengthening of manufacturing as well as agriculture exports.

Trade Balance



Gross Exports

In line with the improvement in the global semiconductor cycle, growth in **gross exports** strengthened to 12.6% in the fourth quarter of 2005 (3Q 2005: 7.5%) supported by a significant improvement in manufactured exports and sustained growth in commodity exports.

Growth in **manufacturing exports** accelerated to 13.1% (3Q 2005: 6.3%), led mainly by the strong pick-up in exports of E&E products. The E&E products grew by 14.7% (3Q 2005: 6.8%) due mainly to higher shipment of semiconductors, computers and parts, and industrial electrical machinery. Meanwhile, higher exports of chemical products (4.7%, 3Q 2005: 1.3%) were supported by favourable demand from the regional countries such as Singapore, Japan and Indonesia. Exports of rubber products increased further by 19.4% (3Q 2005: 10%), as domestic players gradually increased their production capacity to meet the strong external demand for rubber gloves.

In the **commodity sector, agriculture exports** turned around to record a positive growth of 2.9% (3Q 2005: -0.1%), as the decline in palm oil receipts was more than offset by increases in export receipts from rubber, saw logs and sawn timber. Of significance, rubber exports strengthened markedly by 28.4%, supported mainly by strong increase in prices (28.7%). Global demand for natural rubber, particularly from the automotive industry picked up substantially as prices of the competing synthetic rubber, a petrochemical product, continued to rise in tandem with the stronger crude oil prices. Meanwhile, palm oil exports continued to decline by 7.8% during the quarter, due entirely to lower prices (-7.6% to RM1,466 per tonne).

Export receipts from **minerals** expanded further by 22.7% during the quarter due to higher exports of crude oil and LNG. Crude oil exports rose by 37.4%, supported mainly by the high prices, which rose by 25.5% to an average of USD60.48 per barrel. The increase in oil prices was affected by adverse geopolitical events and concerns over continued strong demand for oil in major consuming countries. Similarly, exports of liquefied natural gas (LNG) rose by 14.9%, due to the substantial increase in prices. Malaysian LNG prices breached the RM1,000 per tonne benchmark during the quarter (+17% to RM1,038 per tonne; 3Q 2005: +16.8% to RM986 per tonne) reflecting the worldwide increase in demand for natural gas.

Trade Account

	2004		2005		
	4Q	Year	3Q	4Q	Year
	Annual change (%)				
Gross Exports	**16.1**	**20.8**	**7.5**	**12.6**	**11.0**
Manufacturing	*13.5*	*19.7*	*6.3*	*13.1*	*10.1*
Agriculture	*1.2*	*7.4*	*-0.1*	*2.9*	*3.4*
Minerals	*44.7*	*38.2*	*25.8*	*22.7*	*27.8*
Gross Imports	**19.1**	**26.4**	**8.6**	**7.5**	**8.5**
Capital goods	*37.2*	*36.0*	*21.0*	*-5.9*	*7.7*
Intermediate goods	*13.5*	*22.2*	*6.3*	*7.7*	*7.5*
Consumption goods	*16.4*	*24.1*	*5.2*	*4.4*	*6.0*
Trade balance (RM bil)	**20.6**	**80.7**	**23.3**	**28.6**	**99.8**

Source: Department of Statistics, Malaysia

Malaysia's trade with the regional countries (excluding Japan) continued to expand by 11.5%, with a sustained large share of 46.6%. The growth was driven mainly by stronger growth of exports to ASEAN, P.R. China and Korea. Export growth was supported by demand for E&E products, telecommunications equipment, transport equipment as well as optical and scientific equipment. Exports of resource-based products, such as rubber and plastic products also recorded a higher growth during the quarter. Exports to New Zealand and India remained strong, growing by 42.1% and 32.2% respectively. Exports to New Zealand was supported by iron and steel as well as E&E products while exports to India reflected mainly petroleum-related products and E&E products.

Of significance, exports to the EU countries strengthened (11.2%) underpinned by exports to Germany, France and Netherlands comprising mainly electrical machinery, optical and scientific equipment as well as chemical products. Exports to the US expanded by 18.8% (3Q 2005: 15.8%) reflecting mainly higher demand for computers, optical and scientific equipment as well as resource-based products, namely wood and petroleum products.

On the imports side, Malaysia continued to source components from regional countries, particularly Singapore and P.R. China. The share of imports from countries in the region was sustained at 49.1%, reflecting mainly imports of E&E products, chemicals and metal products.

Malaysia: Direction of Exports

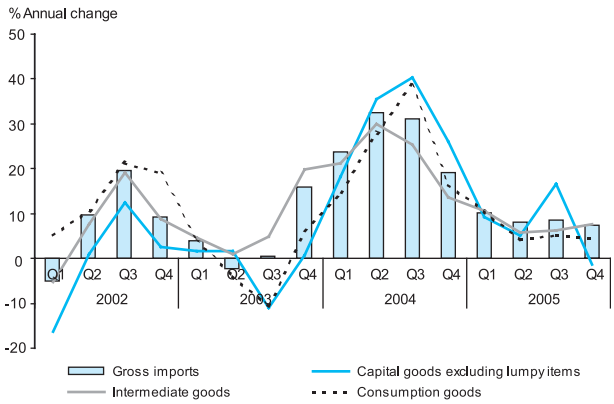
	2004		2005			2004		2005			2004		2005		
	4Q	Year	3Q	4Q	Year	4Q	Year	3Q	4Q	Year	4Q	Year	3Q	4Q	Year
	RM billion					Share of total exports (%)					Annual change (%)				
United States	**23.2**	**90.2**	**28.9**	**27.5**	**105.0**	**18.3**	**18.8**	**21.0**	**19.3**	**19.7**	**9.8**	**15.8**	**15.8**	**18.8**	**16.5**
European Union (EU)	**15.7**	**60.4**	**15.5**	**17.5**	**62.6**	**12.4**	**12.6**	**11.2**	**12.3**	**11.7**	**18.4**	**20.9**	**-4.0**	**11.2**	**3.7**
Selected ASEAN countries[1]	**32.0**	**119.7**	**34.8**	**36.7**	**137.8**	**25.3**	**24.9**	**25.3**	**25.7**	**25.8**	**18.2**	**22.3**	**9.3**	**14.5**	**15.1**
North East Asia	**24.3**	**93.4**	**24.6**	**27.0**	**99.2**	**19.2**	**19.4**	**17.8**	**18.9**	**18.6**	**11.5**	**20.7**	**2.2**	**11.0**	**6.2**
People's Republic of China	*8.3*	*32.1*	*8.5*	*10.5*	*35.2*	*6.6*	*6.7*	*6.2*	*7.3*	*6.6*	*8.9*	*24.6*	*-0.8*	*26.2*	*9.6*
Hong Kong China	*7.3*	*28.7*	*8.4*	*7.8*	*31.2*	*5.8*	*6.0*	*6.1*	*5.5*	*5.8*	*6.4*	*11.5*	*13.8*	*6.5*	*8.8*
Chinese Taipei	*4.1*	*15.8*	*3.9*	*4.0*	*14.8*	*3.2*	*3.3*	*2.9*	*2.8*	*2.8*	*7.4*	*10.0*	*-6.7*	*-2.4*	*-6.0*
Korea	*4.6*	*16.8*	*3.7*	*4.7*	*17.9*	*3.6*	*3.5*	*2.7*	*3.3*	*3.4*	*32.0*	*45.7*	*-3.7*	*2.5*	*6.6*
India	**3.2**	**11.4**	**3.9**	**4.2**	**15.0**	**2.5**	**2.4**	**2.8**	**2.9**	**2.8**	**17.4**	**18.3**	**36.5**	**32.2**	**31.2**
Total exports	**126.7**	**480.7**	**137.9**	**142.6**	**533.8**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**16.1**	**20.8**	**7.5**	**12.6**	**11.0**

[1] Singapore, Thailand, Indonesia, Philippines, Brunei Darussalam and Vietnam

Source: Department of Statistics, Malaysia

Gross imports continued to grow, albeit at a more moderate rate of 7.5%. Import growth was attributed to imports of inputs for manufactured exports as well as imports of consumption goods. Imports of **intermediate goods** increased by 7.7% in line with the upturn in global demand for E&E exports. Imports of primary materials used by the food and beverage industry was supported by higher demand for festivities. Strong growth in imports of fuel and lubricants reflected high oil prices.

Import Growth



Imports of **capital goods** remained high at RM15 billion, accounting for 13.1% of total imports during the quarter. However, capital imports declined by 5.9% due partly to the high base caused by larger imports of transport equipment in fourth quarter of 2004. Capital imports by selected industries continued to record growth. Capacity expansion and upgrading for technology in order to improve productivity in the manufacturing sector led to the stronger growth in imports of machinery and equipment. Imports of office equipment, generators, turbines and electric motors for power generation also registered strong growth. Imports of agriculture equipment strengthened with growth in production of agriculture exports. Imports of **consumption goods** increased by 4.4% during the quarter.

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

	2004		2005		
	4Q	Year	3Q	4Q	Year
	Annual change %				
CAPITAL GOODS	**37.2**	**36.0**	**21.0**	**-5.9**	**7.7**
Capital goods (except transport equipment)	30.4	28.3	18.6	6.0	10.2
Transport equipment	90.8	151.0	39.4	-70.5	-11.5
INTERMEDIATE GOODS	**13.5**	**22.2**	**6.3**	**7.7**	**7.5**
Food and beverages, mainly for industry	25.1	52.9	-6.7	6.9	-5.5
Industrial supplies, n.e.s.	29.2	38.9	1.8	0.6	6.0
Fuel and lubricants	68.4	41.8	24.5	32.2	42.3
Parts and accessories of capital goods (except transport equipment)	-0.3	10.9	5.3	5.3	2.6
Parts and accessories of transport equipment	38.9	35.0	39.4	49.5	46.8
CONSUMPTION GOODS	**16.4**	**24.1**	**5.2**	**4.4**	**6.0**
Food and beverages, mainly for household consumption	18.9	31.3	5.8	-1.1	4.0
Transport equipment, non-industrial	-34.4	-6.7	-0.9	17.5	-4.9
Consumer goods, n.e.s.	16.7	20.8	5.1	7.6	7.5
Durables	*18.5*	*21.1*	*6.3*	*13.6*	*12.7*
Semi-durables	*8.2*	*17.7*	*-3.0*	*5.3*	*0.5*
Non-durables	*22.4*	*23.0*	*10.9*	*6.2*	*10.1*
DUAL USE GOODS	**43.5**	**39.8**	**18.9**	**12.2**	**21.5**
OTHERS	**4.7**	**10.8**	**2.5**	**5.1**	**0.9**
RETAINED IMPORTS	**17.3**	**24.3**	**8.5**	**5.4**	**7.7**
RE-EXPORTS	**77.6**	**102.9**	**10.2**	**53.4**	**26.9**
GROSS IMPORTS	**19.1**	**26.4**	**8.6**	**7.5**	**8.5**

Source: Department of Statistics, Malaysia

Higher FDI amidst significant portfolio outflows

On a cash basis, both **gross** inflows and outflows of **foreign direct investment (FDI)** declined to RM12.4 billion and RM10.1 billion respectively (3Q 2005: RM21 billion and RM20 billion respectively), reflecting mainly the marked decline in short-term inter-company loan transactions from the centralised treasury

operations of non-resident controlled companies in Malaysia. On a **net** basis, FDI increased to RM2.3 billion (3Q 2005: RM1 billion). As this FDI data is on a cash basis, it does not capture retained earnings and investment in the form of imported machinery and equipment. The FDI inflows were broad-based, channelled mainly into the manufacturing, services and oil and gas sectors. In the manufacturing sector, FDI inflows were mainly into the electrical and electronics, petroleum-related and chemical-related sub-sectors. Meanwhile, FDI inflows into the services sector were channelled primarily into the financing, insurance and business services sub-sector, followed by the restaurants, hotels, wholesale and retail trade sub-sector.

Overseas investment recorded a significantly higher gross outflow of RM18.2 billion (3Q 2005: -RM5.5 billion), reflecting mainly short-term loans extended 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. After adjusting for inflows due mainly to repayment of inter-company loans from abroad, overseas investment recorded a net inflow of RM1.9 billion (3Q 2005: -RM1.2 billion). The overseas investments during the quarter were effected mainly by companies in the services sector, particularly the transport and communications sub-sector, reflecting the acquisition of a telecommunication campany in Indonesia. In the manufacturing sector, overseas investments were led by the semiconductor and other electronic component and ship building- and repairing-related industries.

Portfolio investment recorded a higher net outflow of RM13.6 billion (3Q 2005: -RM0.2 billion). Compared with the previous quarter, gross inflows, particularly into debt securities declined, while gross outflows remained large, reflecting mainly the liquidation of equity and debt securities by foreign investors.

External debt declined

Malaysia's total external debt declined to RM195.8 billion or USD51.3 billion as at end-2005 (3Q 2005: RM203.3 billion or USD53.4 billion), equivalent to 42.2% of GNP. The **medium and long-term external debt** was lower at RM149.6 billion (3Q 2005: RM152.6 billion), attributed mainly to the significantly higher net repayment of external debt by the Federal Government amounting to RM3.2 billion, following the maturity of a Euro bond. The NFPEs also recorded a net repayment of RM1 billion, particularly by companies in the oil and gas, utilities and transportation sectors. The private sector recorded a smaller net drawdown of external loans of RM1.1 billion (3Q 2005: RM1.6 billion), due mainly to a lower loan drawdown during the quarter.

The total **short-term external debt** declined to RM46.2 billion or USD12.1 billion (3Q 2005: RM50.8 billion), reflecting mainly lower short-term borrowings by the banking sector. As at end-2005, the short-term debt accounted for 23.6% of

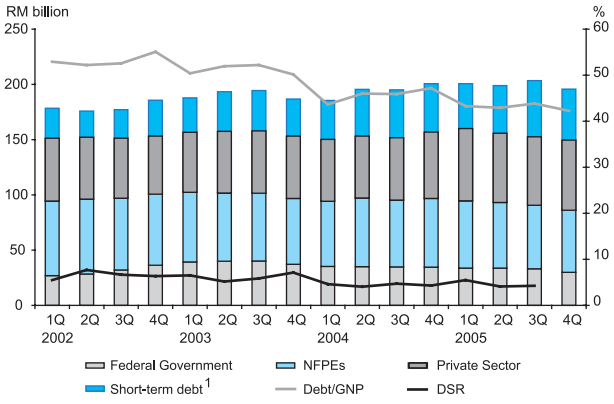
total external debt and is 17.3% of the net international reserves.

External Debt Outstanding

	2004	2005		
	End-Dec.	End-June	End-Sept.	End-Dec.[p]
	RM billion			
Medium- & Long-term debt	156.8	155.7	152.6	149.6
Public sector	96.9	93.3	90.7	86.1
Private sector	60.0	62.5	61.9	63.5
Short-term debt[1]	43.7	43.1	50.8	46.2
Total external debt	200.6	198.9	203.3	195.8
- USD billion equivalent	52.8	52.3	53.4	51.3

[1] Excludes currency and deposits held by non-residents with resident banking institutions
[p] Preliminary
Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

External Debt Outstanding

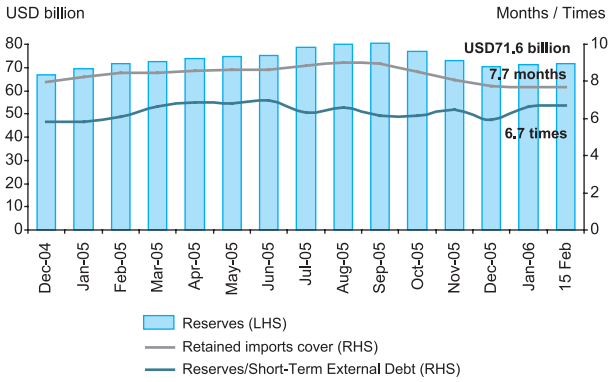


[1] Excludes currency and deposits held by non-residents with resident banking institutions

International reserves

The net international reserves of Bank Negara Malaysia amounted to RM266.4 billion or equivalent to USD70.5 billion as at 31 December 2005. The decline in reserves during the quarter reflected largely the unwinding of speculative short-term positions. Nevertheless, the outflows of short-term funds subsided by December. The reserves amounted to RM270.4 billion or equivalent to USD71.6 billion as at 15 February 2006. The reserves position is sufficient to finance 7.7 months of retained imports and is 6.7 times the short-term external debt.

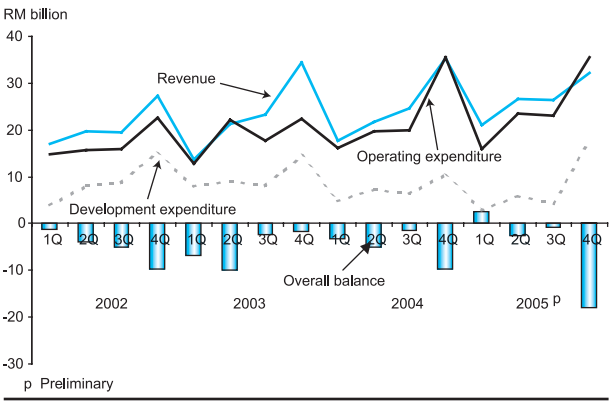
Net International Reserves (as at end-period)



Fiscal deficit for 2005 on target

The Federal Government's development expenditure in the fourth quarter was higher resulting in an overall fiscal deficit of 3.8% of GDP for the year as a whole.

Federal Government Finance



Federal Government Finance[p]

	2004	2005	
	4Q	3Q	4Q
	RM billion		
Revenue	35.3	26.4	32.2
% growth	*2.5*	*7.3*	*-8.7*
Operating expenditure	35.5	23.0	35.5
% growth	*58.3*	*15.3*	*-0.2*
Current account	**-0.2**	**3.4**	**-3.3**
% of GDP	***-0.2***	***2.6***	***-2.5***
Net development expenditure	9.5	4.2	14.6
% growth	*-30.7*	*-32.0*	*53.2*
Overall balance	**-9.8**	**-0.8**	**-17.9**
% of GDP	***-8.3***	***-0.6***	***-13.7***
Memo item:			
Total gross expenditure	**46.0**	**27.3**	**52.9**
% growth	*25.1*	*4.5*	*15.0*
Total Federal Government debt (as at end-period)	216.6	227.6	228.7
% of GDP	*48.2*	*46.0*	*46.2*
Domestic debt	182.0	194.5	198.7
% of GDP	*40.5*	*39.3*	*40.2*
External debt	34.7	33.2	30.0
% of GDP	*7.7*	*6.7*	*6.1*

[p] Preliminary

Revenue performance during the quarter remained favourable on account of higher petroleum income tax. Given the ample liquidity conditions in the domestic banking system, the fiscal deficit was funded largely from domestic borrowings and the drawdown of realisable assets of the Government. As at end-2005, total outstanding debt of the Federal Government amounted to RM228.7 billion or 46.2% of GDP. The external debt of the Federal Government was lower at 6.1% of GDP with the maturity of a Euro Bond in November 2005.

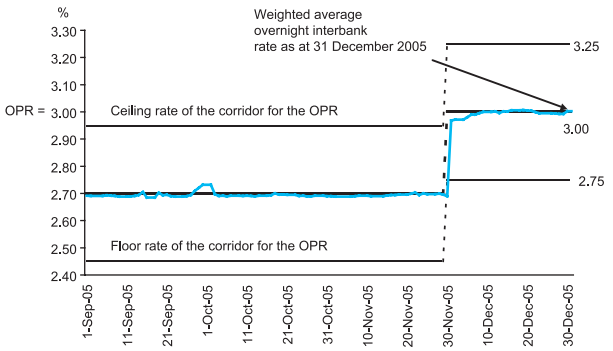
MONETARY AND FINANCIAL DEVELOPMENTS

Interest rates rose in response to the increase in the OPR

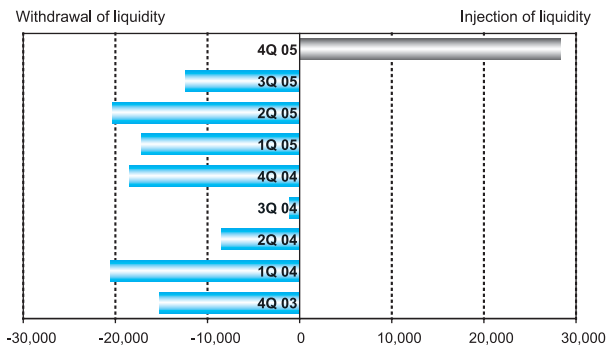
In the fourth quarter, indicators pointed to strong economic growth and for economic activity to gain momentum going into 2006. At the same time, the inflation rate was expected to remain in the region of the prevailing level for some time. Consequently, the OPR was increased by 30 basis points to 3% on 30 November 2005. Notwithstanding the increase, the OPR continued to be below its neutral level and remained supportive of the economy.

Following the increase in the OPR, the daily weighted average overnight interbank rate

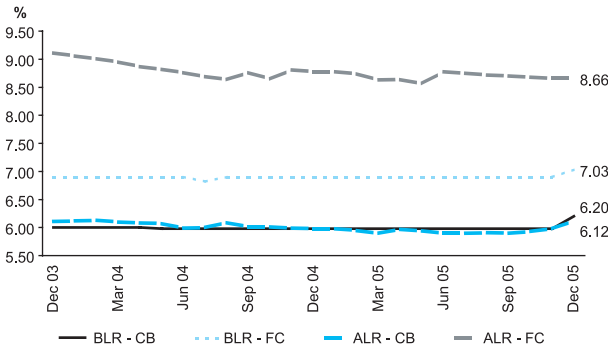
Daily Weighted Average Overnight Interbank Rate



BNM Liquidity Operations
(During the quarter, RM m)



Lending Rates of Commercial Banks & Finance Companies
(average for the period)



Interest Rates

	2004	2005	
	4Q	3Q	4Q
	At end-period (%)		
Overnight Policy Rate (OPR)	2.70	2.70	3.00
Interbank rates			
Overnight	2.69	2.73	3.00
1-month	2.77	2.87	3.12
Base lending rates (BLR)			
Commercial banks	5.98	5.98	6.20
Finance companies	6.90	6.90	7.03
Average lending rates (ALR)			
Commercial banks	5.98	5.90	6.12
Finance companies	8.78	8.70	8.66
Fixed deposit rates			
Commercial banks			
3-month	3.00	3.00	3.02
12-month	3.70	3.70	3.70
Finance companies			
3-month	3.00	3.00	3.00
12-month	3.70	3.70	3.70

moved within a range of 2.97%-3.01% and averaged 3.00% (October-November 2005: 2.69%-2.70%, averaging 2.69%). Interbank rates of other tenures also rose in December.

The average base lending rates (BLRs) of commercial banks (CBs) and finance companies (FCs) increased to 6.20% and 7.03% respectively, as most banking institutions adjusted their BLRs upward in the range of 25-30 basis points. Meanwhile, the average lending rate (ALR) of CBs was higher at 6.12% (3Q 2005: 5.90%), following the increase in banks' BLRs. The ALR of the four remaining FCs remained relatively stable at 8.66% (3Q 2005: 8.70%).

In terms of retail fixed deposit (FD) rates, the adjustments were concentrated in the middle tenures, such as the 6-month and 9-month maturities. The rates for the 1-month and 12-month maturities were mostly unchanged at 3.00% and 3.70%.

Monetary aggregates expanded at more moderate growth rates

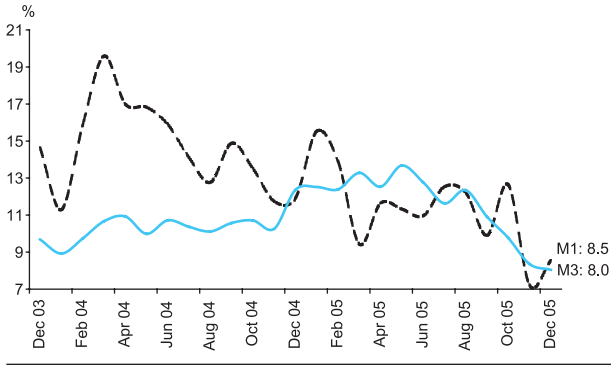
Narrow money, M1, expanded at an annual rate of 8.5% at the end of fourth quarter 2005 (3Q 2005: 9.9%), while broad money, M3, increased at an annual rate of 8% at the end of fourth quarter 2005 (3Q 2005: 10.9%). The main impetus for the expansion in M3 during the quarter was the increase in loans extended to the private sector by the banking system and higher net claims on the Government. The latter was partly attributable to higher Government expenditure in December. Meanwhile, net external operations were contractionary on M3 following the unwinding of short-term portfolio investment during the quarter.

M3 Determinants

	2004		2005		
	4Q	Year	3Q	4Q	Year
	RM billion				
M3	25.7	68.0	4.3	10.8	49.7
Net claims on Government	-5.3	-15.9	-4.3	12.6	-5.5
Claims on private sector	4.1	30.6	15.0	15.0	45.4
Net external operations [1]	30.6	82.0	-1.5	-23.8	16.5
Other influences	-3.8	-28.7	-4.9	7.0	-6.8

[1] Pre-revaluation

Monetary Aggregates: Annual Change

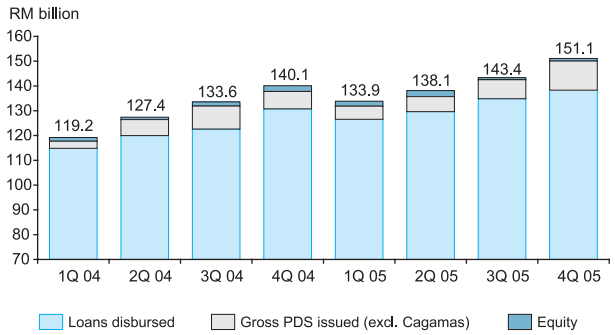


Private sector financing activity increased further

In the fourth quarter, gross financing to the private sector through the banking system and capital market increased to RM151.1 billion, expanding at an annual rate of 7.8% (3Q 2005: RM143.4 billion or 7.3%). Compared with the preceding quarter, the increase was supported mainly by larger PDS issuance and higher banking system loan disbursements. On a net basis, banking system loans and PDS outstanding increased

at a combined annual rate of 9.3% at the end of fourth quarter 2005 (end-3Q 2005: 9.2%).

Gross Private Sector Financing through Banking System and Capital Market



Financing of the Private Sector through Banking System and Capital Market

	During the period (RM billion)				Annual growth (%)		
	2004	4Q 04	3Q 05	4Q 05	2004	3Q 05	4Q 05
Gross total financing	520.3	140.1	143.4	151.1	5.7	7.3	7.8
Loans disbursed *	488.2	130.8	134.8	138.3	10.6	10.0	5.8
Gross PDS (excl. Cagamas)	25.6	7.0	7.7	11.7	-40.2	-17.2	67.1
Equity	6.5	2.3	0.9	1.0	-16.7	-48.8	-55.0
Outstanding total financing (A)+(B)	53.1	15.8	18.6	17.4	8.6	9.2	9.3
Banking system	39.0	10.7	14.5	14.3	7.7	8.1	8.6
Loans outstanding (A)	40.1	11.9	14.4	10.1	8.5	9.2	8.6
Holding of PDS	-1.1	-1.2	0.0	4.2	-3.1	-7.5	8.5
PDS outstanding (B)	13.0	3.8	4.2	7.3	9.0	9.4	11.4
Memorandum item							
Gross PDS (incl. Cagamas)	36.3	10.1	9.7	15.2	-28.7	-23.5	50.4

* Banking system loans include loans sold to Cagamas

Loan Indicators

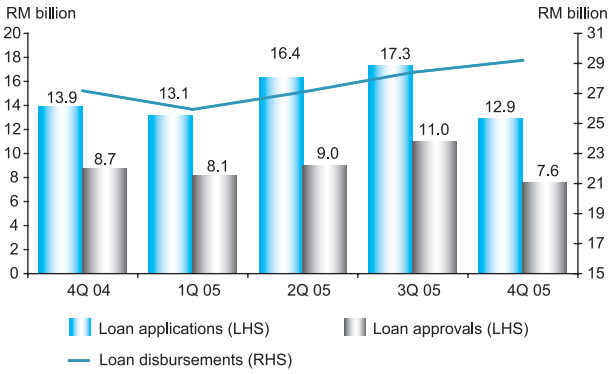
	During the period (RM billion)				Annual Growth (%)			
	2004	4Q 04	3Q 05	4Q 05	2004	4Q 04	3Q 05	4Q 05
Total								
Loan applications	273.3	67.8	83.9	72.1	20.1	21.6	9.7	6.4
Loan approvals	173.6	43.2	55.5	47.7	13.6	10.9	19.1	10.4
Loan disbursements	488.2	130.8	134.8	138.3	10.6	8.3	10.0	5.8
Loan repayments	461.6	120.7	121.5	129.2	7.3	-1.8	2.8	7.1
Change in loan outstanding *	40.1	11.9	14.4	10.1	8.5	8.5	9.2	8.6
Of which:								
Business enterprises								
Loan applications	149.9	37.4	43.1	36.7	20.0	31.0	-2.0	-2.0
Loan approvals	84.9	21.7	27.7	23.6	9.8	14.8	23.6	9.2
Loan disbursements	335.3	90.8	91.2	94.2	10.5	7.8	9.3	3.7
Loan repayments	319.8	84.5	84.5	91.9	6.8	-2.7	1.0	8.7
Change in loan outstanding *	5.5	1.0	4.9	-0.9	2.6	2.6	3.9	3.0
SMEs								
Loan applications	54.2	13.9	17.3	12.9	21.7	41.4	13.9	-7.2
Loan approvals	31.6	8.7	11.0	7.6	22.0	30.5	25.8	-13.1
Loan disbursements	100.4	27.2	28.4	29.2	15.3	9.1	14.7	7.5
Change in loan outstanding *	6.3	2.2	3.0	1.5	7.7	7.7	9.8	8.7
Large corporations								
Loan applications	95.7	23.5	25.8	23.8	19.1	25.5	-10.4	1.1
Loan approvals	53.3	12.9	16.7	16.1	3.7	6.2	22.2	24.2
Loan disbursements	234.9	63.7	62.8	65.0	8.6	7.2	7.0	2.1
Change in loan outstanding *	-0.8	-1.2	1.8	-2.4	-0.6	-0.6	0.0	-0.9
Households								
Loan applications	120.2	29.3	38.9	34.6	22.1	15.0	23.4	18.3
Loan approvals	86.8	21.3	26.4	23.4	20.5	14.1	13.0	9.7
Loan disbursements	130.3	34.0	38.0	37.6	13.9	12.0	11.6	10.8
Loan repayments	107.0	27.9	29.1	29.9	13.7	6.2	8.8	7.3
Change in loan outstanding *	33.3	8.9	11.3	10.7	14.4	14.4	14.9	15.1

* The annual growth is for end-period
Source: Bank Negara Malaysia

Loan disbursements to businesses increased to RM94.2 billion in the fourth quarter, expanding by 3.7% on an annual basis, with a higher amount of funds being channelled to both large businesses and SMEs. Compared with the previous quarter, the increase was particularly evident in the finance, insurance and business services sector. In terms of share, loans to businesses during the quarter continued to be disbursed mainly to the manufacturing (33.7% of total loans disbursed to businesses); wholesale and retail trade, restaurants and hotels (27%); finance, insurance and business services (10.4%); and construction sectors (8.2%). Meanwhile, for large corporations, loan applications and loan approvals were lower compared with the previous quarter, although they still increased on an annual basis. For the SME sector, compared with the high levels recorded in the third quarter, both loan applications and approvals were lower on a preceding quarter as well as on annual basis.

A total of RM7.6 billion was approved for 19,173 SME accounts during the quarter (3Q 2005: RM11 billion for 24,715 SME accounts). At the end of fourth quarter 2005, total loans outstanding to the SMEs grew at an annual rate of 8.7% (end-3Q 2005: 9.8%), to account for a slightly larger share of 42.6% of total business loans outstanding (3Q 2005: 41.7%). Meanwhile, NPLs as a percentage of loans outstanding to SMEs continued to decline, to 10.6% at the end of fourth quarter 2005 (end-3Q 2005: 10.9%).

Bank Lending to SMEs



Loans by Sector

	Loans disbursed					Loans out-standing
	During the period				Share of total	Share of total
	2004	4Q 04	3Q 05	4Q 05		
	RM billion				%	
Business enterprises	335.3	90.8	91.2	94.2	68.1	40.4
Large corporations	*234.9*	*63.7*	*62.8*	*65.0*	*47.0*	*23.2*
SMEs	*100.4*	*27.2*	*28.4*	*29.2*	*21.1*	*17.2*
Households	130.3	34.0	38.0	37.6	27.2	54.5
By sector						
Agriculture, hunting, forestry and fishing	13.7	3.4	4.0	3.6	2.6	2.0
Mining and quarrying	2.0	0.7	0.4	0.4	0.3	0.1
Manufacturing	121.5	32.5	32.0	31.8	23.0	10.9
Broad property sector	88.8	23.2	24.1	24.0	17.4	41.0
Construction	*30.3*	*8.5*	*8.0*	*7.7*	*5.6*	*5.4*
Purchase of residential property	*38.8*	*9.3*	*10.1*	*9.7*	*7.0*	*26.7*
Purchase of non-residential property	*12.1*	*3.3*	*3.6*	*3.9*	*2.8*	*6.3*
Real estate	*7.5*	*2.1*	*2.4*	*2.6*	*1.9*	*2.6*
Electricity, gas and water supply	6.4	2.2	1.6	1.9	1.4	0.8
Wholesale and retail trade, restaurants and hotels	83.7	24.0	25.6	25.5	18.4	8.4
Transport, storage and communication	9.5	2.6	3.3	2.4	1.7	2.0
Finance, insurance and business services	36.5	8.6	7.4	9.8	7.1	5.4
Consumption credit	85.1	23.2	26.5	26.5	19.1	22.1
Of which:						
Credit cards	*36.3*	*10.1*	*11.0*	*11.7*	*8.5*	*3.0*
Purchase of passenger cars	*29.1*	*8.3*	*10.7*	*10.0*	*7.2*	*15.5*
Purchase of securities	12.7	3.1	2.7	3.0	2.2	3.7
Purchase of transport vehicles excluding passenger cars	0.7	0.1	0.2	0.1	0.1	0.5
Others	27.5	7.2	7.0	9.4	6.8	2.9
Total	**488.2**	**130.8**	**134.8**	**138.3**	**100.0**	**100.0**

Source: Bank Negara Malaysia

In the household sector, bank lending remained resilient. Loan applications and approvals increased at annual growth rates of 18.3% and 9.7% respectively during the quarter (3Q 2005: 23.4% and 13% respectively). Loan disbursements to households amounted to RM37.6 billion, expanding by 10.8% on an annual basis (3Q 2005: 11.6%), and were driven mainly by credit card spending (31.1% of total loans disbursed to households); purchase of passenger cars (26.4%); and purchase of residential properties (25.7%). As a result, the annual growth in household loans outstanding was slightly higher at 15.1% at the end of fourth quarter 2005 (end-3Q 2005: 14.8%). Meanwhile, the ratio of NPLs to household loans outstanding was relatively stable at 7.5% (3Q 2005: 7.4%).

Higher funds raised from the capital market

The capital market remained an important source of financing and continued to complement the banking system in financing activity in the Malaysian economy. In total, funds raised through the capital market by both the public and private sectors during the fourth quarter increased to RM12.6 billion (3Q 2005: RM11.1 billion). For the whole of 2005, total net funds raised amounted RM41.7 billion (2004: RM42.7 billion). Financing through the capital market by the private sector surpassed those by the public sector with total net funds raised amounting to RM11.5 billion (3Q 2005: RM5 billion). This private sector financing was mainly undertaken through the issuance of private debt securities (PDS).

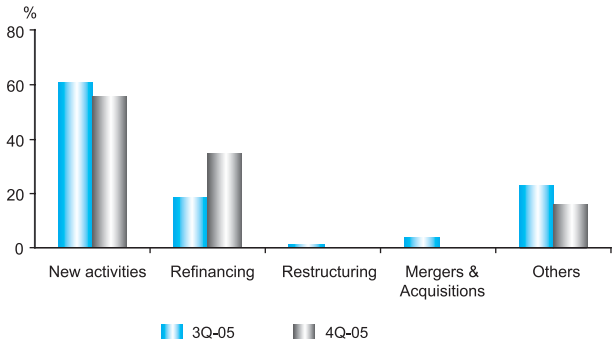
In the PDS market, gross financing increased by 55.8% on a quarterly basis to RM15.2 billion (3Q 2005: RM9.7 billion). The strong issuance during the quarter also partly reflected issuers' anticipation of higher interest rates in the future. Issuances of PDS excluding Cagamas were made by 29 corporations, which were mainly from the finance and business services, construction and utilities sectors. Of the total funds mobilised, a substantial share (52.6% of total PDS excluding Cagamas) was channelled to finance new economic activities, while funds raised to refinance existing debt accounted for 32.5% of the total. In terms of instruments, Islamic bonds and Islamic medium term notes were the preferred forms of issuance (51.6% of total). After adjusting for redemptions, net funds raised through the PDS market were higher at RM10.5 billion (3Q 2005: RM4.1 billion).

Funds Raised in the Capital Market

	2004	2004	2005		2005
	4Q		3Q	4Q	
	RM million				
By Public Sector					
Government Securities, *gross*	7,021	43,173	8,233	6,500	28,276
Less Redemptions	1,000	18,200	2,450	4,850	15,800
Less Government holdings	-	-	-	-	-
Equals Net Federal receipts	6,021	24,973	5,783	1,650	12,476
Khazanah Bonds, *net*	-	(1,198)	-	-	833
Govt. Investment Issues, *net*	1,243	1,423	-	(1,000)	1,000
Merdeka Savings Bond, *net*	436	1,474	383	397	1,516
Net Funds Raised	7,700	26,671	6,166	1,047	15,825
By Private Sector					
Shares	2,316	6,475	851	1,043	6,315
Debt securities	10,083	36,340	9,726	15,161	38,196
Private Debt Securities (PDS)	9,483	28,050	9,726	13,801	35,656
Cagamas	600	8,290	-	1,360	2,540
Less Redemptions	4,463	26,814	5,627	4,701	18,617
Net Issues	5,620	9,526	4,099	10,461	19,579
Net issues (excluding Cagamas)	5,494	8,402	6,359	9,851	22,224
Net Funds Raised	7,936	16,001	4,950	11,504	25,894
Total Net Funds Raised	15,636	42,672	11,116	12,552	41,719
Short-term Papers and Notes, *net* [1]	(1,103)	(3,208)	454	456	1,579
Total	14,533	39,465	11,570	13,008	43,297

[1] Refers to Commercial Papers and Cagamas Notes only.

Private Debt Securities Issued by Purpose
(% of total)



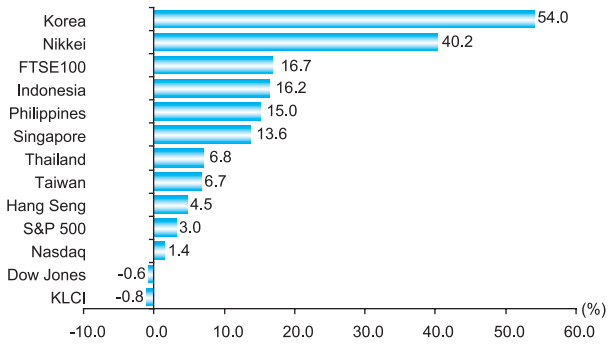
Despite the lacklustre performance of Bursa Malaysia, the RM1 billion in funds raised through the equity market was still higher than in the previous quarter (3Q 2005: RM850 million). The bulk of the funds were raised through 14 initial public offerings (IPOs) totalling RM774 million. During the quarter, there were 16 new listings on Bursa Malaysia, with four listings on the Main Board, one on the Second Board and 11 on the MESDAQ Market.

The Government raised a gross amount of RM8.9 billion via two reopening of Malaysian Government Securities (MGS) and two new issuances of MGS and Government Investment Issues. On a net basis, funds raised by the public sector were lower at RM1 billion (3Q 2005: RM6.2 billion), due to the higher redemptions made during the period.

KLCI was sluggish in the fourth quarter but recovered in early 2006

The absence of market leads weighted down market sentiments during the quarter. Nonetheless, bargain-hunting activities on selected blue chips led to a marginal improvement for the KLCI in December. During the quarter under review, the KLCI declined by 27.75 points (3Q 2005: +39.22 points), ending the quarter lower at 899.79 (3Q 2005: 927.54). Market capitalisation was also lower at RM695 billion (3Q 2005: RM715 billion). Furthermore, trading activity dropped and recorded a lower average daily turnover, at 304 million units during the quarter (3Q 2005: 430 million units). Sentiments in the local market were uplifted in early 2006 with

Performance of Selected Global and Regional Markets in the Fourth Quarter of 2005
(31 Dec 2004 - 30 Dec 2005)



Bursa Malaysia: Selected Market Indicators

	As at end		
	2004	2005	
	4Q	3Q	4Q
Price Indices			
- Composite	907.43	927.54	899.79
- EMAS	214.26	211.02	203.85
- Second Board	110.87	87.48	80.44
Average daily turnover			
- Volume (million units)	441.36	429.71	303.94
- Value (RM million)	835.02	698.06	578.09
Market Capitalisation (RM b)	722.04	715.36	695.27
No. of Companies Listed	963	1,007	1,021

Source: Bursa Malaysia

Bursa Malaysia: Turnover of Corporate Securities

	2004 4Q		2004		2005 3Q		2005 4Q		2005	
	million units	RM million	million units	RM million	million units	RM million	million units	RM million	million units	RM million
Turnover	27,364	51,771	107,610	215,623	27,931	45,374	18,541	35,264	102,338	177,321
of which:										
Main Board	20,186	45,129	78,132	180,408	20,538	40,892	13,788	32,391	73,816	157,445
of which										
- Consumer Products	899	2,924	4,008	12,583	1,156	3,146	647	1,863	3,694	10,197
- Industrial Products	4,036	4,978	12,365	17,427	2,692	3,281	1,633	2,020	12,150	14,143
- Construction	1,070	1,922	4,721	9,582	1,057	1,648	694	1,067	4,141	7,116
- Trading/Services	5,500	16,991	18,937	63,418	4,312	16,954	3,321	12,417	16,008	59,241
- Finance	1,958	8,090	10,843	38,176	2,614	9,199	2,262	8,796	10,108	36,743
- Properties	3,205	5,468	11,749	17,151	2,123	1,665	1,392	1,236	10,649	11,572
- Plantations	771	2,171	2,455	10,184	547	2,266	539	2,762	2,144	9,147
- Mining	-	1	48	175	0	1	0	1	0	10
Second Board	4,227	4,102	18,516	24,948	3,722	2,568	1,708	1,175	15,161	12,289

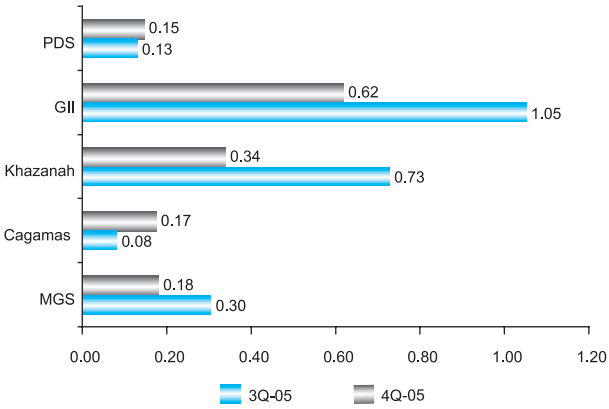
Source: Bursa Malaysia

expectations of better economic performance. As at 21 February 2006, the KLCI closed higher at 925.67 (since end-December: +2.9%) with market capitalisation increasing to RM724.51 billion (since end-December: +4.2%).

Lower secondary trading in the bond market

Trading activity in the secondary market declined to RM69.7 billion in the fourth quarter (3Q 2005: RM92.2 billion), with lower number of trading days following market closure during the festive celebrations. MGS accounted for 43.1% of total trading activity, followed by PDS, which accounted for another 36.1% of the total trade. The lower trading volume resulted in reduced liquidity for most papers, except for the Cagamas and PDS.

Liquidity Ratio: Turnover/ Outstanding

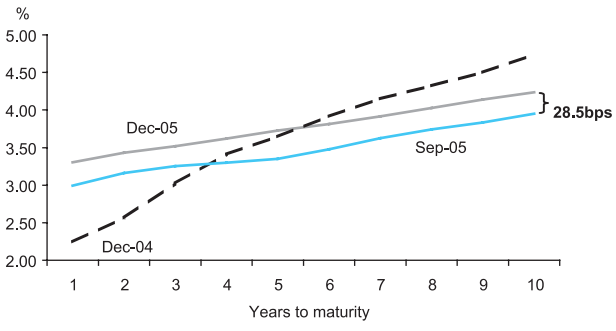


In line with the increase in the overnight policy rate, MGS benchmark yield curves, across all tenures, shifted upwards between 26 - 30 basis points. Secondary market sentiment was generally weak initially with

yields trending upwards, as investors continued to assess the outlook for economic growth, interest rate direction, and inflation amidst high oil prices. In addition, market sentiment was also affected by the uncertainties over the potential issuance size of MGS during the quarter. The increase in the overnight policy rate at end-November and the announcement of the final issuances of government securities for the year in early December helped to mitigate market uncertainties, resulting in stable bond yields in December.

During the quarter, the Bank issued the Guidelines on Regulated Short-Selling of Securities in the wholesale market, to allow market participants and universal brokers to undertake regulated short-selling activity. The widening of participants in the regulated short-selling framework is expected to contribute towards increasing the liquidity in the bond market.

Trend in MGS Yield

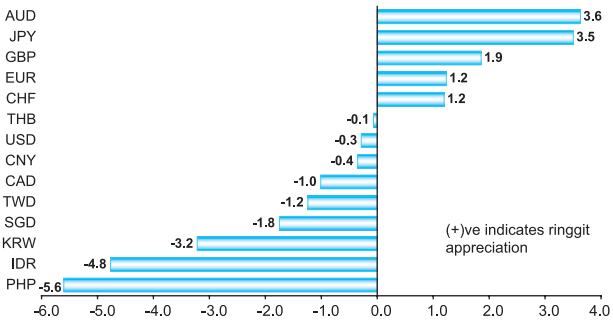


Exchange Rate Developments

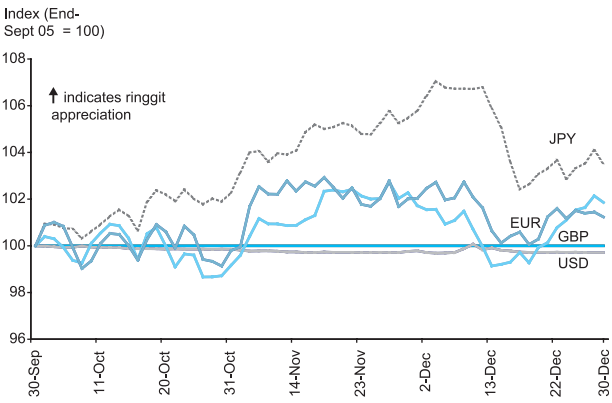
The ringgit appreciated against the yen, pound sterling and euro, but depreciated against the US dollar over the fourth quarter of 2005. The US dollar strengthened amidst general expectations for further increases in the Fed Funds rate. Meanwhile, the euro weakened on market perception that the European Central Bank would not raise its benchmark interest rate. The Japanese yen also depreciated against the ringgit amidst strong Japanese demand for higher yielding foreign assets and market expectations that the Bank of Japan would maintain its quantitative easing policy.

Against regional currencies, the ringgit depreciated in the range of 0.1 - 5.6%. While

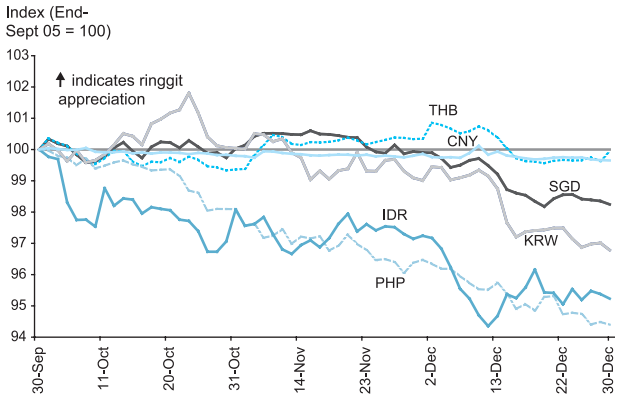
Summary of Ringgit Performance Against Selected Currencies
Percent Change (1 October - 30 December 2005)



Ringgit Performance Against Major Currencies



Ringgit Performance Against Regional Currencies



the ringgit continued to depreciate against most regional currencies in early 2006, this trend reversed in February. In February, the ringgit appreciated against most regional currencies in the range of 0.5 - 2.0%. The Indonesian rupiah appreciated amidst increases in the benchmark interest rates, and market confidence that the newly appointed Ministerial Cabinet would implement policies to spur economic growth. Similarly, the Philippine peso and Korean won strengthened, largely due to the strong repatriation of earnings from abroad.

Performance of Ringgit Against Selected Currencies

RM per foreign currency	As at end					% change since *			
	30 Jun 97	02 Sep 98	4Q 04	3Q 05	4Q 05	30 Jun 97	02 Sep 98	4Q 04	3Q 05
US dollar	2.5235	3.8000	3.8000	3.7692	3.7800	-33.2	0.5	0.5	-0.3
Euro	-	-	5.1729	4.5421	4.4867	-	-	15.3	1.2
Pound sterling	4.1989	6.3708	7.3169	6.6438	6.5226	-35.6	-2.3	12.2	1.9
100 Japanese yen	2.2088	2.7742	3.7026	3.3359	3.2229	-31.5	-13.9	14.9	3.5
Singapore dollar	1.7647	2.1998	2.3258	2.2315	2.2714	-22.3	-3.2	2.4	-1.8
100 Thai baht	9.7470	9.3713	9.7636	9.1988	9.2049	5.9	1.8	6.1	-0.1
100 Philippine peso	9.5878	8.8302	6.7706	6.7262	7.1254	34.6	23.9	-5.0	-5.6
100 Indonesian rupiah	0.1038	0.0354	0.0408	0.0366	0.0385	169.9	-7.9	6.2	-4.8
100 Korean won	0.2842	0.2827	0.3671	0.3619	0.3739	-24.0	-24.4	-1.8	-3.2
Chinese renminbi	0.3045	0.4594	0.4591	0.4669	0.4686	-35.0	-2.0	-2.0	-0.4

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

DEVELOPMENTS IN THE BANKING SYSTEM

The banking system continued to record strong financial performance in the fourth quarter of 2005, with improvements in both profitability and asset quality, whilst maintaining a high level of capitalisation. The strengthened financial position has enabled the banking system to continue supporting economic growth via expanded lending activities.

Capitalisation level remained strong

Although the risk-weighted capital ratio (RWCR) and the core capital ratio (CCR) declined during the fourth quarter of 2005, the level of capitalisation of the banking system remained strong. RWCR and CCR were 13.1% and 10.2% respectively. The decline in the ratios was due mainly to an expansion in risk-weighted assets (+RM13.9 billion or 2.2%) and a marginal decline in the capital base (-RM0.5 billion or 0.5%). The lower capital base was attributed primarily to large dividend payouts by several banking institutions, whilst the increase in risk weighted assets was driven by higher lending activities.

Capital Position Remained Strong

	2004		2005			
	3Q	4Q	1Q	2Q	3Q	4Q
Capital						
CCR (%)	11.4	11.4	10.9	10.8	10.7	10.2
RWCR (%)	13.9	14.4	13.8	13.6	13.5	13.1

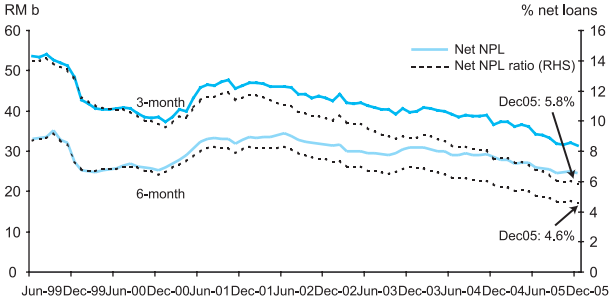
Favourable profitability performance

The banking system recorded an increase in pre-tax profits of RM0.6 billion (+21.9%) to RM3.5 billion during the quarter. The stronger performance was largely on account of higher net investment income (+RM639 million or 209.2%) and higher recoveries (+RM131.8 million or 10%) resulting from improved business conditions. These increases were partially offset by the marginal increase in operating expenses (+RM207.2 million or 6.1%). Consequently, the annualised return on average assets and equity of the banking system stood at 1.4% and 16.7% respectively (3Q 2004: 1.3% and 15.9%).

Asset quality improved further

The quality of the loan portfolio of the banking system continued to improve in the fourth quarter. Net NPLs based on 3-month classification declined by 2% to RM31.3 billion, thus lowering the net NPL ratio to

Banking system: Non-performing loans



5.8% (3Q 2005: 6.1%; end-2004: 7.5%). Similarly, net non-performing loans (NPL) ratio on a 6-month classification trended downwards to 4.6% (3Q 2005: 4.7%; end-2004: 5.8%). This improvement was driven largely by loans that were reclassified as performing, write-offs and lower incidence of new NPLs.

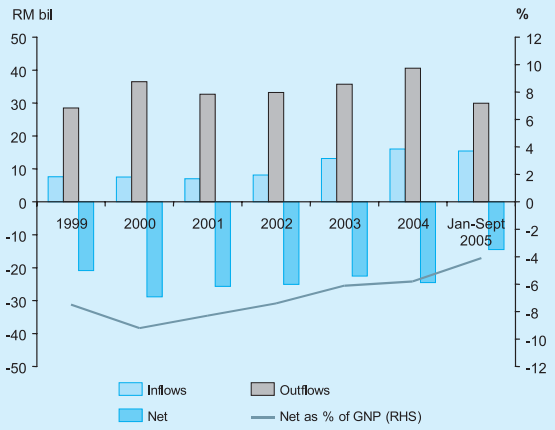
Malaysia: Income Account of Balance of Payments

I. Introduction

- Malaysia has adopted the IMF's Balance of Payments Manual, Fifth Edition's standard in its compilation of the income account since 1999. The income account has then been classified as a separate account from the services account. The components of the income account are **compensation of employees**, which are salaries and other benefits earned by the expatriates working in Malaysia and by Malaysians working abroad, and **investment income**, which refers to income (from direct investment, portfolio investment and other investment) accrued to foreign investors investing in Malaysia as well as income accrued to Malaysians investing abroad.

- The income account of balance of payments of Malaysia has always been in deficit, attributed mainly to profits and dividends accrued to foreign direct investors. This trend is in line with the large presence of multinational companies in the country, and it also reflected the successful operations of these companies in Malaysia. During the period 1999 to 2004, the deficit in income account averaged RM24.6 billion per annum. As a percentage share of GNP, the deficit has been in the range of -7.5% to -5.8%, which also takes into account the improvement in gross inflows of income from abroad particularly, from larger reserves as well as profits and dividends accruing to Malaysian companies investing abroad. In the period January to September 2005, the income account deficit amounted to RM14.5 billion or equivalent to -4.1% of GNP (January -

Income Account



Source: Department of Statistics, Malaysia

September 2004: -RM18.7 billion or -6% of GNP) again reflecting strong performance of Malaysian investments abroad.

- The notable features of the income account over the period are:

  - The strengthening of profits and dividends accrued to Malaysian investors investing abroad in recent years and higher revenue from larger external reserves contributed towards improvement in income account deficit when measured as a percentage of GNP.

  - The proportion of reinvested earnings by foreign direct investors in Malaysia remained high, averaging 55% during the period 1999 to 2004 and 56% for the period January to September 2005. This high ratio points to continued expansion and diversification in operations by existing multinational companies amidst a favourable domestic climate for foreign investment in Malaysia.

II. Developments in Income Account

Income Inflows

- Inflows of **compensation of employees**, which are salaries and other benefits earned by the Malaysians working abroad, more than doubled to RM2.6 billion in 2004 from RM1.2 billion in 1999. In the period January to September 2005, the inflows of compensation of employees amounted to RM3.2 billion. These inflows were mainly

Income Inflows

	1999	2000	2001	2002	2003	2004	Jan-Sept 2005	1999	2000	2001	2002	2003	2004	Jan-Sept 2005 1/
	RM billion							% Annual Change						
Total income inflows	**7.6**	**7.5**	**7.0**	**8.1**	**13.1**	**16.0**	**15.5**	**43.4**	**-0.9**	**-7.0**	**15.8**	**61.6**	**22.0**	**40.3**
* Compensation of employees	1.2	1.3	1.4	1.7	2.2	2.6	3.2	65.4	6.0	7.2	18.5	33.2	19.0	72.7
* Investment income	6.4	6.2	5.6	6.5	10.9	13.4	12.3	-	-2.2	-10.0	15.2	68.8	22.6	33.8
- Direct investment	**0.4**	**-0.8**	**-0.2**	**0.7**	**2.0**	**4.3**	**3.2**	**-**	**-298.4**	**-70.8**	**-373.6**	**192.0**	**117.7**	**22.8**
- Portfolio investment	0.3	0.3	0.2	0.2	0.3	0.4	0.3	-	7.7	-23.1	-30.4	114.3	15.5	12.9
- Other investment	5.7	6.8	5.6	5.6	8.6	8.7	8.7	-	19.5	-17.0	0.1	52.9	1.2	39.3

Source: Department of Statistics, Malaysia

1/ Annual change over the corresponding period of 2004

from Singapore, US and Hong Kong China.

- The **investment income**, comprising income earned from direct investment, portfolio investment and other investment abroad by Malaysians, increased steadily to RM13.4 billion in 2004 from RM6.4 billion in 1999. In the first nine months of 2005, the investment income earned was RM12.3 billion.

  - Of significance, inflows of *direct investment* income grew from RM0.4 billion in 1999 to RM4.3 billion in 2004. In the period January to September 2005, direct investment income amounted to RM3.2 billion. The improvement reflected mainly higher profits and dividends accrued to Malaysian companies investing abroad, particularly in the oil and gas, manufacturing as well as financial services sectors. The direct investment income earned accounted for about 29% of total investment income inflows during the period 2004 to September 2005 (1999: 7%).

  - Income from *other investment* grew from RM5.7 billion in 1999 to RM8.7 billion in 2004, contributing to about 65% of the total investment income inflows in 2004. A significant part of these incomes were earnings from international reserves of Bank Negara Malaysia.

  - Reflecting the limited exposure of Malaysian investors to *portfolio investment* abroad, income from this investment has remained small, averaging RM281 million during the period 1999 to 2004.

Income Outflows

- Outflows of **compensation of employees** have increased steadily (2004: -RM3.8 billion; 1999: -RM1.8 billion) with payments mainly to the US, UK and Japan. In the period January to September 2005, compensation of employees amounted to RM3.4 billion (January-September 2004: RM2.8 billion).

- During the period 1999 to 2004, **investment income** outflows or accrued to foreign investors remained large, averaging RM31.8 billion per annum. In the period

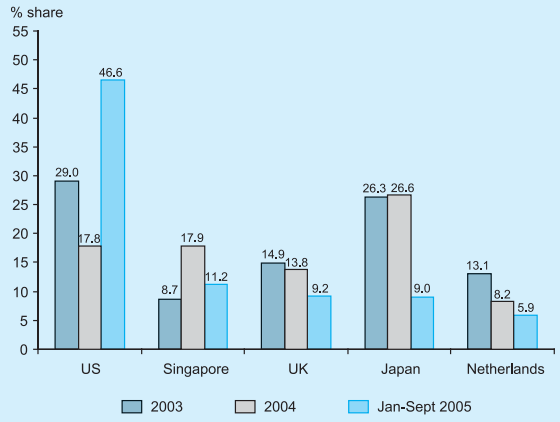
Income Outflows

	1999	2000	2001	2002	2003	2004	Jan-Sept 2005	1999	2000	2001	2002	2003	2004	Jan-Sept 2005[1/]
	RM billion							% Annual Change						
Total income outflows	**28.5**	**36.5**	**32.6**	**33.2**	**35.7**	**40.6**	**29.9**	**41.6**	**27.9**	**-10.5**	**1.7**	**7.5**	**13.7**	**0.7**
* Compensation of employees	1.8	2.3	2.4	2.8	3.2	3.8	3.4	47.4	23.8	5.8	17.6	11.6	19.0	23.3
* Investment income	26.7	34.2	30.2	30.4	32.5	36.8	26.5	-	28.2	-11.6	0.4	7.1	13.2	-1.7
- Direct investment	**20.5**	**27.3**	**22.5**	**23.3**	**25.6**	**29.5**	**21.0**	**-**	**32.8**	**-17.3**	**3.2**	**10.0**	**15.2**	**-3.3**
of which: Reinvested earnings	*13.1*	*20.8*	*9.5*	*13.1*	*10.8*	*14.1*	*11.8*	*-*	*59.3*	*-54.6*	*38.8*	*-18.1*	*30.8*	*14.7*
(as % of direct investment)	*63.7*	*76.4*	*42.0*	*56.5*	*42.0*	*47.8*	*56.3*							
- Portfolio investment	0.9	1.0	0.5	0.5	0.7	1.4	1.2	-	16.9	-51.7	5.8	46.5	94.0	37.8
- Other investment	5.3	5.9	7.2	6.6	6.2	5.9	4.3	-	12.2	21.5	-8.5	-6.4	-4.5	-1.3

Source: Department of Statistics, Malaysia

[1/] Annual change over the corresponding period of 2004

Retained Earnings by Major Destination



Source: Department of Statistics, Malaysia

January to September 2005, the outflow of investment income was RM26.5 billion.

- In line with the large presence of multinational companies and their continued expansion as well as diversification of their operations in Malaysia, *direct investment* income outflows, which accounts for about 80% of total investment income outflows in 2004, grew at a compounded rate of 7.5% per annum, increasing to RM29.5 billion in 2004 from RM20.5 billion in 1999. These outflows were mainly profits and dividends accruing to foreign direct investors. Nevertheless, a substantial portion of these profits and dividends are retained in Malaysia for reinvestment. During the period 1999 to 2004, retained earnings accounted for about 55% of total direct investment income outflows, and credited as inflows of foreign direct investment in the financial account of balance of payments. The profits were reinvested mainly in the manufacturing sector and services sector, particularly financial services and

wholesale and retail trade sub-sectors. Major investors which have retained their profits for investment are from the US, Singapore, UK, Japan and Netherlands.

- Outflows of income from *other investment* remained relatively stable at around RM6.2 billion per annum, reflecting mainly interest payments arising from external borrowings. This trend reflects Malaysia's low external debt position, averaging 53% of GNP during the period 1999 to 2004 (End-2005: 42.2% of GNP). The outflows of RM4.3 billion in the first nine months of 2005 was mainly due to interest payments on Federal Government and Non-Financial Public Enterprise loans.

III. Conclusion

- The developments in the income account of the balance of payments is a reflection of the dynamics of investment in Malaysia and the openness of the economy. The strengthening of profits and dividends accruing to Malaysian investors investing abroad in recent years and the higher revenue from external reserves have contributed to the improvement in the income account deficit as a percentage of GNP. While the profits and dividends that accrue to foreign direct investors investing in Malaysia have remained large, the proportion of reinvestment of these earnings by the foreign direct investors continued to be significant.

Frankfurt European Banking Congress 2005
18 November 2005, Frankfurt

Session III: Financial Markets – Shared Responsibility

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

Reference has already been made by previous speakers to the increased risks that the current prevailing global imbalances impose on the international financial system. The specific issue for this panel - "Financial markets: Shared Responsibility" suggests that a global solution is needed to address the problem of global imbalances, and that the burden of adjustment needs to be a shared responsibility.

There is already a general consensus on the necessary structural adjustments that need to be made by the respective regions, namely, the United States, Europe and Asia. By the very nature of structural adjustments, it involves structural reforms, institutional developments and shifts in the relative significance of economic segments and structures. These adjustments and reforms cannot be expected to occur within a short period of time. While there is concern whether there will be the commitment, the political will and the discipline to undertake these reforms and changes, the more immediate concern is that during the transition, sudden and abrupt adjustments may take place in the financial markets, with adverse implications on the world economy.

I would like to take this opportunity to discuss these issues from the perspective of Asia in general and emerging market economies in particular. More specifically, what might be the role that Asia could have in the adjustment process? Several issues have already been cited as constraints to the process of adjustment. The relative lack of strength in domestic demand outside the US; the large gap between saving and investment in major regions of the world; and the fragmented structure of global capital intermediation that hinders surplus regions from financing productive investments within their region. On all these fronts, significant initiatives are underway in the Asian region to address these issues and substantive progress has already been achieved in contributing to the global adjustment process.

Asia, with more than half the world's population and a growth performance that has been, on average, one-and-a-half times higher than the global average, is becoming increasingly more important in the world economy. While Asian economies have many common characteristics, they are less homogeneous compared to the European economies. The main common feature of Asian economies is its high degree of

openness and export orientation. On average, total trade as a percentage of GDP is 95%. A more recent emerging phenomenon is the growing significance of intra-regional trade. Intra-regional trade now accounts for more than 50% of Asia's total trade. A second distinctive and important feature of most Asian economies is the high degree of flexibility of the economies in adjusting to changing global conditions and in dealing with external shocks. This high degree of economic flexibility has been an important factor in sustaining the region's growth performance and in facilitating rapid recovery from shocks, including from the 1997-98 financial crisis.

While in the past, high economic performance of Asia was driven by the export orientation growth, greater focus is now being accorded in the recent decade to strategies geared toward building the capacity of domestic demand. In particular, increased emphasis has been placed on promoting the role of consumption. Reflecting the success of this policy, the savings rate that exceeded 40% of GDP in several of the Asian economies in the 1990s, (in Malaysia the rate was 42% of GDP) has now trended towards 30%. Private consumption as a percentage of domestic demand has increased from 77% in 1995 to 85% currently. It is projected that by 2010, this will reach 90%. In most economies, fiscal consolidation has also continued, thus reducing the budgetary deficits and the level of public indebtedness, while enhancing the role of the private sector in the economy.

Significant initiatives are also underway to increase the contribution of private investment to growth and to secure new areas of growth. Reforms have been undertaken to boost the investment climate by reducing the cost of doing business and improving the supporting infrastructure. These initiatives will continue to be on-going priorities in the region.

These trends have increased the potential for Asia to contribute to the rebalancing of global growth and thus towards the global adjustment process. This process has been strengthened by several factors. Firstly, the conscious policy measures that have been implemented to promote domestic consumption and investment. Secondly, the cumulative domestic demand of the regional economies in an environment of rising incomes has represented a significant regional market that has fuelled the expansion of intra-regional trade which has, in turn, resulted in a mutually reinforcing process that has strengthened further the regional growth. While the measures to spur regional demand are also being forged though various regional free trade agreements (ASEAN FTA; ASEAN-China FTA and ASEAN-India FTA), the region is also outward looking to strengthen its relations with other parts of the world. The series of reforms being pursued are thus aimed at strengthening the capacity of the region to emerge as a stronger source of global demand.

A further reinforcing factor for Asia to emerge as a stronger source of global demand is the favourable demographic structure in Asia. Asia has the largest share of the world's population, coupled with a young demographic structure, thereby providing a

future source of domestic demand. With the growing income levels, the middle-income groups in China, India, Korea and ASEAN have been increasing and will position Asia as one of the largest markets in the world going forward.

In many respects, the rising trend in intra-regional trade in Asia mirrors developments in Europe. Intra-regional trade in Europe has always been significant, and became increasingly important in the 1990s, rising from 53% in 1985 to surpass 60% in 2004. Since the 1970s, a central feature of Europe's cooperative efforts in the context of increased economic interdependence within the region was exchange rate stability. Exchange rates in Europe evolved, beginning with a fixed parity arrangement among European currencies, within the broader framework of a free float against the other international currencies. The evolution of the exchange rate arrangement has culminated in a common currency in the European Union.

While a single currency is a remote possibility for Asia, exchange rate stability in relation to the currencies of its major trading partners is even more important to Asian economies because of its higher degree of openness both in terms of trade and financial flows and also in view of the relatively smaller size of several of the Asian economies. On account of these factors, the region is rendered more vulnerable to sudden and large swings in exchange rates. While progress has already been made to strengthen the financial markets in the Asian region, Asia still needs to develop the capacity to manage the volatile financial flows and the consequent large swings in the exchange rate.

This brings us to the call being made for Asia to adopt more flexible exchange rate regimes, with the suggestion that the exchange rate should be allowed to appreciate and thus contribute towards reducing the global imbalances. It needs to be recognised that Asia's comparative advantage is not derived from the exchange rate. Wages, prices and other costs are significantly lower in Asia. It is precisely for this reason that multinationals have relocated their operations to Asia. Furthermore, studies have in fact shown that Asian currencies would have to appreciate by 50 to 60% to have any discernible impact in reducing the global imbalances. Any such adjustment within a short period of time would not only lead to significant economic dislocation in Asia, but also precipitate unstable financial market conditions. Given the increased international integration of Asia with the rest of the world, the destabilising financial market conditions would not be contained within the region but can be expected to have its contagion effect on the international financial markets.

What has been important is that while external price stability has been pursued in Asia has, it been accompanied by internal flexibility to adjust to changing conditions. In fact, Asia's strong performance has been due in part to its economic flexibility - the ability for resources to shift to new areas of comparative advantage in response to changing conditions and new opportunities in the global economy. In particular, there is a high degree of labour and capital mobility.

Significant investments in training and education have allowed labour to adjust and become more mobile. This has played a large part in enabling rapid industrialisation and in shifting to higher value added activities. Capital has also shown greater mobility, expanding the potential for the economies to adjust. Many of the Asian countries have actively identified and developed new sources of growth, leveraging on their respective resource advantages and new technologies to move up the value chain. There have also been greater moves toward removing rigidities and transitioning toward greater market orientation and competition.

On the financial front, significant progress has been made in Asia in strengthening the financial sectors (banking system and capital markets). This increases the region's capacity to intermediate funds within the region. The regional banking systems as a whole have increased their resilience and ability to manage risks as reflected in the indicators of profitability, asset quality and capital adequacy, all which have generally strengthened. The renewed strength in the banking systems is mainly underpinned by the recapitalisation programmes; consolidation through mergers; and improvements in banking supervision and regulation. Similarly, in the capital markets, initiatives have been taken to improve the standards of corporate governance and the development of the necessary infrastructure to promote the capital markets.

In this respect, regional financial ties underpin the reforms particularly in the intermediation of capital and for rechanelling for productive investment within the region. The implementation of the Asian Bond Funds (ABF1 and ABF2) marks a significant step in future financial integration as part of the foreign reserves are invested in Asian sovereign bonds. The introduction of ABF2 Funds as a new asset class in Asia, together with infrastructural improvements and tax and regulatory reforms, can be expected to contribute towards the broadening and deepening the bond markets in the region over time. A further step towards increasing market integration within the region, especially in the context of equity markets, has been the recent launch of the FTSE/ ASEAN – 40 Index. These market driven cooperative efforts are also expected to contribute to more efficient financial intermediation in the region over the long-term. Also, as most regional members' markets are small, building a region-wide financial market would increase the potential for the region to become more attractive to both global and regional investors.

Finally, a further issue raised for this session relates to the sustainability of the financing of the current account deficits, particularly in the United States. It has been maintained that Asia as a region that has surplus savings and more recently the Middle East, have engaged in such financing. The concern is if this trend should reverse. In the current environment, the US financial markets are the largest financial markets in the world. It allows for large transactions to occur with minimal impact on market stability. The numbers of players, turnover, and frequency of issues are unmatched in any market. It also has greater diversity of investment

opportunities in the different asset classes. This is a major reason prompting investment in these markets. The further development of non-dollar markets are therefore necessary to facilitate more balanced global investment activities and thus reduce the potential for any concentrated buildups that would be prone to risks of instability should reversals occur. Indeed, Europe can contribute significantly in this area.

More recently, successive upward adjustments in interest rates in the United States have in fact caused the dollar to strengthen significantly. Further increases in interest rates will continue to reinforce this trend as the interest rate differential between dollar and non-dollar-denominated assets widens. As to the direction of financial flows, in the final analysis, it will be the policies and developments in the economies receiving such financial flows that would be important in determining the investment climate and in preserving the stability of its financial markets.

The problem of global imbalances, by its very nature, requires a global solution, and a shared responsibility to ensure its orderly resolution. A gradual and co-ordinated global approach is necessary to avoid destabilizing adjustments. The Asian region recognizes its role in this adjustment process, and policy measures have been introduced to facilitate the adjustment, by enhancing domestic demand-led growth and strengthening the financial systems in Asia. At the same time, strategies aimed at reducing vulnerability and strengthening resilience have also been important so as to manage the emerging risks arising from the process of adjustment. This combination of actions would enhance the prospects of stability in financial markets.

The bull had the benefit of more than half a century to achieve the level of economic and financial development and integration today. The tiger should also be allowed some time to achieve this and assume its place in the global economy.

Regional Conference on Investment Climate and Competitiveness in East Asia
21 - 23 November 2005, Kuala Lumpur

"Financial Reforms and Investment Climate"

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

It is my pleasure to be here today to speak at this Regional Conference on Investment Climate and Competitiveness, co-organised by the World Bank and the Economic Planning Unit of Malaysia. This subject on investment and competitiveness is of particular significance to Asia in the current environment when the world economy is confronted with the problem of unsustainable global imbalances that has brought with it, risks to the global growth prospects. While the resolution to this problem is seen as a shared responsibility by the respective regions in the world economy, Asia is seen as having a particularly major role in the adjustment process.

Among the issues that have been cited as constraints to the adjustment process are the relative lack of strength in domestic demand outside the United States; the large gap between savings and investment in major regions of the world; and the fragmented structure of global capital intermediation that hinders surplus regions from financing productive investments within their own region. An important role for Asia in the adjustment process is to contribute towards the rebalancing of global growth. This is not only in terms of strengthening regional consumption demand but also increasing the home bias for investments by channelling an increased part of the surplus savings into productive investment in the region.

The investment climate and competitiveness in Asia will therefore be important in determining the extent of the role that Asia might have in contributing towards the orderly adjustment process of unwinding the global imbalances.

The investment climate and competitiveness of an economy is shaped by a wide range of factors. These include the economic stability, monetary and financial stability and what is equally important is that it is supported by social and political stability. My remarks this morning will focus on financial reforms and the investment climate.

The financial sector has a major role in facilitating the overall functioning of the economy. It represents the nerve centre of the economy. The financial sector represents the means by which funds are intermediated through which the mobilisation and allocation of funds to productive investments are

undertaken. The greater the financialisation of savings, the greater will be the potential for the channelling of savings to productive activities through the formal financial sector. The financial sector also facilitates the means for payments and the transmission of monetary policy. The effectiveness of the financial sector in performing its functions depends on its ability to meet the changing requirements of the economy and the ability to withstand the economic cycle. The financial sector is also an important factor in facilitating greater economic flexibility and thus in driving the economic transformation process. In order to contribute to the low cost of doing business, the financial sector also needs to be efficient and competitive. This includes being able to meet the economy's financial requirements at the best possible values.

The Asian region has seen significant transformation of its financial landscape driven by the globalisation process, the shift towards greater market orientation and the advances in technology. Emerging market economies in particular need to focus on capacity building and financial infrastructure development. This includes strengthening the financial institutions, developing the domestic financial markets and putting in place the legal, regulatory and supervisory framework that will ensure the soundness and stability of the financial system.

This decade has also seen wide-ranging financial reforms taking place, including reforms relating to greater market orientation to achieve enhanced operational efficiency, productivity and innovation and the strengthening of standards of risk management, corporate governance and transparency. Initiatives have also been undertaken to restructure, rationalise and consolidate the industry to strengthen capacity and address areas of weakness, risks and vulnerability. These initiatives include the establishment of institutional arrangements for restructuring and rehabilitation to be undertaken. The liberalisation process in a number of countries has been intensified to include the liberalisation of foreign ownership limits in domestic institutions to the issuance of new licences and relaxation of rules for foreign transactions. This has been for the most part to enhance inter-regional and global linkages and to facilitate greater trade and investment across borders.

These reforms have brought with them new risks that need to be managed to ensure the maximum benefits of more competitive pricing, higher quality of product offerings and greater innovation in the range of products and services offered. The argument has always been made that the deregulation, removal of controls and liberalisation would produce a more optimal allocation of resources which would lower the cost of capital and thus enhance the investment climate and the overall growth prospects of the economy. The experience has shown that the lack of preparedness has often resulted in marginalisation and destabilising consequences. Appropriate strategies therefore need to be adopted to manage this globalisation process. Of importance, is the need to understand the implications of the changes, build the capacity to deal with the implications of such changes, have mechanisms to conduct surveillance to

monitor developments and finally, to have at the disposal of the monetary authorities, the capacity for policy response to manage the financial developments in the new environment.

In the final part of my presentation, let me share with you Malaysia's experience on the financial dimension in influencing the investment climate, particularly on the financial reforms that Malaysia has implemented as part of our efforts and commitment to continuously enhance the investment climate. The objectives of these efforts are to enhance the flexibility of the economy, strengthen its competitiveness, soundness and investor confidence in the economy.

The financial system in Malaysia has played an important role in providing a stable and positive environment while facilitating diversification of the economy - allowing for focus on the areas of comparative advantage, including new areas of growth that have higher value added potential. Most important is that it provides a supportive environment for private enterprise. Not only has it provided a supportive enabling environment for private sector activity and kept the cost of doing business low, but it has also increased resilience and enhanced stability. It has also been important in making Malaysia an attractive destination for investment. Between 1988 and 1997, Malaysia received foreign direct investment (FDI) averaging 7.7% of Gross Domestic Product (GDP) annually, one of the higher ratios in the world. Even during the period 1998-2004, notwithstanding the shift in global patterns of FDI flows, Malaysia continued to receive FDI amounting to 6% of GDP.

The financial system in Malaysia has had an instrumental and complementary role in creating a sound investment climate. While the economic, political and regulatory elements provide the underlying investment-conducive environment, the financial system provides the link for financial services and the infrastructure for investments to function efficiently in the economy.

Malaysia has undertaken a proactive approach in formulating the financial reforms and in the development of the domestic financial infrastructure, taking into account the stage of development of the financial sector and the context of the prevailing and prospective environment to ensure that the stability of the financial sector in particular, and the economy in general is not destabilised. The objective is to build a resilient, efficient and effective financial sector that is able to meet the changing needs of the domestic environment and provide a catalytic role in the transformation of the economy. Careful considerations were also given to the trades-offs of the conflicting objectives to promote efficiency and innovation within the financial sector whilst maintaining financial system stability and ensuring that the system has the capacity to adapt to changes in an orderly manner. Another important consideration in designing and implementing financial reforms is to also take into account the socio-economic agenda of the nation. As central banks of emerging economies, consideration also needs to be given to develop a financial system that is inclusive, that allows for all

segments, target groups and the different activities to have access to financial services so that balanced growth can be achieved.

Malaysia has also adopted a gradual approach to liberalisation of the financial sector. The process is sequenced, taking into consideration a number of factors. The overriding objective is preserving financial stability. It is important that the domestic banking institutions are ready and have the ability to adapt and respond positively to the dynamics of liberalisation so that the maximum benefits from this process can be realised. As part of this process, lead time has been given for domestic banking institutions to enhance their efficiency and capabilities to strengthen their capacity to operate in a more competitive environment and to elevate themselves and gravitate to benchmarks achieved by international players. This pre-condition is important prior to liberalisation so as to avoid any destabilising implications on financial stability, which may in turn adversely affect the investment climate of the country.

Our Financial Sector Masterplan that was launched in 2001 outlines our strategy on financial sector development and the approach towards liberalisation. The Masterplan provides the blueprint for the medium and long-term development of the financial sector and the integral steps that need to be taken to achieve the objective of creating a financial sector that is resilient and competitive and that is able to contribute more meaningfully to the economic growth and development process. In the first phase of the Masterplan, focus is accorded to nurture a core of strong and forward looking domestic financial institutions that are more efficient, competitive and technology-driven and that are able to face the challenges of liberalisation and globalisation.

The focus of the first phase was essentially on enhancing capacity of domestic institutions and building and enhancing the domestic financial infrastructure. Following the first phase, greater deregulation and liberalisation can be expected to increase the level of competition. These measures will be implemented gradually, taking into consideration the ability of the financial system to absorb the changes. The final phase of the Plan will involve gradual assimilation into the international financial system with possible introduction of new foreign competition. This phase will also see greater participation of domestic banking institutions in the global financial system.

It has been close to five years since the introduction of the Masterplan. Significant progress in building the capacity and capability of the domestic financial institutions and the establishment of the necessary financial infrastructure to provide the foundation for growth of the financial sector, has been achieved. The strengthening of the financial sector has also been driven by the restructuring, reengineering, rationalisation and consolidation efforts that have been undertaken during this period. This has also been reinforced by strengthened risk management practices and infrastructure and the adoption of high governance standards and best practices. The banking sector, in particular, is now anchored by a core group of domestic banking institutions that are well-

capitalised, benefiting from the industry-wide consolidation programme that was completed in 2002. The capitalisation of the banking system is strong, with a risk-weighted capital ratio sustained at high levels of more than 13%, whilst the asset quality has improved significantly. The banking system has also continued to record strong profits amidst greater diversification in their income sources and continuous improvement in their operational efficiency.

The financial sector is also supported by a thriving and evolving Islamic financial system which provides a comprehensive range of products and services based on Syariah principles. Significant milestones have been achieved thus far in terms of the development of the financial infrastructure, and the regulatory framework for Islamic banking. Complementing the developments in the banking sector and Islamic financial sector, the insurance and takaful sectors have also made marked contributions in supporting the economic transformation process. Premiums and contributions of these sectors have continued to expand at double digit growth rates in the first half of 2005. The underlying fundamentals for sustainable expansion have also strengthened, with stronger solvency positions, continued profitability and improved underwriting discipline. In tandem with the holistic development of the financial sector, focus has also been accorded to develop the capital market, in particular, the bond market and the venture capital industries towards achieving the objective of building a strong, vibrant and diversified financial sector. The corporate sector, including foreign multinational corporations and multilateral agencies are now able to access our domestic bond market.

Financial institutions have now also embraced higher levels of technology and improved business processes that enable them to capitalise on larger business opportunities and reap benefits from economies of scale and cross-selling of products and services. Significant milestones have also been achieved in the delivery of personalised and customised financial solutions to meet the increasingly complex needs of consumers. Utilisation of new delivery channels through innovative technology-based mechanisms has also increased, leading to more effective and efficient distribution of products and services to customers. The continuous ability of the financial sector to meet the increasingly diversified and discerning needs and preferences of the various segments of customers with greater product differentiation and value added services are strengthening their competitive advantage and contributing towards enhancing the investment climate for investors.

In tandem with these efforts, internal reorganisation and reengineering of processes to achieve higher levels of operational efficiency have also been emphasized. By December 2005, all finance companies would have successfully merged with their respective commercial bank. Also, the framework on investment banks will pave the way for rationalisation of the merchant banking, stockbroking, discount house and universal broking industry. The creation of

investment banks is envisaged to enhance the capacity and capabilities of domestic capital market players to compete meaningfully in an increasingly challenging environment, hence contributing to the development of a dynamic and vibrant capital market that effectively supports the growth and transformation process of the economy.

Efforts to develop the financial sector have also been complemented by efforts to develop the financial and consumer protection infrastructure. Efforts are being directed to evolve an efficient and effective payments system that has the agility to take advantage of the new technologies that have emerged. We have also embarked on a ten-year comprehensive consumer education programme to elevate the financial literacy of consumers and promote consumer activism as a means to promote greater inclusion and also to drive performance of the financial sector. Continuous enhancements are also underway to strengthen the consumer protection framework. The establishment of a deposit insurance system in Malaysia recently represents one of the initiatives that has now been implemented.

In terms of the regulatory approach, we have evolved from a "rule-based" approach to a more flexible approach, that is "principle-based". This aims to promote competition and innovation whilst maintaining sufficient regulations to ensure financial prudence and stability in the financial system. Emphasis is also given towards developing broad prudential guidelines and principles, with enhanced focus on identifying risks at the system level and ensuring that individual financial institutions have the necessary systems to undertake and manage risks. Within this context, the financial players have the flexibility to design their own strategies and market niches. The supervisory process has also been strengthened and more rigorous surveillance mechanisms at both individual institution and system levels have been instituted.

Given the now strengthened position of the financial sector, several liberalisation measures have been accelerated ahead of the schedule in the Masterplan. A series of measures that were brought forward include the liberalisation of the provision of internet banking by foreign banks in January 2002, and the removal of the 50:50 quota on credit granted to non-resident controlled companies between foreign and domestic banks in April 2003. Three new full-fledged Islamic banking licences to foreign financial institutions were also issued, ahead of the original plan to do so in the third phase of the Masterplan. Other measures that have been accelerated include the increase in the foreign equity participation limit in investment banks and Islamic subsidiaries to 49%, and the flexibility for commercial banks, including the foreign commercial banks to provide factoring services as part of commercial banking business or through a separate legal entity. Other initiatives include the operational flexibility to the locally-incorporated foreign banks to increase the number of their branches. These liberalisation measures which will be done in stages, reflect Malaysia's commitment to undertake liberalisation at a pace that provides a mutually beneficial situation in the domestic economy.

To conclude, the strong and stable financial system, supported by a comprehensive legal and regulatory and supervisory framework, has been a positive factor supporting Malaysia's growth potential. It has provided investors with a safe and stable environment that is conducive for sustainable performance. Efforts will continue to ensuring that the financial sector continues to perform its role in the economy, responding to its needs and functioning efficiently. Skills and expertise in the financial sector will continuously be enhanced so as to create a pool of expertise that can contribute effectively to this process. Areas that will receive special attention will be to develop Malaysia as an Islamic banking and financial hub and to enhance our competitive advantage as a business process outsourcing centre. Amidst all these efforts, Malaysia will continue to strengthen our global linkages through trade, investment, financial flows, strategic alliances, cross-border mergers and acquisitions, internationalisation of businesses, mobility of the workforce as well as regional and international cooperation. This will enable Malaysia to participate particularly with regional economies to strengthen further the mutually reinforcing growth potential of the region.

Payment Systems Forum and Exhibition 2005
28 November 2005, Kuala Lumpur

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

The theme of this inaugural Payment Systems Forum and Exhibition 2005 is the "Migration to E-Payments" with a focus on the issues and challenges in the transition from paper-based payments to electronic payments in Malaysia. The issues that need to be addressed for a nation to effectively migrate from paper-based payment instruments to electronic means of payments are multi-faceted. This will require changes in the infrastructure and business processes, developing and sustaining users' confidence and inculcating a change among all the relevant stakeholders, including the service providers and the customers.

Our objective is to transform the payments system into one that is competitively leveraged on a modern market-based system. Indeed, this will need to be achieved by the cumulative efforts of all parties involved, including the industry and the authorities. This forum and exhibition has, therefore been organised to provide a platform to discuss the range of significant issues and challenges in achieving the common vision of migrating to e-payments in Malaysia and to increase public awareness of the various payment channels available in the market today, as well as to discuss views on the development of services and infrastructure for the next generation of systems. The forum is designed to encourage active dialogue and deliberations from the different perspectives, notably between the service providers and the users. The dialogue will also serve as a platform to discuss how the industry may effectively operate in the context of the prevailing regulatory environment, policies and practices. From the regulators' perspective, the aim is to develop an enabling environment to facilitate and foster greater use of more efficient payment mechanisms in Malaysia.

An efficient, reliable and secure electronic payment system is critical to the soundness of the financial system, the efficiency of the financial markets and the economic growth and development process. With the rapid technological advancements and increasing consumer demands for more efficient delivery services, the Malaysian financial landscape has continued to transition towards the increased significance of an electronic payment systems and channels. Despite the progress that has been achieved, Malaysians however, remain high users of currency notes and coins, with the currency-in-circulation amounting to about 6.4% of GDP. In contrast, the average ratio for high users of electronic payments such as in the Scandinavian economies is only 2.9%. The use of cheques is also dominant in our financial system, accounting for 96% of the

total value of non-cash payment instruments. These indicators suggest that measures to encourage more active use of e-payments would need to go beyond building the electronic payment infrastructure. It needs to address the broader issues revolving around building public awareness and confidence, promoting greater convenience; reviewing business and operating practices and finally, addressing the commercial interfaces between the customers and the service providers.

E-payment increases operational efficiency and improves productivity levels through expedient payments and receipts of funds as well as through the reduction or redeployment of resources used for handling cash and cheques. Whilst the migration to e-payment may require considerable investment and effort to provide the enabling infrastructure, the use of e-payments provide consumers with greater convenience and security that would result in cost savings in the long run. In this regard, it is important for the financial institutions and payment service providers to provide more widespread access points for electronic payment services via multiple channels, including the automated teller machines, the point-of-sale terminals, the gated toll and parking gantries and through the network channels and devices, such as the Internet and the mobile phones. Needless to say, the payment products and services need to be continuously enhanced to meet the changing needs of the consumers.

In addition, the efforts to increase the use of e-payments will not only hinge on the capacity of the service providers to ensure that e-payment services are convenient, but also secure. In the area of fraud prevention, the industry would need to be constantly vigilant to maintain consumers'confidence. Robust technology and strong internal controls must be in place to protect and preserve the integrity of the financial system.

In line with this objective, our banking institutions have successfully replaced the magnetic stripe ATM and credit cards with chip-based cards to ensure a more secure environment for payment cards. This move has effectively eliminated counterfeiting and fraud involving ATM and credit cards in Malaysia. This has provided Malaysia with the platform to further enhance payment card services by maximising the chip infrastructure. The conclusion of this year will see the completion of the industry-wide migration to Europay-MasterCard-Visa (EMV) standards with all of the point-of-sales terminals being fully EMV-compliant. With this, Malaysia will become the first country in the Asia-Pacific region to successfully migrate on a national scale from the magnetic stripe environment to the EMV chip-based credit card infrastructure.

For Malaysia to fully adopt e-payments, the task ahead requires great determination and commitment from all sectors. From the Central Bank's perspective, a strong motivation for promoting e-payments is in the eventual savings from the reduction of paper processing and printing, and the more efficient distribution of money in electronic form in the financial system that generates immediate economic value. Research studies have shown that shifting from an all paper-

based to an electronic-based payment system will generate annual savings of about 1% of the GDP. All stakeholders, including the financial institutions, payment system providers, the authorities, the corporate sector, and the consumers, have their respective roles to play to support this national agenda to reduce the use of paper-based payment instruments, particularly cheques, in Malaysia.

In this regard, the Government had recently announced in the 2006 Budget its intent to increase the acceptance of electronic means of payment with the Government and to promote the use of e-payments nationwide. This should provide a catalyst for the adoption of e-payments on a national scale, as most individuals and businesses have payment transactions with the Government. Key to making this a success is the need to review the business and operating practices and address any impediments that may hinder the use of e-payments. These practices ranges from the inability to store and collect bank account numbers, acknowledging electronic payment and receipt notices, instructing payments electronically, and many more that may be identified during the discussions at this forum. All corporations and institutions that are present at this forum should consider undertaking a business process reengineering in your own organisation to fully use the e-payment channels that are being offered by the service providers and the financial institutions. As a national agenda, I would like to propose that this forum debates and considers the feasibility of setting a realistic target date, perhaps by the year 2010, for a full implementation of a national e-payment roadmap that specifically outlines the strategies and realignments of the business processes and operating practices, for the nation to be fully engaged in making the migration a success.

Let me now move on to the third key point mentioned earlier on the commercial interfaces, whereby the underlying business models and pricing mechanisms for electronic payments, should take into account the need for an incentive structure that promotes the increased use of e-payments. In recent years, several notable developments in e-payments in Malaysia have taken place. Following its introduction in 2000, the Inter-Bank GIRO system, an electronic credit transfer system, had recorded on annual average increase in transactions of 160% in terms of volume and nearly 200% in terms of value between 2003 and 2004. The credit card is also becoming a popular means of payment card, with the total value and volume of increasing annually by 15 and 20 percent respectively. The growing acceptance of Internet banking as a convenient delivery channel for accessing banking services has translated into a significant growth of Internet banking subscribers, which today comprise two thirds of the total internet subscribers. The latest mode of electronic payments channel is the mobile banking services that provide convenience to consumers to access a range of payment services such as funds transfers, bill payments and credit card services through mobile phones. In addition, the establishment of an Internet-based multi-bank payment system in Malaysia, the Financial Process Exchange in October 2004, would facilitate

online payments for a variety of payments by providing convenience and an efficient channel for businesses and consumers to undertake their payment transactions through the internet.

While these positive developments will support the attainment of the objective of migration to e-payments, the commercial issues between the consumers and the service providers have often times inhibited growth in the volume of the e-payments. The business and pricing models have at times inadvertently promoted a less efficient system, such as in the case of the low price that customers pay for using cheques compared to the Inter-Bank GIRO payments, and the popularity of the credit card against debit card, which is a more efficient system that carries less risk. In addition, service providers have also had difficulties in agreeing on a common business platform, due to their own competitive positioning strategies. Such differences have contributed to containing the increased acceptance of e-payments, which is further reinforced by the consumers'need to see a wide spread acceptance by merchants before deciding to use the e-payment mode, while the merchant needs to see a critical mass of consumers before putting in place the required infrastructure. In this regard, a comprehensive review of the industry-wide related issues involving payment instruments and systems needs to be undertaken to make Malaysia more competitive, with a view to promoting the more efficient payment systems and addressing the commercial hurdles. In order to further improve the growth and promote the e-payments, the payments industry may wish to consider establishing a Payment System Association to deal with the industry-wide issues involving electronic payments. A Payment System Association would be able to address the lack of common technology standards between service providers to promote interoperability, and the lack of a collective forum to identify, understand and manage the spectrum of stakeholders' interests and expectations. I should add that this idea is not new, as payment associations are already in existence in several other countries.

The future landscape of the payment industry is one that will continuously evolve with market innovations, resulting in enhanced services that offer improvement in efficiency and cost savings compared to traditional payment methods. Bank Negara Malaysia will continue to play the role of a facilitator to spearhead the development and improvement of the payments system infrastructure and to promote a conducive enabling environment for such developments to take place. In this respect, Bank Negara Malaysia has taken several initiatives to promote greater use of electronic payments by the public sector and in bringing about a mindset change amongst the users. Several taskforces have been established, involving users and service providers to promote the sharing of information and cooperation amongst the players, to develop industry-wide best practices and security standards, and to collaborate with relevant agencies to promptly deal with security infringement issues. Bank Negara Malaysia is also currently undertaking a series of measures to increase the efficiency and reduce risks in the payment

systems, and facilitate a progressive transformation and migration of the payment systems infrastructure. In this regard, a cross-border link between the Ringgit and the USD settlement systems in Hong Kong, that is the RENTAS and USD CHATS in Hong Kong, will be established to reduce foreign exchange settlement risk via a simultaneous payment versus payment mechanism between Ringgit and USD in the same time zone. A cheque truncation system is also being developed to improve operational efficiencies through the elimination of the physical movement of cheques with the use of electronic images and data.

Bank Negara Malaysia also aims to provide a conducive regulatory framework that is supportive of market-based innovation and ensuring transparency for the benefit of consumers. In this regard, I certainly hope that the results of your deliberations in this Payment Systems Forum and Exhibition 2005 will provide valuable input for the formulation of strategies and modalities for both the industry and authorities to accelerate the migration to e-payments in Malaysia. It is also hoped that the exhibition will heighten public awareness of the various payments products and services available in Malaysia, as well as globally.

Third International Forum on Financial Consumer Protection and Education
14 December 2005, Kuala Lumpur

"Fostering Greater Consumer Protection and Education"

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

Promoting a sound and progressive financial system is a vital and key pre-requisite to achieving sustainable economic growth and development. This recent decade has seen a significant transformation of the financial landscape shaped by the forces of globalisation, advances in technology, the trend towards greater market orientation and financial innovation. In this more dynamic environment, the maintenance of financial stability has become increasingly more complex and challenging. The requirements and expectations of consumers are also changing rapidly in tandem with the increased education levels, growing wealth and greater affluence. Following these developments, consumers have become more discerning and demand for better product choices, more efficient delivery channels and more customer centric practices from financial institutions. These trends have also become important in reinforcing an increasingly more competitive environment in the financial services sector. A comprehensive approach thus needs to be adopted to address all the key elements of the financial system so as to form a solid foundation on which the soundness and stability of the system can be achieved. A major strategy that has been adopted has been the strengthening of the prudential regulatory and supervisory framework. The safety and soundness of the banking system however has to extend beyond prudential regulation and supervision. Maintaining financial stability of the financial system also requires the development of the financial infrastructure, in particular, the financial markets; building the capacity of financial institutions and finally to have in place an adequate consumer protection framework.

Consumer protection and education initiatives empower consumers to be better positioned to take responsibility for their own well-being. It allows consumers to assume a more important role in exerting market discipline on service providers to drive greater efficiency, competition and innovation in the market place. In the design of a consumer protection framework, it needs to be recognised that financial products and services differ significantly from most other goods and services. Specifically there is asymmetry in the access to information and bargaining power between the consumers and financial service providers. These imbalances can be addressed by three mutually reinforcing strategies. Firstly, promoting stronger transparency and disclosure standards in financial institutions; secondly

strengthening the mechanisms for consumer protection; and thirdly enhancing consumer education. An increasing number of countries have undertaken this more comprehensive approach in order to give greater focus to consumer protection issues for ensuring the soundness of financial service providers and ultimately to the stability of the financial system. This will also in turn promote more effective consumer participation in the economy, thus contributing more significantly to the economic growth and development process.

The approach and mechanisms adopted to protect consumers in individual jurisdictions will vary from one country to another, given the unique characteristics prevailing in the different respective economies and financial systems. Consideration of country-specific circumstances and contextualisation is important to evolve relevant and effective consumer protection and education infrastructures. Individual countries need to customise the consumer protection and education framework to their environment, taking into account factors such as the stage of economic and regulatory development, the structure of the financial system and the level of consumer sophistication.

Prudential safety and soundness, competition and consumer protection need to co-exist to effectively serve the various stakeholders' interests. Hence, implementing an effective consumer protection and education framework involves achieving an appropriate balance between providing adequate safety for consumers while promoting competition and financial innovation. In formulating policies to safeguard consumers' interests, adequate consideration needs to be given to ensure the appropriate level of consumer regulation without imposing excessive regulatory costs and burden on both financial institutions and consumers, and thus avoid compromising the benefits that the policies are designed to achieve. In this process, ethics and integrity cannot be legislated. Regulators, therefore, need to consider other approaches in preventing market abuses or misconduct and in promoting consumer confidence. Of importance is to evolve an appropriate incentive structure for financial institutions so that they recognise that it is in their best interests to foster fair and equitable business practices as part of good governance, corporate social responsibility and brand building. Good business practices need to be instilled and embedded in all aspects of the operations and at all levels within the institutions.

On consumer education, it is recognised that with more well-informed and financially astute consumers making better financial decisions, competition is promoted among the financial service providers. Moreover, market efficiency would improve with the creation of new products and services that are more responsive to the requirements of consumers. In relation to this, financial literacy has become a vital skill in this increasingly more complex financial world, characterised by increasingly sophisticated financial products and services and growing diversity in financial service providers and distribution channels. While the overarching

objective of consumer education is to impart knowledge that will improve consumers' financial decisions, it cannot be assumed that equipping consumers with more information will automatically lead to improved financial behaviour. Research has shown that consumer decisions may not always be made based on sound advice and knowledge, but are at times made on impulsive intuition. The key challenge lies in determining how behavioural factors and other factors such as socio-economic and cultural backgrounds, life events and skill levels influence rational decision-making. The wide variation in information needs that arise from differences in prior experience, language and cultural background, current financial situation, and competing demands for consumers' time all pose challenges in the development and delivery of relevant information to consumers. In particular, the most effective means of engaging consumers that have a low level of interest in financial planning needs to be determined.

In relation to this, financial service providers need to provide consumers with information that accurately represents the features, risks and returns associated with their products and services and demonstrate integrity and good faith by offering products and services that are appropriate to the customers' financial needs and circumstances. The issue is how a consistent and comprehensive disclosure regime could be established, with the flexibility to apply differentiated rules in response to different situations and circumstances. Finally, disclosure as a consumer protection tool will only serve its purpose if consumers are able to understand the information provided. The challenge is to get the right balance between providing sufficient information to consumers to make informed choices, with the information being clear, concise and effective.

The increase in the number of delivery channels has not resulted in an equitable expansion in the access to financial services. Even in developed countries, there remains minorities that have limited access to basic financial services. For instance, a study conducted in the United Kingdom for the period 2002-2003 found that 2.8 million adults in households had no access to a bank account. In relation to this, regulators have to balance between the need for financial institutions to operate efficiently and the need to ensure access to basic financial services for both individuals and small businesses. In addition, rural communities have also tended to be underserved. The challenge confronting regulators is to ensure that all communities have access to financial services. This greater inclusion is vital to bring the lower income groups into the economic mainstream.

An important aspect in the development of a consumer protection framework is to ensure that the framework remains relevant despite changes in economic and financial environment. Changes in the profile of consumers following changes in the demographic structure for example needs to be taken into account. In most communities, the ratio of retired population relative to working adults is expected to rise more steeply in the next decade. In countries with growing ageing populations, there is an

increasing demand for financial planning, life insurance, wealth management and mutual fund investment services. Consumers' interests in these areas would need to be adequately safeguarded while financial literacy among the various target groups need to be actively promoted.

While regulators have an important role in promoting consumer protection and education, it is equally important to galvanise support and collaboration from all market participants - financial service providers, government agencies, educators and consumer associations and community-based organisations, toward effective implementation of the initiatives.

Let me take this opportunity to share with you the experience of Malaysia in promoting consumer protection and education. The Malaysian economy has transitioned from a production-based economy towards a knowledge-driven economy, with small and medium sized enterprises (SMEs) assuming an increasingly significant role in the economy. The financial sector has also evolved accordingly to facilitate this economic transformation process, with a growing trend towards greater deregulation and market orientation. To achieve a more efficient, competitive and resilient financial system, Malaysia has formulated a blueprint that outlines the roadmap for the development of the financial sector. The Financial Sector Master Plan which was issued in 2001 outlines the key strategies for the development of the financial sector. Amongst the important strategies implemented has been the development of the consumer protection framework and the enabling infrastructure to protect consumers' interests while at the same time to enhance their financial capability to participate effectively in the financial system.

Bank Negara Malaysia has adopted a multi-pronged approach in empowering consumers. As a central bank in an emerging market economy, our mandate is broader than our counterparts in the more advanced and mature economies. We have the important role of developing the financial sectors. In the area of strengthening the consumer protection infrastructure, the agenda covers a wide spectrum of initiatives involving infrastructure and institutional capacity development that includes financial education, advisory services, distress management, rehabilitation and putting in place avenues for redress.

Recent initiatives include evolving a more effective Financial Mediation Bureau (FMB) to ensure that consumers of all financial service providers under the purview of the Central Bank have recourse to an independent, fair and impartial dispute resolution mechanism. Earlier this year a deposit insurance scheme was introduced to further strengthen incentives for financial institutions to adopt sound financial and business practices and enhance public confidence in the financial system by providing explicit protection on deposits. Bank Negara Malaysia is also currently finalising the details for the establishment of a credit counselling and debt management agency to be introduced early next year, with the aim of providing individuals with credit counselling and assistance in restructuring of their debts.

To promote financial education at an early age, Bank Negara Malaysia embarked on an education programme in schools on basic financial knowledge in partnership with the Education Ministry since 1997. Further, in collaboration with the financial industry's associations, Bank Negara Malaysia launched a ten year Consumer Education Programme (CEP) for the banking and insurance sectors. We are now in the fifth year of this programme. Extensive information is being disseminated via the spectrum of distribution channels including newspapers, radio, websites, branches of financial institutions and outreach programmes.

The consumer education efforts are also complemented by initiatives to promote a higher level of disclosure and transparency so as to ensure that consumers have access to relevant, comparable and timely information on products and services. A significant focus has been on the insurance sector, given that a significant segment of the Malaysian consumers do not have good understanding of insurance products. In particular, guidelines on medical and health insurance and the requirements for marketing of life insurance policies, have been strengthened while rules for independent financial advisers have been introduced.

In meeting socio-economic objectives, there is also a need to ensure that the welfare and interests of all segments of society are protected and that no target group is excluded or marginalised. Indeed, an important component of our consumer protection framework is to ensure that all consumers continue to have access to basic banking services at reasonable costs. In this connection, a more interventionist approach has been pursued to require banking institutions to offer a list of basic banking services to all Malaysians and to set guiding principles for the imposition of fees and charges for these retail products and services for individuals and small and medium sized enterprises.

Efforts have also been taken by the Central Bank in collaboration with the financial services industry to enhance the integrity of the payments systems and instruments, aimed at promoting confidence and ensuring that consumers' interests are safeguarded. Specific measures include upgrading the funds transfer systems, migrating all magnetic stripe for ATM card and credit card infrastructure to a chip-enabled environment, and introducing payment platforms that leverages on the Internet to promote users' confidence and safeguard consumers' interests. Malaysia is the first country in the Asia Pacific region that has mandated the migration of ATM cards to chip based cards and has also been the first to complete the implementation of a national migration to EMV chip based credit cards. This is essentially to combat fraud in payment instruments. A number of other initiatives have also been put in place to create greater awareness among the public regarding counterfeit banknotes and to promote increased consumer understanding on credit card usage and protection.

As we advance forward, changes in the financial landscape will continue to be dynamic and the level of complexity and

sophistication in the financial markets will further intensify. While considerable efforts have been undertaken to empower consumers through financial education and enhance protection for consumers, much remains to be done in fostering the commitment of financial service providers to sound business practices and promoting fair and equitable treatment of consumers. Given the global dimension of financial services and the increasing interdependence of financial markets, efforts by individual countries to strengthen consumer protection need to be matched by efforts to enhance safeguards at the international level. Forums like this one provide a good opportunity for regulators to share information and insights, to discuss the issues and challenges at hand, explore potential areas for cooperation and lay the groundwork for future partnerships. Drawing on the experience and expertise of various countries, this forum provide a platform for participants to work together towards developing global best practice standards on consumer protection and education issues. I look forward to the outcome of your deliberations in fostering greater consumer protection and education.

Calendar of Events
October - December 2005

1 October 2005
Governor delivered a luncheon address at the inaugural World Islamic Economic Forum that was held in Kuala Lumpur and organised by the Asian Strategy & Leadership Institute (ASLI). In her speech, Governor shared Malaysia's experience in evolving a comprehensive domestic Islamic financial system which has increasingly become a more internationally-integrated financial system.

13 October 2005
The Bank and the Securities Commission jointly announced that the framework on investment banks announced in March 2005 has been extended to universal brokers. This will further enhance the capacity and capabilities of domestic capital market intermediaries in contributing towards the development of a more resilient, competitive and dynamic financial system.

14 October 2005
Bank Negara Malaysia and the Bank of Korea renewed the two-way Bilateral Swap Arrangement (BSA) agreement under the Chiang Mai Initiative for another three years. The BSA involves the swap of US dollars against local currencies, where the respective Central Banks will be able to request each other to provide US dollars against the local currency of the drawing bank. The swap size in the renewed BSA was increased to US$1.5 billion with a 20% limit for initial withdrawal without IMF conditionality. The BSA agreement is part of regional cooperative efforts towards contributing to greater financial stability in the region.

31 October 2005
The Bank announced the establishment of the Credit Counselling and Debt Management Agency to undertake credit counselling and loan restructuring for individuals. This measure was introduced pre-emptively to provide a channel to resolve potential credit issues that may be faced by households. The Agency is scheduled to commence operations in the first quarter of 2006.

8 November 2005
In helping to promote the orderly development of the financial planning industry, the Bank and the Securities Commission jointly announced that the regulatory framework for the licensing of financial advisers has been established, with the enactment of the amendments to the Insurance Act 2005 and Insurance Regulations 2005.

16 November 2005
The Bank announced the commencement of construction of the Financial Services Resource Centre (FSRC). The FSRC represents Malaysia's investment in a knowledge centre with learning

and research facilities to support the development of a high performance culture for the country's banking and financial sector.

21 - 22 November 2005

The World Bank, The Economic Planning Unit of Malaysia and Bank Negara Malaysia jointly organised the Regional Conference on Investment Climate and Competitiveness in East Asia. The conference which was held in Kuala Lumpur brought together international experts, private sector representatives and policy makers from the East Asian region to share experience and best practices on ways to design and implement policies aimed at enhancing further the investment climate in the region.

28 - 29 November 2005

The Bank organised the country's first Payment Systems Forum and Exhibition, themed "Migration to E-Payments" that included discussion of issues and challenges in migrating to e-payments, developing a common payment standards as well as enhancing consumer awareness in the usage of e-payments instruments.

In her keynote address, the Governor said that measures to encourage more active use of e-payments would need to go beyond building the electronic payment infrastructure, and also stressed on the broader issues such as building public awareness and confidence, promoting greater convenience, reviewing business and operating practices as well as addressing the commercial interfaces between the customers and the service providers.

30 November 2005

The Malaysian economy grew by 5.3% in the third quarter of 2005. Private sector activity continued to provide the main impetus to growth. Growth for the first and second quarters were revised upwards to 6.2% and 4.4% respectively. The Bank also announced an increase in its Overnight Policy Rate by 30 basis points to 3 percent, with the monetary policy stance remaining accommodative and supportive of economic growth.

3 December 2005

At the 26th Annual Dinner of the Association of Merchant Banks in Malaysia, Governor in her speech stressed the need for the merchant banking industry to confront the emerging challenges from the rationalisation of domestic capital market intermediaries towards investment banking, and seize the new opportunities that will emerge with the new intermediation structure.

6 December 2005

In her opening address at the Banking Industry Competency Framework Study Focus Group Discussion, Governor said that the industry needs "a new generation of professional bankers who

are more customer-centric, technology-savvy, highly qualified, flexible and agile, with skill sets that are more comprehensive than previously."

7 December 2005

The RM1 coin ceased to be legal tender effective 7 December 2005, after the completion of a three-month withdrawal period.

8 December 2005

Bank Negara Malaysia and the Hong Kong Monetary Authority signed a Memorandum of Understanding for the establishment of a large-value payment system link between Malaysia and Hong Kong, as part of the efforts to increase the efficiency and safety of payment systems in Malaysia and in the region, particularly in managing the risk exposure for foreign exchange transactions involving the US dollar and Malaysian ringgit.

10 December 2005

The Government of Malaysia announced the establishment of the International Centre for Education in Islamic Finance (INCEIF) to develop and provide a pool of professional talents in Islamic finance, to sustain the market competitiveness of the global Islamic financial industry. An endowment fund of RM500 million was established by Bank Negara Malaysia to support this initiative.

12 December 2005

Governor delivered a special address at the Second Citigroup-INSEAD Financial Education Summit 2005 that was held in Kuala Lumpur, in which she spoke about the issue of financial literacy from the perspective of the Central Bank.

14 December 2005

During the Third International Forum on Financial Consumer Protection and Education hosted by the Bank, Governor delivered the keynote address which focussed on the consumer protection and education from the perspective of maintaining financial stability and development of a progressive and sustainable financial system.

15 December 2005

As part of the efforts to enhance communication and transparency in order to promote greater understanding of monetary policy, the Bank released the decisions of the Monetary Policy Committee (MPC) beginning with the eighth meeting for 2005. The schedule of MPC meetings and press releases for 2006 was also made public.

16 December 2005

The fourth meeting of the National Small and Medium Enterprise (SME) Development Council, chaired by the Prime Minister, discussed the following:

- National SME Development Blueprint 2006, containing 245 programmes that will be implemented in 2006 aimed at strengthening the enabling infrastructure to support SME development, building capacity and capability of SMEs and enhancing further SMEs' access to financing. An allocation of RM3.79 billion has been committed by the Government for the implementation of these programmes.
- Profile and Contribution of SMEs to the Domestic Economy
- SMEinfo Portal: Centralised online information on SMEs and SME Directory
- Annual Report on SME Development 2005
- Promoting Malaysian Products through the "Taste of Malaysia" Roadshow
- Progress of SME Bank in Supporting Development of SMEs

The Bank is the Secretariat to the National SME Development Council.

28 December 2005

As part of the efforts to liberalise the country's financial sector, the Bank announced that locally-incorporated foreign banking institutions will each be allowed to establish up to four additional branches in 2006.

29 December 2005

The Bank announced the release of the 2006 edition of the *Buku Wang Saku (BWS)* and *Buku Perancangan dan Penyata Kewangan Keluarga*. The publication of these books is part of the Bank's on-going efforts to enhance public awareness on the importance of management of personal finances and financial planning. The theme for BWS in 2006 is "Financial education as a foundation for financial planning".