Growth remained strong in the second quarter

The Malaysian economy registered a strong growth of 8.9% in the second quarter of 2010, supported by sustained expansion in domestic demand and continued robust growth in external demand. The stronger domestic demand was on account of an expansion in both the private and public sector spending. External demand benefited from an increase in demand from the regional economies, particularly for crude oil and natural gas. On the supply side, major economic sectors registered a strong expansion led by both the manufacturing and services sectors.

Domestic demand expanded at a faster rate

Domestic demand expanded by 9% in the second quarter (1Q 10: 5.3%). The stronger growth momentum in domestic demand was supported by the increase in private consumption and continued improvements in both business and public sector spending.

Private consumption gained further momentum to grow by 7.9% in the second quarter (1Q 10: 5.1%), supported by the favourable labour market conditions, relatively low inflation and a steady increase in income levels. Robust consumer spending during the quarter was corroborated by the strong performance of major consumption indicators. These include imports of consumption goods, sales of passenger cars, credit card spending, bank lending to households, and wages in the manufacturing sector. Private consumption was also supported by sustained consumer confidence, with the MIER Consumer Sentiments Index at 110.4 points in the second quarter (1Q 10: 114.2 points), indicating that households continued to have a positive outlook on the economy.

Public consumption expanded by 6.9% (1Q 10: 6.3%), led by higher expenditure on emoluments.

Gross fixed capital formation increased strongly by 12.9% (1Q 10: 5.4%), supported by a further improvement in private sector investment and sustained public sector capital spending. Private sector capital spending in the second quarter continued to benefit from the relatively strong increase in domestic production and exports. The higher business spending was reflected in the strong performance of major investment indicators such as imports of capital goods, sales of commercial vehicles, the capacity utilisation rate and bank lending to businesses. During the quarter, business sentiments continued to be positive as reflected by the MIER Business Conditions Index, which remained well above the 100-point level (119.6 points; 1Q 10: 124 points). Meanwhile, public sector capital expenditure provided additional impetus to the domestic economy. Government development expenditure in the second quarter was mainly channelled into the education and transportation sectors.

| 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 |

Source: Department of Statistics, Malaysia
Sustained robust growth in the manufacturing sector

The manufacturing sector sustained its robust performance, growing by 15.9% in the second quarter (1Q 10: 17%). Growth was broad-based across all clusters amidst favourable external and domestic demand conditions.

Growth in the export-oriented industry was led by the E&E cluster, which continued to register a robust growth in production (29.9%, 1Q 10: 36.0%), driven mainly by demand for both semiconductors and audio-visual products. Growth in the primary-related cluster was sustained, supported by demand for chemical and rubber products.

Meanwhile, growth in the domestic-oriented industry strengthened further, due mainly to continued robust expansion in the construction-related cluster. The consumer-related cluster also grew strongly, supported by growth in the transport and food products segments.

Continued strong growth in most sectors

On the supply side, major economic sectors recorded strong expansion in the second quarter. Growth was led by the manufacturing and services sectors, supported by the continued strength of domestic and external demand. The construction sector continued to expand, supported mainly by the strong growth in the non-residential sub-sector. Meanwhile, the mining sector recorded the second consecutive quarter of positive growth, supported by higher production of natural gas. The agriculture sector registered a more moderate growth, mainly reflecting the lower production of crude palm oil as well as lower forestry and logging activities.
Overall capacity utilisation rate in the manufacturing sector increased to 76% in the second quarter (1Q 10: 75%), with the export- and domestic-oriented industries operating at 76% and 74% of total capacity respectively (1Q 10: 77% and 66% respectively).

Strong growth in the services sector

The services sector recorded a strong growth of 7.3% in the second quarter (1Q 10: 8.5%), contributing 4.2 percentage points to overall GDP growth. Growth was supported mainly by the wholesale and retail trade; finance and insurance; and transport and storage sub-sectors.

The wholesale and retail trade sub-sector registered a growth of 8.4% (1Q 10: 9.6%), driven mainly by higher private consumption, including demand for new passenger cars. The finance and insurance sub-sector grew by 8.4% (1Q 10: 6.4%), supported by higher net interest income and insurance premiums collectable during the quarter.

The transport and storage sub-sector expanded by 9.2% (1Q 10: 8.1%), in line with the continued strength of trade activities, which led to higher demand for cargo-related services. Growth in the sub-sector was further supported by increased demand for passenger travel.

Meanwhile, the real estate and business services sub-sector registered a lower growth of 2.6% in the quarter (1Q 10: 14.2%), due primarily to lower activity in the capital market.
Moderate growth in the commodities sector

Growth in the agriculture sector moderated to 2.4% in the second quarter (1Q 10: 6.8%), reflecting the lower production of industrial crops. Crude palm oil production declined, while rubber production moderated amidst unfavourable weather conditions. The mining sector recorded the second consecutive quarter of positive growth of 1.9% (1Q 10: 2.1%), supported by higher production of natural gas.

Growth in the construction sector moderated

The construction sector expanded by 4.1% in the quarter (1Q 10: 8.7%), supported mainly by the strong growth in the non-residential sub-sector. The strong activities in the non-residential sub-sector reflected the construction of office space, schools and Government quarters. Meanwhile, the continued expansion in the civil engineering sub-sector reflected progress in the implementation of several infrastructure projects, such as the construction of highways, the double-track rail project, the second Penang Bridge, the new Low Cost Carrier Terminal, as well as gas pipeline in Sabah and Sarawak. However, the construction of residential properties was lower during the quarter.
Inflation increased in the second quarter

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 largely to food and non-alcoholic beverages, which rose by 2.4% (1Q 10: 1.4%). The increase in food prices was primarily a result of the significant increase of 10.5% (1Q 10: 1.1%) in the vegetables sub-category, arising from the reduced supply of imported vegetables and lower local supply following the shortage of foreign labour domestically. The transport category also registered an increase of 1.1% in the second quarter (1Q 10: 0.7%). These price increases, however, were partially mitigated by declining prices in the clothing and footwear category (2Q 10: -1.8%, 1Q 10: -1.5%).

The Producer Price Index (PPI) increased at a slower rate of 6.2% on a yearly basis in the second quarter of 2010 (1Q 10: 6.4%). Prices in the non commodity-related components of the PPI increased by 3.4% (1Q 10: 3.2%). Meanwhile, prices in the commodity-related components moderated by 16.3% (1Q 10: 18.4%).

In terms of composition, prices in the imported component of the PPI increased at a slower rate of 1.0% (1Q 10: 2.2%). This is reflected in the slower price increase in the machinery and transport equipment category. However, prices in the local component of the PPI increased by 8.8% (1Q 10: 8.4%) due to a higher increase in the mineral, fuels lubricants etc. category.

### Contribution to Consumer Price Inflation

![Graph showing contribution to consumer price inflation]

Source: Bank Negara Malaysia
Favourable labour market conditions

Overall labour market conditions remained favourable in the second quarter. Despite a slight increase in retrenchments, total vacancies remained high, while overall unemployment rate eased during the first two months of the quarter. During the quarter, retrenchments increased to 1,859 persons (1Q 10: 1,714 persons), with retrenchments occurring mainly in the manufacturing sector (1,181 persons, or 63.5%), particularly in the wood, rubber, medical and metal industries. Meanwhile, retrenchments in all other sectors declined.

Labour demand across all sectors of the economy remained strong during the quarter, with an increased number of vacancies posted in the JobsMalaysia Portal (541,993 positions; 1Q 10: 450,042 positions). Corresponding to these developments, the average unemployment rate for April and May eased to 3.3% (1Q 10: 3.7%), following faster growth in employment relative to the labour force. Meanwhile, real wage per worker in the manufacturing sector increased by an annual rate of 8.2% (1Q 10: 15.9%).

Trade activities remained robust

The trade surplus narrowed to RM23.4 billion in the second quarter (1Q 10: RM38.9 billion), as gross imports expanded faster than gross exports. Gross exports increased by 21.7% (1Q 10: 30.7%), while gross imports expanded at a strong pace of 30.3% (1Q 10: 35.1%).

The moderation in gross exports was due mainly to the slower expansion in manufactured and agriculture exports. Manufactured exports grew by 16.8% (1Q 10: 32.5%) as the low base effect from the previous year waned off and external demand started to normalise. Exports of E&E expanded by 16.1% (1Q 10: 36.3%), as demand for semiconductors and consumer electrical products moderated. Growth in the non-E&E exports was broad-based, benefiting from sustained regional demand for chemical products and machineries. Meanwhile, commodity exports increased further by 38.1% (1Q 10: 27.3%), supported by stronger export growth in minerals which more than offset the moderation in exports of agriculture products. Strong regional demand for crude oil and natural gas contributed to higher exports of mineral while the slower growth in agriculture exports was due to lower volume and prices of crude palm oil.
The sustained strong growth in gross imports in the second quarter was due mainly to marked improvements in the import of capital goods and continued strong growth in intermediate imports. Capital imports registered stronger growth, supported by higher public and business investment spending, while the sustained expansion in intermediate imports was led mainly by imports of primary and processed industrial supplies. Meanwhile, import of consumption goods continued to expand, driven by imports of food and beverages as well as motor vehicles, in line with the improvement in private consumption.

Continued inflows of FDI and portfolio investment

On a cash basis, gross inflows of foreign direct investment (FDI) amounted to RM4.7 billion in the second quarter (1Q 10: RM4.9 billion). After adjusting for gross outflows due to repayments 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 manufacturing sector, particularly to the electrical and electronics as well as petroleum-related industries. Meanwhile, FDI in the services sector was channelled mainly into the finance, insurance and business services as well as wholesale and retail trade sub-sectors.

Net direct investment abroad (DIA) by Malaysian companies amounted to RM2.5 billion in the second quarter (1Q 10: -RM3.2 billion). The investments were largely undertaken in the services sector, particularly in the finance and insurance, business services and telecommunication sub-sectors, as well as in the oil and gas sector.

Portfolio investment registered a net inflow of RM6.6 billion in the second quarter (1Q 10: +RM3.8 billion). The larger inflows were mainly into debt securities, particularly arising from the issuance of USD1.25 billion 1Malaysia Sukuk Global as well as from the private debt securities market. Despite the concerns over the European debt crisis, continued improvement in the domestic economic activity led to inflows of foreign funds into the domestic equity market.

*3,4 The statistics for FDI and DIA does not include retained earnings.
External debt remained manageable

As at end-June 2010, Malaysia’s total external debt amounted to RM221.7 billion or USD67.2 billion (end-Mar 2010: RM219.3 billion or USD66.4 billion), equivalent to 30.5% of GNI. The medium- and long-term external debt was higher at RM149.6 billion due to the raising of a USD1.25 billion 5-year 1Malaysia Sukuk Global by the Federal Government. Accordingly, the Federal Government recorded a net drawdown of RM4 billion which more than offset net repayments by both the private sector (-RM2.1 billion) and the NFPEs (-RM0.2 billion). In line with improving corporate profitability, companies in the electronics, utilities and agriculture sectors repaid their external debt resulting in a decline of 3.2% to RM64.2 billion in private sector external debt.

As at end-June 2010, the total short-term external debt remained stable at RM72.1 billion (USD21.9 billion). Short-term external debt accounted for 32.5% of total external debt. The ratio of international reserves was 4.3 times of short-term external debt.

International reserves remained strong

The international reserves of Bank Negara Malaysia amounted to RM309.8 billion (equivalent to USD94.8 billion) as at 30 June 2010. This level of reserves has taken into account the quarterly adjustment for foreign exchange revaluation loss, following the strengthening of the ringgit against most major currencies during the quarter. As at 30 July 2010, the reserves position amounted to RM310.6 billion (equivalent to USD95 billion), sufficient to finance 7.9 months of retained imports and is 4.3 times the short-term external debt.

<table>
<thead>
<tr>
<th>Medium- and long-term debt</th>
<th>Public sector</th>
<th>Private sector</th>
<th>Short-term debt (^1)</th>
<th>Total external debt</th>
<th>USD billion equivalent</th>
<th>External debt/GNI (%)</th>
<th>Reserves/Short-term external debt (times)</th>
</tr>
</thead>
<tbody>
<tr>
<td>146.9</td>
<td>72.9</td>
<td>74.0</td>
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<td>233.3</td>
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<td>147.2</td>
<td>80.9</td>
<td>66.3</td>
<td>72.1</td>
<td>219.3</td>
<td>66.4</td>
<td>30.1</td>
<td>4.3</td>
</tr>
<tr>
<td>149.6</td>
<td>85.4</td>
<td>64.2</td>
<td>72.1</td>
<td>221.7</td>
<td>67.2</td>
<td>30.5</td>
<td>4.3</td>
</tr>
</tbody>
</table>

\(^1\) Excludes currency and deposits held by non-residents with resident banking institutions
\(^{\text{p}}\) Preliminary

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia
Improved fiscal position on higher revenue collection

Stronger revenue performance resulted in a smaller fiscal deficit of RM7.1 billion or 3.8% of GDP in the second quarter. The higher revenue collection was mainly from individual tax and oil-related revenue. In terms of spending, total gross expenditure declined at an annual rate of 4.4% due mainly to the higher base effect as a result of stimulus spending in 2009. Nevertheless, spending on emoluments and subsidies was higher in the second quarter, both on a quarter-on-quarter and annual basis. The bulk of development expenditure was channelled to the education and transportation sectors. The fiscal deficit was financed from issuances of government securities and Sukuk 1Malaysia. In May, as part of the Malaysia International Islamic Financial Centre initiative, the Government issued the 1Malaysia Sukuk Global. As at end-June 2010, total outstanding debt of the Federal Government amounted to RM388.1 billion, or 51.9% of the estimated 2010 GDP. Of this amount, external debt amounted to only RM17 billion or 2.3% of GDP.