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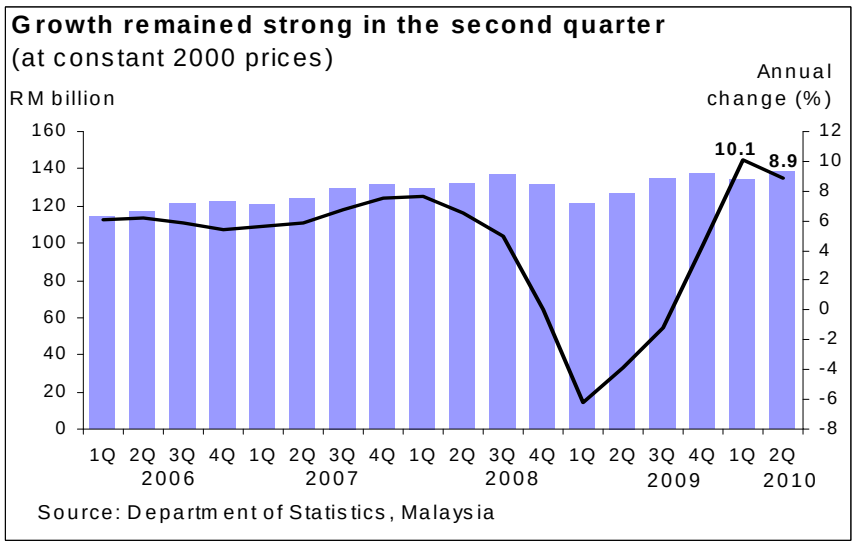
ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE SECOND QUARTER OF 2010

OVERVIEW

The Malaysian economy recorded a strong growth of 8.9% in the second quarter

The Malaysian economy registered a strong growth of 8.9% in the second quarter of 2010, driven by sustained expansion in domestic demand and continued robust growth in external demand. The stronger domestic demand was due to higher private and public sector spending, while the expansion in external demand spurred domestic production. On the supply side, major economic sectors continued to record strong growth during the quarter, led by the manufacturing and services sectors.



During the quarter, domestic demand expanded by 9% (1Q 10: 5.3%), due mainly to higher private consumption and continued improvements in both business and public sector spending. Private consumption grew by 7.9% (1Q 10: 5.1%), supported by the favourable labour market conditions, relatively low inflation and a steady increase in income levels amid sustained consumer confidence. The public sector contributed positively to growth, with public consumption expanding by 6.9% during the quarter, following higher expenditure on emoluments. Gross fixed capital formation also increased, registering a stronger growth of 12.9% (1Q 10: 5.4%), supported by further improvement in private sector investment activity and sustained public sector capital expenditure. Private sector capital spending continued to benefit from the relatively strong increase in domestic production and exports. Public sector capital expenditure provided additional impetus to the domestic economy, with development expenditure disbursed mainly to the education and transportation sectors.

On the supply side, major economic sectors registered strong expansion during the second quarter, driven by the manufacturing and services sectors. The manufacturing sector expanded at a sustained pace of 15.9% (1Q 10: 17%), with broad-based growth across all clusters. The services sector grew strongly by 7.3% (1Q 10: 8.5%), supported mainly by the strong performance of the wholesale and retail trade; finance and insurance; and transport and storage sub-sectors. The construction sector expanded by 4.1% during the quarter (1Q 10: 8.7%), supported mainly by the strong growth in the non-residential sub-sector. Growth in the agriculture sector moderated to 2.4% (1Q 10: 6.8%) due to lower production of industrial crops, while the mining sector registered a growth of 1.9% (1Q 10: 2.1%) supported by higher production of natural gas amid lower production of crude oil.

The headline inflation rate, as measured by the change in the Consumer Price Index (CPI), increased by 1.6% on an annual basis in the second quarter (1Q 10: 1.3%). The increase in consumer prices was attributable mainly to the rise

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in the prices of *food and non-alcoholic beverages* (2Q 10: 2.4%, 1Q 10: 1.4%).

In the external sector, the trade surplus narrowed to RM23.4 billion in the second quarter (1Q 10: RM38.9 billion) as gross imports increased faster than gross exports. Gross exports grew by 21.7% (1Q 10: 30.7%), supported by robust demand for E&E products and sustained demand for non-E&E exports and minerals, particularly from the regional economies. Meanwhile, gross imports expanded at a robust pace of 30.3% (1Q 10: 35.1%), driven mainly by strong growth of imports of intermediate and capital goods. Intermediate imports rose in tandem with the growth in manufactured exports, while the higher capital imports reflected improved domestic capital spending activity. In addition, the expansion in consumption imports was driven by imports of food and beverages and motor vehicles, in line with the improvement in private consumption.

On a cash basis, gross inflows of foreign direct investment (FDI)[1] amounted to RM4.7 billion in the second quarter (1Q 10: RM4.9 billion). After adjusting for gross outflows due to repayment of inter-company loans, net FDI recorded a larger net inflow of RM1.8 billion (1Q 10: +RM0.2 billion). During the quarter, FDI was channelled mainly into the electrical and electronics as well as petroleum-related industries. Net direct investment abroad by Malaysian companies amounted to RM2.5 billion in the second quarter (1Q 10: -RM3.2 billion), largely for investments in the services and oil and gas sectors. Meanwhile, there were further inflows of portfolio investments of RM6.6 billion in the second quarter (1Q 10: +RM3.8 billion) due to strong foreign participation in debt securities.

The international reserves of Bank Negara Malaysia amounted to RM309.8 billion (equivalent to USD94.8 billion) as at 30 June 2010, and RM310.6 billion

[1] The statistics for FDI do not include retained earnings.

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(equivalent to USD95 billion) as at 30 July 2010. The reserves position is sufficient to finance 7.9 months of retained imports and is 4.3 times the short-term external debt.

Monetary policy supported economic activity

The Overnight Policy Rate (OPR) was raised by 25 basis points in May 2010, and a further 25 basis points in July 2010. The upward adjustment of the OPR was undertaken to reflect the improved economic outlook and to normalise monetary conditions. At the new level of 2.75%, the OPR remains accommodative and is considered to be appropriate and consistent with the assessment of growth and inflation.

Subsequent to the increase in the OPR on 4 March and 13 May 2010, the average overnight interbank rate (AOIR) traded higher and interbank rates of other maturities also increased accordingly. In terms of the commercial banks' lending rates, both the average base lending rate and the average lending rate adjusted upwards. The average fixed deposit (FD) rates also rose in tandem.

Financing activity improved further as financing continued to be available to all segments of the economy. The accommodative monetary condition supported financing activity. Furthermore, the continued improvement in domestic economic activity added further impetus to private sector demand for financing. Gross financing raised by the private sector through the banking system and the capital market increased to RM203.4 billion in the second quarter. The high level of gross financing was on account of increased loan disbursements and private debt securities (PDS) issuances. Financing to both the business and household sectors expanded further during the second quarter.

Net funds raised in the capital market by both the public and private sectors amounted to RM17.6 billion (1Q 10: RM22.6 billion). The bulk of funds was

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raised by the private sector through issuances of PDS. In the public sector, funds were raised through issuances of Malaysian Government Securities (MGS), Government Investment Issues (GII), as well as via issuances of Sukuk.

Monetary aggregates continued to grow at a sustained pace in the second quarter. M3, or broad money, expanded at an annual growth rate of 8.8% as at end-June 2010 (end-March 2010: 8.7%).

During the quarter, the ringgit appreciated by 0.5% against the US dollar as signs of further economic recovery in the region contributed to favourable investor sentiments toward the regional financial markets. The ringgit also appreciated against the euro (10.2%) and pound sterling (0.5%), but depreciated against the Japanese yen (-4.8%). The euro depreciated against most currencies due to concerns over the sovereign debt issues in several of the euro area economies. The ringgit appreciated against most regional currencies in the range of 0.1% to 8.8%.

The financial sector remained resilient

Financial stability remained intact throughout the second quarter supported by well-capitalised financial institutions. Financial intermediation activity remained supportive of domestic economic activity. While the financial market exhibited some increase in volatility following developments related to the sovereign debt crisis in some countries in Europe, the domestic markets remained orderly.

The risk-weighted capital ratio and core capital ratio of the banking system were 14.8% and 12.9% respectively with more than RM60 billion worth of financial buffer. Net non-performing loans (inclusive of impaired loans) accounted for 2.2% of net loans. Loan loss provisions remained ample at more than 90%. Pre-tax profit was sustained for the quarter on account of higher income from financing portfolio and fee-based activities, resulting in returns on equity and assets of 16.5% and 1.5% respectively.

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Capital Adequacy Ratio for the insurance industry was 223.5%. Insurance and takaful operators recorded profits totalling RM3.5 billion supported by continued increase in premium income following strengthened demand for insurance protection in line with improvements in economic activities.

Strengthening domestic demand to support growth in the second half of 2010

The recovery of the global economy was uneven in the second quarter as the sovereign debt crisis in the euro area escalated. Major advanced economies achieved a moderate recovery following improvements in private sector demand, but consumer and business sentiments eased towards the latter part of the quarter given the uncertainties arising from the sovereign debt crisis in several economies. Meanwhile, most regional economies continued to sustain strong growth in the second quarter, supported by robust domestic and external demand. Going forward, there is increased risk of a moderation in the global growth momentum following rising concerns over the ongoing sovereign debt crisis and the planned fiscal consolidation in several advanced economies.

The Malaysian economy recorded a strong and broad-based expansion in the second quarter, supported by improving domestic demand and robust external demand, especially from the regional economies. Going forward, the domestic economy is expected to remain strong, sustained by robust private sector demand. While external developments may result in a moderation in the pace of growth, favourable employment conditions, sustained consumer and business sentiments, moderate inflation and an accommodative policy environment are expected to encourage domestic economic activity, while external demand would continue to be supported by regional demand.

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Quarterly GDP by Economic Activity (at constant 2000 prices)

	2009		2010		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
Agriculture	0.4	-2.0	6.8	2.4	4.5
Mining	-3.5	-4.4	2.1	1.9	2.0
Manufacturing	-14.5	-16.2	17.0	15.9	16.4
Construction	4.5	2.9	8.7	4.1	6.3
Services	1.7	0.8	8.5	7.3	7.9
Real GDP (Annual Change)	**-3.9**	**-5.1**	**10.1**	**8.9**	**9.5**
Real GDP (Preceding Change)	**4.6**	**-7.1**	**-2.6**	**3.5**	**0.1**

Source: Department of Statistics, Malaysia

KDNK Suku Tahunan Mengikut Aktiviti Ekonomi (pada harga malar tahun 2000)

	2009		2010		
	S2	ST1	S1	S2	ST1
	Perubahan tahunan (%)				
Pertanian	0.4	-2.0	6.8	2.4	4.5
Perlombongan	-3.5	-4.4	2.1	1.9	2.0
Perkilangan	-14.5	-16.2	17.0	15.9	16.4
Pembinaan	4.5	2.9	8.7	4.1	6.3
Perkhidmatan	1.7	0.8	8.5	7.3	7.9
KDNK Benar (Perubahan Tahunan)	**-3.9**	**-5.1**	**10.1**	**8.9**	**9.5**
KDNK Benar (Perubahan Berbanding Tempoh Sebelumnya)	**4.6**	**-7.1**	**-2.6**	**3.5**	**0.1**

Sumber: Jabatan Perangkaan Malaysia

GDP by Expenditure Components (at constant 2000 prices)

	2009		2010		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
Aggregate Domestic Demand (excluding stocks)	-2.2	-2.7	5.3	9.0	7.2
Consumption	0.6	0.2	5.3	7.7	6.5
Private sector	*0.3*	*-0.2*	*5.1*	*7.9*	*6.5*
Public sector	*1.5*	*1.5*	*6.3*	*6.9*	*6.6*
Gross Fixed Capital Formation	*-9.6*	*-10.4*	*5.4*	*12.9*	*9.4*
Net Exports	-6.7	15.0	-12.9	-38.4	-23.3
Exports of Goods and Services	*-17.9*	*-16.7*	*19.3*	*13.8*	*16.5*
Imports of Goods and Services	*-19.4*	*-21.1*	*27.5*	*21.9*	*24.5*
GDP	**-3.9**	**-5.1**	**10.1**	**8.9**	**9.5**

Source: Department of Statistics, Malaysia

KDNK Mengikut Komponen Perbelanjaan (pada harga malar tahun 2000)

	2009		2010		
	S2	ST1	S1	S2	ST1
	Perubahan tahunan (%)				
Permintaan Dalam Negeri Agregat (tidak termasuk stok)	-2.2	-2.7	5.3	9.0	7.2
Penggunaan	0.6	0.2	5.3	7.7	6.5
Sektor swasta	*0.3*	*-0.2*	*5.1*	*7.9*	*6.5*
Sektor awam	*1.5*	*1.5*	*6.3*	*6.9*	*6.6*
Pembentukan Modal Tetap Kasar	*-9.6*	*-10.4*	*5.4*	*12.9*	*9.4*
Eksport Bersih	-6.7	15.0	-12.9	-38.4	-23.3
Eksport Barangan dan Perkhidmatan	*-17.9*	*-16.7*	*19.3*	*13.8*	*16.5*
Import Barangan dan Perkhidmatan	*-19.4*	*-21.1*	*27.5*	*21.9*	*24.5*
KDNK	**-3.9**	**-5.1**	**10.1**	**8.9**	**9.5**

Sumber: Jabatan Perangkaan Malaysia