



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

STATUTORY REQUIREMENTS

In accordance with section 13 of the Central Bank of Malaysia Act 2009, Bank Negara Malaysia hereby publishes and has transmitted to the Minister of Finance a copy of this Annual Report together with a copy of its Financial Statements for the year ended 31 December 2011, which have been examined and certified by the Auditor-General. The Financial Statements will also be published in the Gazette.

For the purposes of section 115 of the Development Financial Institutions Act 2002, the annual report on the administration of the Development Financial Institutions Act 2002 and other related matters for the year ended 2011 is incorporated in Bank Negara Malaysia's Financial Stability and Payment Systems Report 2011 which forms an integral part of this Annual Report 2011.

A handwritten signature in black ink, appearing to read 'Zeti Akhtar Aziz'.

Zeti Akhtar Aziz
Chairman
Board of Directors

21 March 2012

BOARD OF DIRECTORS

Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz

D.K. (Johor), P.S.M., S.S.A.P., S.U.M.W., D.P.M.J.

Governor and Chairman

Dato' Mohd Razif bin Abd Kadir (until August 2011)*

D.P.M.S., D.I.M.P., D.P.M.P.

Deputy Governor

Dato' Muhammad bin Ibrahim

D.P.M.S.

Deputy Governor

Datuk Nor Shamsiah binti Mohd Yunus

P.M.W.

Deputy Governor

Tan Sri Dato' Sri Dr. Wan Abdul Aziz bin Wan Abdullah

P.S.M., S.P.S.K., S.S.A.P., S.P.D.K., D.P.S.K., P.N.B.S., S.M.W., A.M.N.

Datuk Oh Siew Nam

P.J.N.

Tan Sri Datuk Amar Haji Bujang bin Mohd. Nor

P.S.M., D.A., P.N.B.S., J.S.M., J.B.S., A.M.N., P.B.J., P.P.D.(Emas)

Dato' N. Sadasivan

D.P.M.P., J.S.M., K.M.N.

Tan Sri Dato' Seri Dr. Sulaiman bin Mahbob

P.S.M., P.J.N., S.S.A.P., D.J.B.S., J.S.M., S.M.J., P.M.P., K.M.N., A.M.N.

Encik Chin Kwai Yoong

** The late Dato' Mohd Razif bin Abd Kadir passed away on 8 August 2011*

Governor	Tan Sri Dr. Zeti Akhtar Aziz
Deputy Governor Deputy Governor	Dato' Muhammad bin Ibrahim Datuk Nor Shamsiah binti Mohd Yunus
Secretary to the Board	Abu Hassan Alshari bin Yahaya
Assistant Governor Assistant Governor Assistant Governor Assistant Governor Assistant Governor Assistant Governor Assistant Governor	Dr. Sukhdave Singh Bakarudin bin Ishak Norzila binti Abdul Aziz Jessica Chew Cheng Lian Donald Joshua Jaganathan Abu Hassan Alshari bin Yahaya Marzunisham bin Omar
Director Governor's Office Strategic Communications Internal Audit	Vivienne Leong Sook Leng Shariffuddin bin Khalid Tan Nyat Chuan
Economics Economics Monetary Assessment and Strategy International Statistical Services	Fraziali bin Ismail Dr. Norhana binti Endut Nazrul Hisyam bin Mohd Noh Toh Hock Chai
Regulation Financial Sector Development Islamic Banking and Takaful Financial Surveillance Prudential Financial Policy Development Finance and Enterprise Payment Systems Policy Consumer and Market Conduct Money Services Business Regulation	S. Abd. Rasheed bin S. Abd Ghafur Wan Mohd Nazri bin Wan Osman Madelena binti Mohamed Mohd Zabidi bin Md Nor Kamari Zaman bin Juhari Cheah Kim Ling Suhaimi bin Ali Shahariah binti Othman
Supervision Financial Conglomerates Supervision Insurance and Takaful Supervision Banking Supervision Specialist Risk Unit	Che Zakiah binti Che Din Yap Lai Kuen Marina binti Abdul Kahar Charles Sandanasamy*
Special Investigation Financial Intelligence	Jeremy Lee Eng Huat Aznan bin Abdul Aziz
Investment and Operations Investment Operations and Financial Markets Foreign Exchange Administration Currency Management and Operations	Adnan Zaylani bin Mohamad Zahid Shamsuddin bin Mohd Mahayidin Azman bin Mat Ali
Organisational Development Strategic and Risk Management Strategic Human Capital Finance Legal Human Capital Development Centre LINK and Regional Offices IT Services Central Banking Services	Mohd. Adhari bin Belal Din Jennora Bahari Eugene Hon Kah Weng — Arlina binti Ariff Wan Hanisah binti Wan Ibrahim Alizah binti Ali Thomas Tan Koon Peng
MIFC Promotion Unit	Nik Mohamed Din bin Nik Musa
Centralised Shared Services General Manager Deputy General Manager Facilities Management Corporate Services Security Bank Negara Malaysia Museum and Art Gallery	Dato' Mohd Nor bin Mashor Myrzela binti Sabtu Azmi bin Abd Hamid Lim Foo Thai Mior Mohd Zain bin Mior Mohd Tahir Lucien de Guise
<i>Chief Representative</i> Beijing Representative Office London Representative Office New York Representative Office	Albert See Choon Kwang — Khairuzin bin Mohd Arif
<i>Regional Office</i> Johor Bahru Pulau Pinang	Raman a/l Krishnan Zambre bin Ismail
<i>Branch Manager</i> Kota Kinabalu Kuching Shah Alam Kuala Terengganu	Ishak bin Musa Rosnani binti Mahamad Zain Yusoff bin Yahaya Omar bin Moin

*Administrative Head

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GOVERNOR'S STATEMENT

As we enter 2012, the world economy is confronted with the challenge of managing a sustainable economic recovery in a highly challenging global environment. The international financial reforms and the required structural adjustments in several major economies will not only contribute towards increased uncertainty in the international financial markets but are likely to have negative near-term implications on overall global economic growth. While in these recent months there have been positive signs that conditions in the international financial markets and the major economies have improved, the fiscal austerity currently being undertaken, the ongoing deleveraging by both private and public sectors and the economic restructuring and its near-term resulting economic dislocation, can be expected to contain the potential of the recovery.

As a highly open economy, Malaysia is not insulated from these developments. Overall economic performance will be affected by the general weakness in external demand, while the high level of global liquidity would also lead to risks arising from the large cross-border capital flows and their implications on domestic financial markets and the economy. In this environment, the growth of the Malaysian economy has for some years now been increasingly underpinned by the strength in domestic demand. The solid foundations of the Malaysian economy have followed from a decade of conscious policies that were pursued, during a period of relative stability and growth, to restructure the economy and to reform and strengthen the financial system.

The structure of the economy has become significantly more diversified, with domestic demand currently becoming a significant driver of growth while the export structure has also diversified significantly with increasingly greater trade with emerging economies. The Malaysian financial system has also become more developed, competitive and resilient, through institutional building, financial infrastructure development, and progressive deregulation and liberalisation. The high level of savings, the low unemployment, the strong external position, the low level of external indebtedness and the high level of international reserves have also reinforced the strength of the domestic economy and its capacity to withstand the impact of destabilising external developments.

While this has provided the solid foundation to support our future growth, equally important is the role of macroeconomic policies. Since the onset of the global financial crisis, policy-makers across the world have been re-examining the appropriate macroeconomic policy framework, from monetary policy and fiscal sustainability to macroprudential policies to promote financial stability. Our approach in macroeconomic management has always been guided by the objective to be achieved and having the necessary powers and instruments to deliver the desired outcomes. Also important is

the efficient functioning of the financial system and thus the transmission mechanism for the policies. To be pre-emptive and anticipatory, the Bank has continued to strengthen our surveillance capabilities and our understanding of the operating environment and its attendant risks. Also important is having a long-term focus that extends beyond the business cycle, in particular with respect to the evolving developments and structural changes affecting the economy.

While the focus of monetary policy will continue to be preserving price stability in an environment of sustainable economic growth, an important consideration is to prevent the build-up of financial imbalances. While inflation during 2011 and in early 2012 has been on a moderating trend, the risk of higher commodity and energy prices cannot be ruled out. The potential risk for slower economic growth, however, also remains. While the degree of monetary accommodation was adjusted in 2011, to gradually increase interest rates from 2% to 3%, the stance of monetary policy remains accommodative. The normalisation of the interest rates was largely to prevent the build-up of financial imbalances. During the year, challenges also came from large and volatile capital flows. To manage the risks associated with the build-up of excess liquidity in the domestic financial system, sterilisation operations were reinforced by increases in the Statutory Reserve Requirement and the implementation of a wide range of macroprudential measures.

Fiscal policy also represents an important component of domestic macroeconomic policy. As with many parts of the world, the challenge is to achieve fiscal sustainability and to contain the fiscal deficit and public sector indebtedness while supporting growth of the domestic economy and facilitating the longer term economic transformation. In Malaysia, the trend has been for the gradual reduction of the fiscal imbalance. This gradual reduction process has been possible given the relatively lower level of indebtedness, in particular, the low level of external borrowing by the public sector. As the Government begins to reduce its role in the economy, the role of the private sector will become increasingly important. The role of Government in the economy will therefore change towards facilitating an enabling environment for private sector economic activity. While public expenditure has to be contained, the contribution to growth by the public sector can be through enhancing the efficiency and effectiveness of the public sector while also continuing to support socio-economic well-being and public sector investment that would enhance the growth potential of the economy.

Beyond the short and medium term, attention is also being given to economic transformation to sustain the relevance and competitiveness of the Malaysian economy. Malaysia's aspiration is to advance towards becoming a high-income, high value-added economy in this next decade, with growth that is underpinned by greater innovation, productivity and enhanced efficiency. In this regard, initiatives are already being undertaken to remove the constraints that may impede this economic transformation. Key initiatives to address this are in the areas of human capital development, developing a conducive and competitive business environment, and establishing the required physical infrastructure for a modern economy. Going forward, the Bank's Financial Sector Blueprint launched in late 2011, outlines the direction for the development of the financial sector during this next decade. In particular, it focuses on strengthening the effectiveness of financial intermediation in this new environment, in particular, in the new growth areas and to support the increased economic and financial linkages with the region and international economy.

During the year, measures continued to be undertaken by the Bank to liberalise the foreign exchange administration rules to allow for better management of the foreign exchange transactions by the private sector in an environment of increasing economic and financial linkages with other parts of the world. The liberalisation is also aimed at lowering costs of such transactions and strengthening the competitiveness of our economy. Going forward, there will be accelerated efforts to develop the foreign exchange market and the payments infrastructure to allow for multicurrency settlements. In this environment of highly volatile capital flows, the Malaysian money, bond, equity, and foreign exchange markets have demonstrated their capacity to intermediate these flows and their ability to support the larger two-way real and financial flows from and to other parts of the world.

The year 2011 also saw further advancement in the efforts towards greater regional financial integration. A major motivation for this is to achieve a more effective intermediation of surplus funds from the region to productive investments in the region. For the ASEAN region, the ASEAN Financial Integration Framework is being introduced with the aim of accelerating the financial integration process and strengthening the platform for its interface with other parts of the world. During this period of relative stability and growth in the ASEAN region, the opportunity is also being taken to strengthen the regional arrangements for financial stability. The Bank is committed to and is active in participating in these endeavours. The Bank has participated in the bilateral arrangements initiated by EMEAP central banks to promote more efficient cross-border liquidity management. These cross-border collateral arrangements are also supported by active regional surveillance efforts that are reinforced by the work on developing an integrated crisis management framework for the region.

On organisational matters, the Bank has entered its third phase of organisational transformation in this decade. Changes have been made to the governance structure and practices and to human capital management and development. This has been reinforced by a new compensation framework and internal corporate administration structure. Cumulatively, this has aimed to strengthen the effectiveness, efficiency and cohesiveness of the Bank. The Central Bank Act 2009, which continued to be operationalised during the year, gives greater focus on governance and accountability in the Bank. In 2011, the role of the Board was enhanced to provide further oversight, in particular, on risk management by the Bank, on the utilisation of resources in the delivery of our mandates, and having in place the necessary control measures and the Business Continuity Plan so as to ensure the state of readiness of the Bank for the different eventualities.

The greater clarity of the mandates in the Act has also reinforced the implementation of the three-year Business Plan of the Bank which was concluded in 2011. The plan has provided strategic focus and a benchmark against which to assess the Bank's achievements during this period. The new Business Plan 2012 – 2014, which was introduced early this year, sets the goals, outcomes and reporting structures. In the management of human capital, a new framework is being introduced to recognise role specialisations through job families and differentiated rewards. Targeted development will complement the current development framework to accelerate readiness of talent in the Bank. Equally important in the Bank is the corporate culture and values that we uphold. This year we have upgraded the Code of Conduct and introduced the new Code of Ethics, given the significantly changing and more complex environment in which the Bank operates in. In the currency function of the Bank, a particularly significant event this year will be the introduction of the new currency notes

and coins with leading edge security features. In 2011, Sasana Kijang, our new building was launched as a centre to promote greater regional and international collaboration in the field of central banking and finance. The building also houses the Bank's Art Gallery and Numismatic Museum.

In essence, amidst an increasingly challenging and changing environment, organisational effectiveness is key to ensuring the Bank's ability to fulfil our responsibilities at the highest level of excellence. Having a cohesive workforce that is dedicated to performance has been a vital part of the achievements of the Bank. On behalf of the Board, I wish to express our appreciation to all the staff of the Bank for their hard work, dedication and commitment to ensure that the Bank continues to serve the best interests of the nation. I am also grateful for the support of the Board of Directors, who are an integral part of the governance of the Bank. Going forward, the Bank will continue to strive to achieve the highest standards of excellence in fulfilling our responsibilities and to uphold the trust that has been placed on us.

A handwritten signature in black ink, appearing to read 'Zeti Akhtar Aziz', with a stylized, cursive script.

Zeti Akhtar Aziz
Governor
21 March 2012

2011

EXECUTIVE SUMMARY

EXECUTIVE SUMMARY

The global economy grew at a more moderate pace in 2011 after the strong rebound in 2010. The growth momentum was weighed down by continued structural weaknesses and fiscal issues in the advanced economies, geopolitical developments in the Middle East and North Africa region and the disruptive impact of natural disasters on global manufacturing production. These developments reverberated onto international financial markets and contributed to heightened market volatility throughout the year. Despite the less favourable external environment, emerging economies continued to record firm domestic-driven economic growth. At the same time, emerging economies faced increasing challenges from volatile capital flows and rising inflationary pressures. Amidst this environment, the Malaysian economy continued to grow steadily underpinned by the expansion in domestic activity and firm regional demand. The Annual Report provides detailed analyses of the developments in the Malaysian economy and policies pursued by the Bank during the year, as well as an assessment of the prospects for the economy against the backdrop of on-going developments in the global economic and financial landscape and key challenges going forward. The report also highlights the organisational changes in the Bank to further strengthen its governance and capacity through enhancements in strategic management, risk management and talent development.

The Malaysian Economy in 2011

The Malaysian economy recorded a steady pace of growth of 5.1% in 2011 (2010: 7.2%), despite the challenging international economic environment. Growth was lower in the first half of the year, particularly in the second quarter, as the economy was affected by the overall weakness in the advanced economies and the disruptions in the global manufacturing supply chain arising from the natural disaster in Japan. Although the global economic environment became increasingly more challenging and uncertain in the second half-year, Malaysia's economic growth improved due to stronger domestic demand.

Domestic demand registered a strong growth of 8.2% in 2011 (2010: 6.3%), driven by

both household and business spending, and higher public sector consumption. Private consumption strengthened in 2011, growing by 6.9% (2010: 6.5%), supported by a broad-based growth in income following the overall improvement in labour market conditions and higher commodity prices.

Private investment expanded by 14.4% in 2011 (2010: 17.7%). Higher capital expenditure was evident across all sectors, especially in the first half of the year, driven mainly by strong domestic demand. However, the strong investment momentum began to moderate slightly towards the second half of the year, especially in the manufacturing sector, following increased uncertainties on the global economic environment.

The public sector continued to provide support to growth during the year. Public consumption expanded substantially by 16.8% in 2011 (2010: 0.5%), the outcome of higher public expenditure on emoluments, supplies and services, and the one month bonus payment during the year. Public investment, however, contracted by 2.4% in 2011 (2010: 2.8%) following the lapse of the second stimulus package in 2010. Nevertheless, capital spending by the non-financial public enterprises (NFPEs) remained strong, providing support to overall public investment.

From the supply side, the overall growth in 2011 was sustained by firm activity in the domestic-oriented sectors. The services sector remained the key contributor to growth amid robust domestic demand throughout the year. The sector recorded sustained growth of 6.8% in 2011 (2010: 6.8%) to contribute 3.9 percentage points to overall GDP growth. The wholesale and retail trade sub-sector continued to register steady performance, underpinned by robust private consumption. Meanwhile, the finance and insurance sub-sector expanded firmly following strong performance in bank lending and increased collection of insurance premiums.

The manufacturing sector continued to expand, albeit at a more modest pace (2011: 4.5%; 2010: 11.4%) as growth in the domestic-oriented

industries outweighed weakness in the export-oriented industries. Subdued external demand, particularly from the advanced economies, had weighed down on the performance of the export-oriented industries. Supply disruptions also contributed to the under-performance of the sector. Nevertheless, the domestic-oriented industries remained resilient, supported by favourable domestic demand conditions.

The construction sector expanded at a moderate rate of 3.5% in 2011 (2010: 5.1%) due to slower activity in the civil engineering and non-residential sub-sectors. The civil engineering and special trade sub-sector registered slower growth following the completion of major highway projects and maintenance and upgrading work under the second stimulus package. Growth in the non-residential sub-sector also moderated after strong double-digit growth in the previous year. Growth was weighed down by concerns of an oversupply of office space, particularly in the Klang Valley area. The residential sub-sector registered a much improved performance with a turnaround in growth. The average national house price rose at a faster pace of 8.6% in the first three quarters of the year (2010: 6.7%), significantly above the average growth rate of 3.7% between 2000 and 2010.

The agriculture, forestry and fishing sector expanded at a stronger pace of 5.6% in 2011, supported by a recovery in the production of crude palm oil (CPO). The production of CPO increased by 11.3% to 18.9 million tonnes as good weather conditions and firm prices supported strong production. Output of other key crops such as rubber and food crops was sustained by strong regional and domestic demand.

Value-added in the mining sector contracted by 5.7% in 2011, reflecting the decline in the production of crude oil and condensates. This decline was caused by the shutdown of several production facilities for maintenance purposes, declining production from mature fields, and lower-than-expected production from new fields. Despite higher demand from Japan following the natural disasters in March, output of natural gas rose only marginally, as production was affected by shutdowns of gas processing facilities in Peninsular Malaysia.

Overall labour market conditions improved in 2011, as reflected by the gains in employment and

higher number of vacancies. The unemployment rate declined to 3.1% of the labour force in 2011 from 3.3% in the previous year, the lowest annual rate recorded since the year 2000.

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), averaged 3.2% in 2011 (2010:1.7%). The increase in inflation in the first half of the year was due mainly to supply factors arising from higher food prices and the upward adjustments of administered prices. Inflation peaked in June at 3.5% and subsequently stabilised in the second half of 2011, as the impact from the upward adjustments in the prices of petroleum products and sugar in 2010 gradually diminished. Core inflation, an indicator of the demand-driven pressures on price pressures, rose to 2.7% in 2011 (2010:1.5%).

Malaysia's external position strengthened further in 2011 despite the difficult external environment. The overall balance of payments turned around to record a strong surplus position with the current account achieving another large surplus while the financial account reversed to register a net inflow position. The positive current account performance was supported by a larger trade surplus, emanating mainly from strong commodity exports that reflected the higher commodity prices, and lower net income outflows. The turnaround in the financial account was largely attributed to the continued foreign direct investments (FDI) and inflows of portfolio funds given the positive growth prospects of the Malaysian economy.

The current account surplus widened to RM97.9 billion or 11.8% of GNI (gross national income), from RM88.1 billion or 11.9% of GNI in 2010, reflecting the higher trade surplus arising from the sustained expansion in exports of commodities and non-electronics and electrical (E&E) manufactured products. Nevertheless, in line with the moderate growth in the advanced economies and heightened uncertainties in the global financial markets, gross exports grew at a more modest pace of 8.7% (2010: 15.6%) in 2011. The moderation in gross exports was due mainly to the contraction in exports of E&E products. The lower growth in manufactured exports mainly reflected the weaker external demand. Nonetheless, robust regional demand and favourable commodity prices provided crucial support for exports of commodities and resource-based non-E&E products.

In 2011, the financial account reversed from a net outflow position to record a net inflow of RM15.5 billion (2010: -RM19.9 billion), largely due to the continued FDI and inflow of portfolio funds. Despite heightened uncertainty in the global financial markets, portfolio inflows continued to be buoyed by prospects for strong growth in the region, and expectations for stronger regional currencies. Of significance, FDI inflows were also higher in response to the robust domestic economic conditions and higher corporate profitability. Similarly, direct investment abroad (DIA) by Malaysian companies was higher mainly as an outcome of the expansion of existing business operations abroad. Other investment outflows, which largely reflected private sector flows, moderated sharply during the year.

As at 31 December 2011, the net international reserves amounted to RM423.3 billion (equivalent to USD133.6 billion), which is adequate to finance 9.6 months of retained imports and is 4.1 times the short-term external debt. As at 29 February 2012, the reserves level amounted to RM426.7 billion (equivalent to USD134.7 billion), which is adequate to finance 9.4 months of retained imports and is 4.1 times the short-term external debt. The international reserves held by the Bank remain usable and unencumbered.

Malaysia's total external debt rose to RM257.2 billion (or USD80.4 billion), equivalent to 31% of GNI at the end of 2011 (2010: RM227.1 billion). This reflected the increase in the medium- and long-term as well as short-term debt. The increase in the medium- and long-term external debt partly reflected the net drawdown of external borrowings by the Federal Government and the private sector. In July 2011, the Federal Government successfully issued a dual tranche (5-year and 10-year) Wakala Global Sukuk of USD2 billion. The issuance was Malaysia's third US dollar-denominated sovereign Sukuk issuance, with the preceding Global Sukuk Issuance in 2010. During the year, outstanding short-term external debt rose to RM103.9 billion (2010: RM79.4 billion), attributed primarily to increased interbank borrowings. Nevertheless, the short-term external debt exposure remained relatively small, accounting for only 12.5% of GNI, 24.5% of international reserves and 12.9% of exports of goods and services. The appreciation of some of the major currencies against the ringgit during the year also contributed to the rise in the overall external debt level. As at end-year, Malaysia's external debt profile continued to be skewed towards a longer maturity structure with

medium- and long-term debt accounting for 59.6% of total external debt.

Domestic Monetary and Financial Conditions in 2011

Monetary policy in 2011 focused on sustaining economic growth, while containing the risks to inflation and preventing the build-up of financial imbalances. Maintaining the momentum from 2010, the Malaysian economy experienced sustained growth in the first half of the year. Inflation was expected to be higher compared to the previous year, driven mainly by supply factors and to a lesser extent, domestic demand pressures. Monetary policy in the first half of the year was therefore focused on the need to further normalise interest rates. The Monetary Policy Committee (MPC) raised the Overnight Policy Rate (OPR) by 25 basis points on 5 May 2011 to 3.00%. In the second half of the year, however, the downside risks to economic growth increased significantly due to deteriorating global economic and financial conditions, whereas the upside risks to inflation had begun to moderate. Given the balance of risks, the MPC considered the prevailing OPR level to be appropriate and kept the policy rate unchanged for the remainder of the year.

A key challenge to the conduct of monetary policy during the year was the significant and volatile portfolio inflows. The capital inflows and the consequent build-up of liquidity in the domestic financial system, if not managed, could lead to financial imbalances and create risks for macroeconomic and financial stability. As such, to pre-emptively respond to these risks, the Statutory Reserve Requirement was raised by 1 percentage point each time in March, May and July to 4.00% to reduce the size of the excess liquidity in the banking system.

The performance of the ringgit during the year was influenced by volatility in international financial markets arising primarily from external developments. Between early January and July 2011, the ringgit strengthened due to significant portfolio inflows. Strengthening fundamentals and positive investor sentiments continued to attract capital flows towards regional markets. The appreciating trend of the ringgit and other regional currencies was, however, reversed in August and September as investor risk aversion rose sharply following heightened uncertainty surrounding the global growth outlook and

mounting concerns over the sovereign debt crisis in Europe. The relief following the positive outcomes of the EU summit in October was brief, as capital outflows and ringgit volatility increased towards the end of 2011 amidst renewed market concerns over the crisis in Europe. Ringgit ended the year at RM3.1770 against the US dollar, a depreciation of 2.9%.

The Malaysian Government Securities (MGS) market was significantly influenced by external factors. While MGS yields increased in the first four months of the year, they subsequently reversed to chart a downward trend following strong non-resident inflows. Conditions in the domestic private debt securities (PDS) market also evolved favourably, as market liquidity and credit conditions improved.

The FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI) increased by 0.8% to close at 1,530.7 in 2011 (2010: 19.3%). Domestic equity prices rose in the first half of 2011 on strong domestic fundamentals, but underwent a correction in the second half-year. The FBM KLCI stabilised in late-September and gradually recovered as investors reacted positively to the improvement in global growth prospects following measures undertaken in the advanced economies to stabilise international financial markets.

Liquidity conditions in the banking system remained ample throughout 2011. Private sector liquidity expanded strongly on account of the sizeable capital inflows in the first half of 2011. Despite the episodes of large capital outflows in the second half of 2011, a net expansion in liquidity was recorded for the year as a whole. The sterilisation operations of the Bank were instrumental in offsetting the impact of the flows on domestic liquidity and maintaining relatively stable domestic monetary conditions.

Financing conditions remained supportive of economic activity. The reasonable cost of borrowing and ample liquidity in the financial system sustained financing to all segments of the economy. Net financing raised by the private sector through the banking system and the capital market expanded by 12.5% (2010: 10.9%) with strong demand for financing from both businesses and households.

Outlook for the Malaysian Economy in 2012

Amid the more challenging external environment, Malaysia's economy is projected to experience a steady pace of growth of 4 - 5% in 2012. Domestic demand is expected to remain resilient and will continue to be the anchor for growth. Several measures that were announced in the 2012 Budget are expected to provide support to private consumption. These include the upward revision of public sector wages and the one-off financial assistance to low and middle-income groups. Private investment will be supported by domestic-oriented industries and the ongoing implementation of projects under the Economic Transformation Programme (ETP). The public sector will remain supportive of growth in 2012, with higher capital expenditure by both the Federal Government and the non-financial public enterprises. The implementation of the Special Stimulus Package through Private Financing Initiative that was announced in the 2012 Budget would provide further impetus to real activity during the year.

On the supply side, most sectors will continue to expand in 2012. Nevertheless, the slower growth in global demand may adversely affect the export-oriented industries in the manufacturing sector as well as the trade-related industries in the services sector. The performance of domestic-oriented industries, on the other hand, is expected to remain firm, benefiting from resilient domestic demand conditions. In particular, the construction sector is projected to record stronger growth, supported by the implementation of major infrastructure projects and the Special Stimulus Package. Growth in the mining sector is also expected to recover. However, the agriculture sector is likely to register a more moderate growth on account of lower growth of both palm oil and natural rubber following the strong performance seen in 2011 and the expected moderation in commodity prices.

On the external front, the current account surplus is projected to remain large at RM109.5 billion or 12.2% of GNI. Although gross exports are expected to record a slower growth in 2012, the trade account surplus will remain large. This trade surplus will be primarily supported by exports of commodities and non-E&E manufactured products. It also reflects the anticipated slower growth in gross imports in tandem with the weaker demand for manufactured exports and

the more moderate growth in private domestic demand. Deficits in the services and income accounts are also projected to narrow further in 2012. On the financial account, long-term capital flows are likely to moderate but short-term capital flows could be higher and more volatile, amid heightened global uncertainty.

The GDP growth projection of between 4 – 5% in 2012 is premised upon the expectation of a moderation in global growth and the timely and full implementation of measures announced in the 2012 Budget. Several risks, however, remain. These risks include an escalation in the eurozone sovereign debt crisis and much slower growth in our major trade partners. Should growth in the advanced economies turn out to be stronger than expected, there is some upside potential to domestic growth in 2012. It should also be noted that the authorities have sufficient policy flexibility to support the domestic economy and respond to global developments.

Labour market conditions are expected to soften in 2012 amid the slower economic activity. The unemployment rate is projected to increase to 3.2% of the labour force in 2012 (2011: 3.1%). Job creation is projected to be concentrated in the domestic-oriented sectors, particularly in the services and construction sectors, as domestic demand is expected to remain firm. Employment in the export-oriented sectors may be affected by the weakening external demand.

Headline inflation is expected to moderate in 2012, averaging between 2.5-3.0%. The lower inflation projection reflects the moderation in global commodity prices and a more modest growth in domestic demand. However, upside risks to inflation remain, and could emanate from higher-than-expected global commodity prices, domestic supply disruptions and possible adjustments to administered prices.

Economic and Monetary Management in 2012

Against the challenging global economic environment, the focus of policies by the Government and the Bank is on supporting the Malaysian economy to grow at sustainable levels while managing the risks to inflation. Fiscal policy will be geared towards stimulating domestic economic activity and providing support to the economic transformation program. A key challenge for the Government in 2012 is to continue providing support to

domestic demand amid the weakening external sector, while ensuring that the fiscal position remains sustainable. In this regard, greater emphasis has been placed in the 2012 Budget on generating growth through private sector investment and consumption. This includes measures for accelerating investment, further developing human capital and enhancing rural development, and the implementation of programmes to improve the socio-economic well-being of Malaysians.

Monetary policy will continue to facilitate economic growth while managing the risks to inflation and the build-up of financial imbalances. Prevailing monetary conditions remain supportive of economic activity. Should the global economy enter a new phase of even weaker growth during the course of 2012 and adversely affect the outlook for the Malaysian economy, the MPC at Bank Negara Malaysia has the flexibility to respond to adjust the degree of monetary accommodation. Strong fundamentals, greater policy flexibility and closer cooperation with central banks within the region also places Malaysia in a strong position to face the challenges posed by large and volatile movements of capital flows.

Organisational Development and Governance

In 2011, the Bank had further reinforced its efforts in organisational development and the promotion of more effective governance. During the year, the Board of Directors met to deliberate on various aspects of the Bank's operations including the performance of the Bank in effecting monetary and financial stability, the formulation of the Financial Sector Blueprint and the review of regulatory laws governing financial institutions. At the same time, several initiatives were implemented internally under the oversight of the Board Governance, Audit and Risk Committees with the aim of better aligning the Bank's initiatives with its mandate, ensuring the effectiveness of the internal audit function in providing independent assessments and oversight, as well as, promoting a strong risk management culture and pre-emptively managing risks that may hinder the achievement of the Bank's objectives. 2011 also marked the conclusion of the Bank's Business Plan 2009-2011, which had contributed significantly to the Bank's transformation towards becoming a strategy-focused and high performance organisation. During the year, the Bank launched Sasana Kijang, a modern centre of excellence for central banking and

financial services, which is expected to play a significant role in promoting regional and international collaboration.

The Bank's communications function remained important in fostering stakeholder confidence, especially amid the uncertain global economic and financial environment of 2011. More frequent engagements were undertaken on the Bank's assessment of the impact of external developments on the Malaysian economy and financial sector, as well as, to highlight the underlying strength of domestic economic fundamentals in sustaining the growth momentum of the Malaysian economy. Public outreach programmes aimed to enhance financial literacy, capability, inclusion and access to financing continued to be an important part of the Bank's developmental agenda. With the launch of the new Malaysian currency series in December 2011, the Bank has also engaged closely with financial institutions, businesses and cash-handling

vendors to ensure a smooth transition to the new coins and notes coming into circulation in 2012.

As part of the continuous effort to enhance regional and international cooperation, the Bank continues to be involved in technical collaboration with external agencies and central banks from other emerging economies, particularly in the areas of Islamic finance, organisational development, financial inclusion, consumer protection and financial education.

Bank Negara Malaysia's Audited Financial Statement for 2011

The financial position of Bank Negara Malaysia, as audited and certified by the Auditor General, remained strong in 2011. The total assets of Bank Negara Malaysia amounted to RM473 billion with a net profit of RM4.7 billion for the financial year ended 31 December 2011. Bank Negara Malaysia declared a dividend of RM2 billion to the Government for the year 2011.

2011

ECONOMIC DEVELOPMENTS IN 2011

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THE INTERNATIONAL ECONOMIC ENVIRONMENT

In 2011, the global economic and financial landscape was characterised by five key trends. First, the global growth momentum moderated after the strong rebound in 2010, weighed down by increasing uncertainties surrounding fiscal issues in the advanced economies, geopolitical tensions and natural disasters. Second, these uncertainties contributed to heightened volatility in the international financial markets, while the rise in global risk aversion exerted upward pressures on safe-haven currencies. Third, commodity prices rose strongly following supply disruptions and adverse weather conditions amid sustained demand. Fourth, inflationary pressures remained elevated throughout most of the year, driven by both supply and demand factors. In particular, rising commodity prices were a key contributor to the inflationary pressures. Fifth, in response to the increasingly challenging economic environment, the stance of monetary policy in several countries shifted from policy normalisation or tightening towards accommodation to support growth.

Global growth moderated in 2011 amid heightened downside risks while inflationary pressures continued to remain elevated

Global growth moderated

The world economy entered 2011 with expectations for healthy economic growth during the year, supported by optimism over the favourable growth performance in the fourth quarter of 2010. Adverse developments in several major economies, however, led to the continuous downward revision of global growth expectations throughout the year.

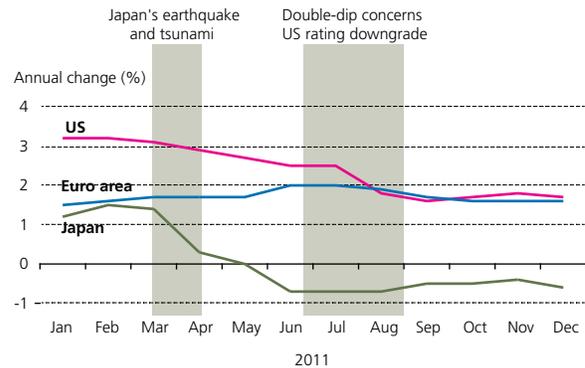
In the first quarter of 2011, most economies experienced a positive growth momentum. The Asian economies, in particular, registered better-than-expected growth underpinned by resilient

domestic demand and robust intra-regional trade. In March, however, Japan's natural disasters and nuclear crisis not only resulted in power supply disruptions and infrastructure damage in Japan, but also led to significant uncertainties in manufacturing production globally, given that Japan was an essential part of the global supply chain for E&E products and automobile production. The impact of Japan on the world economy became more pronounced in the second quarter, as reflected in the moderation in trade and production activity across Asia and the subsequent slowdown in global growth. For the advanced economies, the impact of the supply chain disruptions emanating from Japan was compounded by slower improvements in labour market conditions, elevated fuel prices and rising concerns over fiscal sustainability.

In the second half of 2011, despite diminishing supply disruptions and the moderation in oil prices, the global environment became increasingly challenging. Escalation of the sovereign debt crisis in the euro area and the downgrade of the US sovereign credit rating in August had intensified the fiscal and financial stress in the advanced economies and dampened consumer and business sentiment. In the US, in particular, fears of a double-dip recession rose, as revisions to growth data indicated a slower recovery from the recession than previously envisaged. Furthermore, consumption

Chart 1.1

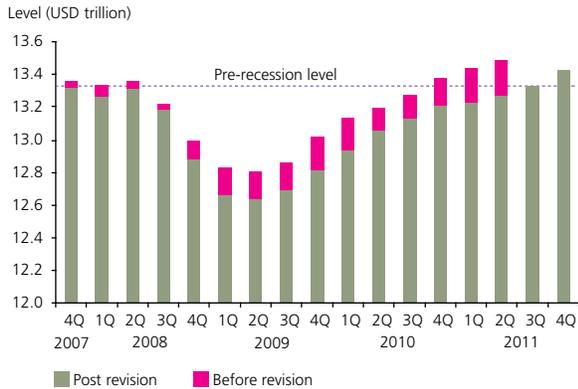
Change in 2011 GDP Forecast for Selected Advanced Economies



Source: Consensus Forecasts

Chart 1.2

Downward Revision to US Real GDP Statistics



Source: US Bureau of Economic Analysis

Table 1.1

World Economy: Key Economic Indicators

	Real GDP Growth (%)		Inflation (%)	
	2010	2011e	2010	2011e
World Growth	5.2	3.8	-	-
World Trade	12.7	6.9	-	-
Advanced Economies				
United States	3.0	1.7	1.6	3.1
Japan	4.4	-0.7	-1.0	-0.3
Euro area	1.9	1.4	1.6	2.7
United Kingdom	2.1	0.8	3.3	4.5
Emerging Asia	9.5	7.9	-	-
Asian NIEs¹	8.4	4.0	2.3	3.5
Korea	6.2	3.6	2.9	4.0
Chinese Taipei	10.7	4.0	1.0	1.4
Singapore	14.8	4.9	2.8	5.2
Hong Kong SAR ²	7.0	5.0	2.3	5.3
The People's Republic of China	10.4	9.2	3.3	5.4
ASEAN-4	7.0	4.3	3.9	4.5
Malaysia	7.2	5.1	1.7	3.2
Thailand	7.8	0.1	3.3	3.8
Indonesia	6.2	6.5	5.1	5.4
Philippines	7.6	3.7	4.1	4.8
India³	10.4	7.3	9.6	9.5

¹ Newly industrialised economies² Inflation refers to composite price index³ Inflation refers to wholesale price index

e Estimate

Source: International Monetary Fund, National Authorities and Bank Negara Malaysia estimates

growth remained modest, constrained by the slow recovery in job creation, continued deterioration in the housing market and lower financial wealth. This led to a sharper downward revision of US growth projections. In the euro area, growth also moderated amid weak domestic demand as private sector sentiments in both the core and peripheral economies were significantly affected by the intensification of the sovereign debt crisis. The Asian economies, meanwhile, experienced slower growth in exports and industrial production. Nevertheless, growth remained supported by sustained domestic demand in the region. Consumption, in particular, was underpinned by favourable labour market conditions, continued access to credit, rising incomes and high commodity prices. In China, growth concerns emerged in October following data releases that indicated, for the first time in a year, declining residential property prices on a month-on-month basis. This in turn, increased the risk of a more significant slowdown in China as property investment accounted for 10%-15% of the economy. Towards year-end, US growth recorded some improvements supported by rising consumption and production activity, albeit remaining modest and vulnerable to increasing risks in the global economy. Economic expansion in Asia also softened as export growth continued to moderate following the more widespread global economic slowdown.

International financial markets experienced heightened volatility

In the first half of 2011, the **international financial markets** were buoyed by the more favourable global economic outlook. This was reflected in the positive growth experienced in both major and regional equity markets, with the emerging markets continuing to experience large capital inflows. There were, however, periodic episodes of volatility following heightened geopolitical tensions in the Middle East and North Africa (MENA) region, the disasters in Japan and renewed concerns over the sovereign debt crisis, particularly with respect to the Greek sovereign debt restructuring. The latter event also increased the risk of contagion to other euro area economies with relatively weaker fiscal positions, namely Portugal, Italy and Spain. The persistent market pressure on these economies was reflected in the elevated long-term bond yields, which eventually led to the EU and IMF providing Portugal with a financial package of €78 billion in May.

Financial market conditions worsened in the second half of the year. Intensified fiscal uncertainties in the US due to the debt ceiling debate and the downgrade of the US sovereign credit rating on 5 August triggered heightened risk aversion among investors. The sovereign debt crisis in the euro area continued to spread, amid concerns about contagion to the core economies. Italy and Spain's credit ratings were downgraded in October and subsequently the long-term bond yields of the two countries rose to record highs despite the announcement of further fiscal austerity measures by the authorities. European banks with large exposures to troubled sovereign debt faced renewed funding stress towards the latter part of the year, raising concerns over potential credit disruptions with substantial contagion risk to the global financial markets.

The European leaders responded to the crisis with a second financial package plan for Greece in July, which included further financial assistance and the voluntary participation of the private sector in a restructuring of Greek debt. The plan was revised in October to include an increased role of the private sector and an expansion of the European Financial Stability Facility (EFSF) to €1 trillion from €440 billion, in part through leveraging. However, the impact of these announcements was temporary as sentiments continued to worsen, given the uncertainties surrounding the implementation of the plan. In November, six major central banks announced coordinated measures to provide liquidity support to the global financial system and mitigate strains on the supply of credit, including lowering interest rates on existing US dollar swap agreements. European leaders agreed to an intergovernmental fiscal treaty in December, aimed at improving fiscal discipline in the region. Despite some improvements following these measures, international financial market conditions remained volatile towards year-end, exacerbated by sovereign rating downgrade warnings on fifteen euro area economies, including Germany and France, by a major credit rating agency. In February 2012, following heightened investors' concerns over a Greek bond redemption in March, European leaders reached an agreement on a second financial package for Greece, which included €130 billion financial assistance and greater private sector participation. Nevertheless, financial markets remained cautious over the adequacy of the recent measures in resolving the crisis.

In the **foreign exchange market**, currency movements remained volatile, following heightened risk aversion in the international financial markets amid fiscal concerns in the advanced economies. In the first half of the year, most major currencies appreciated against the US dollar. Both the euro and the sterling strengthened against the dollar, supported by market expectations that the European Central Bank (ECB) and the Bank of England (BOE) would increase policy rates in view of higher headline inflation in the respective economies. The euro also benefited from investor optimism over the growth prospects of the core euro area economies, particularly Germany. However, this trend reversed in May as global risk aversion heightened on renewed concerns over the escalation of the sovereign debt crisis and emerging signs of weaker global growth. The yen continued to strengthen against the US dollar, reaching a peak of ¥76.25 in March, as market participants pushed up the yen on expectations of large repatriations of funds to Japan following Japan's natural and nuclear disasters. The surge in speculative flows subsequently led to coordinated foreign exchange intervention by the G7 economies on 18 March to curb excessive volatility in the foreign exchange markets that could potentially impinge on global financial stability. Most Asian currencies also strengthened against the US dollar in the first half of the year, amid continued capital inflows that were attracted to the region's relatively favourable growth outlook. In the second half of the year, volatility in the foreign exchange market intensified. Weak investor sentiments following prolonged concerns over fiscal sustainability in the advanced economies resulted in upward pressure on safe-haven currencies, triggering interventions by several national authorities. The US dollar appreciated against the euro, pound sterling and several Asian currencies, amid growing concerns over the sustainability of global growth and fears of a worsening debt crisis in Europe. Similarly, the yen strengthened further against the dollar, despite unilateral interventions by the Japanese authorities in August and October. The Swiss franc also appreciated sharply against the US dollar and the euro, prompting the Swiss National Bank to undertake intervention operations and to set a minimum exchange rate for the currency at CHF1.20 per euro in September. In contrast, increased risk aversion led to strong demand for liquid assets by investors, resulting in a reversal of capital flows and the

depreciation of Asian currencies. The Indian rupee registered the largest depreciation among the Asian currencies in 2011, weakening by 15.6%.

Commodity prices rose to new peaks

Commodity prices rose further in 2011, reaching new peaks in April, due to supply concerns and strong demand amid continued speculative activity. Of significance, Brent crude oil prices averaged USD111 per barrel (p/b) in 2011, a 38% increase from 2010. Crude oil prices began the year with a continuation of the upward trend from the second half of 2010, supported by robust growth in the emerging economies. The Brent one-month futures price breached USD100 p/b in early February, the highest level since September 2008, as concerns mounted over possible supply disruptions following political unrests in the MENA region. In particular, the disruption in Libyan oil production reduced the supply of high-quality sweet crude oil, used in the production of gasoline, diesel and jet fuel. To alleviate this, the International Energy Agency announced in June the release of 60 million barrels (or 2 million barrels per day) from the emergency stockpiles of its member countries, the third time such a measure has been taken in more than three decades. This uptrend in crude oil prices was, however, reversed in August following the resumption of oil production in Libya. Nevertheless, continued political tension in the MENA region towards the end of the year kept crude oil prices at elevated levels. Non-energy prices surpassed the peaks recorded in 2008, as evidenced by the record-high prices of food and metals. Food price increases were largely triggered by

weather-related production shortfalls, with prices peaking in April.

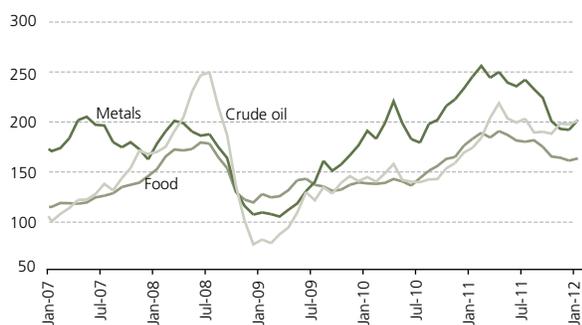
Global inflationary pressures remained elevated Inflationary pressures increased

during the year in both the advanced and emerging economies, underpinned by higher food and energy prices. This upward trend was reflected in core inflation, with country-specific factors playing a role. In the US, the rise in core inflation reflected mainly the rising cost of rent and apparels. In the UK, headline inflation was sustained above the BOE's target of 2% while the rise in core inflation was due largely to the increase in VAT and to a certain extent, the depreciation of the pound sterling. Nevertheless, underlying inflationary pressures in the advanced economies remained subdued and longer-run inflation expectations were stable, underscoring the low levels of resource utilisation and weak domestic demand. Price increases were more pronounced in the emerging economies, given the larger share of commodity-related products in their consumption baskets. In Asia, the weightage of food in the CPI basket ranges from 14% to 39%. Core inflation also trended up in several regional economies, reflecting rising demand pressures on account of favourable employment conditions and rising wages. Towards the latter part of the year, the upward momentum of price increases slowed, and headline inflation rates started to stabilise in both the advanced and the emerging economies, reflecting in part the slower increases in commodity prices. Core inflation continued to increase in several Asian economies as demand remained strong. In Thailand, core inflation rose through November, reaching the upper limit of the central bank's target range of 0.5%-3.0% as domestic demand continued to expand amid fiscal stimulus by the newly-elected government.

Chart 1.3

Indices of Primary Commodity Prices

Index (Jan '05 = 100)



Source: International Monetary Fund

Monetary policy focus shifted from inflation to growth

The **monetary policy** stance in both the advanced economies and Asia was initially focused on inflationary concerns, but subsequently shifted towards supporting growth as the year progressed. In the US, with rising downside risks to the growth outlook, the Federal Reserve (the Fed) indicated in August that it will keep the federal funds rate at exceptionally low levels through mid-2013. This was then extended until late 2014 in January 2012. In September, the Fed announced a maturity extension programme, which consisted of purchasing USD400 billion

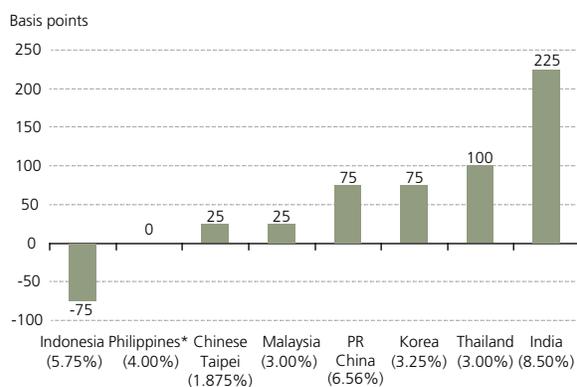
of longer-term Treasury securities, while selling an equivalent amount of short-term securities to keep long-term interest rates low and thereby, support a stronger pace of recovery. In the UK, in view of the weak economic recovery, the BOE maintained its policy rate at 0.5%, but increased its asset purchase programme by £75 billion in October, and a further £50 billion in February 2012 to a total size of £325 billion.

In contrast, rising inflationary pressures in the euro area prompted the ECB to increase its refinancing rate by a cumulative 50 basis points (bps) to 1.5% by July. However, amid heightened strains in the financial market and increasing downside risks to the economic outlook in the second half of the year, the ECB lowered its refinancing rate back to 1% by December. In addition, the ECB embarked on additional credit support measures, which included the introduction of 3-year refinancing operations and a €40 billion covered bond purchasing programme in order to provide liquidity to the banking sector and support lending activity in the region.

The Bank of Japan (BOJ) undertook comprehensive monetary easing measures to support its domestic economy, which included expanding its asset purchase programme by ¥20 trillion in 2011, and a further ¥10 trillion in February 2012. This was conducted mainly through the purchases of Japanese government bonds. In response to the disasters in Fukushima, the BOJ also established a ¥1 trillion loan programme for financial institutions in the areas affected by the earthquake and tsunami.

Chart 1.4

Cumulative Movements of Policy Rates since 2011



Note: Current policy rates in parentheses, as at mid-March 2012

* Bangko Sentral ng Pilipinas raised its key policy rate by 50bps in 2011 and lowered by 50bps in 2012

Source: National authorities

In the Asian region, central banks were largely biased towards monetary policy normalisation or tightening, particularly in the first half of 2011. Rising inflationary pressures prompted most regional central banks (Thailand, Indonesia, India, PR China, Korea, Philippines, and Chinese Taipei) to cumulatively increase benchmark interest rates by 12.5 bps to 125 bps in the first half of 2011. Several monetary authorities also adopted macroprudential measures to mitigate the adverse impact of large portfolio capital inflows on domestic asset prices. However, towards the final quarter of the year, central banks in the region began to shift focus towards supporting growth amid heightened uncertainty in the global economy. Indonesia and the Philippines eased monetary conditions amid increasing signs of a global economic slowdown and moderating domestic inflation. Similarly, Thailand reduced its key policy rate to mitigate the severe impact of flooding. The People's Bank of China reduced its reserve requirement ratio by a total of 100 bps to 20.5% in November 2011 and February 2012. Other central banks in the region were also more cautious in making policy pronouncements. This was reflected by the downgrades of the central bank's assessments on domestic growth prospects, while maintaining current policy rates in view of high inflationary pressure.

THE MALAYSIAN ECONOMY

Despite the challenging international economic environment in 2011, the Malaysian economy recorded a steady pace of growth of 5.1% (2010: 7.2%). Growth was more moderate in the first half of the year, particularly in the second quarter, as the economy was affected by the overall weakness in the advanced economies and the disruptions in the global manufacturing supply chain arising from the disaster in Japan. Although the global economic environment became increasingly more challenging and uncertain in the second half-year, Malaysia's economic growth improved due to stronger domestic demand. Domestic demand registered a higher growth in 2011, driven by both household and business spending, and higher public sector consumption. Private consumption strengthened in 2011, supported by broad-based income growth, following the improvement in the overall labour market conditions. In addition, civil servants benefited from the two half-month bonus payments in the second half of the year, while households in the rural area benefited from the higher rubber and palm oil prices.

Private investment remained firm, although growth moderated slightly in the second half-year, as the external environment became more uncertain. Public consumption also recorded a higher growth in 2011, in tandem with the Government's efforts to improve public delivery services. However, public investment contracted during the year following the lower disbursement of development expenditure by the Federal Government. Investment by the non-financial public enterprises (NFPEs), nevertheless, remained strong during the year. While the external demand for electronics and electrical (E&E) products was affected by the weaker global trade, exports of commodities and non-E&E products remained strong throughout the year, providing additional support to growth.

The Malaysian economy recorded a steady pace of growth of 5.1% in 2011, despite the more challenging external environment

The strong expansion in domestic demand was a key factor in driving the overall growth of the domestic-oriented sectors, while firm regional demand provided support to the commodity-related manufacturing industries and the agricultural sector. The services sector grew strongly in 2011 and remained the largest contributor to growth. The robust expansion in private consumption had provided support to the wholesale and retail trade, and accommodation and restaurant sub-sectors. The manufacturing sector expanded at a much slower pace amid weaker performances in both the export- and domestic-oriented industries. The former was mainly on account of softer external demand and disruptions in the global E&E supply chain, while the latter was due mainly to the contraction in the transport equipment industry following the supply-chain disruptions. Higher production of palm oil had contributed to the stronger growth in the agricultural sector, while the construction sector moderated following the completion of several major projects. The mining sector contracted in 2011, as the output of crude oil and condensates was affected by the shutdown of several production facilities.

Headline inflation averaged at 3.2% in 2011 (2010: 1.7%). The increase in inflation, particularly during the first half of the year, was due mainly to supply factors arising from higher food prices and upward adjustments to administered prices. Inflation peaked in June at 3.5% and trended lower in the second half of 2011, as the impact from the upward adjustments on the prices of petroleum products and sugar in July and December 2010 wore off. Core inflation, an indicator of demand-driven pressures on prices, rose to 2.6% in 2011 (2010: 1.5%).

Malaysia's external position improved in 2011. The overall balance of payments turned around to record a strong surplus as the current account surplus widened and the financial account turned positive. The larger surplus in the trade account, arising mainly from the strong commodity exports which largely benefited from the higher prices, and a lower deficit in the income account, had contributed to the wider surplus in the current account. The positive balance in the financial account was largely attributable to the continued inflows of portfolio funds and foreign direct investment (FDI). Direct investment abroad registered a higher net outflow as the Malaysian companies continued to expand businesses abroad. Other investment outflows, primarily comprising of trade credits and banking flows, moderated sharply during the year. After adjusting for the errors and omissions, the overall balance of payments recorded a large surplus of RM94.7 billion. Consequently, the net international reserves of Bank Negara Malaysia amounted to RM423.3 billion, equivalent to USD133.6 billion, as at 31 December 2011.

DOMESTIC DEMAND CONDITIONS

Domestic demand registered a strong growth of 8.2% in 2011 (2010: 6.3%), driven by both household and business spending, and higher public sector consumption.

Private consumption strengthened in 2011, growing by 6.9% compared to 6.5% in 2010. This was evident in the strong performance of major consumption indicators such as imports of consumption goods, retail sales and credit card spending. Consumer spending was driven by broad-based income growth as overall labour market conditions improved with the unemployment rate declining and job vacancies increasing. A survey conducted by Bank Negara Malaysia indicated that the average salary in the

Table 1.2a

Malaysia - Key Economic Indicators

	2009	2010	2011 ^p	2012 ^f
Population (million persons)	27.9	28.3	28.6	28.9
Labour force (million persons)	12.1	12.4	12.6	12.9
Employment (million persons)	11.6	12.0	12.2	12.5
Unemployment (as % of labour force)	3.7	3.3	3.1	3.2
Per Capita Income (RM)	23,850	26,175	29,094	31,097
(USD)	6,767	8,126	9,508	10,134 ⁶
NATIONAL PRODUCT (% change)				
Real GDP at 2000 prices ¹	-1.6	7.2	5.1	4.0 ~ 5.0
(RM billion)	522.0	559.6	588.3	614.5
Agriculture, forestry and fishery	0.6	2.1	5.6	3.8
Mining and quarrying	-6.3	0.2	-5.7	0.6
Manufacturing	-9.3	11.4	4.5	3.9
Construction	5.9	5.1	3.5	6.6
Services	3.1	6.8	6.8	5.1
Nominal GNI	-7.5	11.1	12.3	8.0
(RM billion)	665.3	739.5	830.7	897.4
Real GNI	0.6	3.9	4.7	5.7
(RM billion)	497.4	516.8	540.9	571.5
Real aggregate domestic demand ²	-0.4	6.3	8.2	6.6
Private expenditure ²	-2.6	8.3	8.2	6.6
Consumption	0.7	6.5	6.9	6.2
Investment	-17.0	17.7	14.4	8.3
Public expenditure ²	5.4	1.5	8.2	6.7
Consumption	3.9	0.5	16.8	0.2
Investment	7.5	2.8	-2.4	16.2
Gross national savings (as % of GNI)	31.6	34.1	34.6	34.4
BALANCE OF PAYMENTS (RM billion)				
Goods balance	141.7	134.7	149.4	155.6
Exports (f.o.b.)	554.1	640.0	696.1	717.8
Imports (f.o.b.)	412.3	505.3	546.7	562.2
Services balance	4.7	1.7	-8.4	-6.2
(as % of GNI)	0.7	0.2	-1.0	-0.7
Income, net	-14.6	-26.5	-22.0	-19.4
(as % of GNI)	-2.2	-3.6	-2.7	-2.2
Current transfers, net	-19.6	-21.8	-21.1	-20.5
Current account balance	112.1	88.1	97.9	109.5
(as % of GNI)	16.9	11.9	11.8	12.2
Bank Negara Malaysia international reserves, net ³	331.3	328.6	423.3	-
(in months of retained imports)	9.7	8.6	9.6	-
PRICES (% change)				
CPI (2010=100) ⁴	0.6	1.7	3.2	2.5 ~ 3.0
PPI (2005=100) ⁵	-7.1	5.6	9.0	-
Real wage per employee in the manufacturing sector	1.9	6.4	0.6	-

¹ Beginning 2007, real GDP has been rebased to 2000 prices, from 1987 prices previously

² Exclude stocks

³ All assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the gain/loss has been reflected accordingly in the Bank's account

⁴ Effective from 2011, the Consumer Price Index has been revised to the new base year 2010=100, from 2005=100 previously

⁵ Effective from 2010, the Producer Price Index has been revised to the new base year 2005=100, from 2000=100 previously

⁶ Based on average USD exchange rate for the period of January-February 2012

^p Preliminary

^f Forecast

Note: Numbers may not necessarily add up due to rounding

Table 1.3a

Malaysia - Financial and Monetary Indicators

FEDERAL GOVERNMENT FINANCE (RM billion)	2009		2010		2011^p	
Revenue	158.6		159.7		185.4	
Operating expenditure	157.1		151.6		182.6	
Net development expenditure	49.0		51.3		45.3	
Overall balance	-47.4		-43.3		-42.5	
Overall balance (% of GDP)	-7.0		-5.6		-5.0	
Public sector net development expenditure	112.2		104.4		132.5	
Public sector overall balance (% of GDP)	-7.6		2.1		-10.5	
EXTERNAL DEBT¹						
Total debt (RM billion)	232.7		227.1		257.2	
Medium- and long-term debt	155.3		147.7		153.4	
Short-term debt ²	77.4		79.4		103.9	
Debt service ratio (% of exports of goods and services)						
Total debt	6.5		7.6		10.3	
Medium- and long-term debt	6.4		7.6		10.3	
	Change in 2009		Change in 2010		Change in 2011	
MONEY AND BANKING	RM billion	%	RM billion	%	RM billion	%
Money Supply M1	17.9	9.8	23.5	11.7	33.8	15.1
M3	85.4	9.2	68.8	6.8	155.8	14.3
Banking system deposits	90.7	9.3	75.0	7.1	161.3	14.2
Banking system loans ³	57.0	7.8	99.8	12.7	120.2	13.6
Loan-deposit ratio (end of year) ⁴	77.9		81.5		80.9	
Financing-deposit ratio ^{4, 5}	84.6		88.0		86.7	
INTEREST RATES (AS AT END-YEAR)						
	%		%		%	
Overnight Policy Rate (OPR)	2.00		2.75		3.00	
Interbank rates						
1-month*	2.06		2.79		3.06	
Commercial banks						
Fixed Deposit 3-month	2.03		2.74		2.99	
12-month	2.50		2.97		3.22	
Savings deposit*	0.86		1.00		1.15	
Base lending rate (BLR)	5.51		6.27		6.53	
Treasury bill (3-month)	1.97		2.83		3.00	
Malaysian Government securities (1-year)	2.12		2.85		2.82	
Malaysian Government securities (5-year)	3.79		3.39		3.23	
EXCHANGE RATES						
	%		%		%	
Movement of Ringgit (end-period)						
Change against SDR	0.2		13.1		-2.8	
Change against USD ⁶	1.2		11.1		-2.9	

¹ Effective from the first quarter of 2008, the external debt data of Malaysia has been redefined to treat entities in Labuan International Business and Financial Centre (Labuan IBFC) as residents

² Excludes currency and deposits held by non-residents with resident banking institutions

³ Includes loans sold to Cagamas

⁴ Exclude financial institution transaction

⁵ Refers to the ratio of loans and holdings of PDS by the banking system to deposits of the banking system

⁶ Ringgit was pegged at RM3.80=USD1 on 2 September 1998 and shifted to a managed float against a basket of currencies on 21 July 2005

^p Preliminary

* Refers to average rate for the month of December

Dynamics of Household Income and its Linkages with Private Consumption

Private consumption is increasingly becoming an important driver of growth in the Malaysian economy. This is reflected in its growing share of GDP, as growth in private consumption has outpaced overall GDP growth over the recent decade (Chart 1). Theoretical and empirical findings across countries consistently highlight the importance of income in determining private consumption¹. This article explores the dynamics of household income and its linkages with private consumption for Malaysia. The analysis provides two key findings. First, the services sector plays a large role in driving overall income, while income from commodities is also important especially during periods of large commodity price increases. Second, econometric evidence suggests that income has a strong and positive causal relationship with private consumption. Shocks to income are found to have large and persistent effects on private consumption.

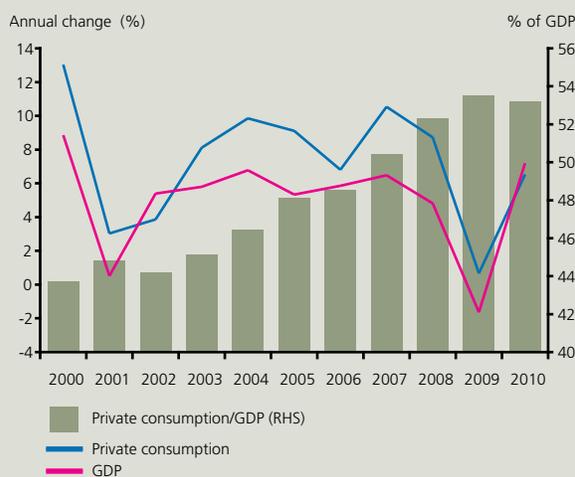
Estimating Household Income from a Bottom-Up Approach

The analysis first involves deriving an estimate of household income that encompasses all sectors of the economy. Existing estimates of household income tend to be constrained by data coverage and periodic frequency. For example, income in the construction and some services sub-sectors are not available on at least a quarterly basis. A commonly-used proxy of income is manufacturing sector wages due to its frequent availability. Wages in the manufacturing sector, however, are an imperfect proxy for overall income within the economy since wages in different sectors tend to be influenced by sector-specific factors. For instance, wages in the construction and services sectors are likely to be influenced more by domestic demand considerations, while manufacturing wages are influenced more by external factors.

To construct a more representative estimate of household income, a quarterly wage series is estimated for each sector where wage statistics are unavailable. This methodology involves estimating the long-run relationship between the wage and labour productivity of the sector, and is premised on the view that wages are primarily a reflection of labour productivity². First, the ratio between wage per worker and value-added per worker of the sector is established using the annual or biannual frequency data from the Department of Statistics Malaysia's survey of companies and the National Accounts. This is done to capture the sectoral variation in the wage-productivity profile. Second, the annual/biannual ratio is interpolated to form a quarterly series. This series is then multiplied by the value-added from the sector to derive quarterly sectoral estimates of gross income. This approach is applied to all sectors except for crude palm oil. This is because wages in the primary commodity sectors are found to be determined more by prices rather than labour productivity due to yield constraints (Chart 2). As such, the price-income relationship that is observed at an annual frequency is utilised to estimate a quarterly series of gross income for the palm oil sector.

Chart 1

Private Consumption and GDP



Source: Department of Statistics, Malaysia

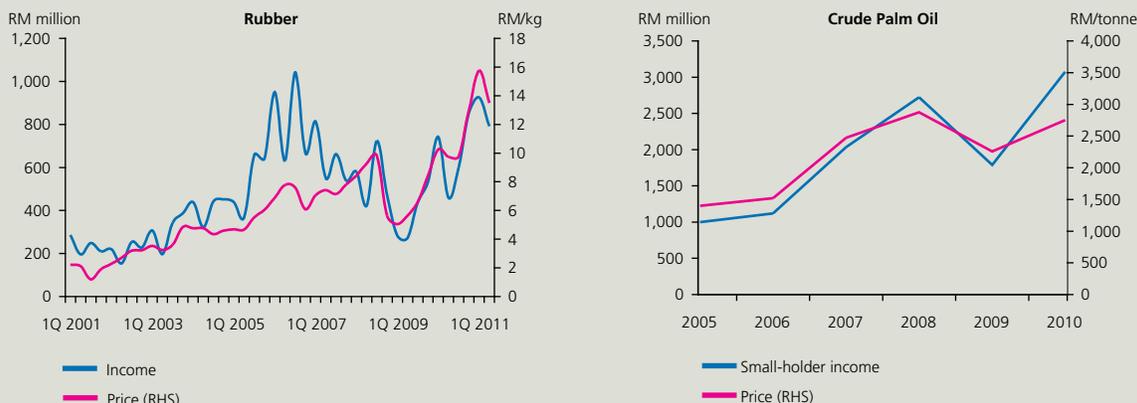
¹ Theoretical examples are Carroll (2001) for a partial equilibrium analysis of the aggregate consumption function and Kydland and Prescott (1980) within a general equilibrium framework. Bacchetta and Gerlach (1997) and Case, Quigley and Shiller (2006) are selected recent papers that empirically find income to have the largest impact on consumption across a sample of countries.

² Wages in certain sectors were found to occasionally deviate from their associated productivity levels, but this deviation was found to be only temporary.

Finally, the observed and estimated income series of all sectors are aggregated to arrive at an estimate of overall household income. An advantage of this approach is that the resulting estimates reflect household income at the overall level from a sectoral perspective.

Chart 2

Price-Income Relationship in the Rubber and Crude Palm Oil Sectors



Source: Department of Statistics, Malaysia and Malaysian Palm Oil Board

The Evolution of Household Income

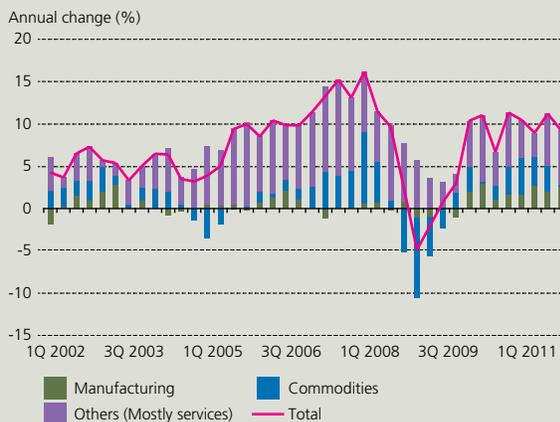
Chart 3 shows nominal income growth and its decomposition across the major sectors from 2002 to 2011. Overall household income grew at an average year-on-year rate of 7.4% per quarter during this period. Household income advanced at a steadily increasing pace from 2005 to 2008, with the highest growth of 16.1% registered in 1Q 2008, the eve of the crisis in the advanced economies.

Two key trends about household income can be observed. First, a large component of overall income growth can be attributed to income from the services sector, with its share of total income growing steadily from 55.7% in 1Q 2001 to 64.6% in 3Q 2011. Chart 3 shows, in particular, that the robust income growth during the 2005-2008 period, as well as its recovery after the crisis in the advanced economies, was attributable to the services sector. This development can be explained by the rise in the share of employment in the services sector to total employment and by higher wage growth in the sector. The share of employment in the services sector rose from 51.1% in 1Q 2001 to 61.5% in 3Q 2011, while wages in major services sub-sectors outpaced overall income growth. For instance, wages in the wholesale and retail, and financial intermediation sub-sectors grew at average rates of 11.1% and 7.7% per quarter respectively, higher than the national average income growth of 7.4%.

The second important finding is that income from the primary commodity sector plays a crucial role in driving the growth of overall income, despite

Chart 3

Nominal Income Growth Across Major Sectors



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

constituting only a relatively small share of total employment. This is because income from commodities is driven significantly by prices, as supply is typically constrained over short- to medium-term horizons. Since commodity prices have been volatile in recent years, income from the sector has also exhibited a similar behaviour. This aspect of income was clearly illustrated during the commodity price cycle from 2008-2009. At the peak of the cycle during the first half of 2008, palm oil prices increased by 64.5% annually, and constituted 48.9% of the 13.8% growth in overall income. Conversely, the subsequent sharp decline in prices, at an average rate of -37%, in the first half of 2009 contributed over 44.1% of the 3.5% decline in overall income.

The Linkages between Household Income and Private Consumption

Chart 4 illustrates the relationship between real private consumption and real household income. Nominal income has been deflated using the implicit consumption deflator to facilitate an appropriate comparison with real private consumption. It is evident that income growth is a coincident and highly correlated indicator of the growth of private consumption, with a correlation coefficient between both series of 0.6. Income growth was also more volatile compared to private consumption, with standard deviations of 4.1 and 3.1, respectively.

The co-movement between the growth in private consumption and income growth has been particularly visible since 2006, where private consumption expanded in tandem with robust income growth from 2006 to 2008. When overall income contracted briefly in 2009, as income from commodities and exports declined along with commodity prices and exports, private consumption moderated as well, although by a smaller magnitude. Private consumption subsequently recovered in the second half of 2009, in tandem with the recovery in income.

A Vector Auto-regression (VAR) was estimated to further investigate the causal link between income and private consumption³. Household credit was also included as a variable to differentiate between the income and credit channels. First, multivariate Granger causality tests were conducted to test if income and credit help to predict future movements in private consumption. The results show that income has a statistically significant positive causal relationship with private consumption. Credit, on the other hand, is not found to have an econometric link with consumption, although the coefficient on the lag of credit shows the expected positive sign. Impulse response analysis was also conducted to estimate the profile of the response of private consumption from shocks to income and household credit (Chart 5). In both cases, their effects on private consumption are positive and statistically significant, especially during the first year after the shock.

These results illustrate the distinct relationships that income and credit have with private consumption. The Granger causality test results indicate that households tend to rely more on their incomes than on credit for their expenditures on consumption goods. Nonetheless, the impulse response analysis demonstrates that credit also has a positive impact on household expenditure.

Chart 4

The Relationship between Real Income and Private Consumption



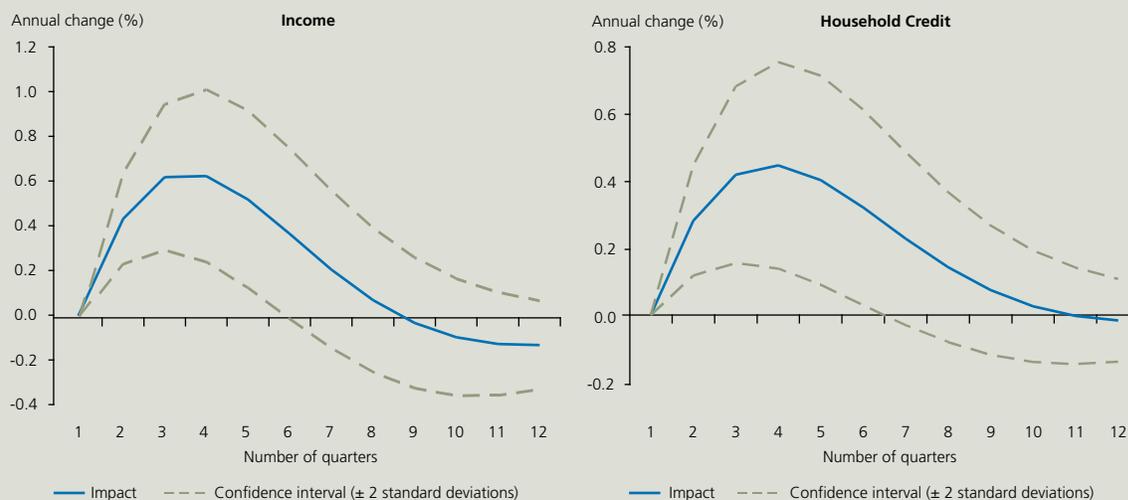
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

³ A one quarter lag was chosen as selected by the Schwartz criterion. The variables were transformed to year-on-year percentage terms. The estimation period ranges from 2002-2011.

These findings suggest that households access credit markets not only to smooth expenditures on durable items, but also to temporarily support expenditures when they experience adverse income shocks. This was observed in 2009. Private consumption continued to register positive growth of 0.7% despite the estimated -1.3% contraction in income. Household credit grew by 9.3% (2008: 9.1%) as a consequence of households using credit to partially compensate for the loss of income during this period.

Chart 5

Responses of Private Consumption to Income and Household Credit Shocks



Source: Bank Negara Malaysia

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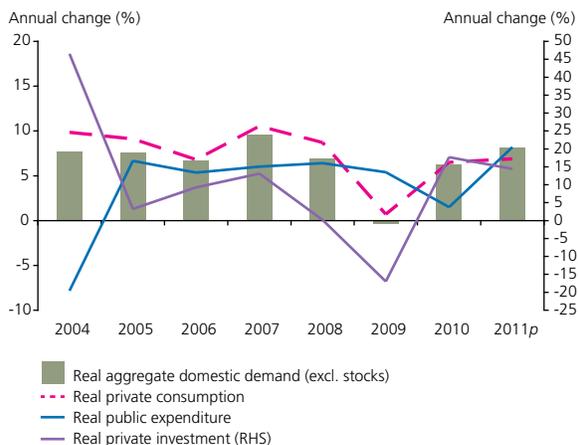
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Chart 1.5

Real Domestic Demand Aggregates



p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

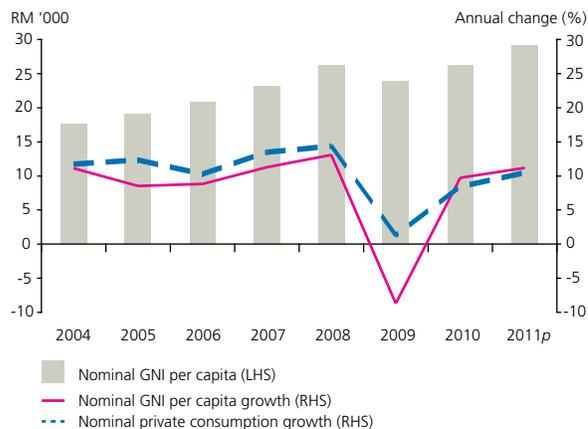
private sector rose by 4.0% in 2011 (2010: 4.5%). Income in the rural areas also experienced strong growth, with rubber and palm oil prices increasing by 27.8% and 19.1% respectively. Feedback from industry engagements indicated that the higher retail spending in the rural areas had led to increased wages and employment within these sectors as well. Consumer spending, particularly on discretionary items, was also supported by sustained consumer confidence, with the MIER Consumer Sentiments Index remaining above the 100-point threshold. The two half-month bonus payments to civil servants during the third and fourth quarters of the year also supported consumer spending.

Domestic demand strengthened, driven mainly by private sector spending and supported by public sector consumption

Financing conditions for households remained supportive of consumer spending, with lending rates remaining low at an average of 5.1% (2010: 5.0%). Loan disbursements for the purchase of passenger cars and for personal consumption expanded by 9% (2010: 12.6%). Overall household indebtedness edged higher to 76.6% of GDP as at

Chart 1.6

GNI per Capita and Private Consumption



p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

end-2011 (end-2010: 75.8%). Despite the higher level of debt, household balance sheets remained sound with the household debt to financial assets ratio remaining at a prudent level of 43.5% (2010: 42.0%).

Private investment expanded robustly by 14.4% in 2011 (2010: 17.7%). Higher capital expenditure was evident across all sectors, particularly in the manufacturing, mining and services sectors, driven by strong domestic demand, and favourable external conditions in the first half of 2011. The implementation of several projects under the Economic Transformation Programme (ETP) had also augmented the strong performance of private investment. Domestic-oriented firms expanded their capacity further, benefiting particularly from the resilience of private consumption expenditure throughout the year. Investment by export-oriented firms was also strong, although it moderated towards year-end due to increased uncertainties on the global economic environment.

The continued expansion in private investment activity was reflected in key investment indicators. Imports of capital goods recorded a strong growth of 9.7% (2010: 12.2%), sales of construction-related materials advanced by 12.1% (2010: 11.2%), while loans disbursed to businesses were higher by 12.5% (2010: 9.8%). However, the strong investment momentum began to moderate slightly towards the second

The Evolution of Capital Stock in Malaysia

Introduction

The capital stock of a country is the total quantity of capital assets available for the production of goods and services. The size and growth of this capital stock have an important bearing on the production capabilities of an economy. Drawing on the newly-published capital stock statistics by the Department of Statistics, Malaysia (DOSM)¹, this article uses Net Capital Stock (NKS)² to analyse the trend in the capital stock in Malaysia as well as the changes in the intensity and productivity of its usage in the recent decades.

Trends in Capital Stock

In this recent four decades, the NKS increased significantly from RM38 billion in 1970 to RM1,008 billion in 2010 based on constant 2000 prices. This trend reflects the large magnitude of capital investment over these four decades. Table 1 provides a snapshot of the NKS in the Malaysian economy by types of economic activity and asset class as at 2010.

Table 1

NKS by Types of Economic Activity and Asset Class in 2010 at Constant 2000 Prices

NKS (RM billion)	Agriculture	Mining	Manufacturing	Construction	Services	Total
Structures	7.1	14.3	65.2	4.2	566.8	657.5
Transport equipment	0.5	0.0	8.1	1.4	40.7	50.6
Machinery and equipment	1.0	27.8	115.9	1.8	49.4	195.9
Other assets	8.6	94.3	0.0	0.0	0.9	103.7
Total	17.2	136.4	189.1	7.4	657.7	1,007.8

Note: "Other assets" includes livestock, capital planting and mineral exploration activity
Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

By type of economic activity (Chart 1), the manufacturing and services sectors together accounted for 84% of total NKS in 2010. The NKS of the manufacturing sector expanded the most since 1970 with an average annual growth of 12.7%. In part, this reflects the significant expansion of the manufacturing sector over this period, particularly between 1980 and 1990. Over the period from the 1970s to the 2000s, policies such as the Export-Oriented Industrialisation (EOI) and the First Industrial Master Plan (1986-1995), and provision of incentives through legislations such as the Promotion of Investment Act (1986), served to intensify the promotion of investment in the manufacturing sector. The rapid development of the country's manufacturing sector further supported the expansion of capital assets in the form of machinery and equipment (Chart 2). Investment in this type of capital asset was deemed essential to enhance technology adoption and improve the productive capacity of businesses in the manufacturing sector.

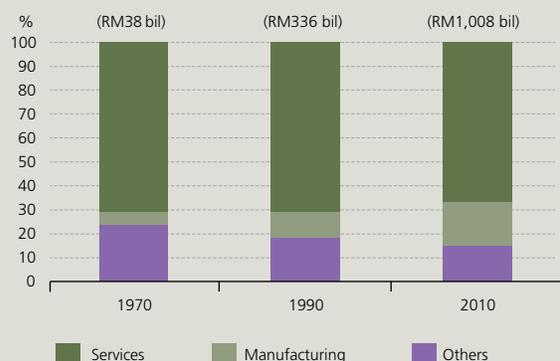
Investment in the services sector also expanded over the years, as reflected in the sector's share of total NKS that was consistently above 60% (Chart 1). This was supported by the strengthening of domestic expenditure, particularly in domestic-oriented services sub-sectors such as the wholesale and retail trade, accommodation and restaurant; and finance, insurance, real estate and business services. Furthermore, the industrialisation of the manufacturing sector naturally spurred the growth of investment in manufacturing-related services such as ICT-network-virtual manufacturing, R&D, quality and standards certification, packaging, transportation and export services.

¹ Technical details of the estimation of Malaysia's capital stock are available in the *National Accounts: Capital Stock Statistics* (1955-2006 and 2000-2010) publication by DOSM.

² NKS refers to the current market value of an economy's capital assets that are still in operation, taking into account the depreciation in their value.

Chart 1

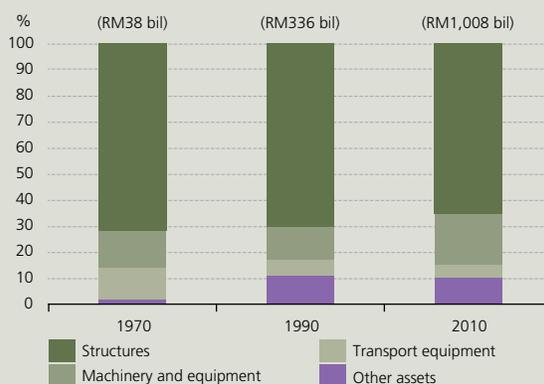
Share of NKS by Type of Economic Activity (2000=100)



Note: "Others" comprises of the agriculture, mining and construction sectors
Source: Department of Statistics, Malaysia

Chart 2

Share of NKS by Type of Asset Class (2000=100)



Note: "Other assets" includes livestock, capital planting and mineral exploration activity
Source: Department of Statistics, Malaysia

Capital assets in structures (Chart 2), on the other hand, comprised 69% of total NKS on average and have remained as the largest capital asset class, particularly in sectors related to transport, storage, and communications; finance, real estate and businesses; and government services. The increase in structure-related capital stock reflects capital spending on residential and commercial office buildings, industrial plants and factories, and physical infrastructure. The fast pace of urbanisation and the development of new growth centres during the period stretching from the 1970s to the 2000s further augmented investments in this type of capital asset.

Preliminary Analysis on Capital Intensity and Productivity

Between the 1980s and the 2000s, the economy became more capital-intensive across most economic sectors, as reflected by the rising proportion of capital assets to the number of workers employed³ (Table 2).

The mining and quarrying sector has been the most capital-intensive, followed by the services and the manufacturing sectors. The accumulation of capital assets in the mining sector was mainly for mineral exploration activity, in line with the development of the oil and gas industry in the country. Capital intensity in the services sector almost doubled, as the liberalisation and modernisation policies that were undertaken to promote services as a new area of growth in the 2000s played a supporting role in attracting higher investment activity. Capital intensity in the manufacturing sector also improved considerably, aligned to the process of industrialisation and the initiatives taken to move the economy to higher value-added manufacturing activities.

During the same period, overall productivity of capital, as measured by the incremental capital-output ratio (ICOR)⁴, has also improved. Further research, however, is needed to analyse the trends of capital productivity from a more holistic perspective by examining the efficiencies of both the human capital and the physical capital (i.e. total factor productivity).

³ Capital intensity is estimated as the ratio of the net capital stock to total employment (total number of employed persons) in the country.

⁴ ICOR is estimated as a ratio of the annual change in net capital stock to the annual change in Gross Domestic Product (GDP) during the same period.

Table 2

Capital Intensity and Productivity

Period	1981-1990	2001-2010
Capital Intensity (RM/employed person)	RM42,788	RM86,899
<i>Agriculture</i>	RM8,028	RM12,573
<i>Mining</i>	RM754,983	RM2,273,546
<i>Manufacturing</i>	RM25,205	RM78,317
<i>Construction</i>	RM16,914	RM8,900
<i>Services</i>	RM64,402	RM105,893
Capital Productivity (ICOR)*	2.6	1.2

* A lower ICOR indicates better productivity as less capital is needed to produce similar amount of output
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Conclusion

The net capital stock of the Malaysian economy has grown significantly in this recent four decades. In terms of sectors, most of the capital assets were accounted for by the manufacturing and services sectors. Building structures and machinery and equipment were the most common type of capital stock. Preliminary analyses on the capital stock data suggest that the economy has also become more capital-intensive and, more importantly, overall capital productivity has improved over the years.

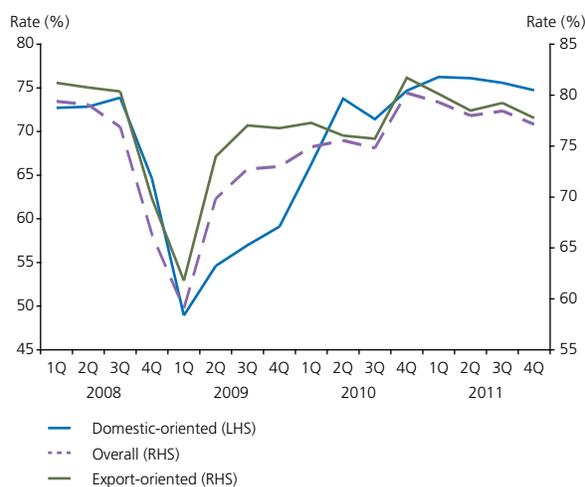
Going forward, as the economy undergoes a transformation towards a high value-added, high income economy, improving the quality of the capital stock and the efficiency of its utilisation would be critical success factors. Indeed, enhancement in capital efficiency and productivity is a critical element in ensuring the new investment projects driven by the Economic Transformation Programme (ETP) boost economic growth and achieve Malaysia's aspiration to become a high value-added, high income economy.

half of the year, especially in the manufacturing sector given the worsening global environment. This was reflected in imports of machinery for manufacturing which recorded a lower growth of 0.7% in the second half of the year compared to a growth of 7.4% in the first half-year. Growth in sales of commercial vehicles also moderated to 2.7% in the second half-year from 8% in the first half-year (2010: 21.8%). This was also reflected in investor sentiments, which deteriorated towards the end of the year. The MIER Business Conditions Index (BCI), which remained above the 100-point confidence threshold in the first three quarters of 2011, dipped to 96.6 points in the fourth quarter, with businesses citing significantly lower sales and new orders.

In the manufacturing sector, higher capital expenditure was incurred for capacity expansion by both the domestic- and export-oriented firms. Nevertheless, investment growth for the manufacturing sector moderated in the second half of the year, especially for export-oriented firms. This was reflected in the lower levels of capacity utilisation observed at end-2011 (77%; end-2010: 80%), leading firms to scale back and delay new capacity expansion. Capital spending in the manufacturing sector, however, was supported by the continued implementation of approved manufacturing projects, investment in new growth areas, namely renewable energy, advanced E&E and medical equipment industries, and product diversification.

Chart 1.7

Capacity Utilisation in the Manufacturing Sector



Source: Bank Negara Malaysia

Investment activity in the services sector registered robust growth, particularly among the domestic-oriented sub-sectors such as communication and wholesale and retail trade, due to continued high consumer spending. Capital spending in the communication sub-sector was focused on the upgrading of mobile broadband infrastructure and the expansion of network coverage. Higher capital expenditure was also observed for the expansion of outlets in the distributive trade and restaurants sub-sectors and for fleet expansion in the air transportation sub-sector.

In the mining sector, capital spending was higher mainly for exploration and development activity in the oil and gas sector, as energy prices remained elevated. Furthermore, tax incentives for deepwater and marginal oil field development provided additional support for higher capital expenditure in these fields.

Progress in the implementation of selected ETP projects especially in the wholesale and retail trade, hotel and accommodation, and oil and gas-related sectors, also augmented the strong growth in overall investment activity.

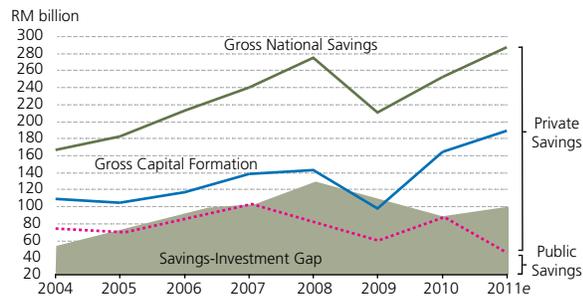
Public consumption expanded by 16.8% in 2011 (2010: 0.5%), following higher public expenditure on emoluments, supplies and services, and the one month bonus payment during the year. The expansion in expenditure on supplies and services reflected the continued efforts by the Government to improve the public delivery services.

Public investment contracted by 2.4% in 2011 (2010: 2.8%) following the lapse of the second stimulus package in 2010 and slower implementation of new projects under the 10th Malaysia Plan. Meanwhile, capital spending by the NFPEs remained strong, providing support to overall public investment.

The Government's development expenditure in the economic sector was focused on improving transportation infrastructure and public amenities in urban and rural areas, and enhancing the competitiveness of small and medium enterprises (SMEs). Capital spending in the social services sector was aimed at improving the infrastructure and facilities for higher education and skills training as well as increasing the provision of healthcare capacity of the nation.

Chart 1.8

Gross National Savings and Savings-Investment Gap



e Estimate

Source: Department of Statistics, Malaysia
Ministry of Finance, Malaysia
Bank Negara Malaysia

As for the NFPEs, the increase in capital spending was mainly in the mining, transportation, utilities and communication sectors. Investment in the mining sector reflected mainly the exploration and development of oil and gas fields, while the expansion of road, rail and air infrastructure was the main area of investment in the transportation sector. Capital spending in the utilities and communication sectors was focused on expanding Malaysia's power-generation capacity and extending the coverage of High-Speed Broadband (HSBB) services respectively.

Private sector savings increased to RM242.1 billion or 29.1% of gross national income (GNI) in 2011 (2010: 22.2%), broadly reflecting the sound financial position of the household and corporate sector. Banking sector deposits held by individuals and businesses rose to RM943.9 billion in 2011 (2010: RM821.8 billion). However, public sector savings declined to RM45 billion or 5.4% of GNI (2010: 11.9%), due to the lower operating surpluses of the NFPEs during the year. Overall, the **gross national savings (GNS)** increased by 13.9% to RM287.1 billion, which in turn led to a larger savings-investment surplus of RM97.9 billion or 11.8% of GNI in 2011. This surplus of savings enabled Malaysia to finance its long-term investment outlays primarily from domestic sources.

SECTORAL REVIEW

From the supply side, overall growth in 2011 was sustained by firm activity in the domestic-oriented sectors. The services sector remained the key contributor to growth amid robust domestic demand throughout the year. In the

Table 1.2

Real GDP by Sector (2000=100)

	2010	2011 ^p
	Annual change (%)	
Agriculture	2.1	5.6
Mining & quarrying	0.2	-5.7
Manufacturing	11.4	4.5
Construction	5.1	3.5
Services	6.8	6.8
Real Gross Domestic Product (GDP)	7.2	5.1

^p Preliminary

Source: Department of Statistics, Malaysia
Bank Negara Malaysia

manufacturing sector, growth in the domestic-oriented industries outweighed the weaker performance in the export-oriented industries amid the softening of external demand. Manufacturing production was also adversely affected by supply disruptions following the natural disasters in Japan and Thailand. Firm regional demand continued to provide

Table 1.3

Services Sector Performance at Constant 2000 prices

	2010	2011 ^p	2010	2011 ^p
	Annual change (%)		Share to GDP (%)	
Services	6.8	6.8	57.7	58.6
Intermediate services	7.2	6.2	25.2	25.5
Finance and insurance	6.4	5.9	11.7	11.8
Real estate and business services	7.8	6.3	5.5	5.5
Transport and storage	6.9	5.3	3.8	3.8
Communication	8.5	7.6	4.2	4.3
Final services	6.5	7.3	32.4	33.1
Wholesale and retail trade	8.0	7.6	13.6	13.9
Accommodation and restaurant	5.0	5.2	2.4	2.4
Utilities	8.2	3.0	3.0	3.0
Government services	5.8	11.6	7.5	8.0
Other services	4.0	4.1	5.9	5.8

^p Preliminary

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

support to the resource-based manufacturing industries despite commodity prices remaining elevated. Nevertheless, the mining sector was adversely affected by the shutdown of several production facilities, while growth in the construction sector moderated following the completion of several major projects.

The **services sector** recorded strong growth of 6.8% in 2011 (2010: 6.8%), amid firm domestic demand. The sector remained the largest contributor to growth, accounting for 3.9 percentage points of overall GDP growth.

The **wholesale and retail trade sub-sector** benefited from the robust growth in private consumption. The retail segment registered strong performance, buoyed by positive consumer spending throughout the year. However, the motor vehicle distributive trade segment was affected by the supply chain disruptions following the Fukushima disaster, especially during the second quarter of the year. The resilience in private consumption also provided support to the sustained growth in the **accommodation and restaurant sub-sector**. This more than offset the slower tourist-related activity in the sub-sector due to slower tourist arrivals amid global economic uncertainties.

The services sector continued to be a major driver of growth

In the **communication sub-sector**, growth was led mainly by the continued expansion in the broadband segment. The broadband penetration rate rose to 62.3% of households as at end-2011 (end-2010: 55.6%), as a result of wider and improved broadband network coverage by key industry players. Initiatives to boost broadband connectivity, including the provision of broadband facilities in rural areas, had also contributed to the higher broadband penetration rate.

The **finance and insurance sub-sector** grew by 5.9% (2010: 6.4%), following strong performance in bank lending and increased collection of insurance premiums. Total loans outstanding in the banking system were higher by 13.6% in 2011 (2010: 12.7%), reflecting strong demand for financing by both households and businesses.

Table 1.4

Selected Indicators for the Services Sector

	2010	2011 ^p
	Annual change (%)	
Utilities		
Electricity production index	8.8	2.0
Wholesale & Retail Trade and Accommodation & Restaurant		
Consumption credit disbursed	13.7	7.1
Tourist arrivals	4.4	0.1
Total sales of motor vehicles	12.8	-0.9
Finance & Insurance and Real Estate & Business Services		
Loans outstanding in the banking system	12.7	13.6
Insurance premiums	11.4	3.2
Bursa Malaysia turnover (volume)	2.1	29.9
Transport & Storage and Communication		
Total container handled at Port Klang and PTP (TEUs)	15.6	11.3
Airport passenger traffic	12.2	10.6
Air cargo handled	14.2	-2.1
SMS traffic	8.3	-3.8
%		
Penetration rate:		
- Broadband ¹	55.6	62.3
- Cellular phone ²	119.2	127.7
- Fixed line ¹	42.5	37.3

¹ of household

² of population

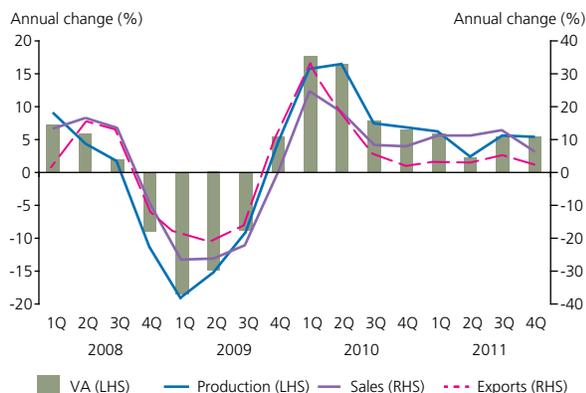
^p Preliminary

Source: Department of Statistics, Malaysia; Malaysia Tourism Promotion Board; Malaysian Automotive Association; Bursa Malaysia Berhad; Port Klang Authority; Pelabuhan Tanjung Pelepas Sdn Bhd; Malaysia Airports Holdings Berhad; Senai Airport Terminal Services Sdn Bhd; Malaysian Communications and Multimedia Commission; and Bank Negara Malaysia.

The **real estate and business services sub-sector** recorded strong growth in the first half of the year, but moderated towards the year-end as increased uncertainties in the global financial markets adversely affected the capital market-related business services segment. In line with the moderation in trade- and manufacturing-related activity, the **transport and storage**, and **utilities sub-sectors** recorded a more modest expansion. Demand for cargo-related transport services and electricity production was lower amid the weakness in external demand.

Chart 1.9

Manufacturing Sector: Value-added, Production, Sales and Exports



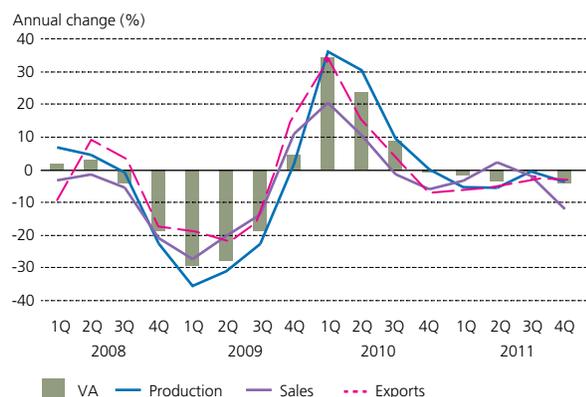
Source: Department of Statistics, Malaysia

Overall, the **manufacturing sector** continued to expand, albeit at a more moderate pace (2011: 4.5%; 2010: 11.4%), as growth in the domestic-oriented industries outweighed weakness in the export-oriented industries. Subdued external demand, particularly from the advanced economies, had weighed down the performance of the export-oriented industries. Supply disruptions were also contributing factors to the under-performance of the sector. Nevertheless, domestic-oriented industries remained resilient, supported by favourable domestic demand conditions.

During the course of 2011, the export-oriented industries expanded at a slower pace of 3.4% (2010: 9.7%), as contraction in the **electronics**

Chart 1.10

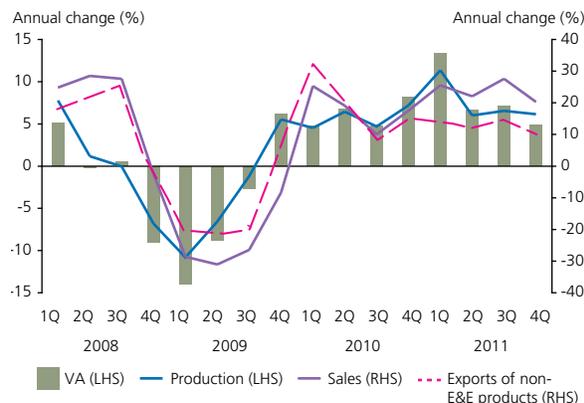
E&E Cluster: Value-added, Production, Sales and Exports



Source: Department of Statistics, Malaysia

Chart 1.11

Primary-related Cluster: Value-added, Production, Sales and Exports



Source: Department of Statistics, Malaysia

and electrical products (E&E) cluster offset growth in the primary-related cluster. E&E output growth weakened in 2011, affected by the weakness in external demand and disruptions in the global E&E supply chain.

More moderate growth in the manufacturing sector

Nevertheless, firm regional demand for the output of the **primary-related cluster** continued to support growth of the export-oriented industries, driven mainly by the refined petroleum

Chart 1.12

Consumer-related Cluster: Value-added, Production and Sales



Source: Department of Statistics, Malaysia

Chart 1.13

Construction-related Cluster: Value-added, Production and Sales



Source: Department of Statistics, Malaysia

Table 1.5

Performance of the Manufacturing Sector

	2010	2011
	Annual change (%)	
Value-added (RM million at 2000 prices)	11.4	4.5
Overall Manufacturing Production¹	11.1	4.7
Export-oriented industries	9.7	3.4
Electronics & electrical products cluster	17.4	-3.6
<i>of which:</i>		
Electronics	3.1	-11.7
Electrical products	47.8	8.4
Primary-related cluster	5.7	7.4
<i>of which:</i>		
Chemicals and chemical products	11.5	8.8
Petroleum products	-2.4	6.2
Rubber products	20.8	13.9
Off-estate processing	-2.3	8.7
Domestic-oriented industries	15.6	8.9
Consumer-related cluster	13.4	2.6
<i>of which:</i>		
Transport equipment	29.7	-1.0
Food, beverage & tobacco products	8.8	5.9
Construction-related cluster	18.9	17.6
<i>of which:</i>		
Construction-related products	21.9	13.0
Fabricated metal products	15.0	23.8
Exports	12.6	3.4

¹ Production data are based on the new Industrial Production Index (2005=100)

Source: Department of Statistics, Malaysia

product, and chemicals and chemical-related product industries.

The domestic-oriented industries continued to register firm growth in 2011, supported mainly by the strong performance of the **construction-related cluster**. The robust performance of this cluster was underpinned by firm domestic construction activity, which benefited both the fabricated metal and non-metallic mineral product industries. However, growth in the **consumer-related cluster** moderated sharply as the contraction in the production of transport equipment, which was adversely affected by supply chain disruptions in the second quarter of the year, outweighed the expansion of the food, beverage and tobacco industry during the year.

The agriculture, forestry and fishing (**agriculture**) sector expanded at a stronger pace of 5.6% in 2011, supported by a recovery in the production of crude palm oil. The production of **crude palm oil** (CPO) increased

Table 1.6

Agriculture Sector: Value-Added and Production

	2010	2011p
	Annual change (%)	
Value-added	2.1	5.6
Industrial crops	-2.3	5.3
<i>Production of which:</i>		
Crude palm oil	-3.3	11.3
Rubber	9.6	6.1
Saw logs	-2.9	-7.7
Cocoa beans	-13.8	-70.6
Food crops	7.4	5.8
<i>Production of which:</i>		
Fish	2.7	1.3
Livestock ¹	2.4	4.4
Vegetables	-17.6	10.5
Fruits	8.3	2.8

¹ Refers to Peninsular Malaysia only
p PreliminarySource: Department of Statistics, Malaysia
Malaysian Palm Oil Board
Malaysian Rubber Board
Forestry Departments (Peninsular Malaysia, Sabah and Sarawak)
Malaysian Cocoa Board
Department of Fisheries, Malaysia
Department of Veterinary Services, Malaysia
Department of Agriculture, Malaysia

by 11.3% to 18.9 million tonnes, supported by factors such as favourable weather conditions and firm prices. Output of other key crops such as rubber and food crops remained firm, driven by strong regional and domestic demand. The agriculture sector benefited from favourable demand and supply conditions.

Stronger growth in the agriculture sector due mainly to higher production of crude palm oil

The average price of SMR 20 rubber strengthened to RM13.67 per kg (2010: RM10.70 per kg). Similarly, the CPO price rose to an average of RM3,279 per tonne (2010: RM2,752 per tonne). Apart from the brief period of adverse weather which led to flooding in key production areas, overall weather conditions were conducive for higher yields of industrial crops during the year.

Value-added of the **mining sector** contracted by 5.7% in 2011, reflecting the decline in the production of crude oil and condensates. This decline was caused by shutdowns of several production facilities for maintenance purposes, declining production from mature fields and lower-than-expected production from new fields. Despite higher demand from Japan following the natural disaster in March, output of natural gas rose only marginally by 0.4%, as production

Table 1.7

Mining Sector: Value-Added and Production

	2011	2011 ^p
	Annual change (%)	
Value-added	0.2	-5.7
Production		
<i>of which:</i>		
Crude oil and condensates	-3.1	-10.2
Natural gas	2.1	0.4

^p Preliminary

Source: PETRONAS
Department of Statistics, Malaysia

was affected by the shutdown of gas processing facilities in Peninsular Malaysia.

Output in the mining sector contracted following a decline in the production of crude oil and condensates

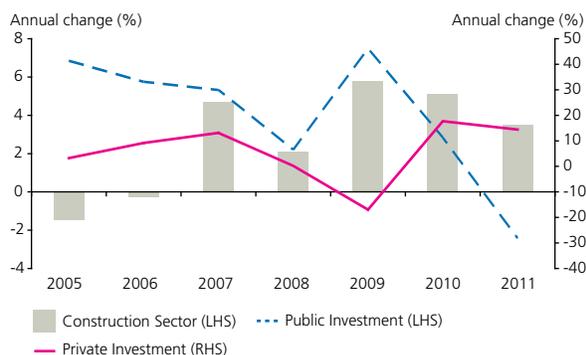
The **construction sector** expanded at a moderate rate of 3.5% in 2011 (2010: 5.1%), following slower activity in the civil engineering and non-residential sub-sectors. The civil engineering and special trade sub-sector registered a slower growth, especially in the second quarter, following the completion of major highway projects, and maintenance and upgrading work under the second stimulus package.

Moderate growth in the construction sector

The residential sub-sector registered an improved performance with a turnaround in growth. Construction of residential properties, particularly in the high-end segment, picked up significantly following a recovery in building approvals in 2010. The combination of robust demand, lower overhang, and higher land and building materials costs resulted in higher house prices in 2011. The average national house price rose at a faster pace of 8.6% in the first

Chart 1.14

Value-added Growth in Construction Sector versus Growth in Public and Private Investment



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table 1.8

Indicators of the Construction Sector

	2010	2011 ^p
	Annual change (%)	
Construction sector value-added	5.1	3.5
Total property transactions		
Value	32.5	27.9
Volume	11.4	14.1
Loans for purchase of residential property		
Loan approvals	19.5	12.8
Loan outstanding	13.2	13.2
Loans for construction sector		
Loan approvals	53.6	25.7
Loan outstanding	4.7	3.8
Housing approvals	23.6	32.2
New sales & advertising permits	16.0	16.1
Imports of construction-related materials	27.5	14.0
Production of construction-related materials	18.9	18.2
Malaysian House Price Index	6.7	8.6 ¹

¹ Jan-Sept 2011^p Preliminary

Source: Bank Negara Malaysia, Department of Statistics of Malaysia, Ministry of Housing and Local Government and National Property Information Centre (NAPIC).

three quarters of the year (2010: 6.7%), significantly above the average growth rate of 3.7% between 2000 and 2010.

In the non-residential sub-sector, growth moderated after posting a strong double-digit growth in the previous year. Concerns over the oversupply of office space, particularly in the Klang Valley, affected the sub-sector's performance in the second half of the year.

EXTERNAL SECTOR

Balance of Payments

Malaysia's external sector strengthened in 2011

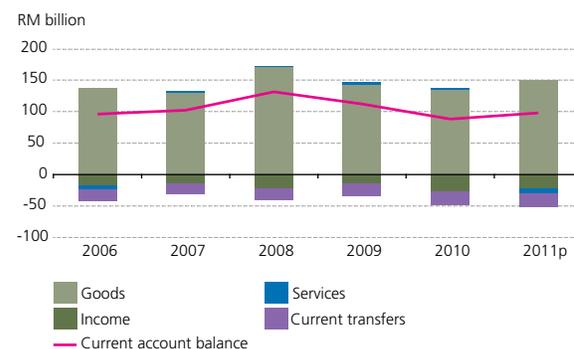
Despite the challenging external environment, Malaysia's external position strengthened further

in 2011. The overall balance of payments turned around to register a strong surplus position, with the current account recording another large surplus while the financial account reversed to register a net inflow position. The current account surplus was supported by a larger trade surplus, attributed mainly to strong exports of commodities following higher commodity prices, and lower net income outflows. The turnaround in the financial account was largely due to the continued inflows of portfolio funds and foreign direct investment (FDI), amid the firm domestic economic prospects. Higher outflows of direct investment abroad reflected continued efforts by Malaysian companies to further expand businesses abroad. Other investment outflows, which primarily comprise private sector flows, moderated significantly during the year.

During the year, errors and omissions (E&O) excluding the cumulative foreign exchange revaluation gain amounted to an outflow of RM26.1 billion. This represented 2.1% of Malaysia's total trade, well within the internationally-accepted norm of 5% of total trade. Being one of the most open economies with relatively significant amount of cross-border trade and financial flows, statistical errors and unrecorded transactions are inevitable in the course of recording these information. In view of the magnitude of these flows, the authorities have undertaken various measures to improve the recording of such transactions. On 1 December 2011, the Money Services Business Act 2011 was enacted to strengthen the regulation and supervision of the money services business industry, which comprises the money changing, remittance and wholesale currency businesses. In order to improve efforts to gather intelligence and evidence on cross-border transactions, international collaboration and information sharing with foreign law enforcement agencies have also been intensified.

Chart 1.15

Current Account

^p Preliminary

Source: Department of Statistics, Malaysia

The Changing Structure of Malaysia's Exports

INTRODUCTION

Malaysia's export sector has evolved significantly over the five recent decades. In line with the nation's economic industrialisation, the composition of exports had gradually shifted from comprising mainly of agricultural and mining products in the 1960s to manufactured goods in the 1980s. The development and growth of the manufacturing sector was so rapid that by the late 1990s, the sector accounted for more than 80% of total exports. Today, manufactured goods remain the largest component of total exports (Chart 1).

Since 2000, two notable trends have emerged in Malaysia's export structure. First, the gradual move away from a heavy concentration in electrical and electronics (E&E) exports, towards non-E&E manufactured products and commodities. The second key trend is the diversification of Malaysia's export markets. This box article examines Malaysia's changing export structure since 2000, identifies the reasons underpinning this trend and broadly outlines key challenges facing the export sector going forward.

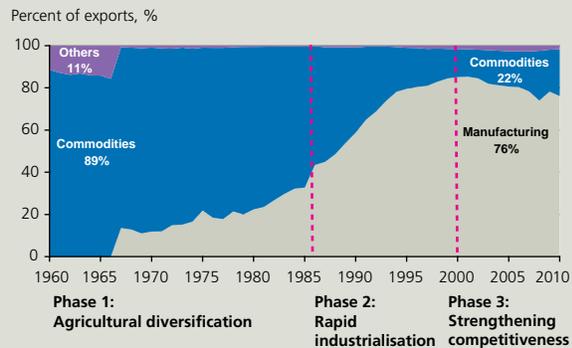
CHANGING STRUCTURE OF MALAYSIA'S EXPORT SECTOR SINCE 2000

Greater diversification in the composition of export products

While E&E products continue to account for a significant proportion of Malaysia's total exports (42.4% in 2010), this most recent decade has seen a steady rise in the share of non-E&E manufactured exports from 23.4% to 33.8%. During the same period, the share of commodities in total exports has also increased, from 13.3% to 22.2% (Chart 2).

Chart 1

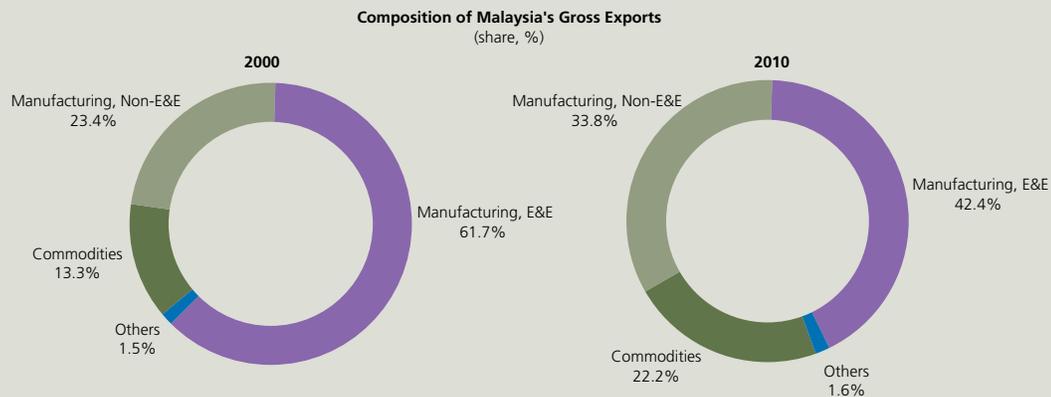
Malaysia has evolved from being a major commodities exporter to being primarily an exporter of manufactured goods



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 2

The share of non-E&E manufactures and commodities have been increasing over this recent decade



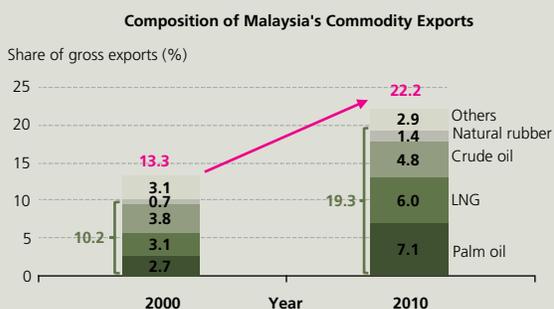
Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

This compositional shift in exports reflects several factors. First is the **rising world demand for raw materials**. Given the country's wealth of natural resources in areas such as agriculture and mining, Malaysia is well positioned to benefit from the growing global demand for raw materials, particularly from the fast growing economies of Asia. This has contributed to the rising share of Malaysia's commodity exports over this recent decade, with four major commodities – palm oil, liquefied natural gas (LNG), crude oil and natural rubber – accounting for most of the increase in the share of commodities in gross exports during the period (Chart 3).

Chart 3

Increased share of commodities in Malaysia's gross exports driven mainly by four major commodities



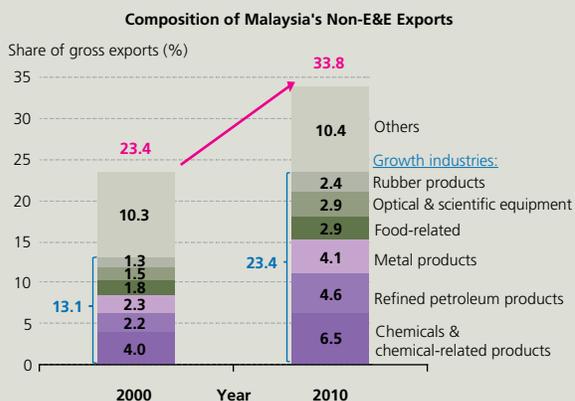
Note: Numbers may not necessarily add up due to rounding
 Source: Department of Statistics, Malaysia and Bank Negara Malaysia

The second factor contributing to the compositional shift in exports is the greater focus on **higher value-added downstream manufacturing activities**. This is reflected in the increasingly capital-intensive investment pattern in the manufacturing sector, with capital investment per employee in approved manufacturing projects rising from RM381,450 in 2000 to RM557,894 in 2011. Supported by the domestic availability of raw materials and continued efforts to move the non-E&E sector up the value chain, Malaysia has, during this recent decade, emerged as a major exporter in key non-E&E industries such as chemicals and chemical-related products, refined petroleum products and rubber products. Growth experienced in these industries has been so rapid that it has contributed to most of the increase in the share

of non-E&E manufactured products in Malaysia's gross exports (Chart 4). The increasing importance of the non-E&E sector is also reflected in the changing investment patterns within Malaysia's manufacturing sector. Relative to the E&E sector, foreign direct investment in the non-E&E sector has also become more important over the years (Chart 5).

Chart 4

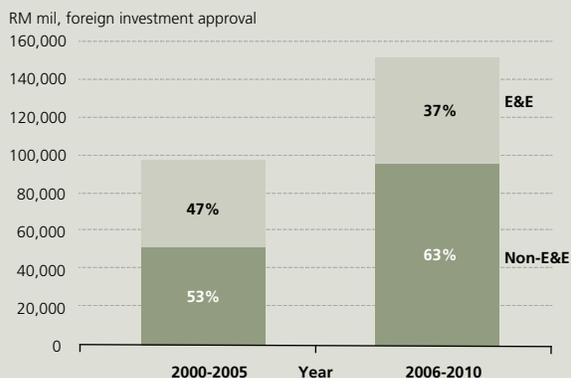
Increased share of non-E&E in Malaysia's gross exports driven mainly by six growth industries



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 5

The share of non-E&E in total foreign investment approved has been increasing over this recent decade



Source: Malaysian Investment Development Authority

Chart 6

Fast growing E&E segments providing support to Malaysia's E&E export performance



Source: World Trade Atlas, UN Comtrade, Bank Negara Malaysia calculations

The compositional shift in exports also reflects the **reduced reliance on E&E products** due to the changing trend away from personal computers to newer mobile electronic devices such as tablets and smart phones – new growth segments in which Malaysia is not heavily involved in. The E&E sector, however, continues to be an important contributor to Malaysia's export growth, with strong performance in segments such as hard disk drives and consumer electrical products such as televisions (Chart 6). The E&E sector's performance is also further supported by its ability to continually evolve into new areas of comparative advantage such as the solar and light-emitting diode (LED) industries.

Greater diversification in the destination of Malaysia's export markets

Another key emerging trend is the **greater diversification in the destination of Malaysia's exports**. While the share of Malaysia's exports to traditional markets such as the US, Japan and the European Union (EU) remains high, demand from the regional economies, particularly East Asia, has risen substantially since 2000 (Chart 7). ASEAN¹ remains a key export market, accounting for about 25% of Malaysia's total exports. Of significance is also the deepening of trade linkages with other Asian economies, particularly the PR China and India. The share of Malaysia's exports to PR China has quadrupled from 3.1% in 2000 to 12.5% in 2010. There has also been an accompanying rise in Malaysia's imports from PR China, thus resulting in PR China as Malaysia's largest trading partner. The rise in bilateral trade relations with PR China has made Malaysia the largest trading partner in South East Asia of PR China. Beyond Asia, Malaysia has also experienced growth in trade with Australia and New Zealand, as well as new markets such as those in the Middle East and Latin America.

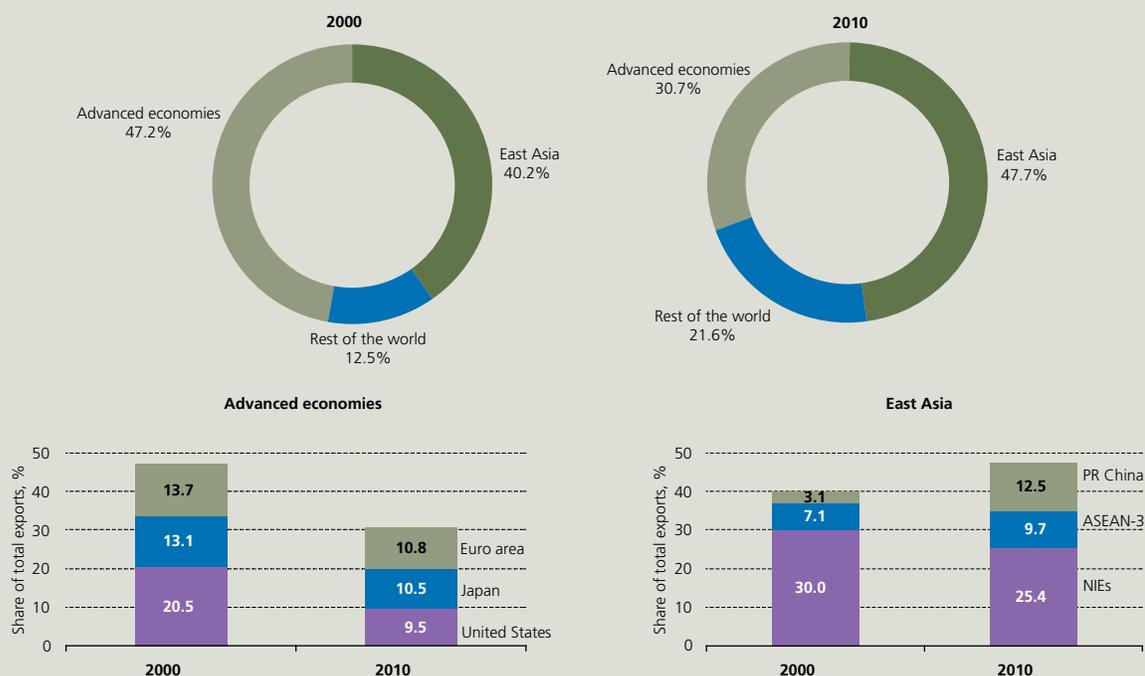
The changing structure of Malaysia's exports over the past decade can also be seen in the context of the **concurrent rise of the emerging economies**. It is projected that the emerging economies will grow twice as fast as the advanced economies and account for more than half of all global growth by 2025². In parallel with this development, a new global middle class is emerging in these countries, resulting in changes in the pattern of global consumption with the growing significance of consumption expenditure in emerging economies. This shift in global consumers is also transforming

¹ ASEAN refers to Singapore, Thailand, Indonesia, Vietnam, Philippines, Brunei Darussalam, Myanmar, Cambodia and Laos.

² World Bank 2011, *Global Development Horizons 2011: Multipolarity: The new global economy*, Washington DC.

Chart 7

East Asia has become an increasingly important export destination for Malaysia



* ASEAN-3 refers to Thailand, Indonesia and Philippines
 * NIEs refer to Singapore, Hong Kong SAR, Chinese Taipei and Korea

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

the patterns of global trade, with trade not only flowing from the advanced economies into emerging economies, but also increasingly among emerging economies. In response to these developments, the product composition and destination of Malaysia’s exports has also been shifting, with a greater focus on the emerging economies. These changes reduce the nation’s vulnerability as exports become less dependent on any specific product or economy.

KEY CHALLENGES AHEAD

While Malaysia has made notable progress in diversifying its export composition and markets over this recent decade, two key challenges remain in the continuing efforts to ensure sustained export performance going forward. Firstly, in the immediate future, with increased uncertainty on the global growth outlook, export demand, particularly from the advanced economies, is expected to be less buoyant. The risk of slower external demand could affect the overall performance of the Malaysian export sector, particularly in industries that are more dependent on the advanced economies, for example, the E&E sector. Secondly, the rise of several large emerging economies, particularly in Asia, will intensify competition in global markets for manufactures, particularly in the export of low-cost, labour-intensive manufactured products. This trend is expected to challenge the competitiveness of the Malaysian export sector, thus intensifying the need for firms in Malaysia to move up to higher value-added activities.

Table 1.9

Balance of Payments

Item	2010			2011 ^p		
	+	-	Net	+	-	Net
	RM billion					
Goods	640.0	505.3	134.7	696.1	546.7	149.4
<i>Trade account</i>	638.8	528.8	110.0	694.5	574.2	120.3
Services	105.3	103.6	1.7	107.1	115.5	-8.4
Balance on goods and services	745.3	608.9	136.4	803.2	662.2	141.0
Income	38.3	64.8	-26.5	52.0	74.1	-22.0
Current transfers	1.9	23.7	-21.8	4.7	25.8	-21.1
Balance on current account	785.5	697.4	88.1	859.9	762.0	97.9
% of GNI			11.9			11.8
Capital account			-0.2			-0.2
Financial account			-19.8			15.5
Direct investment			-13.6			-12.4
Portfolio investment			48.5			30.3
Financial derivatives			-0.7			-0.1
Other investment			-54.0			-2.4
Balance on capital and financial accounts			-20.0			15.3
Errors and omissions			-70.7			-18.5
<i>of which:</i>						
Foreign exchange revaluation gain (+) or loss (-)			-32.6			7.6
Overall balance			-2.6			94.7
Bank Negara Malaysia international reserves, net			328.6			423.3
USD billion equivalent			106.5			133.6

^p Preliminary

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

After adjusting for the E&O, the overall balance of payments recorded a large surplus position of RM94.7 billion. Consequently, the net international reserves of Bank Negara Malaysia amounted to RM423.3 billion, equivalent to USD133.6 billion, as at 31 December 2011. As at 29 February 2012, the reserves remained high at RM426.7 billion (equivalent to USD134.7 billion). This level of reserves is adequate to finance 9.4 months of retained imports and is 4.1 times of the short-term external debt. Malaysia's external reserves remain usable and unencumbered.

CURRENT ACCOUNT

The current account surplus widened to RM97.9 billion or 11.8% of GNI in 2011 (2010: RM88.1 billion or 11.9% of GNI), reflecting a higher trade surplus from the sustained expansion in exports of commodities and non-electronic and electrical (E&E) manufactured products. The larger surplus in the

Table 1.10

External Trade Performance

	2010	2011 ^p
	Annual change (%)	
Gross exports	15.6	8.7
Manufactures	12.6	3.4
Electronics and electrical (E&E)	8.9	-4.1
Non-E&E	17.7	12.8
Commodities	28.8	26.4
Agriculture	28.8	32.9
Minerals	28.9	20.3
Gross imports	21.7	8.6
Capital goods	12.2	9.7
Intermediate goods	23.0	5.4
Consumption goods	9.7	19.0

^p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

goods account was more than sufficient to finance the deficits in the services, income and current transfer accounts.

Current account surplus widened, mainly supported by a larger trade surplus

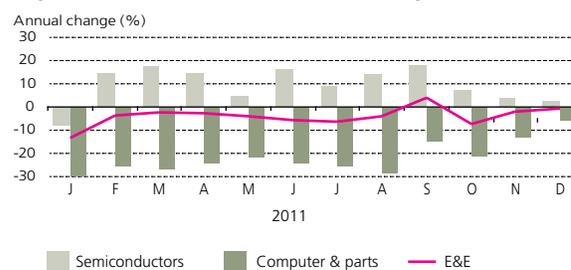
In line with the moderate growth in the advanced economies and heightened uncertainties in the global financial markets, **gross exports** grew at a more modest pace of 8.7% (2010: 15.6%) in 2011. The moderation in gross exports was due mainly to the contraction in exports of E&E products amid sustained growth in exports of commodities and non-E&E products. The lower growth in manufactured exports mainly reflected weaker external demand. Nonetheless, robust regional demand and favourable commodity prices provided crucial support for exports of commodity and resource-based non-E&E products.

External demand for manufactured products was dampened by moderation in global growth

Growth in **manufactured exports** moderated to 3.4%, from a strong growth of 12.6% in 2010. The decline in E&E exports was due mainly to

Chart 1.16

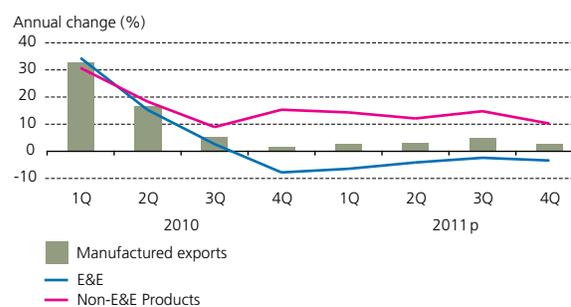
Exports of Semiconductors and Computer and Parts



Source: Department of Statistics, Malaysia

Chart 1.17

Export Performance of Electronics & Electrical (E&E) and Non-E&E Products



p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table 1.11

Direction of External Trade

	2011p				
	Exports		Imports		Trade balance
	RM billion	Annual change (%)	RM billion	Annual change (%)	RM billion
Total	694.5	8.7	574.2	8.6	120.3
<i>of which:</i>					
United States	57.6	-5.5	55.4	-1.5	2.2
European Union (EU)	71.9	4.7	60.0	10.8	12.0
Selected ASEAN countries¹	169.0	5.4	158.4	11.2	10.6
Selected North East Asia countries	171.0	8.9	139.4	5.9	31.6
<i>The People's Republic of China</i>	<i>91.2</i>	<i>13.9</i>	<i>75.6</i>	<i>13.8</i>	<i>15.6</i>
<i>Hong Kong SAR</i>	<i>31.2</i>	<i>-3.6</i>	<i>13.6</i>	<i>7.2</i>	<i>17.7</i>
<i>Chinese Taipei</i>	<i>22.7</i>	<i>12.4</i>	<i>27.1</i>	<i>13.6</i>	<i>-4.4</i>
<i>Korea</i>	<i>25.8</i>	<i>6.1</i>	<i>23.2</i>	<i>-19.2</i>	<i>2.6</i>
West Asia	25.0	12.1	27.3	44.7	-2.4
Japan	80.0	19.8	65.3	-1.8	14.6
India	28.2	34.6	10.2	27.6	18.0

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

p Preliminary

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

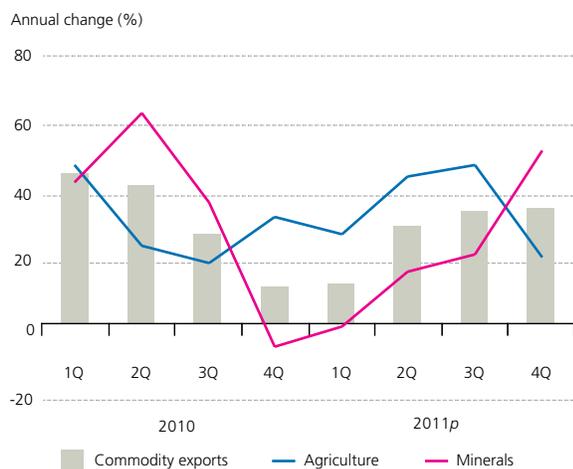
the contraction in exports of computers and parts, while exports of semiconductors expanded further. Exports of computers and parts remained subdued throughout the year. In the first half of 2011, E&E exports registered negative growth as the weak demand from advanced economies was compounded by global supply disruptions following the disaster in Japan. However, the contraction in exports of E&E moderated in the second half of the year as demand for electronics improved while the impact from the global supply-chain disruption receded. Notwithstanding the sluggish performance in E&E exports, non-E&E exports continued to record robust growth in 2011, driven mainly by regional demand for construction-related products such as iron and steel, manufactures of metal and non-metallic mineral products.

Firm regional demand and strong commodity prices boosted export growth

Growth in commodity exports was sustained at 26.4% (2010: 28.8%), amid strong regional demand and high commodity prices. Agriculture exports expanded at a strong pace throughout 2011, mainly on account of resilient domestic demand in the region, and the firm prices of crude palm oil and natural rubber. Mineral exports grew at a more moderate pace of 20.3% (2010: 28.9%), supported by the high prices of crude oil and natural gas. In addition, the export volume of natural gas increased significantly, following higher demand for gas-powered electricity generation in Japan.

Chart 1.18

Commodity Export Performance



P Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Resource-based non-E&E exports also benefited from the elevated commodity prices and firm regional demand, particularly exports of chemicals, petroleum-related products and rubber products. In addition, rebuilding and reconstruction efforts in Japan have further increased demand for exports of wood products and non-metallic mineral products.

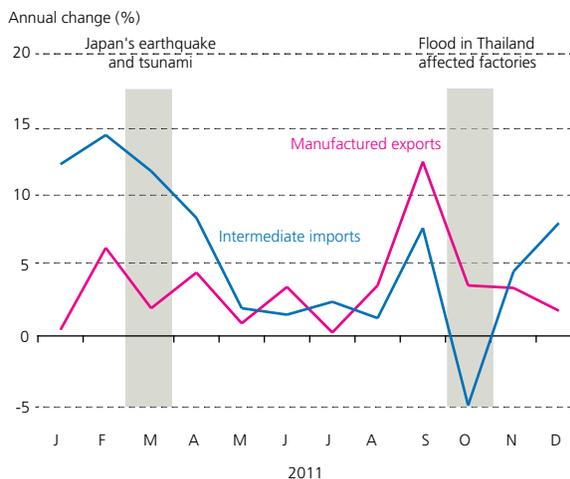
Robust domestic demand spurred higher import growth of consumption goods

Gross imports grew at a more moderate pace of 8.6% (2010: 21.7%) reflecting the slower growth in gross exports and were mainly supported by the continued resilience of domestic demand. Growth in intermediate imports was significantly lower (5.4%; 2010: 23%), in tandem with the moderation in manufacturing activity. Of significance, imports of intermediate goods such as parts and components of machineries were adversely affected by the disaster in Japan in the first half of 2011. The global supply chain was once again disrupted in the fourth quarter of the year as a result of the massive flooding in Thailand, which affected Malaysia's imports of parts and components for computer products.

Capital imports remained strong, albeit registering a more modest growth of 9.7% (2010: 12.2%), driven mainly by the implementation of capital-intensive ETP projects in the manufacturing and mining sectors. Growth in imports of consumption goods more than

Chart 1.19

Impact of Global Supply Chain Disruptions on Manufactured Exports and Intermediate Imports



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

doubled to 19% (2010: 9.7%) due mainly to higher prices of food and beverages, which rose in tandem with global commodity prices. The improvement in domestic labour market conditions and consumer spending also boosted imports of motor vehicles and durable consumer goods.

In 2011, the **services account** reversed to record a deficit of RM8.4 billion. The deficit stemmed mainly from lower net receipts from the travel account and higher net payments for transportation services.

The net surplus in the **travel** account moderated to RM24.3 billion (2010: RM33.3 billion) due to lower tourism receipts and higher travel outflows. The moderation in tourism receipts reflected mainly the marginal improvement in tourist arrivals of 24.7 million visitors (2010: 24.6 million) and lower receipts from excursionists, mainly on account of the uncertain external environment. Nevertheless, travel remained the single largest contributor to gross services receipts. The larger travel outflows were attributable to the higher expenditures incurred by Malaysians travelling abroad, particularly for business, leisure travel and to seek medical treatment. The higher number of Malaysian Muslims performing the pilgrimage during the year was also a contributing factor.

The deficit in the **transportation** account widened to RM25.2 billion (2010: -RM23.2 billion), reflecting largely the increase in freight charges by international shipping lines amid higher fuel costs. Gross receipts were lower due to lower earnings from passenger fares and cargo services provided by domestic shipping companies.

The **other services** account continued to record a large net outflow of RM7 billion (2010: -RM8 billion), as higher receipts from the provision of services was offset largely by larger payments for imported services, particularly for royalties and licence fees, communication, construction as well as insurance and financial services. Computer and information services continued to record a net surplus.

The **income account** deficit narrowed to RM22 billion as the increase in investment income accruing to Malaysian companies investing abroad outpaced the increase in investment income accruing to foreign investors. The higher profits and dividends accruing to Malaysian companies from their investments abroad were mainly accounted for by the mining, financial and insurance as well as agriculture sectors. Investment income accruing to foreign investors also increased following the higher inflows of FDI and portfolio funds into Malaysia during the year.

Table 1.12

Services and Income Accounts

	2010	2011 ^p		
	RM billion			
	Net	+	-	Net
Services Account	1.7	107.1	115.5	-8.4
Transportation	-23.2	14.8	40.0	-25.2
Travel	33.3	55.9	31.6	24.3
Other services	-8.0	36.1	43.2	-7.0
Government transactions n.i.e.	-0.5	0.3	0.7	-0.5
Income Account	-26.5	52.0	74.1	-22.0
Compensation of employees	-2.1	3.6	6.0	-2.4
Investment income	-24.4	48.4	68.1	-19.7
Direct investment	-30.8	28.7	55.7	-27.0
Portfolio investment	-6.9	2.4	11.0	-8.6
Other investment	13.2	17.4	1.4	16.0

n.i.e. Not included elsewhere

^p Preliminary

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

FINANCIAL ACCOUNT

In 2011, the financial account reversed from a net outflow position to record a net inflow of RM15.5 billion (2010: -RM19.8 billion), largely due to the continued inflows of portfolio funds and foreign direct investments (FDI). Despite heightened uncertainty in the global financial markets, portfolio inflows continued to be buoyed by prospects for strong growth in the region, including Malaysia, and expectations of stronger regional currencies. Of significance, FDI inflows were also higher, amid robust domestic economic conditions and higher corporate profitability. Similarly, direct investment abroad (DIA) by Malaysian companies was higher mainly arising from the expansion of existing businesses abroad. Other investment outflows which largely reflected private sector flows, moderated sharply during the year.

For the year as a whole, **portfolio investment** continued to record a strong, albeit smaller, net inflow, amounting to RM30.3 billion (2010: +RM48.5 billion). The inflows of foreign portfolio

Table 1.13

Balance of Payments: Financial Account

	2010	2011 ^p
	RM billion	
Financial Account	-19.8	15.5
Direct Investment	-13.6	-12.4
Abroad	-42.9	-45.3
In Malaysia	29.3	32.9
Portfolio Investment	48.5	30.3
Financial Derivatives	-0.7	-0.1
Other Investment	-54.0	-2.4
Official sector ¹	0.2	-1.3
Federal Government	-0.4	-0.2
NFPEs	0.6	-1.1
Private sector	-54.2	-1.1

¹ Excludes bonds and notes raised abroad by the Federal Government and NFPEs

^p Preliminary

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

funds were channeled into both the equity and debt securities markets, with the bulk of the funds flowing mainly into long-term debt securities, particularly Government papers. In the first half of 2011, net portfolio investments recorded a strong inflow of RM56.4 billion, exceeding the total amount recorded in 2010. These inflows reflected the favourable economic outlook for the region, notably the strong growth prospects and sound economic fundamentals amid low interest rates and more subdued growth in the advanced economies. However, the intensification of fiscal uncertainties in the US and the escalation of the

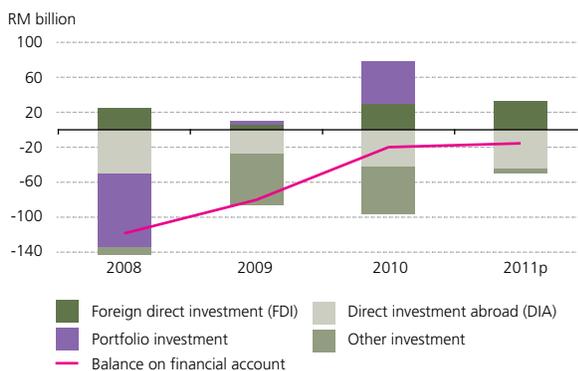
sovereign debt crisis in Europe led to a substantial deterioration in the global financial markets. The second half of the year saw significant outflows amounting to RM26.1 billion. The reversals reflected deleveraging of assets by international investors following heightened risk aversion in the financial markets, and a tightening of global credit conditions.

The financial account recorded a net inflow on account of continued inflows of portfolio investment and higher FDI

Malaysia has ample policy space and was in a strong position to manage volatile capital flows without causing distortions in the domestic financial system. The country's well-developed financial markets, particularly the deep and diversified bond markets, facilitated efficient intermediation of capital flows. The impact of outflows of foreign funds was cushioned by the greater prominence of domestic institutional players in the capital markets, while the high international reserves of Bank Negara Malaysia instilled market confidence in Malaysia's ability to manage reversals of foreign capital. Importantly, the wide range of monetary instruments at the disposal of the Bank facilitated the efficient management of domestic liquidity while the managed float exchange rate regime provided the necessary flexibility for the exchange rate to adjust to external conditions.

Chart 1.20

Financial Account

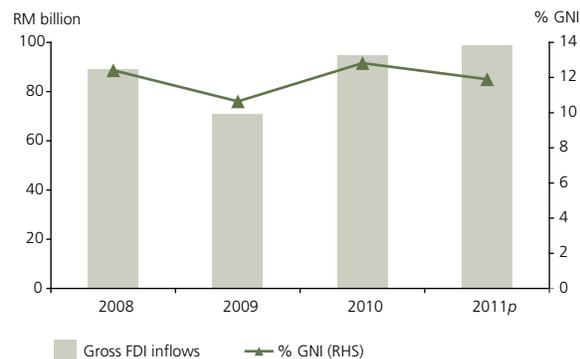


^p Preliminary

Source: Department of Statistics, Malaysia

Chart 1.21

Foreign Direct Investment (FDI)



^p Preliminary

Source: Department of Statistics, Malaysia

Thus, it was observed that the significant gross flows of foreign funds did not cause undue pressure on the domestic financial system.

Gross inflows of **FDI** remained significant at RM98.9 billion, accounting for 11.9% of GNI in 2011, in tandem with the strong overall domestic investment outlook and a revival of corporate earnings. This was evident in the larger inflows of equity capital and the extension of inter-company loans, amid sizeable earnings retained by existing multinational corporations (MNCs) for reinvestment purposes. Malaysia's growth prospects were a key factor underpinning this trend. The domestic investment climate was further boosted by various Government-facilitated economic initiatives.

Throughout the year, several Entry Point Projects (EPPs) under the Economic Transformation Programme (ETP) had attracted substantial investments from foreign investors. Moreover, Malaysia's improved position in various cross-country economic rankings enhanced investment prospects in the country. Notably, Malaysia made progress in the rankings for global competitiveness, ease of doing business, and FDI confidence, according to reports released by the World Economic Forum, World Bank and global management consultants, AT Kearney. After taking into account adjustments for outflows due largely to loan repayments to parent companies, the net inflow of FDI was higher at RM32.9 billion or 4.0% of GNI.

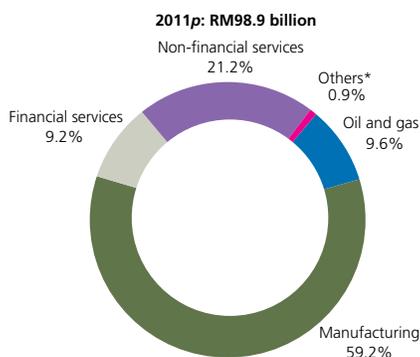
FDI in Malaysia continued to be broad-based, with inflows into the manufacturing sector accounting for most of the FDI (59.2% share), followed by the services (30.3%) and oil and gas (9.6%) sectors. In the manufacturing sector, FDI was mainly channelled into the E&E industry, largely by existing MNCs for the upgrading of equipment and production technology. Other investments in the manufacturing sector were in petroleum refining and petroleum-related products industry, which continued to account for a sizeable portion of FDI in Malaysia. At the same time, there have also been increasingly substantial investments by firms in the solar-energy industry during the year. These investments will boost the expansion of the solar-energy value chain in Malaysia.

In the services sector, FDI inflows were channelled primarily into the wholesale and retail sub-sector, followed by the finance and insurance sub-sector. Of significance, the bulk of investments in the finance and insurance sub-sector were undertaken by foreign financial institutions, mainly in the form of corporate earnings retained for reinvestment. In the wholesale and retail sub-sector, FDI inflows were mainly attributed to foreign general retailers, motor vehicle distributors, and distributive companies related to telecommunications and electronic products.

Investments in the oil and gas sector were largely for extraction operations and production

Chart 1.22

Gross FDI Inflows by Sector



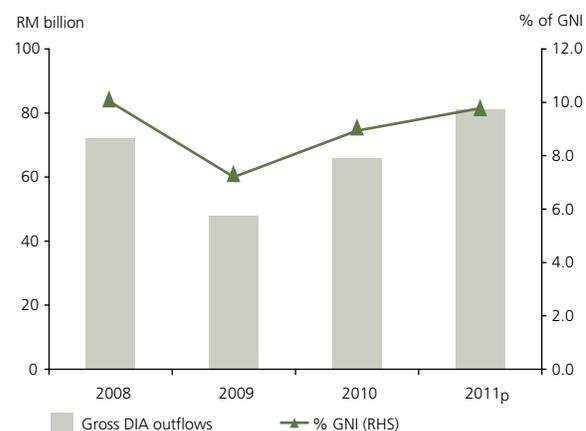
Note: *Refers to agriculture and construction sectors

p: Preliminary

Source: Department of Statistics, Malaysia

Chart 1.23

Direct Investment Abroad (DIA)

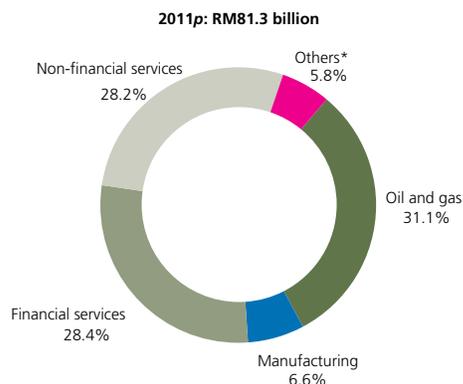


p Preliminary

Source: Department of Statistics, Malaysia

Chart 1.24

Gross DIA Outflows by Sector



Note : *Refers to agriculture and construction sectors

p Preliminary

Source : Department of Statistics, Malaysia

activities. In terms of the country of origin of FDI, major contributors of FDI inflows in 2011 were the advanced economies, particularly the US, Japan and Germany. It is important to note that FDI from regional countries has increased in recent years, accounting for 32.3% of total FDI to Malaysia in 2011, relative to 10.1% in 2003.

In 2011, Malaysian companies continued to explore business opportunities abroad, particularly in Asia and emerging economies as indicated by increased **DIA** outflows during the year. Gross outflows of DIA by Malaysian companies were higher at RM81.3 billion, accounting for 9.8% of GNI. This development reflected the increased capability and rising interest of Malaysian companies to diversify their operations abroad through expansion of existing operations. After taking into account the gross inflows due to repayments of loans by overseas subsidiaries and consolidation of business abroad, net DIA outflows amounted to RM45.3 billion or 5.5% of GNI.

DIA by Malaysian companies were largely channelled into the services (56.5% share) and oil and gas (31.1%) sectors, while investments in the manufacturing sector remained sizeable (6.6%). Of significance, investments in the services sector were led by domestic financial institutions, utilities and telecommunications companies which expanded operations abroad in an effort to further capitalise on business opportunities in the region and to remain competitive on a regional scale.

In the oil and gas sector, the DIA continued to be driven by the Malaysian oil companies, primarily in the exploration and production (E&P) business and downstream processing activities. Investment abroad in the manufacturing sector mainly reflected the continued expansion of operations abroad by companies in the resource-based industries. Of importance, the bulk of DIA during the year were undertaken within the region, particularly in ASEAN, the Newly Industrialised Economies (NIEs) and West Asian economies. There were also sizeable investments abroad by Malaysian companies in the advanced economies, notably in Australia and the United Kingdom.

Other investment recorded a significantly smaller net outflow of RM2.4 billion in 2011 on account of a sharp moderation in private sector outflows. Of significance, the banking sector turned around from a net outflow position to record a net inflow, partly reflecting the deleveraging of assets abroad by domestic financial institutions, in an environment of heightened risk aversion and global economic uncertainties. Net outflows of trade credits were also smaller during the year, in tandem with the slower pace of international trade. The official sector also recorded a net outflow position, mainly reflecting external loan repayments by both the Federal Government and the Non-Financial Public Enterprises.

INTERNATIONAL RESERVES

The **international reserves** held by Bank Negara Malaysia comprise its holdings of gold and foreign exchange, its reserve position with the International Monetary Fund (IMF) and holdings of Special Drawing Rights (SDRs). During the year, net international reserves increased by RM94.7 billion to RM423.3 billion (equivalent to USD133.6 billion) as at 31 December 2011.

The increase in international reserves during the year was mainly supported by the continued surplus in the current account. This was attributed to a larger surplus in the trade account, underpinned by robust exports of commodities and non-E&E exports. Higher international reserves also reflected the inflow of portfolio investment and FDI. The international reserves recorded a significant increase in the second quarter, owing largely to the sizeable inflow of portfolio investment. Nonetheless, the accumulation of international reserves eased in the second half of the year following

Table 1.14

Net International Reserves

	As at end		Change
	2010	2011	2011
	RM million		
SDR holdings	6,442.5	6,253.0	-189.5
IMF reserve position	1,453.5	2,672.2	1,218.7
Gold and foreign exchange	320,774.5	414,432.5	93,658.0
Gross International Reserves	328,670.5	423,357.7	94,687.2
Less Bank Negara Malaysia external liabilities	21.4	26.7	5.3
Net International Reserves	328,649.1	423,331.0	94,681.9
USD million equivalent	106,518.2	133,609.8	27,091.6
Months of retained imports	8.6	9.6	
Reserves/Short-term external debt (times)	4.1	4.1	

Note: Numbers may not necessarily add up due to rounding

Source: Bank Negara Malaysia

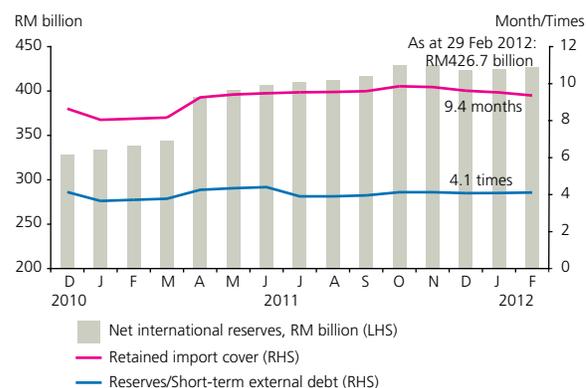
reversals of portfolio investment as the global financial markets turned more volatile. The rise in international reserves was also partly offset by higher direct investment abroad during the year. The cumulative unrealised foreign exchange revaluation gain amounted to RM7.6 billion following the strengthening of some of the major currencies against the ringgit in 2011.

Malaysia remains a participating member in the Financial Transactions Plan of the IMF. Under this plan, a member will provide resources to member countries facing short-term balance of payments difficulties. The increase in Malaysia's **reserve position with the IMF** in 2011 reflected mainly net purchases of currencies by various IMF member countries under the Financial Transactions Plan. The decrease in international reserves held in the form of **SDRs** was attributed mainly to the payment for Malaysia's quota increase under the 2008 IMF Ad Hoc Quota Increase exercise.

The international reserves held by Bank Negara Malaysia continued to be invested in well-diversified markets and asset classes with strong credit quality. In managing the rising financial market volatility from the prolonged European sovereign

Chart 1.25

Net International Reserves (end-month)



Source: Bank Negara Malaysia

debt crisis and lower global growth, investment adjustments were undertaken to manage euro area exposures accordingly and to further diversify investments into Asian markets. Thus, despite widespread credit rating downgrades in the euro area, the credit quality of the investments of Malaysia's international reserves remained high. The scope and granularity of surveillance and risk management in the investment of the international reserves were also enhanced during the year. The strong governance process in place ensures that all key events and risks are appropriately disclosed, and in a timely manner, to the Bank's Reserve Management Committee and Board of Directors.

International reserves increased by RM94.7 billion to RM423.3 billion in 2011, supported mainly by the continued surplus in the current account as well as inflows of FDI and portfolio investment

As at 29 February 2012, the reserves level amounted to RM426.7 billion (equivalent to USD134.7 billion), which is adequate to finance 9.4 months of retained imports and is 4.1 times the short-term external debt. The international reserves held by the Bank are usable and unencumbered. There are no foreign currency loans with embedded options and no undrawn, unconditional credit lines provided by or to other

central banks, international organisations, banks and other financial institutions. Bank Negara Malaysia also does not engage in ringgit-related options activity in the foreign currency markets.

EXTERNAL DEBT

To further enhance efficiency in the management of corporate finance and access to more competitive financing, flexibility was accorded for resident corporations to freely borrow in ringgit or foreign currency within a corporate group in Malaysia and from abroad. In tandem with the flexibility accorded for accessing offshore borrowing, resident corporations were also able to undertake effective asset and liability management through the well-developed domestic financial markets. An early detection mechanism of possible risks to monetary and financial stability has been put in place. In line with this, continuous emphasis is placed on having a well-functioning and robust debt monitoring system that covers the overall debt level, structure, maturity and debt-servicing obligations.

As at end-2011, Malaysia's total external debt amounted to RM257.2 billion (or USD80.4 billion),

Table 1.15

Outstanding External Debt

	2010	2011 ^p	2010	2011 ^p
	RM billion	RM billion	USD billion	USD billion
Total debt	227.1	257.2	72.8	80.4
Medium- and long-term	147.7	153.4	47.4	47.9
Short-term ¹	79.4	103.9	25.5	32.5
<i>As % of total debt</i>	35.0	40.4		
<i>As % of net international reserves</i>	24.2	24.5		
As % of GNI				
Total debt	30.7	31.0		
Medium- and long-term debt	20.0	18.5		
As % of exports of goods and services				
Total debt	30.5	32.0		
Medium- and long-term debt	19.8	19.1		
Debt service ratio (%)²	7.6	10.3		

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

² Includes prepayment of medium- and long-term debt

^p Preliminary

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

equivalent to 31% of GNI (2010: RM227.1 billion). This reflected the increase in both medium- and long-term and short-term debt. The appreciation of some of the major currencies against the ringgit during the year also contributed to the rise in the overall external debt level. As at end-year, Malaysia's external debt profile continued to be skewed towards a longer maturity structure with medium- and long-term debt accounting for 59.6% of total external debt.

Malaysia's external debt remained low at 31% of GNI

The increase in the **medium- and long-term external debt** partly reflected the net drawdown of external borrowings by the Federal Government and private sector. In July 2011, the **Federal Government** successfully issued a dual tranche (5-year and 10-year) Wakala Global Sukuk of USD2 billion. The issuance was Malaysia's third US dollar-denominated sovereign sukuk issuance, after the previous Global Sukuk issuance in 2010. As at end-year, the outstanding external debt of the Federal Government rose to RM18.1 billion (2010: RM16.7 billion), as higher gross borrowings and exchange rate revaluation losses more than offset repayments during the year. The external debt of the **NFPEs** however declined to RM65 billion in 2011 (2010: RM66.6 billion). The improvement came mainly from large repayments of external loans following the maturity of several bonds, as well as continued loan repayments throughout the year.

The medium- and long-term debt of the **private sector** increased to RM70.3 billion (2010: RM64.3 billion), following net drawdown of external borrowings by the banking sector, which outweighed the net repayment by the non-bank sector.

During the year, outstanding **short-term external debt** rose to RM103.9 billion (2010: RM79.4 billion), attributed primarily to increased interbank borrowings. The bulk of the short-term debt continued to be held by the banking sector (88.9% share). The short-term external debt of the non-bank private sector, comprising mainly of term loans, remained low. As at end-2011, the short-term external debt remained low, accounting for only 12.5% of GNI, 24.5% of international reserves and 12.9% of exports of goods and services.

LABOUR MARKET DEVELOPMENTS

Overall labour market conditions improved in 2011, as reflected by the gains in employment and higher number of vacancies. The unemployment rate declined to 3.1% of the labour force in 2011 from 3.3% in the previous year, the lowest annual rate recorded since year 2000.

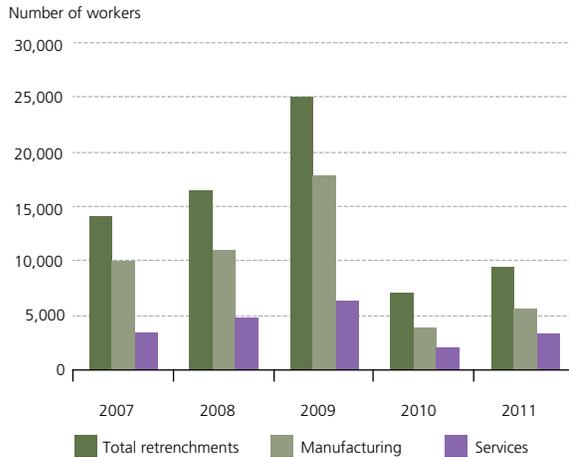
Labour market conditions improved in 2011

During the year, **employment** expanded by 2.4%, equivalent to a net addition of 291,500 jobs. Gains in employment were registered across all major sectors. Services and manufacturing sectors remained the major sources of employment creation, with net additions of 174,300 and 117,500 jobs respectively. Employment gains in the services sector were mainly recorded in the wholesale and retail trade (107,100 jobs); and transport, storage and communications (23,600 jobs) sub-sectors.

Retrenchments increased to 9,450 persons, compared to 7,085 persons in 2010. This was caused mainly by higher layoffs in the manufacturing (5,635 persons; 2010: 3,854 persons) and services sectors (3,329 persons; 2010: 2,073 persons). Nevertheless, this level of retrenchments was still low compared to the 2002-2007 average annual retrenchments of 18,853 persons. More than a third of retrenchments in the manufacturing

Chart 1.27

Retrenchments in Selected Sectors



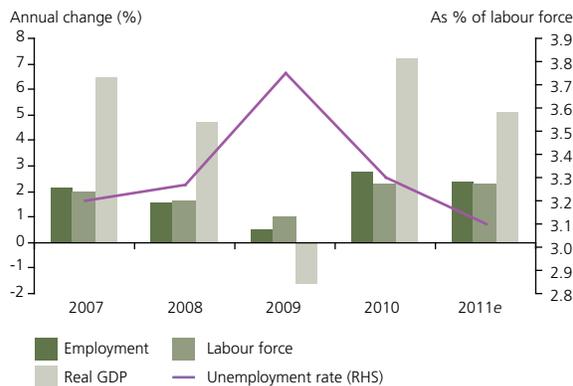
Source: Ministry of Human Resources

sector occurred in the month of August, when 2,056 workers were retrenched as a result of the closure of several low-end E&E and furniture companies. The agriculture and mining sectors recorded improvements in total retrenchments, with the agriculture sector registering 80% lower retrenchments compared to 2010. **Vacancies** posted on JobsMalaysia Portal increased to 2.3 million positions (2010: 1.8 million positions), attributable to higher number of job openings in the services (34% of total positions) and manufacturing (31% of total positions) sectors. Hiring activity in the construction sector was particularly strong in the second half of the year, supported by the expansion in construction activity during this period.

In July 2011, the Government initiated the Illegal Immigration Comprehensive Settlement Programme (6P) to register and legalise illegal immigrants in order to enhance the management and monitoring of **foreign workers**. Under the programme, a total of 2.3 million immigrants, comprising 1 million legal and 1.3 million illegal workers were registered as at end-August 2011. As at 13 February 2012, 379,020 illegal workers had been legalised while a total of 94,856 illegal workers had been granted amnesty and had left the country. Excluding the legalised workers from the 6P programme, as at end-2011, total registered foreign workers (including expatriates) in Malaysia increased by 3.6% to 1.9 million workers (2010: 1.8 million). Of significance, high-skilled expatriates which constituted 2.4% of foreign workforce, increased by 40% to 45,619

Chart 1.26

Output and Employment



e Estimate

Source: Economic Planning Unit and Department of Statistics, Malaysia

Table 1.16

Selected Labour Market Indicators

	2007	2008	2009	2010	2011e
Employment ¹ ('000 persons)	11,398.0	11,576.5	11,632.1	11,956.0	12,247.5
Annual change (%)	2.1	1.6	0.5	2.8	2.4
Labour force ¹ ('000 persons)	11,775.1	11,967.5	12,083.0	12,361.3	12,645.7
Annual change (%)	2.0	1.6	1.0	2.3	2.3
Retrenchments (persons)	14,035.0	16,469.0	25,064.0	7,085.0	9,450.0
Unemployment rate ¹ (% of labour force)	3.2	3.3	3.7	3.3	3.1
Real labour productivity growth ² (%)	4.2	3.1	-2.2	4.5	2.6

¹ Based on estimates by Economic Planning Unit

² Based on estimates by Bank Negara Malaysia e Estimates

Source: Bank Negara Malaysia
Economic Planning Unit
Ministry of Human Resources

persons. In total, foreign workers accounted for 15.4% of employment in Malaysia and were mainly engaged in the manufacturing (38%), agriculture (27.4%) and domestic help (12%) sectors.

Labour productivity, as measured by real value-added per worker, recorded a positive but slower growth of 2.6% in 2011, compared to 4.5% in the previous year. The slower growth reflected a moderation in productivity gains in the services, manufacturing and construction sectors, and a decline in productivity in the mining sector, attributable mostly to the lower value-added growth of these sectors during the year.

According to a survey conducted by Bank Negara Malaysia, the average **salary** in the

private sector increased by 4.0% in 2011 (2010: 4.5%), with an average increment of 2.2% and 4.5% in the manufacturing and non-manufacturing sectors respectively (2010: 3.8% and 5.5% respectively). Increments for executives grew at a slower rate of 3.7% (2010: 4.3%), while non-executives received a salary increment of 3.9% during the year (2010: 4.4%).

PRICE DEVELOPMENTS

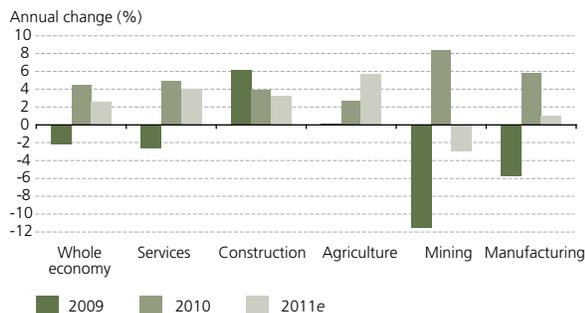
Consumer prices

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), averaged 3.2% in 2011 (2010: 1.7%). Inflation in 2011 was within the Bank's forecast range of 2.5-3.5%. The increase in inflation, particularly during the first half of the year, was due mainly to supply factors, arising from higher food prices and upward adjustments to administered prices. Inflation peaked in June at 3.5% and subsequently stabilised in the second half of 2011, as the impact from the upward adjustments on the prices of petroleum products and sugar in July and December 2010 wore off. Core inflation, an indicator of demand-driven pressures on prices, rose to 2.7% in 2011 (2010: 1.5%).

The main contributors to inflation in 2011 were the *food and non-alcoholic beverages* and *transport* categories, which together accounted for 67.1% of the overall increase in domestic prices during the year. Inflation in the *food and non-alcoholic beverages* category averaged at 4.8% (2010: 2.4%) mainly on account of higher price

Chart 1.28

Labour Productivity Trends



e Estimate

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

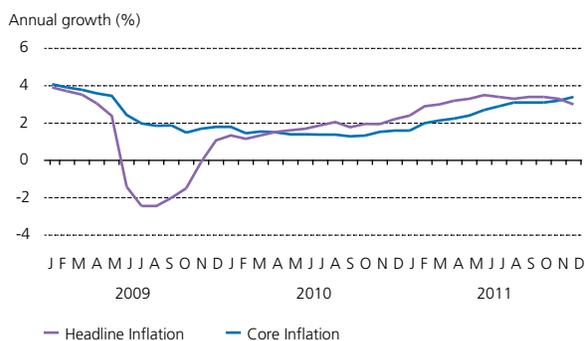
increases in the *meat, fish and seafood, vegetables and fruits* sub-categories. Inflation in the *transport* category registered a significant increase from 1.6% in 2010 to 4.4% in 2011 following adjustments to the price of RON97 petrol and higher maintenance costs for personal transport. However, the increase in inflation during the year was partly mitigated by the decline in prices for *clothing and footwear* and *communication* categories, which averaged -0.2% and -0.3% respectively (2010: -1.4% and -0.2% respectively).

Supply factors, both external and domestic, were the key drivers of inflation during the year. Externally, rising inflationary trends were evident in the emerging economies, underpinned by higher global commodity prices and stronger domestic demand, particularly in the first half of the year. These factors, however, subsided in the second half of the year, following concerns over the strength of global growth. Global food prices, which had been on an uptrend since the second half of 2010, rose further in 2011. Global cereal prices, in particular wheat, corn and rice, increased following adverse weather conditions and low stockpiles in key producing countries. The excessive heat experienced in Russia and the United States had led to reduced supplies of wheat and corn, driving their prices higher, while the floods in Thailand and Vietnam raised global prices for rice. This resulted in the reduction of stockpile for both corn and rice. For rice, global prices were already rising following the new measure announced by the Thai Government to buy rice directly from the farmers at 50% above the market rates.

Global energy prices were also higher. Global crude oil prices rose sharply during the first four months of

Chart 1.29

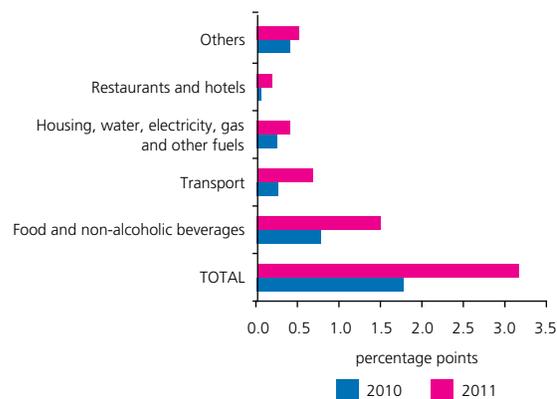
Consumer Price Inflation



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1.30

Contribution to Inflation



Note: Others refer to *communication; clothing and footwear; health; recreation services and culture; furnishings, household equipment and routine household maintenance; alcoholic beverages and tobacco; education and miscellaneous goods and services*

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

the year due to supply concerns following political tensions in Middle East and North Africa (MENA) region. The increase in prices was further amplified by the increase in investors' yield-seeking activities due to the high global liquidity and low interest rate environment. However, the spike in global crude oil prices subsided in May 2011 and into the second half of the year, following the easing of concerns about supply conditions. Supply was expected to improve following a commitment made by the Organisation of the Petroleum Exporting Countries (OPEC) to increase oil production and the announcement of the release of 60 million barrels of crude oil from the emergency stockpile by the International Energy Agency (IEA) member countries.

The high global commodity prices, especially crude oil and food, had also led to higher inflation in Malaysia's key import partners. In addition to pressures from supply factors, some import partners also experienced higher inflation following stronger-than-expected growth in domestic demand. This had led to higher imported prices and subsequently higher domestic retail prices in Malaysia. The upward price pressures from higher global commodity prices and inflation in key import partners were slightly mitigated by the appreciation of the ringgit during the first half of 2011. The role of the ringgit appreciation in mitigating the impact of higher imported inflation on domestic inflation, however, was relatively small (See *white box on Impact of Ringgit Appreciation on Import Prices and Inflation*).

Compared to 2010, the impact from external supply factors on domestic prices was more dominant in 2011. For example, the higher prices of corn and wheat had led to higher prices of poultry feed, which in turn increased poultry prices in Malaysia. The increase in global rice price, however, had a minimal impact on domestic rice prices as the bulk of the rice consumption is sourced domestically and contracts for imports of rice have been secured up to 2012. Following the increase in global energy prices in 2011, there were several upward adjustments on administered prices during the year. The price of RON97 petrol, which was determined under a managed float mechanism, was raised by a total of 50 sen/litre between January and July 2011, and contributed 0.25 percentage points to headline inflation in 2011. Electricity tariffs were also revised upward on average by 7.1% from 31.31 sen/kWh to 33.54 sen/kWh due to the higher price of natural gas. In addition, the Government adjusted the price for kerosene upward by 10 sen/litre, from RM2.40/litre to RM2.50/litre in January 2011, and raised the retail price of sugar by 20 sen/kilogram, in line with the Government subsidy rationalisation plan.

Besides the impact from external prices, disruptions in domestic supply due to irregular weather patterns and labour shortages had also led to increases in food inflation during the year. Heavy rains due to the monsoon season had kept prices of fish and seafood high throughout the year. This was amplified by the withdrawal of additional subsidies for diesel for fishing trawlers in May. For vegetables and fruits, shortages of foreign labour had compounded the supply disruptions arising from adverse weather, adding further upward pressure on prices.

As inflation during the year was driven mainly by supply factors, the Government introduced various initiatives, comprising both short- and long-term measures, to address the rising cost of living and contain the increases in domestic prices. In the short run, to prevent any sudden hikes in prices, the Government employed a more gradual subsidy rationalisation programme and focused on the strict enforcement of the festive season price control scheme. In addition, the Government also calibrated the supply and demand of essential food items to ensure sufficient supply by issuing more

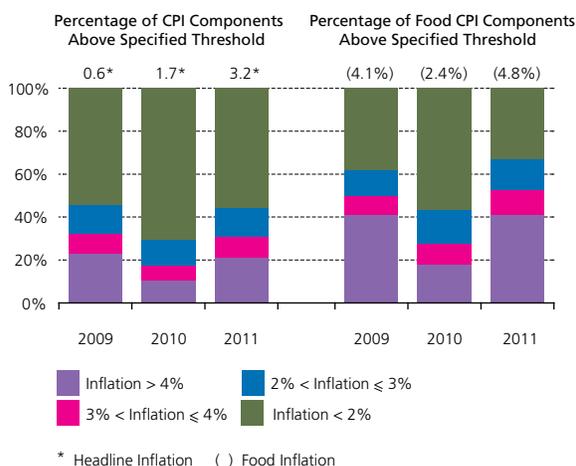
approved permits (APs) for higher food import. This helped contain food price increases in the domestic market.

As for long-term measures, the Government strives to preserve the standard of living and provide more alternatives to consumers. Towards this goal, the Government initiated campaigns to encourage fair pricing, for example, through the launch of *Kedai Rakyat 1Malaysia (KR1M)* and *Menu Rakyat 1Malaysia*. The *1Malaysia Pengguna Bijak Portal* was also created to safeguard the interest of consumers and promote consumer awareness. Furthermore, two new legislations were enacted, namely the Anti-Profitteering Act (2011) and The Competition Act (2010). In ensuring sustainable food supply and to reduce reliance on food imports, the Government introduced the 4th National Agri-food Policy (NAP) 2011-2020 that aimed at improving food security. The Government also implemented measures to improve the public transportation system in Malaysia, including the extension of current Light Rail Transit (LRT) route and the launch of a new Mass Rapid Transit (MRT) project.

Demand pressures were stronger in 2011. There were indications that strong domestic demand reinforced the cost-push inflation. Private consumption increased in 2011 as household spending during the year was supported by favourable labour market conditions and a continued rise in wages. The income boost from high commodity prices also provided further impetus to consumption in the rural areas. In addition, there was limited slack in the economy as output was near its potential. During the year, firms registered higher capacity utilisation of close to 80% (2010: 76%). Given the strong demand conditions, firms were able to pass on the increase in costs arising from high commodity prices by adjusting retail prices upward. Consequently, core inflation rose during the year, with more pervasive increases in inflation across the CPI components. Of significance, the proportion of the CPI sub-categories registering inflation rates of more than 2% rose from 35% in January to 49.6% in September. The pervasive price increases were confined mainly in the *food and non-alcoholic beverages* category, with 65% of food components recording inflation of more than 2% in the first nine months of 2011 (2010: 43%). Towards the end of the year, there was indication

Chart 1.31

Percentage of CPI Components and Food CPI Components Above Specified Threshold



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

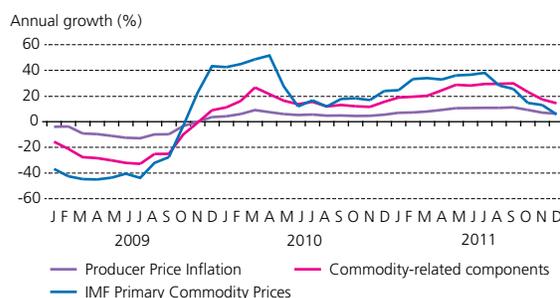
that the widespread increase in inflation had been contained. The percentage of CPI sub-categories registering inflation rate of more than 2% have stabilised since October 2011. The subsiding supply pressures and increased uncertainties over growth prospects in the fourth quarter of the year helped to restrain pressures on inflation.

Producer prices

Producer price inflation, as measured by the annual percentage change in the Producer Price Index (PPI), rose to 9.0% in 2011 (2010: 5.6%) driven by higher global commodity prices. The annual growth of the PPI trended upwards from the beginning of the year and subsequently moderated since October, as global commodity prices declined.

Chart 1.32

Producer Price Inflation and IMF Primary Commodity Prices



Note:

1. Commodity-related components in Producer Price Index (PPI) include crude materials, inedible; mineral fuels, lubricants, etc. and animal and vegetable oils and fats
2. Non-commodity related components in PPI include food; beverages and tobacco; chemicals; manufactured goods; machinery and transport equipment; miscellaneous manufactured articles and miscellaneous transactions and commodities

Source: Department of Statistics, Malaysia, IMF and Bank Negara Malaysia

In terms of composition, the commodity-related components of the PPI saw a significant increase of 23.6% (2010: 15.4%). The increase in global commodity prices during the year led to higher inflation of 24.2% and 23.2% in the *mineral fuels, lubricants, etc.* and *crude materials, inedible* sub-categories respectively during the year (2010: 12.8% and 22.4%). The non-commodity related PPI components, however, increased at a more moderate pace of 2.1% in 2011 (2010: 1.6%). Both local and imported components of the PPI registered higher inflation during the year. The annual growth of the PPI for local components increased to 12.0% (2010: 7.7%) while that for the imported components rose by 2.3% on an annual basis (2010: 1.4%).

Propagation of Global Commodity Prices to Inflation in Malaysia

Introduction

Global commodity prices have surged since early 2007 and have continued to remain high with the exception of the brief and sharp decline in 2009 following a contraction in global growth. Within this period, there were also sharp and large swings in prices of the key commodities, especially crude oil prices. The high and more volatile global commodity prices in the recent years are the result of rising global demand, global supply disruptions and the increased financialisation of commodities amid excess global liquidity. This situation is expected to remain for a sustained period, as these factors are expected to continue.

The increase in global commodity prices has a varying impact on inflation across different countries. The magnitude of the pass-through from global prices to domestic inflation is structurally determined, amongst others, by the contribution of these commodities, either directly or indirectly, to items in the Consumer Price Index (CPI) basket, the extent to which the domestic prices of these commodities are subsidised by the Government, whether a country is a net exporter or importer of commodities, as well as exchange rate movements. This article looks at the channels through which global commodity prices are propagated to domestic inflation in Malaysia based on recent episodes of higher commodity prices in 2008 and 2011.

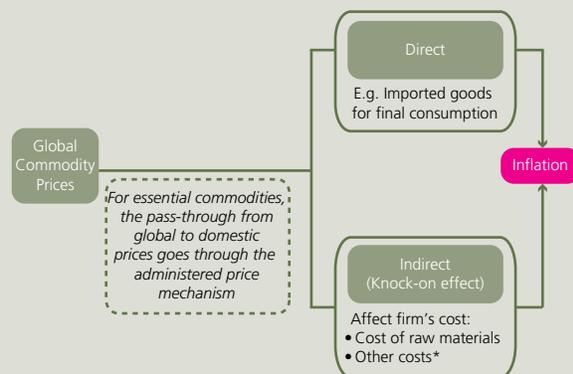
Propagation of Global Commodity Price Shocks in Malaysia

For Malaysia, global commodity prices are one of the key drivers of domestic inflation. The transmission of global commodity prices to inflation is, however, influenced by the Government's administered price mechanism. Domestic prices of essential commodities, such as rice, sugar and fuel, are administered or subsidised by the Government¹. Hence, the degree of adjustments to administered prices in response to changes in global commodity prices would be a key determinant of the ultimate impact on inflation.

Changes in global commodity prices can be transmitted directly and indirectly to domestic inflation. The **direct effect** happens when changes in global commodity prices are transmitted directly into changes in the prices of final goods and services that are purchased by consumers.

Chart 1

Direct and Indirect Effects of Changes in Global Commodity Prices to Inflation



* Other costs include transportation, utilities, packaging, logistics and distribution

Source: Bank Negara Malaysia

The **indirect effect** or the **knock-on effect** of higher global commodity prices on domestic inflation occurs when the prices of other non-commodity related consumer goods and services are raised by businesses in response to the increase in their cost of operations arising from the higher commodity prices. These costs include the cost of raw materials, transportation, logistics and utilities. The magnitude of knock-on effect is conditional on several factors. First, the extent to which the increase in cost affects profit margins. If higher commodity prices lead to a significant increase in costs, businesses may be more inclined to pass on the costs to protect their margins. Second, the structure of the market for the products. In a competitive market, concerns about losing market share may constrain the extent to which firms can raise prices. Conversely, in a monopolistic market,

¹ Details of the Government's Administered Price Mechanism are available in the White Box on Determinants of Inflation in Malaysia, published in the Bank Negara Malaysia 2010 Annual Report.

Chart 2

Global Commodity Prices in 2008 and 2011



Note: The IMF Primary Commodity Index has been rebased to January 2007=100 for the 2007-08 episode and January 2010=100 for the 2010-11 episode.

Source: IMF

or a market with a dominant player, there may be a greater propensity to raise prices. Third, the underlying demand conditions also matter. If demand is weak, or is highly responsive to price changes, businesses may maintain prices to retain sales.

The strength of the knock-on effect on inflation is reflected in the degree of pervasiveness of price increases. If there is a strong knock-on effect, there will be a widespread increase in prices across the CPI components. The more widespread increase in prices would also be reflected in the rise in core inflation. A more generalised and persistent increase in prices will consequently raise the cost of living.

The two most recent episodes of higher global commodity prices occurred in 2008 and 2011. In 2008, the increase in global commodity prices was sharp and persistent. Between January 2007 and July 2008, global crude oil prices more than doubled, while global food prices rose by more

than 50% within the 19-month period. In particular, there was a sharp increase in global rice prices in March 2008 as poor harvests in the major rice-exporting countries caused supply shortages and prompted large-scale stockpiling by some countries to ensure food security, further contributing to the shortages and intensifying the pressure on prices.

The impact of the sharp increases in global commodity prices on domestic inflation was, nevertheless, delayed due to the Government controls over some of the domestic food and energy prices. The average inflation rate in the first five months of 2008 remained subdued at 2.9%. The regional economies², meanwhile, registered a higher inflation rate of 8.7% during the same period (2007: 4.7%). However, as the increases in global commodity prices intensified, the Government revised the prices of several administered items, including retail petroleum products, electricity tariffs and rice to reduce the drain on Government resources in providing the subsidies. Apart from the substantial financial burden to the Government, subsidies were also becoming a source of inefficiencies in the economy and created market distortions. Prices were, therefore, adjusted over three consecutive months. These adjustments were large, with domestic rice prices being raised by 15-40% in May, fuel prices³ increased by an average of 40.4% in June and electricity tariffs adjusted upwards by 5% in July. As a result, the headline inflation rose sharply to 7.7% and 8.5% in June and July respectively. In terms of the direct effects, inflation in the *rice, bread and other cereals* category of the CPI basket rose sharply to 18.8% in May, while inflation in the *transport* category increased by 19.6% in June. Inflation in the *electricity, gas and other fuels* sub-category was higher at 4.4% in July. Together, the direct effects of the adjustments to administered prices contributed to 40% of the average inflation between May and July 2008.

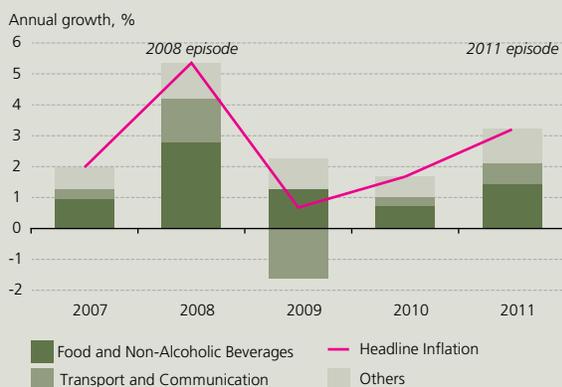
The increase in global energy and food prices, and the subsequent adjustments to administered prices also led to increases in the cost of raw materials, transportation and electricity, which in turn increased

² Comprised of the PR China, Indonesia, India, Philippines, Singapore, Thailand and Vietnam.

³ Refers to prices for RON92 and RON97 petrol and diesel.

Chart 3

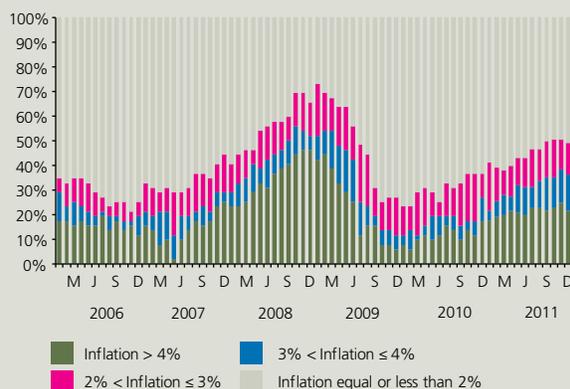
Headline Inflation, 2007 - 2011



Source: Bank Negara Malaysia and Department of Statistics, Malaysia

Chart 4

Percentage of CPI Components Experiencing Specific Levels of Inflation



Source: Bank Negara Malaysia

inflation was contained as the consumption of RON97 petrol is relatively small. There was also an upward adjustment to electricity tariffs in June 2011 by an average of 7.1%. These adjustments had a direct effect in increasing inflation in the *transport and housing, water, electricity, gas and other fuels* categories. Given the smaller and more gradualised price increases this time, the direct impact through the petroleum products and electricity tariffs in the CPI accounted for only 19% of inflation in 2011. In terms of the food categories, the higher global corn prices led to higher prices for poultry feed. As a result, prices for chicken increased sharply by 11.4% in 2011 (average 2007- 2011: 6.7%), and contributed 5.2% to headline inflation in 2011.

Given that adjustments to administered prices over this period were paced, businesses were better able to cope with the rise in costs. These adjustments were also well-anticipated by businesses as the Government

the cost of operations for businesses. The robust domestic demand conditions in the first half of 2008 enabled many businesses to pass on the higher costs to consumers by raising retail prices within three months of the adjustments on administered prices. There were large knock-on effects to other CPI categories, such as *restaurants and hotels and furnishing, household equipment and routine household maintenance*. The strong knock-on effects were reflected in a more pervasive increase in prices. Close to two thirds of the CPI components registered an inflation rate of more than 2% in the second half of 2008. Core inflation was also higher at 4% (an average of 1.8% between 1999 and 2008).

In contrast, global commodity prices rose at a more gradual pace in 2010 and 2011. Between January 2010 and September 2011, both global crude oil and food prices increased by 35% and 26%, respectively. A notable increase was in the global price of corn, which rose by 94% between June 2010 and September 2011 due to disruptions in supply and low stockpiles.

Accordingly, prices of fuel and some of the controlled food items in Malaysia were adjusted upwards in a gradual manner over a span of two years. The adjustments were undertaken as part of the subsidy rationalisation programme and the quantum of each adjustment was also smaller compared to that in 2008. The retail prices of petroleum products⁴ were raised by an average of 1.3% in July 2010 and 3.1% in December 2010. While the retail price of RON97 petrol was adjusted several times in 2010 and 2011, the impact on

⁴ Refers to RON95 and RON97 petrol, diesel and liquefied petroleum gas (LPG).

had earlier communicated its subsidy rationalisation roadmap. While domestic demand was relatively strong, rising by 8.2% in 2011, the knock-on effects were relatively modest and took a longer period of six months to occur. The knock-on effects were observed in the same categories as in 2008, namely the *restaurants and hotels* and *furnishing, household equipment and routine household maintenance* categories. Compared to the 2008 episode, inflation was less pervasive, with a smaller proportion of the CPI categories recording an inflation of more than 2%. Meanwhile, core inflation was also relatively lower at 2.7% in 2011.

The direct and indirect effects of changes in global commodity prices discussed above are also known as the **first-round effects**. Strong first-round effects may result in more broad-based price increases and consequently, lead to higher costs of living, which could raise inflation expectations and increase the pressure on households to demand for higher wages. If businesses accommodate the demand for higher wages and passed on the higher labour costs to consumers by increasing the prices of goods and services, this would create **second-round effects** on inflation. Unless policy action is taken to manage these second-round effects, they can lead to further increases in the prices of goods and services, triggering another round of wage increases and leading to even higher inflation. The repetition of this cycle is called the wage-price spiral. Should this spiral occur, inflation would become both difficult and costly to control.

The likelihood of second-round effects occurring depends on inflation expectations, labour market conditions and the strength of underlying demand in the economy. If inflation expectations are well-anchored, that is, consumers perceive that the increases in prices to be temporary, they will adjust consumption and spending, for instance by temporarily reducing expenditure on non-essential items to compensate for the rising cost of essential goods or, borrow or reduce savings to smooth consumption. In these scenarios, second-round effects on inflation are less likely to occur. However, if inflation expectations are not well-anchored, consumers would believe that the higher level of inflation is persistent, and thus will demand for higher wages to cope with the higher cost of living. In an environment of strong demand and tight labour supply, businesses would accommodate the wage demands and will in turn raise the retail prices of goods and services, leading to the occurrence of the second-round effects on inflation.

Despite the higher inflation in 2008 and 2011, and some signs of inflation pervasiveness particularly in 2008, there was limited evidence that supply pressures had led to second-round effects on inflation. First, wage growth in general was stable. With this, the high food inflation led to cutbacks in discretionary spending as the purchasing power of consumers was eroded, especially in 2008. Second, higher inflation was expected to be transitory. The weak global growth at the end of 2008 and the prospect of slower global growth in the second half of 2011 were expected to restrain further increases in global commodity prices. The expectation that domestic economic growth would also moderate helped to further curb domestic inflation.

Conclusion

Based on the experiences of 2008 and 2011, it can be concluded that the different magnitude of global commodity price increases had a differing impact on the propagation of these shocks to domestic inflation. With the administered price mechanism in place, the propagation of these global price increases to domestic inflation were, in most cases, delayed and incomplete. The pace of adjustments in administered prices in response to global commodity price increases were a key determinant of the strength of inflationary pressures that were transmitted through the first-round effects. The first-round effects would be better contained if adjustments to administered prices were undertaken in a gradual manner, as businesses would be better able to manage the impact on their costs. This, in turn, would result in a more gradual increase in inflation and the cost of living and reduce the risk of second-round effects occurring.

Liberalisation of Foreign Exchange Administration (FEA) Rules to Enhance the Competitiveness of the Malaysian Economy

Malaysia remains committed to further liberalising FEA rules to support and enhance the competitiveness of the economy through the creation of a more supportive environment for trade, business and investment activities.

In 2011, the Bank continued with the efforts to create a more favourable environment to promote the expansion of the private sector's productive capacity abroad in tandem with the liberal regulatory environment on international trade. The liberalisation recognises the growing trend for Malaysian companies to venture abroad given the strong economic growth in the emerging economies, particularly in Asia, and the deepening regional integration. Between 2001 and 2010, direct investments abroad by resident companies averaged 4.3% of GDP and peaked at 9.4% of GDP in 2008. Cumulatively, net direct investments abroad amounted to RM215 billion over this period, where a significant share of the investments was channelled into new areas of comparative advantage particularly in the oil and gas, manufacturing, telecommunication, finance and insurance sectors.

The increasing trend of Malaysian corporations venturing abroad underscores the importance of robust and sound domestic financial markets to meet the demand for more diverse and sophisticated financial solutions and services. Various measures, including the liberalisation of FEA rules, have been implemented by the Bank to promote the liquidity, depth and number of players in the domestic financial markets.

Productive direct investment abroad

As one of the fundamental measures to support the presence of domestic businesses globally, resident companies that meet the Bank's prudential requirements have been granted the flexibility to undertake any amount of direct investment abroad. The implementation of this liberalisation measure is sequenced to take into account the capacity of the resident companies. This is one of the Bank's strategic thrusts towards full cross-border capital mobility for productive purposes that will benefit the Malaysian economy. With this liberalisation measure, direct investment abroad by qualified resident companies will no longer be subject to the annual threshold of RM50 million equivalent in aggregate per corporate group for investment in foreign currency assets.

Access to competitive financing

To facilitate the expansion of the private sector's productive capacity abroad and to enhance the efficiency of financial management, greater freedom has been accorded to resident companies in managing financial resources within their corporate group. This liberalisation measure to allow a company to obtain any amount of inter-company loans from its related resident and non-resident companies will further enhance business efficiency.

Additionally, the limit of RM5 million imposed on foreign currency-denominated trade financing from non-residents has been abolished. Accordingly, foreign currency trade financing will now be computed as part of the prevailing limit on foreign currency borrowing by resident companies and individuals, of RM100 million and RM10 million equivalent, respectively.

Effective risk management

Given the importance of having appropriate risk management practices to the financial health of residents, greater flexibility has also been granted for them to undertake asset and liability management through the swapping of their ringgit or foreign currency debt obligations into debt obligations in another foreign currency. This liberalisation measure will help residents with exposure to international transactions to manage their financial risk exposures related to these transactions.

Greater product innovation

As domestic firms grow in size and strength and become increasingly integrated with the global markets, having a sound, robust and dynamic domestic financial market is critical to support the expansion of the Malaysian economy. In line with this, the FEA rules were liberalised to support domestic financial market players in innovating and offering new financial products to meet the diverse needs of a more developed and internationally-integrated Malaysian economy. In this regard, the scope of product offerings by licensed onshore banks has been expanded to allow greater flexibility in the trading of foreign currency against other foreign currencies with residents. Similarly, flexibility was also granted to licensed onshore banks to offer interest rate derivative contracts to non-bank non-residents for any purpose. These liberalisation measures are in line with the broad thrust of the Bank's Financial Sector Blueprint to widen the investor base and further enhance the development of the domestic financial markets.

Promote Treasury Management Operations

Efforts to create a dynamic and more internationally-integrated economy were further supported by the Budget 2012 announcement on new incentives to promote and facilitate the establishment of Treasury Management Centres (TMCs) in Malaysia by foreign and domestic-owned multinational companies. In addition to the fiscal incentives, FEA flexibilities have also been accorded to TMCs to facilitate effective management of their financial resources. These flexibilities include the ability to undertake investments and foreign currency financing to support the needs of companies with international presence.

Strengthening Malaysia's competitive position

The continuous efforts undertaken by the Bank and the Government to enhance efficiency and reduce the cost of doing business have contributed towards the improvement in Malaysia's ranking in the Global Competitiveness Report published by the World Economic Forum. Malaysia's competitiveness improved from 26th position in 2010/2011 to 21st position in 2011/2012. This was attributed, among others, to the openness of the Malaysian economy to international trade and foreign direct investment, as reflected in its liberal environment, notably on capital mobility. Similarly, the liberal environment for investment in Malaysia has also resulted in Malaysia being ranked as one of the top ten most preferred investment destinations in the world in the A.T. Kearney FDI Confidence Index for 2012.

The strengthening of the Bank's surveillance mechanisms, including enhanced regional cooperation, has enabled the Bank to intensify its liberalisation initiatives while ensuring that the benefits of the liberalisation outweigh the risks. The liberalisation measures are complemented by robust safeguards to ensure monetary and financial stability.

Conclusion

Consistent with the need for greater flexibility on cross-border current account and financial account transactions to support the growing global integration of the Malaysian economy, the implementation of FEA measures will shift towards a more principle-based regulatory framework to enhance clarity of the desired regulatory outcomes. This shift is part of the regulatory reform embarked on by the Bank to create a more facilitative and transparent regulatory environment that will support Malaysia becoming an investment destination of choice.

The policy thrust of FEA to enhance competitiveness of the economy will continue to be pursued in support of the transformation of the Malaysian economy into a high-income, high value-added economy by 2020. Important consideration would be given towards creating an enabling environment to support areas where Malaysia has a comparative advantage and to further enhance the competitiveness of Malaysian corporations. Focus will also be given to areas that will enhance the development of Malaysia's financial markets and also promote regional economic and financial integration. In this regard, continuous engagement and consultation with all stakeholders, including the industry players, will be undertaken to promote the role of the private sector in realising these desired outcomes. The progressive liberalisation of the FEA measures will continue to be reinforced by adequate prudential safeguards to ensure monetary and financial stability, both of which are integral for achieving sustainable growth of the Malaysian economy.

2011

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MONETARY AND FINANCIAL CONDITIONS

INTERNATIONAL MONETARY AND FINANCIAL CONDITIONS

Developments in international monetary and financial conditions broadly followed two distinct phases in 2011. In the first half of the year, global financial markets were trending upwards due to positive sentiments driven by expectations of better prospects for global economic growth. At the same time, the emergence of inflationary pressures and risks of financial imbalances arising from a prolonged period of low global interest rates prompted central banks in emerging economies to adjust upwards their interest rates. This period coincided with episodes of large and sustained capital inflows into emerging economies. In the second half of the year, global financial conditions deteriorated significantly. Financial market volatility intensified in the advanced economies following the escalation of the European debt crisis and heightened fiscal uncertainties in the US. There was also increasing uncertainty over the strength of the recovery in the advanced economies amid structural weaknesses prevailing in these economies. Despite the introduction of additional extraordinary policy measures by authorities in the advanced economies, risk aversion remained high. Asset repatriation by European investors resulted in capital outflows from emerging economies.

Global financial markets started the year on an upward trend, notwithstanding the temporary disruption caused by geopolitical unrest in the Middle East and North Africa, and the earthquake in Japan. Positive news on economic activity and higher than expected corporate profits contributed to increases in equity prices. The IMF revised upwards its estimate for world growth to 4.4% in January, from 4.2% in October 2010. In advanced economies, there were emerging signs of a self-sustaining recovery, with private sector demand holding up well despite the waning effects of fiscal stimulus. Credit conditions in the major advanced economies, including in the euro area, were slowly improving after a prolonged period of incremental tightening. In emerging economies, growth was seen as being more firmly entrenched, with concerns increasingly focused on strong credit expansion and rising demand pressures in these economies.

Global financial markets entered the year on a strong note building on the positive momentum from end-2010

Chart 2.1

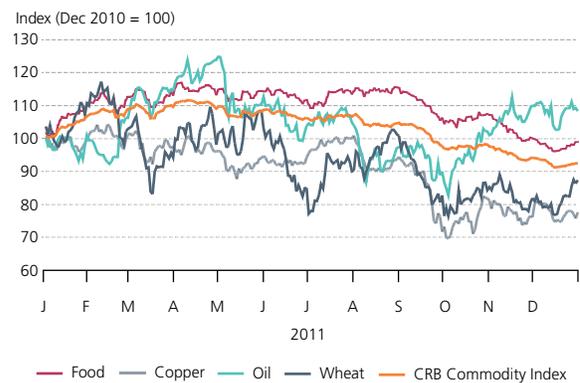
Selected Equity Market Indices



Source: Bloomberg

Chart 2.2

Commodity Prices



Source: Bloomberg

At the same time, inflationary pressures increased, mainly in response to higher global food and energy prices. The rise in global energy prices towards the end of 2010 was amplified by supply disruptions due to the geopolitical tensions in the Middle East and North Africa. Global food supplies were affected by adverse weather conditions and the low stockpiles, especially for wheat and corn. This exerted upward pressure on prices in both the advanced and emerging economies. The multi-speed growth in the global economy, however, meant that demand pressures were uneven. Narrowing output gaps and higher capacity utilisation made emerging economies generally more vulnerable to demand pressures and second-round inflationary effects. In the advanced economies, however, demand pressures remained subdued with the prevailing high unemployment, high debt, deleveraging and weak sentiments.

With signs of the global economic outlook improving, central banks shifted the focus of policy towards gradually removing the degree of monetary policy accommodation. In advanced economies, the expected timing of interest rate increases was brought forward. In February, implied forward rates indicated that policy tightening for the UK and euro area was expected towards the middle of 2011, compared to expectations at end-2010 that such increases would only occur in 2012. For emerging economies, rising inflationary concerns strengthened the case for policy normalisation. A significant number of countries, including PR China, Brazil and India increased policy interest rates in response to higher inflationary pressures. The perceived widening growth and interest differentials amidst a situation of excess global liquidity added to the attractiveness of emerging economies as a destination for capital inflows. In June, the Institute of International Finance estimated that net private capital flows to emerging economies could rise to USD1.04 trillion in 2011, from USD990 billion in 2010. Faced with significant capital inflows and the consequent risks of the build-up of financial imbalances, countries such as Brazil, Korea and Indonesia responded by implementing macro-prudential and capital account measures to preserve financial stability.

Despite the positive outlook for global growth, fundamental issues in the advanced economies remained unresolved. First, governments remain heavily indebted. The sustainability of the fiscal position in the US, Japan and peripheral euro area

countries continued to remain a concern. In April, Portugal became the third euro area country forced into seeking financial assistance from the EU-IMF, while doubts lingered over Greece's solvency and its ability to implement fiscal reform. Second, the health of financial institutions had not recovered in tandem with the overall economy and confidence in the banking systems of many advanced economies had not been fully restored. Third, the high level of unemployment, weak household balance sheets and legacy mortgage problems in the US continued to have a negative effect on consumption.

Financial market volatility increased in the second half of 2011 as the downside risks to the global economy became more apparent with the escalation of the European sovereign debt crisis

In the second half of 2011, the escalation of the European sovereign debt crisis and fears of its attendant contagion caused significant volatility in international financial markets. Concerns over the ability of Greece to service its debt and the implications on European banks exposed to Greek debt led to tighter liquidity conditions and stress in the eurozone money markets. The euro LIBOR-OIS spread, a measure of interbank liquidity conditions, increased by 60 basis points from July to September. There was also speculation on the possibility of Greece abandoning the euro in favour of its own national currency. Amid several rating downgrades, bond yields across the euro area increased significantly. In Italy, the 10-year yield breached the critical 7% level, widely viewed as the threshold where the debt would become unsustainable. In addition, the core European countries were also not spared, with credit default swap spreads for France rising above those of lower-rated emerging economies. These concerns were further compounded by the impasse in the US over its debt ceiling and the downgrade of its AAA sovereign rating by Standard and Poor's in August.

Signs of slowing global growth further weighed on investor sentiments and contributed to the

Chart 2.3

5-year Credit Default Swaps (CDS)



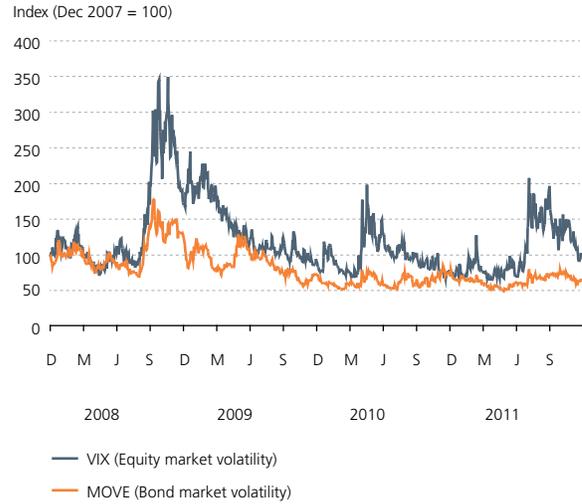
Source: Bloomberg

uncertainty in financial markets. The threat of a double-dip recession resurfaced following the release of negative economic reports in the US, on-going disruptions to the global supply chain from the earthquake in Japan and the likely drag on growth from fiscal consolidation in the advanced economies. For emerging economies, despite the rebalancing of growth towards domestic demand and intra-regional trade, developments in advanced economies would still have an impact both directly and indirectly on emerging economies through the financial market and trade channels. Signs of slowing economic activity in most emerging economies became more evident in the third quarter of 2011, following the slowing of exports caused by deteriorating external demand.

During the period, risk aversion increased, while market sentiments deteriorated considerably. The VIX index, a gauge of investors' risk aversion increased to levels not seen since the collapse of Lehman Brothers in 2008. Investors withdrew funds from emerging market assets in favour of highly liquid US dollar denominated assets such as US Treasuries and precious metals such as gold, causing the 10-year US Treasury yield to decline to a record low of 1.72% and gold prices to reach a new record high of USD1900 per ounce. In addition, some countries which are considered as safe haven

Chart 2.4

Measures of Volatility



Source: Bloomberg

currencies such as the Swiss franc instituted measures to limit currency appreciation.

Several advanced economies, especially in the euro area, being the epicenter of events, were badly affected. Measures introduced to improve sentiments and calm markets, such as the leveraging and expansion of the European Financial Stability Fund from €440 billion to €1 trillion, the voluntary write-down of Greece's debt held by private investors, the recapitalisation of European banks and sovereign bond purchases by the ECB had only limited impact and provided temporary relief to markets. Although global investor risk

Chart 2.5

3-Month LIBOR less OIS



Source: Bloomberg

aversion had subsided and sovereign bond yields declined following the announcement of these measures at the EU summit on 26 October and the coordinated swap arrangement by six major central banks on 30 November, the interbank liquidity conditions remained tight and volatility continued to remain high.

Emerging economies were not insulated from the effects of the turmoil. Market sentiments were adversely affected by developments in the advanced economies. Heightened risk aversion and asset repatriation by European investors facing difficulties with short-term funding resulted in a sharp reversal of capital flows from emerging economies. Between 29 July to 5 October, the MSCI Asia (ex-Japan) index declined by 27.2%, erasing the gains since June 2010. This in turn led to a depreciation of emerging market currencies, reversing the appreciating trend earlier in the year. The tightness in US dollar funding also led to a decline in the supply of US dollar credit from euro area banks to emerging economies, although banking and credit conditions in general remained stable.

Against a backdrop of significant downside risks, the monetary policy focus in the latter part of 2011 broadly shifted towards an accommodative bias. The lack of fiscal space in the advanced economies, coupled with weak economic and financial conditions called for a more supportive role for monetary policy. Policy measures ranged from a reduction in interest rates by the ECB and the Reserve Bank of Australia, a commitment by the US Federal Reserve to maintain interest rates at close to zero till mid-2013, and additional bond purchases by the ECB, BOE, BOJ and the US Federal Reserve aimed at lowering long-term interest rates and injecting liquidity directly into the economy. Emerging economies, however, faced a tradeoff between a slowing external sector and the still robust domestic demand conditions. Several major emerging economies such as Brazil, Indonesia and PR China reduced interest rates, or reduced reserve requirements. Others paused the process of policy normalisation to evaluate the balance of risks and the potential for further negative spillover effects should conditions in the advanced economies worsen.

Despite some tentative signs of improvement in the US economic data towards the end of the year, it was clear that the balance of risks had tilted towards the downside. In the advanced economies, prevailing issues of high debt levels and fragility of financial institutions remain unresolved,

while the ability to sustain the growth momentum without policy support remains uncertain. As a result, emerging economies could face significant external headwinds from slowing external demand and financial contagion. With the global outlook clouded with significant uncertainties, there was a significant likelihood that authorities would introduce additional monetary stimulus going forward. This additional liquidity, coupled with volatile financial market conditions was likely to result in sharp surges and swings in capital flows to emerging economies. Moving forward, such an environment will continue to pose policy challenges for both financial and monetary stability in emerging economies.

DOMESTIC MONETARY AND FINANCIAL CONDITIONS

Exchange Rate

As in the previous year, ringgit developments in 2011 were heavily influenced by significant two-way flows of portfolio investment arising primarily from external factors. Reflecting the volatile developments in international financial markets, ringgit movements during the year followed two noticeable trends. Between early January and July 2011, the ringgit strengthened due to significant portfolio inflows. Strengthening fundamentals and positive investor sentiments continued to attract such short-term capital flows towards regional markets. In August and September, however, heightened risk aversion and asset repatriation by some European investors resulted in the reversal of portfolio flows and contributed to the depreciation of most regional currencies, including ringgit. The respite following the positive outcomes of the EU summit in October was brief, as capital outflows and ringgit volatility increased towards the end of 2011 amidst unresolved market concerns over the sovereign debt crisis in Europe. Ringgit ended the year at RM3.1770 against the US dollar, a depreciation of 2.9%.

The broad appreciating trend of the ringgit in 2010 carried forward into the first half of 2011 as the combination of regional “pull” and global “push” factors continued to attract international investors towards regional financial assets. Economic growth in the region remained resilient, averaging 7.9% in the first half of 2011 (2010 1H: 10.5%)¹, underpinned by sustained domestic demand and intra-regional trade. Rising price pressures in emerging market economies

¹ Bank Negara Malaysia's estimates of EA-9 countries' growth (PR China, Chinese Taipei, Hong Kong SAR, Indonesia, Korea, Malaysia, Philippines, Singapore and Thailand)

during the first half of 2011 also raised investor expectations for further interest rates increases and currency appreciation across the region to contain inflation. Meanwhile, the continued weakness and expectation of a prolonged low interest rate environment in the advanced economies also served to push investors interest towards emerging economies. These factors contributed to the increase in demand for regional financial assets and resulted in net portfolio inflows of RM56.4 billion into Malaysia in the first half of 2011 (2010 1H: RM26.7 billion). Against this backdrop, the ringgit reached RM2.9385 against the US dollar on 27 July 2011, which was the strongest level since the introduction of the managed float system in July 2005.

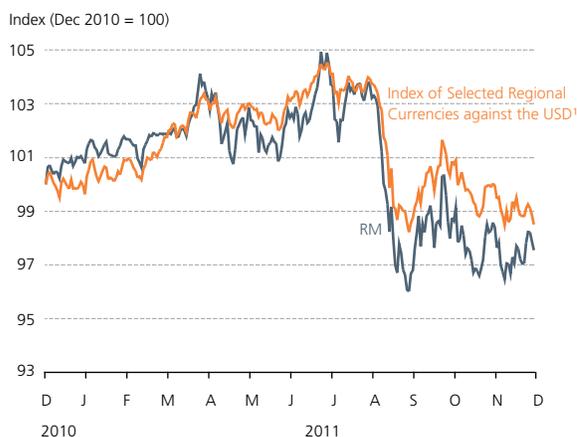
The performance of the ringgit during the year was influenced by volatility in international financial markets

The appreciating trend of the ringgit and other regional currencies was, however, reversed in August and September 2011 as investor risk aversion rose sharply following heightened uncertainty surrounding the global growth outlook and renewed concerns over the sovereign debt crisis in Europe. During this period, investor sentiments deteriorated and caused large portfolio outflows from regional financial markets including Malaysia. Investors began to shift investment preferences towards more liquid US dollar assets during this period of heightened uncertainty. Portfolio outflows were further exacerbated by asset repatriation by some European investors facing potential short-term funding shortages in their home countries. As a result, regional currencies broadly depreciated against the US dollar. For Malaysia, outflows in the third quarter amounted to RM23.4 billion, the highest quarterly outflow since the fourth quarter of 2008. The depreciation briefly abated in October, but volatility remained elevated throughout the remainder of 2011 as financial markets reacted to developments in the euro area.

Against other major currencies, the ringgit depreciated against the Japanese yen (-7.6%), pound sterling (-2.3%) and the euro (-0.8%). The sizeable depreciation against the Japanese

Chart 2.6

Exchange Rate of the Malaysian Ringgit (RM) and Selected Regional Currencies Against the US Dollar



¹ Regional currencies: Chinese renminbi, Indonesian rupiah, Korean won, Philippine peso, Singapore dollar, New Taiwanese dollar and Thai baht. Each currency carries equal weight

Note: An increase in the index represents an appreciation of the ringgit or of selected regional currencies against the US dollar

Source: Bank Negara Malaysia

yen was in line with the regional trend as the Japanese currency strengthened across the board. The ringgit also broadly depreciated against regional currencies, with the exception of the Thai baht, against which the ringgit appreciated by 2.2%. The ringgit's weaker performance in 2011 only partially reversed the ringgit's relatively strong performance against regional currencies

Chart 2.7

Exchange Rate of the Malaysian Ringgit (RM) Against Major Currencies



Note: An increase in the index indicates an appreciation of ringgit against the currency

Source: Bank Negara Malaysia

Chart 2.8

Summary of Malaysian Ringgit Performance against Major and Regional Currencies



Note: (+) indicates an appreciation of the ringgit against foreign currency
Source: Bank Negara Malaysia

in 2010. For the year as a whole, the ringgit's Nominal Effective Exchange Rate (NEER), a measure of ringgit's performance against the currencies of Malaysia's major trading partners, depreciated by 2.8% (2010: +6.4%).

During periods of heightened uncertainty, the policy stance was to ensure that ringgit adjustments remained orderly. Given that Malaysia is a small and highly open economy, avoiding large and excessive exchange rate swings is vital to avoid significant disruptions in the market that could result in dislocations in the real sector. It is therefore important for movements of the currency to be gradual to allow for the corresponding adjustments in the real economy to take place. Consistent with this policy stance, the Bank will continue to ensure that sudden surges in capital flows do not create destabilising conditions in the foreign exchange market. Over the medium to long-term, as the global risk aversion subsides, portfolio flows are expected to return to emerging economies, as fundamental factors such as positive growth and rates of return differentials that favour emerging economies will continue to draw global investors.

Interest rates, bond yields and equity prices

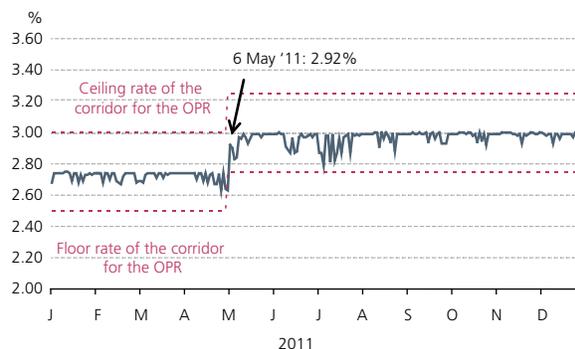
Interest rates rose in 2011 following the Monetary Policy Committee's (MPC) decision to raise the Overnight Policy Rate (OPR) by 25 basis points to 3.00% in May 2011. Taking into account the OPR increases in 2010, the policy rate has since been raised by a cumulative 100 basis points, only partially reversing the 150 basis points OPR reduction following the 2008 financial crisis in the advanced economies. Despite the increase in borrowing costs following the rise in the OPR,

monetary conditions therefore continue to remain accommodative, ensuring an environment that continues to be supportive of economic activity.

The transmission of the OPR normalisation in May 2011 to the wholesale and retail markets was rapid and sizeable. Money market rates adjusted immediately following the May OPR increase; the average overnight interbank rate rose from 2.63% on 5 May 2011 to 2.92% on 6 May 2011 and has since remained stable. Interbank rates of other tenures also increased. Kuala Lumpur Interbank Offered Rates (KLIBOR) and interest rate swap (IRS) rates rose in tandem with other money market rates, and continued to increase slightly after the OPR normalisation

Chart 2.9

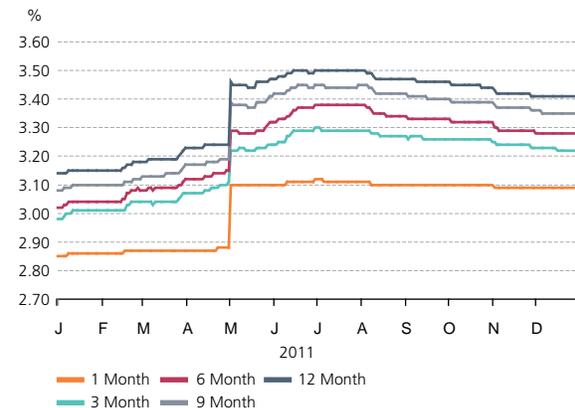
Average Overnight Interbank Rate



Source: Bank Negara Malaysia

Chart 2.10

Kuala Lumpur Interbank Offered Rate (KLIBOR)



Source: Bloomberg

in May, reflecting market expectations of further OPR increases. KLIBOR and IRS rates subsequently moderated beginning August 2011 as market expectations of further OPR increases were tempered given the uncertainties surrounding global growth and its implications for the Malaysian economy.

Interest rates have increased following the normalisation of the OPR, but continue to remain supportive of economic activity

The rise in the OPR resulted in an upward revision in retail deposit rates. Interest rates on fixed deposits rose by 24 to 27 basis points across tenures. The adjustment of fixed deposit rates was undertaken quickly, within ten days of the OPR increase in May.

Given the high OPR pass-through to money market interest rates, retail lending rates also adjusted upwards to reflect the higher cost of funds. The benchmark lending rate, as measured by the average base lending rate (BLR) increased by 27 basis points to 6.54% as at end-May 2011. Compared to previous adjustments, the magnitude of increase was 2 basis points higher than the OPR increase to also take into account the higher cost of financial intermediation following the increase in the Statutory Reserve Requirement (SRR). All domestic commercial banks adjusted their BLRs within eight days of the OPR increase.

Chart 2.11

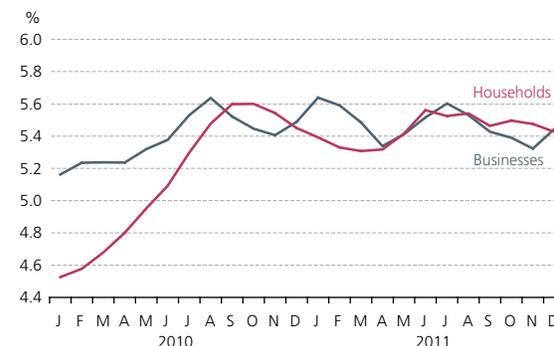
Fixed Deposit Rates



Source: Bank Negara Malaysia

Chart 2.12

ALR on New Loans Approved (3-month moving average)



Source: Bank Negara Malaysia

The impact on lending rates was uneven, with the size of the adjustment varying across loans by different purpose and sector. The average lending rate (ALR) on new loans for the purchase of residential properties, securities and personal use increased by 14, 11 and 27 basis points respectively from end-April to end-May 2011. In contrast, lending rates on hire purchase loans actually moderated during the year. However, this was mainly due to the moderation in the benchmark IRS rates, which is used to price hire purchase loans. Lending rates to businesses also experienced a smaller degree of pass-through, with the ALR on new business loans rising by 7 basis points, from 5.34% to 5.41% during the same period. This was the outcome of the strong competition in the loans market.

Movements in Malaysian Government Securities (MGS) yields in 2011 were primarily driven by external factors. In the first four months of the year, MGS yields trended upwards across all maturities. This was largely attributed to a combination of stronger growth prospects, higher inflationary pressures due to the surge in global commodity prices and expectations of an increase in the policy rate. From January to April 2011, the 5-year MGS yield increased by 15 basis points.

In the subsequent eight months of the year, however, bond yields reversed the upward trend on strong non-resident portfolio inflows into the bond market. The share of non-resident holdings of MGS to total outstanding MGS

Chart 2.13

MGS Yields



Source: Bank Negara Malaysia

increased to 36.9% in December 2011 from 28.3% in December 2010. As in the previous year, the high demand for MGS was driven by international portfolio funds searching for yield in an environment of surplus liquidity. Favourable growth and interest differentials, expectations of currency appreciation and the depth of the Malaysian bond market were key factors attracting these funds to Malaysia. Reduced market expectations of any increase in the policy rate in the second half of 2011, amid signs of slowing global growth and receding inflationary pressures, also supported lower yields.

The downward trend in the yields was punctuated by two temporary episodes of rising yields. In May, short-term yields rose briefly in response to the increase in the OPR, with the 1-year MGS rising 12 basis points from 5 May to 11 May. There was also a brief upward surge in yields in September as heightened global risk aversion prompted a shift in non-resident portfolio flows towards more liquid, US dollar-denominated assets.

MGS yields remained low following strong external demand amid positive domestic growth prospects

This resulted in non-resident holdings of MGS declining from RM100.9 billion as at 24 August to RM92.7 billion as at end-September. The portfolio outflows were, however, temporary as measures taken by governments in the advanced economies to calm markets and restore confidence resulted in a resumption of portfolio inflows into emerging economies. This resulted in inflows into the domestic bond market. Overall, for the year, MGS yields declined by between 4 to 34 basis points. A larger decline was recorded for bonds of longer tenures, resulting in a further flattening of the benchmark yield curve in 2011.

Despite the volatility and stress in the international financial and credit markets, conditions in the

Chart 2.14

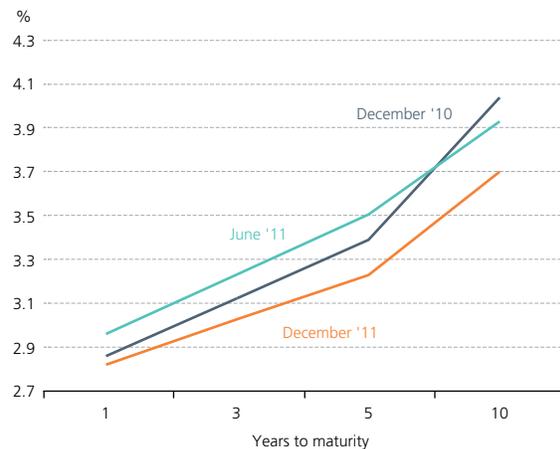
Outstanding Debt Securities Held by Non-Residents



Source: RENTAS, Bank Negara Malaysia

Chart 2.15

MGS Benchmark Yield Curve



Source: Bank Negara Malaysia

Chart 2.16

5-year MGS and 5-year PDS Yields



Source: Bank Negara Malaysia

domestic private debt securities (PDS) market remained robust. PDS yields were largely stable in 2011, with yields on the 5-year AAA and AA-rated papers recording a marginal decline of 9 basis points. As the size of non-resident holdings relative to the total size of the PDS market was small, PDS yields were mostly unaffected by the portfolio outflows experienced in the second half of 2011. Yields on lower-rated PDS, namely the 5-year A-rated paper, declined by 42 basis points, as domestic credit conditions improved, as reflected by the substantial decline in the number of negative rating actions during the year from 106 in 2010 to 51 in 2011.

Conditions in the PDS market were largely unaffected by the turmoil in international financial markets

Liquidity in the PDS market improved further, with total turnover in the PDS market increasing to RM112.3 billion in 2011 from RM89.3 billion in 2010. Of note, turnover in the second half of 2011 was higher than that in the first half, as there was a larger amount of new PDS issuances during the period. New PDS issuances increased to RM69.6 billion in 2011, from RM52.1 billion in 2010, reflecting the higher demand for financing arising from the Economic Transformation Programme (ETP) and infrastructure projects.

The FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI) increased by 0.8% in 2011 (2010: 19.3%) to close at 1,530.7. Domestic equity prices rose in the first half

Chart 2.17

Regional Equity Indices



Source: Bloomberg

of 2011 on strong domestic fundamentals. However, the upward trend was periodically interrupted by negative sentiments following unexpected geopolitical tensions and natural disasters in other regions. The disruption to the supply chain caused by these events proved, however, to be temporary, and the FBM KLCI recovered, recording an increase of 4% in the first half of 2011. In June, the FBM KLCI was upgraded from the Secondary Emerging Markets to Advanced Emerging Markets series for the FTSE Global Equity Index Series. The upgrade provided further support to the FBM KLCI as it recorded a new closing high of 1,594.7 on 8 July 2011.

Shifting investor sentiments and deleveraging contributed to volatility in regional equity markets

In the second half of the year, domestic equity prices were affected by concerns regarding developments in advanced economies. The US debt-ceiling crisis led to a downgrade in its sovereign ratings, a first in history, which triggered a spike in global risk aversion and a large sell-off in global equities. This was followed by a further deterioration in the sovereign debt crisis in Europe that added downward pressure on equities. Increased investor uncertainty arising from these developments was reflected in the higher volatility of FBM KLCI returns in the second half of the year relative to the first half. The FBM KLCI bottomed in late-September before it tracked a slow recovery as investors reacted

Chart 2.18

Global Risk Aversion and Volatility of KLCI Returns



¹ Refers to VIX Index
² Refers to 30-day rolling standard deviation of daily returns

positively to measures taken in advanced economies to stabilise markets. Overall, the FBM KLCI declined by 3.1% in the second half of 2011.

For the first three quarters of the year, equity prices were supported by finance-related stocks as favourable domestic conditions continued to support growth in this sector. The last quarter of the year saw stocks of plantation companies experiencing a boost due to improving global commodity prices. The high turnover in the FBM KLCI reflected sustained interest in the domestic equity market. Continued Government efforts to liberalise certain sectors and divest its stake in government-linked companies (GLCs) further supported interest in the domestic equity market.

Liquidity and Monetary Aggregates

Liquidity conditions in the banking system remained ample throughout 2011. Private sector liquidity expanded strongly on account

of sizeable capital inflows in the first half of 2011. Despite the episodes of large capital outflows in the second half of 2011, a net expansion in liquidity was recorded for the year as a whole. Consequently, Bank Negara Malaysia's monetary operations were focused on offsetting the impact of the flows on domestic liquidity and maintaining relatively stable domestic monetary conditions.

In the banking system, ample liquidity conditions prevailed at both the institutional and system-wide levels. Surplus liquidity placed with Bank Negara Malaysia increased by 18.8% in 2011, due mainly to the unprecedented scale of foreign inflows into the Malaysian financial system.

Bank Negara Malaysia conducted operations in the money market to manage the growth of liquidity arising from the inflows. The concern was that if not managed, the excessive build-up of liquidity could give rise to financial distortions including over-extension of credit to the private sector, mis-pricing of risk, and excessive risk-taking; all of which could result in excessive growth of leverage and the misalignment of asset prices. Accordingly, the inflows were sterilised through a wide range of instruments including direct borrowing, repurchase agreements (repos) and Bank Negara Malaysia bills. The Statutory Reserve Requirement (SRR) was also raised three times between January and May, from 1.00% to 4.00%, to provide longer term sterilisation of the liquidity.

Private sector liquidity, as measured by broad money or M3, exhibited a stronger growth of 14.4% during the year. The main impetus for

Chart 2.19

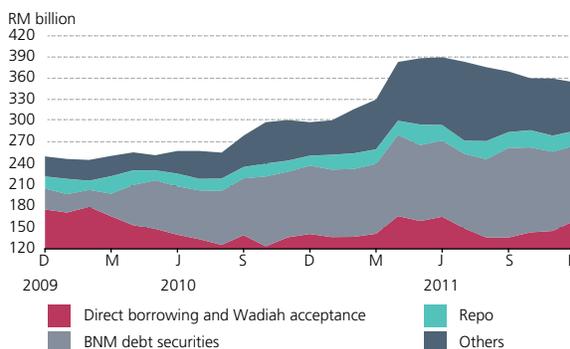
KLCI and Bursa Malaysia Sectoral Indices



Source: Bloomberg

Chart 2.20

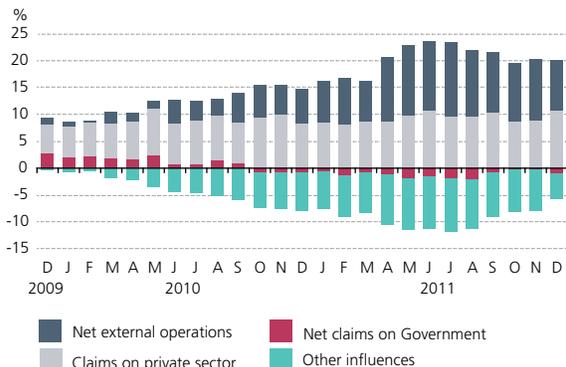
Outstanding Liquidity Placed with BNM (at end-period)



Source: Bank Negara Malaysia

Chart 2.21

Contribution to M3 Growth



Source: Bank Negara Malaysia

Chart 2.22

Broad Money, M3



Source: Bank Negara Malaysia

the increase in broad money was the significant capital inflows in the first half of the year. Broad money also increased throughout the year following higher credit extension by the banking system. The expansion in M3, however, was in part contained by Bank Negara Malaysia’s sterilisation operations. This was reflected in the contraction of “other influences”. Capital outflows in the second half of the year also had a moderating impact on broad money growth.

FINANCING OF THE ECONOMY

Financing conditions remained supportive of economic activity in 2011. The reasonable cost of borrowing and ample liquidity conditions in the financial system sustained financing to all segments of the economy.

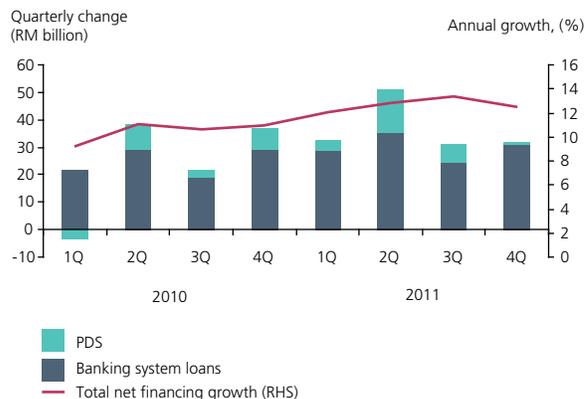
Private sector financing growth has trended upward since 2010 in line with the improved economic growth. For the year as a whole, net financing raised by the private sector through the banking system and the capital market expanded at a faster annual pace of 12.5% (2010: 10.9%). Robust private consumption, underpinned by the continued resilience of the domestic economy, contributed towards sustained demand for financing from both businesses and households.

Financing for consumption and investment supported the domestic economy

During the year, total financing extended through financial institutions and the capital market to the business sector recorded a marked improvement, growing by 11.5% (2010: 7.7%). Financing was extended mainly to the *finance, insurance and business services; real estate; manufacturing and wholesale, retail, restaurants and hotels* sectors. The increase in financing to businesses was driven by improved retail sales and higher investment activity in response to strong domestic demand. The expansion in banking system loans to businesses (2011: 13.5%; 2010: 9.4%) reflected the broad based increase in loans disbursed to finance the investment and working capital needs

Chart 2.23

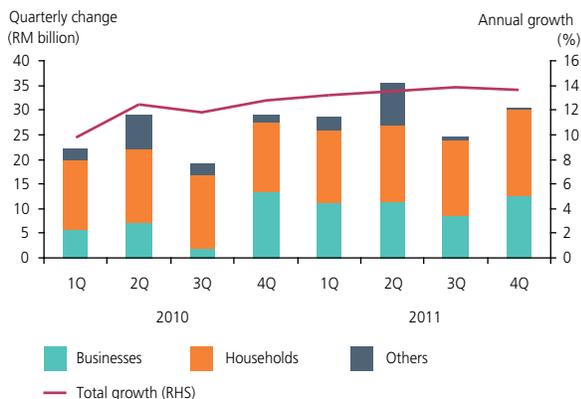
Total Net Financing to the Private Sector through Banking System Loans and PDS Issuances



Source: Bank Negara Malaysia

Chart 2.24

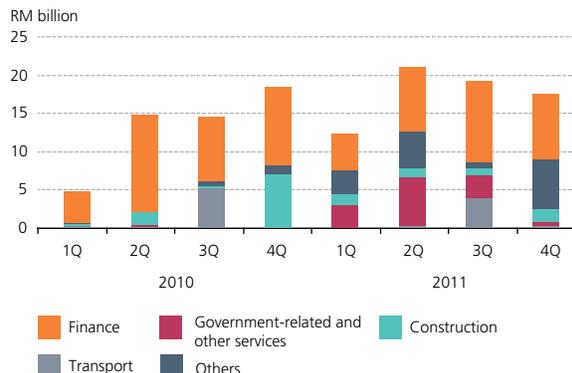
Loans Outstanding by Customers



Source: Bank Negara Malaysia

Chart 2.25

Gross PDS Issued by Sector



Note : Data excludes Cagamas bonds and issuances by non-residents

Source: Bank Negara Malaysia

of businesses, especially in the *manufacturing; real estate; wholesale, retail, restaurants and hotels; and transport, storage and communication* sectors. Despite the moderation in loan applications from the *manufacturing; wholesale, retail, restaurants and hotels and transport, storage and communication* sectors in the fourth quarter of 2011 following the more uncertain outlook for global growth, the overall demand for loans by businesses remained strong.

Business demand for funds from the capital market was also higher, with new issuances of private debt securities (PDS) amounting to RM69.6 billion in 2011 (2010: RM52.1 billion). The increase was due to several large-scale issuances, mainly by the *finance, insurance, real estate and business services and government-related and other services* sectors to fund working capital requirements and refinance debt. Financing via the equity market, however, declined to RM12.6 billion (2010: RM32.1 billion) as turbulent market conditions globally affected market sentiments domestically.

The demand for household loans was also sustained, with outstanding loans increasing by 12.9% in 2011 (2010: 13.4%), driven mainly by loans for the *purchase of residential and non-residential properties*

and for *personal use*. The expansion in household loans reflected growing household consumption expenditure amid favourable income growth, positive employment prospects and improved consumer sentiments. Loan growth for the *purchase of passenger cars*, however, moderated to 6.0% in 2011 (2010: 7.3%) reflecting lower car sales during the year following supply disruptions stemming from the impact of natural disasters in Japan and Thailand.

Although the overall level of household debt and credit growth remained manageable, the Bank nevertheless adopted a pre-emptive approach in dealing with potential vulnerabilities and risks to macroeconomic stability. Several pre-emptive measures were instituted since end-2010 to ensure prudent levels of household debt and to mitigate potential risks of financial imbalances. Among the measures implemented were the maximum loan-to-value (LTV) ratio of 70% on third and subsequent housing loan facility taken out by borrowers, the new measures on credit cards to promote prudent financial management, introduction of the Financial Capability Programme by the Credit Counselling and Debt Management Agency (AKPK) to raise the level of financial literacy and new lending guidelines for financial institutions to promote prudent, responsible and transparent retail financing practices.

New Malaysian Currency Series

Introduction

The introduction of the third series of Malaysian coins and the fourth series of Malaysian banknotes marks yet another significant milestone for Bank Negara Malaysia as the sole currency issuing authority in Malaysia. Each of the banknote and coin series showcases the unique and distinctive aspects of the country. The latest banknote and coin series also incorporates numerous innovations and security features that are more technologically advanced than in the previous issuance of the coin series in 1989 and the banknote series in 1996.

The Third Series of Malaysian Coins

The third series of Malaysian coins was launched on 25 July 2011 and has been introduced into general circulation since 16 January 2012. The new coins, in denominations of 50 sen, 20 sen, 10 sen and 5 sen, will gradually replace the existing series, which has been in circulation since 1989. Themed 'Distinctively Malaysia', the new coins reflect the diversity and richness of Malaysia's national identity. The obverse side of all coins features fourteen dots to represent the thirteen states and the Federal Territory, while the five horizontal lines represent the five principles of the 'Rukun Negara' (national pillars), with exception of the 50 sen coin. The fine lines in the motif background of the new 50 sen coin are part of the security features. The different motifs featured on the reverse side of the respective denominations are as follows:

Denomination	Icon
50 sen	Pea tendrils motif
20 sen	Jasmine flower
10 sen	'Orang Asli' motif
5 sen	<i>Destar Siga</i>



In general, the new coins are smaller, lighter and more user-friendly. The new series of coins has been introduced in two colours – yellow and silver, with different features at the edge for easy recognition and differentiation. This design has been adopted bearing in mind the difficulties faced by the visually challenged.

The new coin series also embodies the latest minting technology that integrates improved anti-counterfeiting security features. The latest security features such as the latent image and indentions have been included in the new 50 sen coins to prevent counterfeiting and also to make authentication easier. The public will be able to see the lettering of the denomination “50” and “SEN” when the coin is tilted slightly. At the same time, the use of new metal alloys will extend the lifespan of the coins, with enhanced protection against wear and corrosion. The technical specifications of the new coin series are as follows:

Denomination	50 sen	20 sen	10 sen	5 sen
Alloy	Nickel Brass Clad Copper	Nickel Brass	Stainless Steel	Stainless Steel
Diameter (mm)	22.65	20.60	18.80	17.78
Thickness (mm)	1.92	1.75	1.50	1.12
Weight (gram)	5.66	4.18	2.98	1.72
Shape	Round with 9 indentations	Round	Round	Round
Edge	Plain	Coarse	Milled	Plain
Colour	Yellow	Yellow	Silver	Silver

The Fourth Series of Malaysian Banknotes

The fourth series of Malaysian banknotes was officially launched by YAB Dato’ Seri Mohd Najib Tun Haji Abdul Razak, the Prime Minister of Malaysia, on 21 December 2011. Similar to the third series of Malaysian coins, the latest series of Malaysian banknotes has been inspired by features that are distinctively Malaysia. The banknotes feature traditional expressions in art and craft, natural wonders, flora and fauna, the economy and the nation’s traditions.

On the obverse side, all denominations of the new banknotes retain the portrait of the First Seri Paduka Baginda Yang di-Pertuan Agong, Tuanku Abdul Rahman ibni Tuanku Muhammad, the national flower *Rosa-sinensis* hibiscus (known locally as the ‘Bunga Raya’) and patterns of traditional woven fabric, the ‘songket’. The different motifs featured on the reverse side of the banknotes are as follows:

Denomination	Icon
RM100	Kinabalu Park, Sabah and pinnacles rock formations of Gunung Api Valley, Sarawak
RM50	Oil Palm & Biotechnology
RM20	Hawksbill Turtle and Leatherback Turtle
RM10	<i>Rafflesia Azlanii</i> flower
RM5	Rhinoceros Hornbill bird
RM1	Moon Kite



The RM20 banknote has been re-introduced in this new series, after its first appearance in the second series in 1982, to serve as an intermediary denomination between RM10 and RM50 for greater convenience in making payments. The old RM20 was discontinued in the third series of the Malaysian banknotes.

The new security features that have been incorporated in the new banknote series include a pixel watermark portrait with a highlight numeral, micro lens thread and iridescent patch. For familiarity and easy identification, the Bank has also retained the existing security features which have proven to be effective, including the shadow image, clear window, colour-shifting security thread, perfect see-through registration, invisible fluorescent elements, intaglio printing and micro printing. The banknotes are printed in durable substrates to maintain a high level of durability and quality while in circulation. The technical specifications of the new banknotes are as below:

Denomination	Substrate	Size (mm)	Predominant Colour
RM100	Paper	150 x 69	Purple
RM50	Paper	145 x 69	Green-blue
RM20	Paper	145 x 65	Orange
RM10	Paper	140 x 65	Red
RM5	Polymer	135 x 65	Green
RM1	Polymer	120 x 65	Blue

The banknotes retain their existing sizes and predominant colours to facilitate easy handling of the new banknotes by the public. For the visually impaired, Braille features have also been retained.

The fourth series of Malaysian banknotes will be available for circulation in the second half of 2012. The RM50 banknote became the first denomination in the series to be introduced into circulation when it was launched on 21 December 2007, in conjunction with the 50th Anniversary of Malaysia's Independence.

Conclusion

Currency usually reflects the identity of a nation, showcasing its unique cultures, natural endowments and historical heritage. In keeping with its responsibility to provide high quality currency and ensure public confidence in the Malaysian currency, Bank Negara Malaysia has incorporated the latest technologies and enhanced the technical specifications of the currency to ensure longevity and higher quality. While counterfeiting has never been a significant issue, newer and better security features have been introduced, from time to time, as a pre-emptive measure to enhance the integrity of Malaysia's currency notes and coins.

The new currency series is legal tender and will co-circulate with the earlier series until the gradual process of phasing out of the older series is completed.

2011

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MONETARY POLICY IN 2011

MONETARY POLICY

Monetary policy in 2011 focused on sustaining economic growth, containing the risks to inflation and preventing the build-up of financial imbalances. Maintaining the momentum from 2010, the Malaysian economy experienced sustained growth in the first half of 2011. Inflation was expected to be higher compared to the previous year, driven mainly by supply factors and to a lesser extent, domestic demand pressures. Monetary policy in the first half of the year was therefore focused on the need to further normalise interest rates and on the need to pre-emptively respond to the risks to macroeconomic stability arising from volatile and large portfolio flows. In the second half of the year, however, the downside risks to domestic economic growth increased significantly due to deteriorating global economic and financial conditions, whereas the upside risks to inflation had begun to moderate. Given the balance of risks, the Monetary Policy Committee (MPC) considered the prevailing Overnight Policy Rate (OPR) level to be appropriate and kept the policy rate unchanged for the remainder of the year.

Monetary policy in 2011 remained supportive of growth, while managing inflationary pressures

At the beginning of the year, economic indicators suggested that the recovery of the global economy was continuing, although the growth performance differed markedly across regions. The advanced economies were expected to grow at a relatively slower pace compared to the regional economies. The European sovereign debt crisis continued to cause ongoing financial market uncertainty while structural weaknesses in several advanced economies continued to restrain economic activity. Growth in the regional economies was, however, expected to remain robust, supported by strong domestic demand. In its January 2011 update of the World Economic Outlook (WEO), the IMF forecast growth in the US, euro area and Japan

to be at 3.0%, 1.5% and 1.6% respectively in 2011, whereas growth in PR China, the Newly Industrialised Asian Economies¹ and the ASEAN-5² economies would be higher at 9.6%, 4.7% and 5.5% respectively.

Domestically, there were positive signs that the economy was on a steady growth path, underpinned by the firm expansion in domestic demand. At this juncture, the assessment was that private consumption would continue to be supported by income growth, given positive labour market conditions and high commodity prices; positive consumer sentiments and continued access to financing. Private investment would be sustained by capital expenditure in the domestic-oriented sectors. Public investment would contribute to economic activity, partly driven by capital spending by the non-financial public enterprises (NFPEs). GDP growth for 2011 was expected to remain robust at 5-6%.

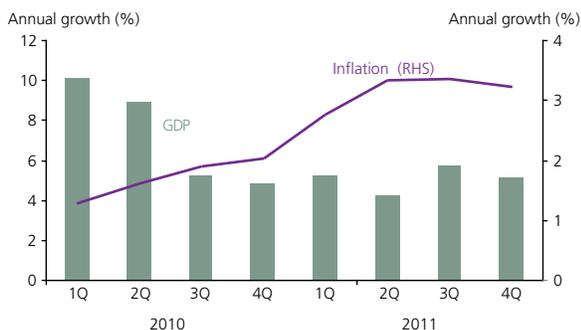
Inflation in 2011 was expected to be higher compared to 2010. Supply factors would be the main source of inflation during the year. The adjustments to the administered prices of petroleum products in December 2010 would inevitably raise headline inflation. Rising global energy and food prices were expected to exert upward pressure on firms' costs of production. Coupled with the expected strong domestic demand, the knock-on effects were expected to be larger and cause more generalised price increases across the economy. Domestic demand forces were also beginning to exert direct upward pressures on inflation. Core inflation had begun to increase and was expected to trend upwards during the year due to strong private consumption, which was supported by firm wage growth amid stable employment conditions. Core inflation had been on an uptrend from the third quarter of 2010, increasing from 1.3% in September 2010 to 1.6% in December 2010. There was also indication that inflation was becoming more pervasive. The share of CPI items

¹ Comprises Hong Kong SAR, Singapore, South Korea and Chinese Taipei

² Comprises Indonesia, Malaysia, Philippines, Thailand and Vietnam

Chart 3.1

GDP and Inflation



Source: Department of Statistics and Bank Negara Malaysia

experiencing price increases of more than 2% had risen over the course of the previous year, and this trend was expected to continue into 2011. Given these demand pressures, second-round inflationary effects could occur should inflation expectations become dislodged and wage increases respond to the higher inflation.

Against this backdrop of sustained economic activity and demand-induced pressures on inflation, the policy focus of the MPC from the beginning of the year was on the need to further normalise monetary policy to avoid keeping interest rates too low for too long. A prolonged period of low interest rates amid ample liquidity would not only lend support to demand-driven inflation, but would also lead to financial imbalances as it creates incentives for excessive leveraging and risk-taking in the search for higher yields that could fuel asset prices while dampening the incentives to save. The pace and extent of interest rate normalisation would, however, require proper calibration so as not to impinge excessively on economic growth. The economy was still recovering and uncertainties with respect to the strength of private consumption and investment remained.

By May 2011, there had been an accumulation of economic indicators that supported the economy being on a sustained growth path. Figures released in February showed GDP growth in the fourth quarter of 2010 was sustained at 4.8%. Forward-looking indicators and measures of consumer sentiment pointed to a continued positive outlook for private consumption. Feedback from the Bank's industrial engagements suggested sustained growth of employment and wages, which would be further supported by

the firm commodity prices in the first half of the year. The expansion in external demand in the first quarter of the year was also higher than had been anticipated and early estimates pointed to GDP growth remaining firm in the first quarter of 2011. The upside risks to inflation remained elevated, emanating from possible adjustments to fuel and food subsidies and electricity tariffs, and the increasing production costs due to the rising cost of inputs. Consequently, the MPC raised the OPR by 25 basis points on 5 May 2011 to 3.00%. The Statutory Reserve Requirement (SRR) was also increased by 1 percentage point each time in March, May and July to 4.00% to reduce the size of the excess liquidity in the banking system.

The transmission of the OPR increase to retail rates was rapid and sizeable. Banking institutions raised base lending rates (BLR) within 8 days of the announcement of the OPR increase, and the BLR was raised by 27 basis points to 6.54% as at end-May.

Table 3.1

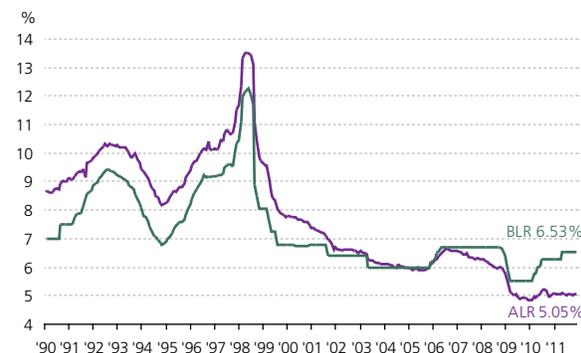
MPC Decision Dates and OPR Changes

MPC Decision Dates	OPR	
	Change	Level (%)
27 Jan 2011	-	2.75
11 Mar 2011	-	2.75
5 May 2011	+ 25 basis points	3.00
7 Jul 2011	-	3.00
8 Sep 2011	-	3.00
11 Nov 2011	-	3.00

Source: Bank Negara Malaysia

Chart 3.2

Base Lending Rate and Average Lending Rate of Commercial Banks



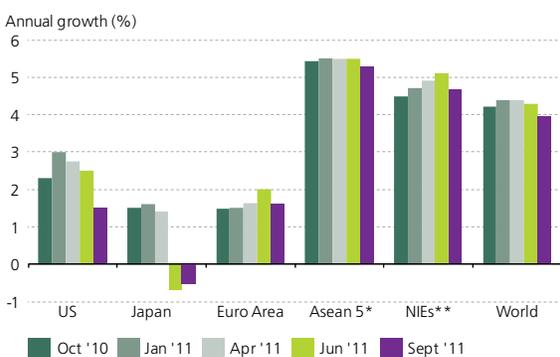
Source: Bank Negara Malaysia

The increase in the BLR was 2 basis points over the OPR increase, after imputing the higher cost of intermediation from the increases in the SRR.

In the second half of the year, however, global growth prospects began to deteriorate following the adverse developments in the advanced economies. The European sovereign debt crisis continued to intensify as the year progressed while policy uncertainties in the advanced economies, particularly in the US and euro area, only served to heighten financial market volatility and worsen confidence. Weaknesses in labour markets in the advanced economies also remained. In the US, the housing market continued to be weak and household balance sheets remained impaired. Overall, growth in the advanced economies in 2011 was expected to be slower than was forecasted at the beginning of the year, with the exception of the euro area where the core economies continued to experience strong growth. Growth in PR China was also expected to moderate, due to the weaker external environment and the effects of earlier tightening measures. Despite sustained domestic demand in the regional economies, growth also moderated. This change in the global growth outlook was reflected in the significant downward revisions to the 2011 and 2012 world growth forecasts by the IMF between its June 2011 and September 2011 updates of the WEO. The world GDP growth outlook was revised downward from 4.3% to 4.0% for 2011, and from 4.5% to 4.0% for 2012. These revisions indicated a renewed fragility of global economic growth and its vulnerability to shocks.

Chart 3.3

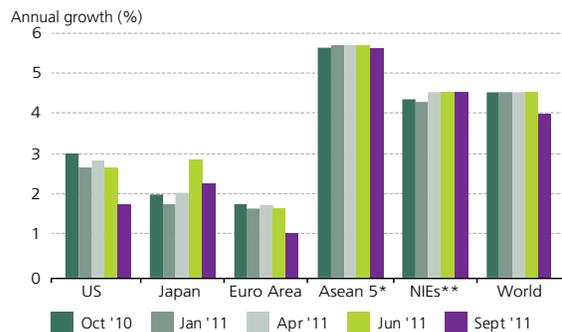
Outlook for Real GDP Growth in 2011



*Indonesia, Malaysia, Philippines, Thailand and Vietnam
 **Newly Industrialised Economies
 Source: IMF, WEO October 2010, January, April, June and September 2011

Chart 3.4

Outlook for Real GDP Growth in 2012



*Indonesia, Malaysia, Philippines, Thailand and Vietnam
 **Newly Industrialised Economies
 Source: IMF, WEO October 2010, January, April, June and September 2011

For the Malaysian economy, concerns about slowing external demand arising from the weaker global economic environment also began to emerge in the second half of the year. The more challenging external environment had thus increased the downside risks to the economy. Consequently, GDP growth was expected to come in at the lower end of the 5-6% range forecasted earlier. Overall growth prospects continued to remain positive, underpinned by the expansion in private consumption and investment, and public consumption. Employment conditions remained favourable amid sustained business and consumer confidence. The MPC, however, was mindful of the potential for lower commodity prices to affect domestic demand, particularly for rural households with reduced incomes.

With regard to inflation, price pressures were expected to remain elevated but more stable for the rest of the year and to moderate in 2012. The contribution from supply factors to inflation was expected to decline. The slower global growth, and the expected more stable supply of commodities, would reduce the pressure on global commodity prices. At the same time, anticipated adjustments to administered prices were not expected to materialise. The influence of domestic demand factors on inflation would be less than what was projected earlier in the year, as the increased uncertainties over growth prospects restrained demand pressures. Inflation was therefore assessed to have peaked. Food price inflation, however, remained a concern, largely due to domestic supply disruptions. This assessment proved to be correct as inflation

moderated from 3.5% in June to 3.0% in December. For the year as a whole, inflation averaged at 3.2%, which was within the Bank's forecast range of 2.5 – 3.5%.

Given the heightened downside risks to domestic growth and lower upside risks to inflation, the MPC considered the OPR level at 3.00% to be appropriate and kept the OPR unchanged for the remainder of the year. The outlook for the Malaysian economy remained positive, as the economy was expected to continue to expand, albeit at a more moderate pace. In the prevailing uncertain global economic environment with its consequent spillover effects onto the domestic economy, access to financing and business opportunities were the most important factors in determining the sustainability of growth.

Monetary conditions remained supportive of economic activity. Borrowing costs, especially in real terms, continued to be highly favourable. Lending rates remained below the levels prevailing before the 2008 financial crisis in the advanced economies. The cumulative 100 basis points increase in the OPR in 2010 and 2011 was only two-thirds the 150 basis points reduction undertaken in 2008 and 2009 to mitigate the impact of the financial crisis in the advanced economies. At end-December 2011, average nominal lending rates on new loans to businesses remained 52 basis points below pre-crisis levels and 11 basis points lower for households. Private sector financing was sustained in 2011. Net financing raised by the private sector through the banking system and

the capital market expanded at a faster annual pace of 12.5% in 2011 (2010: 10.9%).

A key challenge to the conduct of monetary policy during the year was the significant and volatile portfolio inflows. Emerging economies continued to receive large net portfolio inflows particularly in the first half of 2011 due to the sustained divergence in growth prospects and interest rates between the advanced and emerging economies amidst the substantial injections of liquidity by central banks in the advanced economies. The portfolio inflows and the consequent build-up of liquidity in the domestic financial system, if not managed, could lead to financial imbalances and create risks for macroeconomic and financial stability, particularly in terms of exchange rate overshooting and excessive growth in asset prices and credit. A sudden reversal in portfolio flows could also lead to economic and financial instability.

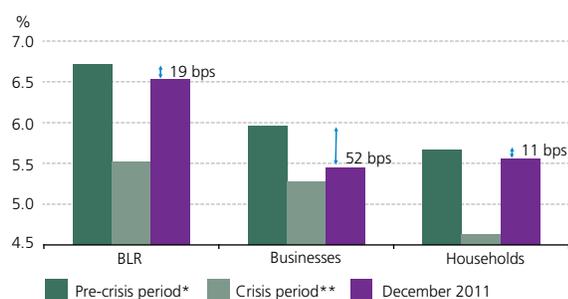
To manage the risks from excess liquidity, the MPC decided to raise the SRR by 1 percentage point each time in March, May and July to 4.00%. The staggered increases facilitated orderly adjustment by financial institutions. An important distinction was made that the SRR was not used as a signal on the stance of monetary policy, but used as an instrument to manage liquidity. It was highlighted that the SRR was one of the monetary instruments being used to manage liquidity in the banking system. The Bank also uses other monetary instruments such as uncollateralised borrowing and the issuance of Bank Negara Monetary Notes (BNMNs).

The Bank also instituted pre-emptive macro-prudential measures to ensure prudent debt management and address the possible risks arising from credit expansion. New measures were introduced on credit cards to promote prudent financial and debt management. New guidelines were also issued to financial institutions to promote prudent, responsible and transparent retail financing practices (*See Financial Stability and Payment Systems Report 2011 for further details*).

The year 2012 will undoubtedly present new challenges for monetary policy. The MPC will continue to assess carefully the evolving developments surrounding inflation, economic growth and financial conditions, and adjust monetary conditions accordingly to ensure the sustainability of growth of the Malaysian economy in an environment of price stability.

Chart 3.5

Average Nominal Lending Rates on New Loans for Various Periods



* January 2008 - October 2008
 ** March 2009 - February 2010

Source: Bank Negara Malaysia

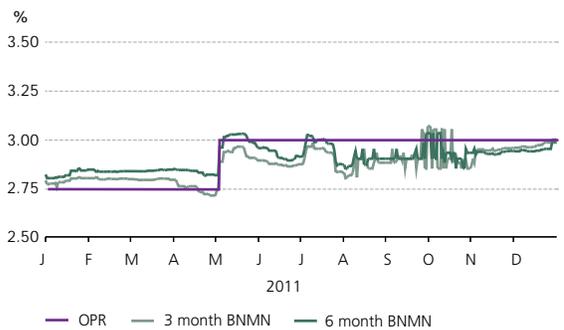
MONETARY OPERATIONS

During the year, the domestic money market and liquidity in the banking system were affected by developments in the international financial markets and volatile portfolio flows. Overall conditions in the domestic money market, however, remained resilient to the global financial turmoil. Interbank markets continued to operate under a surplus liquidity environment, with all participants remaining as net lenders throughout the year. Aggregate surplus liquidity rose from RM299.2 billion as at end-2010 to as high as RM397.5 billion as at June 2011, before declining in the second half of the year.

The earlier surge in domestic liquidity, which peaked in June 2011, corresponded with the portfolio inflows into emerging markets. To absorb the excess liquidity, the Bank increased the issuances of BNMNs. As a result of the significant amount of portfolio inflows, the 3-month and 6-month BNMN yields traded, on average, only 3 and 7 basis points above the OPR prior to the policy rate increase in May 2011 despite the widespread market expectations for monetary policy tightening. After the increase in the OPR, and during the second half of the year, BNMN yields traded below the OPR as a result of continued strong demand by non-residents. The Bank also absorbed liquidity via repo operations and direct money market borrowings. In addition,

Chart 3.7

BNMN Yields and OPR



Source: Bank Negara Malaysia

as part of managing this excess liquidity, the Bank revised the SRR, raising it in a staggered manner from 1.00% to 4.00%.

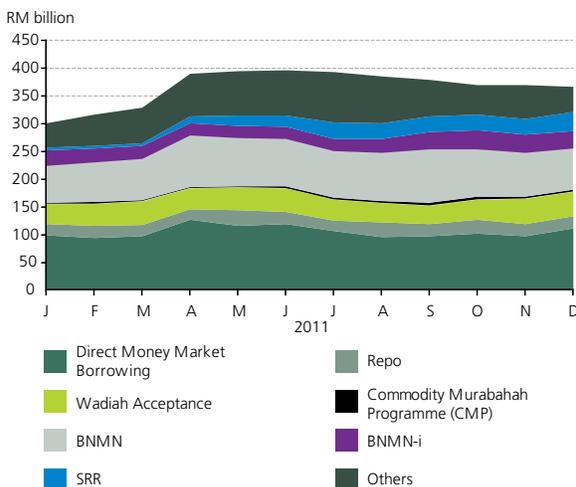
During the later part of the year, excess liquidity conditions in the domestic money market eased as a result of the reversal of portfolio flows. Nevertheless, overall liquidity remained in a surplus position. Bank Negara Malaysia responded to the changed conditions by reducing BNMN issuances and money market borrowings.

As a result of the monetary operation strategies adopted throughout the year, overall liquidity conditions in the domestic money market were stable. This was evidenced by the average overnight interbank rate (AOIR) in 2011, which was maintained within the range of +/- 25 basis points of the OPR. The AOIR adjusted to an average of 2.97% in the period after the 25 basis points increase in the OPR to 3.00% in May 2011, from an average of 2.72% previously. Throughout the year, the AOIR was relatively stable and tracked the OPR closely with an average deviation (AOIR minus OPR) of three basis points.

Several developmental initiatives were implemented in 2011 to increase the operational efficiency of monetary operations and enhance the variety of money market instruments. The Range Maturity Auction (RMA) was fully operationalised during the year and became part of standard monetary operations. The RMA is a variation to the money market term tender, which allows greater flexibility in determining the maturity range for uncollateralised borrowings. With the RMA, the Bank offers a tender amount with a tenor of maturity ranging from 7 days up to 1 year, but provides flexibility to the

Chart 3.6

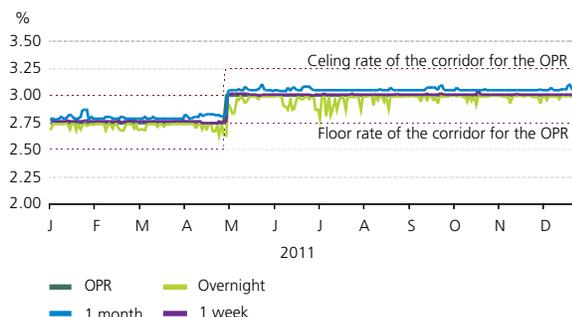
Outstanding Liquidity Placed with Bank Negara Malaysia



Source: Bank Negara Malaysia

Chart 3.8

OPR and Interbank Rates



Source: Bank Negara Malaysia

financial institutions to choose the maturity for the uncollateralised borrowings within the range offered by the Bank. RMA allows liquidity to be managed more precisely by providing financial institutions the option to lend their excess ringgit funds according to their liabilities profile. This has enhanced the Bank's liquidity management by matching the Bank's liquidity forecast with the financial institution's liquidity requirements.

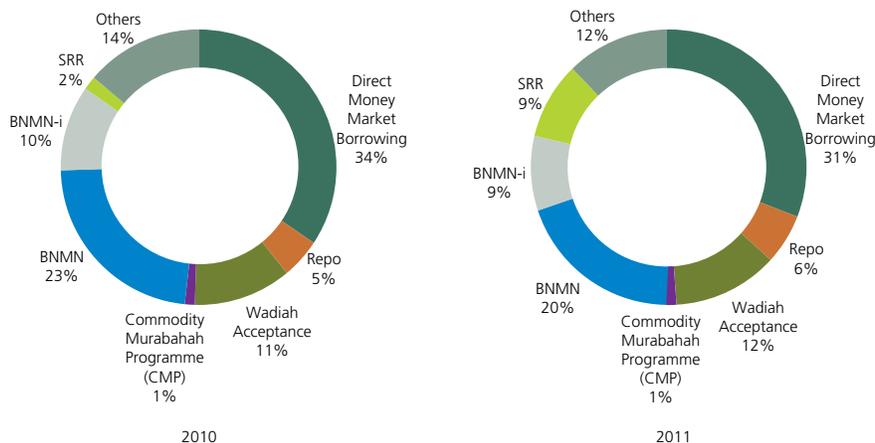
For the Islamic money market, two new instruments were introduced in 2011 to enhance the variety of instruments for liquidity management in the Islamic money market. The first instrument is the Bank Negara Malaysia Monetary Notes-Istithmar (BNMN-Istithmar), which is based on the *Istithmar* (investment) concept that refers to portfolio investments that comprise of *Ijarah* (lease) and

Murabahah (commodity cost-plus) transactions. This new monetary instrument is widely accepted by Islamic banks in Malaysia and is tradable in the secondary market. The second instrument is the Bank Negara Malaysia Monetary Notes-Bai Bithaman Ajil (BNMN-BBA), which is similar to the existing *Murabahah*-based BNMN-i, as both represent indebtedness arising from deferred payments on commodity *Murabahah* sale transactions between the issuer and investor. The BNMN-BBA, however, does not have secondary market tradability features, thus satisfying a different Shariah interpretation on the debt trading (*Bay Al Dayn*) prohibition.

As part of the effort to strengthen cross-border liquidity management, the Bank has embarked on initiatives to establish cross-border collateral arrangements (CBCA) with other central banks in the region. This would enable eligible Malaysian financial institutions operating in these countries to obtain liquidity from the respective central banks by pledging ringgit or ringgit-denominated sovereign and central bank securities. Similarly, eligible foreign financial institutions from these countries operating in Malaysia may obtain ringgit liquidity from Bank Negara Malaysia by pledging foreign currency or foreign currency-denominated sovereign and central bank securities with Bank Negara Malaysia. To date, the Bank has established CBCAs with the Monetary Authority of Singapore and the Bank of Thailand. With more countries in the region expected to participate in this initiative, this will reinforce financial and economic integration and support the expanding regional activity of financial institutions operating in the region.

Chart 3.9

Breakdown of Outstanding Monetary Policy Instruments



Source: Bank Negara Malaysia

2011

OUTLOOK AND POLICY IN 2012

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INTERNATIONAL ECONOMIC OUTLOOK

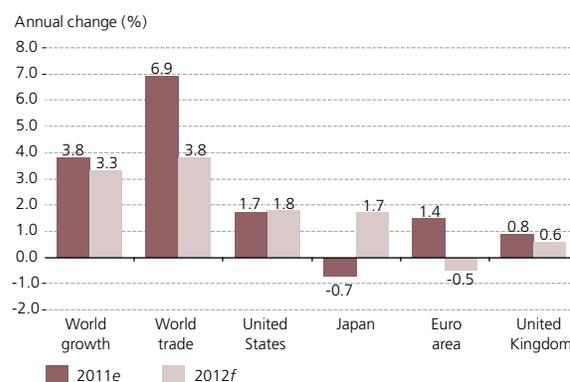
The global economic recovery, which began in the second half of 2009, is expected to slow in 2012 largely due to the ongoing sovereign debt issues in the advanced economies. Growth in these economies would be largely constrained by fiscal consolidation and private sector deleveraging following impairment of balance sheet of financial institutions. The extent of the moderation in global growth is largely contingent on how the debt crisis evolves and the nature and timeliness of the policy actions in restoring market confidence. In particular, given Europe's integration with the rest of the world, the spillover from the sovereign debt crisis will affect growth in both the advanced and emerging economies to varying degrees, through both trade and financial channels. Reflecting the weaker growth outlook and sentiments, global trade activity is expected to moderate, with a larger impact on the more open economies. In addition, continued volatility in international financial markets will have implications for global credit conditions through cross-border exposures to European banks, particularly to the banks that have weak balance sheets. Following the large and unprecedented policy stimulus measures taken during the global financial crisis, fiscal and monetary authorities in the advanced economies now have less policy space to fully mitigate the impact of these adverse developments on growth, thus reinforcing the expectations of a slower growth this year.

Global growth to moderate in 2012 amid increased downside risks, emerging particularly from the advanced economies

The growth prospects of the **advanced economies** are therefore expected to remain subdued. While the recovery in private sector

Chart 4.1

World Growth, World Trade and Growth in Major Advanced Economies (2011-2012)



e Estimate
f Forecast

Source: International Monetary Fund and National Authorities

activity is expected to proceed at a gradual pace, economic growth will be constrained by negative spillovers from the sovereign debt problems in the euro area. This will occur mainly through tighter credit conditions for households and businesses as banks embark on further deleveraging driven by continued financial market uncertainty and new regulatory requirements. In addition, fiscal consolidation measures will be a further factor affecting growth as the authorities attempt to restore fiscal credibility in view of high deficits and debt levels. For several European economies in particular, the pressure for further fiscal austerity is stronger as these economies face large gross financing needs during the year amid elevated sovereign bond yields. Furthermore, persistent crisis-related structural weaknesses, including impaired balance sheets of financial institutions, high unemployment and sluggish housing markets will continue to weigh on the fragile growth prospects.

In the **US**, the prospects are for a moderate recovery in economic activity, underpinned by a modest revival of private sector demand amid very loose monetary conditions. Private consumption is expected to expand, supported by job creation

in the private sector and the extension of the payroll tax holiday and unemployment benefits. Nevertheless, the progress continues to lack the momentum witnessed in previous recoveries due to the unresolved structural issues facing the economy. While employment is expected to improve, there are still approximately six million workers that had lost their jobs since the start of the recession and have yet to regain employment. Long-term unemployment is still unusually high as approximately 40 percent of the unemployed have been jobless for more than 10 months. This highlights the challenges faced by job seekers in finding suitable employment opportunities in the current economic environment. Some progress has been made in improving household balance sheets but deleveraging efforts are expected to continue as household debt remains high at 110% of disposable income (peak in 3Q 2007: 127%). The housing market remains sluggish due to tight credit conditions, weak income growth and subdued sentiments. The persistent excess supply of vacant houses, driven largely by foreclosures, will continue to constrain price increases, limiting new construction activity. Fiscal policy is expected to be a factor affecting growth due to the waning of fiscal stimulus that was implemented during the financial crisis and exacerbated by caps on discretionary spending.

With the **euro area** being the epicentre of the ongoing sovereign debt crisis, growth in that region is expected to be subdued. Economic activity in the core economies, including Germany and France, is expected to slow amid a moderation in external demand. Private sector activity is likely to be restrained by weaker consumer and business sentiments. Financing conditions could tighten as banks in the region might deleverage to meet the new core Tier 1 capital ratio of 9% by mid-2012. For the euro area economies experiencing fiscal sustainability concerns, namely Greece, Portugal, Spain and Italy, growth prospects remain fragile with domestic demand being further constrained by fiscal austerity measures, high unemployment, and weak bank lending.

The **Japanese** economy is expected to rebound from the negative growth in 2011, due mainly to reconstruction spending. The government has approved a few supplementary budgets in 2011 to focus on measures for recovery and reconstruction from the natural disasters. This is complemented

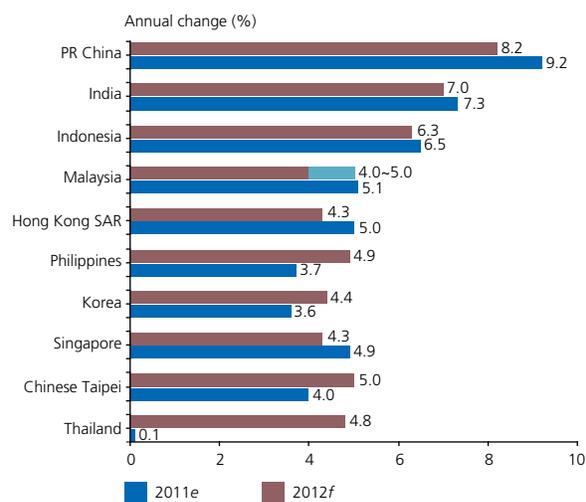
by the approval of a special account of ¥3.8 trillion in the FY2012 Budget. Growth, however, will be restrained by slowing global demand and the persistent strength in yen.

In view of the deterioration in the external environment, growth in the emerging economies will continue to moderate from the highs seen in 2010. In addition, growth of domestic demand is also expected to slow. More cautious private sector sentiments amid high uncertainties in the global economic and financial environment would restrain domestic activity as both firms and consumers reduce their spending. For a number of Asian economies, earlier policy measures to prevent overheating, rapid growth in credit and excessive increases in property prices have reined in demand to a more sustainable level. Emerging economies could also be adversely affected by the large quantity of liquidity being injected by the advanced economies and the consequent low interest rate environment which will continue to spur investors' search for yields. The implication is that many emerging economies will continue to experience large capital flows and significant volatility in their financial markets.

With global growth slowing, several governments in Asia have introduced measures to support

Chart 4.2

Regional Economies: Real GDP Growth



e Estimate
f Forecast

Source: International Monetary Fund and National Authorities

economic activity in their economies. Monetary authorities in the region have also shifted their monetary policy focus from addressing inflation to preserving growth.

In **Asia**, the growth momentum is expected to moderate in view of the weaker external demand outlook and to a certain extent, and for certain economies it is on account of the lagged impact from the previous policy measures. The deterioration in export performance stems mainly from slower demand from the advanced economies, particularly the European Union, which accounts for 23% of final demand for Asia's exports. Slower export growth is expected to have a larger adverse effect on the more open economies, but resilient domestic demand would continue to support growth across the region. Targeted fiscal support in some regional countries such as the Philippines, Indonesia and Korea, and reconstruction spending in Thailand are expected to mitigate some of the impact of the external weaknesses.

Global inflation is expected to moderate in tandem with lower food and energy prices and the slowdown in the global economic activity. Both headline and core inflation in the advanced economies are expected to remain subdued as a consequence of moderation in commodity prices, excess capacity and weak demand in these economies. In the emerging economies, including those in Asia, cost-push inflationary pressures are also expected to moderate, with lower core inflation rates amid slower growth. Commodity prices are generally expected to ease, due mainly to lower global demand and improved supplies. Nevertheless, there is the risk that the continuation of political unrest in the Middle East and North Africa could lead to further disruptions of oil supplies, leading to higher oil prices. In addition, given the low level of stocks in some agricultural markets, particularly for grains, food prices are vulnerable to supply disruptions caused by adverse weather conditions. The easy monetary conditions globally may also prompt demand for commodities as an asset class, which could pressure prices higher.

Several **downside risks** have emerged which significantly raise the prospect of challenging global economic and financial conditions going forward. The risks from the sovereign debt crisis in

the euro area could have significant ramifications on the global economy. Concerns over fiscal sustainability and other economic uncertainties are likely to contribute to continued heightened global financial market volatility and greater investor risk aversion. For several of the affected economies in Europe, some concerns revolve around the elevated international borrowing costs which could potentially pose a risk to fiscal sustainability given the large government refinancing needs during the year. Impairment of bank balance sheets and the reduced availability of credit are expected to continue to be a factor affecting growth. In addition, commitments by fiscal authorities to lower deficits and debt ratios in many of the advanced economies may also serve to further weaken growth in these economies. The implementation of needed structural reforms would enhance the flexibility and competitiveness of euro area economies, but could also lead to lower growth in the near to medium term.

The emerging economies face the risk of spillovers from the problems in the advanced economies through both the trade and financial channels. In addition, sudden reversals of capital flows may not only result in tighter domestic credit conditions but could also pose risk to financial stability. On the inflation front, the risk that the emerging economies could face renewed inflationary pressures due to higher food and commodity prices cannot be discounted given the potential for geopolitical and weather-related disruptions of supplies. In addition, China and India, the largest economies in the region, face risks that could lead to lower growth during 2012. Less favourable growth in these major economies, especially China, would have a negative impact on trading partners in Asia.

Notwithstanding the high downside risks, there have been tentative signs of improvement in the global economic and financial environment in the beginning of 2012, which could provide some upside potential to the global outlook. In the US, a stronger recovery could take place if the recent positive developments in the labour market picks up further. In addition, with the recent progress made in alleviating the risks of a disorderly default in Greece, market sentiments may improve further if continuous efforts are made to stem the contagion of the sovereign debt crisis. This would allow a gradual recovery in financial conditions

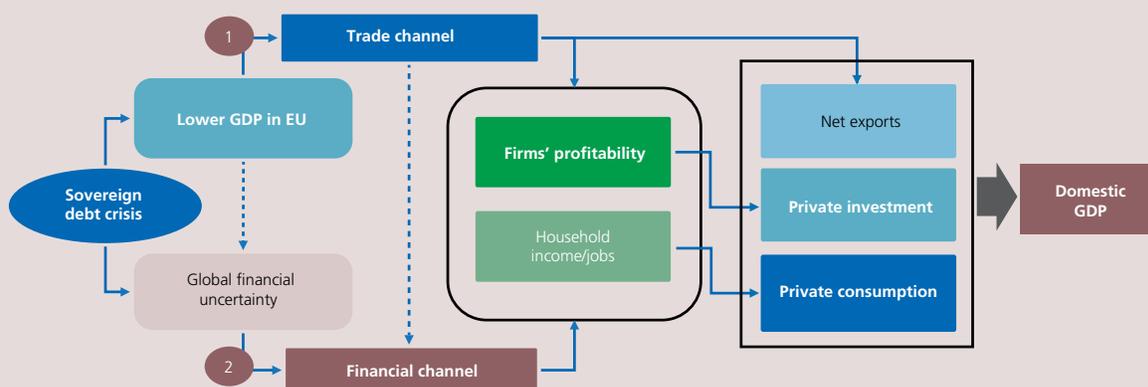
Impact of the European Sovereign Debt Crisis on Malaysia

Introduction

The European sovereign debt crisis poses a key risk to the global economy, as its potential escalation may have significant spillover effects on the real economy and the financial markets. The transmission of the impact of the Euro debt crisis to the Malaysian economy is through two major channels, namely the trade and financial flows (Chart 1). While Malaysia faces downside risks to growth from such external shocks, the resilience of the economy has improved steadily over the years. This is attributable mainly to the country's sound macroeconomic fundamentals, more resilient economic structure, stronger and more developed financial system, and the efficacy and flexibility of its macroeconomic policies.

Chart 1

Transmission of the European Sovereign Debt Crisis to Malaysia



Channels of Transmission to the Malaysian Economy

On the real sector side, Malaysia is exposed to the Euro debt crisis mainly through the trade channel, with potential subsequent spillover effects on private investment and consumption spending. In 2011, Malaysia's direct exports to EU¹ accounted for a relatively small share of total exports (2000: 13.7%). A more complete assessment of trade exposure, however, has to include indirect exports, in particular, exports of intermediate goods that are processed and subsequently exported to EU (Chart 2). Based on an analysis of intermediate goods flowing from Malaysia to the East Asian economies (Chart 3), which are then processed and exported worldwide, the indirect exposure to EU is estimated to be around 3.8% of Malaysia's total exports in 2011². This brings the overall exposure to EU to approximately 14.2% of total exports³. The main products exported to EU are E&E manufactures, particularly semiconductors, and computers and parts. The types of goods exported, however, have become more diversified to include more commodity and resource-based manufactured products such as rubber gloves and chemical and chemical products (Chart 4). These changes reduce the nation's vulnerability as exports become less dependent on any specific product.

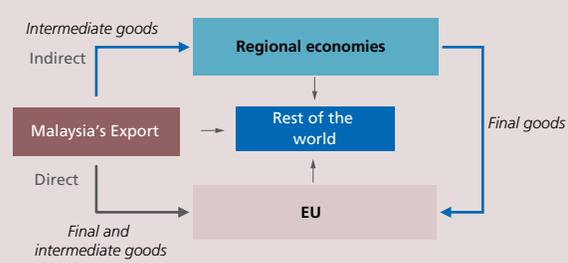
¹ EU includes all 27 countries in the union.

² The method assessed intermediate goods exports to EA8 economies, which are processed and then exported globally, with a smaller share of the goods going to the EU. This method only provides an estimate of the indirect exposure for the purpose of analysis.

³ Other studies have shown similar results. For example, Pula and Peltonen (2009) argued that based on an updated 2006 Asian Input-Output table, Malaysia's total exposure to EU15 (a smaller group of European countries) is estimated to be 9%.

Chart 2

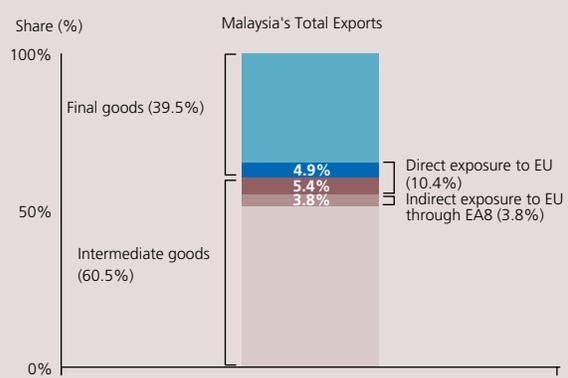
Direct and Indirect Linkage in Malaysia's Exports, an Illustrative Example



Shocks to trade may also spill over to other demand components. If such spillover effects materialise, they would have an impact on production activity and capacity utilisation rates, and may prompt businesses to delay investments in new capacity and products. Naturally, the manufacturing export-oriented industries, which account for about 30% of total private investment spending in 2011, will likely be the most affected. More directly, foreign direct investment (FDI) may also be affected, particularly by firms with direct linkages with the EU, and with other major trading partners of Malaysia that are also affected by the crisis. On average, net FDI flows from the EU accounts for about 29% of total net FDI flows into Malaysia between 2008 and 2011 (Chart 5).

Chart 3

Exposure of Malaysia's Exports to EU



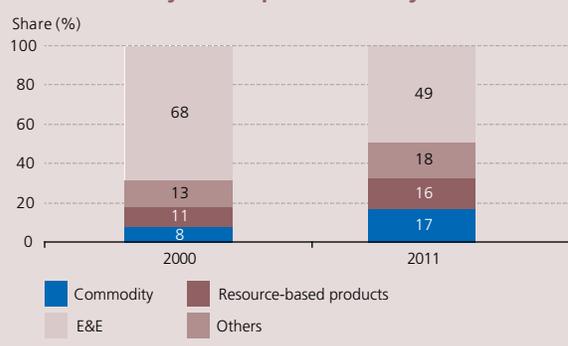
Note: EU includes all 27 countries in the union; EA8 includes PR China, Hong Kong SAR, Singapore, Korea, Chinese Taipei, Philippines, Thailand, and Indonesia; Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Furthermore, firms may undertake cost-cutting measures, including shorter working hours, wage cuts, or even retrenchments. Thus, household consumption spending may be affected by the resultant loss in income, especially among workers in the export-oriented manufacturing sector (about 12.2% of total employment) and in the trade-related services sector, such as transportation services (4.8% of total employment). Ultimately, the magnitude of the spillover impact would depend largely on the size of shock to the trade channel. However, given

Chart 4

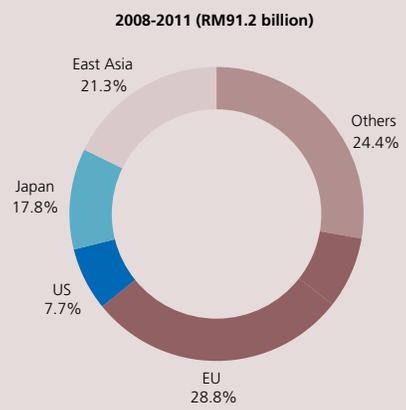
Share of Malaysia's Exports to EU by Product



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 5

Cumulative Flows of Net Foreign Direct Investment by Blocks of Countries



Source: Department of Statistics, Malaysia

Malaysia's diversified trade structure, any shock to Malaysia's overall trade arising from the EU would have a limited impact on the economy.

On the financial side, the impact from the European sovereign debt crisis will be transmitted mainly via increased uncertainty and volatility in the global financial markets, and the attendant rise in deleveraging activity, particularly among European financial institutions. Due to the close correlation that exists across markets and across asset classes, the heightened uncertainty in global financial markets may lead to significant volatility in the movement of cross-border capital. Uncertainty in the financial markets could affect not only confidence and subsequently domestic spending, but may also dampen fund-raising activity of businesses. At the same time, the weaker capital positions of some European banks create concerns that deleveraging by these institutions may restrain the availability of credit, including trade credit.

Malaysia, however, is somewhat insulated from the deleveraging by European banks. In Malaysia, all foreign banks are locally-incorporated subsidiaries with dedicated capital committed to the Malaysian operations as required under the Malaysian banking legislations. These subsidiaries are funded domestically, well-capitalised and are subject to the same standards of rigorous supervision and regulation that Bank Negara Malaysia imposes on domestic-owned banks. Given the strong and consistent financial performance and sustainable returns of the Malaysian operations of the locally-incorporated European banks, a material scale back of Malaysian operations as a result of deleveraging by the European parent banks is unlikely. Even in the unlikely event of a wide-scale retreat of European banks from the Malaysian market, domestic intermediation activity would continue to be well-supported by the domestic-owned and non-European banks in Malaysia that are well-capitalised and have strong liquidity positions. A more detailed exposition of the impact of external developments on the Malaysian financial system can be found in *Managing Contagion from External Developments* from Chapter 1 of Bank Negara Malaysia's Financial Stability and Payment Systems Report 2011.

Resilience of the Malaysian Economy

Malaysia's resilience and capacity to withstand the Euro debt crisis, and other potential external shocks from its major trading partners, have steadily improved over the years. Malaysia's strength could be broadly classified into four broad areas, namely sound macroeconomic fundamentals, more resilient economic structure, stronger and more developed financial system, and greater policy efficacy and flexibility.

The economy has been on a steady growth path, in an environment of low and stable inflation, while the financial system is now more developed with improved regulatory and supervisory structures. The external position remains favourable, with a sustained current account surplus and a high level of international reserves providing the buffer against the volatility in global financial flows.

Moreover, the economic structure has grown to become more resilient. Trade has become more diversified both in terms of products and markets. Malaysia's reliance on trade with the advanced economies including the EU is now smaller. The direction of trade has shifted progressively towards the regional economies, reflecting robust final demand amid the rising affluence of a large and expanding middle-class population in Asia. As a result, Malaysia's trade with the East Asian economies has surpassed that with the advanced economies, accounting for 47% of total exports in 2011 (2000: 40.2%). In terms of product mix, Malaysia's exports have also become more diversified, as its dependence on E&E exports has declined, with higher exports of commodities and non-E&E manufactured products. At the same time, domestic demand has been an anchor of growth in the Malaysian economy for the past few years, especially household consumption spending, benefiting from the steady increase in incomes and continued access to financing. These healthy fundamentals

and a more resilient economic structure, therefore, place the economy in a better position to endure external shocks to the economy.

The financial system is also on a stronger footing. The domestic financial markets are deeper and broader, and the range of counterparties have over the years become more diversified, which means that financial shocks such as volatile capital flows can be absorbed more effectively. Having a broad range of instruments for monetary operations has also increased the efficiency of domestic liquidity management. Greater exchange rate flexibility through the managed float regime and high external reserves provide the necessary flexibility to adjust to external shocks. In addition, intensified supervision and a strengthened regulatory framework have ensured that financial globalisation and openness do not undermine the stability of the domestic financial system. Of significance, Malaysian banking system has remained resilient, supported by strong financial buffers even during the peak of the Global Financial Crisis. Given the prudent levels of capitalisation, a stable ringgit deposit-based funding structure, and limited exposure to European counterparties, Malaysian banking institutions are well-positioned to withstand potential shocks emanating from the more challenging external environment.

More importantly, unlike the crisis-affected countries, there are no domestic imbalances to constrain the transmission of policy impulses. Inflation is low, while household debt is still at a manageable level. Impaired loans of businesses have been on a declining trend. There is, therefore, flexibility to implement counter-cyclical policies to manage potential shocks coming from the external environment.

Conclusion

The European sovereign debt crisis poses a key downside risk to domestic growth prospect. Thus far, the impact on the domestic economy has been manageable. While Malaysia continues to face risks from potential escalation of the Euro debt crisis, the economy has sufficient buffers against shocks emanating from the external environment. Sound macroeconomic fundamentals, a resilient economic structure, a stronger and more developed financial system and the authorities' ability to implement policies effectively and efficiently are expected to put Malaysia in a good position to manage potential external shocks to the economy. Nevertheless, given the possible scale and intensity of the shocks from Europe, domestic policy makers are in a high state of vigilance in monitoring and assessing the situation. In this respect, closer cooperation among regional authorities will contribute to efforts to improve regional surveillance and monitoring systems against potential shocks, in particular, from volatile capital flows into the region. Malaysia has been active in promoting policy surveillance and coordination with other regional economies to further strengthen the country's and the region's defense mechanisms against external shocks.

and hence, facilitate a faster recovery of economic activity. Emerging economies would stand to benefit from a stronger recovery in demand from the advanced countries. For economies in Asia, a better external environment would support the favourable domestic fundamentals in elevating growth prospects across the region.

MALAYSIAN ECONOMY

Amid the more challenging external environment, Malaysia's economy is projected to experience a steady pace of growth of 4 – 5% in 2012. Domestic demand is expected to remain resilient and will continue to be the anchor for growth. Following the strong expansion in 2011, the growth of both private consumption and investment is projected to soften in 2012, as both income and capital expenditure in the external-related sectors of the economy are affected by the slower global growth. Nevertheless, some measures announced in the 2012 Budget are expected to provide support to private consumption. These include the one-off financial assistance to low- and middle-income groups and the higher increment of public sector wages. Private investment will be supported by continued investment by domestic-oriented industries and the ongoing implementation of projects under the Economic Transformation Programme (ETP). The public sector will remain supportive of growth in 2012, with higher capital expenditure by both the Federal Government and the non-financial public enterprises (NFPEs). The implementation of the Special Stimulus Package through Private Financing Initiative that was announced in the 2012 Budget would also provide further impetus to real activity during the year.

On the supply side, most sectors will continue to expand in 2012. Nevertheless, the slower growth in global demand may adversely affect export-oriented industries in the manufacturing sector as well as trade-related industries in the services sector. The performance of domestic-oriented industries, on the other hand, is expected to remain firm, benefiting from resilient domestic demand conditions. In particular, the construction sector is projected to record a stronger growth, supported by the implementation of major infrastructure projects and the Special Stimulus Package. Growth in the

mining sector is also expected to strengthen. However, the agriculture sector is likely to register a more moderate growth mostly on account of lower growth of both palm oil and natural rubber following the strong performance seen in 2011.

Amidst a more challenging external environment in 2012, the Malaysian economy is expected to experience a steady pace of growth of 4 – 5%, anchored by sustained expansion in domestic demand

Headline inflation is expected to moderate in 2012, averaging between 2.5 - 3.0%. The lower inflation projection reflects the moderation in global commodity prices and the weaker global growth outlook. Domestically, more modest growth in domestic demand would also restrain price pressures. In the absence of significant adjustments to administered prices, domestic inflation would remain contained.

On the external front, the current account surplus is projected to remain large at RM109.5 billion or 12.2% of gross national income (GNI). Although gross exports are expected to record a slower growth in 2012, the trade account surplus will remain large. This is due to the anticipated slower growth in gross imports in tandem with the weaker demand for manufactured exports and moderate growth in private domestic demand. Deficits in the services and income accounts are also projected to narrow further in 2012. On the financial account, capital flows are likely to remain volatile, amid heightened global uncertainty.

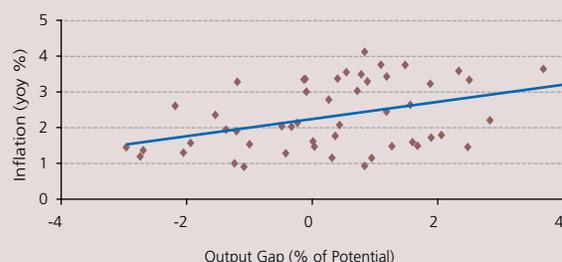
Despite the moderation in economic growth in 2012, the underlying fundamentals of the economy is expected to continue to remain strong, with the unemployment rate projected to remain low at 3.2% of the labour force. Financial stability is expected to remain intact, underpinned by well-capitalised financial institutions which will continue to provide support for financial intermediation in the economy. Given the comfortable level of reserves and relatively low external debt, Malaysia is well

Potential Output of the Malaysian Economy

Potential output is the maximum level of output (or production capacity) that an economy can sustain without generating inflationary pressures. The level of potential output, and correspondingly the output gap¹, is one of the important factors in policy considerations relating to Bank Negara Malaysia's core mandate of maintaining low and stable inflation for sustainable economic growth. When actual output is above its potential level (positive output gap), the economy is experiencing high resource utilisation. This usually corresponds to tight labour market conditions and increased wage pressures, and thus higher inflation (Chart 1). Conversely, the economy has surplus capacity when actual output is below its potential level (negative output gap). This in turn is generally associated with higher unemployment and lower inflationary pressures.

Chart 1

Positive Output Gap Corresponds with Higher Inflation

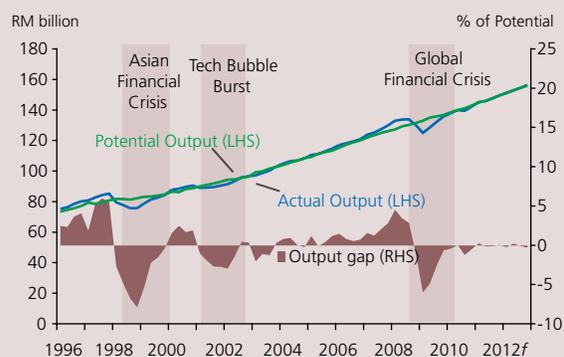


Note: Observations from 1Q 1995 to 3Q 2011, excluding periods with supply shocks

Source: Department of Statistics, Malaysia and Bank Negara Malaysia estimates

Chart 2

Actual and Potential GDP



f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia estimates

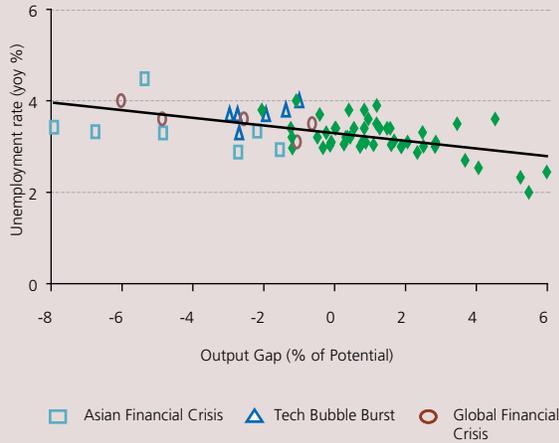
Since 1995, Malaysia has experienced periodic cycles of positive and negative output gaps. Of significance, Malaysia experienced three episodes of large negative output gaps, namely during the Asian Financial Crisis (AFC), the bursting of the tech bubble in 2001-2002 and the recent financial crisis in the advanced economies (Chart 2). During these periods, unemployment was higher (Chart 3) and capital accumulation was lower, as the contraction in both domestic and external demand caused actual output to fall significantly below the productive capacity of the economy. It is noted that though lower inflation is normally seen alongside negative output gaps, this was only witnessed during the 2001-2002 period. Despite negative output gaps, the economy experienced higher inflation during the AFC and the recent crisis. This can be mainly attributed to the large depreciation in the exchange rate² during the former episode and the sharp increase in global commodity prices during the recent global crisis. Nonetheless, in all three episodes, the negative output gap narrowed with improving demand as the economy recovered. Within two years, output converged back to the level of potential output and unemployment declined.

¹ The output gap is the difference between the levels of actual and potential output, and is generally measured as a percentage of potential output. A positive output gap indicates that actual output is above potential output, while a negative output gap indicates the reverse.

² A depreciation in the exchange rate typically leads to higher import prices which can result in increased inflationary pressures.

Chart 3

Malaysia experienced three episodes when the negative output gaps were large and unemployment rates increased during 1995-2011



Note: Observations from 1Q 1995 to 3Q 2011

Source: Department of Statistics, Malaysia and Bank Negara Malaysia estimates

Table 1

Actual Real GDP and Potential Output

Period	Actual Real GDP	Potential Output	Output Gap
	Annual change (%)		(% of Potential Output)
1996	10.0	7.1	3.2
1997	7.3	5.8	4.6
1998	-7.4	2.7	-5.6
1999	6.1	2.5	-2.3
2000	8.9	4.3	1.9
2001	0.5	4.6	-2.1
2002	5.4	4.1	-0.9
2003	5.8	6.0	-1.0
2004	6.8	5.3	0.4
2005	5.3	5.0	0.7
2006	5.8	5.6	0.9
2007	6.5	5.4	1.9
2008	4.8	4.3	2.4
2009	-1.6	4.3	-3.5
2010	7.2	4.0	-0.5
2011e	5.1	4.6	0.0

e Estimate

In 2011, the analysis of potential output and the output gap revealed three key observations. First, latest estimates indicate that the Malaysian economy was operating close to its potential despite the challenging external economic environment. In tandem, labour market conditions were favourable while inflation remained manageable. Second, the higher inflation of 3.2% (historical average of 2.9%) was largely attributable to increases in global food and fuel prices. Third, although potential output grew at a faster pace of 4.6% in 2011 (2010: 4%), it remained below the 2000-2010 average of 4.8%. In this regard, continuous improvements in productivity, higher private investment to sustain capital stock accumulation, and continued job creation especially for high-skilled workers would be important for supporting a higher growth in potential output.

Going forward, despite concerns on the fragility of the global economy, the Malaysian economy is projected to continue growing close to its potential. Over the medium term, potential output is estimated to return to its trend growth rate of about 5%.

positioned to manage volatile capital flows under the current environment of continued volatility in the international financial markets.

The GDP growth projection of between 4 – 5% in 2012 is premised upon the expectation of a moderation in global growth and the timely and full implementation of measures announced in the 2012 Budget. Several risks, however, remain. These risks include a deterioration in the eurozone sovereign debt crisis, and much slower growth in our major trading partners. Should growth in the advanced economies turn out to be stronger than expected, there is some upside potential to domestic growth in 2012. It should also be noted that the authorities have sufficient policy flexibilities and tools to support the domestic economy and manage the international challenges, should conditions warrant it.

Domestic Demand Conditions

Domestic demand will continue to be the main driver of growth in 2012, with the rate of expansion remaining resilient at 6.6%. The weaker global growth outlook is likely to affect both income and capital expenditure in the external-related sectors of the economy, thus constraining the overall momentum in private consumption and investment. The public sector is expected to remain supportive of growth, driven by higher capital expenditure by both the Federal Government and the NFPEs.

Domestic demand to anchor growth in 2012

Private consumption will remain strong in 2012. The slight moderation of consumer expenditure is mainly attributed to moderating income in the private sector. Overall labour market conditions are expected to soften but not significantly so, and job creation will continue, especially in the domestic-oriented sectors. However, the lower demand for exports, particularly from the advanced economies, is expected to weigh down more on employment and wages in the export-oriented industries and the trade-related services sectors. In addition, the expected moderation of rubber and crude palm oil prices during the year may also adversely affect the incomes of smallholders.

Table 4.1

Real GDP by Expenditure (2000=100)

	2011p	2012f	2011p	2012f
	Annual change (%)		Contribution to real GDP growth (percentage point)	
Domestic Demand¹	8.2	6.6	7.2	6.0
Private sector expenditure	8.2	6.6	5.2	4.4
Consumption	6.9	6.2	3.7	3.4
Investment	14.4	8.3	1.6	1.0
Public sector expenditure	8.2	6.7	2.0	1.7
Consumption	16.8	0.2	2.2	0.0
Investment	-2.4	16.2	-0.3	1.6
Change in stocks			-0.7	-1.5
Net exports of goods and services	-14.4	-1.4	-1.4	-0.1
Exports	3.7	1.4	4.0	1.5
Imports	5.4	1.6	5.4	1.6
Real Gross Domestic Product (GDP)	5.1	4.0~5.0	5.1	4.0~5.0

¹ Excluding stocks

p Preliminary

f Forecast

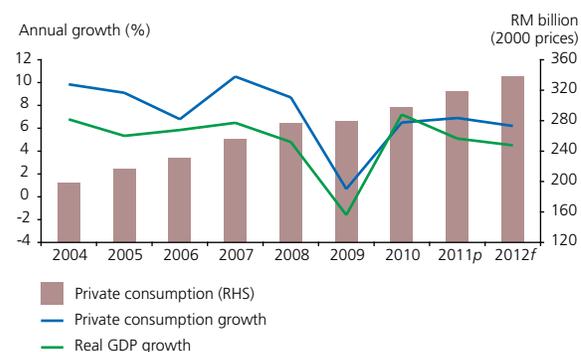
Note: Figures may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

However, the higher salary increment for the civil servants under the improved Malaysian Remuneration System or *Sistem Saraan Malaysia (SSM)*, and the temporary income support initiatives that were announced in the

Chart 4.3

Real GDP and Private Consumption



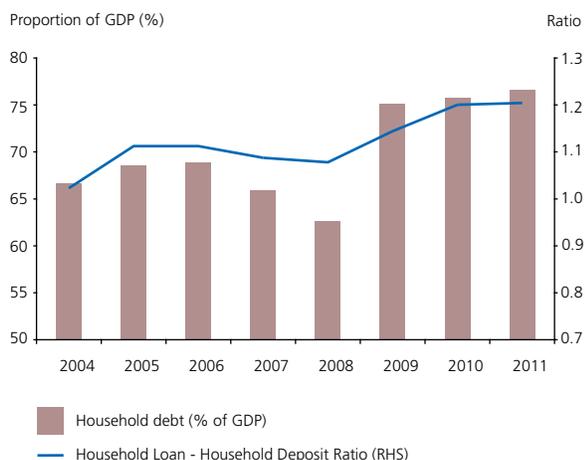
p Preliminary

f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 4.4

Household Debt Indicators



Source: Bank Negara Malaysia

2012 Budget will provide support to private consumption. The latter include the RM500 assistance to households with a monthly income of RM3,000 and below, RM100 schooling assistance to all primary and secondary students from Year 1 to Form 5 and the book voucher worth RM200 to all Malaysian students in Form 6 and institutions of tertiary education. Households also continue to have access to credit markets, especially for the purchase of durable assets, supported by more sustainable financing and accommodative monetary conditions.

Private investment is expected to expand further in 2012, albeit at a more moderate pace. Continued investment by domestic-oriented industries is expected to mitigate the anticipated moderation in investment by export-oriented industries. The ongoing implementation of projects under the ETP will also augment private investment activity.

Investment in the manufacturing sector is expected to be the most affected by the external developments. Despite the large amount of investment approved in 2010 and 2011, some companies, especially in the export-oriented sub-sector, can be expected to delay their investment plans due to the increased uncertainty about global prospects. Some capital spending projects, nevertheless, will continue, especially in the resource-based industries such as basic metal products and chemicals, and in new growth areas encompassing

renewable energy and advanced E&E products, such as light-emitting diodes (LEDs) and test equipment.

In the services sector, capital expenditure will be supported by the consumer-oriented business segments, including distributive trade and communications. Businesses in the communications sub-sector are expected to add new capacity for mobile networks and data transmission, while those in the wholesale and retail trade sub-sector are expected to further expand their operations with strategically-located new outlets. The liberalisation of several services sub-sectors under the ETP will also contribute to higher investment activity in the services sector.

Investment in other sectors is also expected to support private investment growth. Capital spending in the mining sector is expected to be lifted by exploration and development activities in the deepwater and marginal oil fields, supported by recent incentives targeted to spur investment in the oil and gas sector. Construction sector investment is also expected to benefit from the implementation of infrastructure projects identified in the 10th Malaysia Plan (10MP) and ETP.

Public consumption is projected to register a small positive growth in 2012. This is mainly on account of a significant moderation in the expenditure on supplies and services as the Government is expected to continue with its consolidation efforts. In addition, it is assumed that the Government, in view of the higher salary increment to the civil servants under the improved SSM during the year, will not be making further bonus payments in 2012.

After contracting marginally in 2011 on account of slower implementation of new 10MP projects, **public investment** is expected to expand significantly in 2012. Growth will be supported by higher Federal Government development expenditure and NFPEs' investments in the mining and transportation sectors. A major portion of the Federal Government's development expenditure will be allocated to the economics sector, mainly to improve the public transportation system and infrastructure. Funds will be channeled towards expanding the capacity of KTM Komuter services, on-going construction of double-tracking projects and provision of clean water and electricity. Expenditure in the social services sector will involve spending for education and training to meet

the demand for a skilled and knowledgeable workforce. The additional impetus to growth in public investment is expected to come from the implementation of a Special Stimulus Package through the Private Financing Initiative that was announced in the 2012 Budget. Several public projects will be implemented under this initiative, such as the upgrading and maintenance of schools, upgrading hospitals, flood mitigation programme, and the construction of public housing. The bulk of the budgeted amount (RM6 billion) will be spent in 2012.

Capital spending by NFPEs in the mining sector will focus on the upstream and downstream segments, in activities such as the development of new oil and gas fields and enhanced oil recovery projects. In the transportation sector, the Light Rail Transit line extension project, fleet expansion, and airport construction are expected to be major drivers of investments. Capital expenditure in the utility and communication sectors will reflect the construction of new power plants and continued efforts to expand the coverage of the High-Speed Broadband (HSBB).

Sectoral Outlook

In 2012, most sectors are expected to continue to grow but at a more moderate pace as the uncertain global outlook is expected to weigh on industries directly exposed to external demand. These include the trade-related industries in the services sector, and the export-oriented industries within the manufacturing sector. Nevertheless, the performance of domestic-oriented industries is expected to remain firm, benefiting from resilient domestic demand conditions. In particular, the construction sector is expected to perform well, supported by the implementation of major infrastructure projects. Growth in the mining sector is expected to strengthen, while the agriculture sector is expected to register a more moderate growth.

The **services** sector is projected to continue to drive growth in 2012. Growth will be supported by consumer-related sub-sectors, which is likely to cushion the effects of slower trade-related activity during the year. In the wholesale and retail trade sub-sector, growth will be led by the retail segment, in line with the trend in private consumption. However, growth in the wholesale trade segment is expected to be lower, amidst

slowing trade-related activity. Growth in the finance and insurance sub-sector is expected to remain firm, supported by bank lending activity. In the insurance segment, growth is expected to emanate from the general insurance business, following favourable motor vehicle sales and the implementation of the new motor cover framework which will enhance efficiency in the motor insurance and takaful sector. Growth in the communication sub-sector is projected to be sustained, amidst margin compression resulting from rising competition among service providers. Growth will be supported by the expected launch of advanced wireless technology, the ongoing widening of the High-Speed Broadband (HSBB) infrastructure and Government initiatives to promote broadband services nationwide. Growth in the transport and storage sub-sector is anticipated to moderate, amidst the uncertain external outlook.

Most sectors will continue to expand in 2012

The **manufacturing** sector is expected to grow at a slower pace due to the anticipated slower activity in the export-oriented industries. The E&E cluster will be particularly vulnerable to sluggish growth in the advanced economies as it would adversely affect demand for personal computers and semiconductors. Nevertheless, this will be partially offset by demand for

Table 4.2

Real GDP by Sector (2000=100)

	2011 ^p	2012 ^f
	Annual change (%)	
Agriculture	5.6	3.8
Mining & quarrying	-5.7	0.6
Manufacturing	4.5	3.9
Construction	3.5	6.6
Services	6.8	5.1
Real Gross Domestic Product (GDP)	5.1	4.0 ~ 5.0

^p Preliminary

^f Forecast

Source: Department of Statistics, Malaysia
Bank Negara Malaysia

products in the communications sub-segment, and normalisation of the global E&E supply chain following the natural disaster in Japan. The cluster will also be supported by new growth areas such as the renewable energy and light-emitting diode (LED) industries. The primary-related cluster is also projected to moderate. However, growth for the cluster is expected to be supported by firm demand from regional countries, particularly for resource-based products such as refined petroleum products, chemicals and chemical products as well as rubber products. Notwithstanding the weakness in the export-oriented industries, growth in the domestic-oriented industries will continue to provide support to the manufacturing sector. In particular, the performance of the consumer-related cluster is expected to improve in tandem with the trend in private consumption and recovery in the automotive segment, which was affected by supply chain disruptions in 2011. Construction-related manufacturing industries are expected to move in tandem with the broad construction sector but outlook for the cluster remains constrained by the weaker external demand for its products.

The **construction** sector is anticipated to record a stronger growth, driven by the civil engineering sub-sector. Growth will be contributed mainly by the launch of key infrastructure projects such as the Sungai Buloh-Kajang MRT line and the Government's Special Stimulus Package. Continued progress in existing projects such as the Second Penang Bridge, Ipoh-Padang Besar double track, KLIA 2 and the extension of the Kelana Jaya and Ampang LRT lines will lend further support to growth. Growth in the non-residential sub-sector is expected to be sustained, owing to public sector expenditure on hospitals and schools. In contrast, the residential sub-sector is projected to grow at a slower pace as developers shift focus to mass market housing from the high-end segment.

The **mining** sector is projected to improve, recording a positive growth rate in 2012. This reflects the higher production of natural gas, driven largely by strong demand from Japan for electricity generation. Output of crude oil is expected to remain subdued amidst maturing fields and delays in the commencement of production of some new fields. However, measures such as the enhanced oil

recovery and tax incentives to promote production from marginal fields are anticipated to contribute favourably to oil production in the longer term.

Growth in the **agriculture** sector is expected to be more moderate, caused mainly by lower growth of both palm oil and natural rubber following the strong performance seen in 2011 and the moderation in commodity prices. Growth will be supported by food production, namely fish and poultry, amid ongoing efforts to improve productivity as outlined in the National Agro-Food Policy 2011-2020.

Balance of Payments

The protracted slow growth in the global economy and persistent uncertainty in the international financial markets are expected to continue to affect trade activities and capital flows in Malaysia in 2012. Both exports and imports are expected to record a slower growth in 2012. Nevertheless, the current account surplus is expected to remain large at RM109.5 billion or 12.2% of GNI, supported by a sustained large surplus in the trade account and smaller deficits in the services and income accounts. On the financial account, long-term capital flows are likely to moderate, but short-term capital flows could be higher and more volatile amid heightened global economic uncertainty.

Current account surplus is expected to remain large with a sustained trade surplus and smaller services deficits

Growth in **gross exports** is expected to be slower due mainly to the weaker performance in commodities. The moderation in commodity exports reflects largely the price effect, a trend that was already prevalent in the fourth quarter of 2011. Export prices for LNG, however, are expected to be higher due to sustained demand from major importing countries. Manufactured exports would be supported by non-E&E (electronics and electrical) exports including resource-based and metal products, which are mainly determined by regional demand. While demand for E&E products is expected to

Table 4.3

Balance of Payments

	2011 ^p	2012 ^f
	RM billion	
Goods	149.4	155.6
Trade account	120.3	125.6
Exports (% annual change)	8.7	3.2
Imports (% annual change)	8.6	3.0
Services	-8.4	-6.2
Balance on goods and services	141.0	149.4
Income	-22.0	-19.4
Current transfers	-21.1	-20.5
Balance on current account	97.9	109.5
% of GNI	11.8	12.2
Capital account	-0.2	
Financial account	15.5	
Balance on capital and financial accounts	15.3	
Errors and omissions	-18.5	
of which:		
Foreign exchange revaluation gain	7.6	
Overall balance	94.7	

^p Preliminary

^f Forecast

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

remain sluggish, the contraction in E&E exports is expected to be smaller because the E&E production is expected to rebound from the low production base in 2011, which was affected by supply disruptions. E&E demand will also be supported by the growing level of semiconductor content embedded in a wide range of consumer and business applications.

In tandem with the weaker demand for manufactured exports and slower domestic economic activity, growth in **gross imports** is also expected to be slower in 2012. Growth of intermediate imports is projected to moderate as manufacturers reduce production in line with the declining export orders. Slower growth in capital imports is attributable mainly to the moderation in investment by export-oriented industries. Imports of consumption goods would be smaller due to more cautious consumer spending and the relatively high-base effect in 2011 is also likely to be a contributing factor to this trend.

Table 4.4

External Trade

	2011 ^p	2012 ^f
	Annual change (%)	
Gross exports	8.7	3.2
of which:		
Manufactured	3.4	4.5
Agriculture	32.9	-9.3
Minerals	20.3	6.1
Gross imports	8.6	3.0
of which:		
Capital goods	9.7	6.8
Intermediate goods	5.4	2.5
Consumption goods	19.0	3.7
Trade balance	9.4	4.4

^p Preliminary

^f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

The deficit in the **services account** is projected to narrow in 2012. Net payments for transportation are expected to be smaller in line with the lower volume of trade. Net travel receipts would be slightly higher on account of a modest growth in tourist arrivals. Outflows in the **income account** are expected to be smaller, reflecting mainly the lower investment income accruing to foreign direct investors from investments in Malaysia, particularly in the manufacturing, oil and gas and services sectors.

Capital flows in the financial account are expected to moderate as FDI and DIA activity may be affected by global slowdown and uncertainty

On the financial account, gross inflows of **FDI** are anticipated to moderate in 2012. FDI inflows, which began to soften in the second half of 2011, are expected to moderate further in 2012, reflecting weak external demand and greater uncertainty in the global economic environment. While there has been higher levels

of foreign manufacturing projects approved by the Malaysian Investment Development Authority (MIDA) in 2010 and 2011 (RM29.1 billion and RM34.1 billion respectively), investments in the manufacturing sector may moderate as foreign firms are expected to turn more cautious following the heightened uncertainty in the global economy. However, FDI into new growth areas such as renewable energy, and advanced E&E products such as light-emitting diodes and test equipment, is expected to continue given the growing global interest in green technology. Foreign investments in the oil and gas sector are also projected to remain firm, supported by increased government incentives to the sector. In addition, the liberalisation of several services sub-sectors under the ETP will also contribute to further inflows of FDI into the services sector.

The trend in **direct investment abroad (DIA)** by Malaysian companies is likely to mirror that of the FDI, although by a lesser degree. This is mainly attributed to the diversified profile of overseas investment in terms of economic activity as well as the investment destination. DIA is projected to be channeled mainly into the services and oil and gas sectors, with a continued focus on high-growth markets in the region. Despite the highly challenging global economic conditions, Malaysian companies are anticipated to continue venturing abroad to seek access to new and larger markets. Over the medium term, this regional and global expansion will contribute in creating more competitive and globalised Malaysian companies.

Labour Market Outlook

Labour market conditions are expected to soften in 2012, amid the slower economic activity. Job creation is projected to be concentrated in the domestic-oriented sectors, particularly in the services and construction sectors, as domestic demand is expected to remain firm. Employment in the export-oriented sectors may be affected by the weakening external demand.

The unemployment rate is projected to increase to 3.2% of the labour force in 2012 (2011: 3.1%). Income growth in 2012 will be affected by the cautious economic outlook, which affects firms' decisions on salary increments and bonus payments. Nevertheless, the expected implementation of a minimum wage policy

during the year would provide some support to low-income workers, while the higher salary increment for the civil servants under the improved Malaysian Remuneration System or *Sistem Saraan Malaysia* (SSM) would support public sector incomes.

Labour market conditions may soften in 2012

Inflation Outlook

Headline inflation is expected to moderate in 2012, averaging between 2.5 - 3.0%. The lower inflation projection reflects moderation of global commodity prices for 2012 as a whole and slower global inflation precipitated in part, by the weaker global growth outlook. Domestically, the moderation in growth of domestic demand would also restrain price pressures. In the absence of significant adjustments to administered prices, the pressure on domestic inflation would remain contained.

Global commodity prices are expected to remain elevated in 2012. For food commodities, the Food and Agriculture Organisation of the United Nations (FAO), in its November 2011 edition of Food Outlook, projected that food prices would remain below the February 2011 peak, but would continue to be high and volatile. Despite the global slowdown, demand for high-protein food from countries experiencing sustained growth would continue to be strong. In terms of supply, while there are expectations of an improvement in production, particularly for cereals, there is also a higher probability that bad weather conditions could adversely affect production. The Intergovernmental Panel on Climate Change (IPCC) projected a high likelihood of warm spells on a global scale. High costs of inputs, such as fertilisers and energy would also continue to exert upward pressure on food prices.

Crude oil prices are expected to remain volatile in 2012, but the levels would be restrained by the slower growth of the global economy. The deterioration in global growth prospects prompted the International Energy Agency (IEA) to trim its 2012 projections for oil demand growth to 0.8 million barrels per day (mb/d) from an earlier

forecast of 1.1 mb/d. Conversely, despite the higher output target announced by the Organisation of the Petroleum Exporting Countries (OPEC), geopolitical tensions in the MENA region have raised uncertainties over oil supply. This could keep oil prices high throughout 2012. The IMF's World Economic Outlook (WEO) update in January 2012 projected crude oil to trade at an average¹ of USD99 per barrel in 2012, slightly lower than the 2011 average price of USD104.

Inflationary pressures among Malaysia's key import partners are expected to be modest in 2012 in line with weaker global growth and lower global commodity prices. Weak consumer confidence, prevailing economic slack and subdued demand pressures would keep inflationary pressures muted in the advanced economies. The January 2012 update of the WEO projected a lower inflation of 1.6% for the advanced economies (2011: 2.7%). Price pressures are also expected to be moderate in the emerging economies in line with the stable domestic demand in these economies. The emerging and developing economies are expected to register a lower inflation of 6.2% in 2012 (2011: 7.2%). The reduced pressure from external prices could provide greater flexibility for producers to align prices with the more moderate domestic demand.

Price pressures arising from demand factors are expected to be contained as the growth of both private consumption and investment are projected to soften. However, the upward revision of public sector wages and other measures announced in the 2012 Budget would continue to support household consumption spending in 2012. Overall, the economy is expected to operate slightly below its potential (*See white box on Potential Output of the Malaysian Economy*). Firms would be able to accommodate the demand as production capacity had expanded following high investment in previous years.

There are, however, upside risks to inflation from both the external and domestic factors. Externally, there is potential for upward bias in global commodity prices. First, if global growth is stronger than expected, the corresponding

expansion in global demand for commodities could exert significant upward pressure on prices, as production may not be able to adjust quickly enough to meet the unexpected surge in demand. Second, geopolitical risk to oil supply could intensify further and escalate the upward pressure on oil prices. Third, the surplus liquidity that is flooding the major financial markets, and the resulting search for higher yields, could spill over to the commodity markets. The low interest rate environment, and possible weakness in the US dollar could prompt more speculative investment in commodities, further driving up prices. While recognising these risks, the dominant assumption is that slower global growth would restrain increases in commodity prices.

Aside from the external factors, there are also potential upside risks from domestic supply factors. Potential supply disruptions could keep food prices elevated. High vegetables, fruits and fish prices may persist due to labour shortages and adverse weather conditions. Meat prices could remain elevated if higher global corn prices lead to more expensive feed. There could also be possible adjustments to administered prices if global commodity prices are higher than expected.

MONETARY POLICY

Monetary policy in 2012 will continue to operate in a complex global environment characterised by slower growth, rising uncertainties and increased volatility in the financial and commodities markets amid high liquidity in the international monetary system. The Malaysian economy entered 2012 with increasing downside risks to growth amid softening inflationary pressures domestically. Monetary policy in 2012 will focus on ensuring the sustainability of economic growth in an environment of price stability. Emphasis will also be placed on ensuring monetary policy remains appropriate to avoid the build-up of financial imbalances.

There are increased downside risk to global growth from the ongoing uncertainties and weaknesses in the advanced economies. Growth in the advanced economies continues to be constrained by prevailing structural weaknesses, ongoing strains in public finances and impaired financial intermediation. The Asian growth

¹ Average price of Brent, Dubai and West Texas Intermediate (WTI) crude oil, equally weighted.

momentum is likely to moderate due to weak external demand from advanced economies. Key engines of growth within the region, such as China, have also showed signs of moderating growth. As a small and highly open economy, Malaysia will not be insulated from these external developments and is likely to experience some moderation in real activity, particularly in the export-oriented industries.

Monetary policy in 2012 will focus on ensuring the sustainability of economic growth in an environment of price stability

Despite the highly challenging external environment, the fundamentals supporting the economy remain intact. The Malaysian economy is expected to remain resilient and to grow within the range of 4 - 5% in 2012. Domestic demand will continue to be the anchor for growth. Private sector economic activity will be sustained, underpinned by stable employment conditions and a favourable outlook for the domestic-oriented sectors. This will be further reinforced by public sector spending and investment via the ETP and policy initiatives announced during the 2012 Budget such as the one-off financial assistance to low and middle income groups, upgrading of schools, hospitals and basic rural infrastructure and the construction of public housing.

Inflation is expected to moderate in 2012. Demand pressures on inflation should be contained. In terms of supply pressures, slowing global demand is expected to relieve some of the pressure on the international prices of key commodities. Nevertheless, there remains upside risks to inflation. Adverse geo-political developments, irregular weather patterns and the ample global liquidity which could prompt the financialisation of commodity markets could result in large swings in global food and energy prices, and keep prices elevated. Some of the increase in global cost pressures could be transmitted to the prices of domestic goods and services.

At the current level of the Overnight Policy Rate (OPR), monetary conditions remain supportive of economic activity. This is evident in the retail lending rates to businesses and households which are still below pre-crisis levels, and the sustained financing growth of 12.5% in 2011. However, should the global economy enter a new phase of even weaker growth during the course of 2012 and adversely affect the outlook for the Malaysian economy, the Monetary Policy Committee (MPC) at Bank Negara Malaysia has the flexibility to respond to adjust the degree of monetary accommodation. Any consideration for further monetary stimulus, however, will be weighed carefully by the MPC against the potential upside risks to inflation, as well as the build-up of financial imbalances that could adversely affect macroeconomic and financial stability in the medium to long-run.

Liquidity in the international monetary system has risen significantly in recent years following the unprecedented scale of monetary policy easing by central banks in the major advanced economies. Large shifts of this liquidity have resulted in significant inflows and equally large outflows of portfolio investments to and from emerging economies, including Malaysia. These large movements in portfolio flows could raise short-term exchange rate volatility, creating risks for the economy and financial system, and disrupting international trade and investment activity. The surges in inflows could also lead to a build-up of liquidity in the domestic financial system, giving rise to distortions that eventually result in excessive growth of leverage and misalignment of asset prices.

Malaysia is in a strong position to manage these challenges. First, the more developed and diversified financial system is better able to intermediate the large volume of capital flows. Second, the managed float regime currently adopted by the Bank also allows the exchange rate to flexibly adjust to changing conditions. Third, the Bank has sufficient international reserves to attenuate volatility in the foreign exchange market to prevent extreme currency movements that may cause severe dislocations in financial markets and the overall economy. Fourth, the Bank's ability to manage domestic liquidity has also improved significantly, supported by a wider range of instruments for monetary

Impact of Ringgit Appreciation on Import Prices and Inflation

Introduction

The ringgit and other Asian currencies have been on a broad appreciating trend since early 2009 amid the nascent global economic recovery and improvements in the global financial markets. As market sentiments and risk appetites improved against a background of increased global liquidity, portfolio inflows to Asia rose significantly and regional currencies appreciated between 6.2% and 44.4% relative to the US dollar between March 2009 and July 2011 (Chart 1). At the same time, the fast pace of the economic recovery in the region over the course of 2010 and 2011 coincided with a gradual build-up of inflationary pressures following sustained increases in global commodity prices and rising domestic demand amid global supply disruptions. Given the heightened inflationary risks during the period, a pertinent issue is whether the currency appreciation would dampen some of the effects of the global cost-push factors on inflation by lowering the local-currency price of imports.

Chart 1

Performance of Regional Currencies Against US Dollar (March 2009 - July 2011)



Source: Bank Negara Malaysia

The relationship between the exchange rate and inflation is highly complex and it involves interactions through a number of transmission channels in the economy, including trade, domestic demand, expectations of households and businesses, financial markets, liquidity and monetary conditions, and the costs of production. This article discusses the role of exchange rate appreciation in containing the costs of imported inputs and final consumption goods and consequently, consumer prices. In summary, consistent with the findings in the literature, the pass-through from ringgit appreciation to import prices was found to be partial and incomplete. An even smaller pass-through to consumer prices was also observed. Given the weak relationship between the exchange rate and inflation, care must be exercised on the role that is attributed to the exchange rate in mitigating cost-push inflation from abroad.

The transmission of exchange rate changes to consumer prices

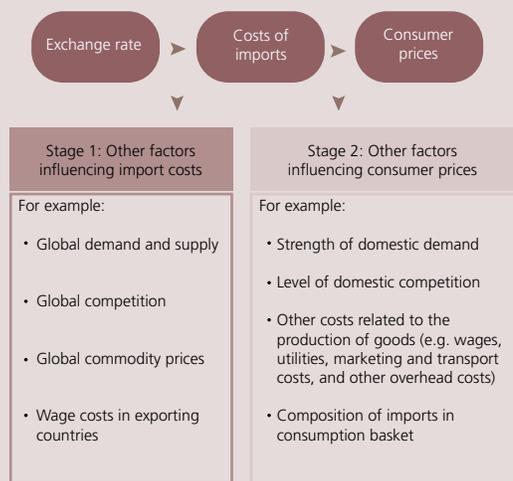
In general, exchange rate movements may have an effect on inflation through imports. The impact of exchange rate movements on consumer prices can be observed in two stages, namely from the exchange rate impact to import prices, and subsequently from import prices to consumer prices. At the first stage, changes in the exchange rate may be reflected through import prices that are paid by importers¹. In the absence of other influences, the hypothesis is that a ringgit appreciation against the US dollar would lower import costs in ringgit terms for Malaysian importers, assuming US dollar was

¹ These may include imports of raw materials, intermediate goods and final goods.

used for trade settlement. While the exchange rate could be an important consideration, there are other factors that could influence the prices of imports. These include global demand and supply conditions, global competition, prices of global commodities and production costs in the exporting countries.

Chart 2

Transmission of Exchange Rate Changes to Consumer Prices through the Cost of Production Channel



Source: Bank Negara Malaysia

At the second stage, the changes in import prices would feed into the overall cost of domestic production and eventually determine the final prices paid by consumers. The degree of pass-through from import prices to consumer prices depends essentially on the share of imported inputs and goods in overall production and distribution. In general, the smaller the proportion of imported inputs and goods into overall production and distribution, the smaller the impact on consumer prices. Beyond cost considerations, factors such as the strength of domestic demand and the extent of market competition could also influence the decision by firms to pass-on cost savings from cheaper imported prices.

The transmission of exchange rate changes to consumer prices in Malaysia is partial and incomplete

For Malaysia, the impact of exchange rate changes on import prices and subsequently on consumer prices was estimated using monthly observations from July 2005 to mid-2011². Our estimation suggests that exchange rate movements are statistically significant in influencing import prices³. A 10% Nominal Effective Exchange Rate⁴ (NEER) appreciation lowers import prices by between 1-3% within four months. This suggests that while ringgit appreciation can lower import prices, the degree of pass-through is relatively smaller than the magnitude of ringgit appreciation. The result also indicates that

² The model is developed on the basis that the effect of exchange rate movements on consumer prices is transmitted in two stages. At the first stage, import prices are determined by the costs of production in the exporting country, global demand conditions and the nominal effective exchange rates (NEER), in which the degree of exchange rate pass-through to import prices is given by the NEER coefficient. At the second stage, consumer prices are determined by import prices, the output gap and lagged inflation. The import price coefficient would reflect the degree of pass-through to consumer prices.

³ Imported goods are assumed to go through local production and distribution channels once they arrive in Malaysia. As a small economy, Malaysian importers are assumed to be price-takers; hence all imports are priced in foreign currency. This is not an extreme assumption as the bulk of our imports are denominated in USD, EUR and JPY in 2011.

⁴ NEER is the weighted average of home country's currency against the currencies of major trading partners.

global demand is a more important factor in influencing import prices in Malaysia, whereby a 10% increase in global demand would increase import prices by 1-5%. At the second stage, the impact of changes in import prices on consumer prices was found to be even lower. A 10% decrease in import prices would lower domestic inflation by 0.5% within 6 months. This estimate also suggests that domestic demand conditions are more important in influencing consumer prices. Combining the results for stage 1 and stage 2, the research outcome suggests that a 10% appreciation of the ringgit results in a fall of only 0.05-0.15% in consumer prices.

The finding that the impact of an exchange rate appreciation is greater on import prices than on consumer prices suggests that although ringgit appreciation can lower import prices, producers may not necessarily pass on these savings completely to consumers. An important caveat to this finding, however, is that the evidence of low pass-through reflects the average outcome across a range of different episodes. The degree of pass-through may vary across time in response to different shocks. For example, an extreme appreciation of the ringgit could erode export competitiveness, which in turn could reduce incomes and weaken domestic demand.

The findings from Malaysian data are broadly consistent with similar studies conducted elsewhere. Exchange rate appreciations are found to only partially reduce import costs, whereas the pass-through is even lower from import costs to consumer prices. Campa and Goldberg (2006) found that the consumer price index is less sensitive to exchange rate changes than import prices. For Organisation for Economic Co-operation and Development (OECD) countries, in the long run (about four quarters), a 10% depreciation of local currency leads to an average of 6% increase in import prices and 2% increase in consumer prices. For the United States, a 10% depreciation in the US dollar leads to an average of 4% increase in import prices and 0.1% increase in consumer prices. Ca'Zorzi, Hahn and Sanchez (2007) also found that the exchange rate pass-through to be lower on consumer prices than import prices. For selected Asian countries, the study found that exchange rate pass-through to import prices was between 0.12% and 0.78% within four quarters, while the pass-through from exchange rate to consumer prices was between 0.01% and 0.19%, also within four quarters. The paper also found that countries with low average inflation experienced lower levels of exchange rate pass-through than countries with higher average inflation. Mihaljek and Klau (2008) estimated a sample of 14 emerging economies and found that exchange rate pass-through to inflation was below 0.3% and that there has been a general declining trend across emerging economies since the 1980s⁵. Importantly, Mihaljek and Klau also found that there is an asymmetric effect of the impact of exchange rate movements on inflation. Exchange rate depreciations seems to have a significant and stronger effect on inflation than appreciations in Korea, Malaysia, Mexico, Poland and Turkey. Conversely, appreciations seems to have a significant and stronger effect on inflation in Philippines, Brazil and Hungary. Other countries in their sample⁶ however, do not display the presence of asymmetric effects of exchange rate movements on inflation.

Price rigidity and local currency pricing as sources of partial and incomplete exchange rate pass-through

There are several explanations for the partial and incomplete pass-through from exchange rate changes to consumer prices. These can be broadly categorised as rigidity in price adjustments, increasingly globalised production chain, the importance of distribution costs, firms changing profit margins, local currency pricing, magnitude of exchange rate changes and country-specific factors.

1. **Rigidity in price adjustments.** It is often observed that firms do not instantaneously adjust prices in response to changes in business conditions. More importantly, price adjustments are often seen to be asymmetric between price increases and price decreases, with less likelihood for firms to revise prices downward. Consequently, while an exchange rate appreciation may lower import costs and the overall cost of productions, these costs savings are not fully translated into lower prices

⁵ The decline in exchange rate pass-through to inflation across emerging economies since 1980 coincides with lower levels and volatility of domestic inflation and foreign prices.

⁶ Other countries refer to Thailand, South Africa, Chile, Peru and Czech Republic.

for consumers. There were various explanations for such observations, including the existence of pre-existing contracts to ensure stable prices, the high cost of frequently adjusting prices and the association of prices as a signal for quality and exclusivity.

2. **Increasingly globalised production chain.** There are now more goods being produced through multiple stages of production that are located in different countries. As a result, the final goods being produced embody input costs in various currencies that do not necessarily move in tandem. This means that a fall in cost from a bilateral appreciation against one particular currency may be offset by a rise in cost from a bilateral depreciation against another currency. As a result, the net impact of exchange rate movements on final goods' prices was limited.
3. **Distribution costs.** For some goods that are imported from abroad, the production costs may include a proportionately larger domestic cost component such as transportation, marketing, wholesaling and retailing. For example, a study by Feenstra (1998) illustrated that a Barbie doll shipped from PR China to the United States cost about USD2, where it sold for about USD10⁷. The relatively insignificant cost of imports in the overall cost structure reduces the price sensitivity to the impact of exchange rate changes.
4. **Firms changing profit margins.** In practice, many goods and services are traded in imperfectly competitive markets that allow producers to charge prices based on margins over costs. Producers may respond to exchange rate fluctuations by adjusting their profit margins instead of prices, which reduces the sensitivity of consumer prices to exchange rate changes.
5. **Local currency pricing.** International business strategies may also result in producers absorbing the impact of exchange rate variations. Cross-border product differentiations, market segmentations and competition have led many producers to price products based on the specific conditions in each market. This would reduce import and consumer price sensitivity to exchange rate changes.
6. **Magnitude of exchange rate changes.** Large changes in exchange rates may have more significant impact on pass-through to import prices and consumer prices than smaller exchange rate changes.
7. **Malaysia-specific factors.** The low pass-through could be attributed to the inherent characteristics of the domestic Consumer Price Index (CPI), which is compiled based on the expenditure pattern of the average household in Malaysia.
 - a. *CPI captures many goods that are not traded internationally.* Many items that are captured in the computation of the CPI are not traded internationally. For example, services like car wash, haircuts and other specialised services are determined entirely by domestic conditions and do not necessarily respond directly to external developments. While there are some imported inputs in the services category, the contribution to the overall cost of production is relatively small. Services components account for about 47.5% of the CPI basket in Malaysia.
 - b. *Limited direct import of final goods.* For Malaysia, direct imports of final goods only accounts for 15.9% of the overall CPI basket. Hence, the direct impact of exchange rate changes on consumer prices is often not pervasive and is limited to selected items. Prices for some of these imported items, such as petroleum products, were also subject to the Government's administered price mechanism, which would further limit the overall sensitivity of prices to

⁷ Source: "The Exchange Rate–Consumer Price Puzzle", FRBSF Economic Letter, 2006

exchange rate movements. While the gradual removal of price controls and Government subsidies on these products could potentially increase the degree of pass-through, the actual impact should not be overstated given that even countries with few price controls have low exchange rate pass-through.

Policy Implications and Conclusion

Empirical evidence suggests that there is only a relatively small reduction in import costs as the ringgit appreciates. Producers, in turn, do not entirely pass on these cost savings to consumers. This insensitivity of the CPI to exchange rate movements implies a rather limited role for the exchange rate in mitigating the impact of imported inflation. Although the finding is consistent with other studies in the literature, an important qualifier is that the period of coverage corresponds to the environment of relatively stable inflation and orderly ringgit appreciation. As noted, the magnitude of the exchange rate changes is important in terms of determining its impact on import prices and consumer prices. An extremely strong currency appreciation could erode competitiveness, which in turn reduces incomes and weakens domestic demand. Conversely, a very strong depreciation could exert upward inflationary pressure on consumer prices as rising import prices become unbearable for importers, who would in turn pass on this rise in import cost to consumers. In this regard, the importance of orderly two-way adjustment in the currency should remain an important policy objective for the central bank in a small open economy.

operations, including the use of the Statutory Reserve Requirement (SRR) which provides more longer-term sterilisation of liquidity. This has been augmented by better surveillance and information systems. Fifth, closer cooperation among central banks in the region also enhances the Bank's ability to manage the risks emanating from capital flows.

FISCAL POLICY

Fiscal policy in 2012 is geared towards stimulating domestic economic activity and providing support to the economic transformation plan. A key challenge for the Government in 2012 is to continue providing support to domestic demand amid the weakening external sector while ensuring that the fiscal position remains sustainable. In this regard, greater emphasis has been placed in the 2012 Budget on generating growth through private sector investment and consumption. Timely implementation of the Government's reform initiatives under the National Key Result Areas (NKRAs), National Key Economic Areas (NKEAs) and Strategic Reform Initiatives (SRIs) is also a major focus of the Government.

As part of the Government's efforts to accelerate investment, several major initiatives were outlined

Table 4.5

Federal Government Finance

	RM billion		% change	
	2011 ^p	2012 ^B	2011 ^p	2012 ^B
Revenue	185.4	186.9	16.1	0.8
Total expenditure	229.0	230.8	12.0	0.8
<i>Operating expenditure</i>	182.6	181.6	20.4	-0.6
<i>Gross development expenditure</i>	46.4	49.2	-12.1	6.1
Loan recoveries	1.1	0.9		
Overall balance	-42.5	-43.0		
% of GDP	-5.0	-4.7		
<i>Sources of financing:</i>				
Net domestic borrowing	45.1	-		
Net external borrowing	0.5	-		
Realisable assets ¹ and adjustments	-3.1	-		

¹ A positive (+) sign indicates a drawdown in the accumulated realisable assets

^p Preliminary

^B Budget

Note: Numbers may not add up due to rounding

Source: Ministry of Finance

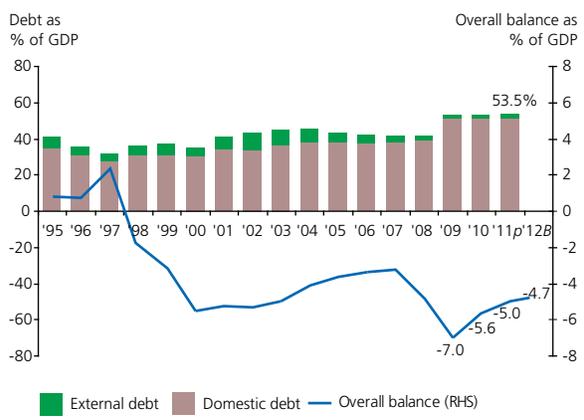
in the 2012 Budget. First, the enhancement of the existing public-private partnership (PPP) initiative to undertake development projects through private sector funding. Towards this end, RM2.5 billion is allocated in the 2012 Budget under the PPP Facilitation Fund to assist the private sector in initiating various catalytic projects. Second, the introduction of various tax incentives to facilitate the development of high-impact projects in targeted sectors. These incentives are provided for projects in Kuala Lumpur International Financial District (KLIFD), Iskandar Development Region (IDR) and other regional corridors which are expected to have large multiplier effects on economic activity. The third initiative involves attracting foreign investments and participation in the economy through further liberalisation of the 17 services sub-sectors that allow up to 100% foreign ownership. This initiative is expected to enhance the competitiveness of the domestic services sector which has been identified as one of the key drivers of economic growth.

In line with the Government's transformation initiatives under NKRAs, the 2012 Budget also emphasises further developing human capital and enhancing rural development. Both areas are critical to Malaysia becoming a high-income nation that is based on inclusive and sustainable fundamentals. In terms of developing human capital, priority is given to enhancing the quality of education. Among the measures announced are the establishment of several funds to promote creativity and innovation, and the introduction of various tax incentives to encourage greater participation of the private sector in areas related to building talent and enhancing the quality of education. The Rural Transformation Programme was introduced to attract investment and thus create new employment opportunities in the rural areas. The programme also includes assisting small-scale rural entrepreneurs to reach a wider market to distribute their products.

Priority is also placed on the implementation of programmes to improve the socio-economic well-being of Malaysians, particularly those in the lower income groups. The Government has provided financial assistance programmes such as the cash assistance of RM500 to households

Chart 4.5

Federal Government Fiscal Balance and Debt



p Preliminary
B Budget
Source: Ministry of Finance

with monthly income of less than RM3,000 and introduced the SARA 1Malaysia scheme. Apart from improving the well being of the rakyat, these measures also act as a catalyst for growth as they will contribute towards supporting private consumption. Given the expectation of continued high global commodity prices and the impact on cost of living, a total amount of RM33.2 billion was allocated for various forms of subsidies, assistance and incentives. Incentives were provided for programmes aimed at increasing food production such as rice, meat, vegetable and fruits. In addition, several policy measures to stimulate home ownership were also announced, including the 1Malaysia People’s Housing Scheme (PRIMA) introduced to

develop affordable and quality housing for the middle-income group.

The Federal Government fiscal deficit is expected to narrow further from 5.0% in 2011 to 4.7% of GDP in 2012. Revenue collection is expected to improve to RM186.9 billion, supported by better tax administration and higher compliance in tax submission and collection. Total expenditure continues to remain supportive of growth with an allocation of RM181.6 billion for operating expenditure and RM49.2 billion for development expenditure. Development expenditure will be channeled for projects and programmes under the second rolling plan (RP2) of the 10MP including transformation initiatives under the NKRA, NKEAs and SRIs. The Government will continue to finance the fiscal deficit from domestic sources, mainly through the issuances of Malaysian Government Securities (MGS) and Government Investment Issues (GI), given the high domestic savings and the ample liquidity in the financial system.

Moving forward, the Government continues to face the challenging task of striking a balance between fiscal consolidation and the need to support initiatives to transform the country into a high-income economy. In the medium-term, the Government will remain committed to fiscal consolidation. A successful implementation of the ETP and all other reform initiatives are expected to ensure sustainable growth which will enhance tax revenues, thus contributing to the efforts to strengthen the fiscal position of the Government.

2011

GOVERNANCE, ORGANISATIONAL
DEVELOPMENT AND COMMUNICATIONS

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The Bank is entrusted with the core mandate of preserving monetary and financial system stability and supporting sustained medium and long-term growth. The success of the Bank in delivering on its mandate is made possible through sustained efforts in the areas of governance and organisational development. During the year, the Bank had further solidified its efforts in these areas to enhance effectiveness and efficiency, and to strengthen its agility in responding to the challenges ahead.

GOVERNANCE

The Board of Directors of the Bank has the key role in ensuring that the Bank continues to deliver on its mandate of promoting monetary stability and financial stability in an environment that is conducive to the sustainable growth of the Malaysian economy. In discharging its duties, the Board of Directors exercises oversight over the management of the Bank and reviews the performance of the Bank in delivering its mandates and in discharging the responsibilities placed upon the Bank. The Board of Directors also reviews the allocation and utilisation of resources, the Bank's financial position, and oversees other administrative matters that influence the effectiveness and efficiency of the Bank's operations. To support the Board in performing these functions, a comprehensive governance, control and risk management framework has been put in place to provide the appropriate supporting infrastructure for the Board to discharge its oversight function and to keep the Board well informed on all key matters affecting the Bank.

In 2011, the Board of Directors met twelve times to deliberate on various aspects of the Bank's operations. One of the key permanent Board agenda items is the discussions on the economic and financial conditions, and how domestic and external developments may impact the economy and affect the Bank's operations to achieve its mandate. This also involves deliberation of policy measures being considered by the Bank to address emerging issues. Also discussed at each meeting are the Bank's financial condition, reserve management and currency management. This enables the Board to keep under constant review the performance of the Bank in giving effect to its

object. Policy developments and the risk outlook involving the conventional and Islamic financial systems and payment systems are also brought to the Board's attention on a regular basis.

One of the key outcomes of the Bank in 2011 was the publication of the Financial Sector Blueprint. In formulating the Blueprint, the Board discussed on the policy thrusts to be adopted that would shape the development of the financial sector over the next ten years. Another key outcome during the year was the completion of a comprehensive review of existing regulatory laws governing financial institutions, markets and payment systems under the purview of the Bank, which culminated with the recommendation for an integrated new legislation. In considering the proposals, the Board's deliberations took into account the global regulatory reform measures, the increasing cross-border presence of Malaysian entities operating abroad and financial conglomeration, and how the new legislation will serve to complement the Central Bank of Malaysia Act 2009.

Organisational development and well-being are also overseen by the Board of Directors. In 2011, several initiatives were undertaken with respect to human capital management policy to ensure that the Bank continues to have highly skilled knowledge workers to deliver its mandates. In deliberating these initiatives, the Board considered initiatives that will enable the Bank to achieve a higher level of performance while ensuring that the staff receive the relevant development, interventions and competitive remuneration. Equally important is the organisational culture through continuous support for the enhancement to the Bank's internal policies relating to governance, internal controls and risk management.

In carrying out its oversight function, the Board is supported by three Board Committees namely, the Board Governance Committee (BGC), the Board Audit Committee (BAC) and the Board Risk Committee (BRC). The respective Board Committees comprises three independent and non-executive Board members and are governed by its own by-laws as approved by the Board. (Details of the responsibilities for each Committee

are available in the 2010 Annual Report white box article '*Operationalisation of the Central Bank of Malaysia Act 2009*').

The budget and operating plan of the Bank are reviewed by the BGC which includes an assessment of its efficiency in budgeting and financial management activities. Amongst the areas discussed were prioritisation of the Bank's projects and initiatives, and cost-saving initiatives including intensifying efforts to migrate to e-payments. One of the key areas of focus for the BAC during the year was the review pertaining to the internal audit function to ensure its effectiveness in providing an independent assessment of governance, internal control and risk management measures. The BAC also ensured that appropriate remedial actions were taken to address issues raised in the audit reports prepared by the National Audit Department. The BRC monitored closely the Bank's management of enterprise-wide risks, in areas that could lead to financial loss, disruption of operations and failure to attain objectives or damage to the Bank's reputation. In 2011, the BRC also worked closely with the BAC to ensure the successful implementation of risk management policies and processes within the Bank.

Risk Management

Risk management is a fundamental component of the governance framework to enable effective and efficient delivery on the mandates of the Bank while safeguarding the assets and reputation of the Bank. In 2011, the Bank continued to strengthen its risk management governance framework to ensure that it is sufficiently robust to face the challenges ahead. The Bank also undertook initiatives to further enhance its risk management culture, including further embedding risk management processes into all strategic initiatives, policy making and operations of the Bank.

Risk Management framework

The Bank adopts an Enterprise Risk Management (ERM) approach to effectively manage risks that are increasingly becoming more complex and interlinked across the different functions of the Bank. This overall framework sets out the general principles and processes to ensure consistent and effective management and oversight of risks in the Bank. Under ERM, the Operational Risk Management and Financial Risk Management frameworks are designed to provide greater clarity in managing specific risk types. The ERM is also supported by more detailed policies, standards,

procedures and guidance to ensure that risk interlinkages are addressed at all levels.

Risk Management governance structure

The Bank's risk management governance and structure provides clear accountabilities and responsibilities, which ensure that the risk management strategies remain effective and that significant risks are promptly and adequately identified, assessed, monitored, managed and reported.

At the top of the governance structure, the Board and BRC provide the overall oversight over the management of risks in the Bank. The Board provides strategic direction on risk management by the Bank and ensures that the Bank identifies its key risks and has in place the appropriate systems, processes and resources to manage these risks.

The Risk Management Committee (RMC), which is chaired by the Governor, is responsible for managing organisational risks related to the achievement of the Bank's mandates and strategic objectives. It is also a platform for focused deliberations on issues and concerns arising from any aspect of the Bank's activities that could expose the Bank to substantial risks, and it also ensures effective management of risks within the Bank. All significant risk events will also be escalated to the BRC and the Board. In equipping the Bank to face a more challenging environment, the RMC also drives enhancements to the Bank's risk management frameworks, practices and culture. Two sub-committees, the Operational Risk Management Committee as well as the Financial Risk Management Committee, each headed by a designated Deputy Governor, provide the essential platforms to assist the RMC in making informed decisions on operational and financial risks. The Committees provide effective oversight over risks pertaining to the Bank's systems, people and processes, as well as the Bank's financial risk.

The Reserve Management Committee (ReMC) oversees risks and returns related specifically to the management of the nation's international reserves. It provides a platform for a centralised and holistic review of all the risks emanating from the management of the international reserves to ensure a thorough risk assessment is undertaken on all investment strategies. This includes the assessment of returns on strategic investments that are measured on a risk-adjusted-return basis. Quarterly meetings, as well as daily and weekly

reporting by risk managers to the members of the ReMC, on market, credit and operational risks of all investment exposures ensure that all risks are within the approved investment guidelines and risk appetite of the Bank, and that investment decisions are executed in a timely and accurate manner.

Strengthening the Risk Management framework

The implementation of the three lines of defence in the governance approach institutionalises effective risk management practices within the Bank and provides clarity to the roles, responsibilities and accountabilities of all parties in the organisation.

The first line of defence comprises the line departments which are responsible for identifying, assessing, mitigating and reporting risks within their own areas. They are expected to be fully conversant with the risks undertaken and are accountable for ensuring that adequate controls are in place. In addition, they must also be able to align their risk management strategies to ensure their ability to perform the Bank's mandates and that the strategic objectives are not compromised.

The second line of defence refers to the risk management functions within the Bank which provide oversight and advice to the line departments. There are three main parts of the Bank involved, the first being the Strategic and Risk Management Department (SRMD), which is responsible for developing and maintaining the overall risk management framework. SRMD also reviews the risk assessments made by the line departments, identifying enterprise-wide risks events for deliberation at the relevant risk committees. The second also includes the Risk Policy Owners (RPOs) that manage specific transversal risks (risks which result from activities/processes that are common to all other business processes), for example, people, technology and legal risks. Also included in this second line is the Treasury Risk Management section of the Investment Operations and Financial Markets Department, which is responsible for monitoring the risk exposures and risk management related to management of international reserves in the areas of market, credit and operations risks.

The third line of defence refers to the Internal Audit Department which provides independent assurance and verification on the implementation and effectiveness of the risk management practices.

Key initiatives in 2011

The establishment of a more structured periodic reporting of organisational risks provided a consistent assessment and monitoring mechanism for RMC and BRC to perform their oversight over the Bank's risk taking activities. This has also triggered a more robust identification, assessment and deliberation of key risks facing the Bank. More comprehensive and quality risk identification and assessments were achieved through increased accountability demonstrated by the first line of defence, coupled with the validation process as well as advisory services provided by SRMD. There was also a greater linkage of the year's risk assessments with the strategic outcomes of the Business Plan. Active top-down views added strategic perspectives for more effective management of risks at enterprise level. The enhanced process and governance provides greater clarity for senior management to actively manage risks within their respective sectors.

Risk management strategies have become more pre-emptive, with special focus being given to addressing risks related to new initiatives such as the issuance of the new currency notes and coins, as well as the newly emerging risks such as cyber threats and information security risks posed by mobile devices. Significant emerging risks such as the impact of the European crisis on the Bank's reserves and strategic portfolios were also deliberated by the RMC and BRC.

The implementation of the system based Risk Control Self Assessment (eRCSA) has facilitated Bank-wide horizontal assessment of risks based on risk events and causes. In formulating the Bank's Business Plan for 2012-14, the different sectors performed risk assessments on emerging environmental risks, as well as risks that may hinder Bank's achievement of its mandates.

This year has also seen more active involvement among the RPOs in managing transversal risks. The concept of RPOs was introduced to ensure that departments that are accountable for transversal risks are effectively managing the risks. Greater involvement of RPOs encourages a more effective management of transversal risks in the Bank and ensures that all types of risks are well accounted for.

In view of the importance of preserving the credibility and reputation of the Bank, during the year, efforts were dedicated to formulating an effective strategy for managing reputational risk. Greater efforts

were made towards creating increased clarity across the organisation about risk events that could impact the Bank's reputation. This would enable the Bank to develop a more systematic approach in understanding the nature of the specific reputational risk event and direct resources to address the root causes. A key component in this initiative is the formulation of the Stakeholder Engagement Framework.

Enhancing BCM infrastructure, framework and policy

The Bank's Business Continuity Management (BCM) remains a crucial agenda in ensuring that the Bank is prepared to provide continuous critical central banking functions, as well as to protect the Bank's staff and assets in crisis situations.

The Bank's state of readiness and its response capabilities during business disruptions were further strengthened with the enhancements to its business recovery infrastructure, particularly through the upgrading of the Recovery Centre which now has an increased capacity to house critical operations of the Bank in the event of crisis events lasting up to one month. The Bank also continued to conduct Bank-wide live runs, call tree exercises and systems connectivity tests throughout the year.

The Bank was also involved in the national level disaster recovery platform. This includes participation in recovery exercises, such as the annual national level cyber drill, to ensure greater collaboration and coordination with other regulatory agencies as well as the institutions supervised by the Bank. The Bank leveraged on its involvement at national level to gain increased access to the national level recovery infrastructure to further strengthen its recovery capabilities. A strategic relationship between the Bank and Majlis Keselamatan Negara (National Security Council) was established to further strengthen the robustness of the Bank's Business Continuity Plan during emergency situations.

Additionally, the Bank's BCM Framework was revised in 2011 to align it with current industry BCM practices. Among the key enhancements was the establishment of a more effective BCM governance structure. The scope of critical functions was also expanded, taking into consideration all the principal objects of the Bank as outlined in the Central Bank of Malaysia Act 2009. The revised BCM Framework also institutes a more systematic communication strategy in the form of enhanced

coordination and collaboration with the financial industry in preparing for potential systemic risk or operational disruptions in the financial sector.

Embedding a Risk Management culture at all levels

The socialisation of the new Operational Risk Management and Financial Risk Management frameworks instilled a consistent understanding of the Bank's risk management framework. Improvements made to the Risk Control Self Assessment (RCSA), including linking it to the strategic outcomes of the business plan and further facilitated by the new eRCSA system, have resulted in greater commitment and involvement of senior officers within the first line of defence. This annual risk assessment exercise has enabled the line departments to inculcate greater understanding among their staff of the risks facing their areas, the root causes and the controls that are in place to mitigate the risks. The new frameworks have also shaped a common risk management language and taxonomy used throughout the Bank, which has facilitated a more consistent assessment and risk reporting of risks. At the enterprise level, aggregation of self assessments provides a platform for greater deliberation of risks within sectors and across the organisation.

To facilitate staff compliance to internal policies and guidelines, SRMD had embarked on establishing a central repository for the Bank's internal policies and guidelines. This platform will provide a single point of reference and allow easy access by all staff, and is expected to be fully operational in early 2012. Greater focus was also given to information security management to ensure that the Bank's confidential and strategic information is adequately safeguarded.

Risk Management outlook

The Bank anticipates greater challenges in managing the risks that are dynamic in nature as well as in building the right risk management culture. Several initiatives are in the pipeline to prepare for the challenges.

Greater integration of risk management tools is planned for a more robust risk management methodology that can be applied for business planning and decision making. For this purpose, a more holistic ERM strategy will be developed to incorporate the integration and enhancement of the risk management

methodology. Among the priorities is the seamless integration of risk, strategic, financial and resource management. A more structured and clearer approach in defining risk appetite and tolerance is also considered a key area for enhancement.

Risk management awareness and culture is expected to grow with the maturity of the risk assessment tools, where the tools are expected to be embedded within daily operations and decision making at all levels in the Bank

Risk management awareness and culture is expected to grow with the maturity of the risk assessment tools, where the tools are expected to be embedded within daily operations and decision making at all levels in the Bank. This will be augmented by efforts targeted specifically at elevating the risk management awareness including risk management training and structured engagement sessions.

In addition, risk management in the Bank will continue to be monitored through continuous benchmarking with industry best practices, particularly with other central banks. These initiatives are geared towards developing a risk management methodology that can provide strong support to the Bank in fulfilling its mandate and achieving its strategic objectives.

Internal Controls

The Internal Audit Department (IAD) provides an independent and objective assessment on the Bank's risk management measures, internal controls and governance processes with respect to the key functions and activities of the Bank with the aim of supporting the BAC in fulfilling its mandates. The audit activities are planned over a three year period, and regular reviews are undertaken to allow for adjustments to be made due to changes in the Bank's activities and operating environment. IAD regularly engages SRMD and other key line departments to ensure that its audit plan remains focused on the Bank's priority areas and key risks.

The IAD continued its three-pronged audit approach during the year, to facilitate an end-to-end review of the Bank's core processes, thematic reviews of common activities for benchmarking purposes and reviews of significant activities that are specific to the respective line departments and entities. In this regard, concurrent audits were also conducted in a coordinated manner on relevant departments and entities in order to achieve several objectives, such as the identification of risks in the chain of activities of core processes and the uncovering of risks which are systemic across departments. The identification of such risks would allow IAD to assess the adequacy of the Bank's risk management practices and controls, and to recommend Bank-wide measures to address such risks. In addition, IAD also carried out audits of the Bank's subsidiaries and affiliates to provide a holistic assessment of the key risks that might affect the Bank's achievement of its mandates and objectives.

To complement its audit activities, IAD had provided inputs to various working committees, taskforces, line departments and related third party entities, in its effort to promote internal controls, governance processes and risk management measures that are sufficiently robust to mitigate the key risks to the Bank. In addition, as part of IAD's efforts to continuously improve the quality and effectiveness of its deliverables, feedback and comments on the conduct and performance of the audit teams were solicited and action has been taken to address valid issues relating to the audit quality and effectiveness. The feedback and improvement measures were also reported to the BAC and Management of the Bank.

For 2011, IAD had completed its audit plan, and additional ad-hoc assignments requested by the BAC and Management. During the year, the auditors made recommendations that were accepted and implemented by the respective line departments and entities to facilitate further enhancements to the risk management and control functions in the operational areas of the Bank, and in the respective entities to ensure that key risks continue to be actively managed.

ORGANISATIONAL DEVELOPMENT

Becoming a High Performance Organisation

This year marked the conclusion of the Bank's Business Plan 2009-2011 ("Business Plan"). The implementation of the Business Plan had contributed significantly to the Bank's

transformation to being a strategy-focused and high performing organisation. See white box 'Bank Negara Malaysia's Business Plan 2009-2011' for an overview and achievements of the Business Plan.

For 2011, the Bank remained focused on delivering on its core mandates of monetary and financial stability, which was particularly challenging given the volatile global economic and financial environment. In line with the desired outcomes set in the Business Plan, strategies continued to be implemented to strengthen the Bank's effectiveness and efficiency in discharging its responsibilities. To further improve the Bank's decision making process, internal committees in the Bank were streamlined and the Bank's participation in external committees was also reviewed and consolidated. Risk management practices were enhanced through stronger risk frameworks, tools and methodologies. In addition, a new framework to improve stakeholder engagement and communications was also finalised.

In preparation for the next business plan for the period of 2012-2014, the Bank improved the strategic planning process with enhanced tools, methodologies and processes. Environmental scanning and analysis was strengthened to better understand the current and prospective, external and internal environment and the expected trends moving forward for the next three years.

The Senior Management Conference 2011 themed 'Strategic. Smart. Sustainable' was designed to provide a platform to discuss balancing the need to meet increased expectations of stakeholders while preserving a sustainable working environment. It was also an opportunity to identify and discuss critical enabling factors in ensuring successful delivery on the Bank's mandates. Renowned speakers were invited to share experiences in the areas of risk management, leadership and innovation to achieve breakthrough performance.

Human Capital Management

Focus on human capital

The Bank continued with the integrated human capital approach and in 2011, implemented several initiatives to develop a competent and progressive workforce encompassing the supply and demand of talent, development, performance and reward. The Bank forged ahead with progressive measures

to attract, assess, develop, reward and retain talent to drive the performance of the Bank.

Sasana Kijang as a regional centre for thought leadership in central banking

During the year, the Bank launched Sasana Kijang - a modern centre of excellence for central banking and financial services which promotes regional and international collaboration. The building hosts the Islamic Financial Services Board and the SEACEN Research and Training Centre and is fully equipped with the state-of-the-art meeting and conference facilities

Greater job and role fit to enhance performance

A key initiative in human capital management introduced in 2011 was the job families. The approach, which is characterised by the grouping of jobs with similar characteristics such as common competencies, skills and knowledge as well as having similar purpose or processes into specific families, would enable the Bank to effectively implement more differentiated human capital strategies, encompassing recruitment, development, performance management and reward. The job family approach recognises the different value contributions and accountabilities. It also enables the Bank to reward staff on a differentiated basis to better attract, motivate and retain talent. The first phase of the implementation of the new job families was rolled out in June 2011 for the first level executives.

The Bank also strengthened the technical specialist ladder framework. The technical specialist ladders enabled staff with high and distinguishing technical skills to progress within the ladder and continue

Bank Negara Malaysia's Business Plan 2009 – 2011

Introduction

Bank Negara Malaysia's three-year Business Plan is an important strategic management process aimed at providing clarity and focus to the organisation's policies and activities towards achieving the mandates of the Bank. Amidst a changing and often challenging operating environment, organisation-wide clarity and alignment of key outcomes and deliverables are essential in ensuring that the Bank is effective in discharging its roles and functions. The Business Plan is also a key tool in ensuring the Bank achieves its vision of being a progressive and high performing central bank that is committed to the highest standards of excellence.

Overview

The last three-year Business Plan, 2009 – 2011, outlined eight strategic focus areas, each comprising of key strategic outcomes with corresponding strategies and action plans to achieve these outcomes. The strategic focus areas were clustered around the key mandates of the Bank, namely ensuring monetary and financial stability, developing a progressive financial sector, and fostering a reliable and efficient payment system. In addition, priority was also placed on strengthening the internal capacity and capability of the Bank, specifically in the areas of human capital development, risk management practices, financial resources management, and physical and information technology infrastructure. Another key focus area was in external communications and stakeholder engagement to ensure the Bank's policies and initiatives are well understood and achieved their intended outcomes.

The Business Plan is outcome driven, and for the period 2009 – 2011, a total of 33 strategic outcomes were identified as key priorities for the Bank. To ensure the effective implementation of the Business Plan, a robust strategic management process was put in place to achieve organisation-wide clarity of the strategic objectives, create line-of-sight to organisational goals, provide a greater appreciation of interdependencies among policy outcomes and emphasises the need for effective horizontal collaboration across the Bank. In addition, the Business Plan also allowed for more informed decision making on the optimal allocation of resources to areas that were of strategic importance.

Key Achievements of Business Plan 2009 – 2011

As 2011 concluded, the Bank achieved almost all strategic outcomes. During this period, the Bank created a conducive operating environment through implementation of wide ranging policies to sustain domestic growth with price stability, financial stability and orderly domestic money and foreign exchange markets. As an economic adviser to the Government, the Bank was also involved in the formulation of macroeconomic policies to mitigate the impact of the global financial crisis on the domestic economy, and in providing advice on key strategies for the long-term transformation of the Malaysian economy. The financial system remained stable and resilient during the year and continued to function without disruption of the intermediation process. Important in this endeavour is the robust surveillance mechanism, as well as the strengthened regulatory and supervisory framework. The Bank also strengthened cooperation and coordination on surveillance and crisis management with other central banks and regulatory agencies in the region. Success was also achieved in further strengthening the internationalisation of Islamic finance as well as market conduct and consumer protection.

To ensure a high level of effectiveness and efficiency, the Bank embarked on initiatives to strengthen its internal capacity and capability, with emphasis on governance, risk management, human capital development, and communications and stakeholder engagement. The enactment of the new Central Bank of Malaysia Act 2009 equipped the Bank with enhanced capacity to pursue its mandates reinforced by the institutionalisation of the governance framework that ensures a high level of accountability and transparency. The Board's oversight function was also further strengthened through the establishment of Board Risk Committee and Board Governance Committee that enabled a higher level checks and balances. Risk management practices were further reinforced by adopting new Operational Risk Management and Financial Risk Management frameworks, as an integral part of the Bank's decision-making process.

In continuing to build a competent and progressive workforce, the Bank strengthened its leadership pipeline, streamlined roles and job functions with a competitive remuneration package and invested in an effective knowledge management system. Communications and stakeholder engagement strategies enabled the Bank to more effectively provide its views and perspectives while receiving feedback on its policies and issues.

Moving forward

The Bank's Business Plan 2009 – 2011 created the foundation to ensure organisational continuity and preparedness to better face the challenges going forward in achieving the Bank's desired outcomes. In line with the implementation of the Financial Sector Blueprint, focus will be given to developing a more inclusive financial system, promoting greater integration of Malaysia into the regional and global economic and financial system as well as sustaining the high performance of the Bank. These issues and priorities are being addressed in the new Business Plan 2012 – 2014 to ensure that the Bank continues on its path towards becoming a strategically-focused, outcome-driven and sustainable organisation.

to focus in specific technical areas with minimal involvement in administrative matters with attractive reward packages as a retention effort. To date, three specialist ladders in the areas of risk, actuary and legal have been established to meet the demand for internal technical advisory service in the organisation.

To maintain a healthy leadership pipeline, scheduled talent assessments were performed to facilitate strategic progression and movement within mission critical positions. Continuous effort is undertaken to create healthy and strong succession pool through leadership profiling of potential managers via the Leadership Profiling Center (LPC). The Bank's talent pool was further reinforced via strategic external hires for manager level and above in instances where specific skills were sought.

Targeted development for greater value add

Targeted talent and leadership development as well as intensification of career growth continued to be given greater focus for succession and potential new roles in the Bank. During the year, a structured leadership development framework was developed to strengthen the leadership pipeline and to assist individual staff to enhance their leadership qualities. This structured framework provides a set of leadership development programmes (LDP) to improve staff performance as well as to support leaders in transitioning across various levels in the Bank. The LDP combines on-the-job experiential learning, mentoring, coaching, classroom programmes and other relevant exposures.

On the technical competencies, learning programmes in 2011 were organised with greater emphasis on central banking knowledge and specific technical subject areas such as financial sector regulation and supervision, macroeconomics, payment systems and financial surveillance. To ensure a more structured and holistic development, the Bank is refining its technical competency framework and learning roadmaps to meet the different knowledge and requirements and within the newly implemented job families.

Apart from refining both the leadership and technical competency frameworks, the design of the various learning programmes was also strengthened to ensure greater value add to the stakeholders. Greater emphasis was placed on measuring learning effectiveness, particularly on the transfer of learning from classroom to

the workplace. In line with the sophisticated and advanced training and learning facilities established in Sasana Kijang, the delivery processes of learning programmes have also been streamlined and enhanced to ensure greater efficiency and effectiveness.

Managing the talent pool

To sustain a high performance workforce and effectively manage staff based on their different performance levels, 2011 was the second year of implementation of the Performance Improvement Programme to assist staff to improve their performance. Staff enrolled in this programme would be provided with structured developmental interventions with support from their supervisors. Management of scholars continued as an important activity as a source of talent pool for the Bank. In 2011, the Bank awarded scholarships to 54 selected students with excellent results to pursue pre-university, first degree and post graduate programmes in selected universities. The Bank also continued to support staff to pursue further studies in relevant fields by providing scholarship opportunities.

As a firm commitment to utmost excellence and nation building as well as to recognise exceptional achievements of the nation's best and brightest, the Bank awarded three Kijang Emas Scholarship Awards to students with exemplary results in the Sijil Pelajaran Malaysia (Malaysian Certificate of Education) in 2011. This brought the total recipients of Kijang Emas Scholarship Awards to 35 since its inception in 2004. Being the most prestigious scholarship awards granted by the Bank, the recipients have the freedom to pursue their own field of study in selected top universities in any country of their choice, with no bond imposed except for the requirement to serve the nation upon the completion of their study.

Staff strength

As the role of the Bank evolved, several departments were realigned and rationalised to increase efficiency and effectiveness. To ensure an optimum level of manpower at all levels, a holistic approach was considered, taking into account technology, process improvements and staff competency. In 2011, the staff strength of the Bank increased by 3.8% to 2,838 from 2,734 in 2010. Attrition remained at 4.7%. The ratio of executive to non-executive staff was sustained at 3:2 in 2011.

Moving forward

Targeted and strategic differentiation as well as a systematic approach in development intervention will be a major milestone in 2012 to promote a competent and progressive workforce. Further development in the job families encompassing the whole staff population will be implemented to enhance the Bank's competitive edge.

To promote a competent and progressive workforce, the Bank will continue to invest in developing its talent and the LDP is one of the key initiatives. In terms of operational efficiency, more streamlined work to focus and improve operational processes and the effectiveness of human resource services to harness the full potential of knowledge resources and technology will be implemented. The Bank will continue to invest in the modernisation of human capital practices and its supporting IT infrastructure to enhance its sourcing processes and human resource operations.

Knowledge Management Centre

To provide the opportunity and environment to network, exchange views and share knowledge, the Bank has re-engineered and relocated the Knowledge Management Centre (KMC) to Sasana Kijang in July 2011 for the staff. In addition to the staff, the KMC is also accessible to external parties including other central bankers, researchers and academicians. In an effort to be the regional resource and research centre in the areas of central banking, Islamic Finance and financial services, KMC has continued to acquire knowledge resources, both physical and online.

International Technical Cooperation Programmes

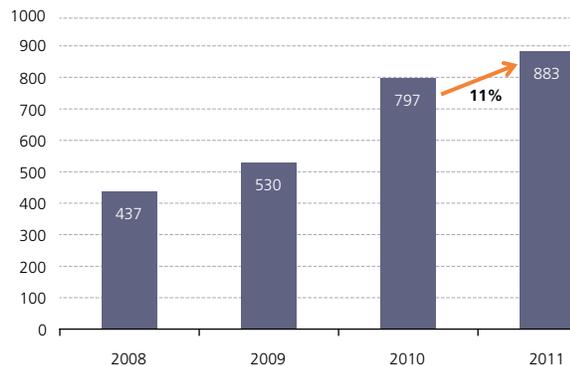
The Bank's international technical cooperation programmes continued to provide strong support to the objective of enhancing collaboration and knowledge sharing among regional and international central banks and regulatory authorities. The international technical cooperation programmes provide a powerful platform to share Malaysia's experience in central banking, and also create opportunities to learn from central banks from other parts of the world.

During 2011, 883 participants from 85 countries participated in the Bank's international technical cooperation programmes. Participants were keen to learn about the methods and systems that have contributed to the development of the Malaysian economy and financial system. Areas that were of interest included Islamic finance, organisational development, financial inclusion, consumer protection and financial education. The Bank's international technical cooperation programmes created opportunities for the Bank to engage more with counterparts from South-East Asia, Central Asia, Western Asia and Africa.

In its efforts to improve the outreach, breadth and depth of the technical cooperation programmes, the Bank collaborated with many international and domestic partners. The international partners included the South East Asian Central Banks Research and Training Centre (SEACEN), the Islamic Development Bank (IDB), Alliance for Financial Inclusion (AFI), International Finance Corporation (IFC), the World Bank,

Chart 5.1

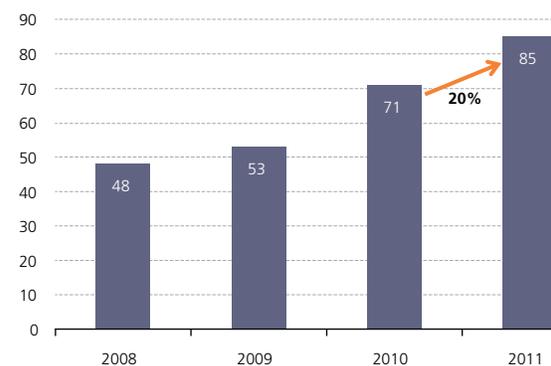
Technical Cooperation Programmes: No. of Participants



Source: Bank Negara Malaysia

Chart 5.2

Technical Cooperation Programmes: No. of Countries Participated



Source: Bank Negara Malaysia

Consultative Group to Assist the Poor (CGAP), Organisation for Economic Cooperation and Development (OECD), the Asian Development Bank (ADB), Japan International Cooperation Agency (JICA) and German International Cooperation (GIZ). The Bank's domestic partners, such as the Asian Institute of Finance (AIF), ICLIF Leadership and Governance Centre, International Centre for Education in Islamic Finance (INCEIF), International Shari'ah Research Academy for Islamic Finance (ISRA) and various industry players also contributed to the sharing of new ideas and practices.

The growing global interest in Islamic finance was evident from the 235 participants representing 33 countries that participated in various Islamic finance programmes during the year. This encouraging development can be attributed to the long partnership between the Bank and IDB which played a key role in supporting the programmes organised in Kuala Lumpur and Ankara, Turkey. New programmes for 2011 included two Islamic finance programmes in French and Russian introduced for the Central Asian countries and the Western African countries, thus increasing the outreach to non-English speaking countries; and three new technical workshops focusing on Islamic Liquidity Management, Risk Management and Islamic Capital Markets. These international technical cooperation programmes created a platform that brought together policymakers and practitioners of Islamic finance from many parts of the world to discuss the development of the Islamic financial services industry, thereby supporting the continued internationalisation of Islamic finance.

Another area of importance is financial inclusion. The objective of supporting capacity building for policymakers and practitioners is to contribute to the global agenda of building more inclusive financial systems to enable those who remain underserved to have the opportunity to undertake financial transactions, generate income, accumulate assets and protect themselves financially against unexpected adverse events, thereby enabling them to benefit from economic progress. Highlights for the year included the 4th Financial Inclusion Advisor (FIA) programme conducted in Namibia in collaboration with the Bank of Namibia and AFI; the Financial Inclusion Policymakers Forum in collaboration with CGAP and the OECD International Network on Financial Education

(INFE); and the Retail Credit Risk Management workshop with the IFC. These international dialogues focused on topical issues, such as consumer protection, financial education, sound market conduct, the effective use of credit information to promote access to finance and the need for a coherent national agenda that supports the development of more inclusive financial systems.

The Bank also conducted programmes in various aspects of institutional capacity building, from enterprise risk management and auditing to governance, leadership and financial accounting. These programmes focused on the modernisation of the internal processes and structures of central banks, with the goal of achieving sustainable organisational performance improvements and greater flexibility to respond to new challenges.

Given the uncertainties and challenges arising from the more globalised financial environment, cross-border collaboration and knowledge sharing is becoming integral to good policy making. As the Bank moves forward, the international technical cooperation programmes will continue to provide a platform for central bankers to network, exchange views and share experiences to be better positioned to meet future challenges.

Leveraging on Technology for High Performance Workplace

The performance bar for Information and Communications Technology (ICT) services was raised in year 2011, with the implementation of new technology focusing on the delivery of an enabling environment for the achievement of business outcomes.

The year started with the focus being on the new converged network infrastructure deployed in Sasana Kijang and the Bank's newly established Regional Offices in Pulau Pinang and Johor Bahru. The converged network, based on the Internet Protocol (IP) standard, enables Bank staff to easily access information and business applications across multiple locations, thus encouraging greater work collaboration and improved process efficiencies. These services include dedicated and better quality video and audio conferencing and streaming, and integrated systems for building management and security.

In line with the objective to provide members of public with greater opportunities to access and

interface with the Bank, remote access to ICT systems supporting the LINK operations were configured in MobileLINK. Enhanced accessibility to the designated systems utilised in MobileLINK enabled the capturing of public information such as customer biodata, photograph and supporting documents via data capturing devices, integrated process for monitoring public enquiries and complaints, as well as the provision of convenient self-generated personal credit report facilities. Internal organisational process efficiencies were also further enhanced by the implementation of the Bank's new Financial Management System and an integrated and centralised portal for staff to have easy access to human resource services.

The critical factor that is fundamental to the successful deployment of a resilient, robust and secured ICT infrastructure is stringent security surveillance and management. Internal and external ICT security risk assessments were conducted on a quarterly basis to ensure that the protection of the Bank's information and ICT assets were sustained at all times. In addition, progressive reviews of the Bank's security perimeter defences were conducted to counter more sophisticated attacks that target end-users through social engineering and mobile applications. Business Continuity Management processes for ICT system resiliency and capacity were also further enhanced for the critical ICT applications in the Bank. A heightened state of readiness (covering all three aspects of systems, people and processes) continued to be the underlying objective guiding the improvements.

Moving forward, the priority is to drive new ICT services for high-efficiency and seamless collaboration capabilities for the Bank, whilst ensuring greater mobility and assurance of security embedded in its business applications and processes. Planned deployment for an integrated information system catering to the Bank's requirements for advanced statistical analysis of financial, monetary and macroeconomic data is also in the pipeline.

COMMUNICATIONS

The Bank's communications function remained important in fostering confidence, especially amid the uncertain global economic and financial environment of 2011. More frequent communications were undertaken, on the Bank's assessment of the impact of external developments on the Malaysian economy and financial sector

as well as to highlight the underlying strength of domestic economic fundamentals in sustaining the growth momentum of the domestic economy.

Providing comprehensive assessments of the economy and the financial sector

The Annual Report and Financial Stability and Payment Systems Report briefings, the quarterly GDP press conferences and the periodic Quarterly Bulletins and Monthly Statistical Bulletins are now the established communications platforms for the Bank. Aside from providing the Bank's assessments of economic and financial developments, the sessions provided feedback from the public and other stakeholders. Regular in-depth discussions with key stakeholders such as representatives from various sectors of the economy, rating agencies, economists/analysts, fund managers, businesses and consumer associations provide additional perspectives that supplement the Bank's own surveillance and analysis.

Monetary policy communications

The Monetary Policy Statement (MPS) is the main medium for conveying the decisions by the Monetary Policy Committee (MPC) of the Bank. Additional communication is undertaken through senior management engagements with the industry, analysts, economists and the media through media interviews as well as commentaries at major conferences. In the first half of the year, monetary policy communications centered on conveying the assessment underlying the decision to raise the Overnight Policy Rate (OPR). Through the MPS and other communications, the Bank elucidated that the policy rate was normalised further as a pre-emptive measure to prevent an accumulation of financial imbalances, against the backdrop of sustained economic activity and risks to inflation. In the second half of the year, however, the focus shifted towards providing the assessment underlying the decision to keep the policy rate unchanged. The operating environment had changed as downside risks to domestic economic growth had increased significantly due to the deteriorating global economic and financial conditions, whereas the upside risks to inflation had subsided. The decision to raise the statutory reserve requirement (SRR) were pre-emptive measures to ensure that the risks arising from the build-up of liquidity within the financial system did not result in macroeconomic and financial imbalances. These decisions were conveyed in separate statements and not in the MPS. This was to emphasise that the SRR was an instrument to

manage liquidity and not a signal on the stance of monetary policy. Changes in the stance of monetary policy are solely reflected in the decisions on the OPR.

Reinforcing confidence on the strength of the financial sector

The Financial Sector Blueprint (2011-2020) was launched in December 2011 to provide direction on the future development of the financial sector, as well as the role of the financial sector in promoting the effective intermediation towards the achievement of a high income economy. In finalising the Blueprint and its strategies, the Bank had benefited from in-depth discussions with the various stakeholders. The cumulative efforts from the industry, the public sector and other regulators are key to realising the goals of the Blueprint.

Communications efforts were also undertaken in providing the strategic intent of the introduction of two macro prudential measures – namely, promoting responsible financing practices and prudent utilisation of credit cards. Various engagement sessions were held with the key stakeholders on these pre-emptive measures. The overriding messages in these sessions can be broadly classified, namely, that consumers who have the affordability will have access to financing and on a macro level, the measures will ensure household debt remains at a healthy level and thereby contribute not only to financial stability but also in sustaining domestic economic growth.

The year also saw promotional efforts in expediting migration to e-payments through collaboration with key entities in communication plans to inform the public on the benefits of using e-payments. These include the Bank's strategic partnership with the Public Services Department, MEPS and MyClear to execute promotional strategies for e-payments adoption nationwide as well as collaborating with MEPS and representatives of financial institutions in promoting mobile banking.

Meanwhile, the Money Services Business Act 2011 was successfully legislated, following strategic and comprehensive engagements with all key stakeholders. Explanation was given on how the new Act would provide an enabling environment for more modern and professional money services business activities, with the appropriate protection for consumers and safeguards to preserve the integrity of the industry against

money laundering, terrorist financing and illegal activities. The consultative approach with the money changing and remittance industry paved the way for a smooth transition to the new regulatory framework.

The New Motor Cover Framework which was announced in March 2011 was a culmination of the strategic engagement with all key stakeholders in addressing their concerns and issues, leading to the formulation of feasible and effective measures to be incorporated in the Framework. Subsequently, in January 2012, the first adjustment of the motor insurance premium (after thirty years of non-adjustment) was undertaken.

Public outreach programme continues to be an important part of the Bank's developmental agenda

A major initiative by the Bank during the year was the upgrading of the role and status of its branches in Pulau Pinang and Johor Bahru to become Regional Offices (ROs) of the Bank. The objective is to strengthen the Bank's presence and economic surveillance at the northern and southern regions. In addition to the previous role of the branches in ensuring efficient cash management, the role of the ROs were expanded to include consumer financial redress and advisory services, undertaking economic and financial surveillance and driving the execution of the Bank's agenda, including the promotion and enhancement of financial inclusion. Through heightened engagements with the industry and public, the ROs have obtained valuable insights on the regions' economic developments which serve as inputs to the Bank's policy analysis and review. Financial consumers and SMEs continued to benefit from the access to financial information and consumer redress mechanism channels namely, BNMLINK (walk-in services) and BNMTELELINK (acting as a call centre). The number of individuals and businesses seeking advice on financial matters rose to about 320,000 in 2011 (+14%). More than 90% of the 10,000 complaints received against the financial institutions had been resolved. The introduction of MobileLINK services in December 2011 was aimed at reaching out to the underserved communities in semi urban and rural areas.

The Bank continued to intensify its outreach efforts to create and enhance awareness on access to financing for SMEs and micro enterprises. During the year, the Bank had conducted various briefings and seminars on its schemes and services particularly on Special Funds, *Pembiayaan Mikro*

and Green Technology Financing Scheme. In addition, as a member of the National SME Development Council, the Bank forged collaborative efforts supporting SME outreach programmes such as seminars and exhibitions organised by the various ministries and government agencies, banking institutions and business associations. This has partly contributed to the healthy growth of SMEs and microfinance loans, by 17.1% and 14.3% respectively.

Efforts were also taken to continuously increase awareness of the public, through various channels, so that they do not fall prey to financial scams. These included new, fast and effective channels such as SMS blasts to about 27.2 million subscribers, wide media coverage on successful raids and alerts issued on financial scams in the Bank's website, BNM Facebook and Twitter as well as part of the MobileLINK services.

Meanwhile, Credit Counselling and Debt Management Agency (AKPK) counseled a higher number of customers, of close to 32,000 nationwide, with more than 50% of them being further assisted via its debt management programme. Furthermore, a specially designed programme targeted primarily for young individuals and new borrowers with the aim of empowering this group to effectively manage their finances, known as the Pengurusan Wang Ringgit Anda (POWER!) Programme was rolled out by AKPK in early 2011. By end of the year, around 23,000 individuals have benefited from the programme. The online version of the POWER! Programme was launched in November, targeting the wider online community to acquire personal money management skills conveniently. A total of 947 banking sector cases and 1,270 insurance sector cases were registered with the Financial Mediation Bureau for resolution, with the majority of cases related to Internet banking, credit card and motor and life insurance issues. However, the actual cases resolved for the year were much higher, with 1,284 banking and 1,560 insurance sector cases, bringing the total to 2,844 cases.

Issuance of new currency series

The new Malaysian currency series was launched in December 2011 by the Prime Minister, creating excitement and with extensive coverage in the media. The Bank has also engaged closely with financial institutions, businesses and cash handling vendors to ensure a smooth transition to the new series with the coins and notes coming into circulation in 2012.

Online communications - an increasingly effective delivery channel

The Bank continues to leverage on web technology to expand its web presence, increase its outreach and to better engage with the general public. In 2011, visitors to the Bank's website have increased by 2.1 million (+3.6%), with about 5.6 million visits (+2.1%) and viewed about 14 million pages (+1.6%). Of significance is the 200% increase (+300,000 visits) via mobile devices. To increase the Bank's web presence, the Bank has started to share its corporate videos and photographs in social media such as YouTube and Flickr besides broadcasting relevant messages through Facebook and Twitter. Reflecting all these positive developments, the Bank was awarded a 5-star rating in MAMPU's Malaysia Government Portals and Websites Assessment for 2011.

The Bank has also introduced a new financial education website for financial consumers, the Islamicfinanceinfo (www.islamicfinanceinfo.com.my), consisting of easy to understand contents related to Islamic banking and Takaful such as Shariah concepts and products available in the retail market.

Moving towards a more robust stakeholder engagement framework

With the Bank's operating environment expected to be increasingly challenging in the coming years, the Bank has placed significant priority on enhancing the effectiveness of the interface with the key stakeholders. The introduction of the Stakeholder Engagement Framework sets out the respective stakeholder engagement governance, disciplines and methodology, and the socialisation process for the Bank. With the Framework in place, the Bank's engagement undertakings will be more systematic, dynamic and meaningful, thereby equipping the Bank to deliver on its mandate effectively.

BANK NEGARA MALAYSIA Organisation Structure



*Administrative Head

As at 1 March 2012

2011

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**CERTIFICATE OF THE AUDITOR GENERAL
ON THE FINANCIAL STATEMENTS OF
BANK NEGARA MALAYSIA
FOR THE YEAR ENDED 31 DECEMBER 2011**

I have audited the financial statements of Bank Negara Malaysia for the year ended 31 December 2011. These financial statements are the responsibility of the management. My responsibility is to audit and to express an opinion on these financial statements.

The audit has been carried out in accordance with the Audit Act 1957 and in conformity with approved standards on auditing. Those standards require an audit be planned and performed to obtain reasonable assurance that the financial statements are free of material misstatement or omission. The audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. It also includes assessment of the accounting principles used, significant estimates made by the management as well as evaluating the overall presentation of the financial statements. I believe that the audit provides a reasonable basis for my opinion.

In my opinion, the financial statements give a true and fair view of the financial position of Bank Negara Malaysia as at 31 December 2011 and of the results of its operations for the year then ended in accordance with the approved accounting standards.


(TAN SRI DATO' SETIA HAJI AMBRIN BIN BUANG)
AUDITOR GENERAL
MALAYSIA

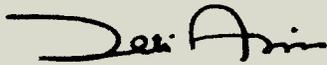
PUTRAJAYA
14 MARCH 2012



STATEMENT BY CHAIRMAN AND ONE OF THE DIRECTORS

We, Zeti Akhtar Aziz and Oh Siew Nam, being the Chairman and one of the Directors of Bank Negara Malaysia, do hereby state that in the opinion of the Board, the financial statements are drawn up so as to give a true and fair view of the state of affairs of Bank Negara Malaysia as at 31 December 2011 and of the results of operations for the year ended on that date.

On behalf of the Board,



ZETI AKHTAR AZIZ
CHAIRMAN

12 MARCH 2012
KUALA LUMPUR

On behalf of the Board,



OH SIEW NAM
DIRECTOR

12 MARCH 2012
KUALA LUMPUR

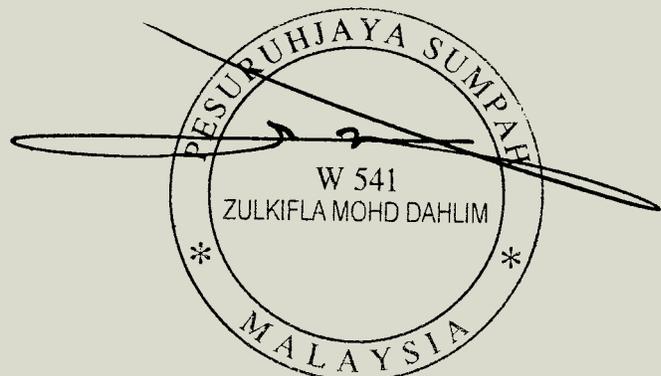
DECLARATION BY THE OFFICER PRIMARILY RESPONSIBLE FOR THE FINANCIAL MANAGEMENT OF BANK NEGARA MALAYSIA

I, Eugene Hon Kah Weng, being the officer primarily responsible for the financial management of Bank Negara Malaysia, do solemnly and sincerely declare that the financial statements, are to the best of my knowledge and belief, correct and I make this solemn declaration conscientiously believing the same to be true and by virtue of the provisions of the Statutory Declarations Act, 1960.

Subscribed and solemnly declared)
by the abovenamed at Kuala Lumpur)
this 12 March 2012.)



Before me,



106, BANGUNAN LOKE YEW
1, JALAN MAHKAMAH PERSEKUTUAN
50050 KUALA LUMPUR

Bank Negara Malaysia

Statement of Financial Position as at 31 December 2011

		2011 RM	2010 RM
ASSETS			
Gold and Foreign Exchange	3	414,432,520,031	320,774,448,194
International Monetary Fund Reserve Position		2,672,204,523	1,453,521,555
Holdings of Special Drawing Rights		6,252,997,720	6,442,516,703
Malaysian Government Papers	4	2,017,022,067	2,285,433,098
Deposits with Financial Institutions	5	28,797,250,000	40,583,035,000
Loans and Advances	6	10,671,155,047	11,837,444,956
Other Assets	7	8,126,397,188	6,795,391,854
Total Assets		472,969,546,576	390,171,791,360
LIABILITIES AND CAPITAL			
Currency in Circulation		61,874,099,518	55,787,812,628
Deposits by: Financial Institutions		214,905,708,306	170,732,428,628
Federal Government		10,817,830,921	14,226,350,050
Others	8	13,066,091,926	3,663,691,712
Bank Negara Papers		107,983,490,852	100,376,801,291
Allocation of Special Drawing Rights	9	6,548,320,169	6,396,555,926
Other Liabilities	10	25,844,324,400	19,273,907,766
Total Liabilities		441,039,866,092	370,457,548,001
Paid-up Capital	11	100,000,000	100,000,000
General Reserve Fund	12	14,368,386,506	13,643,961,478
Other Reserves	13	17,461,293,978	5,970,281,881
Total Capital		31,929,680,484	19,714,243,359
Total Liabilities and Capital		472,969,546,576	390,171,791,360

Notes on the following pages form part of these financial statements.

Bank Negara Malaysia

Income Statement for the Year Ended 31 December 2011

		2011 RM	2010 RM
Total Income	Note 14	6,071,018,517	7,478,425,194
Less:			
Recurring Expenditure	15	964,570,808	873,712,705
Development Expenditure	16	382,022,681	438,819,340
Total Expenditure		1,346,593,489	1,312,532,045
Net Profit		4,724,425,028	6,165,893,149
Appropriation of Net Profit:			
Transfer to Other Reserves	17	2,000,000,000	4,000,000,000
Transfer to General Reserve Fund		724,425,028	165,893,149
Amount Payable to Federal Government		2,000,000,000	2,000,000,000
Net Profit		4,724,425,028	6,165,893,149

Notes on the following pages form part of these financial statements.

Notes to the Financial Statements - 31 December 2011

1. Principal Activities of the Bank

The principal objects of the Bank are to promote monetary stability and financial stability conducive to the sustainable growth of the Malaysian economy. In this regard, the Bank's primary functions are as follows:

- (a) to formulate and conduct monetary policy in Malaysia;
- (b) to issue currency in Malaysia;
- (c) to regulate and supervise financial institutions which are subject to the laws enforced by the Bank;
- (d) to provide oversight over money and foreign exchange markets;
- (e) to exercise oversight over payment systems;
- (f) to promote a sound, progressive and inclusive financial system;
- (g) to hold and manage the foreign reserves of Malaysia;
- (h) to promote an exchange rate regime consistent with the fundamentals of the economy; and
- (i) to act as financial adviser, banker and financial agent of the Government.

2. Accounting Policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These accounting policies are consistently applied to both of the financial years presented, unless otherwise stated.

2.1 Basis of Preparation of Financial Statements

- (a) These financial statements have been prepared in accordance with the Central Bank of Malaysia Act 2009 and applicable Malaysian Financial Reporting Standards (FRS). Section 10 of the Central Bank of Malaysia Act 2009 provides that the Bank, in preparing its financial statements, shall comply with accounting standards to the extent that it is, in the opinion of the Bank, appropriate to do so, having regard to the objects and functions of the Bank. The Bank, having considered its responsibilities for the formulation and conduct of effective monetary policy, is of the opinion that, it is appropriate to differ, in some aspects, from the Malaysian FRS.
- (b) The preparation of the financial statements in conformity with the requirements of the Malaysian FRS requires management to use certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of income and expenses during the financial year. Although these estimates are based on the management's best knowledge of current events and actions, the actual results could differ from those estimates.

2.2 Measurement Base and Accrual Accounting

The financial statements have been prepared on the historical cost basis of accounting and on an accrual basis.

2.3 Foreign Currency Translation

- (a) The financial statements have been prepared using ringgit Malaysia, the currency of the primary economic environment in which the Bank operates.
- (b) Assets and liabilities in foreign currencies have been revalued into ringgit Malaysia at rates of exchange prevailing on the balance sheet date. Transactions in foreign currencies during the year have been translated into ringgit Malaysia at rates of exchange prevailing on the value dates.
- (c) The unrealised revaluation gains or losses arising from changes in the exchange rates are recognised in Other Reserves.

2.4 Securities and Investments

Securities and investments are stated mainly at cost and provisions have been made for diminution in value as at 31 December 2011. Designated financial instruments which have been identified as Available For Sale are stated at fair value and the unrealised revaluation gains or losses arising from changes in market prices are recognised in Other Reserves.

2.5 Repurchase and Reverse-Repurchase Agreements

The amount borrowed under repurchase agreements is reported under 'Other Liabilities'. The amount lent under reverse-repurchase agreements is reported under 'Other Assets'. The difference between the amount received and amount paid under repurchase and reverse-repurchase agreements is recognised as interest expense and interest income on a straight-line basis, respectively.

2.6 Fixed Assets

The capital expenditure incurred on fixed assets are written down to nominal value or written off completely in the year of acquisition.

2.7 Net Profit

The net profit of the Bank is appropriated in accordance with section 7 of the Central Bank of Malaysia Act 2009 and only realised gains are made available for dividend distribution.

3. Gold and Foreign Exchange

	2011 RM	2010 RM
Foreign Securities	359,284,482,783	275,379,932,314
Foreign Deposits	15,588,170,298	13,631,359,440
Balances with Other Central Banks, Bank for International Settlements (BIS) and International Monetary Fund (IMF)	6,036,194,304	6,767,913,697
Others	33,523,672,646	24,995,242,743
	<u>414,432,520,031</u>	<u>320,774,448,194</u>

4. Malaysian Government Papers

Malaysian government papers refer to holdings of Government debt instruments.

	2011 RM	2010 RM
Malaysian Government Securities	2,016,831,567	2,285,423,098
Sukuk 1Malaysia 2010	190,500	10,000
	<u>2,017,022,067</u>	<u>2,285,433,098</u>

5. Deposits with Financial Institutions

Deposits with financial institutions comprise deposits placed by the Bank with financial institutions under section 75(i) and section 100 of the Central Bank of Malaysia Act 2009.

6. **Loans and Advances**

Loans and advances comprise mainly advances extended by the Bank to the participating institutions under various schemes such as Fund for Small and Medium Industries and New Entrepreneur Fund aimed at promoting growth and development of small and medium business establishments. The extensions of these advances are mainly provided under section 49 and section 100 of the Central Bank of Malaysia Act 2009.

7. **Other Assets**

Other assets include investments in shares and bonds of RM7,790,647,218 acquired under section 48(1) and section 100 of the Central Bank of Malaysia Act 2009.

8. **Deposits by Others**

A substantial part of these deposits comprises deposits from national institutions, government agencies and public authorities.

9. **Allocation of Special Drawing Rights**

IMF member countries are allocated Special Drawing Rights (SDR) in proportion to their subscription to the IMF. The allocation represents a dormant liability of the Bank to the IMF, against which assets are received in SDR from the IMF. The net cumulative allocation of SDR was RM6,548,320,169 equivalent to SDR1,346,143,721.

10. **Other Liabilities**

Other liabilities include mainly placements by financial institutions under the repurchase agreements.

11. **Paid-up Capital**

The paid-up capital of RM100 million is owned by the Government of Malaysia.

12. **General Reserve Fund**

	2011 RM	2010 RM
As at 1 January	13,643,961,478	13,478,068,329
Transfer from Net Profit	724,425,028	165,893,149
As at 31 December	<u>14,368,386,506</u>	<u>13,643,961,478</u>

13. **Other Reserves**

Other reserves comprise:

(a) **Exchange Rate Fluctuation Reserve**

A reserve established to meet unrealised exchange revaluation gains or losses on assets and liabilities in foreign currencies of the Bank as a result of the fluctuations of exchange rates against ringgit Malaysia.

(b) **Revaluation Reserve**

A reserve established to deal with the movements in the market values of the Bank's investment portfolios which have been designated as Available For Sale portfolios and measured at fair value.

(c) **Contingency Reserve**

A reserve established to provide for future losses resulting from unfavorable external circumstances which are not within the reasonable control of the Bank.

14. **Total Income**

Total income comprises revenue from foreign reserves management which includes interest and dividends, non-treasury income, realised capital gains/losses, and is stated at net of amortisation/accretion of premiums/discounts and the monetary policy cost.

15. **Recurring Expenditure**

Recurring expenditure are expenses incurred in the management and administration of the day-to-day operations of the Bank.

16. **Development Expenditure**

Development expenditure are expenses incurred mainly to finance developmental and long term projects undertaken by the Bank that are in line with its principal objects and functions.

17. **Transfer to Other Reserves**

This transfer is made in accordance with section 7 of the Central Bank of Malaysia Act 2009.

18. **Contingencies and Commitments**

18.1 **Contingent Assets**

Total contingent assets as at 31 December 2011 amounted to RM1,400,000,000. These comprise the Bank's total contributions to International Centre for Leadership in Finance (ICLIF) Trust Fund of RM800,000,000 and International Centre for Education in Islamic Finance (INCEIF) Trust Fund of RM600,000,000, to finance activities related to training, research and development of human resource on banking and financial services managed by The ICLIF Leadership and Governance Centre and INCEIF. It is provided in the Trust Deeds that the total contributions will be returned to the Bank when the Centres become self-sufficient in the future.

18.2 **Contingent Liabilities**

Total contingent liabilities as at 31 December 2011 comprise the following:

(a) **Membership with IMF**

- (i) The Bank has an obligation to pay to IMF an amount of RM6,099,006,711 in SDR or other convertible currencies which represents the unpaid portion of Malaysia's quota in the IMF under the Articles of Agreement.
- (ii) The IMF has recently conducted a quota review exercise for its member countries in order to reflect changes in the global economy or changes in members' economic position. On 15 December 2010, in accordance with the Board of Governors Resolution No. 66-2, the IMF adopted the "Fourteenth General Review of Quotas and Reform of the Executive Board" under which the quotas of members of the Fund shall be increased. As at 31 December 2011, from the current level of quota of SDR1,773,900,000, Malaysia has consented to the increase of its quota to SDR3,633,800,000.
- (iii) The Bank has participated in the New Arrangements to Borrow (NAB), a set of credit arrangements between IMF and its member countries to provide supplementary source of financing to IMF for the purpose of safeguarding the stability of the international monetary system. For the year ended 31 December 2011, the Bank has provided SDR23.4 million (equivalent to RM112.2 million) out of SDR340 million under the NAB credit arrangement.

(b) **Investment with Bank for International Settlements**

An amount of RM58,738,874 which represents the uncalled portion of the 3,220 units of shares held by the Bank in the BIS. The amount is based on the nominal value (SDR5,000) of the uncalled portion and SDR rate as at the balance sheet date.

18.3 Commitments

Total commitments as at 31 December 2011 comprise the following:

(a) **ASEAN Swap Arrangement**

The Bank has participated in the multilateral ASEAN Swap Arrangement (ASA) together with other ASEAN central banks and monetary authorities to provide short-term foreign currency liquidity support to member countries with balance of payments difficulties. As at 31 December 2011, the Bank's total commitment amounted to USD300 million (equivalent to RM950.6 million) and there has been no request for liquidity support under ASA from any member country during the financial year.

(b) **Bilateral Swap Arrangement**

On 7 January 2009 and 2 April 2010, the Bank renewed the Bilateral Swap Arrangement (BSA) agreements with the Bank of Korea and the People's Bank of China respectively under the Chiang Mai Initiative under which financial resources in US Dollar can be obtained through swap arrangements against the respective local currencies. As at 31 December 2011, the Bank's commitment under each BSA is USD1.5 billion (equivalent to RM4.8 billion) and there has been no request to activate the BSAs during the financial year.

(c) **Bilateral Currency Swap Arrangement**

On 8 February 2009, the Bank entered into the Bilateral Currency Swap Arrangement (BCSA) agreement with the People's Bank of China with the objective of promoting and facilitating trade settlement in local currency between the two countries. As at 31 December 2011, the Bank's total commitment under the BCSA is RM40 billion. For the financial year ended 31 December 2011, there was no request to activate BCSA.

(d) **Chiang Mai Initiative Multilateralisation Arrangement**

The Bank has participated in the Chiang Mai Initiative Multilateralisation (CMIM) arrangement to provide financial support to ASEAN+3 member countries facing balance of payments and short-term liquidity difficulties. The effective date of the CMIM Agreement is 24 March 2010. Under the CMIM arrangement, member countries facing balance of payments and short-term liquidity constraints can obtain financial support in US Dollar through swap arrangements against their respective local currencies. As at 31 December 2011, the Bank's total commitment is USD4.6 billion (equivalent to RM14.4 billion). For the financial year ended 31 December 2011, there was no request for liquidity support from any member country.

19. Financial Risk Management

The Reserve Management Committee oversees treasury and investment risks in the management of reserves to be within acceptable levels to ensure that the objectives of capital preservation, liquidity and return are met. The scope of such risks areas are as follows:

(a) **Market Risk**

Market risk is the exposure of the Bank's financial position to adverse movements in market prices such as equity prices, interest rates and foreign exchange rates. The management of market risk is governed by the benchmark policy approved by the Board of Directors which reflects the long-term investment objectives and acceptable risk-return profile. Within the benchmark policy, the 'active risk' may be taken through investments that deviate from the benchmark. The degree of 'active risk' is measured and controlled through a 'tracking error' limit. Sensitivity analysis and stress testing is also undertaken to assess potential marked-to-market losses on the reserves due to unexpected fluctuations and volatility in the market.

(b) **Credit Risk**

The credit risk on reserves is the risk that a counterparty, either financial institutions that the Bank deals with, or issuers of a debt instrument, fails to perform its contractual obligation to the Bank. A comprehensive rating-based credit risk framework approved by the Board of Directors governs the permissible activities and investment of the Bank. The Bank also takes into account in its credit assessment market-based indicators such as ratings implied by the credit default swap market, equity and bond price movements. This framework ensures investment activities remain with counterparties with high credit quality and investments in highly rated issuers.

(c) **Operational Risk**

Operational risk in treasury operations is the risk of financial loss due to failed internal processes, inadequate controls and procedures, or any other internal or external events that impede operations. Operational risk is mitigated through a robust governance framework and effective implementation of risk controls and limits. A comprehensive operational risk database is in place to support the identification of emerging risk in the Bank's treasury operations for action to be taken in managing gaps and mitigating financial loss.

20. **Income Tax**

The Bank is exempted from payment of income tax and supplementary income tax as set out in the Income Tax (Exemption) (No. 7) Order 1989.

2011

ANNEX



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Table A.1

Gross Domestic Product by Kind of Economic Activity at Constant 2000 Prices

	2007	2008	2009	2010	2011 ^p	2012 ^f
	RM million					
Agriculture	38,177	39,825	40,083	40,916	43,188	44,828
Mining and quarrying	42,881	41,831	39,209	39,270	37,032	37,265
Manufacturing	151,257	153,078	138,784	154,640	161,621	167,967
Construction	15,707	16,365	17,329	18,220	18,856	20,095
Services	272,406	293,072	302,045	322,611	344,549	362,185
Less: Undistributed FISIM ¹	19,607	20,412	21,897	23,171	24,804	26,219
Plus: Import duties	5,521	6,924	6,449	7,068	7,855	8,367
GDP at purchasers' prices²	506,341	530,683	522,001	559,554	588,297	614,488
	Annual change (%)					
Agriculture	1.3	4.3	0.6	2.1	5.6	3.8
Mining and quarrying	2.0	-2.4	-6.3	0.2	-5.7	0.6
Manufacturing	2.8	1.2	-9.3	11.4	4.5	3.9
Construction	7.3	4.2	5.9	5.1	3.5	6.6
Services	10.2	7.6	3.1	6.8	6.8	5.1
Less: Undistributed FISIM ¹	6.7	4.1	7.3	5.8	7.0	5.7
Plus: Import duties	4.4	25.4	-6.9	9.6	11.1	6.5
GDP at purchasers' prices	6.5	4.8	-1.6	7.2	5.1	4.0~5.0

¹ Financial intermediation services indirectly measured

² Numbers may not necessarily add up due to rounding

^p Preliminary

^f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.2

Growth in Manufacturing Production (2005=100)

	2008	2009	2010	2011	2009	2010	2011
	Index				Annual change (%)		
Export-oriented industries	109.9	97.7	107.1	110.8	-11.1	9.7	3.4
Electronics and electrical products cluster	107.8	83.2	97.7	94.2	-22.8	17.4	-3.6
<i>Electronics</i>	113.5	85.5	88.1	77.8	-24.7	3.1	-11.7
<i>Electrical products</i>	96.8	78.8	116.5	126.3	-18.6	47.8	8.4
Primary-related cluster	111.2	107.4	113.5	121.9	-3.5	5.7	7.4
Chemicals and chemical products	107.6	105.8	117.9	128.3	-1.7	11.5	8.8
Petroleum products	117.4	116.5	113.7	120.7	-0.8	-2.4	6.2
Textiles, wearing apparel and footwear	100.3	80.4	83.8	92.5	-19.8	4.2	10.4
Wood and wood products	91.2	76.0	84.9	79.9	-16.6	11.7	-5.9
Rubber products	128.2	124.3	150.2	171.0	-3.0	20.8	13.9
Off-estate processing	115.0	112.6	110.0	119.6	-2.1	-2.3	8.7
Paper products	120.6	114.0	125.8	140.4	-5.5	10.4	11.6
Domestic-oriented industries	121.5	114.6	132.5	144.3	-5.7	15.6	8.9
Construction-related cluster	126.9	112.4	133.7	157.1	-11.4	18.9	17.6
Construction-related products	116.9	95.8	116.8	132.0	-18.1	21.9	13.0
<i>Non-metallic mineral products</i>	114.9	99.3	121.7	148.0	-13.6	22.6	21.6
<i>Basic iron & steel and non-ferrous metal</i>	119.3	91.5	110.9	112.4	-23.3	21.1	1.4
Fabricated metal products	146.2	144.6	166.3	205.9	-1.1	15.0	23.8
Consumer-related cluster	117.6	116.1	131.6	135.0	-1.2	13.4	2.6
Food products	125.8	129.8	133.8	140.1	3.2	3.1	4.7
Transport equipment	116.4	102.0	132.3	131.1	-12.4	29.7	-1.0
Beverages	117.2	114.5	150.4	163.0	-2.3	31.4	8.4
Tobacco products	93.5	87.5	88.2	98.6	-6.4	0.9	11.8
Others	101.7	129.1	115.4	114.0	27.0	-10.6	-1.2
Total	112.2	101.0	112.2	117.4	-10.0	11.1	4.7

Source: Department of Statistics, Malaysia

Table A.3

GNI by Demand Aggregates

	2007	2008	2009	2010	2011 ^p	2012 ^f
	at Current Prices (RM million)					
Consumption	371,436	427,068	435,313	465,504	522,514	568,577
<i>Private consumption</i>	293,040	335,213	339,395	367,991	406,682	445,911
<i>Public consumption</i>	78,396	91,855	95,918	97,513	115,832	122,666
Investment	138,393	145,414	137,504	155,594	171,490	198,971
<i>Private investment</i>	76,577	77,986	64,633	78,730	93,977	106,015
<i>Public investment</i>	61,816	67,428	72,871	76,864	77,513	92,956
Change in stocks ¹	10	-1,948	-39,288	8,443	17,726	-162
Exports of goods and services	706,382	766,096	655,336	745,311	803,227	830,215
Imports of goods and services	574,172	594,160	508,927	608,886	662,223	680,837
GDP at purchasers' prices	642,049	742,470	679,938	765,965	852,734	916,764
Net factor payments abroad	-13,984	-23,033	-14,640	-26,514	-22,032	-19,363
GNI	628,065	719,438	665,298	739,451	830,702	897,401
	at Constant 2000 Prices (RM million)					
Consumption	320,644	349,417	354,030	372,613	405,685	425,603
<i>Private consumption</i>	255,263	277,540	279,361	297,604	318,098	337,863
<i>Public consumption</i>	65,381	71,877	74,669	75,009	87,587	87,740
Investment	116,751	118,077	111,516	122,443	129,822	145,289
<i>Private investment</i>	62,813	62,950	52,264	61,509	70,364	76,199
<i>Public investment</i>	53,938	55,127	59,253	60,933	59,459	69,090
Change in stocks ¹	-770	-5,466	-14,391	11,891	7,775	-787
Exports of goods and services	614,815	625,370	559,537	614,988	637,624	646,426
Imports of goods and services	545,099	556,715	488,691	562,382	592,610	602,043
GDP at purchasers' prices	506,341	530,683	522,001	559,554	588,297	614,488
Net factor payments abroad	-23,522	-36,360	-24,565	-42,721	-47,370	-42,942
GNI	482,819	494,323	497,436	516,833	540,927	571,546

¹ Includes statistical discrepancy^p Preliminary^f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.4

Savings-Investment Gap

	2007	2008	2009	2010	2011 ^p
	RM million				
Public gross domestic capital formation	61,816	67,428	72,871	76,864	77,513
Public savings	103,841	80,880	60,767	88,309	45,010
Deficit/surplus	42,025	13,452	-12,104	11,445	-32,503
Private gross domestic capital formation	76,587	76,038	25,345	87,173	111,703
Private savings	136,752	193,999	149,587	163,807	242,079
Deficit/surplus	60,165	117,961	124,242	76,634	130,376
Gross domestic capital formation	138,403	143,466	98,216	164,037	189,216
(as % of GNI)	22.0	19.9	14.8	22.2	22.8
Gross national savings	240,593	274,879	210,354	252,116	287,089
(as % of GNI)	38.3	38.2	31.6	34.1	34.6
Balance on current account	102,190	131,413	112,138	88,079	97,873
(as % of GNI)	16.3	18.3	16.9	11.9	11.8

^p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.5

Labour Market: Selected Indicators

	2007	2008	2009	2010	2011e
	(number of positions/persons)				
Vacancies by Industry¹					
Agriculture, hunting, forestry and fishery	226,759	275,548	230,303	327,670	399,522
Mining and quarrying	1,163	1,450	1,377	2,517	3,369
Manufacturing	275,155	327,798	695,418	693,711	689,422
Construction	117,217	107,421	111,622	250,820	388,241
Services	204,599	346,763	507,627	512,503	778,994
<i>Electricity, gas and water supply⁽ⁱ⁾</i>	1,477	2,047	4,367	8,269	15,091
<i>Wholesale and retail trade, hotels and restaurants⁽ⁱⁱ⁾</i>	66,600	99,317	162,270	147,303	185,577
<i>Transport, storage and communication⁽ⁱⁱⁱ⁾</i>	12,578	15,264	15,090	17,888	20,100
<i>Financial intermediation, real estate, renting and business services^(iv)</i>	50,235	125,821	148,001	168,067	372,346
<i>Public administration, defence and compulsory social security</i>	11,287	11,132	16,128	20,414	6,897
<i>Community, social and personal service activities</i>	62,422	93,182	161,771	150,562	178,983
Others not elsewhere classified	289	0	0	0	0
Total vacancies	825,182	1,058,980	1,546,347	1,787,221	2,259,548
Retrenchments by Industry					
Agriculture, hunting, forestry and fishery	255	398	278	866	172
Mining and quarrying	61	89	78	30	24
Manufacturing	9,970	11,014	17,850	3,854	5,635
Construction	291	199	503	262	290
Services	3,458	4,769	6,355	2,073	3,329
<i>Electricity, gas and water supply</i>	5	77	156	0	66
<i>Wholesale and retail trade, hotels and restaurants</i>	1,929	2,052	1,429	662	1,322
<i>Transport, storage and communication</i>	322	773	643	208	293
<i>Financial intermediation, real estate, renting and business services</i>	761	1,008	1,923	934	672
<i>Community, social and personal service activities</i>	441	859	2,204	269	976
Total retrenchments	14,035	16,469	25,064	7,085	9,450
Employment by Industry² ('000 persons)					
Agriculture, forestry, livestock and fishery	1,389.8	1,390.9	1,390.8	1,390.1	1,388.6
Mining and quarrying	42.9	42.8	42.5	41.9	40.7
Manufacturing	3,296.6	3,338.2	3,209.9	3,382.1	3,499.6
Construction	757.3	758.4	762.4	765.5	768.0
Services	5,911.4	6,046.1	6,226.5	6,376.4	6,550.7
<i>Electricity, gas and water supply⁽ⁱ⁾</i>	96.8	97.6	97.7	100.4	101.8
<i>Wholesale and retail trade, hotels and restaurants⁽ⁱⁱ⁾</i>	1,957.7	1,984.3	2,140.2	2,242.1	2,349.2
<i>Transport, storage and communication⁽ⁱⁱⁱ⁾</i>	660.0	673.2	675.5	684.2	707.8
<i>Finance, insurance, real estate and business services^(iv)</i>	789.7	811.9	825.6	840.9	853.0
<i>Government services</i>	1,225.6	1,263.5	1,247.9	1,249.5	1,251.8
<i>Other services</i>	1,181.6	1,215.6	1,239.6	1,259.3	1,287.0
Total employment	11,398.0	11,576.5	11,632.1	11,956.0	12,247.5
Unemployment rate² (% of labour force)	3.2	3.3	3.7	3.3	3.1

e Estimates

¹ Refers to vacancies reported by employers through the JobsMalaysia portal (formerly known as Electronic Labour Exchange, ELX).² Refers to estimates by Economic Planning Unit⁽ⁱ⁾ From 2010 onwards, refers to electricity, gas, water, steam and air conditioning supply⁽ⁱⁱ⁾ From 2010 onwards, refers to wholesale and retail trade, accommodation and food services⁽ⁱⁱⁱ⁾ From 2010 onwards, refers to transport, storage, information and communication^(iv) From 2010 onwards, refers to financial intermediation, real estate, professional, scientific, technical, administrative and support services

Source: Economic Planning Unit and Ministry of Human Resources

Table A.6

Private Consumption Indicators

	2010	2011				
		1Q	2Q	3Q	4Q	Year
Sales of passenger cars ('000 units)	543.6	142.5	123.1	137.0	132.4	535.1
Annual change (%)	11.8	7.1	-11.3	0.3	-2.0	-1.6
Imports of consumption goods (RM billion)	34.5	8.8	10.1	10.8	11.4	41.0
Annual change (%)	9.7	5.8	17.5	26.5	25.4	19.0
Tax collection						
Sales tax (RM billion)	8.1	1.9	2.1	2.1	2.4	8.5
Service tax (RM billion)	3.9	1.0	1.2	1.3	1.5	5.0
Narrow Money (M1)						
Annual change (%)	11.7	14.0	14.5	13.3	15.1	15.1
Loans disbursed by banking system						
Consumption credit (excl. passenger cars)						
Annual change (%)	12.5	26.6	14.8	9.6	4.7	13.3
Retail trade, restaurants and hotels						
Annual change (%)	16.3	9.8	1.6	21.8	22.8	13.8
MRA retail sales (Annual change in %)	8.4	5.1	9.1	7.0	11.5	8.1
Credit card turnover spending ¹ (RM billion)	78.0	20.6	21.2	21.8	23.2	86.8
Annual change (%)	14.5	10.9	12.7	11.7	9.8	11.2
MIER Consumer Sentiment Index	-	108.2	107.9	108.7	106.3	-
FBM KLCI	1,518.9	1,545.1	1,579.1	1,387.1	1,530.7	1,530.7
Commodity prices						
CPO (RM/tonne)	2,752	3,668	3,348	3,090	3,010	3,279
Crude oil (USD/barrel)	79.6	106.2	118.9	114.4	115.8	113.8
Rubber (sen/kg)	1,070.0	1,575.9	1,405.2	1,363.6	1,121.4	1,366.5

¹ Resident spending only

Table A.7

Private Investment Indicators

	2010	2011				
		1Q	2Q	3Q	4Q	Year
Sales of commercial vehicles ('000 units)	61.6	15.9	15.7	16.0	17.2	64.8
Annual change (%)	21.8	10.6	5.4	2.8	2.6	5.2
Imports of capital goods (RM billion)	73.8	17.8	19.6	20.2	23.3	80.9
Annual change (%)	12.2	16.7	10.2	5.5	8.2	9.7
Approvals by MITI (Manufacturing sector)						
No. of projects	910	194	258	182	212	846
Capital investment (RM billion)	47.2	13.5	13.8	11.3	17.4	56.1
<i>Foreign</i>	29.1	6.1	7.9	7.2	12.9	34.1
<i>Local</i>	18.1	7.4	5.9	4.1	4.5	21.9
New investment (% share)	50.6	47.8	39.9	78.3	70.3	59.0
Reinvestments (% share)	49.4	52.2	60.1	21.7	29.7	41.0
Loans disbursed by banking system						
Manufacturing sector						
Annual change (%)	12.0	23.5	11.7	24.2	28.7	21.9
Construction sector						
Annual change (%)	5.5	12.0	-3.6	-4.7	17.9	5.4
Private Debt Securities (excluding Cagamas)						
Total funds raised (RM billion)	52.1	12.2	20.9	19.1	17.4	69.6
New activities	13.5	1.5	4.3	1.2	1.3	8.4
Initial Public Offerings (Bursa Malaysia)						
Total funds raised (RM billion)	19.8	0.5	2.9	3.2	0.7	7.4
MIER Business Conditions Survey						
Business Conditions Index	-	113.3	114.0	104.5	96.6	-
Capacity Utilisation Rate	-	82.8	81.1	82.4	81.2	-
MSC-Status Companies						
No. of companies	218	35	49	60	71	215
Approved investment (RM billion)	1.5	0.3	0.4	0.8	1.0	2.5

Table A.8

Balance of Payments

Item	2008			2009		
	+	-	Net	+	-	Net
	RM million					
Goods¹	663,875	492,076	171,799	554,067	412,322	141,745
<i>Trade account</i>	663,014	519,804	143,209	552,518	434,670	117,848
Services	102,221	102,084	137	101,270	96,606	4,664
Transportation	22,509	37,938	-15,429	15,518	32,551	-17,034
Travel	50,961	22,451	28,510	55,589	22,886	32,704
Other services	28,624	40,978	-12,354	30,015	40,414	-10,399
Government transactions n.i.e. ²	127	716	-589	148	755	-607
Balance on goods and services	766,096	594,160	171,936	655,336	508,927	146,409
Income	40,335	63,368	-23,033	39,347	53,986	-14,639
Compensation of employees	4,264	5,157	-894	3,984	5,475	-1,491
Investment income ³	36,072	58,211	-22,139	35,363	48,511	-13,148
Current transfers	1,414	18,904	-17,490	3,714	23,345	-19,631
Balance on current account	807,845	676,431	131,414	698,398	586,258	112,139
% of GNI			18.3			16.9
Capital account			593			-161
Financial account			-119,082			-80,208
Direct investment			-25,996			-22,908
<i>Abroad</i>			-49,920			-27,948
<i>In Malaysia</i>			23,924			5,040
Portfolio investment			-83,193			-1,689
Financial derivatives			-2,029			2,453
Other investment			-7,865			-58,064
<i>Official sector</i>			852			6,556
<i>Private sector</i>			-8,717			-64,620
Balance on capital and financial accounts			-118,489			-80,369
Errors and omissions			-31,174			-17,939
of which:						
Foreign exchange revaluation gain (+) / loss (-)			-5,824			10,697
Overall balance (surplus + / deficit -)			-18,250			13,831
Bank Negara Malaysia international reserves, net⁴						
RM million			317,445			331,277
USD million			91,529			96,688
Reserves as months of retained imports			7.6			9.7

¹ Adjusted for valuation and coverage to the balance of payments basis. Imports include military goods which are not included in trade data

² Include transactions of foreign military and diplomatic establishments

³ Include undistributed earnings of foreign direct investment companies. The counterpart of these earnings is shown as reinvested earnings under "Direct Investment" in the Financial Account

⁴ All assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the gain/loss has been reflected accordingly in the Bank's account

p Preliminary

f Forecast

n.i.e. Not included elsewhere

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

2010			2011 ^p			2012 ^f		
+	-	Net	+	-	Net	+	-	Net
RM million								
640,043	505,317	134,726	696,116	546,693	149,422	717,826	562,214	155,612
638,822	528,828	109,994	694,548	574,232	120,316	716,881	591,281	125,600
105,268	103,570	1,698	107,111	115,530	-8,418	112,389	118,623	-6,234
15,095	38,248	-23,153	14,834	40,020	-25,185	18,639	43,164	-24,525
58,868	25,541	33,327	55,871	31,621	24,250	56,971	31,215	25,755
31,045	38,998	-7,953	36,136	43,155	-7,019	36,390	43,526	-7,136
260	783	-523	270	734	-464	390	719	-329
745,310	608,887	136,424	803,227	662,223	141,004	830,215	680,837	149,378
38,297	64,811	-26,514	52,038	74,070	-22,032	41,985	61,347	-19,363
3,548	5,634	-2,086	3,632	6,014	-2,382	4,059	6,026	-1,967
34,748	59,176	-24,428	48,407	68,057	-19,650	37,926	55,322	-17,396
1,855	23,686	-21,831	4,656	25,755	-21,099	4,326	24,822	-20,496
785,462	697,383	88,079	859,922	762,048	97,873	872,026	766,492	109,519
		11.9			11.8			12.2
		-165			-151			
		-19,827			15,494			
		-13,611			-12,376			
		-42,932			-45,301			
		29,322			32,925			
		48,457			30,334			
		-701			-73			
		-53,973			-2,392			
		237			-1,300			
		-54,211			-1,092			
		-19,993			15,344			
		-70,713			-18,535			
		-32,641			7,565			
		-2,628			94,682			
		328,649			423,331			
		106,518			133,610			
		8.6			9.6			

Table A.9

Gross Exports

	2009	2010	2011 ^p	2010	2011 ^p	2011 ^p
	RM million			Annual change (%)		% share
Manufactures	432,179	486,849	503,427	12.6	3.4	72.5
<i>of which:</i>						
Electronics, electrical machinery and appliances	248,948	271,147	260,131	8.9	-4.1	37.5
Electronics	180,743	194,412	182,149	7.6	-6.3	26.2
Semiconductors	93,057	97,975	107,090	5.3	9.3	15.4
Electronic equipment & parts	87,686	96,438	75,060	10.0	-22.2	10.8
Electrical machinery & appliances	68,205	76,734	77,981	12.5	1.6	11.2
Electrical industrial machinery and equipment	21,641	24,655	27,511	13.9	11.6	4.0
Industrial & commercial electrical products	24,646	22,731	24,300	-7.8	6.9	3.5
Consumer electrical products	18,793	25,804	22,369	37.3	-13.3	3.2
Household electrical appliances	3,126	3,544	3,801	13.4	7.3	0.5
Chemicals & chemical products	34,079	41,557	47,765	21.9	14.9	6.9
Petroleum products	21,939	29,217	36,654	33.2	25.5	5.3
Manufactures of metal	22,645	26,201	31,014	15.7	18.4	4.5
Optical and scientific equipment	13,275	18,319	18,754	38.0	2.4	2.7
Rubber products	12,125	15,454	17,453	27.5	12.9	2.5
Textiles, clothing and footwear	9,376	9,652	10,939	3.0	13.3	1.6
Wood products	7,977	8,378	8,385	5.0	0.1	1.2
Agriculture	53,354	68,731	91,358	28.8	32.9	13.2
<i>of which:</i>						
Palm oil	36,329	44,730	60,444	23.1	35.1	8.7
Rubber	4,460	9,210	13,278	106.5	44.2	1.9
Minerals	56,806	73,205	88,049	28.9	20.3	12.7
<i>of which:</i>						
Liquefied natural gas (LNG)	29,018	38,742	49,963	33.5	29.0	7.2
Crude oil and condensates	25,360	30,765	31,982	21.3	4.0	4.6
Others	10,179	10,037	11,714	-1.4	16.7	1.7
Total	552,518	638,822	694,548	15.6	8.7	100.0

^p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.10

Exports of Primary Commodities

	2009	2010	2011 ^p	2010	2011 ^p
	Volume and value			Annual change (%)	
Commodity exports (RM million)	110,160	141,937	179,407	28.8	26.4
Agriculture exports (RM million)	53,354	68,731	91,358	28.8	32.9
<i>of which:</i>					
Palm oil					
('000 tonnes)	16,256	16,945	18,448	4.2	8.9
(RM/tonne)	2,235	2,640	3,276	18.1	24.1
(RM million)	36,329	44,730	60,444	23.1	35.1
Palm kernel oil					
('000 tonnes)	1,028	1,021	1,077	-0.6	5.5
(RM/tonne)	1,599	2,494	3,571	56.0	43.2
(RM million)	1,643	2,548	3,847	55.1	51.0
Rubber					
('000 tonnes)	703	901	946	28.1	5.0
(sen/kilogramme)	634	1,023	1,404	61.2	37.3
(RM million)	4,460	9,210	13,278	106.5	44.2
Saw logs					
('000 cubic metres)	4,211	4,329	3,315	2.8	-23.4
(RM/cubic metre)	482	495	589	2.7	19.1
(RM million)	2,029	2,142	1,953	5.6	-8.8
Sawn timber					
('000 cubic metres)	1,688	2,152	2,085	27.5	-3.1
(RM/cubic metre)	1,841	1,507	1,562	-18.1	3.6
(RM million)	3,108	3,243	3,256	4.3	0.4
Cocoa beans					
('000 tonnes)	14.4	23.7	25.4	64.8	7.3
(RM/tonne)	9,063	11,534	10,038	27.3	-13.0
(RM million)	130	273	255	109.7	-6.6
Mineral exports (RM million)	56,806	73,205	88,049	28.9	20.3
<i>of which:</i>					
Crude oil and condensates					
('000 tonnes)	16,412	16,373	12,506	-0.2	-23.6
(USD/barrel)	58.00	76.55	110.04	32.0	43.7
(RM million)	25,360	30,765	31,982	21.3	4.0
Liquefied natural gas (LNG)					
('000 tonnes)	22,095	22,953	24,848	3.9	8.3
(RM/tonne)	1,313	1,688	2,011	28.5	19.1
(RM million)	29,018	38,742	49,963	33.5	29.0
Tin					
('000 tonnes)	22.9	33.7	42.3	47.3	25.5
(RM/tonne)	45,771	61,831	76,460	35.1	23.7
(RM million)	1,047	2,084	3,234	98.9	55.2

^p Preliminary

Source: Department of Statistics, Malaysia

Table A.11

Principal Markets for Manufactured Exports

Country	2007	2008	2009	2010	2011 ^p	2007	2008	2009	2010	2011 ^p
	RM million					% share				
ASEAN	123,809	134,424	114,026	130,666	138,717	26.1	27.4	26.4	26.8	27.6
Singapore	78,490	84,904	70,183	78,370	81,830	16.6	17.3	16.2	16.1	16.3
Thailand	24,991	25,643	24,148	28,285	28,492	5.3	5.2	5.6	5.8	5.7
Indonesia	12,574	16,319	13,016	15,675	18,904	2.7	3.3	3.0	3.2	3.8
Philippines	6,564	6,202	5,218	6,992	7,954	1.4	1.3	1.2	1.4	1.6
Brunei Darussalam	1,190	1,356	1,462	1,344	1,537	0.3	0.3	0.3	0.3	0.3
European Union	66,971	63,061	52,612	58,218	58,180	14.1	12.8	12.2	12.0	11.6
Germany	13,393	13,574	13,739	15,408	16,082	2.8	2.8	3.2	3.2	3.2
Netherlands	19,060	18,605	15,301	16,389	13,548	4.0	3.8	3.5	3.4	2.7
United Kingdom	9,219	8,587	6,657	6,801	6,578	1.9	1.7	1.5	1.4	1.3
Others	25,299	22,295	16,915	19,619	21,972	5.3	4.5	3.9	4.0	4.4
The People's Republic of China	38,009	44,396	51,254	61,027	63,648	8.0	9.0	11.9	12.5	12.6
United States	90,102	76,633	56,897	55,604	50,948	19.0	15.6	13.2	11.4	10.1
Japan	32,574	35,944	30,204	35,596	37,697	6.9	7.3	7.0	7.3	7.5
Hong Kong SAR	26,690	26,942	28,293	31,548	30,251	5.6	5.5	6.5	6.5	6.0
Middle East	18,815	23,342	20,659	21,273	22,892	4.0	4.8	4.8	4.4	4.5
Australia	12,081	14,794	13,927	13,154	13,933	2.6	3.0	3.2	2.7	2.8
India	9,172	10,119	8,319	11,508	14,198	1.9	2.1	1.9	2.4	2.8
Chinese Taipei	11,724	10,529	10,216	13,357	13,491	2.5	2.1	2.4	2.7	2.7
Korea	10,732	10,294	9,895	12,313	12,994	2.3	2.1	2.3	2.5	2.6
Latin American countries	7,156	9,172	7,362	9,063	9,806	1.5	1.9	1.7	1.9	1.9
Canada	2,971	2,964	2,630	2,977	2,584	0.6	0.6	0.6	0.6	0.5
Rest of the World	22,888	28,296	25,886	30,547	34,088	4.8	5.8	6.0	6.3	6.8
Total	473,695	490,908	432,179	486,849	503,427	100.0	100.0	100.0	100.0	100.0

^p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.12

Principal Export Markets for Electronics

Country	2007	2008	2009	2010	2011 ^p	2007	2008	2009	2010	2011 ^p
	RM million					% share				
The People's Republic of China	22,640	27,298	34,862	38,326	38,644	10.6	13.9	19.3	19.7	21.2
Singapore	34,326	33,859	28,049	32,027	28,301	16.1	17.3	15.5	16.5	15.5
Hong Kong SAR	17,524	17,434	20,283	22,500	21,464	8.2	8.9	11.2	11.6	11.8
United States	56,406	43,365	28,170	24,605	20,384	26.4	22.1	15.6	12.7	11.2
Japan	11,244	10,211	9,565	9,936	9,469	5.3	5.2	5.3	5.1	5.2
Thailand	9,954	9,356	9,352	9,344	8,779	4.7	4.8	5.2	4.8	4.8
Germany	6,618	6,588	7,658	8,413	8,018	3.1	3.4	4.2	4.3	4.4
Netherlands	13,535	11,225	9,493	10,264	6,086	6.3	5.7	5.3	5.3	3.3
Chinese Taipei	5,357	4,517	5,851	6,242	5,696	2.5	2.3	3.2	3.2	3.1
Korea	4,110	3,621	3,547	4,369	5,281	1.9	1.8	2.0	2.2	2.9
Others	31,991	28,551	23,912	28,386	30,027	15.0	14.6	13.2	14.6	16.5
Total	213,704	196,023	180,743	194,412	182,149	100.0	100.0	100.0	100.0	100.0

^p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.13

Principal Export Markets for Electrical Products

Country	2007	2008	2009	2010	2011 ^p	2007	2008	2009	2010	2011 ^p
	RM million					% share				
United States	15,759	14,825	12,979	12,484	11,591	21.3	18.3	19.0	16.3	14.9
European Union	12,214	13,364	9,423	9,255	10,700	16.5	16.5	13.8	12.1	13.7
Japan	5,936	7,269	6,961	9,251	9,376	8.0	9.0	10.2	12.1	12.0
Singapore	10,983	10,838	8,190	8,470	8,396	14.8	13.4	12.0	11.0	10.8
Middle East	4,393	5,634	5,089	6,479	6,584	5.9	7.0	7.5	8.4	8.4
The People's Republic of China	3,555	3,824	3,201	3,972	4,211	4.8	4.7	4.7	5.2	5.4
Thailand	2,784	2,693	2,601	3,427	3,504	3.8	3.3	3.8	4.5	4.5
Australia	2,522	3,600	4,122	4,285	3,262	3.4	4.5	6.0	5.6	4.2
Hong Kong SAR	3,287	3,410	3,110	3,278	2,907	4.4	4.2	4.6	4.3	3.7
Others	12,561	15,443	12,530	15,833	17,450	17.0	19.1	18.4	20.6	22.4
Total	73,993	80,899	68,205	76,734	77,981	100.0	100.0	100.0	100.0	100.0

^p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.14

Principal Export Markets for Chemicals and Chemical Products

Country	2007	2008	2009	2010	2011 ^p	2007	2008	2009	2010	2011 ^p
	RM million					% share				
The People's Republic of China	5,009	5,076	5,348	6,772	8,050	13.5	12.5	15.7	16.3	16.9
Indonesia	2,902	3,969	3,070	4,012	4,610	7.8	9.7	9.0	9.7	9.7
Thailand	3,389	3,658	2,764	3,295	4,185	9.1	9.0	8.1	7.9	8.8
Japan	2,866	3,104	2,286	3,093	4,015	7.7	7.6	6.7	7.4	8.4
Singapore	3,329	3,714	3,299	3,756	3,906	9.0	9.1	9.7	9.0	8.2
India	1,874	2,194	2,011	2,490	2,831	5.0	5.4	5.9	6.0	5.9
Korea	1,550	1,293	1,230	1,420	1,710	4.2	3.2	3.6	3.4	3.6
Chinese Taipei	1,723	1,607	1,148	1,483	1,666	4.6	3.9	3.4	3.6	3.5
United States	1,512	1,567	1,166	1,339	1,543	4.1	3.8	3.4	3.2	3.2
Hong Kong SAR	2,004	1,965	1,515	1,591	1,454	5.4	4.8	4.4	3.8	3.0
Others	11,001	12,576	10,241	12,306	13,794	29.6	30.9	30.1	29.6	28.9
Total	37,159	40,723	34,079	41,557	47,765	100.0	100.0	100.0	100.0	100.0

^p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.15

Principal Export Markets for Palm Oil

Country	2007	2008	2009	2010	2011 ^p	2007	2008	2009	2010	2011 ^p
	'000 tonnes					% share				
The People's Republic of China	3,786	3,808	4,059	3,463	4,034	28.2	25.6	25.0	20.4	21.9
European Union	2,097	2,010	1,694	1,809	2,069	15.6	13.5	10.4	10.7	11.2
<i>Netherlands</i>	1,527	1,333	1,117	1,133	1,293	11.4	8.9	6.9	6.7	7.0
<i>Italy</i>	126	165	151	188	212	0.9	1.1	0.9	1.1	1.1
<i>Sweden</i>	134	85	54	119	158	1.0	0.6	0.3	0.7	0.9
<i>Germany</i>	30	105	154	160	127	0.2	0.7	0.9	0.9	0.7
<i>Others</i>	280	323	219	209	279	2.1	2.2	1.3	1.2	1.5
Pakistan	1,062	1,291	1,764	2,134	1,851	7.9	8.7	10.9	12.6	10.0
Middle East	1,212	1,257	1,364	1,864	1,775	9.0	8.4	8.4	11.0	9.6
India	515	925	1,263	1,184	1,723	3.8	6.2	7.8	7.0	9.3
United States	516	1,078	866	1,032	1,045	3.8	7.2	5.3	6.1	5.7
Japan	516	530	528	542	551	3.8	3.6	3.2	3.2	3.0
Korea	225	199	299	322	365	1.7	1.3	1.8	1.9	2.0
Bangladesh	170	254	113	171	149	1.3	1.7	0.7	1.0	0.8
Chinese Taipei	129	128	155	154	137	1.0	0.9	1.0	0.9	0.7
Australia	121	113	126	127	122	0.9	0.8	0.8	0.8	0.7
Others	3,064	3,304	4,025	4,143	4,626	22.8	22.2	24.8	24.4	25.1
Total	13,412	14,894	16,256	16,945	18,448	100.0	100.0	100.0	100.0	100.0

^p Preliminary

Source: Department of Statistics, Malaysia

Table A.16

Principal Export Markets for Rubber

Country	2007	2008	2009	2010	2011 ^p	2007	2008	2009	2010	2011 ^p
	'000 tonnes					% share				
The People's										
Republic of China	371	301	272	348	409	36.4	32.9	38.7	38.6	43.2
European Union	294	279	166	236	238	28.9	30.5	23.6	26.3	25.2
<i>Germany</i>	136	123	82	118	114	13.3	13.5	11.6	13.1	12.0
<i>Netherlands</i>	17	21	19	27	23	1.6	2.3	2.7	3.0	2.5
<i>United Kingdom</i>	16	17	8	12	18	1.5	1.8	1.1	1.3	1.9
<i>France</i>	43	32	18	22	16	4.3	3.5	2.6	2.4	1.7
<i>Italy</i>	20	17	9	12	10	1.9	1.9	1.3	1.4	1.1
<i>Spain</i>	9	8	4	6	4	0.9	0.8	0.6	0.6	0.4
<i>Others</i>	54	61	26	40	52	5.3	6.7	3.7	4.4	5.5
Middle East	54	69	54	64	55	5.3	7.5	7.7	7.1	5.8
<i>Iran</i>	27	40	32	39	28	2.7	4.4	4.5	4.3	2.9
<i>Turkey</i>	21	21	17	20	21	2.1	2.3	2.4	2.2	2.3
<i>Others</i>	5	7	6	5	6	0.5	0.8	0.8	0.6	0.6
Korea	61	52	47	49	44	6.0	5.6	6.7	5.4	4.6
United States	53	53	28	40	34	5.2	5.8	4.0	4.4	3.6
Brazil	38	35	23	27	21	3.8	3.8	3.3	3.0	2.3
Canada	19	12	9	9	7	1.9	1.4	1.3	1.0	0.8
Others	129	114	103	128	138	12.7	12.5	14.6	14.3	14.6
Total	1,020	916	703	901	946	100.0	100.0	100.0	100.0	100.0

^p Preliminary

Source: Department of Statistics, Malaysia

Table A.17

Principal Export Markets for Crude Oil

Country	2007	2008	2009	2010	2011 ^p	2007	2008	2009	2010	2011 ^p
	'000 tonnes					% share				
Australia	3,331	3,272	3,321	5,166	3,729	19.7	19.5	20.2	31.5	29.8
India	3,908	3,890	2,872	2,320	2,454	23.2	23.2	17.5	14.2	19.6
Thailand	1,435	1,579	2,767	2,262	2,042	8.5	9.4	16.9	13.8	16.3
The People's Republic of China	240	837	1,429	1,382	944	1.4	5.0	8.7	8.4	7.5
Japan	987	751	469	616	922	5.8	4.5	2.9	3.8	7.4
Korea	1,545	1,356	877	950	865	9.2	8.1	5.3	5.8	6.9
New Zealand	381	356	214	539	409	2.3	2.1	1.3	3.3	3.3
Philippines	872	759	561	946	297	5.2	4.5	3.4	5.8	2.4
Singapore	1,607	2,497	1,428	896	169	9.5	14.9	8.7	5.5	1.4
Indonesia	2,038	1,289	2,098	682	153	12.1	7.7	12.8	4.2	1.2
United States	46	165	371	147	0	0.3	1.0	2.3	0.9	0.0
Others	491	13	5	468	524	2.9	0.1	0.0	2.9	4.2
Total	16,880	16,763	16,412	16,373	12,506	100.0	100.0	100.0	100.0	100.0

^p Preliminary

Source: Department of Statistics, Malaysia

Table A.18

Principal Export Markets for LNG

Country	2007	2008	2009	2010	2011 ^p	2007	2008	2009	2010	2011 ^p
	'000 tonnes					% share				
Japan	13,238	13,350	12,877	13,990	15,416	57.8	57.6	58.3	60.9	62.0
Korea	6,069	6,541	5,659	4,839	3,972	26.5	28.2	25.6	21.1	16.0
Chinese Taipei	3,524	3,242	2,455	2,828	3,362	15.4	14.0	11.1	12.3	13.5
Others	72	31	1,104	1,296	2,097	0.3	0.1	5.0	5.6	8.4
Total	22,904	23,164	22,095	22,953	24,848	100.0	100.0	100.0	100.0	100.0

^p Preliminary

Source: Department of Statistics, Malaysia

Table A.19

External Debt and Debt Servicing

	2007	2008 ³	2009	2010	2011 ^p
	RM million				
Medium- and long-term debt:					
Gross borrowing	23,844	26,112	35,844	53,369	76,629
Federal Government	489	479	459	4,493	6,534
NFPEs	1,706	5,952	17,900	4,076	3,043
Private sector	21,650	19,681	17,485	44,800	67,052
Repayment and prepayment	25,699	13,015	36,100	51,520	77,881
Federal Government	4,803	943	6,767	823	5,968
NFPEs	7,840	2,069	8,128	3,455	7,288
Private sector	13,055	10,004	21,206	47,242	64,623
Net borrowing	-1,855	13,097	-256	1,849	-1,251
Federal Government	-4,314	-463	-6,308	3,670	565
NFPEs	-6,134	3,884	9,772	620	-4,245
Private sector	8,594	9,677	-3,721	-2,441	2,429
Outstanding debt	132,978	156,594	155,328	147,660	153,364
Federal Government	19,602	20,316	13,787	16,745	18,103
NFPEs	41,854	63,146	71,600	66,589	64,981
Private sector	71,521	73,133	69,941	64,325	70,280
Short-term debt:					
Outstanding debt	54,468	79,689	77,390	79,447	103,871
Banking sector ¹	42,134	72,042	68,527	67,982	92,299
Non-bank private sector	12,334	7,647	8,863	11,465	11,572
Total external debt:	187,445	236,283	232,717	227,107	257,235
Total external debt (USD million)	56,027	67,409	67,324	72,828	80,363
% GNI	29.8	32.8	35.0	30.7	31.0
Annual change (%)	1.6	26.1	-1.5	-2.4	13.3
Currency composition (% share)	100.0	100.0	100.0	100.0	100.0
US dollar	81.2	76.6	72.7	65.8	68.4
Japanese yen	10.6	9.2	8.4	8.8	8.2
Others	8.3	14.2	18.9	25.4	23.4
Total servicing (including short-term interest payment)	33,155	19,704	42,288	56,973	82,897
of which:					
Medium- and long-term debt					
Repayment²	25,699	13,015	36,100	51,520	77,881
Federal Government	4,803	943	6,767	823	5,968
NFPEs	7,840	2,069	8,128	3,455	7,288
Private sector	13,055	10,004	21,206	47,242	64,623
Interest payment	5,126	5,484	5,718	4,974	4,516
Federal Government	1,426	1,107	931	558	292
NFPEs	2,282	2,493	3,025	3,132	3,102
Private sector	1,418	1,884	1,762	1,284	1,122
Debt service ratio (% of exports of goods and services)					
Total debt	4.7	2.6	6.5	7.6	10.3
Medium- and long-term debt	4.4	2.4	6.4	7.6	10.3
Federal Government	0.9	0.3	1.2	0.2	0.8
NFPEs	1.4	0.6	1.7	0.9	1.3
Private sector	2.0	1.6	3.5	6.5	8.2

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

² Includes prepayment

³ Effective from the first quarter of 2008, the external debt data of Malaysia has been redefined to treat entities in Labuan International Business and Financial Centre (IBFC) as residents

^p Preliminary

Note: Numbers may not necessarily add up due to rounding

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Table A.20

Consumer Price Index

	Weights (%) (2010=100)	2008	2009	2010	2011
		Annual Change (%)			
Total	100.0	5.4	0.6	1.7	3.2
<i>of which:</i>					
Food and non-alcoholic beverages	30.3	8.8	4.1	2.4	4.8
Alcoholic beverages and tobacco	2.2	7.3	6.1	4.0	4.6
Clothing and footwear	3.4	-0.5	-0.9	-1.4	-0.2
Housing, water, electricity, gas and other fuels	22.6	1.6	1.4	1.1	1.8
Furnishings, household equipment and routine household maintenance	4.1	3.0	2.9	0.7	1.8
Health	1.3	2.2	2.3	1.6	2.7
Transport	14.9	8.8	-9.4	1.6	4.4
Communication	5.7	-0.6	-0.5	-0.2	-0.3
Recreation services and culture	4.6	1.8	1.5	1.6	2.0
Education	1.4	2.3	2.4	1.7	2.2
Restaurants and hotels	3.2	6.6	2.9	2.0	5.9
Miscellaneous goods and services	6.3	3.3	3.8	2.7	2.4

Source: Department of Statistics, Malaysia

Table A.21

Producer Price Index

	Weights (%) (2005=100)	2008	2009	2010	2011
		Annual Change (%)			
Total	100.0	10.3	-7.1	5.6	9.0
<i>of which:</i>					
Food	5.4	12.3	0.3	2.6	8.6
Beverages and tobacco	0.9	1.4	1.7	-0.5	3.7
Crude materials, inedible	5.4	11.5	-11.8	22.4	23.2
Mineral fuels, lubricants, etc.	17.4	34.5	-22.0	12.8	24.2
Animal and vegetable oils and fats	4.2	24.5	-19.5	17.9	24.4
Chemicals	7.0	7.3	-7.5	3.0	9.4
Manufactured goods	10.9	6.7	-0.5	1.8	3.2
Machinery and transport equipment	42.9	0.7	1.5	1.2	-0.6
Miscellaneous manufactured articles	5.4	1.7	1.5	0.6	2.5
Miscellaneous transactions and commodities	0.5	12.4	-6.2	12.2	6.2
Local production	65.6	13.3	-10.4	7.7	12.0
Import	34.4	4.0	0.5	1.4	2.3

Source: Department of Statistics, Malaysia

Table A.22

Broad Money (M3)

	Annual change					As at end
	2007	2008	2009	2010	2011	2011
	RM million					
Broad money (M3) ¹	72,436	99,127	85,439	68,791	155,838	1,241,932
Currency in circulation ²	2,746	4,178	3,015	4,246	5,813	53,498
Demand deposits	24,247	11,093	14,707	18,449	28,112	204,744
Broad quasi-money	45,444	83,856	67,717	46,096	121,913	983,690
<i>Fixed deposits</i>	10,701	27,969	23,347	27,038	72,789	553,155
<i>Savings deposits</i>	8,703	7,786	10,050	2,675	10,728	115,671
<i>NIDs</i>	-15,279	144	-8,583	-4,115	-1,239	17,190
<i>Repos</i>	-72,366	-3,046	898	655	-1,701	10
<i>Foreign currency deposits</i>	1,570	16,649	15,283	1,432	12,736	68,757
<i>Other deposits</i>	112,116	34,356	26,721	18,412	28,601	228,908
Factors Affecting M3						
Net claims on Government	-641	33,649	25,808	-8,119	-12,037	37,060
<i>Claims on Government</i>	-490	33,652	35,919	-3,116	5,886	108,756
<i>Less: Government deposits</i>	151	3	10,110	5,003	17,923	71,696
Claims on private sector	53,407	94,229	50,957	84,847	116,889	1,076,413
<i>Loans</i>	50,926	76,903	46,481	91,981	111,793	974,805
<i>Securities</i>	2,481	17,326	4,476	-7,134	5,096	101,608
Net foreign assets	71,166	-51,985	22,462	31,785	102,805	488,853
<i>Bank Negara Malaysia³</i>	44,569	-18,265	7,343	-1,793	94,530	416,783
<i>Banking system</i>	26,597	-33,720	15,119	33,578	8,275	72,070
Other influences	-51,496	23,235	-13,789	-39,722	-51,819	-360,393

¹ Excludes interplacements among banking institutions

² Excludes holdings by banking system

³ Includes exchange rate revaluation loss/gain

Table A.23

Money Supply: Annual Change and Growth Rates

	2007		2008		2009		2010		2011	
	RM million	%	RM million	%	RM million	%	RM million	%	RM million	%
Currency in circulation	2,728	8.1	4,178	11.5	3,015	7.5	4,246	9.8	5,813	12.2
Demand deposits with commercial banks and Islamic banks	24,913	23.1	9,863	7.4	14,855	10.4	19,221	12.2	28,027	15.9
M1 ¹	27,640	19.6	14,040	8.3	17,869	9.8	23,467	11.7	33,840	15.1
Other deposits with commercial banks and Islamic banks ²	41,552	7.1	92,514	14.7	68,044	9.4	47,343	6.0	120,397	14.4
Deposits with other banking institutions ^{3,4}	3,244	9.9	-7,427	-20.7	-475	-1.7	-2,020	-7.2	1,601	6.2
M3 ⁵	72,436	9.5	99,127	11.9	85,439	9.2	68,791	6.8	155,838	14.4

¹ Comprising currency in circulation and demand deposits of the private sector

² Comprising savings and fixed deposits, negotiable instruments of deposits (NIDs), repos and foreign currency deposits of the private sector placed with commercial banks and Islamic banks

³ Comprising fixed deposits and repos of the private sector placed with finance companies, merchant banks/investment banks and discount houses. Also includes savings deposits with finance companies, negotiable instruments of deposits (NIDs) with finance companies and merchant banks/investment banks, foreign currency deposits placed with merchant banks/investment banks and call deposits with discount houses. Excludes interplacements among the banking institutions

⁴ The large decline since 2004 reflected the absorption of finance companies by commercial banks

⁵ Comprising M1 plus other deposits of the private sector placed with commercial banks and Islamic banks and deposits of the private sector placed with other banking institutions, namely the finance companies, merchant banks/investment banks and discount houses

Table A.24

Interest Rates (%)

	As at end-month in 2011										As at end-month in 2010							
	As at end-month in 2011																	
	2005	2006	2007	2008	2009	2010	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
Overnight interbank	3.00	3.50	3.49	3.25	1.99	2.72	2.74	2.72	2.74	2.63	2.99	2.97	2.98	2.99	2.99	2.99	3.00	2.99
1-week interbank	3.06	3.53	3.52	3.27	2.00	2.77	2.76	2.76	2.76	2.76	3.01	3.01	3.01	3.01	3.02	3.01	3.01	3.01
1-month interbank	3.12	3.58	3.56	3.30	2.07	2.83	2.80	2.79	2.82	3.11	3.08	3.05	3.05	3.05	3.09	3.06	3.05	3.05
Commercial banks																		
Fixed deposit:																		
3 months	3.02	3.19	3.15	3.04	2.03	2.74	2.74	2.74	2.74	3.00	2.99	3.00	3.00	3.01	3.00	2.99	2.99	2.99
12 months	3.70	3.73	3.70	3.50	2.50	2.97	2.97	2.98	2.98	3.23	3.23	3.23	3.23	3.24	3.22	3.22	3.22	3.22
Savings deposit	1.41	1.48	1.44	1.40	0.86	1.00	1.01	1.01	1.02	1.08	1.14	1.09	1.09	1.10	1.03	1.14	1.15	1.15
Base lending rate (BLR)	6.20	6.72	6.72	6.48	5.51	6.27	6.27	6.27	6.27	6.54	6.54	6.54	6.54	6.54	6.54	6.54	6.54	6.53
Treasury bills (91 days)	2.96	3.37	3.41	3.02	1.97	2.83	2.82	2.84	2.82	2.97	2.92	2.92	2.94	2.99	3.00	2.97	2.98	3.00
Government securities (1 year)	3.30	3.55	3.53	2.89	2.12	2.85	2.84	2.89	2.92	2.99	2.96	2.96	2.91	2.94	2.99	2.90	2.82	2.82
Government securities (5 years)	3.73	3.70	3.78	3.00	3.79	3.39	3.48	3.50	3.54	3.56	3.50	3.49	3.49	3.38	3.40	3.35	3.30	3.23
Private Debt Securities																		
AAA																		
3-years	3.95	4.01	4.07	4.17	3.72	3.63	3.69	3.71	3.72	3.73	3.72	3.72	3.72	3.72	3.68	3.68	3.66	3.65
5-years	4.38	4.24	4.28	4.48	4.32	4.07	4.11	4.12	4.09	4.07	4.09	4.08	4.08	4.08	4.07	4.05	4.00	3.99
AA																		
3-years	4.36	4.38	4.39	4.95	4.50	4.34	4.35	4.36	4.35	4.35	4.35	4.32	4.32	4.34	4.30	4.31	4.29	4.29
5-years	4.81	4.71	4.64	5.31	5.07	4.75	4.75	4.76	4.74	4.74	4.77	4.72	4.72	4.74	4.68	4.71	4.66	4.65
A																		
3-years	5.94	5.91	6.06	6.90	6.80	6.90	6.94	6.97	6.85	6.72	6.68	6.59	6.59	6.65	6.58	6.61	6.57	6.57
5-years	6.70	6.53	6.51	7.43	7.57	7.53	7.49	7.50	7.38	7.34	7.27	7.19	7.19	7.20	7.14	7.16	7.12	7.11
BBB																		
3-years	9.44	9.57	9.71	10.32	10.18	10.40	10.34	10.35	10.31	10.29	10.29	10.23	10.23	10.29	10.25	10.29	10.22	10.21
5-years	10.41	10.51	10.72	11.36	11.32	11.43	11.42	11.45	11.37	11.38	11.41	11.31	11.31	11.35	11.36	11.28	11.23	11.24
BB & below																		
3-years	11.97	12.06	11.92	12.68	12.58	12.78	12.81	12.82	12.77	12.76	12.82	12.68	12.68	12.74	12.72	12.70	12.65	12.62
5-years	13.04	13.13	13.16	13.86	14.02	14.51	14.45	14.46	14.27	14.32	14.45	14.15	14.15	14.20	14.23	14.19	14.12	14.13

Table A.25

Movements of the Ringgit

	RM to one unit of foreign currency ¹			Annual change (%)		Change (%)
	2005	2010	2011	2010	2011	21 Jul.'05 - Dec. '11
	21 Jul. ²	End-Dec.				
SDR	5.5049	4.7273	4.8621	13.1	-2.8	13.2
US dollar	3.8000	3.0835	3.1770	11.1	-2.9	19.6
Singapore dollar	2.2570	2.3859	2.4427	2.3	-2.3	-7.6
100 Japanese yen	3.3745	3.7869	4.0975	-2.1	-7.6	-17.6
Pound sterling	6.6270	4.7817	4.8962	15.0	-2.3	35.3
Swiss franc	2.9588	3.2720	3.3755	1.1	-3.1	-12.3
Euro	4.6212	4.0804	4.1118	20.6	-0.8	12.4
100 Thai baht	9.0681	10.227	10.009	0.4	2.2	-9.4
100 Indonesian rupiah	0.0386	0.0344	0.0347	6.0	-0.9	11.5
100 Korean won	0.3665	0.2707	0.2746	8.5	-1.4	33.5
100 Philippine peso	6.8131	7.0400	7.2468	5.4	-2.9	-6.0
Chinese renminbi	0.4591	0.4662	0.5034	7.6	-7.4	-8.8

¹ US dollar rates are the average of buying and selling rates at noon in the Kuala Lumpur Interbank Foreign Exchange Market

Rates for foreign currencies other than US dollar are cross rates derived from rates of these currencies against the US dollar and the RM/US dollar rate

² Ringgit shifted from a fixed exchange rate against the US dollar to a managed float against a basket of currencies

Table A.26

Housing Credit Institutions

	Year of establishment	Objective	Lending rate for new housing loans (%)		No. of branches	
			2010	2011	2010	2011
Commercial banks	-		4.0 ^{1,2}	4.24 ^{1,2}	4108 ³	4197 ³
Treasury Housing Loans Division	1970	To provide housing loans to Government employees	4.0 ¹	4.0 ¹	2	2
Bank Kerjasama Rakyat Malaysia Berhad	1954	A co-operative society which collects deposits and provides banking facilities according to Syariah principles	6.8 ¹	7.0 ¹	127	134
Malaysia Building Society Berhad	1950	To be a consumer driven financial institution offering property lending and deposit taking activities leading to wealth management creation for its valued customers	7.04 ~ 7.08	7.29 ~ 7.31	33	35
Borneo Housing Mortgage Finance Berhad	1958	To provide housing loans mainly to Sabah and Sarawak State Government employees	6.75~8.25	6.75 ~ 8.25	1	1
Bank Simpanan Nasional	1974	To promote and mobilise savings particularly from small savers and to inculcate the habit of thrift and savings	4.2 ¹	4.5 ¹	384	390
Sabah Credit Corporation	1955	To uplift the social economic development of Malaysians in Sabah through the provision of easy acces to financial credit	3.0 ~ 7.5	3.0 ~ 7.5	11	11

¹ 12-month average lending rate

² Excludes Islamic banks

³ Includes Islamic banks

Source: Bank Negara Malaysia and various housing credit institutions

Table A.27

Housing Loans Outstanding

	2010	2011 ^p	2010	2011 ^p	2010	2011 ^p
	RM million		Annual change (%)		% share	
Commercial banks ¹	226,963	255,849	12.9	12.7	85.3	85.4
Treasury Housing Loans Division	26,007	31,207	-2.7	20.0	9.8	10.4
Bank Kerjasama Rakyat Malaysia Berhad	3,837	3,382	-8.4	-11.9	1.4	1.1
Malaysia Building Society Berhad	5,354	5,160	1.5	-3.6	2.0	1.7
Borneo Housing Mortgage Finance Berhad	682	652	-4.8	-4.4	0.3	0.2
Bank Simpanan Nasional	3,132	3,299	3.2	5.3	1.2	1.1
Sabah Credit Corporation	141	0	-13.1	...	0.1	...
Total	266,116	299,549	10.3	12.6	100.0	100.0

¹ Includes Islamic banks

^p Preliminary

... Negligible

Source: Bank Negara Malaysia and various housing credit institutions

Table A.28

Housing Loans Approved

	2010	2011 ^p	2010	2011 ^p	2010	2011 ^p
	RM million		Annual change (%)		% share	
Commercial banks ¹	80,327	88,666	18.6	10.4	91.0	90.9
Treasury Housing Loans Division	6,254	6,796	5.7	8.7	7.1	7.0
Bank Kerjasama Rakyat Malaysia Berhad	402	487	73.0	21.3	0.5	0.5
Malaysia Building Society Berhad	396	512	-76.0	29.2	0.4	0.5
Borneo Housing Mortgage Finance Berhad	37	52	-37.3	39.9	...	0.1
Bank Simpanan Nasional	900	1,042	12.8	15.8	1.0	1.1
Sabah Credit Corporation	3	0	-37.0
Total	88,319	97,556	15.6	10.5	100.0	100.0

¹ Includes Islamic banks

^p Preliminary

... Negligible

Source: Bank Negara Malaysia and various housing credit institutions

Table A.29

Financing of the Economy

By customer By financing type/institution	Businesses ¹		Households	Government	Total Financing
	Total	of which: SMEs ²			
RM million					
Net Change in Financing (2010)					
Financial Intermediaries					
Banking Institutions	33,787	3,031	57,933	8,058	99,778
Development Financial Institutions (DFIs) ³	3,311	(3,480)	7,536	-	10,847
Other Domestic Intermediaries ⁴	4,163	(195)	(709)	-	3,454
Capital Market					
Bond Market ⁵	16,345	-	-	34,222	50,567
Equity Market	32,139	-	-	-	32,139
External Financing					
Foreign Direct Investment	29,321	-	-	-	29,321
External Loan ^{6,7}	(3,013)	-	-	(2,052)	(5,065)
Total	116,053	(644)	64,760	40,228	221,040
Net Change in Financing (2011)					
Financial Intermediaries					
Banking Institutions	53,153	24,860	63,151	3,923	120,227
Development Financial Institutions (DFIs) ³	2,164	(657)	4,570	-	6,734
Other Domestic Intermediaries ⁴	9,948	(277)	5,200	-	15,148
Capital Market					
Bond Market ⁵	27,198	-	-	45,221	72,419
Equity Market	12,621	-	-	-	12,621
External Financing					
Foreign Direct Investment	32,925	-	-	-	32,925
External Loan ^{6,7}	6,062	-	-	(251)	5,811
Total	144,070	23,926	72,921	48,893	265,884

¹ Businesses include non-bank financial institutions, domestic non-business entities and foreign entities

² Adjusted to include reclassification of SMEs to large corporation

³ Refers to DFIs governed under the Development Financial Institutions Act, 2002

⁴ Other domestic intermediaries include insurance companies, Employees Provident Fund (EPF), housing credit institutions, leasing and factoring companies and the Treasury Housing Loan Division

⁵ Refers to changes in outstanding of private debt securities (PDS) and all Malaysian Government securities. Data excludes Cagamas bonds and issuances by non-residents. PDS includes irredeemable convertible unsecured loan stocks (ICULS) and medium term notes (MTN) issued by the corporate sector

⁶ Based on the new classification of external debt, which has been redefined to treat entities in Labuan International Business and Financial Centre (Labuan IBFC) as residents, effective from first quarter of 2008

⁷ External financing of Government includes financing to non-financial public enterprises (NFPEs)

Table A.30

Consolidated Public Sector Finance

	2008	2009	2010	2011 ^p	2012 ^f
	RM billion				
Revenue ¹	128.3	132.9	131.3	165.5	161.6
% growth	15.9	3.5	-1.1	26.0	-2.4
Operating expenditure	165.0	170.6	167.2	195.9	196.3
% growth	22.2	3.4	-2.0	17.2	0.2
Current surplus of NFPEs ²	119.4	98.4	124.2	76.1	121.1
Current balance	82.7	60.7	88.4	45.7	86.4
% of GDP	11.1	8.9	11.5	5.4	9.4
Net development expenditure ³	124.4	112.2	104.4	132.5	163.8
% growth	29.1	-9.8	-6.9	26.9	23.6
General Government ⁴	50.5	56.5	55.1	57.4	59.9
NFPEs	73.8	55.7	49.3	75.1	103.9
Overall balance	-41.7	-51.5	-16.0	-86.8	-77.4
% of GDP	-5.6	-7.6	-2.1	-10.2	-8.4

¹ Excludes transfers within general Government

² Refers to 30 NFPEs from 2004 onwards

³ Adjusted for transfers and net lendings within public sector

⁴ Comprises Federal Government, state and local governments and statutory bodies

^p Preliminary

^f Forecast

Note: Numbers may not add up due to rounding

Source: Ministry of Finance and non-financial public enterprises (NFPEs)

Table A.31

Major Advanced Economies: Key Economic Indicators

	2007	2008	2009	2010	2011e	2012f
	Annual change (%)					
REAL GDP						
United States	1.9	-0.3	-3.5	3.0	1.7	1.8
Japan	2.2	-1.0	-5.5	4.4	-0.7	1.7
Euro area	3.0	0.4	-4.3	1.9	1.4	-0.5
<i>Germany</i>	3.3	1.1	-5.1	3.7	3.0	0.3
United Kingdom	3.5	-1.1	-4.4	2.1	0.8	0.6
INFLATION						
United States	2.9	3.8	-0.3	1.6	3.1	1.2
Japan	0.0	1.4	-1.4	-0.7	-0.3	-0.5
Euro area	2.1	3.3	0.3	1.6	2.7	1.5
<i>Germany</i>	2.3	2.8	0.2	1.2	2.5	1.3
United Kingdom	2.3	3.6	2.2	3.3	4.5	2.4
	% of labour force					
UNEMPLOYMENT						
United States	4.6	5.8	9.3	9.6	9.0	9.0
Japan	3.9	4.0	5.1	5.1	4.5	4.8
Euro area	7.6	7.6	9.6	10.1	10.2	9.9
<i>Germany</i>	8.7	7.5	7.8	7.1	5.9	6.2
United Kingdom	5.3	5.6	7.6	7.8	8.1	7.8
	% of GDP					
CURRENT ACCOUNT BALANCE						
United States	-5.1	-4.7	-2.7	-3.2	-3.1	-2.1
Japan	4.8	3.2	2.8	3.6	2.5	2.8
Euro area	0.2	-0.7	0.1	0.3	0.1	0.4
<i>Germany</i>	7.5	6.3	5.6	5.7	5.0	4.9
United Kingdom	-2.6	-1.6	-1.7	-3.2	-2.7	-2.3
FISCAL BALANCE¹						
United States	-2.7	-6.5	-12.8	-10.3	-9.6	-7.9
Japan	-1.9	-3.4	-9.4	-8.0	-8.9	-7.7
Euro area	-0.7	-2.0	-6.3	-6.0	-4.2	-3.1
<i>Germany</i>	0.3	0.1	-3.1	-3.3	-1.7	-1.1
United Kingdom	-2.7	-4.9	-10.3	-10.2	-8.5	-7.0

¹ Refers to general government fiscal balance

e Estimate

f Forecast

Source: International Monetary Fund and National Authorities

Table A.32

Emerging Asia: Key Economic Indicators

	2007	2008	2009	2010	2011e	2012f
REAL GDP	Annual change (%)					
The People's Republic of China	14.2	9.6	9.2	10.4	9.2	8.2
Korea	5.1	2.3	0.3	6.2	3.6	4.4
Chinese Taipei	6.0	0.7	-1.8	10.7	4.0	5.0
Singapore	8.9	1.7	-1.0	14.8	4.9	4.3
Hong Kong SAR	6.4	2.3	-2.6	7.0	5.0	4.3
Malaysia	6.5	4.8	-1.6	7.2	5.1	4.0~5.0
Thailand	5.0	2.5	-2.3	7.8	0.1	4.8
Indonesia	6.3	6.0	4.6	6.2	6.5	6.3
Philippines	6.6	4.2	1.1	7.6	3.7	4.9
INFLATION	Annual change (%)					
The People's Republic of China	4.8	5.9	-0.7	3.3	5.4	3.3
Korea	2.5	4.7	2.8	2.9	4.0	3.5
Chinese Taipei	1.8	3.5	-0.9	1.0	1.4	1.8
Singapore	2.1	6.6	0.6	2.8	5.2	2.9
Hong Kong SAR ¹	2.0	4.3	0.6	2.3	5.3	4.5
Malaysia	2.0	5.4	0.6	1.7	3.2	2.5~3.0
Thailand	2.2	5.4	-0.9	3.3	3.8	4.1
Indonesia	6.6	11.1	2.8	5.1	5.4	6.5
Philippines	2.8	9.3	3.2	3.8	4.4	4.1
CURRENT ACCOUNT BALANCE	% of GDP					
The People's Republic of China	10.1	9.1	5.2	5.2	3.3	3.2
Korea	2.1	0.3	3.9	2.8	1.5	1.4
Chinese Taipei	8.9	6.9	11.4	9.3	11.0	11.0
Singapore	27.3	14.6	19.0	22.2	19.8	18.5
Hong Kong SAR	12.3	13.7	8.6	6.2	5.4	5.5
Malaysia	15.9	17.7	16.5	11.5	11.5	11.9
Thailand	6.3	0.8	8.3	4.6	3.4	2.5
Indonesia	2.4	0.03	2.5	0.8	0.3	-0.4
Philippines	4.8	2.1	5.6	4.2	3.1	1.3
FISCAL BALANCE²	% of GDP					
The People's Republic of China	0.9	-0.4	-3.1	-2.3	-2.0	-2.0
Korea	2.3	1.6	0.02	1.7	2.1	2.4
Chinese Taipei	-1.4	-2.2	-5.2	-4.8	-4.3	-3.3
Singapore	10.0	5.3	-0.8	5.2	3.2	3.6
Hong Kong SAR	8.2	0.1	1.6	4.5	2.7	4.2
Malaysia ³	-3.2	-4.8	-7.0	-5.6	-5.0	-4.7
Thailand	0.2	0.1	-3.2	-2.7	-2.6	-2.9
Indonesia	-1.0	-0.003	-1.8	-1.2	-1.8	-1.3
Philippines	-1.5	-1.2	-3.7	-3.5	-2.9	-2.5

¹ Refers to composite price index

² Refers to general government fiscal balance

³ Refers to central government fiscal balance

e Estimates

f Forecast

Source: International Monetary Fund, National Authorities and Bank Negara Malaysia estimates